1

VALUATION OF GOODWILL AND SHARES

Unit Structure :

1.1 MEANING OF GOODWILL

Goodwill is an intangible but not fictitious assets that means it has some realisable value. From the accountant's point of view, goodwill, in the sense of attracting custom, has little significance unless it has a saleable value. To the accountant, therefore, goodwill may be said to be that element arising from the reputation, connection, or other advantages possessed by a business which enables it to earn greater profits than the return normally to be expected on the capital represented by the net tangible assets employed in the business. In considering the return normally to be expected, regard must be had to the nature of the business, the risks involved, fair management remuneration and any other relevant circumstances.

The goodwill possessed by a firm may be due, *inter alia*, to the following:

(a) The location of the business premises. The nature of the firm's products or the reputation ofits service.

(b) The possession of favourable contracts, complete or partial monopoly, etc.

(c) The personal reputation of the promoters.

(d) The possession of efficient and contented employees.

(e) The possession of trademarks, patents or a well known business name.

(f) The continuance of advertising campaigns.

(g) The maintenance of the quality of the firm's product, and development of the business withchanging conditions.

The need for evaluating goodwill may arise in the following cases:

(a) When the business or when the company is to be sold to another company or when the company is to be amalgamated with another company;

(b) When, stock exchange quotations not being available, shares have to be valued for taxationpurposes, gift tax, etc.;

(c) When a large block of shares, so as to enable the holder to exercise control over the company concerned, has to be bought or sold; and When the company has previously written off goodwill and wants its written back.

In valuation of goodwill, consideration of the following factors will have a bearing:

(a) Nature of the industry, its history and the risks to which it is subject to.

(b) Prospects of the industry in the future.

(c) The company's history – its past performance and its record of past profits and dividends.

(d) The basis of valuation of assets of the company and their value.

(e) The ratio of liabilities to capital.

(f) The nature of management and the chance for its continuation.

(g) Capital structure or gearing.

(h) Size, location and reputation of the company's products.

(i) The incidence of taxation.

(j) The number of shareholders.

(k) Yield on shares of companies engaged in the same industry, which are listed in the StockExchanges.

(l) Composition of purchasers of the products of the company.

(m) Size of block of shares offered for sale since for large blocks very few buyers would be available and that has a depressing effect on the valuation. Question of control, however, may become important, when large blocks of shares are involved.

(n) The major factor of valuation of goodwill is the profits of the company. One who pays for goodwill looks to the future profit. The profits that are expected to be earned in future are extremely important for valuation of goodwill. The following are the important factors that have a bearing on future profits.

(i) Personal skill in management.

(ii) Nature of business.

(iii) Favourable location.

(iv) Access to supplies.

(v) Patents and trademarks protection.

(vi) Exceptionally favourable contracts and

(vii) Capital requirements and arrangement of capital.

(o) Estimation of the profits expected to be earned by the firm and the amount of capital employed to earn such profits, are to be computed carefully.

(p) Market reputation which the company and its management enjoys.

(q) Returns expected by investors in the industry to which the firm or company belongs.

1.2 CONCEPT OF GOODWILL

When one company buys another company, the purchasing company may pay more for the acquired company than the fair market value of its net identifiable assets (tangible assets plus identifiable intangibles, net of any liabilities assumed by the purchaser). The amount by which the purchase price exceeds the fair value of the net identifiable assets is recorded as an asset of the acquiring company. Although sometimes reported on the balance sheet with a descriptive title such as "excess of acquisition cost over net assets acquired", the amount is customarily called goodwill.

Goodwill arises only as part of a purchase transaction. In most cases, this is a transaction in which one company acquires all the assets of another company for some consideration other than an exchange of common stock. The buying company is willing to pay more than the fair value of the identifiable assets because the acquired company has a strong management team, a favorable reputation in the marketplace, superior production methods, or other unidentifiable intangibles.

The acquisition cost of the identifiable assets acquired is their fair market value at the time of acquisition. Usually, these values are determined by appraisal, but in some cases, the net book value of these assets is accepted as being their fair value. If there is evidence that the fair market value differs from net book value, either higher or lower, the market value governs.

Illustration 1: Company X acquires all the assets of company Y, giving Company Y Rs. 15 lakhs cash. Company Y has cash Rs. 50,000 accounts receivable that are believed to have a realizable value of

Rs. 60,000, and other identifiable assets that are estimated to have a current market value of Rs. 11 lakhs.

Particulars	Rs.	Rs.
Total purchase price		15,00,000
Less: Cash acquired	50,000	
Accounts receivable	60,000	
Other identifiable assets (estimated)	11,00,000	12,10,000
Goodwill		**2,90,000**

This extra amount of Rs. 2,90,000 paid over an above, Net worth Rs. 12,10,000 is goodwill, which is a capital loss for purchasing company and to be shown on assets side of Balance Sheet. This entire amount will be written off against revenue profit, i.e., Profit and Loss Account over period of time.

1.3 TYPES OF VALUING GOODWILL

There are basically two types of valuing goodwill: (a) Simple profit method and (b) Super profit method.

(a) Simple Profit Method: Goodwill is generally valued on the basis of a certain number of years' purchase of the average business profits of the past few years. While calculating average profits for the purposes of valuation of goodwill, certain adjustments are made. Some of the adjustments are as follows:

Trading Profit/Business Profit/Recurring Profit/ Normal Profit (of past year)

Particulars	**1st Year**	**2nd Year**	**3rd Year**
Net Profit before Adjustment and Tax	xx	xx	xx
Less: Non-trading Income (i.e., Income from Investment/Asset)	(xx)	(xx)	(xx)
Less: Non-recurring Income (i.e., Profit on Sale of Investment/Asset)	(xx)	(xx)	(xx)
Add: Non-recurring Loss (i.e., Loss on Sale of Investment/Asset)	xx	xx	xx
Trading Profit after Adjustment and before Tax.	xxx	xxx	xxx

Calculation of Average profit:

$$\text{a) Simple Average Profit} = \frac{\text{Total profit of past years}}{\text{Total number of past years}}$$

b) Weighted Average profit:

Years	Trading Profit (a)	Weight (b)	Product (a × b)
2014	xx	1	xx
2015	xx	2	xx
2016	xx	3	xx
		6	**xxx**

$$\text{Weighted Average Profit} = \frac{\text{Total Profit}}{\text{Total Weight}}$$

Notes: If past profits are in increasing trend, then calculate Average Profit by weighted average method or otherwise simple average method.

Calculation of FMP (Future Maintainable Profit):

(a) All actual expenses and losses not likely to occur in the future are added back to profits.

(b) All actual income and gain not likely to occur in the future are deducted from profits.

(c) All profits likely to come in the future are added and all expenses likely to come in future are deducted.

Particulars	Rs.
Simple/Weighted Average Profit before Tax	XX
Add: Expenses incurred in past not to be incurred in future (i.e., Rent paid in past not payable in future)	XX
Less: Expenses not incurred in past to be incurred in future (i.e., Rent not paid in past payable in future)	(XX)
Less: Notional management Remuneration	(XX)
Future maintainable profit before tax	XXX
Less: Tax (If rate is not given, assume 50%)	(XX)
Future maintainable profit after tax	XXX

After adjusting profit in the light of future possibilities, average profit are estimated and then the value of goodwill is estimated.

This method is a simple one and has nothing to recommend since goodwill is attached to profits over and above what one can earn by starting a new business and not to total profits.

It ignores the amount of capital employed. for earning the profit. However, it is usual to adopt this method for valuing the goodwill of the practice of a professional person such as a chartered accountant or a doctor.

Calculation of Capital Employed and Average Capital Employed

Particulars	Rs.	Rs.
Tangible Trading Assets (at agreed/adjustment value) (except: intangible, non-trading/ fictitious assets):		
Plant and Machinery	xx	
Land and Building	xx	
Furniture and Fixtures	xx	
Stock	xx	
Cash/Bank	xx	xxx
Less: External Liability (at agreed/adjustment value) (except: capital and reserves and surplus):		
Loans	xx	
Debentures	xx	
Creditors	xx	
O/s Expenses, etc.	xx	xxx
Capital Employed		xxx

$$\therefore \text{Average Capital Employed} = \frac{\text{Opening Capital Employed} + \text{Closing Capital Employed}}{2} \quad OR$$

$$\text{Average Capital Employed} = \text{Closing Capital employed} - [\tfrac{1}{2} \text{ of current year's profit} + \text{Current year's dividend}$$

OR

$$\text{Average Capital Employed} = \text{Opening Capital employed} - [\tfrac{1}{2} \text{ of current year's profit} + \text{Current year's dividend}$$

(b) **Super Profit Method:** The future maintainable profits of the firm are compared with the normal profits for the firm. Normal earnings of a business can be judged only in the light of normal rate of earning and the capital employed in the business. Hence, this method of valuing goodwill would require the following information:

(i) A normal rate of return for representative firms in the industry.

(ii) The fair value of capital employed.

The normal rate of earning is that rate of return which investors in general expect on their investments in the particular type of industry. Normal rate of return depends upon the risk attached to the investment, bank rate, market, need, inflation and the period of investment.

Normal Rate of Returns (NRR)

It is the rate at which profit is earned by normal business under normal circumstances or from similar course of business. Normal Rate of Returns means rate of profit on capital employed which is normally earned by others in a similar type of business. It will always be given in the problem in form of percentages.

Or

$$\text{NRR} = \text{Rate of Risk} + \text{Rate of Returns or } \frac{\text{Dividend per share}}{\text{Market price per share}} \times 100$$

As the capital employed may be expressed as aggregate of share capital and reserves less the amount of non-trading assets such as investments, the capital employed may also be ascertained by adding up the present values of trading assets and deducting all liabilities. Super profit is the simple difference between future maintainable operating profit and normal profit.

Illustration 2:

Rishi Computers Ltd. gives you the following summarised balance sheet as at 31st December, 2014.

Liabilities	Rs.	Assets	Rs.	Rs.
Preference Share Capital	5,00,000	Fixed Assets: Cost	50,00,000	
		Depreciation	(30,00,000)	20,00,000
Equity Share Capital	20,00,000	Capital Work-in-progress		40,00,000
Reserves and surplus	25,00,000	Investment (10%)		5,00,000
Long-term Loans	27,00,000	Current Assets		25,00,000
Current Liabilities and Provisions	15,00,000	Underwriting Commission		2,00,000
	92,00,000			**92,00,000**

The company earned a profit of Rs. 18,00,000 before tax in 2014. The capital work-in-progress represents additional plant equal to the capacity of the present plant; if immediately operational there being no difficulty in sales. With effect from 1st January, 2015, two additional Works Managers are being appointed at Rs. 1,00,000 p.a. Ascertain the future maintainable profit and the capital employed, assuming the present replacement cost of fixed assets is Rs. 1,00,00,000 and the annual rate of depreciation is 10% on original cost.

Solution:

Normal Profit: Suppose investors are satisfied with a 18% return. In the above example, thenormal profit will be Rs. 11,34,000, i.e., 18% of Rs. 63 lakhs.

The following are some items which generally require adjustment in arriving at the average of thepast earnings:

1. Exclusion of material non-recurring items such as loss of exceptional nature through strikes, fires, floods and theft, etc., profit or loss of any isolated transaction not being part of the business of the company.

2. Exclusion of income and profits and losses from non-trading assets.
3. Exclusion of any capital profit or loss or receipt or expense included in the profit and loss account.
4. Adjustments for any matters suggested by notes, appended to the accounts or by qualifications in the Auditor's Report, such as provision for taxation and gratuities, bad debts, under or over provision for depreciation, inconsistency in valuation of stock, etc.
5. Depreciation is an important item that calls for careful review. The valuer may adopt book depreciation provided he is satisfied that the value was realistic and the method was suitable for the nature of the company and they were consistently applied from year to year. But imbalances do arise in cases where consistently written down value method was in use and heavy expenditure in the recent past has been made in rehabilitating or expanding fixed assets, since the depreciation charges would be unfairly heavy and would prejudice the seller. Under such circumstances, it would be desirable to readjust depreciation suitably as to bring a more equitable charge in the profits meant for averaging.

Another important factor comes up for consideration in averaging past profits and that is the trend of profits earned. It is imperative that estimation of maintainable profits be based on the only available record, i.e., the record of past earnings, but indiscrete use of past results may lead to an entirely fallacious and unrealistic result.

Where the profits of a company are widely fluctuating from year to year, an average fails to aid future projection. In such cases, a study of the whole history of the company and of earnings of a fairly long period may be necessary. If the profits of a company do not show a regular trend upward or downward, an average of the cycle can usefully be employed for projection of future earnings.

In some companies, profits may record a distinct rising or falling trend from year; in these circumstances, a simple average falls to consider a significant factor, namely, trend in earnings.

The shares of a company which record a clear upward trend of past profits would certainly be more valuable than those of a company whose trend of past earnings indicates a downtrend. In such cases, a weighted average giving more weight to the recent years than to the past is appropriate. A simple way of weighing is to multiply the profits by the respective number of the years arranged chronologically so that the largest weight is associated with the most recent past year and the least for the remotest.

Future Profitability Projections: Project is more a matter of intelligent guesswork since it is essentially an estimation of what will happen in the risky and uncertain future. The average profit earned by a company in the past could be normally taken as the average profit that would be maintainable by it in the future, if the future is considered basically as a continuation of the past. If future performance is viewed as departing significantly from the past, then appropriate adjustments will be called for before accepting the past average profit as the future maintainable profit of the company.

There are three methods of calculating goodwill based on super profit. The methods and formulaeare as follows:

Purchase of Super Profit Method: Goodwill, as per this method, is Super Profit multiplied by a certain number of years. Under this method, an important point to note is that the number of years of purchase as goodwill will differ from industry to industry and from firm to firm. Theoretically, the number of years is to be determined with reference to the probability of a new business catching up with an old business. Suppose it is estimated that in two years' time a business, if started now will be earning about the same profits as an old business is earning now, goodwill will be equivalent to two times the super profits. In the example given above, goodwill will be Rs. 12.12 lakhs, i.e., Rs. 6.06 lakhs × 2 years.

Annuity Method of Super Profit: Goodwill, in this case, is the discounted value of the total amount calculated as per purchase method. The idea behind super profits methods is that the amount paid for goodwill will be recouped during the coming few years. But, in this case, there is a heavy loss of interest. Hence, properly speaking what should be paid now is only the present value of super profits paid annually at the proper rate of interest. Tables show that the present value 18% of Re. 1 received annually two years is 1.566. In the above example, the value of goodwill under this method will be 1.3 × Rs. 6.06 lakhs or Rs. 9.49 lakhs.

Capitalisation of Super Profit Method: This method tries to find out the amount of capital needed for earning the super profit.

The formula is:

$$= \frac{\text{Super Profit}}{\text{NRR}} \times 100$$

In above example, Goodwill will be:

$$= \frac{6.06 \text{ lakhs} \times 100}{18}$$

= Rs. 33.67 lakhs

Given in the Problems:

(a) Information of old firms assets and liabilities.

(b) Information regarding past or profit.

(c) Adjustment valuation of goodwill.

Required to Prepare:

Valuation of goodwill by different methods.

Steps, Method and Formula for Calculation of Goodwill:

I. Goodwill by purchase of average profit method:

(a) Find out average trading profit.

(b) Find out the number of years purchase (it will always be given in problem).

(c) Goodwill = Number of year of purchase × Average trading profit.

II. Goodwill by purchase of future maintainable profit method:

(a) Find out future maintainable profit.

(b) Number of year purchase (given in problem).

(c) Goodwill = Number of years of purchase × Future maintainable profit.

III. Goodwill by capitalisation of future maintainable profit method:

(a) Find out future maintainable profit.

(b) Find out capitalised value of future maintainable profit

$$\text{Capitalisation Value of Future Maintainable Profit} = \frac{\text{EMP}}{\text{NRR}} \times 100$$

(c) Calculate Capital Employed.

(d) Goodwill = Capitalised Value of FMP – Capital Employed

IV. Goodwill by purchase of super profit method:

(a) Find out average trading profit.

(b) Find out future maintainable profit.

(c) Find out capital employed.

(d) Find out Normal Rate Return (always given in the problem in terms of %).

(e) Find out number of year of purchase (given in the problem).

(f) Find out normal profit:

$$\text{Normal Profit} = \frac{\text{Capital Employed} \times \text{NRR}}{100}$$

(g) Find out super profit:

(h) Super profit = Future maintainable profit – Normal profit

(i) Goodwill = Number of year purchase × Super profit

V. Goodwill by capitalisation of super profit method:

Calculate super profit as discussed above.

$$\text{Goodwill} = \frac{\text{Super Profit} \times 100}{\text{NRR}}$$

VI. Goodwill by present value of super profit method:

(a) Calculate super profit as discussed above.

(b) Goodwill = Annuity Rate × Super Profit

Note: Annuity Rate will always be given in the problem.

Illustration 3: X agreed to purchase the business of Y on 30th June, 2016. Profits earned by Y for the three preceding years were as below:

Year ending	Rs.
31/12/2013	82,000
31/12/2014	80,000
31/12/2015	84,000

The profit for the year 2014 includes an abnormal income of Rs. 3,000. The profit for the year 2015 is after writing off a loss due to theft of Rs. 4,000. At present, the assets of the business are not insured. X wants to take a comprehensive policy and has ascertained that an annual premium of Rs. 400 would have to be paid. X would like to manage the business whole time and this would involve giving up the present job in which he is drawing Rs. 2,000 per month. If X manages the business, the employment of the manager who is looking after the business for a salary of Rs. 1,500 per month can be terminated and X will draw a salary of Rs. 2,000 per month from the business. Calculate the goodwill if both the parties have agreed to value it at 2 year's purchase of average profits.

Particulars	Rs.	Rs.
Profit for the year 2013		82,000
Profit for the year 2014	80,000	
Less: Abnormal Income	(3,000)	77,000
Profit for the year 2015	84,000	
Add: Loss due to theft	4,000	88,000
		2,47,000
Average Profits (2,47,000/3)		82,333.33
Less: Expenses to be paid-up future	400	
Insurance Premium		
X's salary (2,000 × 12)	24,000	(24,400)
		57,933.33
Add: Manager's salary (1,500 × 12)		18,000.00
Expected average annual profits		**75,933.33**

Goodwill = Expected average annual profits × Number of years of purchase

= Rs. (75,933.33 × 2) = Rs. 1,51,866.66

Illustration 4: P is negotiating with M for the purchase of the latter's business. It was decided to value goodwill according to the super profit method. M has been running the business only for the three years and hence P would like to attach weights for the profits of the three years in such a way that the most recent profits would be assigned a higher weight than the other year's profits. The profits of the past three years are as follows:

Year	Rs.
2013	36,000
2014	40,000
2015	38,000

Calculate the annual average profits.

Solution: Since P would like to attach a higher weightage to the profits of 2001, one method of weighting would be:

Year	Weight
2013	1
2014	2
2015	3

The weighted average annual profits of the business may be calculated as follows:

Year	Profits (Rs.)	Weights	Product (Rs.)
2013	36,000	1	36,000
2014	40,000	2	80,000
2015	38,000	3	1,14,000
		6	**2,30,000**

$$\therefore \text{Weighted Average Annual Profits} = \frac{\text{Total Product}}{\text{Total Weight}}$$

$$= \frac{2,30,000}{6}$$

$$\text{Average Annual Profits} = 38,333$$

Illustration 5: The following particulars are available in the books of Bharti Telecom.

(a) Capital employed Rs. 1,50,000

(b) Trading profit after tax

2012	Rs. 1,12,200
2013	Rs. 1,15,000
2014	Rs. 1,02,000 (loss)
2015	Rs. 1,21,000

(c) Market rate of interest on investment 8%.

(d) Rate of risk return on capital invested in business 2%.

(e) Remuneration from alternative employment of the proprietor (if not engaged in business Rs. 13,600 p.a.).

You are required to compute the value of goodwill on the basis of 3 years' purchase of superprofits of the business calculated on the average profit of the last four years.

Solution:

(a) Calculation of Average Profits:

Year	Rs.
2012	1,12,200
2013	1,15,000
2014	(1,02,000)
2015	1,21,000
	2,46,200

$$\text{Average Profit} = \frac{2,46,200}{4} = 61,550$$

(a) Calculation of Super Profits:

Particulars	Rs.
Average Profits	61,550
Less: Remuneration	13,600
	47,950
Less: Normal Profit @ 10% Capital employed × NRR (8% + 2%) on Rs. 1,50,000 (1,50,000 × 10%)	15,000
	32,950

$$\begin{aligned}\text{Goodwill} &= 3\text{year's purchase of super profits}\\ &= 3 \times 32,950\\ &= 98,850\end{aligned}$$

Illustration 6: From the following information given by Tata Telecom, calculate the value of goodwill:

(a) Average capital employed Rs. 12,00,000.

(b) Company declares 15% dividend on the shares of Rs. 20 each fully paid which is quoted in themarket at Rs. 25.

(c) Net trading profit of the firm (after tax) for the past 3 years Rs. 2,15,200, Rs. 1,81,400 and Rs. 2,25,000.

You are required to compute the value of goodwill on the basis of 5 years' purchase of superprofits of the business calculated on the average profit of the last three years.

Particulars	Rs.
1st Year	2,15,200
2nd Year	1,81,400
3rdYear	2,25,000
	6,21,600

$$\text{Average Profit} = \frac{6,21,600}{3} = 2,07,200$$

Calculation of super profit:

Particulars	Rs.
Average Trading Profit	2,07,200
Less: Normal profit @ 12% on Rs. 12,00,000	(1,44,000)
Super Profit	**63,200**

$$\begin{aligned}\text{Goodwill} &= 5 \text{ year's purchase of super profits}\\ &= 5 \times 63,200\\ &= 3,16,000\end{aligned}$$

Working Notes:

Dividend per share = 15% of Rs. 20 = Rs. 3

$$\text{Rate of return on capital} = \frac{\text{Dividend per share (DPS)}}{\text{Market price per share (MPS)}} \times 100 = \frac{3}{25} \times 100 = 12\%$$

Illustration 7: From the following information, ascertain the value of goodwill of Micro Computers Ltd. under super profit method.

Balance Sheet as on 31st March, 2014

Liabilities	Rs.	Assets	Rs.
Paid-up Capital (5,000 share of 100 each fully paid)	5,00,000	Goodwill at Cost	50,000
Bank Overdraft	1,16,700	Land and Building (at Cost)	2,20,000
Sundry Creditors	1,81,000	Plant and Machinery (at cost)	2,00,000
Provision for Taxation	39,000	Stock in Trade	3,00,000
Profit and Loss Appropriation A/c	1,13,300	Bad Debts	1,80,000
	9,50,000		**9,50,000**

The company commenced operations in 1995 with a paid-up capital of Rs. 5,00,000. Profits for recent years (after taxation) have been as follows:

Year ended 31st March	Rs.
2010	40,000 (loss)
2011	88,000
2012	1,03,300
2013	1,16,000
2014	1,30,000

The loss in 2010 occurred due to a prolonged strike.

The income tax paid so far has been at the average rate of 40%. Dividends were distributed at the rate of 10% on the paid-up capital in 2011 and 2012 and at the rate of 15% in 2013 and 2014. The market price of shares is ruling at Rs. 125 at the end of the year ended 31st March, 2009.

Solution: Valuation of Goodwill of Micro Computers Ltd.

Particulars	Rs.	Rs.
Capital Employed:		
Land and Building (at Cost)		2,20,000
Plant and Machinery (at Cost)		2,00,000
Stock in Trade		3,00,000
Sundry Debtors		1,80,000
		9,00,000
Less: Sundry Liabilities	1,16,700	
Bank Overdraft	1,81,000	
Sundry Creditors Provision for Taxation	39,000	3,36,700
Capital employed at the end of the year		**5,63,300**
Add back		
Dividend paid for the year	75,000	
Less: Half of the profits	(65,000)	10,000
Average capital employed Rate of Return		**5,73,300**
Average Dividends for the last 4 years at $12\frac{1}{2}\%\ \left(\frac{10+15+10+15}{4}\right)$		
Market price of shares on 31st March = Rs. 125		
Normal Rate of Return = $\frac{12.5}{125} \times 100 = 10\%$		

It may be more appropriate to relate the normal rate of return to the dividend paid in the last two years since price is related to dividend expected in future and for that, the most recent experience is relevant.

In that case, the normal rate of return will be:

Normal Profit on Average Capital employed:

at 10% on Rs. 5,73,300 57,330

at 12% on Rs. 5,73,300 68,796

Future Maintainable Profits – Weighted Average

Year	**Profits** Rs.	**Weights**	**Product** Rs.
2011	88,000	1	88,000
2012	1,03,000	2	2,06,000
2013	1,16,000	3	3,48,000
2014	1,30,000	4	5,20,000
		10	**11,62,000**

Super Profits

Particulars	**Normal Rate 12%** (Rs.)	**Normal Rate 10%** (Rs.)
Average maintainable profits	1,16,200	1,16,200
Normal profit on capital employed	68,796	57,330
Super Profit	**47,404**	**58,870**
Goodwill at 5 years' purchase of Super Profits	2,37,020	2,94,350
Goodwill at 3 years' purchase	1,42,212	1,76,610

Three to five years' purchase of super profits can be taken as fair value of goodwill. Thus, depending on the assumptions regarding the normal rate of return and the number of years' purchase, goodwill may range between Rs. 1,42,212 and Rs. 2,94,350.

Illustration 8: The following is the balance sheet of HCL Ltd. as on March 31, 2015.

Liabilities		Rs.	**Assets**	Rs.
40,000 Equity Shares of Rs. 10 each		4,00,000	Goodwill	40,000
10% Debenture		1,20,000	Land and Building	2,00,000
Profit & Loss Balance as on 01/04/14	40,000		Plant and Machinery	2,90,000
Add: Profit for the year before			Investment	1,00,000
providing for taxes	1,60,000	2,00,000	Stock	80,000
Sundry Creditors		80,000	Debtors	90,000
Provision for Tax		40,000	Cash and Bank	40,000
		8,40,000		**8,40,000**

Profit includes Rs. 10,000 which is the income from investments. The present market value of the assets are:

Particulars	Rs.
Land and Building	2,50,000
Plant and Machinery	3,50,000
Investment	1,50,000

Current assets (book value).

Normal return on capital employed in this type of business is 10%. Adjustment of depreciation is not required for valuation of goodwill.

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

Solution: **Average Trading Capital Employed**

Particulars		Rs.
Land and Building		2,50,000
Plant and Machinery		3,50,000
Stock		80,000
Debtors		90,000
Cash and Bank		40,000
Less: **Current Liabilities**		**8,10,000**
Sundry Creditors	Rs. 80,000	
Provision for Taxation	Rs. 40,000	(1,20,000)
Capital Employed		**6,90,000**
Less: Half of current year's profit		(37,500)
Average Capital Employed		**6,52,500**

Working Notes:

The half of current year's profit is calculated as below:

Particulars	Rs.
Profit for the year	1,60,000
Less: Non-trading income	10,000
	1,50,000
Less: Income tax (assume 50%) Current year's profit	75,000
	75,000
$\frac{75000}{2} = 37500$	

$$\therefore \text{Normal Profit} = \text{Average Capital Employee} \times \frac{\text{NRR}}{100}$$

$$= 6,52,000 \times \frac{10}{100}$$

$$= 65200$$

$$\text{Super Profit} = \text{Average profit - Normal profit}$$

$$= 75000 - 65200$$

$$= 9800$$

$$\therefore \text{Gooodwill} = \text{Super profit - No of years purchase}$$

$$= 9800 \times 3$$

$$= 29400$$

Illustration 9: Following is the Balance sheet of A Limited as on 31st March, 2014:

Liabilities	Rs.	Assets	Rs.	Rs.
Share Capital		Goodwill		1,25,000
5,000 share of Rs. 100 each	5,00,000	Land and Building (at cost)	1,80,000	
Reserve Fund	1,50,000	*Less:* Depreciation	(36,000)	1,44,000
Workmen Compensation Fund	25,000	Plant and machinery (at cost)	2,40,000	
Workmen Profit Sharing Fund	45,000	*Less:* Depreciation	(40,000)	2,00,000
Profit and Loss Account	1,50,000	Investment for replacement of plant		1,00,000
Creditors	2,30,000	& machinery		
Other Liabilities	1,00,000	Books Debts	3,60,000	
		Less: R.D.D.	(30,000)	3,30,000
		Stock		2,00,000
		Cash at Bank		75,000
		Preliminary expense		26,000
	12,00,000			**12,00,000**

Further Information:

(i) A Ltd. had been carrying on business for the past several years. The company is to be taken over by another company and for this purpose, you are required to value Goodwill by "Capitalisation of maintainable profits method". For this purpose, following additional information is available.

(a) The profit earned by the company for the past three years were as under:

Year ended 31st March, 2012	Rs. 3,10,000
Year ended 31st March, 2013	Rs. 2,73,000
Year ended 31st March, 2014	Rs. 2,90,000

The profits given are profits before tax, which was 50% throughout.

(b) The new company expects to carry on business with its own board of directors, withoutany addition.

The directors' fees paid by A Ltd. to its directors amounted to Rs. 9,000 per year, no morepayable in future.

(c) The new company expects a large increase in volume of business and therefore, will have to pay extra rent of Rs. 12,000 per year.

(d) As on 31st March, 2015, land and buildings were worth Rs. 3,00,000, whereas plant and machinery were worth only Rs. 1,80,000. There is sufficient provision for doubtful debts. There is no fluctuation in the value of investment and stock.

(e) Liability under workmen compensation fund was only Rs. 5,000.

(f) The expected rate of return on similar business may be taken at 12%.

You are required to value Goodwill according to above instructions. All your workings should form part of your answer. (Take average capital employed, the same as closing employed for your calculations.)

$$\text{Simple Average} = \frac{\text{Total profit (past year)}}{\text{Total Number of years}}$$

$$= \frac{3,10,000 + 2,73,000 + 2,90,000}{3}$$

$$= \text{Rs. } 2,91,000$$

Particulars	Rs.
Simple Average Profit	2,91,000
Add: Directors' fees not required in future	9,000
Less: Extra rent payable in future	(12,000)
FMP before tax	2,88,000
Less: Tax @ 50%	(1,44,000)
FMP after tax	**1,44,000**

1. Calculation of Capital Employed:

Particulars	Rs.	Rs.
Tangible Trading Asset (at Average Value):		
Land and Building	3,00,000	
Plant and Machinery	1,80,000	
Investment	1,00,000	
Debtor	3,30,000	
Stock	2,00,000	
Cash at Bank	75,000	11,85,000
Less: External Liabilities:		

Workmen Compensation Fund	5,000	
Workmen Profit Sharing Fund		
Creditors	45,000	
Other Liability	2,30,000	
Capital Employed	1,00,000	(3,80,000)
		8,05,000

3. NRR = 12% (Given)

4. Number of years' purchase = 3 years (Given)

5. Calculation for capitalised value of FMP:

$$\text{Capitalised Value of FMP} = \frac{\text{FMP}}{\text{NRR}} \times 100$$

$$= \frac{1,44,000}{12} \times 100$$

$$= \text{Rs. } 12,00,000$$

6. Calculation of Goodwill by capitalised of FMP Method:

Goodwill = Capitalised value of FMP – Capital Employed

= 12,00,000 – 8,05,000

= Rs. 3,95,000

Illustration 10: From the following Balance sheet of Prosperous Ltd. as at 31st Dec. 2015 and further information, value goodwill at five-year purchase of super profit based on average profit of last three years.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital:			**Fixed Assets:**		
Equity Capital	1,50,000		Goodwill	20,000	
Preference Capital	50,000	2,00,000	Machinery	2,10,000	
Reserves and Surplus:			Land and Building	1,20,000	
General Reserves	2,60,000		Furniture	60,000	
Profit and Loss Account	15,000	2,75,000	Vehicles	90,000	5,00,000
Secured Loan		1,25,000	Stocks	55,000	
Current Liabilities:			Debtors	1,00,000	
Sundry Creditors	60,000		Cash and Bank Balance	25,000	1,80,000
Bills Payable	30,000		Misc. Expenditure		20,000
Outstanding Exp	10,000	1,00,000			
		7,00,000			**7,00,000**

(a) Profit (before tax)

For 2015 Rs. 1,11,000

For 2014 Rs. 1,05,000

For 2013 Rs. 99,000

(b) Machinery costing Rs. 10,000 purchased on 31st December, 2015 was wrongly charged torevenue.

(c) Normal return in similar business is 10% of the average net tangible capital employed.

(d) Machinery, land and buildings have appreciated by 10% and 20% respectively. Furniture and vehicles have depreciated by 5% and 10% respectively. Outstanding expenses were up by Rs. 3,750.

(e) Provision for tax – 50%.

(f) Ignore additional depreciation effect on revalued figures of Assets.

Solution: **Calculation of Average Profit**

Year	Profit	Weight	Product
2013	99,000	1	99,000
2014	1,05,000	2	2,10,000
2015	1,11,000 + 10,000	3	3,63,000
		6	**6,72,000**

1. Weighted Average Profit $= \frac{\text{Total of product}}{\text{Total of weight}}$

$$= \frac{6,72,000}{6}$$

$$= 1,12,000$$

2. Calculation of FMP:

Average profit before.tax	1,12,000
Less: Tax @ 50%	(5,60,000)
FMP after tax	**56,000**

3. Calculation of Capital Employeyed:

Particulars	Rs.	Rs.
Tangible Trading Assets (at value):		
Machinery [2,10,000 + 10,000 + 22,000]	2,42,000	
Land and Building	1,44,000	
Furniture	57,000	
Vehicles	81,000	
Stock	55,000	
Debtors	1,00,000	
Cash and Bank	25,000	7,04,000
Less: Sundry Creditors	60,000	
Bills Payable	30,000	
O/s Expenses	13,750	
Secured Loan	(1,25,000)	(2,28,750)
Capital Employed		**4,75,250**

4. NRR = 10% (Given)

5. Normal years' purchase = 5 years (Given)

6. Calculation of Normal Profits:

$$\text{Normal profit} = \text{Capital Employed} \times \frac{\text{NRR}}{100}$$

$$= 4,75,250 \times \frac{10}{100}$$

= Rs. 47,525

7. Calculation of super profits:

Super Profit = FMP – Normal Profit

= 56,000 – 47,525

= Rs. 8,475

8. Calculation for Goodwill by purchased super profit method:

Goodwill = Number of years' purchase × Super Profit

= 5 × 8,475

= Rs. 42,375

1.4 VALUATION OF SHARES

In the case of shares quoted in the recognised Stock Exchanges, the prices quoted in the Stock Exchanges are generally taken as the basis of valuation of those shares. However, the Stock Exchange prices are determined generally on the demand supply position of the shares and on business cycle. The London Stock Exchange opines that the Stock Exchange may be linked to a scientific recording instrument which registers not its own actions and options but the actions and options of private institutional investors all over the country/world. These actions and options are the result of fear, guess work, intelligent or otherwise, good or bad investment policy and many other consideration. The quotations what result definitely do not represent valuation of a company by reference to its assets and its earning potential. Therefore, the accountants are called upon to value the shares by following the other methods.

The value of share of a company depends on so many factors such as:

1. Nature of business.
2. Economic policies of the government.
3. Demand and supply of shares.
4. Rate of dividend paid.
5. Yield of other related shares in the stock exchange, etc.
6. Net worth of the company.
7. Earning capacity.
8. Quoted price of the shares in the stock market.
9. Profits made over a number of years.
10. Dividend paid on the shares over a number of years.
11. Prospects of growth, enhanced earning per share, etc.

1.5 NEED AND PURPOSE OF VALUATION OF SHARES

The need for valuation of shares may be felt by any company in the following circumstances:

1. For assessment of Wealth Tax, Estate Duty, Gift Tax, etc.
2. Amalgamations, Absorptions etc.
3. For converting one class of shares to another class.
4. Advancing loans on the security of shares.
5. Compensating the shareholders on acquisition of shares by the Government under a schemeof nationalisation.
6. Acquisition of interest of dissenting shareholder under the reconstruction scheme, etc.

1.6 FACTORS INFLUENCING VALUATION

The valuation of shares of a company is based, *inter alia*, on the following factors:

1. Current stock market price of the shares.
2. Profits earned and dividend paid over the years.
3. Availability of reserves and future prospects of the company.
4. Realizable value of the net assets of the company.
5. Current and deferred liabilities for the company.
6. Age and status of plant and machinery of the company.
7. Net worth.of the company.
8. Record of efficiency, integrity and honesty of Board of Directors and other managerialpersonnel of the company.
9. Quality of top and middle management of the company and their professional competence.
10. Record of performance of the company in financial terms.

1.7 METHODS OF VALUATION OF SHARES

Certain methods have come to be recognized for valuation of shares of a company, *viz*., (1) Open market price; (2) Stock exchange quotation; (3) Net assets basis; (4) Earning per share method; (5) Yield or return method; (6) Net worth method; (7) Break-up value etc.

IDEAL VALUATION METHOD

The various methods of valuation of shares of a company as mentioned above have their individual merits and demerits. Therefore, it has been universally recognized that while valuing the shares of a company, it is advisable not to depend upon any single method but to resort to a combination of three well recognized methods, *viz*., market value method, yield or return on investment method and net assets value method for arriving at a fair and reasonable shares exchange ratio. While doing this, due weightage should be given to each method based on the company's performance and future prospects.

INTRINSIC VALUE METHOD

This method is also called as Assets backing method, Real value method, Balance Sheet method or Break-up value methods. Under this method, the net assets of the company including goodwill and non-trading assets are divided by the number of shares issued to arrive at the value of each share.

If the market value of the assets is available, the same is to be considered and in the absence of such information, the book values of the assets shall be taken as the market value. While arriving at the net assets, the fictitious assets such as preliminary expenses, the debit balance in the Profit and Loss A/c should not be considered. The liabilities payable to the third parties and to the preference shareholders is to be deducted from the total asset to arrive at the net assets. The funds relating to equity shareholders such as General Reserve, Profit and Loss Account, Balance of Debenture Redemption Fund, Dividend Equalisation Reserve, Contingency Reserve, etc. should not be deducted.

Illustration 11: From the information given below and the balance sheet of Cipla Limited on 31st December, 2015, find the value of share by Intrinsic value method.

Balance Sheet

Particulars	Rs.	**Particulars**	Rs.
1000, 8% Preferential Shares of 100 each fully paid	1,00,000	Buildings	70,000
4,000 Equity shares of Rs. 100 fully paid	4,00,000	Furniture	3,000
Reserves	1,50,000	Stock (Market value)	4,50,000
Profit and Loss Account	5,10,000	Investment at cost (Face value Rs. 4,00,000)	3,35,000
Creditors	48,000	Debtors	2,80,000
		Bank	60,000
		Preliminary Exp	10,000
	12,08,000		**12,08,000**

Building is now worth of Rs. 3,50,000 and the Preferential shareholders are having preference as tocapital.

Solution: Valuation of Equity Share (Intrinsic Value Method)

Particulars	Rs.
Building	3,50,000
Furniture	3,000
Stock	4,50,000
Investment	3,35,000
Debtors	2,80,000
Bank	60,000
Total Assets	14,78,000
Less: Creditors	(48,000)
Net Assets	14,30,000
Less: Preference Share Capital	(1,00,000)
Assets Available for equity shareholders	**13,30,000**

$$\text{Value of equity share} = \frac{\text{Net assets available to Equity Shareholders}}{\text{No. of Equity Shares}}$$

$$= \frac{13,30,000}{4,000}$$

$$= \text{Rs. } 332,5$$

$\therefore$ Intrinsic value of each equity shares = Rs. 332.50

Yield Method

The valuation of shares under the Yield method may be done under two categories:

(a) **Return on Capital Employed Method:** This methods is applied for the purpose of valuation of the shares of majority shareholding. A big investor is more interested in what the company earns and not simply in what the company distributes. Even if the company does not distribute 100% of its earning among its shareholders, it, as a matter of fact, strengthens the financial position of the company. The value of the share under this method is calculated by the formula.

$$\frac{\text{Return of Capital Employed}}{\text{Normal Rate of Return}} \times \text{Paid - up value of shares}$$

(b) **Valuation on the Basis of Dividend:** This method is more suitable for valuation of small block of shares. The method of calculation is:

$$\frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Dividend}} \times \text{Paid - up value of shares}$$

NORMAL RATE OF DIVIDEND

Illustration 12: The following particulars are available in respect of Goodluck Limited.

a) Capital 450, 6% preference shares of Rs. 100 each fully paid and 4,500 equity shares Rs. 10 each fully paid.

b) External liabilities: Rs. 7,500.

c) Reserves and Surplus: Rs. 35,000.

d) The average expected profit (after taxation) earned by the company Rs. 8,500.

e) The normal profit earned on the market value of equity shares (full paid) of the same type ofcompanies is 9%.

f) 10% of the profit after tax is transferred to reserves.

Calculate the intrinsic value per equity share and value per equity share according to dividendyield basis.

Assume that out of total assets, assets worth of Rs. 350 are fictitious.

Solution:

Intrinsic Value of Shares

Particulars		Rs.
6% Preference Share Capital (450 × 10)		45,000
Equity Shares (4,500 × 10)		45,000
Reserves and Surplus		3,500
External Liabilities		7,500
Total Liabilities		**1,01,000**
As Total Liabilities = Total Assets,		
Total Assets		1,01,000
Less: Fictitious Assets	(350)	
External Liabilities	(7,500)	
Preference Shares	(45,000)	52,850
Net Assets Available for Equity Shareholders		**48,150**

$$\therefore \text{Instrinsic Value of Share} = \frac{\text{Net assets Available for sharefolder}}{\text{Number of Equity Shares}}$$

$$= \frac{48,150}{4,500}$$

Yield Basic $=10,70$

Profit Available to Equity Shareholders

Particulars	Rs.
Average Profit after Taxation	8,500
Transfer to General Reserves (10%)	(850)
	7,650
Less: Preference Dividend (60% of 45,000)	2,700
Profit Available to Equity Shareholders	**(4,950)**

$$Rate\ of\ dividend = \frac{4,950}{45,000} \times 10$$

$$=10\%$$

$$\therefore \text{Value of Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate}} \times \text{Paid - up value of share}$$

$$= \frac{11}{9} \times 10$$

$$= \text{Rs. } 12.22$$

Illustration 13: The capital structure of company as on 31st March, 2015 was as under:

Equity Share Capital	5,00,000
11% Preference Share Capital	3,00,000
12% Secured Debentures	4,00,000
Reserves	3,00,000

The company on an average earns a profit of Rs. 4,00,000 annually before deduction of interest on Debentures and Income Tax, which works out to 45%. The normal return on equity shares oncompanies similarly placed is 15% provided.

(a) The profit after tax covered the fixed interest and fixed dividends at least four times.

(b) Equity capital and reserves are 150% of debentures and preference capital.

(c) Yield on shares is calculated at 60% of profits distributed and 5% on undistributed profits.

The company is regularly paying an equity dividend of 18%. Ascertain the value of equity shareof the company.

Solution:

Particulars	Rs.
Average Profit of the companies before Interest and Tax	4,00,000
Less: Debenture interest (12% of 4,00,000)	(48,000)
Profit after interest but before tax	3,52,000
Less: Tax @ 45%	(1,58,400)
Profit after Interest and Tax	**1,93,600**

Evaluation of Conditions given in the question:

(a) Profit after tax whether covers fixed interest and fixed dividend at least four times. Profit aftertax.

= 4,00,000 – 1,58,400 = 2,41,600 Fixed interest and fixed dividend interest.

Interest	48,000
Fixed dividend 11% of 3,00,000	33,000
	81,000

$$= \frac{2,41,600}{81,000}$$

$$= 2.9827 \text{ times}$$

$\therefore$ Fixed interest and dividend coverage is 2.98 times only and is less than the prescribed 4 times.

(b) Whether equity capital and reserves are of 150% of preference share capital and debentures.

Particulars	Rs.	Particulars	Rs.
Equity share	5,00,000	Preference share	3,00,000
Reserves	3,00,000	Debentures	4,00,000
	8,00,000		**7,00,000**

$\therefore \text{Ratio} = \frac{8,00,000}{7,00,000} \times 100 = 114.28\%$

∴Ratio is less than the Prescribed Ratio of 150%

1.8 SOLVED PROBLEMS

Illustration 1 From the following particulars, find out the value of goodwill as per

Annuity method.

Capital employed Rs.3,00,000

Normal Rate of Return 3.10%

Present value of Re.1 for 5 years at 10% at 3.78

Normal profit for 5 years

Year	Rs.
1	30,000
2	32,000
3	34,000
4	36,000
5	38,000

Non-recurring income Rs.1,600

Non-recurring expenses Rs.1,000

Solution

Valuation of Goodwill

$$\text{Average Profit} = \frac{30,000 + 32,000 + 34,000 + 36,000 + 38,000}{5}$$

$$= \frac{1,70,000}{5}$$

$$= \text{Rs. } 34,000$$

		Rs.
Average Profit	34,000	
Less: Non-Recurring income	1,600	32,000
Add: Non-recurring Expenses		1,000
Average Profit		33,400

Normal Profit = Capital Employed × Normal Rate of Return

= Rs.3,00,000 × 10/100 = Rs.30,000

Super Profit = Average Profit 3 Normal Profit

= 33,400 - 30,000 = Rs. 3,400

Goodwill = Super profit × Reference to Present value table

= 3,400 × 3.78 = Rs.12,852

Illustration 02 The following particulars are available in respect of Goodluck Limited

(a) Capital 450, 6% preference shares of Rs. 100 each fully paid and 4,500 equity shares Rs. 10 each fully paid.

(b) External liabilities: Rs. 7,500.

(c) Reserves and Surplus: Rs. 35,000.

(d) The average expected profit (after taxation) earned by the company Rs. 8,500.111111

(e) The normal profit earned on the market value of equity shares (full paid) of the same type ofcompanies is 9%.

(f) 10% of the profit after tax is transferred to reserves.

Calculate the intrinsic value per equity share and value per equity share according to dividendyield basis.

Assume that out of total assets, assets worth of Rs. 350 are fictitious.

Solution:

Intrinsic Value of Shares

Particulars		Rs.
6% Preference Share Capital (450 × 10)		45,000
Equity Shares (4,500 × 10)		45,000
Reserves and Surplus		3,500
External Liabilities		7,500
Total Liabilities		**1,01,000**
As Total Liabilities = Tota1 Assets,		
Tota1 Assets		1,01,000
Less: Fictitious Assets	(350)	

External Liabilities	(7,500)	
Preference Shares	(45,000)	52,850
Net Assets Available for Equity Shareholders		**48,150**

$$\therefore \text{Intrinsic Value of Share} = \frac{\text{Net Assets Available for Equity Shareholder}}{\text{Number of Equity Shares}}$$

$$= \frac{48{,}150}{4{,}500}$$

Yield Basic $= 10.70$

Profit Available to Equity Shareholders

Particulars	Rs.
Average Profit after Taxation	8,500
Transfer to General Reserves (10%)	(850)
	7,650
Less: Preference Dividend (60% of 45,000)	2,700
Profit Available to Equity Shareholders	**(4,950)**

$$\textit{Rate of dividend} = \frac{4{,}950}{45{,}000} \times 10$$

$$= 11\%$$

$$\therefore \text{Value of Equity Share} = \frac{\text{Rate of Dividend}}{\text{Share Normal Rate}} \times \text{paid - up value of}$$

$$= \frac{11}{9} \times 10$$

$= \text{Rs. } 12.22$

Illustration 03: The balance sheet of a partnership was as follows:

Particulars	Rs.	Rs.	Particulars	Rs.
Capital Accounts:			Goodwill	1,000
A	50,000		Plant	70,000
B	30,000		Furniture	3,000
C	20,000	1,00,000	Stock in trade	45,000
Current Accounts:			Sundry debtors	28,000
A	8,000		Prepayments	10,000
B	7,000		Bank balance	19,000
C	10,000	25,000		
Sundry Creditors		51,000		
		1,76,000		**1,76,000**

It was proposed to form a company to acquire the business for the purpose of the acquisitions.

The assets were revalued as follows:

Plant of Rs. 60,000; Furniture Rs. 4,000; Stock Rs. 25,000; Pre-payment Nil. It was ascertained that the profits before charging anything in respect of the partners, for the past five years been as follows Rs. 25,000, Rs. 29,000, Rs. 33,000, Rs. 35,000 and Rs. 33,000. Included in these profits were non-recurring items, averaging Rs. 1,500. But from the nature of the business, casual non-recurring items were found to arise every year and promoters agreed that a figure of Rs. 1,200 should be allowed as profit from this source.

Similar business paid a dividend of 8% p.a. on their ordinary share and partners who would be directors of the company were worth remuneration of: A – Rs. 4,000; B – Rs. 5,000 and C – Rs. 6,000 p.a.

Five years' purchase of the adjusted super profits on annuity basis was the agreed price for goodwill; the super profit being taken on the value of the goodwill. Ignore taxation. Annuity rate for Re. 1 @ 8% is 3.75.

Solution:

Calculation of average profit:

$$\text{Simple Average} = \frac{25,000 + 29,000 + 33,000 + 35,000 + 33,000}{5}$$

=	31,000
Less: Non-recurring items [1,500 – 1,200]	300
Average Profit	**30,700**

2. Calculation of FMP:

Average profit before tax	30,700
Less: Managerial Remuneration (4,000 + 5,000 + 6,000)	(15,000)
FMP	**15,700**

3. Calculation of capital Employed:

Particulars	Rs.	Rs.
Tangible Trading Assets:		
Plant	60,000	
Furniture	4,000	
Stock	42,000	
Debtors	25,000	
Pre-payments	Nil	
Bank	19,000	1,50,000
Less: External Liabilities:		
Sundry Creditors		(51,000)
Capital Employed		**99,000**

4. Calculation of NRR = 8%

5. Number of years' purchase = 5 years

6. Calculation of Normal Profit:

$$\text{Normal Profit} = \text{Capital Employed} \times \frac{\text{NRR}}{100}$$

$$= 99,000 \times \frac{8}{100}$$

= Rs. 7,920

7. Calculation of Super Profit:

Super Profit = FMP – Normal Profit

= 15,700 – 7,920

= Rs. 7,780

8. Calculation of Goodwill by purchase of super profit method:

Goodwill = Normal of years' purchase × Super Profit

= 5 × 7,780

= Rs. 38,900

9. Calculation of Goodwill by Annuity method of Super Profit:

Goodwill = Annuity Rate × Super Profit

= 3.75 × 7,780

Goodwill = Rs. 29,175

Illustration 04: From the following information supplied to you, ascertain the value of Goodwill of Anamika Ltd. which is carrying business as retail trader under the capitalisation of profit method.

Balance sheet as on March 31, 2015

Particulars	Rs.	Particulars	Rs.
Paid-up Capital		Goodwill at cost	50,000
5,000 Equity Shares of Rs. 100 each fully paid	5,00,000	Land and Buildings at cost	2,20,000
Profit and Loss Appropriation A/c	1,13,300	Plant and Machinery cost	2,00,000
Bank Overdraft	1,16,700	Stock in Trade	3,00,000
Provision for Taxation	39,000	Book Debt (–) Provisions for bad debts	1,80,000
Sundry Creditors	1,81,000		
	9,50,000		**9,50,000**

The company commenced operations in 1985 with a paid-up capital of Rs. 5,00,000. Profit forrecent years (after taxation) have been as follows:

Year ending March, 31	Rs.
2011	(Loss) 40,000
2012	88,000
2013	1,03,000
2014	1,16,000
2015	1,30,000

(a) The loss in 2011 occurred due to prolonged strike.

(b) The income tax paid so far has been at the average rate of 40%, but it is likely to be 50% nowonwards.

(c) Dividend were distributed at the rate of 10% at the end of the year ending March 31, 2015.

(d) The market price of shares is ruling at Rs. 125 at the end of the year ending March, 31, 2015.

(e) Profit till 2015 had been ascertained after debiting Rs. 40,000 as remuneration to the managingdirector. The Government has approved a remuneration of Rs. 60,000 with effect from April 1, 2015.

(f) The company has been able to secure a contract for supply of materials at advantageous prices. The advantage has been valued at Rs. 40,000 p.a. for the next five years.

Illustration 5: The balance sheet of a partnership was as follows:

Particulars	Rs.	Rs.	Particulars	Rs.
Capital Accounts:			Goodwill	1,000
A	50,000		Plant	70,000
B	30,000		Furniture	3,000
C	20,000	1,00,000	Stock in trade	45,000
Current Accounts:			Sundry debtors	28,000
A	8,000		Prepayments	10,000
B	7,000		Bank balance	19,000
C	10,000	25,000		
Sundry Creditors		51,000		
		1,76,000		**1,76,000**

It was proposed to form a company to acquire the business for the purpose of the acquisitions.

The assets revalued as follows:

Plant of Rs. 60,000; Furniture Rs. 4,000; Stock Rs. 25,000; Pre-payment Nil. It was ascertained that the profits before charging anything in respect of the partners, for the past five years been as follow Rs. 25,000, Rs. 29,000, Rs. 33,000, Rs. 35,000 and Rs. 33,000. Included in these profits were non-recurring items, averaging Rs. 1,500. But from the nature of the business, casual non-recurring items were found to arise every year and promoters agreed that a figure of Rs. 1,200 should be allowed as profit from this source.

Particulars	`	`
Tangible Trading Assets:		
Plant	60,000	
Furniture	4,000	
Stock	42,000	
Debtors	25,000	
Pre-payments	Nil	
Bank	19,000	1,50,000
Less: External Liabilities:		
Sundry		
Creditors		(51,000)
Capital Employed		**99,000**

Similar business paid a dividend of 8% p.a. on their ordinary share and partners who would be directors of the company were worth remuneration of: A – Rs. 4,000; B – Rs. 5,000 and C – Rs. 6,000 p.a.

Five years' purchase of the adjusted super profits on annuity basis was the agreed price for goodwill; the super profit being taken on the value of the goodwill. Ignore taxation. Annuity rate for Re. 1 @ 8% is 3.75.

Five years' purchase of the adjusted super profits on annuity basis was the agreed price for goodwill; the super profit being taken on the value of the goodwill. Ignore taxation. Annuity rate for Re. 1 @ 8% is 3.75.

Solution:

1. Calculation of average profit:

$$\text{Simple Average} = \frac{25,000 + 29,000 + 33,000 + 35,000 + 33,000}{5}$$

=	31,000
Less: Non-recurring items [1,500 – 1,200]	300
Average Profit	**30,700**

2. Calculation of FMP:

Average profit before tax	30,700
Less: Managerial Remuneration (4,000 + 5,000 + 6,000)	(15,000)
FMP	**15,700**

3. Calculation of capital Employed:

4. Calculation of NRR = 8%

5. Number of years' purchase = 5 years

6. Calculation of Normal Profit:

$$\text{Normal Profit} = \text{Capital Employed} \times \frac{\text{NRR}}{100}$$

$$= 99,000 \times \frac{8}{100}$$

= Rs. 7,920

7. Calculation of Super Profit:

Super Profit = FMP – Normal Profit

= 15,700 – 7,920

= Rs. 7,780

8. Calculation of Goodwill by purchase of super profit method:

Goodwill = Normal of years' purchase × Super Profit

= 5 × 7,780

= Rs. 38,900

9. Calculation of Goodwill by Annuity method of Super Profit:
Goodwill = Annuity Rate × Super Profit

= 3.75 × 7,780

Goodwill = Rs. 29,175

Illustration 6: ALTO agreed to purchase business of A. For that purpose, goodwill is to bevalued at three years' purchase of the weighted average of previous 4 years adjusted profits.

The profits for the year ending 31/12/2012 to 31/12/2015 were as under:

Year ending 2012	Rs. 20,200
Year ending 2013	Rs. 24,800
Year ending 2014	Rs. 25,000
Year ending 2015	Rs. 30,000

Following additional information is available:

a) On 01/09/2014, major repair expenditure to plant and machinery for 6,000 was charged to revenue. That was agreed to be capitalized for goodwill, subject to 10% p.a. depreciation on diminishing balance method to be calculated.

b) The closing stock for the year ending 31/12/2013 was overvalued by Rs. 2,400.

c) In order to cover cost of management, an annual charge of Rs. 4,800 should be made for valuation of Goodwill.

Compute value of goodwill.

Solution:

Calculation of Trading profit:

Particulars	**2012** (Rs.)	**2013 (Rs.)**	**2014** (Rs.)	**2015** (Rs.)
Profit before adjustment	20,200	24,800	25,000	30,000
Add: P/M [capital Expenses charged as Revenue Exp]	–	–	6,000	–
Less: Depreciation 10% on above P/M For (4 & 12 month)	–	–	(200)	W.D.V. method (580) (6,000 – 200 × 10%)
Less: Closing Stock overvalued		(2,400)		–
Add: Opening Stock overvalued			2,400	
Less: Cost of Management	(4,800)	(4,800)	(4,800)	(4,800)
Adjusted Profit				
	15,400	**17,600**	**28,400**	**24,620**

Year	**Profit**	**Weights**	**Product**
2012	15,400	1	15,400
2013	17,600	2	35,200
2014	28,400	3	85,200
2015	24,620	4	98,480
		10	**2,34,280**

$$\text{Weighted Average Profit} = \frac{2,34,280}{10} = \textbf{Rs. } 23,428$$

Calculation for Goodwill by purchase of Weighted Average method:

Goodwill = Number of years' purchase × Weighted Average Profit

= 3 × 23,428

= Rs. 70,284

Illustration 7: L, M and N are partners sharing profit and losses in the ratio of 4:3:3 respectively. The firm closes its account on 31st December, every year. On 31st March, 2015, N died and it was decided to calculate the amount of the goodwill to be paid to the heirs of Mr. N. According to the partnership agreement, Goodwill was to be valued at the three-year purchase of average super profits of the three years upto the death after deducting 17.5% interest on capital employed and paying a reasonable remuneration of Rs. 30,000 per annum to each partner. Average capital employed in the business was Rs. 2,00,000.

The profits of the earlier years before charging interest on capital employed were as follows:

Year	Rs.
2012	1,47,000
2013	1,59,000
2014	2,23,000

The profits for the year ending 31st December, 2015 were Rs. 1,31,000. Profits may be considered to have been earned uniformly for all the years including 2015. Calculate the amount of goodwill to be paid to the heirs of Mr. N.

Solution:

1.

Year	Profit	Weight	Total Product
2012	1,47,000	1	1,47,000
2013	1,59,000	2	3,18,000
2014	2,23,000	3	6,69,000
		6	**11,34,000**

2. Calculation for Average Profit:

$$\therefore \text{Weighted Average Profit} = \frac{11,34,000}{6} = \text{Rs. } 1,89,000$$

3. Calculation for FMP:

Weighted Average present	1,89,000
Less: Managerial Remuneration (30,000 × 3)	(90,000)
FMP	**99,000**

4. Calculation for Capital Employed = Rs. 2,00,000

5. Calculation of NRR = Rs. 17.5%

$$\text{Calculation for Normal Profit} = \text{Capital Employed} \times \frac{\text{NRR}}{100}$$

$$= 2,00,000 \times \frac{17.5}{100}$$

$$= \text{Rs. } 35,000$$

6. Calculation for super profit:

Super Profit = FMP – Normal Profit
= 99,000 – 35,000
= 64,000

7. Calculation of Goodwill by purchase of super profit.

Goodwill = Number of years purchase × super profit
= 3 × 64,000
= Rs. 1,92,000

$$\therefore \text{Goodwill to be paid to legal heirs of N} = 1,92,000 \times \frac{3}{10} = 57,600$$

Illustration 8: The average net profit was (before adjustment) Rs. 2,07,000. It included investment income Rs. 2,000. The cost (also present value) of investment was Rs. 50,000. Expenses amounting to Rs. 3,000 p.a. are likely to be discontinued in future. 50 paise in rupee may be taken as average annual taxation. 6% represented a fair commercial return. The average capital employed was Rs. 13,50,000 but upon valuation obtained, the actual was valued Rs. 14,50,000.

(a) Assuming seven years' purchase of super profit, what is the value of goodwill?

(b) What will be the value of goodwill under capitalisation method?

Solution:

1. Calculation of Average Profit:

Average profit (before adjustment)	2,07,000
Less: Investment income	(2,000)
Average profit (after adjustment)	**2,05,000**
2. Calculation of Future Maintainable Profit:	
Average profit (before adjustment)	2,05,000
Add: Expenses likely to be discontinued in future	3,000
Future maintainable profit before tax	2,08,000
Less: Tax @ 50%	(1,04,000)
Future maintainable profit after tax	**1,04,000**
3. Calculation for Capital Employed:	
As given	14,50,000
Less: Investment	(50,000)
Actual Capital Employed	**14,00,000**

4. NRR = 6% (Given)
5. Normal of years' purchase = 7 years (Given)
6. Calculation of Normal Profit:

$$\text{Normal Profit} = \text{Capital} \times \frac{\text{NRR}}{100}$$

$$= 14,00,000 \times \frac{6}{100}$$

= Rs. 84,000

7. **C**alculation of Super Profit:

Super profit = 1,04,000 – 84,000

= Rs. 20,000

8. Calculation of Goodwill by purchase of super profit method:

Goodwill = No. of years × Super Profit

= 7 × 20,000

= Rs. 1,40,000

9. Goodwill by capitalisation of super profit:

$$\text{Goodwill} = \frac{\text{Super Profit}}{100} \times 100$$

$$= \frac{20,000}{6} \times 100$$

= Rs. 3,33,333

Illustration 9: A company desirous of selling its business to another company has earned an average profit in past Rs. 1,50,000 per annum. It is considered that such average profit fairly represents the profit likely to be earned in the future except that:

(a) Director's fees Rs. 10,000 charged against such profit will not be payable by the purchasing company whose existing board can cope up with additional work without additional fees.

Rent at Rs. 20,000 p.a. which has been paid by the existing company will not be charged in the future.

The value of the tangible assets of the existing company at the proposed date of sale was

Rs. 19,00,000 and was considered that reasonable return on capital invested, for the type of companywas 8%.

Calculate the value of Goodwill at 3 years' purchase of super profits.

Solution:

1. Calculation of Average Profit: Rs. 1,50,000 (Given)
2. Calculation of future maintainable profit:

Average profit	1,50,000
Add: Director's fees not required in future	10,000
Add: Rent not payable in future	20,000
Future maintainable profit	**91,600**

3. Calculation of capital employed: Rs. 19,00,000 (Given)
4. Calculation of NRR: 8% (Given)
5. Calculation of number of years' purchase: 3 years (Given)

Calculation of Normal Profit:

$$\text{Normal Profit} = \text{Capital Employed} \times \frac{\text{NRR}}{100}$$

$$= \frac{19,00,000 \times 8}{100}$$

$$= 1,52,000$$

i) Calculation of Super Profit:

Super Profit = FMP – Normal Profit

= 1,80,000 – 1,52,000

= Rs. 28,000

ii) Calculation of Goodwill by purchase of super profit method:

Goodwill = Super profit × Number of years' purchase

= 28,000 × 3

= Rs. 84,000

1.9 UNSOLVED PROBLEMS

1. From the following information, ascertain the value of goodwill of Micro Computers Ltd. under super profit method.

Balance Sheet as on 31st March, 2014

Liabilities	Rs.	**Assets**	Rs.
Paid-up Capital (5,000 share of 100 each fully paid)	5,00,000	Goodwill at Cost	50,000
Bank Overdraft	1,16,700	Land and Building at cost	2,20,000
Sundry Creditors	1,81,000	Plant and Machinery at cost	2,00,000
Provision for Taxation	39,000	Stock in Trade	3,00,000
Profit and Loss Appropriation A/c	1,13,300	Bad Debts	1,80,000
	9,50,000		**9,50,000**

The company commenced operations in 1995 with a paid-up capital of **Rs.** 5,00,000. Profits for recent years (after taxation) have been as follows:

Year ended 31st March	Rs.
2010	40,000 (loss)
2011	88,000
2012	1,03,300
2013	1,16,000
2014	1,30,000

The loss in 2010 occurred due to a prolonged strike.

The income tax paid so far has been at the average rate of 40%. Dividends were distributed at the rate of 10% on the paid-up capital in 2011 and 2012 and at the rate of 15% in 2013 and 2014. The market price of share is ruling at **Rs.** 125 at the end of the year ended 31st March, 2009.

2. Super Profits: Purchase + Capitalisation)

i. From the following information calculate value of the goodwill by (a) Super Profit Method and

ii. (i) Average capital employed in the business 6,00,000.

iii. () Net trading profits of the firm for the past three years were 1.07,600, 90,700 and 1,12,500. (ii) Rate of Interest expected from capital having regard to the risk involved 12 per cent. (iv) Fair Remuneration to the partners for their services 12,000 per annum.

iv. (v) Sundry assets of the firm 7,54,762 Current liabilities 31,329. Note: Take 8 years' purchase of super profits as value of Goodwill

3. The net profits of a Company, after providing for taxation, for the past five years are Rs. 42,000; Rs. 47,000; Rs. 45,000; Rs. 39,000 and Rs. 47,000. The capital employed in the business is Rs. 4, 00,000 on which a reasonable rate of return of 10% is expected.

Calculate the goodwill under:

(a) Capitalisation of Average Profit Method and

(b) Capitalisation of Super Profit Method.

4. Ram runs a chemist shop. His net assets on 31st December 2004 amount to Rs. 20, 00,000. After paying a rent of Rs. 20,000 a year and salary of Rs. 20,000 to the chemist, he earns a profit of Rs. 1,50,000. His landlord, who happens to be an expert chemist, is interested in purchasing the shop 12% is considered to be a reasonable return on capital employed. What can Ram expect as payment for goodwill?

5. Sumana, Suparna and Aparna are partners in a firm. They share profits and losses in the ratio of 3: 2: 1. The partnership deed provides that, on the retirement of a partner, Goodwill shall be calculated on the basis of 5 years' purchase of the average net profits of the preceding 8 years. Aparna retires from the business on 31.12.1993. The net profits for the last 8 years are as follows: 1996 Rs. 6,000; 1997 Rs. 12,000; 1998 Rs. 20,000; 1999 Rs. 16,000; 2000 Rs. 25,000; 2001 Rs. 30,000; 2002 Rs. 36,000; 2003 Rs. 31,000. Compute the Goodwill of the firm which is payable to Aparna.

1.10 MCQ's

1. Which of the following methods are used for the valuation of goodwill?

   a. Super profit method

   b. Weighted profit method

   c. Average profit method

   d. All of the above

   Answer: d

2. What is the primary purpose for the valuation of shares?

   a. To advance a loan against the security of shares

   b. For purchase of shares by employees where they can retain these shares till the period of their employment

   c. To purchase a block of shares to acquire control in the company

   d. All of the above

   Answer: d

3. Which of the following factors is not affecting the goodwill of a company?

   a. The location of a company's customers

   b. The nature of business

   c. The efficiency of a company's management

   d. None of the above

   Answer: a

4. The formula for calculating goodwill under the simple average profit method is ________.

   a. Goodwill = Super profit * Annuity factor

   b. Goodwill = Super profit * No. of years purchase

   c. Goodwill = Average profit * No. of years purchase

   d. Goodwill = Weighted average profit * No. of years purchase

   Answer: c

5. **The market value method for the valuation of a share is preferred _________.**

    a. When the shares are not listed

    b. When there is a valuation for a division within the company

    c. When the shares of a company are frequently traded in a stock exchange that has nationwide trading

    d. None of the above

    Answer: c

6. **The amount that is treated as goodwill by a firm is paid for obtaining _______.**

    a. Present benefit

    b. Future benefit

    c. Both a and b

    d. None of the above

    Answer: b

7. **The formula for valuation of equity shares is __________ multiplied by the price-earnings ratio.**

    a. Interest per share

    b. Bonus per share

    c. Earnings per share

    d. None of the above

    Answer: c

8. **The shares appear at _________ in the balance sheet of a company.**

    a. Paid-up value

    b. Market price

    c. Adjusted market value

    d. None of the above

    Answer: a

9. **Which of the following is not essential to calculate the yield value per share?**

   a. Super profit

   b. Paid-up value

   c. Normal return rate

   d. Expected return rate

   Answer: a

10. **For any organization, goodwill is _______.**

    a. A valuable asset

    b. A non-current asset

    c. An intangible asset

    d. All of the above

    Answer: d

❖❖❖❖

2

FINAL ACCOUNTS OF BANKING COMPANIES

Unit Structure:

2.1 INTRODUCTION

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

Banking. According to Banking Regulation Act, 1949. Section 5 Banking is defined as "the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdraw able by cheque, draft, order or otherwise

Section 6 of the Act states that in addition to the business of banking, a banking company may engage in any one or more of the following businesses:
The borrowing, raising, or taking up of money

i. The lending or advancing of money either upon or without security

ii. The drawing, making, accepting, discounting, buying, selling, collecting and dealing in b bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrip and other instruments, and securities whether transferable or negotiable or not.

iii. The granting and issuing of letter of credit, travellers cheques and circular notes

iv. On receiving of all kinds of bonds, scrip's or valuables on deposit or for safe custody or otherwise.

v. The buying, selling and dealing in bullion

vi. The collecting and transmitting of money and securities

vii. Contracting for public and private loans and negotiating and issuing the same

viii. Carrying on and transacting every kind of guarantees and indemnity business

ix. Undertaking and executing trusts, etc…

Classification of Bank Advances.

a. **Bills purchased and discounted** – It is the advances given to customers on the security of bills, pronote etc. The amount after deducting the discount from the amount of the bill is credited in the customer's account.

b. **Loans** – A loan is an advance of a fixed amount give to a customer for a specified period. Interest is charged on the whole amount loaned.

c. **Cash credit** – It is a form secured advance by a bank. Under this arrangement the bank allows a fixed limit within which the customers can withdraw on the bank. Interest is charged on the amount actually withdrawn.

d. **Overdraft** – Under this arrangement, the bank agrees to allow its customers to overdraw from his current account up to a certain limit either with or without security.

2.2 ACCOUNTING SYSTEM

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

1) Entries in the personal ledgers are made directly from the vouchers

2) From such entries in the personal ledgers each day summary sheets

in total are prepared which are posted to the control accounts in the general ledger.

3) The general ledger's trial balance is extracted and agreed every day.

4) All entries in the personal ledgers and summary sheets are checked by persons other than those who have recorded entries. It helps in detection of mistakes.

5) A trial balance of detailed personal ledgers is prepared periodically and gets agreed with the general ledger control accounts.

6) Two vouchers are prepared for every transaction not involving cash.

2.3 BOOKS REQUIRED BY BANK

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

1. Cash Book
2. General Ledger

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

Final Accounts of Banks

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

Profit and Loss Account

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

2.4 FORMAT

Form B

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

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

SCHEDULE 13 – INTEREST EARNED (000s omitted)

	Year ended 31.3..(Current Year)	Year ended 31.3.(Previous Year)
Interest/ discount on advances/bills Income on investments Interest on balances with Reserve Bank of India and other inter-bank funds Others		
Total		

SCHEDULE 15 – INTEREST EXPENDED (000s omitted)

	Year ended 31.3..(Current Year)	Year ended 31.3.(Previous Year)
Interest on deposits Interest on Reserve Bank of India/ inter-bank borrowings Others		
Total		

SCHEDULE – 16 OPERATING EXPENSES (000s omitted)

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

2.5 FORMAT

Balance Sheet

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

FORM OF BALANCE SHEET

BALANCE SHEET OF …… (here enter name of the banking company) as on 31st March (Year) (000s omitted)

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

2.6 GUIDELINES OF THE RESERVE BANK OF INDIA FOR THE PREPARATION OF FINAL ACCOUNTS OF BANKING COMPANIES

Statutory Reserve Ratio

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

Cash Reserve Ratio (CRR)

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

Statutory Liquidity Ratio (SLR)

As per Section 24 of the Banking Regulation Act1949 every commercial bank is required to maintain not less than 25% of its total time and demand liabilities in liquid assets in the form of cash, gold, and unencumbered Government securities and other securities within India. It is called SLR. At present the norm of SLR is 21.5 %.

Rebate on Bills Discounted/ Unexpired Discount

Rebate on bills discounted is the interest received in advance and represents unearned discounts for those bills which will mature after the close of the financial year. Rebate on bills discounted for the current year is debited to discount account. In the Profit and Loss account this item is deducted from Interest earned, schedule No.13 and in Balance sheet it is shown on the liability side under the head other liabilities and provisions schedule No.5. If it is given as a ledger balance, it is shown under schedule No.5 only.

Interest and discount A/c

Dr To Rebate on bills discounted.

If rebate on bills discounted is given in trial balance, it should e taken to Balance sheet under “Other Liabilities and Provisions”. If it is given under adjustments, it should be deducted from “Interest and Discount” in Profit and loss Account and should be taken to Balance sheet under “Other Liabilities and Provisions”. At the commencement of next accounting year it is transferred to Interest and Discount Account by reversing the above entry.

2.7 BRANCH ADJUSTMENTS OR INTER - OFFICE ADJUSTMENTS

Banks usually have a network of branches spread over different places. Various transactions take place between head office and branches and also between branches themselves. The head office will record this transactions after advises are received from branches. Unless advises are received such items will remain unadjusted under the heading Branch Adjustments. If such entries may remain unadjusted in the head office of the bank at the close of the financial year, such entries are recorded in the balance sheet. If it is a debit balance, it is comes under the Schedule No. 11 of asset side and if it is a credit balance, it comes under the schedule No.5 of liability side.

Clean bill

These are the bills to which no documents such as bill of lading, insurance policy etc are attached.

Discounting of bills

Discounting of bill means making the payment of the bill before the maturity date of the bill. Bills for Collection. These are the drafts and bills drawn by sellers of goods on the purchasers of goods and sent to the bank for collection. If some bills are left uncollected at the end of the year, they are shown under the head Bills for collection.

Money at call and Short Notice

This item appears on the assets side of a bank Balance sheet and represents temporary loans to bill brokers, stock brokers and other banks. If the loan is given for one day, it is called “money at call” and if the loan cannot be called back on demand and will require at least a notice of three days for calling back, it is called “money at short notice”. The rate of interest on which money is lent fluctuates every day.

Non-banking Assets

These are the temporary assets acquired by the bank for granting loans and advances. Eg. Immovable properties, stock, title deeds etc. Such assets are acquired by a bank from defaulters in satisfaction of their outstanding to the bank. In short, the asset acquired in satisfaction of the claim of the bank is called Non-banking assets. It showed under the schedule No. 11 Other assets. Such assets acquired should be disposed of within a period of seven years from the date of their acquisition.

Interest on doubtful debts treated in a bank

When loan advanced become bad and doubtful, interest due on such loan is not credited to P/L Account. Instead, interest suspense account is credited. Unlike interest account, interest suspense account is not credited to P/L Account. If any portion of interest suspense is realised in subsequent year, then that portion will be credited to interest account and subsequently credited to P/L Account.

Items of Contingent liabilities in the case of Banking Company

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

a. Liability for partly paid investments.

b. Liability on account of forward exchange contract.

c. Guarantees given to customers.

d. Acceptances, endorsements and other obligations.

e. Claims against the bank not acknowledged as debt. Non Performing Assets (NPA)

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

2.8 CLASSIFICATION OF BANK ADVANCES AND ITS PROVISIONING (ASSET CLASSIFICATION)

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

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

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

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

c. Doubtful assets – An asset which has remained NPA for a period exceeding two years should be treated as doubtful. 100 percent of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful: The provision is made on the following basis -

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

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

2.9 SOLVED PROBLEM

Problem 1:

Prepare a profit and loss account of ABC bank LTD for the year 31.3.2018 from the following

Particulars	Rs.	Rs.
Interest on Fixed Deposits	162410	
Rebate on Bills discounted	29000	
Interest on Loans		45000
Commission charged to Customers		62500
Establishment	15000	
Discount on Bills discounted		89000
Interest on Cash Credit		24000
Amount charged against Current Accounts		71500
Directors' Fees	10000	
Audit Fees	20000	
Postage and Telegram	2000	
Printing and Stationery	4000	
Rent and Taxes	22500	
Interest on Overdraft		71000
Sundry Charges	1500	
Interest on Savings Bank Deposits	57780	

Solution:

Profit and Loss Account for the Year ended 31.3.2018		
Particulars	**Schedule**	**Rs.**
I. Income		
Interest Earned	13	271500
Other Income	14	62500
Total		334000
II. Expenditure		
Interest Expended	15	220190
Operating Expenses	16	75000
Total		295190
III. Profit and Loss		
Profit for the year		38810
IV. Appropriation		
Transfer to Statutory Reserve		9702.5
Balance to Balance Sheet		29107.5
		38810

Problem 2:

Particulars	Rs.
Interest on Fixed Deposits	36500
Rebate on Bills discounted	4800
Interest on Loans	34900
Commission charged to Customers	910
Office Expenses	15500
Discount on Bills discounted	19400
Interest on Cash Credit	22400
Directors' Fees	420
Postal Expenses	150
Printing and Stationery	390
Rent and Taxes	1800
Interest on Overdraft	12800
Other Expenses	180
Interest on Savings Bank Deposits	6900

Solution :

Profit and Loss Account for the Year ended 31.3.2019		
Particulars	**Schedule**	**Rs.**
I. Income		
Interest Earned	13	84700
Other Income	14	910
Total		85610
II. Expenditure		
Interest Expended	15	43400
Operating Expenses	16	18440
Total		61840
III. Profit and Loss		
Profit for the year		23770
IV. Appropriation		
Transfer to Statutory Reserve		5942.5
Balance to Balance Sheet		17827.5
		23770

Schedule 13: Interest Earned	**Rs.**	**Schedule 15: Interest Expended**	**Rs.**
Interest on Loan	34900	Interest paid on Fixed Deposits	36500
Interest on Cash Credit	22400	Interest paid on Savings Bank Deposits	6900
Interest on Overdrafts	12800		**43400**
Discount on Bills discounted	19400		
Less: Rebate on Bills discounted	-4800	**Schedule 16: Operating Expenses**	**Rs.**
		Office Expenses	15500
	84700	Rent and Taxed	1800
		Director Remuneration	420
Schedule 14: Other Income	**Rs.**	Postal Expenses	150
Commission charged to customer	**910**	Printing and Stationery	390
		Other Expenses	180
			18440

Problem 3:

The following financial data extracted from the books of Mysore bank Limited as on 31.3.2019 :

Particulars	Rs.
Interest on Fixed Deposits	55000
Rebate on Bills discounted	9800
Interest on Loans	51800
Commission	1600
Depreciation on Bank Property	1000
Discount on Bills discounted	29200
Interest on Cash Credit	44600
Directors' Fees	600
Postage and Telegram	300
Printing and Stationery	600
Rent and Taxes	3600
Interest on Overdraft	30800
Sundry Expenses	400
Interest on Savings Bank Deposits	13600
Interest on Current Accounts	8400
Locker Rent	200
Salaries and Allowances	10800
Auditor's Fees	200
Transfer Fees	100

Solution:

Profit and Loss Account for the Year ended 31.3.20		
Particulars	**Schedule**	**Rs.**
I. Income		
Interest Earned	13	155000
Other Income	14	1800
Total		**156800**
II. Expenditure		
Interest Expended	15	68600
Operating Expenses	16	17600
Provision and Contingencies		
Total		**86200**
III. Profit and Loss		
Profit for the year		**70600**
IV. Appropriation		
Transfer to Statutory Reserve		17650
Balance to Balance Sheet		52950
		70600

Schedule 13 : Interest Earned	**Rs.**		**Schedule 15 : Interest Expended**	**Rs.**
Interest on Loan	51800		Interest paid on Fixed Deposits	55000
Interest on Cash Credits	44600		Interest paid on savings Bank Deposits	13600
Interest on Overdrafts	30800			**68600**
Discount on Bills Discounted	29200			
Less : Rebate on Bills Discounted	9800		**Schedule 16 : Operating Expenses**	**Rs.**
Interest on Current Accounts	8400		Salaries and Allowances	10800
	155000		Rent and Taxed	3600
			Director's Fees	600
Scheduled 14 : Other Income	**Rs.**		Auditor's Fees	200
Commission received	1600		Postage and Telegram	300
Locker rent	200		Printing & Stationary	600
	1800		Transfer Fees	100
			Depreciation on Bank Property	1000
			Sundry charges	400
				17600

Problem 4:

From the following information, prepare a Profit and Loss Account of Adarsha Bank Limited for the period ending 31.3.2017 along with necessary schedules.

Particulars	**Rs. In '000**	**Particulars**	**Rs. In '000**
Interest on Loans, Cash Credit and Overdraft	31628	Advertisement and publicity	87
Income on Investment	11810	Depreciation on Bank's property	297
Interest on Balances with RBI	4243	Director's fees, allowances and expenses	7
Commission, Exchange and Brokerage	2907	Auditor's fees and expenses	41

Profit on Sale of investments	114	Low charges	22
Interest on Deposites	31404	Postage, telegram, telephone etc.	312
Interest on RBI Borrowing	3361	Repairs and maintenance	91
Payment to and Provision for employees	9717	Insurance	915
Rent, taxes and lighting	955	Printing and stationary	213
Other experditure	884	Balance of Profit/ Loss b/f	1524

Supplementary Information:

i) Make a provision for (including surcharge) at 51.75%

ii) Every year the bank transfer 25% of profits to statutory Reserve and 5% profit to Revenue Reserve.

iii) Dividend amounting to Rs. 2,00,000 for the ended 31.3.2017 is proposed by board of Directors.

Solution:

Profit and Loss Account for the Year ended 31.3.2017		
Particulars	**Schedule**	**Rs.**
I. Income		
Interest Earned	13	47681
Other Income	14	3021
Total		**50702**
II. Expenditure		
Interest Expended	15	34766
Operating Expenses	16	13536
Provision and Contingencies		1242
Total		**49544**
III. Profit and Loss		
Profit for the year		**1158**
P&L balance b/d		1524
		2682
IV. Appropriation		
Transfer to Statutory Reserve		671
Transfer to Other reserves (5% on 1158)		58
Proposed Dividend		200
Balance to Balance Sheet		1754
		2682
* Provision - Income at 51.75% on Rs.2400 i.e., (Rs.50702 - Rs. 48302)		

Schedule 13: Interest Earned	Rs.		Schedule 16: Operating Expenses	Rs.
Interest and Discount on Advances/Bills	31628		Salaries	9717
Interest on Investments	11810		Rent, Rates and Lighting	955
Interest on RBI Deposits	4243		Printing & Stationery	213
	47681		Advertisement and publicity	87
			Depreciation on Bank Property	292
Schedule 14: Other Income	**Rs.**		Director's fees	7
Commission, Exchange and Brokerage	2907		Audit Fees	41
Profit on sale of investment	114		Law charges	22
	3021		Postage and telegram	312
			Repairs and maintenance	91
Schedule 15: Interest Expended	**Rs.**		Insurance	915
Interest on Deposits	31404		Other Expenses	884
Interest on Borrowings	3361			**13536**
	34765			

Problem 5:

The following balances have been taken from the books of Indian Banking Corporaion on 31st March, 2017			
	₹		₹
Paid up Capital	10,00,000	Furniture	20,000
Local Bills Discounted	9,00,000	Fixed Deposits	20,00,000
Reserve Fund	3,85,000	Profit and Loss Account-balance (Cr.)	1,10,000
Loans, Advances	14,00,000	Stamps on hand	5,000
Unpaid dividend	5,000	Cash Balance	2,50,000
Overdrafts	23,00,000	Cash Balance with other Banks	6,50,000
Current and Savings Deposits	25,00,000	Investments (Cost)	4,75,000

The directors of the bank have instructed that the investment should be shown in the Balance Sheet.

The authorised capital of the was ₹12,00,000 in ₹10 shares.

Prepare the Balance Sheet of the Bank, as on 31st March, 2017.

Balance Sheet as on 31.03.......

Particulars	Schedule No	Rs.
CAPITAL AND LIABILITIES		
Capital	1	1000000
Reserves and Surplus	2	545000
Deposits	3	4500000
Borrowings	4	0
Other Liabilities and Provisions	5	5000
TOTAL		6050000
ASSETS		
Cash and Balances with Reserve Bank of India	6	250000
Balance with banks and money at call and short notice	7	650000
Investments	8	525000
Advances	9	4600000
Fixed Assets	10	20000
Other Assets	11	5000
TOTAL		6050000
Contingent Liabilities	12	Nil
Bills for collection		Nil

Schedule 1: Capital	Rs.
Authorised Capital	*1200000*
Paid-up Capital	1000000
Total	**1000000**
Schedule 2: Reserves and Surplus	**Rs.**
Reserve Fund	385000
Investment Reserve (525000-475000)	50000
Profit and Loss account	110000
Total	**545000**
Schedule 3: Deposits	**Rs.**
Current and Savings Deposits	2500000
Fixed Deposits	2000000
Total	**4500000**
Schedule 4: Borrowings	**Nil**
Schedule 5: Other Liabilities	**Rs.**
Unpaid Dividend	**5000**
Schedule 6: Cash and Balances with RBI	**250000**
Schedule 7: Balance with other banks and Money at Call and short notice	**Rs.**
Cash balance with other banks	**650000**
Schedule 8: Investments	**Rs.**
Investments at cost	475000
Add: Increase in the value of investments	50000
Total	**525000**
Schedule 9: Advances	**Rs.**
Local Bills Discounted	900000
Loans and advances	1400000
Overdrafts	2300000
Total	**4600000**
Schedule 10:Fixed Assets	**Rs.**
Furniture	**20000**
Schedule 11: Other Assets	**Rs.**
Stamps on hand	**5000**
Schedule 12: Contingent Liabilities	**Nil**

Problem no. 6:

The following information's extracted from the Trial Balance of Excellent Bank Limited as on 31.3.2018

	Rs. in '000		Rs. in '000
Paid up Capital	10000	Statutory Reserve	10363
Overdraft	8800	Revenue Reserve	2800
Bills purchased & discounted	33100	Balance in P & L A/c	642
Premises	3500	Inter-Office adjustments (Cr)	4555
Current Deposits	54000	Bills Payable	1088
Money at Call and Short notice	1500	Investments in Shares	4700
Investments in Govt. Securities	45200	Cash Credits	43800
Borrowings	12200	Cash in hand	438
Interest Accrued (Cr)	1477	Cash with other banks	6869
Savings Bank Deposits	14520	Term Deposits	37180
Non-Banking Assets	43	Interest Accrued (Dr)	875
Acceptance, Endorsements & Other Obligations	1168		

Required: Prepare Balance Sheet of Excellent Bank Limited as on 31.3.2018

Solution :

Balance Sheet as on 31.03.2018

Particulars	Schedule No	Rs.
CAPITAL AND LIABILITIES		
Capital	1	10000
Reserves and Surplus	2	13805
Deposits	3	105700
Borrowings	4	12200
Other Liabilities and Provisions	5	7120
TOTAL `		**148825**
ASSETS		
Cash and Balances with Reserve Bank of India	6	438
Balance with banks and money at call and short notice	7	8369
Investments	8	49900
Advances	9	85700
Fixed Assets	10	3500
Other Assets	11	918
TOTAL `		**148825**
Contingent Liabilities	12	1168
Bills for collection		

Schedule 1: Share Capital	Rs.	Money at call	Rs.
Paid up Capital	10000	Cash with other banks	6869
		Money at Call and Short notice	1500
Schedule 2: Reserves and Surplus	**Rs.**		**8369**
Statutory Reserve	10363	**Schedule 8: Investments**	**Rs.**
Balance in P&L account	642	Investments in Shares	4700
Revenue Reserve	2800	Investments in Govt. Securities	45200
	13805		**49900**
Schedule 3: Deposits	**Rs.**	**Schedule 9: Advances**	**Rs.**
Current Deposits	54000	Cash Credits	43800
Savings Bank Deposits	14520	Overdraft	8800
Term Deposits	37180	Bills purchased & discounted	33100
	105700		**85700**
		Schedule 10: Fixed Assets	**Rs.**
Schedule 4: Borrowings	**Rs.**	Premises	3500
Borrowings	**12200**		**3500**
Schedule 5: Other Liabilities	Rs.	**Schedule 11: Other Assets**	**Rs.**
Interest Accrued (Cr)	1477	Interest Accrued (Dr)	875
Inter-Office adjustments (Cr)	4555	Non-Banking Assets	43
Bills Payable	**1088**		**918**
	7120	**Schedule 12: Contingent Liabilities**	**Rs.**
Schedule 6: Cash and Balance with RBI	**Rs.**	Acceptance, Endorsements & Other Obligations	**1168**
Cash in hand	438		
	438		

Problem 7:

The following information's extracted from the Trial Balance of SMDC Bank Limited as on 31.3.2018

	Rs. in '000		Rs. in '000
Authorised Capital	250	Demand Deposits	520.12
Issued, Subscribed and Paid up Capital	198	Borrowings in India from other Banks	110
Cash in hand	160.15	Balance with Other Banks	149.14
Investments in Govt. Securities	110.17	Cash Credit, Overdrafts	840.1
Bank Guarantees	162.23	Statutory Reserve	268
Furniture	70.12	Balance with RBI	44.61
Money at Call and Short Notice	210.12	Fixed Deposits	517
Balance in P & L Account	525	Investments in Gold	55.23
Savings Bank Deposits	450	Term Loans	630.65
Other Liabilities and Provisions	0.1	Premises	155.7
Claims against bank not acknowledged as debts	0.55	Acceptance, Endorsements	14.12

Solution :

Balance Sheet as on 31.03.2018

Particulars	Schedule No	Rs.
CAPITAL AND LIABILITIES		
Capital	1	198
Reserves and Surplus	2	793
Deposits	3	1487.12
Borrowings	4	110
Other Liabilities and Provisions	5	0.1
TOTAL `		**2588.22**
ASSETS		
Cash and Balances with Reserve Bank of India	6	204.8
Balance with banks and money at call and short notice	7	359.3
Investments	8	165.4
Advances	9	1632.98
Fixed Assets	10	225.8
Other Assets	11	
TOTAL `		**2588.28**
Contingent Liabilities	12	14.67
Bills for collection		

Schedule 1: Share Capital	**Rs.**
Issued, Subscribed and Paid up Capital	**198**

Schedule 2: Reserves and Surplus	**Rs.**
Statutory Reserve	268
Balance in P&L account	525
	793

Schedule 3: Deposits	**Rs.**
Fixed Deposits	517
Savings Bank Deposits	450
Demand Deposits	520.12
	1487.12

Schedule 4: Borrowings	**Rs.**
Borrowings in India from other Banks	**110**

Schedule 5: Other Liabilities	Rs.
Other Liabilities and Provisions	0.1

Schedule 6: Cash and Balance with RBI	**Rs.**
Cash in hand	160.15
Balance with RBI	44.61
	204.76

Schedule 7: Balance with banks & Money at call	**Rs.**
Money at Call and Short Notice	210.12
Balance with Other Banks	149.14
	359.26

Schedule 8: Investments	**Rs.**
Investments in Govt. Securities	110.17
Investments in Gold	55.23
	165.40

Schedule 9: Advances	**Rs.**
Cash Credit, Overdrafts	840.1
Term Loans	630.65
Bank Guarantees	162.23
	1632.98

Schedule 10: Fixed Assets	**Rs.**
Furniture	70.12
Premises	155.7
	225.82

Schedule 11: Other Assets	**Nil**

Schedule 12: Contingent Liabilities	**Rs.**
Claims against bank not acknowledged as debts	0.55
Acceptance, Endorsements	14.12
	14.67

Problem 8:

From the following you are required to prepare the Profit and Loss Account and the Balance Sheet of the Shivaji Bank Limited as on 31st March 2015 in prescribed form:

Particulars	Debit Rs.	Credit Rs.
Issued Capital 20,000 shares of Rs. 100 each		20,00,000
Money at call and short notice	8,00,000	
Reserve Fund		7,00,000
Cash in hand and with RBI	6,50,000	
Deposits		
a) Saving		10,00,000
b) Current		5,00,000
c) Fixed		10,00,000
Cash with other Banks	9,50,000	
Borrowing from SBI		5,00,000
Investment in Government Securities	9,00,000	
Secured Loans	15,00,000	
Cash Credits	5,00,000	
Premises less depreciation	5,80,000	
Furniture less depreciation	1,20,000	
Rent	5,000	60,000
Interest and discount		8,00,000
Interest paid on deposits	3,00,000	
Commission and brokerage		70,000
Salaries to the staff	1,50,000	
Interest paid on borrowings	50,000	
Audit Fees	10,000	
Directors Fees	8,000	
Bill discounted	80,000	
Depreciation on Bank's property	13,000	
Printing and Stationery	8,000	
Postage	6,000	
	66,30,000	66,30,000

Adjustments:

a) Provide Rs. 20,000 for doubtful debts.
b) Acceptances and endorsements on behalf of customers amounting to Rs. 4, 00, 000.
c) Provide Rs. 60,000 for taxation reserve.
d) Provide Rs. 1 0,000 on bill discounted but not matured on 31 March 2015

Solution :

Profit and Loss Account for the year ended 31.3…..

Particulars	Schedule No.	Rs.
I) Income		
Income earned	13	7,90,000
Other income	14	1,30,000
Total		9,20,000
II) Expenditure		
Interest expended	15	3,50,000
Operation expenses	16	2,00,000
Provisions and Contingencies		20000
Total		5,70,000
III) Profit/ Loss		

Net Profit/ Loss for the year (I-II)		3,50,000
Profit/ Loss (*) brought forward		0
Total		3,50,000
IV) Appropriations		
Transfer to Statutory Reserves		87500
Taxation Reserve		6000
Balance carried over to Balance Sheet		2,02,500
Total		3,50,000

Schedule 13:Interest Earned	**Rs.**
Interest and discount	8,00,000
Less Rebate on Bills discounted	-10000
	7,90,000
Schedule 14 : Other income	**Rs**
Rent	60,000
Commission	70,000
	1,30,000
Schedule 15 : Interest Expended	**Rs.**
Interest On Deposits	3,00,000
Interest paid on borrowings	50,000
	3,50,000

Schedule 16: Operating Expenses	**Rs.**
Salaries to the staff	1,50,000
Audit Fees	10,000
Directors Fees	8,000
Depreciation on Bank's property	13,000
Printing and Stationary	8,000
Postage	6,000
Rent	5,000
	2,00,000
	2,00,000
Provision for Bad debts	**20000**

Particulars	Schedule No	Rs.
CAPITAL AND LIABILITIES		
Capital	1	20,00,000
Reserves and Surplus	2	10,50,000
Deposits	3	25,00,000
Borrowings	4	5,00,000
Other Liabilities and Provisions	5	10,000
TOTAL `		**60,60,000**

ASSETS		
Cash and Balances with Reserve Bank of India	6	6,50,000
Balance with banks and money at call and short notice	7	17,50,000
Investments	8	9,00,000
Advances	9	20,60,000
Fixed Assets	10	7,00,000
Other Assets	11	0
TOTAL		**60,60,000**
Contingent Liabilities	12	
Bills for collection		

Schedule 1: Share Capital	**Rs.**
Share Capital	20,00,000
	20,00,000
Schedule 2: Reserves and Surplus	**Rs.**
Reserve fund	7,00,000
Taxation Reserve	60,000
Statutory Reserve	87,500
P&L account	2,02,500
	10,50,000
Schedule 3: Deposits	**Rs.**
Fixed deposits	10,00,000
Savings Bank account	10,00,000
Current Account	5,00,000
	25,00,000
Schedule 4: Borrowings	**Rs.**
Borrowings from SBI	5,00,000
	5,00,000
Schedule 5: Other Liabilities	**Rs.**
Rebate on bills discounted	10000
	10,000

Schedule 6: Cash with RBI	**Rs.**
Cash in hand and with RBI	**6,50,000**
Schedule 7: Cash with other banks	**Rs.**
Money at Call	
Money at call and short notice	8,00,000
Cash with other Banks	9,50,000
	17,50,000
Schedule 8: Investments	**Rs.**
Investment in Government Securities	9,00,000
Schedule 9: Advances	**Rs.**
Secured Loans	15,00,000
Cash Credits	5,00,000
Bill discounted	80,000
Less: Provision for doubtful debts	-20,000
	20,60,000
Schedule 10: Fixed Assets	**Rs.**
Premises less depreciation	5,80,000
Furniture less depreciation	1,20,000
	7,00,000
Schedule 11: Other Assets	**Nil**
Schedule 12: Contingent Liabilities	**Rs.**
Acceptance on behalf of customers	**4,00,000**

Problem 9:

The following is the Trial Balance extracted from the books of Vysya Bank. You are required to prepare profit & Loss account and balance sheet as on 31.03.2014 after taking into consideration the adjustments given below :

Particulars	Debit (Rs)	Credit (Rs)
60,000 equity shares of Rs. 10 each		6,00,000
30,000 8% preferential shares of Rs. 10 each		3,00,000
Fixed deposits		3,50,000
Savings Bank account		2,50,000
Current Account		6,00,000
Reserve fund		3,00,000
Interest and Discount		3,00,000
Money at call and short notice	3,00,000	
Cash in hand	3,00,000	
Cash at bank	3,60,000	
Investment in Government securities	1,80,000	
Loans and cash credits	13,48,200	
Furniture	30,000	
Premises	2,52,000	
Interest on Deposits	1,80,000	
Salaries	48,000	
Audit fees	6,000	
Directors fees	3,000	
Depreciation on Bank property	6,000	
Printing and stationery	3,000	
Non-Banking assets	30,000	
Other expenditure	1,800	
Profit and loss Account 1.4.2013		42,000
Unclaimed Dividend		1,20,000
Pension fund		36,000
Borrowings		90,000
Rent		12,000
Commission		48,000

Solution :

Profit and Loss Account for the year ended 31.03.......

Particulars	Schedule No	Rs.
I. **INCOME:**		
Interest earned	13	296000
Other income	14	60000
TOTAL `		**356000**
II. **EXPENDITURE**		
Interest expended	15	180000
Operating expenses	16	67800
Provisions and Contingencies		10000
TOTAL `		**257800**

III. **PROFIT/LOSS**		
Net Profit/Loss for the year (I – II)		98200
Profit/Loss (+) brought forward		42000
TOTAL `		**140200**
IV. **APPROPRIATIONS**		
Transfer to Statutory Reserves Transfer to other Reserves		24550
Balance carried over to Balance Sheet		115650
TOTAL `		**140200**

Schedule 13: Interest Earned	**Rs.**
Interest and Discount	3,00,000
Less: Rebate on Bills discounted	-4000
	2,96,000
Schedule 14: Other Income	**Rs.**
Rent	12,000
Commission	48,000
	60,000
Schedule 15: Interest Expended	**Rs.**
Interest on Deposits	**1,80,000**

Schedule 16: Operating Expenses	**Rs.**
Salaries	48,000
Audit fees	6,000
Directors fees	3,000
Depreciation on Bank property	6,000
Printing and stationery	3,000
Other expenditure	1,800
	67,800
Provision and Contingencies	**Rs.**
Provision for Bad debts	**10000**

Balance Sheet as on 31.03.......

Particulars	**Schedule No**	**Rs.**
CAPITAL AND LIABILITIES		
Capital	1	900000
Reserves and Surplus	2	440200
Deposits	3	1200000
Borrowings	4	90000
Other Liabilities and Provisions	5	160000
TOTAL `		**2790200**
ASSETS		
Cash and Balances with Reserve Bank of India	6	300000
Balance with banks and money at call and short notice	7	660000
Investments	8	180000
Advances	9	1338200
Fixed Assets	10	282000
Other Assets	11	30000
TOTAL `		**2790200**
Contingent Liabilities	12	500000
Bills for collection		480000

Schedule 1: Share Capital	Rs.
Share Capital	6,00,000
8% Preference Share Capital	3,00,000
	9,00,000
Schedule 2: Reserves and Surplus	**Rs.**
Reserve fund	3,00,000
Statutory Reserve	24,550
P&L account	1,15,650
	4,40,200
Schedule 3: Deposits	**Rs.**
Fixed deposits	3,50,000
Savings Bank account	2,50,000
Current Account	6,00,000
	12,00,000
Schedule 4: Borrowings	**Rs.**
Borrowings	90,000
	90,000
Schedule 5: Other Liabilities	**Rs.**
Unclaimed Dividend	1,20,000
Pension fund	36,000
Rebate on bills discounted	4000
	1,60,000

Schedule 6: Cash with RBI	Rs.
Cash in hand	**3,00,000**
Schedule 7: Cash with other banks	**Rs.**
Money at Call	
Money at call and short notice	3,00,000
Cash at bank	3,60,000
	6,60,000
Schedule 8: Investments	**Rs.**
Investment in Government securities	**1,80,000**
Schedule 9: Advances	**Rs.**
Loans and cash credits	13,48,200
Less: Provision for Bad debts	-10000
	13,38,200
Schedule 10: Fixed Assets	**Rs.**
Furniture	30,000
Premises	2,52,000
	2,82,000
Schedule 11: Other Assets	**Rs.**
Non-Banking assets	**30,000**
Schedule 12: Contingent Liabilities	**Rs.**
Acceptance on behalf of customers	**5,00,000**

2.10 UNSOLVED PROBLEMS

Problem 1:

The following financial data extracted from the books of mysore bank limited as on 31.3.2019

Particulars	Rs.
Interest on fixed deposits	55000
Rebate on bills discounted	9800
Interest on loans	51800
commission	1600
Depreciation on bank property	1000
Discount on bills discounted	29200
Interest on cash credit	44600
Directors' fees	600
Postage and telegram	300
Printing and stationery	600
Rant and taxes	3600
Interest on overdraft	30800
Sundry expenses	400
Interest on savings bank deposits	13600

Problem 2:

From the following information prepare profit and loss account of yes bank Ltd. For the year ended 31-3-2019

Particulars	Rs. In crores
Interest on loans	2590
Interest on fixed deposits	2750
commission	82
Rebate on bills discounted	490
Salaries and allowances	540
Discount on bills discounted	1850
Interest on cash credit	2230
Depreciation on bank's property	400
Rent and rates	180
Interest on overdraft	1540
Director's fees	30
Audit fees	50
Interest on savings deposits	680
Postage	14
Printing and stationery	29
Sundry expenses	15

Problem 3:

Prepare a profit and loss account of ABC bank Ltd of the year ended 31.3.2018 from the following

Particulars	Rs.	Rs.
Interest on fixed deposits	162410	
Rebate on bills discounted	29000	
Interest on loans		45000
Commission charged to customers		62500
Establishment	15000	
Discount on bills discounted		89000
Interest on cash credit		24000
Amount charged against current accounts		71500
Directors' Fees	10000	
Audit Fees	20000	
Postage and telegram	2000	
Printing and stationery	4000	
Rent and taxes	22500	
Interest on overdraft		71000
Sundry charges	1500	
Interest on savings bank deposits		

Problem 4:

Prepare a profit and loss account of ABC bank Ltd of the year ended 31.3.2018 from the following

Particulars	Rs.	Rs.
Interest on fixed deposits	162410	
Rebate on bills discounted	29000	
Interest on loans		45000
Commission charged to customers		62500
Establishment	15000	
Discount on bills discounted		89000
Interest on cash credit		24000
Amount charged against current accounts		71500
Directors' Fees	10000	
Audit Fees	20000	
Postage and telegram	2000	
Printing and stationery	4000	
Rent and taxes	22500	
Interest on overdraft		71000
Sundry charges	1500	
Interest on savings bank deposits		

Problem 5:

Prepare a profit and loss account of ABC bank Ltd of the year ended 31.3.2018 from the following

Particulars	Rs.	Rs.
Interest on fixed deposits	162410	
Rebate on bills discounted	29000	
Interest on loans		45000
Commission charged to customers		62500
Establishment	15000	
Discount on bills discounted		89000
Interest on cash credit		24000
Amount charged against current accounts		71500
Directors' Fees	10000	
Audit Fees	20000	
Postage and telegram	2000	

Printing and stationery	4000	
Rent and taxes	22500	
Interest on overdraft		71000
Sundry charges	1500	
Interest on savings bank deposits		

2.11 MCQ's

1. Banks prepare the accounts for

   a. Calander year

   b. Financial year

   c. Cooperative year

   d. Diwali year

   Answer: Financial year

2. As per sec. 17 of the banking regulation act every bank has to transfer of profit to statutory reserve fund account:

   a. 10%

   b. 15%

   c. 20%

   d. 25%

   Answer:25%

3. Banks show the provision for income-tax under the head:

   a. Contingency accounts

   b. Contingent liabilities

   c. Other liabilities and provisions

   d. Borrowing

   Answer: other liabilities and provision

4. The heading other assets does not include:

   a. Silver

   b. Interest accrued

   c. Inter-office adjustment (Dr.)

   d. Gold

   Answer: Gold

5. Income from standard asset is to be recognised on ?

   a. Cash basics

   b. Accrual basics

   Answers: Accrual basics

6. Sub-standard asset in one which has been classified as NPA for a period not exceeding:

   a. 1 year

   b. 2 year

   c. 3 year

   d. 4 year

   Answer: 1 year

7. Doubtfull asset is one which has remained in the sub-standard category for:

   a. 12 months

   b. 18 months

   c. 24 months

   d. 48 months

   Answer: 12 months

8. When income is to be recognised on cash basic, a distinction should be made between:

   a. Performing and non-performing asset

   b. Banking and non-banking asset

   c. Monetary and non-monetary asset

   d. Current and non-current asset

   Answer: performing and non-performing

9. Provision created against loose asset and unsecured doubtfull dept is:

   a. 10%

   b. 20%

   c. 30%

   d. 100%

   Answer: 100%

10. Provision is created for sub-standard asset:

   a. 10%

   b. 15%

   c. 20%

   d. 30%

Answer: 15%

❖❖❖❖

3

ACCOUNTING FOR LIMITED LIABILITYPARTNERSHIP (LLP)

Unit Structure :

3.1 INTRODUCTION

- Governed by LLP Act 2008, The Act came into force for most of its part on 31/03/2009, followed by its rules on 01/04/2009 and the registration of first LLP on 02/04/2009

- It came as a result of the recommendations made by several expert committees like Bhatt Committee of 1972, Naik Committee of 1992, Abid Hussain Committee of 1997, Gupta Committee of 2001, Naresh Chandra Committee of 2003 and the JJ Irani Committeeof 2005.

3.2 FEATURES

- Corporate vehicle with a flexibility of a partnership More suitable for service industry, and small and mid- size enterprises

- Separate legal entity

- Perpetual succession The mutual rights and duties of partners of an LLP is governed by the agreement and if the agreement is silent, it shall be governed by the provisions of theproposed legislation
- Limited liability, no partner would be liable on account of the independent or unauthorized acts of other partners or their misconduct;
- Every LLP shall have at least two partners and shall also have at least two individuals as Designated Partners, of whom at least one shall be residentin India.
- Audit becomes mandatory for those companies whose contribution exceeds 25 lakhs or annual turnover exceeds 40 lakhs. A statement ofaccounts and solvency shall be filed by every LLP with the Registrar every year
- The Central Government has power to investigate the affairs of an LLP, if required, by appointment of competent inspector for the purpose;
- A partnership firm, a private company and an unlisted public company mayconvert themselves to LLP in accordance with provisions of the proposed legislation

3.3 DISTINCTION BETWEEN LLP AND PATERNSHIP:

- LLP is a separate legal entity, it can sue and can be sued
- Limited Liability
- Perpetual succession
- Registration becomes compulsory when it comes to LLP
- Maximum limit on members is not specified
- Registration is much easier when it comes to an LLP
- LLP agreement is like the MOA & AOA
- Change in name/registered office address is simple in LLP
- No mandatory time period for meetings
- Mostly ownership and management be in the hands of the same person when it comes to an LLP
- In case of a company, no individual director can conduct the business of the company but in an LLP, each partner has the authority to do so unless expressly prohibited by the partnership term
- Remuneration to Directors is regulated in companies

- No restriction on borrowing powers
- The LLP can choose to maintain the accounts on cash basis/accrual basis whereas under the Companies Act, accrual method is compulsory.
- Audit becomes compulsory for companies from day one
- Cost audit is not mandatory for an LLP
- CS appointment is not mandatory; However, the annual return of an LLP in Form 11 is to be certified as 'true and correct' by a Company Secretary in practice.

3.4 INCORPORATION OF LIMITED LIABILITY PATERNSHIP

- To be discussed using the e-form FiLLiP
- Any person who makes a false statement during the registration process shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.
- Subject to prior compliance with the requirements of section 11(1) of the Act, section 12(1) mandates the Registrar to register the incorporation document and issue a certificate of incorporation within 14 days.

3.5 REGISTERED OFFICE OF LLP

Notice of change of registered office to be filed with the Registrar within 30 days from the date of the change in LLP -Form 15 prescribed under Rule 17 of the LLP Rules 2009 along with the prescribed fees.

List of documents required to attached with LLP Form 15:

- Consent letter of all DP's
- Consent letter of all Secured Creditors
- Copy of Board Resolution
- Copy of Advertisement – Daily newspaper published in English and in the principle language of the District where the registered office is situated (only if from one state to another)
- Proof of New Registered Office Address (If Rented then Rent Agreement, Utility Bill in the name of Owner & NOC)

3.6 NAME OF LLP

1. Every limited liability partnership shall have either the words "limited liability partnership" or the acronym "LLP" as the last words of its name.

2. Naming guidelines are similar to Companies

3. Name can be reserved through RUN-LLP, one resubmission for 15 daysis allowed, to be filed with the following enclosures

a) Certified copy of consent of all partners involved for the name change;

b) Copy of the existing LLP agreement;

c) Trademark copy or a copy of the registration certificate; Once the name is approved, form LLP-5 has to be filed within 30 days.

After the partners get the new certificate of registration, a supplementary agreement needs to be laid out

3.7 LLP AGREEMENT

- The mutual rights and duties of the partners of a limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and itspartners. – Section 23

- To be filed with the registrar within 30 days from incorporation in form 3

3.8 ALTERATION OF LLP AGREEMENT

To be filed within 30 days from the date of amendment in form 3 along with the following documents

a) Initial LLP Agreement

b) Supplementary/ Altered agreement

c) Optional attachments if any

3.9 PARTNERS AND DESIGNATED PARTNERS

- Any person can be a 'partner'

- Every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

- in case of a limited liability partnership in which all the partners are body corporates, at least two partners shall nominate their respective individuals who are to act as "designated partners" and one of the nominees shall be a resident of India. Vide Circular No. 2/2016 dated 15th January 2016,

WHO CANNOT BECOME A PARTNER:

- He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- he is an undischarged insolvent; or
- he has applied to be adjudicated as an insolvent and his application is pending.

HUF or its Karta cannot become partner or designated partner in LLP

3.10 DISQUALIFICATION OF A DESIGNATED PARTNER

- Has at any time within the preceding five years been adjudged insolvent; or
- Suspends, or has at any time within the preceding five years suspended payment to his creditors and has not at any time within the preceding five years made, a composition with them;
- has been convicted by a Court for any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months; or
- has been convicted by a Court for an offence involving section 30 of the Act.

LIABILITIES OF DESIGNATED PARTNER:

- The designated partner would be liable to all penalties imposed on the LLP for the contravention ofthe provisions of the Act and as such the designated partner would be required to pay all the monetary fines imposed on the LLP. There is no provision in theAct providing for the reimbursement of such monetary penalties to him by the LLP.

OBLIGATION OF PARTNER:

- All partners, are agents of the LLP, but not of otherpartners.
- LLP shall not be liable for the omissions/mistakesof its partners if that partner is not properly authorized to carry on that activity
- Liabilities of the LLP shall be met only with theproperties of the LLP

LLP FOR THE PROFESSIONALS:

- To insulate them from third party claims against professional negligence or deficiency
- Cross section of the professional may cometogether under a banner
- Solution under one roof for clients
- Helps to grow in heavy competition

VALUATION OF CAPITAL CONTRIBUTION:

- If other than cash is given as contribution, it shall be valued by a practicing Chartered Accountant or by a practicing Cost Accountant or by approved valuer from the panel maintained by the Central Government.

FOREIGN LIMITED LIABILITY PATERNSHIP:

- Should file within 30 days of establishing a place ofbusiness in India to the respective Registrar in Form 27 – Form 27 to be discussed using the e- form
- FDI in LLP

INVESTIGATION OF THE AFFAIRS OF LIMITED LIABILITY PATERNSHIP (SECTION 43):

As per Section 43, the Central Government may appoint one or more competent persons as inspectors to investigate

- if not less than one-fifth of the total number of partners of the limited liability partnership make an application along with supporting evidence and security amount as may be prescribed; or
- if the limited liability partnership makes an application that the affairs of the limited liability partnership oughtto be investigated; or if, in the opinion of the Central Government, there are circumstances suggesting—

a) that the business of the limited liability partnership is being or has been conducted with an intent to defraud its creditors, partners or any other person, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive or unfairly prejudicial to some or any of its partners, or that the limitedliability partnership was formed for any fraudulent or unlawful purpose; or

b) that the affairs of the limited liability partnership are not being conducted in accordance with the provisions of this Act; or

c) that, on receipt of a report of the Registrar or any other investigating or regulatory agency, there are sufficient reasons that the affairs of the limited liability partnership ought to be investigated.

ANNUAL COMPLIANCES OF LLP:

- Annual returns are filed in Form 11 - within 60 daysof the closure of the financial year (i.e.,3oth May every year). In case the annual turnover of the LLP crosses Rs 5 crores or the Capital contribution from Partners exceeds more than Rs 50 Lakhs the Annual return should be accompanied by a Certificate from Practising Company Secretary.

- Statement of Solvency in Form 8 – before 30th of October every year – Penalty Rs.100 per day

CONVERSION OF COMPANY INTO LLP:

- Any existing private company or existing unlisted public company can be converted into LLP by complying with the Provisions of clause 58 and Schedule III and IV of the LLP Act.

- Form 18 needs to be filed with the registrar along with Form 2 for such conversion after getting the name approved

- Once approved file form 3 From 18 to have the following attachments

- Statement of shareholders.

- Incorporation Documents & Subscribers Statements in Form 2 filed electronically.

- Statement of Assets and Liabilities of the company duly certified as true

- List of all the Secured creditors along with their consent to the conversion.

- Approval of the governing council (In case of professional private limited companies)

- NOC from Income Tax authorities and Copy of acknowledgement of latest income tax return.

- Approval from any other body/authority as may be required.

- Particulars of pending proceedings from any court/Tribunal etc.

- An LLP can be converted into a Pvt. Ltd. company as per the provisions contained in Section 366 of the Companies Act, 2013,

- Prerequisites for conversion

- an LLP must have at least 7 partners (however as per Companies Amendment Act, 2017 LLP with 2 partners can be convert into Company),

- approval from all the partners is required,
- advertisement in newspaper is to be done in a local and a national newspaper, Apply for name and file form URC-1

STRIKE OFF:

- In case of an existing LLP which is not carrying on any business or operation for a period of one year or more make an application in form 24 on voluntary basis
- STRIKE OFF BY ROC SUO MOTU: - Same as it is applicable to a company – 2 Continuous years

RESTORATION OF THE LLP:

Application to be made to NCLT in form NCLT -9 by any one of the following persons

1. LLP
2. Partner or
3. Creditor

Copy of the application to be sent to the concern ROC get their opinion also

3.11 WINDING UP BY TRIBUNAL

A limited liability partnership may be wound up by the Tribunal—

- if the limited liability partnership decides that limited liability partnership be wound up by the Tribunal;
- if, for a period of more than six months, the number of partners of the limited liability partnership is reduced below two;
- if the limited liability partnership is unable to pay its debts;
- if the limited liability partnership has acted against the interests of the sovereignty and integrity of India, the security of the State or public order;
- if the limited liability partnership has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years; or

if the Tribunal is of the opinion that it is just and equitable that the limited liability partnership be wound up.

3.12 SOLVED PROBLEM

Q1 Ramesh & Mahesh are Partners sharing Profits & losses 2:1 Following is the Trial Balance an on 31-03-2015

Particular	Dr	Cr
Land and Building	55000	
Machinery	40000	
Salary and Wages	21000	
Cash at Bank	40000	
Cash in hand	1100	
Motor Van	20000	
Office Expenses	1000	
Ramesh's Capital		116000
Mahesh's Capital		62000
Carriage	2000	
Purchases	220000	
Return outward		5500
Sales		280000
Return inward	2000	
Bad debts	1000	
Debtors	32800	
Creditors		20000
Rent	1100	
Bills Payable		35000
Travelling Expenses	7000	
Stock (1-4-2014)	30000	
Insurance	1500	
Discount	8000	
Advertisement	12000	
Furniture	20000	
Total	518500	518500

Adjustments:

1. On 31-3-2015 the cost price of closing stock was Rs 41000 and its market price was Rs 42000
2. Goods worth Rs 5000 taken over by Ramesh for personal use were not entered in the books of accounts.
3. Goods worth Rs 5000 were destroyed by fire and Insurance Co agreed to pay 4,000 in full settlement of the claim
4. Outstanding expenses Rent 100 and Salary Rs 500
5. Provide depreciation 10% on machinery and 5% on furniture
6. Provide Rs 800 for Reserve for doubtful debts on debtor

You are required to prepare Trading and Profit and Loss Account for the year ending 31-3-2015 and the Balance Sheet as on that date after considering the abov adjustments

SOL :-

Statement of Income & Expenditure of Ramesh & Mahesh LLP For the period from 1-04-2014 to 31-03-2015

Particular	**Amt**	**Amt**	**Amt**
I INCOME			
1.Turnover			
Gross	280000		
Less: Returns Inward	(2000)	278000	
2.Other Income (specify)			
Goods lost by Fire		5000	
Goods taken by Partner		5000	
3. Increase/(Decrease) in Stocks			
Closing Stocks	41000		
Less: Opening Stocks	(30000)	11000	
TOTAL INCOME			299000
II EXPENSES			
Purchases			
Gross	220000		
Less: Returns Outward	(5500)	214500	
2. Personnel Expenses			
Salaries & Wages	21000		
Add: Outstanding	500	21500	
3. Administrative Expenses			
Office Expenses		1000	
Rent	1100		
Add: Outstanding	100	1200	
General Expenses			
4. Insurance		1500	
5.Selling Expenses			
Carriage		5000	
Bad Debts		1000	
Travelling		7000	
Discount		8000	
Advertisement		12000	
6. Depreciation			
Machinery (10% of 40,000)	4000		
Furniture (5% of 20,000)	1000	5000	
7. Interest		NIL	
8. Interest Other Expenses (to specify)			
Reserve for D. D.		800	
Loss by Fire (5,000 - 4,000)		1000	
TOTAL EXPENSES			279500
III. Profit/(Loss) before Taxes			19500
IV. Provision for Tax			NIL
V. Profit/(Loss) after Tax			
VI.Profit/(Loss) transferred to Partners' Account			19500
Ramesh (2/3)	13000		
Mahesh (1/3)	6500		
Profit transferred to Reserves and Surplus			19500
			NIL

Particular		Amt.	Amt.
I.CONTRIBUTION AND LIABILITIES			
1. Partners Funds			
(a) Contribution			
Ramesh :			
Balance b/d	116000		
Add Net Profit	13000		
	129000		
Less Goods taken	(5000)	124000	
Mahesh:			
Balance b/d	62000		
Add: Net Profit	6500	68500	
(b) Reserves and Surplus		NIL	192500
2. Liabilities			
(a) Secured Loans		NIL	
(b) Unsecured Loans		NIL	
(c) Short term Borrowings		NIL	
(d) Creditors/Trade Payables		NIL	
Sundry Creditors	20000		
Bills Payable	35000		
Salary Outstanding	500		
Rent Outstanding	100	55600	
(e) Other Liabilities (to specify)		NIL	
(f) Provisions		NIL	
			55600
TOTAL			248100
II.ASSETS			
(a) Fixed Assets			
Land & Building		55000	
Motor Vans		2000	
Machinery	40000		
Less: Depreciation	(4000)	36000	
Furniture	20000		
Less: Depreciation	(1000)	19000	130000
(b) Investments			NIL
(c)Loans and Advances			
Insurance Claim Receivable			4000
(d) Inventories			41000
(e)Debtors/Trade Receivables			
Debtors	32800		
Less Reserve for D.D.	(800)		32000
(f) Cash and Cash Equivalents			
Cash in Hand		1100	
Cash at Bank		40000	41000
(g) Other Assets (to specify)			NIL
TOTAL			248100

Statement of Assets & Liabilities of Ramesh & Mahesh LLP 31.03.2015

Problem no 2

From the following trial balance of x co a limited liability partnership and the other information given below prepare the statement of income and expenditure for the year ending 31.03.2016 and the statement of assets and liabilities as on 31.03.2016

No	Name of Accounts	dr	Cr
1	Partner contribution		1000000
2	General reserve		120000
3	Mortgage loan from bank on building		80000
4	Unsecured loan		60000
5	Trade payable		84000
6	Turnover (sale)		2460000
7	Excise duty on turnover	60000	
8	Interest from bank & on investment		30000
9	Opening stock (on 1.04.2015)	200000	
10	Purchases	1310000	
11	Purchases returns		30000
12	Salaries and wages	364000	
13	Rent and rates	148000	
14	Printing and stationery	6000	
15	Postage and telephone charges	12000	
16	Light charges	24000	
17	Advertisement	20000	
18	Carriage on sales	8000	
19	Interest on loans	58000	
20	Building	600000	
21	Furniture and fitting	240000	
22	Investments in govt securities	140000	
23	Trade receivable	160000	
24	Cash in hand	94000	
25	Cash at bank	420000	
		3864000	3864000

Other information

A. closing stock on 31.03.2016 was valued at RS 250000
B. unpaid salaries and wages were RS 4000 and outstanding interest amounted to RS 12000
C. Depreciate building by 5% and furniture and fittings by 10%
D. make provision for bad and doubtful debts at RS 10000
E. make provision for income tax RS 80000

Sol

Statement of Income & Expenditure

For the year ending 31.03.2016

Particular	RS	RS
1 Income:		
A] Turnover (Sale)	2460000	
B] Less : Excise Duty	60000	2400000
C] Other Income :		
Interest From Bank And Investments		30000
D] Increase In Closing Stock (I.E. Closing Stock)		
250000- 200000 Opening Stock)		50000
Gross Income		2480000
2 Expenses:		
A] Purchases	1310000	
Less: Returns	30000	1280000
B] Personal Expenses;		
Salaries & Wages	364000	
Add: Unpaid Amount	4000	368000
C] Administrative Expenses;		
Rent & Rates	148000	
Printing & Stationary	6000	
Postage & Telephone Charges	12000	
Light Charges	24000	190000
D] Selling Expenses		
Advertisement	20000	
Carriage On Sales	8000	28000
E] Depreciation On:		
Building (I.E. 5% On 600000)	30000	
Furniture & Fitting (I.E. 10%)	24000	54000
F] Interest On Loans	58000	
Add: Outstanding	12000	70000
G] Other Expenses:		
Provision For Bad & Doubtful Debts		10000
Profit Before Tax		480000

H] Provision For Income Tax		80000
Profit After Tax		400000
I] Profit Taken To Statement Of Asset And Liabilities Balance		400000

Statement of assets and liabilities

Of X & co LLP as 31.03.2016

Particular	RS	RS
1] contribution & Liabilities		
A] Partners funds		
As per last Balance sheet		1000000
B] general reserve		
As par last balance sheet		120000
Profit during the year		400000
2] liabilities		
A] secured loans		
From bank		80000
B] unsecured loans		
From others		60000
C] trade payables		84000
D] other liabilities		
Interest on loan outstanding	12000	
Unpaid salary and wages	4000	16000
E] other liabilities		
F] provision for income tax		80000
TOTAL		1840000
ASSETS		
A] Fixed Assets		
Building	600000	
Less: Dept (At 5%-	30000	580000
Furniture And Fittings	240000	
Less : Dep. (10%)	24000	260000
B] Investment		140000
C] Loans And Advance		
D] Inventories (Closing Stock)		250000
E] Trade Receivables	160000	

Less: Provision For Bad And Doubtful Debts	10000	150000
F] Cash And Cash Equivalents		
Cash In Hand	94000	
Cash At Bank	420000	514000
G] Other Assets		
Total		1840000

Q3 Mr. Andyand Mr. Ben were partners sharing profit & losses in the ratio 3:2

The following is the Trial Balance of AB (LLP) for year ended 31st March 2020.

Particulars	**Debit**	**Credit**
Stock on 01-04-2019	75,000	
Purchase	12,50,000	
Sales	21,45,000	
Capital of Mr. Andy		300,000
Capital of Mr. Ben		200,000
Drawings of Mr. Andy	30,000	
Drawings of Mr. Ben	20,000	
Returns inwards	12,500	
Returns outwards		15,200
Wages (Productive)	5,600	
Wages (Unproductive)	3,500	
Salaries	12,000	
Rent, rates and taxes	4,800	
Discount Allowed	2,400	
Discount Received		4,200
Machinery	360,000	
Buildings	850,000	
Cash	4,500	
Bank Overdraft		4,100
Sundry Debtors	245,000	
Sundry Creditors		206,800
Total	2,875,300	2,875,300

Additional information:-

1 Outstanding Unproductive wages were Rs. 4,000

2 Prepaid rent is Rs800

3 Closing stock on 31st March 2020 was Rs. 72,000

4 Depreciate Building by 5% and Machinery by10%You are required to prepare for the year ended 31st March 2020

Statement of Income and Expenditure and balance sheet from the given data

Sol :

STATEMENT OF ASSETS & LIABILITIES

Of AB (LLP) as on 31st March 2020

Particulars	Sch.No.	Rs.	Rs.
CONTRIBUTIONS & LIABILITIES			
CONTRIBUTIONS			
Partners fund	1	1,238,900	
Reserves	2	Nil	1,238,900
LIABILITIES			
Secured loans	3	Nil	
Unsecured loans	4	Nil	
Short Term Borrowings	5	4,100	
Creditors & Trade Payables	6	210,800	
Other Liabilities	7	Nil	
Provisions	8	Nil	214900
Total			1,453,800
ASSETS			
Fixed Assets	9		1,131,500
Investments	10		Nil
Loans & Advances	11		800
Inventories	12		72,000
Debtors &Trade Receivables	13		245,000
Cash & Cash Equivalents	14		4,500
Other Assets	15		nil
Total			1,453,800

STATEMENT OF INCOME & EXPENDITURE Of AB (LLP)

for the period 1st April 2019 to 31st March 2020

Particulars	Sch.No.	Rs.	Rs.
INCOME			
Turnover	16	2,132,500	
OtherIncome	17	4,200	
Increase/Decrease in Stock	18	-3,000	2,133,700
EXPENSES			

Purchases & Direct Expenses	19	1,234,800	
Personnel Expenses	20	25,100	
Administrative Expenses	21	4,000	
Selling Expenses	22	Nil	
Depreciation	23	78,500	
Interest	24	Nil	
Other Expenses	25	2,400	1,344,800
Net Profit before Tax			788,900
Less:-Provision for Tax			-
Net Profit after Tax			788,900
Transfer to partners (PSR 3:2)			
Mr.Andy's Capital a/c		473340	
Mr. Ben's Capital a/c		315560	788900
Transfer to Reserves			0

Notes / Schedules to accounts

Sch.No	Particulars	Rs.	Rs.	Rs.
	CONTRIBUTIONS & LIABILITIES			
	CONTRIBUTIONS			
1	Partners fund			
	Capital Balance of Mr. Andy	300,000		
	(+) Net profit of the year	473,340		
	(-) Drawings	- 30,000	743,340	
	Capital balance of Mr Ben	200,000		
	Netprofit of the year	315,560		
	(-) Drawings	- 20,000	495,560	
	Total Partners Fund			1,238,900
2	Reserves			Nil
3	Secured loans			Nil
4	Unsecured loans			Nil
5	Short Term Borrowings			

	Bank Overdraft			4,100
6	Creditors & Trade Payables		206,800	
	Outstanding wages		4,000	210,800
7	Other Liabilities			Nil
8	Provisions			Nil
	ASSETS			
9	Fixed Assets Machinery	360,000		
	(-) Depreciation @10%	36,000	324,000	
	Buildings	850,000		
	(-) Depreciation @5%	42,500	807,500	1,131,500
10	Investments			Nil
11	Loans & Advances			
	Prepaid Rent			800
12	Inventories			
	Closingstock			72,000
13	Debtors & Trade Receivables			
	Sundry Debtors			245,000
14	Cash & Cash Equivalents			
	Cash			4,500
15	Other Assets			Nil

Sch.No.	Particulars	Rs.	Rs.
16	INCOME		
	Turnover		
	Gross Sales	2,145,000	
	(-) Return Inwards	- 12,500	2,132,500
17	Other Income		

	Discount Received		4,200
18	Increase/Decrease in Stock		
	Closing Stock	72,000	
	(-) Opening Stock	- 75,000	- 3,000
	EXPENSES		
19	Purchases & Direct Exp	1,250,000	
	(-) Return Outwards	- 15,200	1,234,800
20	Personnel Expenses		
	Wages (Productive)	5,600	
	(+) Outstanding wages	4,000	
		9,600	
	Wages (Unproductive)	3,500	
	Salaries	12,000	34,700
21	Administrative Expenses		
	Rent, rates and taxes	4,800	
	(-) Prepaid rent	800	4,000
22	Selling Expenses		Nil
23	Depreciation		
	on machinery	36,000	
	on building	42,500	78,500
24	Interest		Nil
25	Other Expenses		
	Discount Allowed		2,400

Q4 Mr. Jack and Mr. Ken were partners sharing profit & losses in the ratio: 3:2

The following is the Trial Balance of JK (LLP) foryear ended 31st March 2020.

Particulars		**Debit**	**Credit**
ReserveFund			2,000
Bills payable			1,200
Returns Outwards			2,100
Reserve for doubtful debts			1,600
Creditors			19,400
Sales			315,000
Machinery		90000	
Office Rent		2,500	
Discount		3,200	
Bad debts		2,150	
Wages and salaries		8,900	
Investment in Debentures		6,000	
Cash balance		2,400	
Purchases		197,800	
Bank overdraft			4,100
Capital of Mr. Jack			64,500
Capital of Mr. Ken			48,700
Opening Stock		42,500	
Royalties		3,410	
Loanfrom Mrs. Ken			4,500
Trademarks		12,500	
Unpaid general expenses			3,210
Travelling expenses		2,150	
Printing and stationery		3,500	
Debtors		53,100	
Drawings of Mr. Jack		22,500	
Drawings of Mr. Ken		18,700	
Bank Loan			5,000
		471,310	471,310

Additional information:-

1 Jack to get a commission of 1% on Net sales

2 Revalue Machinery to Rs. 85,000

3 Unpaid expenses were Rs. 2,000 for Salary

4 Rent is paid for two months in advance

5 New bad debts are Rs. 1,200. Maintain RDD @5% on Debtors

6 Closing stock is valued at Rs. 38,500 whereas the cost price was Rs. 35,800

Sol

STATEMENT OF ASSETS & LIABILITIES

Of JK(LLP) as on 31st March 2020

Particulars	**Sch.N**	**Rs.**	**Rs.**
CONTRIBUTIONS & LIABILITIES			
CONTRIBUTIONS			
Partners fund	1	149,952	
Reserves	2	2,000	151,952
LIABILITIES			
Secured loans	3	5,000	
Unsecured loans	4	4,500	
Short Term Borrowings	5	4,100	
Creditors & Trade Payables	6	25,810	
Other Liabilities	7	0	
Provisions	8	0	39,410
Total			191,362
ASSETS			
Fixed Assets	9		97500
Investments	10		6000
Loans &Advances	11		357
Inventories	12		35800
Debtors &Trade Receivables	13		49305
Cash & Cash Equivalents	14		2400
Other Assets	15		0
			191362

STATEMENT OF INCOME & EXPENDITURE

Of JK (LLP) for the period 1stApril 2019 to 31st March 2020

Particulars	**Sch.No.**	**Rs.**	**Rs.**
INCOME			
Turnover	16	315,000	
Other Income	17	-	
Increase/Decrease in Stock	18	-6,700	308,300
EXPENSES			
Purchases & Direct	19	199,110	
Personnel Expenses	20	10,900	

Administrative Expenses	21	5,643	
Selling Expenses	22	8,700	
Depreciation	23	5,000	
Interest	24	-	
Other Expenses	25	4,145	233,498
Net Profit before Tax			74,802
Less:- Provisionfor Tax			-
Net Profitafter Tax			74,802
Transfer to partners (PSR 3:2)			
Mr. Jack's Capital a/c		44,881	
Mr. Ken's Capital a/c		29,921	74,802
Transfer to Reserves			-

Q5 Mr. G, Mr. H and Mr. Iwere partners sharing profit & losses in the ratio 2:2:1 the following is the Trial Balance of GHI (LLP) for year ended 31stMarch 2020.

Particulars	**Debit**	**Credit**
Goodwill	22000	
Patents	15000	
Copyrights	8000	
Salary and Wages	24500	
Machinery	32800	
Vehicle	12500	
Cash in Hand	3300	
ICICI Bank Balance (current A/C)	6200	
FD with ICICI bank	2000	
Freight	200	
Freight inwards	1040	
Freight outwards	2100	
Purchases and Sales	87240	138200
Returns	1250	2100
Billls Payable / Receivable	3920	2390
Debtors / Creditors	23820	12470
Bad debts	200	
Rent, rates and taxes	2100	
Mr.G's Capital		45200
Mr.H's Capital		44850
Mr.I's Capital		31200
Travelling expenses	8250	
Opening Stock	11200	
Discount		810
Advertisement (for 2 years)	1600	
MutualFunds	8000	
	277220	277220

Additional information:-

1 Closing stock on 31st March was valued at Rs. 16,500

2 Goods worth Rs. 12,000 weresold on 27th March for which no entrywas passed in the books of accounts

3 Depreciate Vehicles by15% and Machinery by10%

4 Unpaid expenses were Rs. 1,200 for Rent and Rs. 2,400 for Salary

5 Income from Mutual Funds was Rs. 2,000 reinvested, not recordedinthe books of accounts

6 Advertisement contract was taken on 1st October 2019You are requiredto prepare for the year ended 31stMarch 2020

Statement of Income and Expenditure & Balance sheet from the given data

Sol

STATEMENT OF ASSETS & LIABILITIES of GHI (LLP) as on 31st March 2022

Particulars	Sch.No.	Rs.	Rs.
CONTRIBUTIONS & LIABILITIES			
CONTRIBUTIONS			
Partners fund	1	149,225	
Reserves	2	-	149,225
LIABILITIES			
Secured loans	3	-	
Unsecured loans	4	-	
Short Term Borrowings	5	-	
Creditors &Trade Payables	6	14,860	
Other Liabilities	7	-	
Provisions	8	-	14,860
Total liabilities			164,085
ASSETS			
Fixed Assets	9		85,145
Investments	10		12,000
Loans & Advanvces	11		1,200
Inventories	12		16,500

Debtors &Trade	13		39,740
Cash & Cash Equivalents	14		9,500
Other Assets	15		-
Total assets			164,085

STATEMENT OF INCOME & EXPENDITURE of GHI (LLP) for the period 1stApril 2019 to 31st March 2020

Particulars	Sch.No.	Rs.	Rs.
INCOME			
Turnover	16	148,950	
Other Income	17	2,810	
Increase/Decrease in Stock	18	5,300	157,060
EXPENSES			
Purchses & Direct Expenses	19	86,380	
Personnel Expenses	20	24,500	
Administrative Expenses	21	2,100	
Selling Expenses	22	10,950	
Depreciation	23	5,155	
Interest	24	-	
Other Expenses	25	-	129,085
Net Profit before Tax			27,975
Less:-Provision for Tax			-
Net Profit after Tax			27,975
Transfer to partners (PSR			
Mr.G's Capital a/c		11,190	
Mr,H's Capital a/c		11,190	
Mr.I's Capital a/c		5,595	27,975
Transfer to Reserves			-

NOTES / SCHEDULES TO ACCOUNTS

Particulars	Sch.No.	Rs.	Rs.	Rs.
CONTRIBUTIONS & LIABILITIES				
CONTRIBUTIONS				
Partners fund	1			
Capital Balance of Mr. G		45,200		
(+) Netprofit ofthe year		11,190	56,390	
Capital Balance of Mr. H		44,850		
(+) Netprofit ofthe year		11,190	56,040	
Capital Balance of Mr. I		31,200		
(+) Netprofit of the year		5,595	36,795	
Reserves	2		-	149225
LIABILITIES				
Secured loans	3		-	-
Unsecured loans	4		-	-
Short Term Borrowings	5		-	-
Creditors &Trade Payables	6			
Bills Payable / Receivable			2,390	
Creditors			12,470	14860
Other Liabilities	7			-
Provisions	8			-
ASSETS				
Fixed Assets	9			
Goodwill			22,000	
Patents			15,000	
Copyrights			8,000	
Machinery		32,800		
(-) Depreciation @10%		- 3,280	29,520	
Vehicle		12,500		
(-) Depreciation @15%		-		85145

		1,875	10,625	
Investments	10			
FD with ICICI bank			2,000	
Mutual Funds		8,000		
(+) Income from Mutual Funds		2,000	10,000	12000
Loans &Advances	11			
Prepaid Advertising expenses				1200
Inventories	12			
Closing Stock				16500
Debtors &Trade Receivables	13			
Debtors			23,820	
Bills Receivables			3,920	
(+) Unrecorded Sales			12,000	39740
Cash & Cash Equivalents	14			
Cash in Hand			3,300	
Cash & Cash Equivalents			6,200	9500
Other Assets	15			0

Q6.From the following Trial Balance of Sona and Mona, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March 2015 and the Balance Sheet as on that date, after taking into the consideration the additional information

Trial Balance as on 31st Mar 2015

Particular	Dr	Cr
Opening Stock	17,500	
Salaries and Wages	4,600	
Cash in hand	5,000	
Purchases and Sales	112,600	165,000

Office expenses	4,300	
Productive wages	7,000	
Bills receivable	4,000	
Legal expenses	1,500	
Bad debts	500	
Works Manager's Salary	3,000	
Commission	1,500	2,400
Investments	10,000	
Debtors and Creditors	20,000	10,000
Bank Overdraft		5,000
Patents	4,000	
Loose Tools	3,000	
Furniture	6,000	
Goodwill	6,500	
Interest on investment		3,600
Land and Building	25,000	
Capital Accounts:		
Sona		30,000
Mona		20,000
	236,000	236,000

Adjustments :

1. Partners share Profits and Losses in their capital ratio.
2. The Closing Stock - Cost 20,000 Market Value 22,500
3. Sona has withdrawn goods worth rs 600 for his personal use.
4. Uninsured goods worth rs 5,000 were destroyed by fire.
5. rs 225 written off as bad debts from debtors.
6. Outstanding salaries and wages rs 400,
7. Depreciation on Land and Building at 7 1/2 %

Sol

Statement of income & Expenditure of sona & mona LLP
For the period from 1/04/2014 to 31/03/2015

Particular	Amt	Amt	
I.INCOME			
1.Turnover		165,000	
2.Other Income (specify)			
Goods withdrawn by Sona	600		
Commission	2,400		
Interest on Investments	3,600	6,600	
3. Increase/(Decrease) in Stocks			
Closing Stocks	20,000		
Less Opening Stocks	-17,500	2,500	
TOTAL INCOME			174,100
II.EXPENSES			
1. Purchases		112,600	
2. Personnel Expenses			
Productive Wages	7,000		
Salaries & Wages	4,600		
Add: Outstanding	400		
Works Manager's Salary	3,000	15,000	
3. Administrative Expenses			
Office Expenses	4,300		
Legal Expenses	1,500	5,800	
4. Selling Expenses			
Bad Debts	500		

Add: Additional Bad Debts	225		
Commission	1,500	2,225	
5. Depreciation			
Land & Building		1,875	
6. Interest		Nil	
7. Other Expenses (to specify		Nil	
TOTAL EXPENSES			137,500
III. Profit before Taxes			36,600
IV. Provision for Tax			Nil
V. Profit after Tax			36,600
VI. Profit transferred to Partners' Account			
Sona (3/5)		21,960	
Mona (2/5)		14,640	36,600
VII Profit transferred to Reserves and Surplus			-

Statement of Assets & Liabilities of Sona & Mona LLP as on 31/03/2015

Particular		**Amt**	**Amt**
CONTRIBUTION AND LIABILITIES			
Partner fund			
(a) Contribution			
Sona			
Balance b/d	30,000		
Add: Net Profit	21,960		
	51,960		
Less: Drawings	-600	51,360	
Mona			
: Balance b/d	20,000		
Add: Net Profit	14,640	34,640	86,000
(b) Reserves and Surplus			NIL

2. Liabilities			
(a) Secured Loans		NIL	
(b) Unsecured Loans		NIL	
c)Short term Borrowings			
Bank Overdraft		5,000	
(d)Creditors/Trade Payables			
Sundry Creditors	10,000		
Wages Outstanding	400	10,400	
(e)Other Liabilities (to specify)		NIL	
(f) Provisions		NIL	
			15,400
TOTAL			101,400
11. ASSETS			
(a)Fixed Assets		-	
(i) Intangible			
Goodwill		6,500	
Patents		4,000	
(ii)Tangible			
Land & Building	25,000		
Less Depreciation	1,875	23,125	
Furniture		6,000	
Loose Tools		3,000	42,625
		-	
(b)Investments			10,000
(c) Loans and advances			NIL
(d)Inventories			20,000
(e) Debtors/Trade Receivables			
Debtors		20,000	
Less Bad Debts		225	19,775
Bills receivables			4,000
(f) Cash and Cash Equivalents			
Cash in Hand			5,000
(g) Other Assets (to specify)			NIL
TOTAL			101,400

3.13 UNSOLVED PROBLEM

Q1 P and Q were partners sharing profit & losses in the ratio 3:2 respectively

The following is the Trial Balance of PQ (LLP)for year ended 31st March 2020.

Particulars	Debit	Credit
Goodwill	25,000	
Plant and Machinery	124,000	
Bills Receivable	1,300	
Carriage	400	
Miscellaneous expenses	8,600	
Lighting and Power	5,600	
Sundry Customers	45,600	
Trade expenses	2,150	
Commission on sales	3,120	
10% Loan from Mr. Joshi (1st October 19)		
Vehicles	30,000	
Salaries	6,000	
Bonus to employees	1,500	
Rent		4,500
Discount	2,100	3,200
Cash balance	18,200	
Bank Overdraft		5,900
Units of Mutual Funds	4,600	
GOIT-Bills	2,500	
Capital of P		45,000
Capital of Q		30,000
Drawings of P	5,000	
Drawings of Q	6,000	
Inventories	12,500	
Sundry Suppliers		42,700
Purchases	165,000	
Sales		322,87
	469,170 -	469,170

Additional information:-

1 Closing stock was valued at cost Rs. 22,800 and market price Rs. 28,200

2 Lighting and Power included a deposit paid to Power board Rs. 500

3 Depreciate fixed assets by10%

4 Income from Mutual funds not received yet Rs. 600

5 Goods worth Rs. 4,200 purchsed on 31-03-2020 were not recorded.

6 Bills receivable include a dishonoured bill of Rs. 200You are required to prepare for the year ended 31st March 2020

Statement of Income and Expenditure & Balance sheet from the given data

Q2 Changu and Mangu are partners sharing profits and losses equally. From the following Trial Balance and adjustments you are required to prepare a Trading A/c, Profit and Loss A/c for the year ended on 31st March, 2015 and Balance Sheet as on that date

Trial Balance as on 31-03-2015

Debit Balance	Amt	Credit Balance	Amt
Carriage	2000	Capitals :	
Opening Stock	30760	Changu	60000
Salary	4000	Mangu	40000
Wages	1000	Commission	4000
Discount	500	Interest	4200
Interest	750	Sales	92000
Motive Power	4500	Purchase Return	3800
Motor Van	28000	Sundry Creditors	27400
Bad Debts	1920	Outstanding Salary	400
Building	34000		
Debtors	20000		
Cash at Bank	16120		
Machinery	10000		
Investment	12000		
Purchases	60250		
Drawings:			
Changu	2800		
Mangu	3200		
Total	213800		213800

Adjustments:

1. Outstanding wages Rs 400.
2. Provide depreciation at 10% p.a. on Building and Motor Van.
3. Accrued interest on investment Rs360.
4. Provide 5% RBDD on Debtors
5. Stock at 31st March, 2015 was Market Value 40,000; Cost Price 50,000

Q3. Following is the Trial Balance of Rohit and Sweety. They share profit and losses in the proportion 32 From the following balances and adjustments, prepare Trading and Profit and Loss A/c for the year ending 31st March 2015 and Balance Sheet on that date

Trial Balance

Particular	Dr	Cr
Stock on 1-4-2014	45000	
Purchases and Sales	112500	187500
Drawings:		
Sona	16500	
Mona	15000	
Returns	3600	1500
Wages:		
Productive	5250	
Unproductive	900	
Salaries	9300	
Rent, Rates, Insurance	5100	
Bad Debts	600	
Discount	1950	1500
Machinery	22500	
Building	54300	
Sundry Debtors and Creditors	76500	45000
Cash	1500	
Capitals:		
Rohit		52500
Sweety		67500
Bank overdraft		15000
	370500	370500

Adjustments

1. On 31st March 2015 the stock was valued at 28,000.
2. Outstanding productive wages 300
3. Rent. Rates and Insurance include 800 paid for one year ending on 30th June, 2015
4. Provide for doubtful debts on debtors at 5%
5. Depreciate Building by 5% and Machinery by 10%
6. Goods worth Rs 1250 were distributed as free samples for which no record has been made in the books

Q4 D and R partner sharing Profits and Losses equally in LLP From the following Trial Balance of the firm prepare Income Statement and balance sheet as on 31st mar 2015

Particular	amt	particular	amt
Stock	20000	Capital Accounts:	
Purchases	130000	D	15000
Sales Returns	700	R	15000
Debtors	20000	Commission	1000
Wages	6000	Rent	1000
Royalties	1000	Miscellaneous Income	2000
Furniture	5000	Sales	170500
Machinery	30000	Purchase	3200
Advertisement for 4 years	4000	ReturnCommission	
Salaries	3000	Provident Fund	300
Provident Fund Investment	2000	Interest on Provident	2000
Contribution to Provident	500	Fund	
Fund	500	Investment	200
Insurance	3000	Reserve for Doubtful	
Cash		Debts	500
Drawings:	3500	Creditors	20000
D	1500		
R			
	230700		230700

Adjustment

1. Closing stock price rs 25000 market price rs 30000
2. D has taken goods worth rs 500 for his personal loans
3. Prepaid Insurance amounted to rs 100
4. Depreciate furniture by 15% & machinery by 20%
5. Write off rs 400 as bad debts and maintains the reserve for doubtfull debts at 3% on debtors

Q5 Given below is the Trial Balance of M/s Jay and Vijay (LLP) on 31st March, 2015. They divide profits and losses as 3:2 respectively.

From the following Trial Balance and additional information, prepare Profit and Loss Account for the year ended 31st March, 2015 and the Balance Sheet as on that date:

Particular	Dr	Cr
Stock (1-4-2014)	30000	
Purchases and Sales	75000	125000
Drawings:		
Jay	11000	
Vijay	10000	
Returns	2400	1000
Sundry Expenses	600	
Wages	3500	
Salaries	5600	
Travelling Expenses	600	
Advertisement	600	
Rent, Rates and Insurance	2800	

Bad Debts	400	
Discount	1300	1000
Interest and Commission	200	
Building	36000	
Machinery	15000	
Furniture	5000	
Sundry Debtors and Creditors	46000	30000
Cash	1000	
Capitals:		
Jay		35000
Vijay		45000
Bank Overdraft		10000
	247000	247000

Additional Information:

1. Stock is valued at 45,000 on 31st March, 2015
2. Outstanding expenses Rent 300: Wages 200
3. Prepaid Insurance 400.
4. Write off 1,000 for Bad Debts and provide Reserve for Doubtful Debts at 5% on debtors
5. Provide depreciation Building 5%, Machinery 10% and Furniture 15%
6. Provide 5% interest on Capital

3.14 MCQ

1. The statement of account and solvency in a Limited Liability Partnership should be prepared __________.
   a. Within four months from the end of the financial year
   b. Within six months from the end of the financial year
   c. Within three months from the end of the financial year
   d. Within two months from the end of the financial year

   Answer: b

2. The Limited Liability Partnership Act, 2008 came into force on ______.
   a. 21st March 2009
   b. 23rd March 2009
   c. 31st March 2009
   d. 30th March 2009

   Answer: c

3. Who is the head of Central Information Commission?
   a. The State Information Commissioner
   b. The Chief Information Commissioner
   c. The Chief Information Officer
   d. The Chairman of Information Commission

   Answer: b

4. Which of the following is true about a Limited Liability Partnership?
   a. A Limited Liability Partnership is not a distinct entity from its partners
   b. A Limited Liability Partnership is a legal entity separate from its partners
   c. A Limited Liability Partnership is a body corporate
   d. Both b and c are correct

   Answer: d

5. Dependents benefit is paid at the rate of
   a. 60% of wages in the form of monthly payment.
   b. 75% of wages in the form of monthly payment.
   c. 80% of wages in the form of monthly payment.
   d. 90% of wages in the form of monthly payment.

   Answer: d

6. In case of banker's refusal to honour the cheque inspite of sufficient funds in customer's account, the banker is
   a. liable to compensate the drawer.
   b. not liable to compensate the drawer.
   c. criminally liable under section 138.
   d. liable to be delisted.

   Answer: d

7. A person who is employed by the seller to raise the price by fictitious bids. Such person is known as
   a. Puffer
   b. By bidder
   c. Decoy Ducks
   d. All of the above

   Answer: d

8. In the absence of Partnership agreement, the Partner has

   a. right to avail interest on advances paid to partnership firm.

   b. right to avail interest on advances paid to partnership firm provided there is profit.

   c. has no right to avail interest on advances.

   d. has right to avail interest on advances even after dissolution of the firm.

   Answer: a

9. Provisions of EPF & misc Prov Act 1952 are applicable to Cinema/Theatre employing

   a. 10 or more persons.

   b. 20 or more persons.

   c. 5 or more persons.

   d. 15 or more persons.

   Answer: c

10 Publication of name and limited liability is provided in section of LLP Act 2008

a Section 24 of LLP Act 2008

b Section 22 of LLP Act 2008

c Section 21of LLP Act 2008

d Section 23 of LLP Act 2008

Correct: C

❖❖❖❖

4

NON-BANKING FINANCIAL COMPANIES

Unit Structure

4.1 Meaning of NBFC

4.2 Difference between NBFC and bank

4.3 Types/categories of NBFC

4.4 Incorporation of NBFC

4.5 Resolution of NBFC

4.6 MCQ

Non-Banking Financial Companies (NBFCs)

4.1 MEANING OF NBFC

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act,1956 / 2013 engaged in the business of –

a) loans and advances,

b) acquisition of shares/stocks/bonds/debentures/securities issued by Government or localauthority or other marketable securities

c) leasing,

d) hire-purchase,

e) insurance business,

f) chit business

but does not include any institution whose principal business is that of

a) agriculture activity,

b) industrial activity,

c) purchase or sale of any goods (other than securities) or providing any services andsale/purchase/construction of immovable property.

Note –

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company.

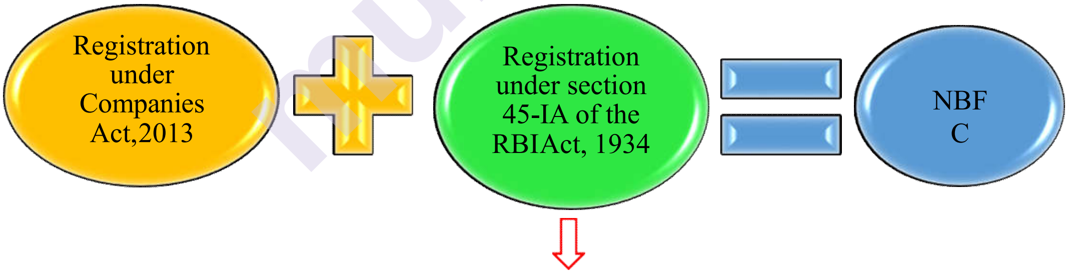
<u>Meaning of Financial activity as principal business – 50-50 test for NBFC's</u>

A 50/50 test means that –

a firm's financial assets constitute more than 50% of the total assets; **and**

income from financial assets constitute more than 50% of the gross income.

A firm which fulfills both these criteria will be registered with the RBI as an NBFC. If, after registration, a firm violates the 50/50 criteria then RBI has the authority to penalize the NBFC.



For carrying on business as NBFC, a non-banking financial institution –

a) must obtain a certificate of registration from the Reserve Bank and
b) must have a Net Owned Funds of Rupees 2 crore.

Certain categories of NBFCs which are regulated by other regulators are exempted from therequirement of registration with RBI –

- Venture Capital Fund/Merchant Banking companies/Stock broking companies registered withSEBI,
- Insurance Company holding a valid Certificate of Registration issued by IRDA,
- Nidhi companies,
- Chit companies as defined in Section 2(b) of the Chit Funds Act, 1982,
- Housing Finance Companies regulated by National Housing Bank,
- Stock Exchange or a Mutual Benefit company.

4.2 DIFFERENCE BETWEEN NBFC AND BANK

BASIS FOR COMPARISON	NBFC	BANK
Meaning	An NBFC is a company that provides banking services to people without holding a bank license.	A bank is a government-authorized financial intermediary that aims at providing banking services to the general public.
Incorporated under	Companies Act 1956	Banking Regulation Act, 1949
Demand Deposit	Not Accepted	Accepted
Payment and Settlement system	Not a part of the system and cannot issuecheques drawn on itself.	An integral part of the system.
Maintenance of Reserve Ratios	Not required	Compulsory
Deposit insurance facility	Not available	Available
Transaction services	Not provided by NBFC.	Provided by banks.

4.3 TYPES/CATEGORIES OF NBFCS –

1) *Asset Finance Company (AFC)* –

a) An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as –

- automobiles,
- tractors,
- lathe machines,
- generator sets,
- earth moving and material handling equipments,
- moving on own power and general-purpose industrial machines.

b) Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is **not less than 60% of its total assets and total income respectively.**

2) ***Investment Company (IC) –***

IC means any company which is a financial institution carrying on as its principal business the acquisition of securities.

3) ***Loan Company –***

LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own **but does not include an Asset Finance Company.**

4) ***Infrastructure Finance Company (IFC) –***

IFC is a non-banking finance company –

a) which deploys at least 75% of its total assets in infrastructure loans,

b) has a minimum Net Owned Funds of ₹ 300 crore,

c) has a minimum credit rating of 'A' or equivalent) and a CRAR (**Compounded Rate of Annual Return)** of 15%.

5) ***Systemically Important Core Investment Company (CIC-ND-SI) –***

CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions: -

a) it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;

b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;

c) it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI Act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.

e) ***Its asset size is ₹ 100 crore or above*** *and*

f) It accepts public funds

6) *Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC) –*

a) IDF-NBFC is a company registered as NBFC to facilitate the flow of long-term debt into infrastructure projects.

b) IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5-year maturity.

c) Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

7) *Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI) –*

"Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI)" means a non-deposit taking NBFC (other than a company formed and registered under section 25 of the Companies Act, 1956 or Section 8 of the Companies Act, 2013) that fulfils the following conditions:

- Minimum Net Owned Funds of ₹ 5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at ₹ 2 crore).
- Not less than 85% of its net assets are in the nature of "qualifying assets."

Note –

1) "Net assets" shall mean total assets other than cash and bank balances and moneymarket instruments

2) "Qualifying assets" shall mean a loan which satisfies the following criteria: -

a. loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding ₹1,25,000 or urban and semi-urban household income not exceeding ₹2,00,000;

b. loan amount does not exceed ₹75,000 in the first cycle and ₹1,25,000 in subsequent cycles;

c. total indebtedness of the borrower does not exceed ₹1,25,000; Provided that loan, if any availed towards meeting education and medical expenses shall be excluded while arriving at the total indebtedness of a borrower.

d. tenure of the loan not to be less than 24 months for loan amount in excess of ₹ 30,000 with prepayment without penalty;

e. loan to be extended without collateral;

f. aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs;

g. loan is repayable on weekly, fortnightly or monthly installments at the choice of the borrower

8) ***Non-Banking Financial Company – Factors (NBFC-Factors) –***

a) NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring.

b) The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

9) ***Mortgage Guarantee Companies –***

MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is ₹100 crore.

10) ***NBFC- Non-Operative Financial Holding Company (NOFHC) –***

It is a financial institution through which promoter / promoter groups will be permitted to set up a new bank. It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

11) ***Systemically important non-deposit taking non-banking financial company –***

It means a non-banking financial company not accepting / holding public deposits and having total assets of ₹ 500 crore and above as shown in the last audited balance sheet.

4.4 INCORPORATION OF NBFCS

A) Incorporation as company –

a) Form RUN for approval of name should contain financing as the principal activity.

b) The principal business of NBFC mentioned in the MOA, while registering under the Companies Act shall be lending credit, making investments in various types of shares and stocks, leasing, hire-purchase, insurance business, chit business, and receiving deposits under any scheme or arrangement.

B) Registration Process with Reserve Bank of India –

a) After incorporation of the company, the NBFC must obtain certificate of registration.

b) For obtaining certificate of registration, NBFC should have minimum net owned fund of 2crore rupees

c) NBFC should make an application to RBI for registration,

d) Registration of NBFC is done under section 45I-A of RBI Act, 1934

For your knowledge –

- The applicant company is required to **apply online and submit a physical copy** of the application along with the necessary documents to the Regional Office of the Reserve Bankof India.
- The application can be submitted online by accessing RBI's secured website *https://cosmos.rbi.org.in*.

C) Prerequisite before applying for registration –

a) It should have minimum one director from NBFC background or senior Bankers as full-timedirector in the company

b) Clean CIBIL records

c) Understanding of NBFC / Finance business

Certain categories of NBFCs which are regulated by other regulators are exempted fromthe requirement of registration with RBI –

- Venture Capital Fund/Merchant Banking companies/Stock broking companiesregistered with SEBI,
- Insurance Company holding a valid Certificate of Registration issued by IRDA,
- Nidhi companies,
- Chit companies as defined in Section 2(b) of the Chit Funds Act, 1982,
- Housing Finance Companies regulated by National Housing Bank,
- Stock Exchange or a Mutual Benefit company.

D) Conditions to be fulfilled for getting registration –

Before Granting registration to NBFC, RBI will check that the following conditions are fulfilled –

a) **NBFC is** or shall be in a position to pay its present or future depositors in full as and when theirclaims accrue

b) **Affairs of the NBFC** are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;

c) general character of the management or the proposed management of the NBFC shall not beprejudicial to the public interest or the interests of its depositors;

d) NBFC has adequate capital structure and earning prospects;

e) Granting registration to NBFC will be in public interest;

f) Grant of registration should not be against the financial sector of the country;

g) Such other conditions as the RBI thinks fit.

If all the above conditions are satisfied then RBI will grant registration and provide license to an NBFC.

E) Cancelation of a Certificate of Registration –

RBI may cancel a certificate of registration of NBFC if such NBFC –

a) ceases to carry on the business of a non-banking financial institution in India; or

b) has failed to comply with any condition subject to which the certificate of registration had beenissued to it; or

c) at any time fails to fulfil any of the conditions such as adequate capital structure and earning prospects; public interest, monetary stability, and economic growth etc. or

d) fails to comply with any direction issued by the Reserve Bank of India under the provisions ofChapter III B of RBI Act; or

e) fails to maintain accounts as per direction or order of RBI; or

f) fails to submit or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of RBI; or

g) has been prohibited from accepting deposit by an order made by the RBI for minimum 3months.

If any person is aggrieved by the order for cancellation of registration given by RBI then such aggrieved person may file and appeal within 30 days to central government and decision of central government shall be final.

Reserve Fund – Section 45-IC

1) Every NBFC shall create a reserve fund

2) Amount to be deposited in reserve fund = 20% of net profit every year (Profit shall be asdisclosed in the P&L Account and it should be before payment of any dividend.

3) Reserve fund can only be used for such purpose as specified by RBI.

4) Whenever NBFC will withdraw any amount from reserve fund, it shall report to the RBI within21 days of withdrawal.

5) Period of 21 days can be extended by RBI if there is sufficient cause.

CG has the power to exempt any NBFC from the requirements of maintaining reservefund.

But such exemption should be given only on the recommendation of RBI.

Maintenance of Percentage of Assets – Section 45-IB

A) *Percentage of assets to be maintained –*

Every NBFC shall invest and maintain of continuous basis minimum 5% and maximum 20% of the deposits outstanding at the close of business on the last working day of the secondpreceding quarter.

B) *Where investments should be made –*

a) Investment should be made in unencumbered approved securities.

b) "Approved securities" means securities of any State Government or of the Central Government or bonds which have full guarantee by CG or SG.

c) "Unencumbered approved securities" includes the approved securities kept as security by NBFC with another financial institution for securing loan

C) Important points –

a) If the amount invested by NBFC falls below the specified rate then such company shall be liable to pay RBI a **penal interest at a rate of 3% p.a.** above the bank rate forthe shortfall.

b) If the **shortfall continues in the subsequent quarters, then penal interest rate will be 5% p.a. above the bank rate** for the shortfall.

c) **Penal interest should be paid within 14 days**

Power of Reserve Bank of India to Remove Directors from Office –

1) If RBI thinks that it is necessary to remove director of any NBFC (other than government owned

NBFC) in the public interest or in the interest of deposit holders or for any other reason than RBImay remove such director from the office.

2) Before removing an opportunity of being heard should be given to such director.

3) Where any order of removal is made in respect of a director of a company, he shall cease to bea director of NBFC.

4) Once director is removed then he shall not act as director for any NBFC for such time which willbe specified by NBFC but it cannot be more than 5 years.

5) Director removed cannot claim any compensation for the loss or

6) termination from office.

Appointment of director in place of removed director –

a) RBI may appoint a suitable person in place of director so removed.
b) Such director will hold office for maximum period of 3 years or such further periods notexceeding three years at a time;

Supersession of Board of Directors of Non-Banking Financial Company –

1) If RBI thinks that it is necessary to supersede board of directors of any NBFC (other than government owned NBFC) in the public interest or in the interest of deposit holders or for anyother reason then, RBI may supersede the BOD of such NBFC.

2) Maximum time for which BOD can be superseded = Maximum 5 years.

3) After supersession of the BOD, RBI may appoint a suitable person as the Administrator.

4) Administrator will work as per the orders and directions of RBI.

5) Whenever RBI orders supersession of BOD of NBFC then the chairman, managing director and other directors should vacate their office and all the powers to manageNBFC gets transferred to RBI's Administrator.

Reserve Bank to Regulate or Prohibit Issue Of Prospectus or Advertisement Soliciting Deposits of Money – Section 45J

RBI has the power to –

a) Regulate or prohibit the issue of any prospectus or advertisement soliciting deposits ofmoney from the public by NBFCs; and

b) specify the conditions for issuing prospectus or advertisements.

Power of Bank to Determine Policy and Issue Directions – Section 45JA

If RBI thinks that it is necessary in the public interest or in the interest of deposit holders or for any other

reason then, RBI will make policies and may issue directions with to NBFCs for aspects relating to –

- income recognition,
- accounting standards
- provision for bad and doubtful debts,
- capital adequacy,
- deployment of funds, etc.

Power of Bank to Collect Information from Non-Banking Institutions as to Deposits and to Give Directions – Section 45K

1) RBI has the power to direct anytime that every NBFC shall furnish to RBI statements information or details relating to the deposits received by the NBFCs.
2) The details to be called by RBI may include –

a) The amount of deposit;

b) Purpose of accepting deposit;

c) Tenure of deposits;

d) Rate of interest; etc.

3) RBI also has the power to issue directions to NBFCs for the matters relating to –

b) The amount of deposit;

c) Purpose of accepting deposit;

d) Tenure of deposits;

e) Rate of interest; etc.

If any NBFC fails to follow the order or directions of RBI then RBI may prohibit the acceptanceof deposits by that NBFC.

Power of Bank to Call for Information from Financial Institutions and to Give Directions –

If RBI thinks that for the purpose of enabling RBI to regulate the credit system of the country to its advantage it is necessary to do so, RBI may –

a) Require any NBFC or all NBFCs to submit such information as may be considered necessary by RBI and specified in the order of RBI.

b) Give directions to and NBFC or all NBFCs relating to the conduct of business by them.

Powers and Duties of Auditors –

1) It is the duty of the auditor of the NBFC to inquire whether or not the NBFC hassubmitted all the necessary information to the RBI

2) Auditor shall include the report made to RBI in his report made under Audit reportprepared under Companies Act, 2013

3) RBI also has the power to conduct special audit of NBFC and the auditor conducting special audit shall submit report to the RBI. Remuneration of the auditor for special audit shall be fixed by RBI and shall be borne by NBFC.

Power to Take Action against ditors –

Where any auditor fails to comply with any direction given or order made by the RBI then RBI

May remove or debar the auditor from exercising the duties as auditor of any of the Reserve Bank regulated entities for a maximum period of three years, at a time.

Power of Bank to Prohibit Acceptance of Deposit and Alienation of Assets –

1) If any NBFC violates the provisions of any section or fails to comply with any direction or order given by the RBI then RBI may prohibit the NBFC from accepting any deposit.

2) If RBI thinks that it is necessary in the public interest or in the interest of deposit holders then RBI may order to the NBFC against whom an order for prohibition to accept deposit has already been passed that such NBFC shall not sell, transfer or create charge or mortgage on the property or assets of the NBFC without prior permission of RBI and such order will be valid for maximum 6 months.

4.5 RESOLUTION OF NBFC – SECTION 45MABA

A) If RBI thinks that it is necessary in the public interest or in the interest of deposit holders or for any other reason then, RBI will order –

a) Amalgamation of two or more NBFCs

b) reconstruction of the NBFCs

c) splitting the NBFC in different units.

RBI can also order for establishment of Bridge institutions.Now, what is Bridge institutions?
"Bridge Institutions" mean temporary institutional arrangement made under the scheme topreserve the continuity of the activities of a NBFC that are critical to the functioning of the financial system.

B) RBI may also provide for –

1) reduction of the pay and allowances of the chief executive officer, managing director, chairman or any officer in the senior management of the NBFC;

2) cancellation of all or some of the shares of the non-banking financial company held by the chief executive officer, managing director, chairman or any officer in the senior management of the nonbanking financial company or their relatives;

3) sale of any of the assets of the NBFC.

Power of Reserve Bank to File Winding Up Petition – Section 45MC

If the RBI is satisfied that an NBFC –

- is unable to pay its debt; or
- has become disqualified to carry on the business of a nonbanking financial institution; or
- has been prohibited by the Reserve Bank from receiving deposit for minimum 3 months; or

Chapter IIIB OF RBI Act to Override Other Laws –

- the continuance of the NBFC will be against the public interest.

Then RBI will file an application for winding up of such NBFC under Companies Act.

Note –

A NBFC will deem to be unable to pay its debt if it has refused or has failed to meet within five working days any lawful demand made and the RBI certifies in writing that such company is unable to pay its debt.

The provisions of this Chapter IIIB of RBI Act shall have overriding effect on other laws

Returns to be submitted by deposit taking NBFCs –

Situations	Forms
Quarterly Returns on deposits in First Schedule.	**NBS-1**
Quarterly return on Prudential Norms is required to be submitted by NBFC accepting public deposits.	**NBS-2**
Quarterly return on Liquid Assets by deposit taking NBFC	**NBS-3**
Annual return of critical parameters by a rejected company holding public deposits	**NBS-4**
Monthly return on exposure to capital market by deposit taking NBFC with total assets of ` 100 crore and above.	**NBS-6**
NBFC holding public deposits of more than ` 20 crore or asset size of more than ` 100 crore	**NBFC holding public deposits of more than ` 20 crore or asset size of more than ` 100 crore**

Note –

In addition to above returns, NBFCS should also submit –

a) ***Audited Balance sheet and Auditor's Report***

b) Branch Info Return

Returns to be submitted by NBFCS-ND-SI –

1) NBS-7 A Quarterly statement of capital funds, risk weighted assets, risk asset ratio etc., for

NBFC-NDSI.

2) Monthly Return on Important Financial Parameters of NBFCs-ND-SI.

3) ALM returns –

a) Statement of short-term dynamic liquidity in format ALM [NBS-ALM1] -Monthly,

b) Statement of structural liquidity in format ALM [NBS-ALM2] Half yearly,

c) Statement of Interest Rate Sensitivity in format ALM -[NBS-ALM3], Half yearly

4) Branch Info return.

4.6 MCQ'S:

1. The Life Insurance Corporation of India was established in the year:
a. 1954
b. 1958
c. 1956
d. 1950
Answer: 1956

2. As per the guidelines issued by the Reserve bank of India in June 2021, each NBFC-MFI is required to maintain not less than _______ of its net assets as qualifying assets:
a. 50%
b. 85%
c. 75%
d. 25%
Answer: 85%

3. NBFCs in India are companies that are registered under which of the following act:
a. Companies act 2013
b. RBI act 1934
c. SEBI act 2002
d. Government of India act 1935
e. None of the above

Answer: Companies act 2013

4. The Life Insurance Corporation of India was established in the year:
a. 1954
b. 1958
c. 1956
d. 1950
Answer: 1956

5. As per the guidelines issued by the Reserve bank of India in June 2021, each NBFC-MFI is required to maintain not less than ______ of its net assets as qualifying assets:
a. 50%
b. 85%
c. 75%
d. 25%
Answer: 85%

6. NBFCs in India are companies that are registered under which of the following act:
a. Companies act 2013
b. RBI act 1934
c. SEBI act 2002
d. Government of India act 1935
e. None of the above
Answer: Companies act 2013

7. Who is the regulatory authority for Merchant banking of India
a. Securities and exchange Board of India
b. Reserve Bank of India
c. Union Ministry of corporate affairs
d. Union Ministry of finance
Answer Securities & Exchange Board of India

❖❖❖❖

5

FINAL ACCOUNTS OF INSURANCE COMPANIES

Unit Structure :

5.1 MEANING

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

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

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

General Insurance – it includes all other types of insurance except life insurance. e.g. – Fire, Marine, Accident, Theft.etc. Under this type of insurance the insurer undertakes to indemnify the loss suffered by the insured on happening of a certain event in consideration for a fixed premium. **Insurance Regulatory and Development Authority (IRDA)**

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

5.2 PREPARATION OF FINANCIAL STATEMENTS

Final Accounts of Life Insurance Companies

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

Revenue Account (Form A-RA)

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

FORM A – RA

Name of the insurer

Registration No. and Date of Registration with the IRDA

Revenue Account for the year ended 31st March, 20….

Policyholders' Account (Technical Account)

No.	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Premiums earned – net			
	(a) Premium	1		
	(b) Reinsurance ceded			
	(c) Reinsurance accepted			
	Income from investments			
	(a) Interest, dividends & rent – Gross			
	(b) Profit on sale/redemption of investments			
	(c) (Loss on sale/redemption of investments)			
	(d) Transfer/ Gain on revaluation/change in fair value*			
	Other income (to be specified) Total (A)			
	Commission	2		
	Operating Expenses related to insurance business	3		

	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)			
	Benefits Paid (Net) Interim Bonuses paid	4		
	Change in valuation of liability in respect of life policies			
	(a) Gross**			
	(b) Amount ceded in Reinsurance			
	(c) Amount accepted in Reinsurance			
	Total (C)			
	Surplus (Deficit) (D)=(A)-(B)-(C)			
	Appropriations			
	Transfer to Shareholders' Account Transfer to Other Reserves (to be specified) Balance			
	being Funds for Future Appropriations Total (D)			

Profit And Loss Account (Form A-PL)

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

FORM A - PL

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

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

Shareholders' Account (Non-technical Account)

No.	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Amounts transferred from/to the Policyholders Account (Technical Account)			
	Income from investments			
	(a) Interest, dividends & rent – Gross			
	(b) Profit on sale/redemption of investments			
	(c) (Loss on sale/redemption of investments) Other income (to be specified)			
	Total (A)			
	Expenses other than those directly related to the insurance business			
	Bad debts written off Provision for tax			
	Provisions (other than taxation)			
	(a) For diminution in the value of investments (net)			
	(b) Provision for doubtful debts			
	(c) Others (to be specified) Total (B)			
	Profit (Loss) before tax Provision for taxation Appropriations			
	(a) Balance at the beginning of the year (b) Interim dividends paid during the year (c)			
	Proposed final dividend			
	(d) Dividend Distribution Tax			
	(e) Transfer to Reserves/other accounts (to be specified)			
	Profit carried .... to the Balance Sheet			

Notes to Form A-RA and A-PL:

(a) Premium income received from business concluded in and outside India shall be separately disclosed.

(b) 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

(c) Claims incurred shall comprise claims paid, specific claims settlement costs wherever applicable and change in the outstanding provisions for claims at the year-end.

(d) Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.500000 whichever is higher, shall be shown as a separate line item.

(e) Fees and expenses connected with claims shall be included in claims.

(f) Under the sub-head "Others" shall be included items like foreign exchange gains or losses and other items.

(g) Interest, dividends and rentals receivable in connection with an investment should be stated at gross amount, the amount of income tax deducted at source being included under "advance taxes paid and taxes deducted at source".

(h) Income from rent shall include only the realized rent. It shall not include any notional rent.

Balance Sheet (Form A-BS)

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

No.	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Sources of Funds			
	Shareholders' Funds:			
	Share Capital	5		
	Reserves and Surplus	6		
	Credit/[Debit] Fair Value Change Account			
	Sub-Total Borrowings	7		
	Policyholders' Funds:			
	Credit/[Debit] Fair Value Change			

	Account			
	Policy Liabilities			
	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			

5.3 SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE 1 - PREMIUM

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

SCHEDULE 2 COMMISSION EXPENSES

Particulars	**Current Year (Rs.'000**	**Previous Year (Rs.'000**
Commission paid Direct - First Year Premiums Renewal Premiums Single Premiums Add: Commission on Re-insurance Accepted Less: Commission on Re-insurance Ceded Net Commission		

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

SCHEDULE 3

OPERATING EXPENSES RELATED TO INSURANCE BUSINESS

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

SCHEDULE 4 – BENEFITS PAID [NET]

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

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

SCHEDULE 5 SHARE CAPITAL

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

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

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

SCHEDULE 6 – RESERVES AND SURPLUS

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

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

SCHEDULE 7 – BORROWINGS

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

SCHEDULE 8 – INVESTMENTS

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

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

SCHEDULE 9– LOANS

No.	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	**Security-wise Classification** Secured (a) On mortgage of property (aa) In India (bb) Outside India (b) On Shares, Bonds, Govt. Securities, etc.		

	(c) Others (to be specified) Unsecured Total		
2.	**Borrower-wise Classification** (a) Central and State Governments (b) Banks and Financial Institutions (c) Subsidiaries (d) Companies (e) Loans against policies (e) Others (to be specified) Total		
3.	**Performance-wise Classification** (a) Loans classified as standard (aa) In India (bb) Outside India (b) Non-standard loans less provisions (aa) In India (bb) Outside India Total		
4.	**Maturity-wise Classification** (a) Short Term (b) Long Term Total		

SCHEDULE 10– FIXED ASSETS

Particulars	Cost/Gross Block				Depreciation				Net Block	
	Opening	Addition	Deductio	Closing	Up to	For the	On	To Date	As at	Previous Year

Goodwill Intangibles (specify) Land-Freehold Leasehold Property Buildings Furniture & Fittings Information Technology Equipment Vehicles Office Equipment Others (Specify nature) Total Work in progress Grand Total Previous Year										

SCHEDULE 11– CASH AND BANK BALANCES

No.	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Cash (including cheques, drafts and stamps)		
2.	Bank Balances		
	(a) Deposit Accounts		
	(aa) Short-term (due within 12 months of the date of Balance Sheet)		
	(bb) Others		
	(b) Current Accounts		
	(c) Others (to be specified)		
3.	Money at call and short notice		
	(a) With banks		
4.	(b) With other institutions Others (to be specified)		
	Total		
	Balances with non-scheduled banks in 2 and 3 above		
	Cash and Bank Balances		
	1. In India		
	2. Outside India		
	Total		

SCHEDULE 12– ADVANCES AND OTHER ASSETS

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

SCHEDULE 13– CURRENT LIABILITIES

No.	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1. 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 be specified) Total		

SCHEDULE 14– PROVISIONS

No.	Particulars	Current Year	Previous Year
1.	For taxation (less payments and taxes deducted at source)		
2. 3. 4.	For proposed dividends For dividend distribution tax Others (to be specified) Total		

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

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

5.4 TYPES OF LIFE INSURANCE POLICIES

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

5.5 EXPLANATION OF ITEMS IN THE FINAL ACCOUNTS OF LIFE INSURANCE COMPANY

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

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

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

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

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

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

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

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

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

Commission on reinsurance ceded and Commission on reinsurance Accepted

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

5.6 DETERMINATION OF PROFIT IN LIFE INSURANCE BUSINESS

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

Valuation Balance Sheet

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

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

Surplus as per Valuation Balance Sheet ………

Less: Actuarial expenses …….

Dividends payable to shareholders ……..

Add: Interim bonus paid ……..

Surplus ………

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

Final Accounts of General Insurance Companies

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

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

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

The final accounts of a general insurance company consist of (a) Revenue Account,

(b) P&L A/c and (c) Balance Sheet.

Revenue Account (Form B-RA)

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

FORM B – RA

Name of the insurer

Registration No. and Date of Registration with the IRDA

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

No.	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Premiums Earned (Net)	1		
2.	Others (to be specified)			
3.	Change in Provisions for unexpired risk			
4.	Interest, Dividend & Rent - Gross			
	Total (A)			
1.	Claims Incurred			

2.	Commission			
3.	Operating Expenses related to insurance business	2		
4.	Others (to be specified)	3		
	Total (B)	4		
	Operating Profit/ (Loss) from Fire/ Marine/			
	Miscellaneous business (C)=(A-B)			
	Appropriations			
	Transfer to Shareholders' Account			
	Transfer to Catastrophe Reserve			
	Transfer to Other Reserves (to be specified)			
	Total (C)			

Profit And Loss Account (Form B-PL)

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

FORM B-PL

Name of the insurer

Registration No. and Date of Registration with the IRDA

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

Shareholders' Account (Non-technical Account)

No.	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Operating Profit/ (Loss) (a) Fire Insurance			
	(b) Marine Insurance			
	(c) Miscellaneous			
	Insurance			

2.	Income from investments			
	(d) Interest, dividends &			
	rent – Gross			
	(e) Profit on sale/redemption of investments			
	Less: Loss on sale of investments			
3.	Other income (to be			
	specified) Total (A)			
4.	Provisions (other than			
	taxation)			
	(a) For diminution in the			
	value of investments			
	(net)			
5.	(b) For Doubtful Debts			
	(c) Others (to be specified)			
	Other Expenses			
	(a) Expenses other than			
	those directly related			
	to the insurance business			
	(b) Bad debts written off			
	(c) Others (to be specified)			
	Total (B)			
	Profit before tax Provision			
	for taxation Profit after tax			
	Appropriations			
	(f) Interim dividends paid			

	during the year			
	(g) Proposed final			
	Dividend			
	(h) Dividend Distribution			
	Tax			
	(i) Transfer to Reserves or			
	other accounts (to be			
	specified)			
	Balance of Profit/Loss			
	brought forward fro last			
	Year			
	Balance carried forward to			
	the Balance Sheet			

Balance sheet FORM B – BS

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

Name of the Insurer

Reg,N o and date of registration with IRDA

Balance Sheet as at 31st March, 20….

No.	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Sources of Funds			
	Shareholders' Funds:			
	Share Capital			
	Reserves and Surplus	5		
	Fair Value Change Account	6		
	Borrowings			
	Total			
	Application of Funds	7		

	Investments			
	Loans			
	Fixed Assets			
	Current Assets	8		
	Cash and Bank Balances	9		
	Advances and Other Assets	10		
	Sub-Total (A)			
	Current Liabilities	11		
	Provisions	12		
	Sub-Total (B) Net Current Assets (C)=(A)-(B) Miscellaneous Expenditure (to the extent not	13 14		
	written off or adjusted)			
	Debit Balance in Profit and Loss Account			
	Total	15		

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

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

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

SCHEDULE 2 – CLAIMS INCURRED [NET]

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

SCHEDULE 3 – COMMISSION

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

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

SCHEDULE 4 – OPERATING EXPENSES RELATED TO INSURANCE BUSINESS

No.	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Employees' remuneration & welfare benefits		
2.	Managerial remuneration		
3.	Travel, conveyance and vehicle running expenses		
4.	Rents, rates & taxes		
5.	Repairs		
6.	Printing & stationery Communication expenses Legal &		
7.	Professional charges Medical fees		

8.	Auditors' fees, expenses etc		
9.	(a) As auditor		
10.	(b) As adviser or in any other capacity, in respect of: (j)		
	Taxation matters		
	(ii) Insurance matters		
	(iii) Management services; and		
	(c) In any other capacity Advertisement and publicity Interest &		
	bank charges Others(to be specified) Depreciation		
	Total		

Note: Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.500000 whichever is higher, shall be shown as a separate line item.

SCHEDULE 5 – SHARE CAPITAL

No.	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Authorised capital		
2.	Equity shares of Rs…..each		
3.	Issued Capital		
4.	Equity shares of Rs…..each		
	Subscribed Capital		
	Equity shares of Rs…..each		
	Called-up Capital		
	Equity shares of Rs…..each		
	Less: Calls unpaid		
	Add: Equity Shares forfeited (Amount originally paid up) Less: Par value of equity shares bought back		
	Less: Preliminary		

	Expenses Expenses including commission or brokerage on underwriting or subscription of shares Total		

Notes:

(a) Particulars of the different classes of capital should be separately stated.

(b) The amount capitalized on account of issue of bonus shares should be disclosed.

(c) In case any part of the capital is held by a holding company, the same should be separately disclosed.

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

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

SCHEDULE 6 – RESERVES AND SURPLUS

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

6.	Catastrophe Reserve		
7.	Other Reserves (to be specified) Balance of Profit in P&L A/c Total		

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

SCHEDULE 7 – BORROWINGS

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

SCHEDULE 8 – INVESTMENTS

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

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

SCHEDULE 9– LOANS

No.	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	**Security-wise Classification** Secured (a) On mortgage of property (aa) In India (bb) Outside India (b) On Shares, Bonds, Govt. Securities, etc. (c) Others (to be specified) Unsecured Total **Borrower-wise Classification**		

SCHEDULE 10– FIXED ASSETS

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

SCHEDULE 11– CASH AND BANK BALANCES

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

SCHEDULE 12– ADVANCES AND OTHER ASSETS

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

SCHEDULE 13– CURRENT LIABILITIES

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

6.7 RESERVE FOR UNEXPIRED RISK

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

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

b. 100% of net premium for marine hull business.

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

5.8 UNSOLVED PROBLEMS

1) From the following information as on 31st Mar 2014 prepare the Revenue Accounts of sagar Bhima Co.Ltd engaged in Marine Insurance Business

Particulars		Direct Business	Re-Insurance
I Premium			
Received		2400000	360000
Receivable	**-1st Aprl 2013**	120000	21000
	-31st Mar 2014	180000	28000
Premium Paid			240000
Payable	**-1st April 2013**		20000
	-31st Mar 2014		42000
II Claims			
Paid		1650000	125000
Payable	**-1st Aprl 2013**	95000	13000
	-31st Mar 2014	175000	22000
Received		-	100000
Receivable	**-1st Aprl 2013**	-	9000
	-31st Mar 2014	-	12000
III Commission			
On Insurance accepted		150000	11000
On Insurance ceded			14000

Salaries 2,60,000, Rent, Rates and Taxes 18,000; Printing and Stationery 23,000; Indian Income Tax paid 2,45,000: Interest, Dividend and Rent received (net) 1 15,500; Income Tax Rel deducted at source 24,500; Legal Expenses (Inclusive of 20,000 in connection with the settlement of claims) 60.000; Double Income Tax refund 12,000; Profit on Sale of Motor car 5,000. Balance of Fund on 1st April, 2013 was 26,50,000 including Additional Reserve of 3,25.000 Additional Reserve has to be maintained at 5% of the net premium of the year

2) Prepare revenue of Sudhir insurance engaged in Marine Insurance Business.

Particulars	Direct Business	Re-Insurance
I Premium		
Received	360000	38000
Receivable -1st Aprl 2013	10000	1600
-31st Mar 2014	16000	1800
Premium Paid		24000
Payable -1st Aprl 2013		1000
-31st Mar 2014		2200
II Claims		
Paid		
Payable -1st Aprl 2013	154000	14000
-31st Mar 2014	78000	1500
Received	16000	4200
Receivable -1st Aprl 2013	-	17000
-31st Mar 2014	-	1400
III Commission	-	1900
On Insurance accepted	96000	5600
On Insurance ceded		8000

Illustration Q.3 From the following information of XYZ Marine Insurance Co. Ltd. for the year ending 31st March 2014, find out the (i) Net Premium Earned and (ii) Net Claims Incurred.

Particulars	Direct Business	Re-insurance
Premium received	92,00,000	7,86,000
Premium receivable as on 1-4-2013	4,59,000	37,000
Premium receivable as on 31-3-2014	3,94,000	33,000
Premium paid		6,36,000
Premium payable as on 1-4-2013		28,000
Premium payable as on 31-3-2014		20,000
Claims paid	73,00,000	5,80,000
Claims payable as on 1-4-2013	94,000	16,000
Claims payable as on 31-3-2014	1,01,000	12,000
Claims received		2,10,000
Claims receivable as on 1-4-2013		42,000
Claims receivable as on 31-3-2014		39,000

Illustration Q4 Prepare a revenue a/c respected of fire Business from the following details of year 2017-18

Particular	amt
Reserve for unexpired risk on 1-4-2017 @ 50%	1800000
Additional Reserve	360000
Estimated Liability for claim intimated on 1-4-2017	310000
Estimated Liability for claim intimated on 31-3-2018	420000
Claims Paide	3650000
Legal Expenses	60000
Re-insurance Recoveries (ceded)	310000
Miscellaneous Expenses	40000
Bad Debts	8000
Premium Recovered	4860000
Premium on Re-insurance accepted	320000
Premium on Re-insurance ceded	430000
Commission of Direct Business	486000
Commission on Re-insurance accepted	16000
Commission on Re-insurance ceded	21000
Expenses on Management	900000
Interest, Dividend and Rent (Cr.)	240000
Profit on Sale of Investment	30000

Calculate Reserve on 31^{st} Mar 2018 to the same extent as on 1st Apr 2017

Illustration 05 From the following balances of Meghdoot General Insurance Company. Prepare Revenue accounts and Profit and Loss Account for the year ending 31st December, 2017 In the case of fire insurance, increase the additional reserve by 7.5% of net premium. This is to be provided in addition to the usual reserves.

Particular	Amt
Depreciation	26500
Interest, dividend, etc. received	48000
Difference in exchange (Cr.)	780
Fire Fund (1 January, 2017).	375000
Marine Fund (1 January, 2017)	1230000
Bad Debts (Fire)	4500
Bad Debts (Marine)	12000
Auditor's Fees	1800
Director's Fees	7500
Share Transfer Fees	6200
Fire Department:	
Outstanding claims as on 1st January, 2017-	75000
Claims paid during the year	200000
Outstanding claims as on 31 December, 2017	148000
Marine Department:	
Outstanding claims as on 1st January, 2017	60000
Claims paid during the year	400000
Outstanding claims as on 31 December 2017	230000
Commission Paid:	
Fire	162000
Marine	135000
Additional Reserve (fire) on 1st January, 2017	75000
Miscellaneous Receipts	7500
Premium received (including fire premium 9,00,000)	2700000

Outstanding Premium on 31st Dec 2017 for fire business rs 25000 & for Marine business rs 48000 tax to be provided @30%

5.9 SOLVED PROBLEMS

Illustration Q1

Perfect General Insurance Co. Ltd

Revenue Account for the year ended 31st March, 2011 Fire and Marine Insurance Business

Particulars	Schedule	Fire Current year (Rs.)	Marine Current year (Rs.)
Premium earned (net)	1	4,27,500	1,40,000
Interest, Dividends and Rent – Gross		-	-
Double Income Tax refund		-	-
Profit on sale of motor car		-	-
Total (A)		**4,27,500**	**1,40,000**
Claims incurred (net)	2	82,000	88,000
Commission	3	40,000	20,000
Operating expenses related to Insurance business	4	70,000	50,000
Bad debts		-	-
Indian and Foreign taxes		-	-
Total (B)		**1,92,000**	**1,58,000**
Profit from Marine Insurance business (A-B)		**2,35,500**	**(18,000)**

Schedules forming part of Revenue Account

Schedule - 1

Premium earned (net)	Fire Current year (Rs.)	Marine Current year (Rs.)
Premium from direct business written (4,50,000+30,000)	4,80,000	3,50,000
Less: Premium on re-insurance ceded	(25,000)	(15,000)
Total Premium earned (WN-3)	4,55,000	3,35,000
Less: Change in provision for unexpired risk (2,27,500-2,00,000)	(27,500)	(1,95,000)
(3,35,000-1,40,000)	4,27,500	1,40,000
Schedule – 2		
Claims incurred (net)	82,000	88,000
Schedule – 4		
Operating Expenses related to Insurance business	70,000	50,000
Expenses of Management	(60,000+10,000)	(45,000+5,000)

Form – B.P.L
Perfect General Insurance Co. Ltd.
Profit and Loss Account for the year ended 31st March, 2011

Particulars	**Schedule**	**Current year(Rs.)**	**Previous year(Rs.)**
Operating Profit / (Loss)			
a. Fire Insurance		2,35,500	
b. Marine Insurance		(18,000)	
c. Miscellaneous Insurance		-	
ncome from Investment			
Interest, Dividend & Rent – Gross		1,29,000	
(1,00,000 + 19,000 + 10,000)			
Other Income (To be specified)			
Total (A)		**3,46,500**	
Provision (Other than taxation)		-	
Depreciation		9,000	
Other Expenses – Director's Fee		80,000	
Total (B)		89,000	
Profit Before Tax(A-B)		2,57,500	
Provision for Taxation		99,138	
Profit After Tax		1,58,362	

Working Notes:

S.No.	Particulars	Fire (Rs.)	Marine (Rs.)
	Claims under policies less reinsurance		
	Claims paid during the year	1,00,000	80,000
1.	**Add:** Outstanding on 31st March, 2011	10,000	15,000
		1,10,000	95,000
	Less: Outstanding on 1st April, 2010	(28,000)	(7,000)
		82,000	88,000
2.	Expenses of management		
	Expenses paid during the year	60,000	45,000
	Add: Outstanding on 31st March, 2011	10,000	5,000
		70,000	50,000
3.	Premium less reinsurance		
	Premiums received during the year	4,50,000	3,30,000
	Add: Outstanding on 31st March, 2011	30,000	20,000
		4,80,000	3,50,000
	Less: Reinsurance premiums	(25,000)	(15,000)
		4,55,000	3,35,000

4. Reserve for unexpired risks is 50% of net premium for fire insurance and 100% of net premium formarine insurance.

5. ***Dr.*** **Provision for taxation account** **Cr.**

Particulars	Amount	Particulars	Amount
31.03.2011 To Bank A/c		1.4.2010 By Balance b/d	85,000
(taxes paid)	60,000	31.3.2011 By P & L A/c (b/f)	99,138
31.03.2011 To Balance c/d	1,24,138		
	1,84,138		1,84,138

Illustration Q2

Form – B

Revenue A/c of Moon Shine Ltd for the year ending 31st March, 2005

Particulars	Schedule No.	Current Year
Premium Earned (Net)	1	7,60,000
Total A		7,60,000
Claims incurred (Net)	2	12,00,000
Commission	3	62,400
Operating Expenses related to Insurance Business	4	2,43,000
Total B		15,05,400
Operating loss from Marine Insurance Business (A – B)		(7,45,400)

Form – B

Profit & Loss A/c for the year ending 31.03.2005

Particulars	Schedule No.	Current Year
1. Income from investments – Interest & Dividend		2,40,000
2. Other Income – Share Transfer fee		600
Total A:		2,40,600
3. Operating Loss – Transfer from Revenue A/c		(7,45,400)
4. Expenses Other than those related to Insurance Business		
Total B:		(7,45,400)
Profit / Loss before Tax		(5,04,800)
(Less) Provision for taxation		-
Profit / Loss for the year before appropriation		(5,04,800)
(Add) Balance of profit and Loss A/c brought forward from last year		2,40,000
Balance carried forward to Balance Sheet		(2,64,800)

Form – B

Balance Sheet as on 31.03.2005

Particulars	Schedule	Current Year
Source of Funds:		
Share capital Reserves and SurplusFair value change A/cBorrowings	5 6 - 7	15,00,000 - - -
Total		**15,00,000**
Application of Funds:		
InvestmentsLoans	8 9	23,40,000 -
Fixed Assets	10	6,300
Current Assets:		
Cash & Bank balance	11	94,400
Advances and other Assets	12	2,49,500
Sub Total – A		**26,90,200**
Current Liabilities	13	2,15,000
Provisions	14	12,40,000
Sub Total – B		14,55,000
Net Current Assets (A – B)		12,35,200
Misc. Exp. To the extent not written off	15	2,64,800
Debit balance in Profit & Loss A/c		**1500000**
Total Application of Funds		-

Sol Schedule – 1 (Premium)

Particulars	Amount
Net Premium received before adjustment for Unexpired risk reserve	12,40,000
Less: Adjustment for change in Unexpired risk Reserve – 100% of Net Premium	
Less: Opening balance in Unexpired Risk reserve (100% x 12,40,000 – 7,60,000)	(4,80,000)
Total Premium earned (Net)	7,60,000

Schedule – 2 (Claims)

Particulars	Amount
Claims Paid Less Re-Insurance	10,60,000
Add: Claims outstanding at the end of the year	1,40,000
Total Claims incurred	12,00,000

Schedule – 4 (Operating Expenses)

Particulars	Amount
Other Operating expenses	2,20,000
Dep. On Furniture	2,100
Rents, rates and taxes (Foreign Taxes on Insurance)	12,300
Other – Donations	8,600
Total	2, 43,000

Particulars	Amount
Issued, Subscribed, called up and paid up capital 1,50,000 E-share of 10 each	15,00,000
Total	15,00,000

Particulars	Amount
Long term Investments	
1. Government of India Securities	9,20,000
2. State Government Securities	8,80,000
3. Other Investments	
a) Share (E-S)	3,60,000
b) Debentures / Bonds	1,80,000
Short term investments	-
	23,40,000

Schedule – 10 (Fixed Assets)

Particulars	Gross	Acc. Dep.	Net Block	
			Opening	Closing
Furniture and Fittings	12,600	6,300	8,400	6,300
Total	12,600	6,300(4,200+ 2,100)	8,400	6,300

Schedule – 12 (Advances and Current Assets)

Particulars	Amount
Sundry Debtors	9,200
Interest accrued but not due	8,200
Stock of Stationary	2,500
Agents Balance	1,46,400
Outstanding Premium	21,200
Advance Income Tax Paid	62,000
	2,49,500

Schedule – 13 (Current Liabilities)

Particulars	Amount
Sundry creditors	12,600
Claim Outstanding	1,40,000
Unclaimed Dividend	2,400
Due to Re-insurance	60,000
Total	**2,15,000**

Schedule – 14 (Provision)

Particulars	**Amount**
Reserve for unexpired risk for Marine Insurance	12,40,000
Total	12,40,000

Illustration Q.3 Modern Insurance Company's Fire insurance division provide the following information, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2014.

Particulars	**Direct Business**	**Re-Insurance**
Claim paid during the year	35,30,000	8,20,000
Claim received	-	3,20,000
Claim payable		
- 1st April, 2013	8,23,000	58,000
- 31st March, 2014	8,75,000	87,000
Claim Receivable :		
- 1st April, 2013	-	85,000
- 31st March, 2014	-	1,42,000
Expenses of Management (includes 38,000 Surveyor's fee and 42,000 Legal expenses for settlement of claims)	3,45,000	

Solution: Modern Insurance Company (Abstract showing the amount of claims)

Particulars	Amount	Amount
Claims paid on Direct Business (35,30,000 + 38,000 +		36,10,000
42,000)	8,20,000	
Add: Re-insurance	87,000	
Add: Outstanding as on 31-3-2014	(58,000)	8,49,000
Less: Outstanding as on 1-4-2013		44,59,000
	3,20,000	
Less: Claims received from Re-insurance	1,42,000	
Add: Outstanding as on 31-3-2014	(85,000)	(3,77,000)
Less: Outstanding as on 1-4-2013		40,82,000
		8,75,000
Add: Outstanding Direct claims at the end of the year		49,57,000
		(8,23,000)
Less: Outstanding claims at the beginning of the year		
		41,34,000
Net Claims Incurred		

Q.4 From the following information as on 31st March, 2014, prepare the Revenue Accounts of Sagar Bhima Co. Ltd. engaged in Marine Insurance Business:

Particulars	Direct Business (₹)	Re-insurance
1. Premium :		
Received	24,00,000	3,60,000
Receivable - 1st April, 2013	1,20,000	21,000
-31st March, 2014	1,80,000	28,000
Premium paid	--	2,40,000
Payable - 1st April, 2013	--	20,000
-31st March, 2014	--	42,000
II. Claims:		
Paid	16,50,000	1,25,000
Payable -1st April, 2013	95,000	13,000
-31st March, 2014	1,75,000	22,000
Received	--	1,00,000
Receivable -1st April, 2013	--	9,000
- 31st March, 2014	--	12,000
III. Commission:		
On Insurance accepted	1,50,000	11,000
On Insurance ceded	--	14,000

Other expenses and income:

Salaries-Rs.2,60,000; Rent, Rates and Taxes - 18,000; Printing and Stationery - Rs.23,000; Indian Income Tax paid - Rs.2,45,000; Interest, Dividend and Rent received (net) -Rs.1,15,500; Income Tax deducted at source-24,500; Legal Expenses (Inclusive of Rs.20,000 in connection with the settlement of claims) - 60,000; Double Income Tax refund - Rs.12,000; Profit on Sale of Motor car Rs.5,000. Balance of Fund on 1st April, 2013 was Rs.26,50,000 including Additional Reserve of 3,25,000/-

Additional Reserve has to be maintained at 5% of the net premium of the year.

Solution:

Particulars	Schedule	Current year	Previous year
Premiums earned (net)	1	25,21,750	
Interest, Dividends and Rent - Gross		1,15,500	
Double Income Tax refund		12,000	
Profit on sale of motor car		5,000	
Total (A)		26,54,250	
Claims incurred (net) Commission	2	17,81,100	
	3	1,47,000	
Operating expenses related to Insurance	4	3,41,000	
business Indian and Foreign taxes		2,45,000	
Total (B)		25,14,000	
Profit from Marine Insurance business (AB)		1,40,250	

Schedules forming part of Revenue Account

Particulars	Current year	Previous year
Schedule 1: Premiums earned (net)		
Premiums from direct business written Less:	28,27,.000	
Premium on reinsurance ceded	2,62,000	
Total Premium earned	25,65,000	
Less: Change in Provision for unexpired risk	(43,250)	
(26.93,250 26,50,000)	25,21,750	
Premium (net)		
Schedule 2	17,81,000	
Claims incurred (net) [16,95,000+ 1,85,000-99000]		
Schedule 3: Commission paid	1,150,000	
Direct	11,000	
Add Re-insurance accepted	14,000	
Less reinsurance ceded	1,47,000	
schedule 4: Operating expenses related to insurance		
business	2,60,000	
Employees' remuneration and welfare benefits	18,000	
Rent Rates and Taxes	23,000	
Printing and Stationery	40,000	
Legal and Professional charges	3,41,000	

Illustration Q5 Prepare Revenue Account in proper form for the year ended 31st March 2014, from the particulars related to Krishna General Insurance Co. for the year ended 2013-14

Particular	Related to Direct Business	Related to Reinsurance
Premiums:		
Amount received	3000000	240000
Receivable at the beginning	180000	24000
Receivable at the end	240000	36000
Amount paid		360000
Payable at the beginning		30000
Payable at the end		42000
Claims:		
Amount paid	1800000	180000
Payable at the beginning	60000	12000
Payable at the end	120000	18000
Amount recovered		120000
Receivable at the beginning		18000
Receivable at the end		12000
Commission :		
Amount paid	72000	10800
Amount received (-)		14400

Additional Information:

1. Interest, dividend and rent received rs 30.000
2. Income tax in respect of above rs 6,000
3. Management expenses including rs 12.000 related to legal expenses regarding claims rs 1,32.000
4. Provision for income tax existing at the beginning of the year was 1.95.000, the income-tax actually paid during the year 1,68.000 and the provision necessary at the year end 2.07.000
5. The net premium income of the company during the year 2012-13 was 24,00,000 on which reserve for unexpired risk @ 50% and additional reserve @ 7 1/2% was created. This year, the balance to be cared forward is 50% of net premium on reserve for unexpired risk and 5% on additional risk

Sol

Form B RA

REVENUE ACCOUNT FOR THE YEAR ENDED 31/03/2014

Particular	Schedule	Amt
1. Premium earned (Net)	1	2703000
2. Profit/Loss on Sales / Redemption of investment		
3. Other		
4. Interest, dividend and rent (Gross)		30000
Total (A)		2733000
5. Claims incurred (Net)	2	1944000
6. Commission	3	68400
7. Operating expenses related to insurance business	4	120000
Total (B)		2132400
Operating Profit/Loss from Insurance Business (C) = (A - B)		600600
Appropriation		
Transfer to Shareholders Account		
Transfer to Catastrophe Reserve		
Transfer to Other Reserves		
Total (D)		

Schedules Forming part of revenue account

SCHEDULE 1 PREMIUM EARNED

Particular	amt
Premium received from direct business (WN 1)	3060000
Add: Premium on reinsurance accepted (2.40,000+ 36,000-24,000)	252000
	3312000
Less Premium on reinsurance ceded (3,60,000+ 42,000-30,000)	372000
Net Premium	2940000
Adjustment for change in reserve for unexpired risk (WN 2)	237000
Total Premium earned (Net)	2703000

SCHEDULE 2 CLAIM

Particular	Amt
Claims paid (Direct)	1800000
Add: Legal expenses regarding claims	12000
	1812000
Add: Reinsurance Accepted	180000
	1992000
Less Reinsurance ceded (1,20,000+ 12,000-18,000)	114000
	1878000
Add: Claims outstanding at the end (1,20,000+ 18,000)	138000
Less: Claims outstanding at the beginning (60,000 + 12.000)	72000
Total claim incurred	1944000

SCHEDULE 3 COMMISSION

Particular	Amt
Commission paid (Direct)	72000
Add: Reinsurance accepted	10800
	82800
Less: Re-insurance ceded	14400
Net Commission	68400

SCHEDULE 4 OPEEEEERATING EXPENSES RELATED TO INSURANCE BUSINESS

Particular	amt
Expenses of Management	120000

5.10 MCQ's

1) In case of fire insurance the provision required to make against un expired risk is __________________
   a) 40
   b) 50
   c) 100
   d) 30

2) As per IRDA regulations an insurance company is required to prepare
   a) Revenue account
   b) Profit and loss account
   c) Balance sheet
   d) All of the others

3) Insurance commission on general insurance policy renewed during the year cannot exceed
   a) 40% of the premium
   b) 5% of the premium
   c) 15% of the premium
   d) None of the above

4) Outstanding premium is shown in the balance sheet of the insurance company under
   a) Current assets
   b) Current liability
   c) Advance
   d) Other assets

5) Deposit held on reinsurance CEDED is shown in the balance sheet of the insurance company under
   a) Loans
   b) Current liability
   c) Advance
   d) Other assets

6) Insurance business is controlled by
   a) 100%
   b) 50%
   c) 25%
   d) 10%

7) Reserve for unexpected Risk is shown in the balance sheet of a General Insurance Company under
   a) Reserve & Surplus
   b) Capital
   c) Misc Expenditure not written off
   d) Provision.

8) Claims outstanding is shown in the balance sheet of a Insurance company
   a) Current Assets
   b) **Current Liabilities**
   c) Advance
   d) Other assets

9) Claims made in respect of general Insurance contracts shall be recognized on an actuarial basis
   a) Every year
   b) Every three year
   c) Where the claims payment period exceeds four year
   d) Never

10) Unallocated premium is shown in the balance sheet of an Insurance Company under
   a) Current Assets
   b) Current liabilities
   c) Advance
   d) Other Assets

❖❖❖❖