C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

CORPORATE PROFESSIONAL ACCOUNTING

SUB.CODE: 19CCCPA7

COURSE: B.COM (PROFESSIONAL ACCOUNTING)

UNIT – I

Company accounts – introduction – legal provisions regarding issue of shares, application, allotment, calls, forfeiture, re – issue, premium and discount – accounting entries.

UNIT – II

Issue and redemption of debenture and preference shares.

UNIT – III

Amalgamation, absorption, nature of purchase – nature of merger, external and internal reconstruction of company.

UNIT – IV

Holding companies account – consolidation of balance sheet (excluding intercompany owing, cross holding, chain holding).

UNIT – V

Final accounts of banking companies (new format) and insurance Companies (new format).

NOTE:

Distribution of marks : problems 80% and theory 20%

TEXT BOOK:

Advance Accountancy – R.L. Guptha & Radhaswamy
Corporate Accounting . – Reddy & Murthy.

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

UNIT – I

SHARES MEANING: -

The capital of the company can be divided into different units with definite value called shares. A share is one of the units in to which the total capital of the company is divided. Share capital constitutes the basis of the capital structure of a company. Ownership of a company is vested in its shareholders and a share represents the extent of ownership or interest in the assets and profits of the company.

STOCK-MEANING:

Stock means a bundle of fully paid up shares put together for convenience. Stock means the shares of the company in a different form. In fact the stock is the aggregate of fully paid up shares consolidated and divided into different parts.

KINDS OF SHARES :

- Equity shares
- Preference shares
- Deferred shares

MEANING OF EQUITY SHARES:

Equity shares are those shares which do not carry and preferential right in respect of payment of dividend and repayment of capital. These are shares having no special rights. The rate of dividend on such shares is not fixed. The holders of equity shares participate in the profits available after all preferential rights have been fully satisfied. Equity share holders are the real owners of the company.

MEANING OF PREFERENCE SHARES:

These are shares which enjoy preferential rights which as to the payment of dividend at a fixed rate during the life of the company and as to return of capital on winding up of the company Preference shares may be

- ✓ Cumulative preference shares
- ✓ Non-Cumulative preference shares
- ✓ Participating preference shares.

- ✓ Non-participating preference shares
- ✓ Redeemable preference shares
- ✓ Irredeemable preference shares
- ✓ Convertible preference shares
- ✓ Non-convertible preference shares.

MEANING OF DEFERRED SHARES:

Deferred shares are also known as ‘founder’s shares’ or ‘management shares’. They are issued to promoters and their friends at the time of formation of a company. These shares enjoy all the residuary benefits in profits, after satisfying the preference and equity dividend claims. They also have voting rights.

Basis of distinction	**Shares**	**Stock**
Nominal Value	A share has a nominal or face value	Stock does not have a nominal value.
Issue	Shares can be directly issued to the public	Stock cannot be issued directly. Only fully paid up shares can be converted into stock.
Transferability	Shares can be transferred only in round numbers	Stock may be transferred in small fractions.
Denominations	All shares are of equal denominations, such as Rs.10,100	Stock may be of unequal amounts Rs.41,81 etc.
Numbering	Each share bears a distinctive number.	Stock does not bear myd

ISSUE OF EQUITY SHARES:

Shares may issued at a price which is termed as,

- ❖ At par
- ❖ At a premium
- ❖ At a discount

SHARES ISSUED AT PAR:

If a company issues its shares at the original value it is called issue of shares at par. For example Rs.100 worth of an equity share issued at a price of Rs.100.

SHARES ISSUED AT A PREMIUM:

A company issues shares at a price greater than its face value is called issue of shares at a premium. For example Rs.100 worth of an equity share issued at a price of Rs.110. The excess amount of Rs.10 is called share premium.

SHARES ISSUED AT A DISCOUNT:

A company may issue shares at a price less than the face value is called issue of shares at a discount. For example Rs.100 worth of an equity share issued at a price of Rs.90. The difference of Rs.10 is called discount on issue of shares.

TYPES OF SHARE CAPITAL

IMPORTANT STEPS IN ISSUE OF SHARES

Issue of prospectus :

A prospectus is an invitation of the company to the public to purchase its shares and debentures. A person who desires to invest money in the shares or debentures of companies can obtain detailed information about shares and debentures from the prospectus.

Application for shares :

Those who wish to subscribe to the shares of the company, submit application for shares, along with the required application money to the companies bankers. Board of Directors fix the amount of application money which should not be less than 5% of the face value of shares.

Allotment of shares :

After the last day of receipt of application, the Board of Directors starts allotment of shares in consultation with stock exchange. As per rules of allotment of shares is to be made. Within 120 days of issue of prospectus. Allotment of shares means issue of shares to applicants on the basis of application submitted by them.

Making calls :

A call is a demand made by a company on its members to pay the whole or part of the unpaid amount on shares held by them. A company can collect amount due from members in two or three installments called, First Call, Second Call, Third Call.

LEGAL PROVISIONS REGARDING THE ISSUE OF SHARES AT DISCOUNT

When shares are issued at a price less than its pa value is called issued at discount. The following are the Legal provisions regarding the issue of shares at discount ;

- The shares proposed to be issued at discount must belong to a class already issued.
- The issue must be authorized by an ordinary resolution in the general body meeting of the company.
- The company law board has to sanction such an issue.
- The rate of discount does not exceed @ 10%.
- Issues are to be made within two months after receiving sanction.

FORFEITURE OF SHARES

In case a member fails to pay any call money on the day fixed for payment, the directors may either by adopting Table A or by an express provision in its articles proceed to forfeit the shares held by a defaulting shareholder. The necessary notice should be given to defaulting shareholders for forfeiture or shares.

REISSUE OF SHARES

Shares forfeited on the non-payment of calls can be reissued by the company at any price it likes. But the discount should not exceed the amount earlier received in respect of such shares. Such discount is to be debited to forfeited shares account.

CALLS-IN ARREARS

When one or more shareholders fail to pay the amount due from them towards allotment and or calls, such dues are called calls in arrears. Usually the accounts of allotment and calls are debited with the amount due from and credited with the actual received; the balance in these accounts represents the amount in arrears.

If accounts are to be closed before such arrears are settled, a separate account is opened, 'called calls-in-arrears account' to transfer the amount due on all the calls. The balance of the calls-in arrears account is subtracted from the 'called up capital' in the liabilities side of the balance sheet to arrive at the 'paid up capital'. The directors of a company may forfeit shares on which there are calls-in-arrears, after giving due notice.

CALLS-IN-ADVANCE

When a company accepts money from the shareholders in advance towards calls not yet made by the company, such amounts are termed as 'calls-in-advance'. As per section 92 of the Companies Act, company's articles should specifically permit the company for accepting calls-in-advance. Calls in advance may be generated in two ways :

- ❖ Any shareholders may pay cash towards calls not yet made at the time of allotment or at any other date.
- ❖ The company may transfer excess application money of pro-rata allotters towards allotment and calls in advance.

In both the cases mentioned above, the calls-in-advance is meant to be adjusted calls, whenever they are made.

PRO-RATA ALLOTMENT

Shares may be allotted proportionate to the applications received to all the applicants. It may be possible to reject some applications on the basis of some criterion and for the balance applications, proportionate allotment may be made.

The surplus application money of the pro-rata allotters can be adjusted towards the sums due from them for allotment and even calls, if the company's Articles of Association provides for it, In the absence of details, it is usual to adjust the surplus applications money towards the sum due on allotment and return any further excess amount

UNDER SUBSCRIPTION

If total number of shares for which applications are received is less than the number of shares issued, it is a situation of under subscription. If the actual applications received are more than the minimum subscription, allotment can be made for all the applicants. Entries for application, allotment and calls can be made for those allotters only.

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

OVER SUBSCRIPTION

When a company receives applications for a large number of shares than those offered to the public, it is situation of over subscription.

JOURNAL ENTRY

1.	**Bank A/c** **To Share application** **(Being the share application money received)**	**Dr**	**xxx**	 **xxx**
2.	**Share application A/c** **To share capital** **(Being the Share application Money transfer to share capital)**	**Dr**	**Xxx**	 **Xxx**
3.	**Share application A/c** **To Bank** **(Being the excess share application money rejected)**	**Dr**	**xxx**	 **xxx**
4.	**Share Application A/c** **To Share Allotment** **(being the excess share application money adjusted towards share allotment stage)**	**Dr**	**xxx**	 **xxx**
5.	**Share allotment A/c** **To Share Capital** **(Being the share Allotment money due)**	**Dr**	**xxx**	 **xxx**
6.	**Share allotment A/c** **To Security Premium** **To Share capital**	**Dr** **Dr**	**xxx** **xxx**	 **xxx**

	(Being the share Allotment money due)			
7.	**Share Allotment A/c** **Share Discount A/c** **To Share Capital** **(Being the share Allotment money due)**	**Dr** **Dr**	**xxx** **xxx**	 **xxx**
8.	**Bank Account A/c** **To Share Allotment** **(Being the share Allotment money received)**	**Dr**	**xxx**	 **xxx**
9.	**Share I Call A/c** **To Share Capital** **(Being the share I call money Due)**	**Dr**	**xxx**	 **xxx**
10.	**Bank A/c** **To share I call** **(Being the share I call money received)**	**Dr**	**xxx**	 **xxx**
11.	**Share II call A/c** **To Share Capital** **(Being the share II call Money due)**	**Dr**	**xxx**	 **xxx**
12	**Bank A/c** **To Share II Call** **(Being the share II call money received)**	**Dr**	**xxx**	 **Xxx**
13.	**Share Capital A/c** **Security Premium A/c** **To Share allotment** **To Share I call** **To Share II call** **To Share Forfeited** **(Being the share were forfeited)**	**Dr** **Dr**	**xxx** **xxx**	 **Xxx** **Xxx** **Xxx** **Xxx**

14.	**Bank A/c** **Share Forfeiture A/c** **To Share Capital** **(Being the share were Reissued)**	**Dr** **Dr**	**Xxx** **Xxx**	 **xxx**
15.	**Share forfeiture A/c** **To Capital reserve** **(Being the Profit on reissue transfer to capital reserve)**	**Dr**	**xxx**	 **xxx**

QUESTION BANK

TWO MARKS

1. What is mean by shares?
2. What is mean by stocks?
3. What is mean by subscribed capital?
4. What is mean by paid up capital?

FIVE MARKS

1. What is mean by calls – in - arrears?
2. What is mean by calls in advance?
3. What is mean by forfeiture of shares?
4. What is mean by pro –rata allotment of shares?
5. What is mean by shares issued at premium?

TEN MARKS

1. Differences between stock and shares?

1. What is mean by Shares?

The capital of the company can be divided into different units with definite value called shares. A. Share is one of the units in to which the total capital of the company is dividend. Share capital constitutes the basis of the capital structure of a company

2. What is mean by Stock?

Stock means a bundle of fully paid up shares put together for convenience. Stock means the shares of the company in a different form.

3. What is mean by Equity Shares?

Equity shares are those shares which do not carry and preferential right in respect of payment of dividend and repayments of capital. These are shares having no special rights. The rate of dividend on such shares is not fixed.

4. What is mean by forfeiture of shares?

In case a member fails to pay any call money on the day fixed for payments, the directors may either by adopting table A or by an express provision in its articles proceed to forfeit the shares held by a defaulting share holder.

5. What is mean by re issue of shares?

Shares forfeited on the non – payments of calls can be reissued by the company at any price it likes. But the discount should not exceed the amount earlier received in respect of such shares. Such discount is to be debited to forfeited shares account.

6. What is mean by calls - in - arrears?

When one or more shareholders fail to pay the amount due from them towards allotment and or calls, such dues are called calls in arrears. Usually the accounts of allotment and calls are debited with the amount due from and credited with the actual received; the balance in these accounts represents the amount in arrears

7. What is mean by calls – in - advance?

When a company accepts money from the share holders in advance towards calls not yet made by the company, such amounts are termed as 'calls-in-advance'. As per section 92 of the Companies Act, company's articles should specifically permit the company for accepting calls-in-advance

8. What is mean by Pro – Rata Allotment of Shares?

Shares may be allotted proportionate to the applications received to all the applicants. It may be possible to reject some applications on the basis of some criterion and for the balance applications, proportionate allotment may be made.

9. What is mean by under subscription?

If total number of shares for which applications are received is less than the number of shares issued, it is a situation of under subscription. If the actual applications received are more than the minimum subscription, allotment can be made for all the applicants.

10. What is mean by over subscription?

When a company receives applications for a large number of shares than those offered to the public, it is situation of over subscription.

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

UNIT – II

Debenture Meaning :

Debenture is a written document issued by a company as an evidence of its debt. It also defined as an instrument in writing acknowledging a debt under the seal of the company, bearing a fixed rate of interest and repayable within or after specified period. Debenture is issued for the purpose of raise medium term funds. Debenture includes debenture stock, bonds and any other securities of the company. The company's assets may be given as security for the debentures but such security is not mandatory.

Classification of Debentures :

Debentures may be classified in different ways as follows:

1. On the basis of security :

Debentures may be secured or unsecured. The secured debentures usually have assets mortgaged. So, they are called mortgage debentures. The mortgage can be on specific assets or the company's assets in general. In mortgage on specific assets, the debentures are secured by "fixed charge" and in the latter case, 'floating charge'. The unsecured debentures are called naked or simple debentures.

2. On the basis of performance:

Debentures may redeemable or irredeemable. Redeemable debentures may have a specified future date for redemption or they may be repayable at the company's option. Irredeemable debentures have no date for redemption and for all practical purposes they may be repayable at the time of winding up of the company.

3. On the basis of priority:

Debentures may be termed according to the order of their repayment. First debentures are repayable prior to any other debentures. Second debentures are repayable after redemption of the first debentures and so on.

4. On the basis of convertibility:

Debenture may be non convertible, partly convertible or fully convertible. The terms of issue of debentures may specify the manner of their conversion.

5. On the basis of recording:

Debentures may be registered debentures or bearer debentures. Registered debentures are recorded in the company's register. The holders' name, addresses, etc., are entered therein. Interest is paid and repayment is made on the basis of the register. In case of bearer debentures no record is maintained for transfers. Coupons are attached to the debentures for the purpose of claiming interest. They can be sold and transferred by mere physical delivery.

ISSUE OF DEBENTURES

Debentures may be issued at par, at a premium or at a discount. They may be issued for cash or for consideration other than cash (purchase of assets). The amount on debentures may be collected in lump-sum or installments.

REDEMPTION OF DEBENTURES

Redemption meaning:

Redemption of debentures refers to discharge the liability on a/c. of debenture. Redemption is made according to the terms of issue mentioned in the deed.

Methods of redemption of debentures:

The following are the methods of redemption of debentures,

A. Redemption without provision:

The debenture trust deed or the debenture issue terms may not provide for creating a sinking fund for redemption of the debentures. In such cases, redemption of debentures carried out without any provision for such redemption. Redemption without provision may be in the following ways.

- **Redemption on specified due date:**

On specified due date, debentures are repaid, as per the terms of the issue at par or at premium.

- **Redemption is out of profit:**

The amount equivalents to the debentures, redeemed are transferred from profit and loss account to debenture redemption reserve account. When all the debentures are redeemed the debenture redemption reserve may be closed by transferring to general reserve.

- **Redemption is out of capital:**

When Redemption is out of capital, usually, the new issue of shares or debentures might have been made for this specific purpose. This method is preferable when the company's liquidity position is good.

- **Redemption by Installments:**

When debentures are issued, the terms of issue may provide for the repayment of the debentures. The following methods can be adopted for redemption is installments.

- **Drawing by lot:**

The company may agree to repay every year a predetermined amount of debentures by conducting a lot, using many numbers. The debentures whose number is taken out in the lot will have to be repaid by the company it may be at par or at premium.

- **Open market buying:**

The terms of issue of debentures may permit a company to buy its own debentures in the open market and cancel, or retain or reissue them.

- **Redemption by conversion:**

Redemption of debentures by conversion is possible when debentures were originally issued as convertible debentures'. They may be partly convertible or fully convertible.

- **Conversion on the date of redemption:**

When the debentures were issued, a specified redemption date is fixed and that date the conversion takes place. The original issue price of the debenture is immaterial.

Conversion before the date of redemption:

Sometimes, option may be given to the debenture holders to convert their debentures into shares earlier than the due date for redemption.

B. Redemption with provision :

In the normal course, liquid cash may not be available for the redemption. Making provision is the best way to ensure that necessary cash is available on the date of redemption. Two methods are universally adopted to ensure liquidity for debentures redemption.

- **Sinking fund method :**

A sinking fund may be created for redemption of debentures. This is created out of revenue profits by debiting the profit and loss appropriation account and is not a charge against the profits.

- **Insurance policy method :**

This method is an absolutely certain method of providing exact amount of cash for redemption of debentures. However, this method can be followed when debentures are to be repaid on a definite future date. A sinking fund policy is taken to make provision for redemption. The insurance company receives the premium year after year and pays the agreed amount on the specified future date which can be used to repay the debentures.

CUM-INTEREST AND-EX-INTEREST QUOTATION

Cum-Interest :

When a company buys and sells its own debentures in the open market, the prices quoted may include or exclude interest accrued till that date on the debentures. If the quoted price includes interest on the debentures from the previous interest date till the date of sale, the price is known as ‘cum-interest price’.

Ex-interest :

When a company buys and sells its own debentures in the open market, the prices quoted may include or exclude interest accrued till that date on the debentures. If the quoted price does not include the interest on the debentures from the previous interest date till the date of sale, the price known as ‘ex-interest price’.

TWO MARKS

1. What is mean by debentures?
2. What is mean by Cum – Interest?
3. What is mean by Ex – Interest?

FIVE MARKS

1. What is mean by Redemption of Debentures?
2. What is mean by sinking fund method?

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

TEN MARKS

1. What are the types of debentures?
2. What is mean by sinking fund method and insurance policy method?

JOURNAL ENTRY

a)	**When issued at par and Repayable at par :**			
	Bank A/c	**Dr**	**xxx**	
	To Debentures			**Xxx**
b)	**When issued at discount and repayable at par:**			
	Bank A/c	**Dr**	**Xxx**	
	Discount on issue of Debentures A/c	**Dr**	**Xxx**	
	To Debentures			**Xxx**
c)	**When issued at premium and repayable at par :**			
	Bank A/c	**Dr**	**xxx**	
	To Debentures premium			**Xxx**
	To Debentures			**Xxx**
d)	**When issued at premium and repayable at premium**			
	:	**Dr**	**Xxx**	
	Bank A/c	**Dr**	**Xxx**	
	Loss on issue debentures A/c			**Xxx**
	To Premium on redemption of debentures			
e)	**When issued at discount and repayable at premium**			
	:	**Dr**	**Xxx**	
	Bank A/c	**Dr**	**Xxx**	
	Discount on issue of debenture A/c	**Dr**	**Xxx**	
	Loss on issue of debentures A/c			**Xxx**
	To Premium on redemption of debentures			**Xxx**
	To Debentures			
	SINKING FUND METHOD			
I.	**At the end of the First Year :**	**Dr**	**Xxx**	
	a) Profit & loss appropriation A/c			**Xxx**

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
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	To Sinking fund A/c			
	(Being the amount set aside)			
		Dr	Xxx	
	b) Sinking Fund Investment A/c			Xxx
	To Bank			
	(Being the amount invested)			
II.	At the end of the second year :			
	a) Bank A/c	Dr	Xxx	
	To Sinking Fund			Xxx
	(Being the interest on investment transfer to sinking fund A/c)			
	b) P/L Appropriation A/c	Dr	Xxx	
	To Sinking Fund			Xxx
	(Being the amount set aside)			
	c) Sinking Fund investment A/c	Dr	Xxx	
	To bank			Xxx
	(Being the amount invested)			
III.	At the end of Last Year :			
	a) Bank A/c.	Dr	Xxx	
	To Sinking Fund A/c			Xxx
	(Being the Interest on investment Transfer to sinking fund)			
	b) P/L Appropriation A/c	Dr	Xxx	
	To Sinking Fund			Xxx
	(Being the amount set aside)			
	A) Debentures A/c	Dr	Xxx	
	Debentures Interest A/c	Dr	Xxx	
	To Bank			Xxx
	(Being the Own debentures were purchased Under Ex-Interest and cum – Interest)			

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

HINTS FOR EXAMINATION

1. **What is mean by debentures?**

   Debenture is a written document issued by a company as an evidence of its debt. It also defined as an instrument in writing acknowledging a debt under the sea! of the company, bearing a fixed rate of Interest and repayable within or after specified period.' Debenture are issued for the purpose of raise medium term funds

2. **What is mean by issue of debentures?**

   Debentures may be issued at par, at a premium or at a discount. They may be issued for cash or for consideration other than cash (purchase of assets). The amount on debentures may be collected in lump-sum or installments.

3. **What is mean by redemption of debentures?**

   Redemption of debentures refers to discharge the liability on a/c. of debenture. Redemption is made according to the terms of issue mentioned in the deed.

4. **What is mean by Cum Interest?**

   When a company buys and sells its own debentures in the open market, the prices quoted may include or exclude interest accrued till that date on the debentures. If the quoted price includes interest on the debentures from the previous interest date till the date of sale, the price is known as 'cum-interest price'.

5. **What is mean by Ex – Interest?**

   When a company buys and sells its own debentures in the open market, the prices quoted may include or exclude interest accrued till that date on the debentures. If the quoted price does not include the interest on the debentures from the previous interest date till the date of sale, the price known as 'ex-interest price'

6. **What is mean by sinking fund method?**

   A sinking fund may be created for redemption of debentures. This is created out of revenue profits by debiting the profit and loss appropriation account and is not a charge against the profits.

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Arasu College of Arts and Science for women, Karur.

MEANING OF PREFERENCE SHARES:

These are shares which enjoy preferential rights which as to the payment of dividend at a fixed rate during the life of the company and as to the return of capital on winding up of the company.

Definition :

The companies Act Defines a preference share as that part of the share capital of the company which enjoys the following preferential rights as to :-

- ❖ The payment of dividend at a fixed rate during the life time of the company.
- ❖ The return of the capital on winding up of the company.

Types of preference shares:

The various types of preference share are as follows.

Types of preference shares

- → Cumulative preference Shares
- → Non-Cumulative preference shares
- → Participating preference shares
- → Non-participating preference shares
- → Redeemable preference shares
- → Irredeemable preference shares
- → Convertible preference shares
- → Non-convertible preference shares

Cumulative preference shares:

Cumulative preference shares are those shares which carry the right to Cumulative dividends. That means, if the company fails to pay the dividend in any particular year, due to insufficiency of profits, such dividend is payable even out of future profits.

Non-Cumulative preference shares :

These are the preference shares which do not carry the right to receive arrears of dividend. If the company fails to declare dividend in a particular year that need not be paid out of future profits.

Participating preference shares:

This type of shares which have right to participate in the surplus profits of the company after paying the equity share holders in addition to the fixed rate of their dividend, are called participating preference shares.

Non-participating preference shares:

Preference shares which have no right to participate on the surplus profits of the company are called non-participating preference shares.

PROCEDURE FOR REDEMPTION OF PREFERENCE SHARES

The acts lays down the following procedures:

- A company limited by shares, may, if authorized by its Articles of Association, issue preference shares which are liable to be redeemed as per terms of the issue.
- Shares can be redeemed either out of profits of the company which would otherwise available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of redemption.
- If the shares are redeemed out of profits, sum equal must be transferred to reserve a/c. called "capital redemption reserve".
- Fully paid up redeemable shares only can be redeemed.
- If shares are redeemed at a premium then such a premium must be provided for out of profits or out of share premium of the company.

- Capital redemption reserve can be utilized to issue fully paid bonus shares to the equity shareholders.

CAPITAL REDEMPTION RESERVE

When preference shares are to be redeemed out of divisible profits, a amount equal to the face value of the shares so redeemed is transferred to "Capital Redemption Reserve". Capital redemption reserve a/c. is to be treated as 'capital reserve' like paid up capital. Capital redemption reserve is used to issue fully paid bonus shares to its shareholders.

PROFITS AVAILABLE FOR DIVIDEND.

- General reserve, Dividend equalization fund.
- Reserve fund.
- Profit on sale of investment and fixed assets (revenue portion)
- Workmen's compensation fund and workmen's accident fund.
- Insurance fund, debenture redemption fund and debenture redemption account.
- Profit and Loss Account.

PROFITS NOT AVAILABLE FOR DIVIDEND

- Capital reserve, capital redemption reserve (existing)
- Development rebate reserve and depreciation reserve.
- Forfeited shares account.
- Profits prior to incorporation.
- Profit on sale of fixed assets (capital portion).
- Securities premium account.

JOURNAL ENTRY

1.	**Redeemable preference share capital A/c** **To preference Share holders** **(Being amount due to preference share holder)**	**Dr**	**xxx**	**Xxx**

2.	Redeemable Preference share capital A/c Premium on redemption a/c To preference share holders a/c (Being the amount due to preference share holder)	Dr Dr	Xxx Xxx	 xxx
3.	Security premium a/c Profit & Loss A/c To Premium on redemption a/c (Being premium on redemption adjusted)	Dr Dr	Xxx xxx	 xxx
4.	Bank a/c To Equity share capital a/c (Being the fresh issue of equity shares)	Dr	xxx	 Xxx
5.	Bank a/c To Share premium A/c To Equity Share capital A/c (Being fresh issue of equity shares)	Dr	xxx	 Xxx Xxx
6.	General reserve A/c Profit & Loss A/c To capital redemption reserve A/c (Being the amount of redemption adjusted and transfer to C.R.R A/c)	Dr Dr	Xxx xxx	 Xxx
7.	Bank A/c Profit & Loss A/c To investment A/c (Being the investment are sold)	Dr Dr	Xxx Xxx	 Xxx
8.	Capital Redemption reserve A/c To bonus to share holder A/c (Being the bonus declared to equity share holders)	Dr	xxx	 Xxx
9.	Bonus to share holder A/c To Equity share capital (Being bonus share's Transfer to equity share capital)	Dr	xxx	 Xxx

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

10.	**Redeemable preference share holder A/c.** **To bank A/c** **(Being to Amount paid preference share holders)**	**Dr**	**xxx**	**Xxx**

TWO MARKS

1. What is mean by preference shares?
2. What is mean by capital redemption reserve?

FIVE MARKS

1. What are the various types of preference shares?
2. What is mean by redeemable preference shares?
3. What is mean by cumulative preference shares?

TEN MARKS

1. What are the procedures for redemption of preference shares?

HINTS FOR EXAMINATION

1. **What is a preference share?**

   These are shares which enjoy preferential rights which as to the payment of dividend at a fixed rate during the life of the company and as to the return of capital on winding up of the company.

2. **What are the types of preference shares?**

   (Types of preference shares)

   - ✓ Cumulative preference Shares
   - ✓ Non-Cumulative preference shares
   - ✓ Participating preference shares fen-participating preference shares
   - ✓ Redeemable preference shares
   - ✓ Irredeemable preference shares
   - ✓ Convertible preference shares
   - ✓ Non-convertible preference shares

3. What are the procedures of redemption of preference shares?

- A company limited by shares, may, if authorized by its Articles of Association, issue preference shares which are liable to be redeemed as per terms of the issue.
- Shares can be redeemed either out of profits of the company which would otherwise available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of redemption.
- If the shares are redeemed out of profits, sum equal must be transferred to reserve a/c. called "capital redemption reserve".
- Fully paid up redeemable shares only can be redeemed.

4. What is mean by capital redemption reserve?

When preference shares are to be redeemed out of divisible profits, a amount equal to the face value of the shares so redeemed is transferred to "Capital Redemption Reserve". Capital redemption reserve a/c. is to be treated as 'capital reserve' like paid up capital.

UNIT - III

AMALGAMATION:

Amalgamation refers to the case where two or more existing companies go into liquidation and a new company is formed to take over the business of those liquidating companies. Hence, two or more liquidations take place and one formation takes place in case of amalgamation.

ABSORPTION:

When one existing company takes over the business of one or more existing companies it is called absorption. No new company is formed.

ACCOUNTING STANDARD (AS 14):

Accounting for amalgamations (AS 14), issued by the institute of Chartered Accountants of India is mandatory in nature for all companies and is applicable to accounting periods commencing on or after 1.4.1995. The standard specifies the procedure of accounting for amalgamations and the treatment of any resultant goodwill or reserves. The following terms have been used in the standard with the meanings specified:

1. Amalgamation means an amalgamation pursuant to the provisions of the companies Act 1956 or any other statute which may be applicable to companies.
2. (b)Transferor Company means the company which is amalgamated into another company.
3. (c)Transferee Company means the company into which a transferor company is amalgamated.

Perusal of the above terms makes it clear that the term 'Amalgamation' as used in AS 14 includes absorption also.

TYPES OF AMALGAMATION:

The ICAI has issued accounting standards for amalgamation. It classifies amalgamation into two types:

1] Amalgamation in the nature of purchase

2] Amalgamation in the nature of merger.

Amalgamation in the nature of merger:

According to the standard an amalgamation to be considered as a merger, the following conditions are to be satisfied:

1.All the assets and liabilities of the transferor company become the assets and liabilities of the transferee company after amalgamation.

2.Shareholder holding not less than 90% of the face value of the equity shares of the transferor company becomes equity share holder of the transferee company by virtue of an amalgamation..

3.The consideration to the shareholder of the transferor company (willing to become equity share holder of the transferee company) is discharged by the transferee company wholly by issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

4.The business of the transferor company is intended to be carried on after amalgamation by the transferee company.

5.No adjustment is intended to be made to the book value of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferor company except to ensure uniformity of accounting policies.

Amalgamation in the nature of purchase:

If any one or more of the conditions specified for the merger are not satisfied, the amalgamation is in the nature of purchase.

Suppose A ltd acquires the business of B ltd with no intention to continue such business it is a purchase and not merger. Similarly, share holders of B ltd holding 90% of the share capital do not become share holders of A ltd. The amalgamation is only in the nature of purchase.

PURCHASE CONSIDERATION:

The price payable by the purchasing company to the selling company for taking over its business is called purchase consideration. The purchase consideration may be in the form of cash, shares or debentures.

METHODS OF DETERMINING PURCHASE CONSIDERATION:

a) Lump sum method:

The purchase price to be paid may be mentioned in the agreement directly.

b) Net payment method:

The agreement between the selling company and purchasing companies may specify the exact amount payable to the share holder, debenture holder etc of the selling company in the form of cash or shares or debentures is the purchase consideration. The total of the payment represents the net payment made.

c) Net asset method:

Net assets taken over by the purchasing company is deemed as the purchase consideration under net assets method.

Net assets = agreed value of assets taken over (-) agreed value of liabilities taken over.

If full details are not given, when a company takes over another company or the business of another company it implies that both assets and liabilities are taken over.

d) Intrinsic value method:

Here purchase consideration is ascertained on the basis of the ratio in which the shares of purchasing company are exchanged with those of selling company. The exchange ratio is usually determined on the basis of intrinsic value of the respective companies.

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

$$\text{Intrinsic value} = \frac{\text{Assets available for equity share holders}}{\text{Number of equity shares.}}$$

DISTINCTION BETWEEN AMALGAMATION AND ABSORPTION:

Amalgamation	Absorption
It necessarily involves the liquidation of at least two existing company	It need not necessarily involves the liquidation of two existing company generally it requires the liquidation of only one company.
It necessitates the formation of a new company to take over the business of the amalgamating companies.	It does not necessitate the formation of a new company.

Accounting treatment in the books of selling company and purchasing company:

Journal entries in the books of selling company:

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
(1) For transferring assets to realisation A/c: Realisation A/c Dr. To Sundry Assets A/c	xxx	Xxx	Repayment at discount: Debenture A/c (face value) Dr. To Debenture holder A/c To Realisation A/c (discount)	xxx	xxx xxx
(2) For transferring liabilities taken over: Liabilities A/c (individually) Dr. To Realisation A/c	xxx	Xxx	(b) For payment to deb. holders: Debenture holders A/c Dr. To Bank A/c (if cash is paid) To Debenture in Purch. Comp. A/c	xxx	xxx xxx
(3) For purchase consideration receivable Purchasing company's A/c Dr.	xxx		(9) For discharge of preference share capital: (a) For repayment at premium:		

To Realisation A/c		xxx	Pref. Share Capital A/c Dr. Realisation A/c (premium) Dr. To Pref. Shareholders A/c	xxx xxx	xxx
(4) For receiving the purchase consideration: Bank A/c Dr. Share in Purchase Co. A/c (agreed value) Dr. Debenture A/c (agreed value) Dr. To Purchasing company A/c	xxx xxx xxx	Xxx	For repayment at discount: Pref. Share capital A/c Dr. To Pref. Shareholder A/c To Realisation A/c	xxx	xxx xxx
(5) For realizing assets not taken over: Bank A/c Dr. To Realisation A/c	xxx	Xxx	(b) For payment to Pref. Sh. holders: Pref. Shareholder A/c Dr. To Bank A/c To Share in purchasing Co	xxx	xxx xxx
(6) For payment of liabilities not taken over: Liability A/c (book value) Dr. Realisation A/c (premium on repayment) Dr. To Bank A/c. (actual amount paid) To Realisation A/c (discount on repayment)	xxx xxx	xxx xxx	(10) For transfer of equity share capital and accumulated profit: Eq. Share Capital A/c Dr. General Reserve A/c Dr. Profit & Loss A/c Dr. Any other Reserve A/c Dr. To Eq. Shareholder A/c	xxx xxx xxx xxx	xxx
(7) For payment of realisation expenses: (a) If expenses are to be borne by selling Co. Realisation A/c Dr. To Bank A/c	xxx	xxx	(11) For transfer of accumulated losses: Eq. Shareholders A/c Dr. To Profit & loss A/c To Preliminary exp. A/c To Discount on issue of share	xxx	xxx xxx xxx
(b) If expenses are to borne by the Purchasing Co			(12) For Realisation Profit / loss:		

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

Purchasing Co. A/c Dr.	xxx		(a) If there is profit on	xxx	
To Realisation A/c		xxx	realisation:		xxx
(Being exp. paid on behalf of			Realisation A/c Dr.		
purchasing Co.)			To Eq. Shareholders A/c	xxx	
Bank A/c Dr.	xxx		(b) If there is loss on		xxx
To Purchasing Co. A/c		xxx	realisation:		
(Being expenses paid reimbursed by			Equity shareholder A/c Dr.		
purchasing Co.)			To Realisation A/c		
(8) For discharging the debenture:			(13) For final payment of the		
(a) Repayable of at a premium:			equity shareholder:		
Debenture A/c (face value) Dr.	xxx		Equity shareholder A/c Dr.	xxx	
Realisation A/c (premium) Dr.	xxx		To Bank A/c		xxx
To debenture holder S/c		xxx	To Share in purchasing Co.		xxx

Journal entries in the books of purchasing company:

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
(1) For purchase consideration			(4) For expenses of liquidation		
payable:			agreed to paid by transferee Co.:		
Business purchase A/c Dr.	Xx		Goodwill A/c Dr.	xxx	
To Liquidator of transferor	x	xxx	To Bank A/c		xxx
Co. A/c					
(2) For assets and liabilities taken			(5) For formation expenses of		
over:			Transferee Co.:		
Sundry assets A/c Dr.	xxx		Preliminary expenses A/c Dr.	xxx	
Goodwill A/c Dr.	xxx		To Bank A/c		xxx
To Sundry liabilities A/c		xxx	(6) For statutory reserve of the		
To Business purchase A/c		xxx	transferor Co. to Continued:		
To Capital reserve A/c		xxx	Amalgamation Adjustment A/c	xxx	
			Dr.		xxx
			To Statutory Reserve A/c		
(3) For payment of purchase of			(7) For settlement of debenture		
purchase price:			holder or creditor of transferor		
Liquidator of selling Co. A/c Dr.	Xx		Co.:	xxx	

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

To Bank A/c	x	xxx	Debenture A/c Dr.	xxx	
To Share capital A/c		xxx	Creditors A/c Dr.		xxx
To Share premium A/c		xxx	To Debenture A/c		xxx
To debenture A/c		xxx	To Bank A/c		

Question banks:

Two marks questions

1. What mean by amalgamation.
2 what is mean by absorption.
3. Write note on purchase consideration
4. Write the differences between amalgamation and absorption

Five marks questions

1. What are the method determining purchase consideration?
2. Explain the types of amalgamation.

Ten marks questions

1.write short notes on

A. Amalgamation

B. Absorption

C. Purchase consideration.

Internal reconstruction or reduction of share capital:

Reconstruction means rebuilding something I different form. Reconstruction of a company implies the rearrangement of share capital. It is of two types they are internal reconstruction and external reconstruction.

External reconstruction refers to a company which, under reconstruction goes into liquidation and in its place a new company is formed.

Internal reconstruction is the reorganization of a company to enable it to make a fresh beginning, after eliminating accumulated losses

Reduction of share capital:

A company can reduce its share capital as per the provisions of sec 100 to 105 of the companies act, 1956, reduction of capital can take any of the following forms:

1. Reducing or completely extinguishing shareholders liability for uncalled capital.
2. Refunding surplus paid up capital which is found to be in excess of the needs of the company.
3. Canceling or writing off paid up capital which is lost and not represented by assets.

Alteration of share capital:

According to sec 94, 95, & 97 of the companies act, 1956, deal with alteration of share capital. The articles of the association of the company should permit the alteration. The memorandum also can be altered. Alteration of capital includes increase of capital, consolidating and sub- division of shares, decrease in the un issued capital and conversion of fully paid up shares into stock.

There are two types of alteration the share capital of a company:

1. Alteration which do not require the approval of the court of law.
2. Alteration which require prior approval of a court of law.

Different kinds of alteration of share capital:

a) Increase of share capital:

Increase its share capital by such amount as it thinks expedient by issue of new shares. Accounting entries are the same as are done for issue of new shares.

b) Consolidation of shares:

Consolidation of all or part of its existing shares of smaller amounts into shares of larger amount. The result is that the paid up capital remains the same but total number of shares reduces.

c) Subdivision of shares:

Subdivision of its shares into shares of higher denomination subject to the condition that in the case of partly paid up shares, the proportion between the paid up and the unpaid amount on the shares continue to be the same after sub division before. The effect is that the paid up capital does not change but the total number of share increases.

d)Conversion of shares into stock and vice versa:

This involves conversion of all or any of its fully paid up share into stock or reconvert the stock into fully paid up shares.

e) Cancellation of un issued shares:

Cancel those shares which have not been taken up, i.e. decrease its un issued capital with out resulting in the reduction of paid up capital.

Procedure for reducing share capital:

1. A company cannot reduce its share capital unless it is authorized by its articles. However, if the articles do not permit capital reduction, they may be altered by special resolution to enable the company to reduce its share capital.
2. The company must pass a special resolution for reduction of capital.
3. The company must apply to the court for an order confirming the capital reduction. The court must look after the interests of creditors and share holders before giving an order confirming the capital reduction.
4. The order of the court confirming the reduction must be produced before the register and a certified copy of the order and of the minutes of reduction should be filed with the registrar for the registration.

UNIT - IV

HOLDING COMPANY:

A holding company is better defined in the context of the definition of a subsidiary company Sec.4 of the companies Act 1956 define a subsidiary company. According to the Sec (1) a company shall be deemed to be a subsidiary company of another if and only if:

- "That other company controls the composition of its board of directors; (or)
- That other:
  - When the first mentioned company is an existing company in respect of which the holders of preference share issued before the commencement of this Act have the same voting rights in all respect as the holders of equity shares, exercise (or) controls more than half of the total voting power of such company;
  - When the first mentioned company is another company holds more than half in nominal value of its equity share capital; or
- The company is a subsidiary of any company which is that other company's subsidiary".

SUBSIDIARY COMPANY:

From Sec.4 it is clear that a company is a subsidiary of a holding company in any of the following three cases:

- When the holding company controls the compositions of the board of directors of the subsidiary company i.e., the holding company is able to appoint or dismiss the majority of directors of the subsidiary company.
- Where the holding company holds more than 50% in nominal value of the equity share capital of the subsidiary company i.e., the holding company holds the majority of voting power in the subsidiary company.
- When a subsidiary company is a holding company of another subsidiary company the original holding company is also a holding company of that other subsidiary company.

CONSOLIDATED FINANCIAL STATEMENT:

The legal balance sheet of a holding company should contain the assets and liabilities. However, consolidated financial statement (or) 'Group accounts' are in addition to the 'legal financial statement' which is to be statutorily filed with appropriate authorities.

Consolidated Profit & loss A/c and balance sheet imply preparation of a single Profit & loss A/c and balance sheet of a holding company and its subsidiaries. This is done by aggregating all items of income, expenses, assets, liabilities etc., of the holding company and its subsidiaries. Such consolidation is also known as 'Group accounts'.

CONSOLIDATE BALANCE SHEET:

The consolidated balance sheet shows the combined assets in holding & subsidiary companies on the assets side except the holding company's investment in the subsidiary.

The liabilities side shows the capital reserves and other accumulated profits of the holding company and combined liability of outsiders.

The minority interest may also be shown on the liabilities side of the consolidated balance sheet.

The holding company's share of the capital profits would be added and investments made in subsidiary company are subtracted.

Finally the company's share of revenue profits is also added to the holding company's existing P&L a/c.

Any amount owed by the holding co and subsidiary co., to each others are eliminated from the consolidated balance sheet. They may be a part of debtors and creditors, B/R, B/P, or loan to each other.

MINORITY INTEREST:

A holding company acquires majority of 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'.

Calculation of minority interest	
Face value of minority equity shares Face value of minority preference shares Minority share of capital profit Minority share of revenue profit Minority share of bonus shares issued	XXX XXX XXX XXX XXX
 (-) Minority share of capital losses Minority shares of revenue losses	XXX XXX XXX
Total minority interest	XXX

COST OF CONTROL / GOODWILL (OR) CAPITAL RESERVE:

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

The excess amount paid represents payment for goodwill and less amount paid represents Capital reserve.

Calculation of cost of control or capital reserve		
Amount paid for shares purchased by the holding company in the subsidiary **ADD:** Holding company's share of capital loss		XXX XXX
		XXX

LESS: Face value of share purchased	XXX	
Holding company's share of capital profits	XXX	
Holding company's share of Bonus shares issued by subsidiary	XXX	
Holding company's share of dividend paid out of capital profit	XXX	XXX
Goodwill or capital reserve		XXX

The goodwill or capital reserve ascertained must be merged with any goodwill in the balance sheets of the holding and subsidiary companies.

CAPITAL PROFIT OR PRE-ACQUISITION PROFIT:

All the accumulated profits of the subsidiary company on the date of purchase of shares by the holding company is called 'capital profits' or 'pre acquisition profits'.

a) Capital reserve, general reserve, reserve fund, share premium, profit & loss account, etc.

b) If shares are acquired during the current year, profit earned by the subsidiary in the months before purchase of shares in the current year is also to be taken as capital profit.

c) Similarly, any profit on revaluation of assets or liabilities on the date of purchase of shares has to be treated as capital profit.

CAPITAL LOSS OR PRE ACQUISITION LOSS:

All accumulated losses on the date of purchase of shares by the holding company are termed as 'Capital losses'.

Computation of capital profit		
General reserve, capital reserve, profit & loss A/c & other reserve of subsidiary on the date of purchasing of shares		XXX
Less: Bonus shares issued by subsidiary from pre acquisition profit	XXX	
Dividend paid by subsidiary of pre-acquisition profit	XXX	XXX
		XXX
Add: Subsidiary company profit during the current year before purchase of share	XXX	
Profit on revaluation of assets & liabilities of the subsidiary n the date of purchase	XXX	XXX
		XXX
Less: Loss on revaluation of assets & liabilities of subsidiary on		XXX

the date of purchase		
Net capital profit		XXX

REVENUE PROFIT (OR) POST ACQUISITION PROFIT:

Profit earned by a subsidiary company after the date of acquisition of shares by the holding company is called revenue profit (or) post acquisition profits. These profits may be a part of profit and loss account of the subsidiary company or they might have been transferred to reserve or proposed as dividend.

REVENUE LOSSES OR POST-ACQUISITION LOSSES:

Any loss incurred by the subsidiary co,.after the date of purchase of shares by the holding company is called 'Revenue loss or 'Post acquisition losses.

REVALUATION OF ASSETS & 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 loss on revaluation of the assets and the outside liabilities has to be adjusted in the respective assets and liabilities in the consolidated balance sheet, if it is not already done. The same profit or loss has to be included in the computation of 'capital profits'.

BONUS SHARES:

After the holding company acquired controlling interest, subsidiary company may issue bonus shares out of its profits to all the shareholders. As a result, holding company also receives the bonus shares and the face value of shares acquired increases.

Treatment of bonus issue by subsidiary depends on the source of profit out of which the bonus is issued: (a) Bonus issue out of capital profit, (b) Bonus issue out of revenue profit (or) post acquisition profit.

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

UNREALIZED PROFIT:

An unrealized profit exists when a companies stock is at a selling price i.e., at a profit. It is agreed that this should be treated as an unrealized profit and it should be eliminated from stock as well as from profit and loss account. Towards this, a separate reserve called stock reserve is normally created.

DIVIDEND:

When dividend has been declared by the subsidiary company and the holding company received it, the treatment of dividend will be as follows:

- ☞ Dividend received by the holding company from the capital profit of the subsidiary company are created to invest in share of the subsidiary account thereby reducing the cost of control or increasing capital reserve.
- ☞ If the dividends received out of the revenue profits are treated as income and credited to profit & loss account by the holding company.
- ☞ If dividend declared party out of the capital profits and partly out of revenue profits, the dividend received is dividend into two parts in proportion to its declaration out of capital profit and revenue profits.
- ☞ If the dividend has simply been proposed by the subsidiary. The holding companies share of it is added to its profit and shown as profit and loss balance. The share due to minority shareholders may be either shown as proposed dividend in the balance sheet or added to the minority interest.

PREPARATION OF BALANCE SHEET:

Specimen of consolidated balance sheet of holding company and its subsidiary company:

Liabilities	Rs.	Assets	Rs.
Share capital:		Fixed assets:	
Share capital of Holding company	XXX	(i) Cost of control goodwill Add: Goodwill in B/S of Holding Co.,	
Reserve & surplus:			
(i) Capital Reserve of holding company	XXX	Add: Goodwill in B/S of Subsidiary Co.,	XXX
Add: Share in Pre-acquisition Reserve & Profits of subsidiary		Less: Capital Reserve as pre contra	XXX
Less: Goodwill as per contra	XXX	(ii) All other fixed assets of Holding Co.,	

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

(ii) Revenue reserve of Holding Co.,		Add: All other fixed assets of subsidiary	XXX
Add: Share in revenue reserve of subsidiary	XXX	Investments:	
		Investments of Holding Co., except investments in subsidiary	
(iii) P & L A/c balance of Holding Co.,		Add: Investments of subsidiary	
Add: Share in revenue profit of subsidiary company	XXX	Current assets, loans and advances:	XXX
		Current assets, loans and advances of subsidiary co.,	XXX
Less: Share in unrealized profits			
Secured loans:	XXX	Less: Inter company debts	
Secured loans of holding Co.,		Less: Unrealized profit in stock	
Add: Secured loans of subsidiary Co.,		Miscellaneous expenditure:	
		P & L A/c of Holding Co.,	
Unsecured loans:			
Unsecured loans of Holding Co.,			
Add: Unsecured loans of subsidiary Co.	XXX XXX		
Current liabilities and provisions:			
(i) Current liabilities & Provision of Holding Co.,			
Add: Current liabilities & provisions of subsidiary Co.,			
Less: Inter-company liabilities			
(ii) Minority interest			

Questions banks

Two marks questions

1. Define the holding company.
2. Write the meaning of subsidiary company.

Five marks questions

1. Explain the revenue losses
2. Explain the following terms

a. bonus shares   b.dividend   c. unrealized profits

Ten marks questions.

1. Given the specimen of consolidated balance sheet of holding company and subsidiary company.

UNIT – V

MEANING OF BANKING COMPANIES

Banking companies are governed by the banking regulation Act, 1949. Sec.5 of the Act defines banking as "the accepting, for the purpose of lending or investment, of deposits, of money from the public repayable on demand or otherwise & withdrawable by cheque, draft, order or otherwise. Therefore, any company which engage itself in the manufacture of goods or carries on any trade & accepts deposits of money from the public for financing its business activities will not be treated as doing business of banking.

Sec.2 of the Act provides that provisions of companies Act, 1956 in the absence of special provisions in that regard in banking companies Act, will apply to banks also.

LEGAL REQUIREMENTS REQUIRED TO BANKING COMPANY

The important provisions relating to final accounts of a banking company are as follows:-

1) Prescribed form-

As per Sec.29 to33 of Banking Regulation Act, every banking company is required to prepare a balance sheet in accordance with Form A set out in the third schedule and a profit & loss A/c in conformity with form 15 of the same schedule.

2) Accounting year-

On account of the amended provision of the Income Tax Act 1961 requiring every company to close its accounts on 31st March every year. w.e.f financial year ending 31st March 1989, now a banking company also closes its accounts on 31st March each year.

3) Prohibition of trading-

According to Sec.8, a banking company cannot directly or indirectly deal in the business of buying or selling or bartering of goods, except in connection with the realization of security given to or held by it or engage in any trade or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or for the administration of estate as executor, trustee or otherwise.

4) Non-banking assets-

A banking company may have to take possession of certain assets charged in its favour on account of the failure of the debtor to repay the loan in time. According to Sec.9, a banking company cannot hold any immovable property however acquired, except for its own use, for any period exceeding seven years from the date of acquisition thereof. Gain or loss on sale of such as asset has to be shown separately in the P& L A/c of the banking company.

5) Share capital-

In order to ensure that no banking company commences or carriers on business with a weak and vulnerable capital structure, Sec.11 lays down the minimum limits of paid up capital & reserve to be complied with by a banking company which wishes to commence or carry on business in India.

6) Reserve fund-

Every banking company incorporated in India is required under Sec.17 (1) of the Act to create a reserve fund & to transfer to such fund, before any dividend is declared, a sum equal to not less than 25% of the profit, as disclosed in P& L A/c. Such reserve is termed as "statutory reserve".

7) Payment of dividend-

Sec.15 prohibits payment of dividend by any banking company until all of its capitalized expenses have been completely written off. Payment of dividend out of the profits is considered inappropriate when capitalized expenses are outstanding.

8) Payment of commission, brokerage etc. -

According to Sec.13, a banking company cannot pay out directly or indirectly any commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, exceeding 2 ½ % of the paid up value of the shares.

9) Charge on uncalled capital-

According to Sec.14, a banking company cannot create any charge on unpaid capital & any such charge is invalid. Under Sec 14A, banking company can not create a floating charge on the undertaking or any property of the bank except with the written permission of the RBI certifying that the charge will not be detrimental to the interest of the depositors.

10) Subsidiary companies-

In order to prevent the banking company from carrying on trading activities indirectly by acquiring controlling interest, it has been provided that a banking company can form a subsidiary company only for one or more of the following purposes.

1) The undertaking & executing of trust.

2) The undertaking of the administration of estates as executor, trustee or otherwise.

3) The carrying on business of banking exclusively outside India, with the prior permission of the reserve bank.

4) Such other purposes as are incidental to banking business (Sec.19).

11) Cash reserve-

Under Sec.18 every banking company (not being a schedule bank) shall maintain a cash reserve with itself or with the reserve bank or the State Bank India or any other bank notified by the Central Government in this behalf a sum equal to at least 3% of its time and demand liabilities in India.

12) Statutory liquidity ratio-

According to Sec.24 (2A) of the Banking Regulation Act, every banking company in India whether schedule or non-scheduled, is required to maintain in India in cash, gold, or unencumbered approved securities an amount which is not less than 25% of the total of its demand and time liabilities in India. This is known as "Statutory Liquidity Ratio".

13) Loan & advances-

Sec.20 of the Banking Regulation Act imposes certain restrictions on the loan granted by banks to persons connected with their management.

a) No banking company can grant loans and advances on the security of its own shares;

b) The banking company should not enter in to any commitment for giving any loan or advance to:

i. Any of its directors;

ii. To a firm in which any of is directors is interested as partner, manager, employee or guarantor.

iii. To any company of which any of the directors of the banking company is a director, manager, guarantor or

iv. To any individual with whom of its directors is a partner or a guarantor.

14) Limits as to investments in shares and debentures-

Reserve bank of India has removed limits on investments made by the banks in the equity and debenture issues of 17 financial institutions.

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

BILLS FOR COLLECTION

These are drafts & bills drawn by sellers of goods on the purchase of goods and sent to the bank for collection against delivery documents. (i.e., railway receipts, truck receipts, bill of lading). The bank hands over the documents authorizing the delivery of the goods to the borrower only after the collection of the amount of the bill. If some bills are left uncollected at the end of the year, they are shown under contingent liability on the liability side of the balance sheet.

REBATE ON BILLS DISCOUNTED

This is also termed as "Unexpired discount" or "discount received but not earned". Bill discounted may have maturity data beyond the current accounting year. The amount of discount relating to the period of a bill falling in the next accounting year is the unexpired discount. In other words, this is the unearned amount of discount received for those bills that will mature after the date of closing the final accounts.

CASH CREDIT

It is an arrangement by which the customer is granted the right to borrow money from time to time upto a certain limit. Cash credit is usually given on hypothecation or pledge of stock. The bank usually charges a higher bank interest on the actual amount withdrawn than that charged on loan because the bank has to keep the amount allowed as cash credit always ready under the fear that money allowed may be demanded at any time. Further, in case of cash credit arrangement, the customer is required to pay a minimum instead whether the customer draws any amount or not.

MONEY AT CALL & SHORT NOTICE

This means amount lent should be repayable at call or at short notice. These loans are given to bill brokers, stock brokers and other banks for a short period. When the banks have surplus money with them, they advance their surplus to another banker under this category. At any time or by giving a short notice the money will be repaid by the borrower. The rate of interest will depend on the current money market condition.

CONTINGENT LIABILITIES

A contingent liability is one which is not an actual liability but which will become an actual one on the happening of some even which is uncertain. Contingent liabilities have two characteristics:

(i) Uncertainly as to whether amount will be payable at all &

(ii) Uncertainly about the amount involved. It is sufficient for the amount of contingent liability to be stated on the face of the balance sheet by way of a foot note.

CLASSIFICATION OF BANK ADVANCES

The usual practices in all banks was to recognize income from advances on "Accrual basis" & take credit for interest accrued on all loans, overdraft etc., while closing books for an accounting year. This was the case even with advances doubtful of recovery because it was helpful in 'window dressing' of profits & was considered as a part of "Bottom line management".

However, in line with international accounting standards, the present practice is to make a distinction between the treatment of income on different advances by classifying them into 'performing' and 'non-performing' assets. Income from 'performing assets is recorded on accrual basis'. Income from 'non-performing assets' is recorded only when income from them is received in cash. In this context the exact meaning of non-performing assets becomes important.

NON-PERFORMING ASSETS

Any asset which generates income is a 'Performing assets'. An asset becomes 'non-performing' when it ceases to generate income for a bank, due dates and the delay exceeds a 'stipulated time'.

Reserve Bank of India (RBI) has given clear guidelines in determining when an asset becomes non-performing which are briefly given below:

a) Term loan

When interest and /or installment of principal remains over due for more than 180 days, it should be considered as Non-performing assets.

b) Cash credit and overdraft

When the account remains 'out of order' for more than 180 days, they are to be considered as non-performing assets. An account is out of order is the outstanding balance is in excess of the sanctioned limit or drawing power or there are no credits for a continuous period of 180 days in the account or credits during the period are not enough to cover the interest debited.

c) Bills purchased and discounted

If the bill remains overdue for a period of more than 180 days, it should be considered as non-performing assets.

d) Agricultural advances

If advances to agricultural sector remain over due for two harvest seasons, not exceeding two half years, they are to be considered as non-performing assets.

e) Other advances

When other advances remain over due for more than 180 days, they are to be considered as non-performing assets. Non performing assets are to be determined on 'Borrower Basis' and not on the basis of each kind of advance separately. So, if an advance of one kind to a particular borrower becomes NPA, all other advances to him should be considered as non performing assets. It is the usual practice to determine the status of different advances on the balance sheet date.

PROVISION FOR NON-PERFORMING ASSETS

For the purpose of making provision for Non-performing assets, different advances of a bank are classified into four categories namely, standard assets, sub-standard assets, doubtful assets and loss assets with variable provisions, as explained in detail below:

i) Standard assets- These assets do not disclose any problem and also do not carry more than normal risk attached to the business. These are not Non performing assets.

ii) Sub-standard assets- Such assets have been classified as NPA for a period not exceeding two years. The current net worth of the borrower/guarantor or the current market value of the security charged under such cases is not enough to ensure recovery of dues to the bank in full. Such an asset will have well defined weaknesses that jeopardize the liquidation of the debt and perhaps the bank will have to sustain some loss if deficiencies are not corrected. Where instalments of term loans are overdue for a period exceeding one year should be treated as sub-standard assets. Where terms of loan agreement regarding interest and principal are renegotiated or rescheduled after commencement of production should be classified as sub-standard and should remain in such category at least for two years of satisfactory performance under the renegotiated or rescheduled terms.

iii) Doubtful assets- An asset which has remained NPA for a period exceeding two years. In term loans if the instalments of the principal have remained overdue for a period of exceeding two years should be treated as doubtful. A loan is classified as doubtful if all the weaknesses inherent in that classified as sub-standard with the added characteristics that weaknesses make collection or liquidation in full on the basis of currently known facts, conditions and values highly questionable and improbable.

iv) Loss assets- Where the loss on an asset has been identified by bank or internal auditor or the RBI inspector but that amount has not been written off wholly or partly is known as loss assets. Such an asset is uncollectible and is of such little value that is not desirable to show it as bank's asset though it may have some salvage or recovery value.

Q.GIVE THE SPECIMEN OF PROFIT AND LOSS ACCOUNT AND BALANCE SHEET

FORM 'B'

Third Schedule

Form of Profit and Loss Account

Profit and Loss Account for the year ended 31st March (000's omitted)

	Schedule No.	Year ended on 31.3… (Current year) Rs.	Year ended on 31.3…(Previous year) Rs.
I) Income: Interest earned Other income	 13 14	 xxx xxx	
Total			
II) Expenditure: Interest expended Operating expenses Provisions & contingencies	 15 16	 xxx xxx xxx	
Total			
III) Profit / Loss: Net profit / loss (-) for the year Profit / loss (-) brought forward		 xxx xxx	
Total			
IV) Appropriations: Transfer to statutory reserves		 xxx	

Transfer to other reserves		xxx	
Transfer to government / proposed dividend		xxx	
Balance carried over to balance sheet		xxx	
Total			

Format of Balance Sheet

Balance Sheet of …..(here enter name of the banking company) as on 31.3.(year)

	Schedule No.	As on 31.3… (Current year) Rs.	As on 31.3… (Previous year) Rs.
Capital and Liabilities:			
Capital	1	xxx	
Reserves & surplus	2	xxx	
Deposits	3	xxx	
Borrowings	4	xxx	
Other liabilities & provisions	5	xxx	
Total		xxx	
Assets:			
Cash and balance with RBI	6	xxx	
Balance with banks and money at call	7	xxx	
and short	8	xxx	
notice	9	xxx	
Investments	10	xxx	
Advances	11	xxx	
Fixed assets			
Other assets			
Total		xxx	
Contingent liabilities	12	xxx	
Bills for collection		xxx	

Questions banks

Two marks questions

1. Write the meaning of banking
2. What is mean by cash credit?

Five mark questions

1. Explain the types of banking advances

Ten mark questions

1. What are the legal requirements to banking company?

INSURANCE

Insurance is an invaluable means to provide protection against risks. It is the nature of insurance to mitigate various sorts of risks about which people are ignorant or careless. Insurance is an agreement between two parties whereby the insurer undertakes to indemnify the risk of the insured on receipt of a small sum known as premium.

According to Justice Tindle, "Insurance is a contract through which the insurer agrees to pay a stipulated amount to the insured on the occurrence of an eventuality in lieu of a sum of premium.

VARIOUS TYPES OF INSURANCE

Insurance business can be divided in to two well marked classes viz life insurance and general insurance.

LIFE INSURANCE:

A contract of life insurance is a contract under which, in consideration of sums of money called premium, the insurer agrees to pay a certain amount on the death of the assured or upon the expiry of a certain fixed period, whichever is earlier. Life policies are of various types, but their main varieties are the following:

Whole life policy: Under this policy, the premium continues to be paid throughout the lifetime of the assured, but the policy money becomes payable only after his/her death.

Endowment life policy: It is a policy which runs for a fixed period. Under this policy, the money is payable either at the end of a specified number of years or upon death of the insured person whichever is earlier.

With-profit policy: Under this policy, the policyholders are entitled to participate in the profit of the company in addition to receiving a guaranteed sum of money on maturity.

Without profit policy: Under this policy, the policyholder will get only a fixed sum of money on maturity and they are not eligible to get any share in the profits of the company.

Annuity: The person taking out an annuity may pay the premium in regular installments over a certain period or, he/she may pay it in a lump sum at one go. After the assured reaches a certain age, the insurer will pay back the money by monthly, quarterly, half yearly or yearly installments. An annuity provides a source of regular income to the assured or to his/her dependents after the expiry of a specified period.

GENERAL INSURANCE:

It is a contract under which the insurer, in consideration of a certain premium, undertakes to reimburse the insured for any loss or liability he/she may incur on the happening of an uncertain event. In practice, all insurance other than life are regarded as general insurance. The following are the various type of insurance included in it.

Fire insurance:

It is a contract of indemnity under which the insurance company undertakes to pay the insured for the damage or loss caused to the property insured against fire for consideration of premium. Moreover, the compensation given to the insured never exceeds the amount insured.

Marine insurance:

It is a contract of insurance under which the insurer who is also known as the underwriter agrees to indemnify the insured against the losses incidental to marine adventure. A contract of marine insurance today covers cargo, the ship and also the freight.

Accident insurance:

Under these contracts amount of insurance become payable on the happening of insured accident. Insured has to pay premium in this case also like all other cases.

Other insurance:

In addition to fire, marine and accident insurance there are other forms of insurance also, as a musician insures his voice and a dancer insures his/her legs etc. Sometimes, the policy may also be taken for burglary, fidelity, third party, workmen compensation, consequential loss etc.

CLAIM

Claims refer to the amount payable by the insurance company to various persons who have suffered loss on account of the event insured against. In life insurance business, claim may arise due to death of policy holder or maturity of policies. Claims can be classified in the following categories.

a) Claims intimated, accepted and paid.

b) Claims intimated, accepted but not paid.

c) Claims intimated but not yet accepted and paid.

d) Claims rejected.

Two kinds of claims are shown separately

- Claims by death refer to the amount paid on account of the death of the insured.
- Claims by maturity refer to claims paid by insurance company on the completion of the policy period like in endowment policies.

PREMIUM

Premium is the consideration for payment of the 'sum assured' on completion of the stipulated period of time or on the happening of the death of policyholder. Thus premium is payable for purchasing 'Insurance protection'. Usually it is a "series of equal payments' occurring at regular intervals throughout the life of the insurance policy. The mode of payment is determined on the basis of agreement entered by both parties i.e., policyholder and insurance company. Premium is shown under schedule I under the following heads.

First year premium:

It is the total of premiums paid by policyholders in the first year of their policies.

Renewal premium:

It is the premium paid by policyholders in the subsequent years.

Single premiums:

If the entire premium payable is paid by the policyholder in a lump sum, it is known as 'Single premium'

REINSURANCE

Life Insurance Company provides cover for risk to life. When the management of an insurance company feels that the risk taken is more than its risk bearing capacity, risk can be shifted through "reinsurance". So, reinsurance means transferring the whole or apart of the risk undertaken by an insurance company to another insurance company by paying agreed premium. The risk and resulting loss are shared between the two

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

companies in the ratio of the premium. When there is claim on policies which are reinsured, the company which reinsured pays its share of the claim.

COMMISSION & COMMISSION ON REINSURANCE ACCEPTED AND CEDED

Insurance company pays commission to its agents. The rates of commission are specified separately for principal agents and others. The commission payable to agents is the commission on direct business.

Commission on re-insurance accepted:

It is the commission payable by an insurance company to another insurance company for the insurance business provided by it.

Commission on re-insuranceded:

It is the commission receivable by an insurance company from another insurance company for the reinsurance business conceded to it.

SURRENDER VALUE

It is the amount that the insurer is willing to pay on the insured requesting that the life insurance policy covering his life be terminated and he be relieved from the obligation to pay further premiums. There is no surrender value if only one annual premium is paid. Thereafter with passage of time the surrender value as a proportion of the premium paid goes on increasing. Surrender value will also include the present value of bonus in the case of "With profit policies".

PAID UP VALUE

When a policy holder finds it very difficult to pay the premiums, he may be allowed an option to get the policy paid up. In such a case, the policy holders will not be asked to pay the rest of premium but he will not get the full value of policy. The amount paid on maturity in respect of paid up policies is included in the amount of claims. The paid up value of policy is calculated in the following manner:

$$\text{Paid up value} = \text{Sum assured X } \frac{\text{Total No.of premiums paid}}{\text{Total No.of premiums payable}}$$

BONUS & ITS TYPES

Bonus refers to the share of profit which a policyholder gets from the insurance company.

Bonus in cash:

It refers to bonus paid in cash to the eligible policyholders after actuary's valuation of liability is made. It is shown separately in schedule 4, benefits paid.

Interim bonus:

It refers to bonus payable on the maturity of a policy pending ascertainment of profit. It is shown in the revenue account as a separate item after schedule 4, benefits paid (Net).

Bonus in reduction of premium:

It refers to bonus which is payable in cash but utilized by the policyholders to adjust the premium due from them. It is shown under schedule 4 – benefits paid. The premiums adjusted from bonus are also recorded as premiums.

Reversionary bonus:

It refers to bonus declared by insurance company which is payable only on the maturity of the policy together with policy amount. Usually it becomes a part of the claim amount and is not separately shown. Endowment life policies usually are issued subject to the clause of reversionary bonus.

LIFE ASSURANCE FUND

A life insurance company maintains a life assurance fund which represents the excess of revenue income over revenue expenditure relating to the life insurance business. The fund is available to meet the aggregate liability on all life policies. In fact, when actuaries assess the liability of a life insurance company, such liability is 'matched' with life assurance fund on that date. Any surplus is called 'valuation surplus' and is treated as a profit.

Life assurance fund is shown under "Schedule 6 reserves and surplus" under the heading "Other reserves" fund future appropriations transferred from revenue account represents the surplus for the year and is added to the life assurance fund in schedule 6.

RESERVE FOR UNEXPIRED RISK

It is peculiar to general insurance business. It represents the income received in advance by the insurance company as premium. Policies in general insurance business are only for one year and there is no question of liability after the years over. But the point to be noted is that policies are issued throughout the year and most of these will be in force even after the end of the financial year. A provision must be made to meet claims, which may arise under such policies, which may mature after the close of the accounting year of the company. Such a provision is known as reserve for unexpired risk.

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

DOUBLE INSURANCE

Taking more than one policy on the same subject matter with two or more insurance companies is called double insurance. The insured can do so because he has unlimited interest in his valuable life and he can realize money from all the insurance companies on maturity but the same does not apply to fire and marine insurance for they are contracts of indemnity. In these cases nothing more can be realized than the actual loss. A person may get his property insured with as many companies as he/she likes for reasons of security for the total value of the property and when loss takes place he can realize the actual loss from any one or all the companies. In this case all the companies will meet the actual loss jointly. If a single insurance company makes the entire payment it can realize proportionate amount from the remaining companies.

TREATMENT OF FINAL ACCOUNTS OF LIFE INSURANCE COMPANY

Final accounts of a life insurance company comprise of (a) Revenue account (b) Profit & loss account and (c) Balance sheet. The following are the relevant forms under schedule B of the IRDA regulations, 2002, applicable to general insurance companies.

Revenue account – Form B-RA

Profit & loss A/c – From B-PL.

Balance sheet – Form B-Bs

The revenue account, profit & loss account and balance sheet are in 'Summary form'. They are accompanied by 15 schedules. The first four schedules are related to Revenue account the remaining eleven schedules are pertaining to balance sheet. The schedules provide 'details' of the summary heads in revenue A/c and balance sheet.

TO DETERMINE THE NET LIABILITY OF INSURANCE BUSINESS.

Generally, the life policies are taken for a number of years. The premium received on such long term policies cannot be treated as income for computation of profit for that year. But at the same time, under a contract of annuity, premium is received once but the payment is made till the death of the annuitant. In case of life insurance, the claim must arise either on the death of the assured or expiry of the policy period. The different between the present value of the future premium to be received and the present value of future liability on all policies in fore is known as 'net liability' for life insurance companies. Hence it becomes desirable to create a reserve equal to its net liability in order to calculate the profit made by the company. In order to ascertain net liability all outstanding policies should be calculated. The method of calculation is a highly technical one and is done by experts called actuaries. The process by which net liability is determined by an actuary is called actuarial valuation.

VALUATION BALANCE SHEET

Once the net liability of Life insurance business is determined it is to be compared with the life assurance fund on that particular date in order to calculate the surplus or deficiency. This comparison is made by preparing a valuation balance sheet, specimen form of which is given below:

Valuation balance as on …			
To Net liability as per Actuary's valuation To surplus (B/F)	*** ***	By Life Assurance Fund as per balance sheet By Deficiency (B/F)	*** ***
	***		***

Surplus or deficiency may be the balancing figure. Only surplus will be shown in the balance sheet.

Treatment of profit:

According to Sec 28 of life insurance corporation act 1956, 95% of the surplus as disclosed in valuation balance sheet should be declared as bonus to the policy holders. The following points should be taken into account while calculating the amount due to the policy holders.

- Any interim bonus paid to policy holders should be added back to surplus as disclosed by the valuation balance sheet as interim bonus is really an advance payment of bonus.
- Any dividend payable, provision for loss on revaluation of investments etc., should be subtracted from the surplus as disclosed by the valuation balance sheet, if those items were not already adjusted.
- After making the above mentioned adjustments, the balance of surplus amount should be taken as surplus available for bonus, of which only 95% should be calculated as bonus to policyholders. Any interim bonus already paid should be deducted from the amounts as calculated. The balance is the amount now due to policyholder. The balance of 5% of surplus is available to the shareholders. Policy holders are paid bonus only in that year when profit is found out by valuation method, but shareholders are usually paid dividend every year.

C.Thilagavathi, M.Com.,(CF)., M.Phil., (Ph.D)
Head and Assistant Professor of Commerce,
Arasu College of Arts and Science for women, Karur.

LIFE INSURANCE REVENUE ACCOUNT

It is a summary of schedules one to four. Separate revenue account is prepared for each kind of insurance business like fire, marine, accident under Form B – RA prescribed by IRDA. Premiums, Income and profit from investments and other incomes are added up as “Total (A)”. Expenditure on claims (Net), commission and operating expenses are totaled as “Total (B)”. Difference between Total (A) and Total (B) is the operating profit of the business concerned. After making appropriations if any the operating profit is transferred to P&L a/c.

Questions banks

Two marks questions

1. What is mean by insurance?
2. Write the meaning of re-insurance
3. What is mean by double insurance?

Five marks questions

1. State the treatments of final accounts of life insurance company
2. Explain the following terms
   a. Premium
   b.claim

ten marks questions.

1. Explain the various types of insurance.