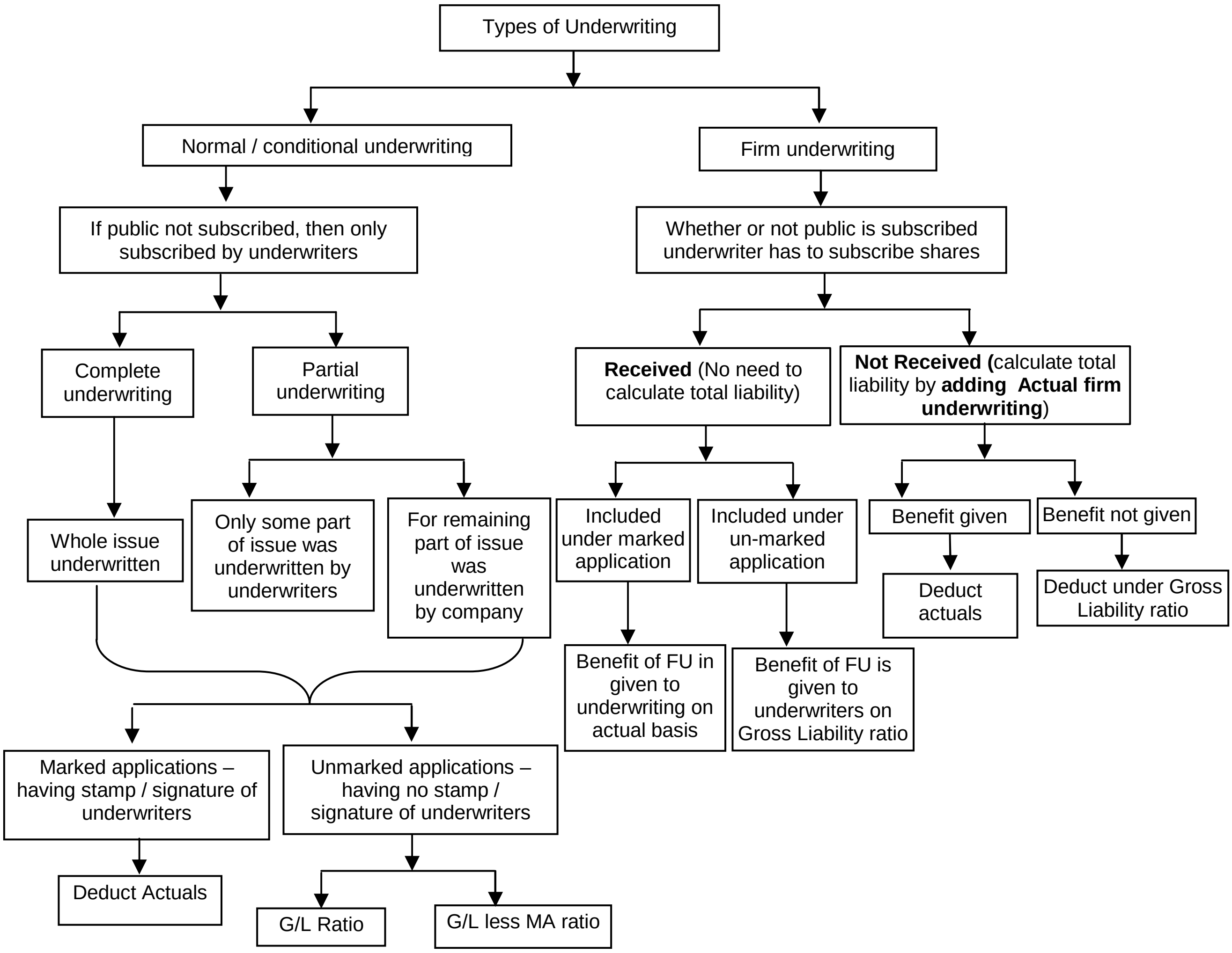
INDEX

1. UNDERWRITING OF SHARES



Accounting treatment relating to Underwriting of shares & debentures

Date	Transactions	Journal Entry	Amount
1.	When shares or debentures are allotted to underwriters in respect of their liability.	Underwriters A/c Dr To share capital A/c To debentures A/c	With the value of the shares or debentures taken up by the under writers.
2.	When commission becomes payable to the underwrites.	Underwriting commission A/c Dr To underwriters A/c	With the amount of commission due on the total issue price of the shares underwritten.
3.	When the net amount due from the underwriters on the shares or debentures taken up by them is received.	Bank A/c Dr To Underwriters A/c	With the net amount due from underwriter.
4.	When the net amount due to the underwriters on the shares or debentures taken up by them is paid.	Underwriters A/c Dr To Bank A/c	With the net amount due to underwriter.

Underwriting Commission

Particulars	% of Commission
On issue of Equity Shares	5% of issue price
On issue of Debentures	2.5% of issue price

Calculation of underwriting liability: (in number)

particulars	A	B	C	TOTAL
Gross liability	XXX	XXX	XXX	XXX
Less: Marked applications(MA)	(XXX)	(XXX)	(XXX)	(XXX)
Unmarked application(UMA)	(XXX)	(XXX)	(XXX)	(XXX)
Firm application(FA)	(XXX)	(XXX)	(XXX)	(XXX)
	XXX	XXX	XXX	XXX
Adjustment excess application of one under writer to another on gross liability ratio	XXX	XXX	XXX	XXX
Net liability:	XXX	XXX	XXX	XXX
Add : firm underwriting	XXX	XXX	XXX	XXX
Total liability:	XXX	XXX	XXX	XXX

Calculation of net amount due to/from underwriter: (in Rs.)

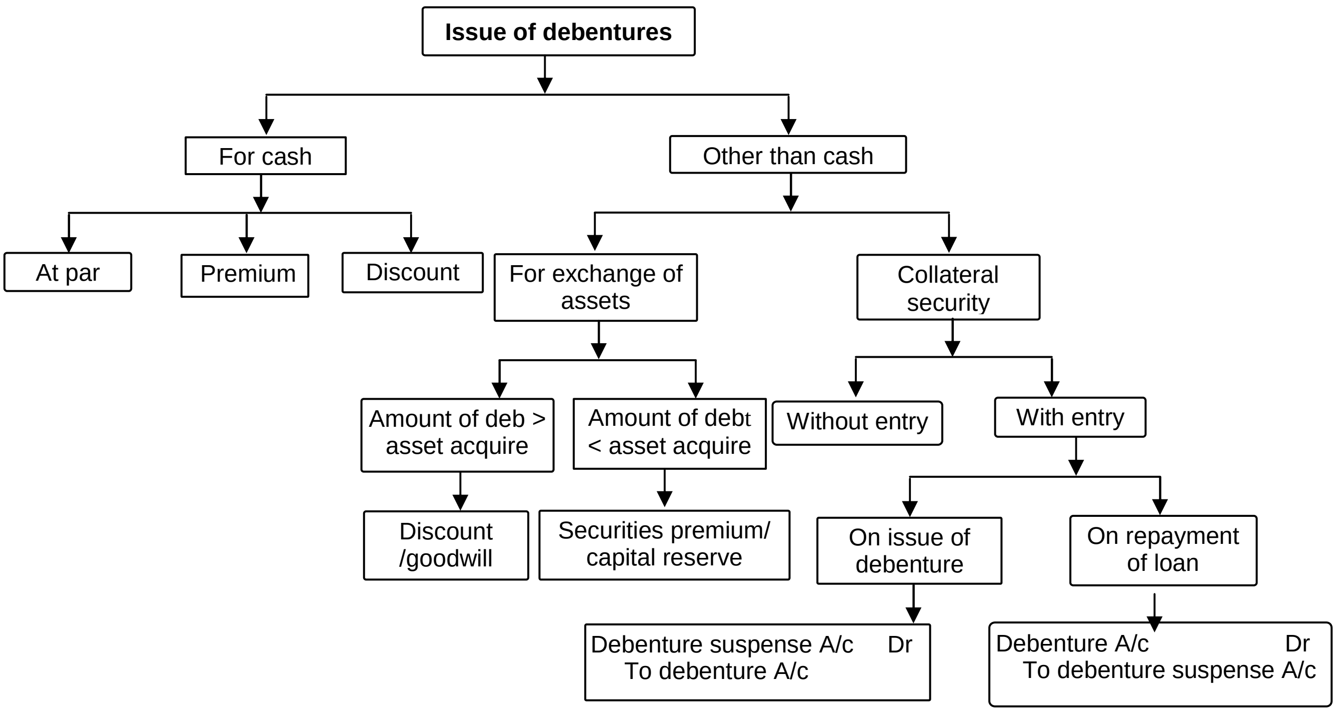
Particulars	A	B	C	TOTAL
Amount due on shares allotted to underwriters	XXX	XXX	XXX	XXX
(less) Underwriting commission payable	XXX	XXX	XXX	XXX
(less) Application amount received	XXX	XXX	XXX	XXX
Balance payable/ receivable	XXX	XXX	XXX	XXX

Note: If nothing is specified about Firm underwriting benefit is given or not, then same can be assumed as benefit is not given

For theory (Questions asked in previous 10 Years)

1. What do you understand by the term ‘Firm Underwriting’? (2 Marks, November, 2007) (PCC)

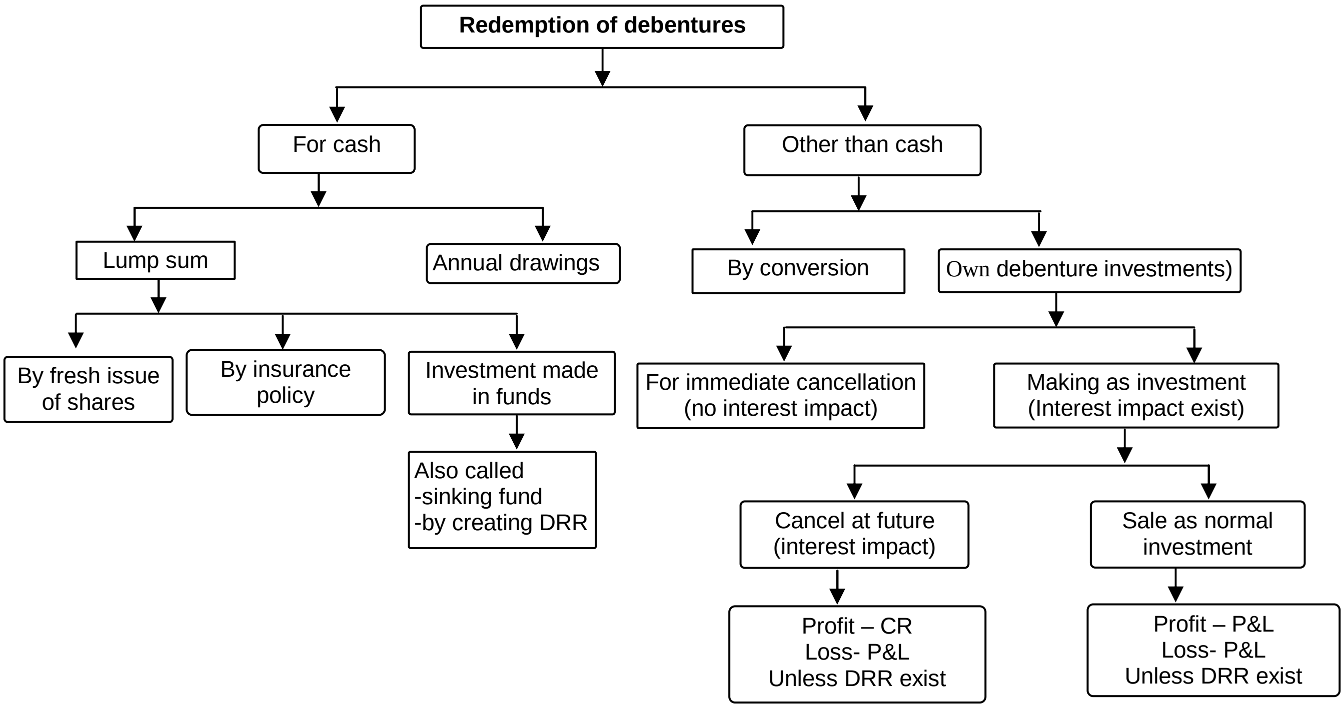
2. ISSUE & REDEMPTION OF DEBENTURES



Note: Loss in the form of discount on issue of debentures and premium on redemption of debentures has to be writing of over the life of debentures.

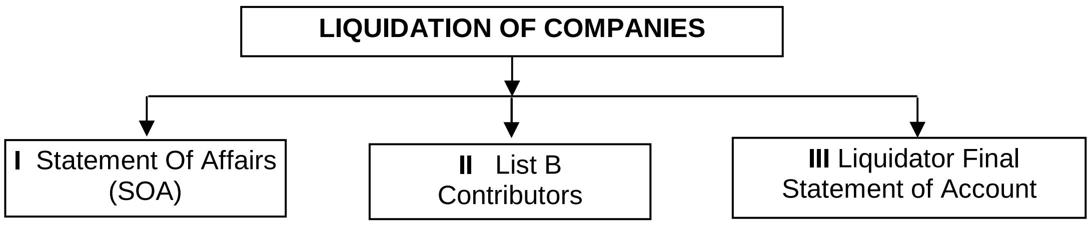
A) On straight line basis or

B) On the proportion of outstanding basis



3. LIQUIDATION OF COMPANIES

The process of winding up is called as Liquidation.



<u>I: Statement of Affairs:</u>

1. Assets not specifically pledged as per List A:

Particulars	ERV [Rs.]
--------	XXX
--------	XXX
Total	XXX

Here only estimated realizable values are given

2. Assets specially pledged as per List B:

Particulars	ERV	Liability	Shortfall/ Deficiency Ranking as Unsecured	Surplus C/D To last Column	Amount (Rs.)
---------					XXX
---------					XXX
				Total	XXX

Estimated assets available for preferential creditors, Creditors with floating charge and unsecured creditors. (Total of 1st + 2nd Table) (Carried forward)	XXX

Only total Amount is given

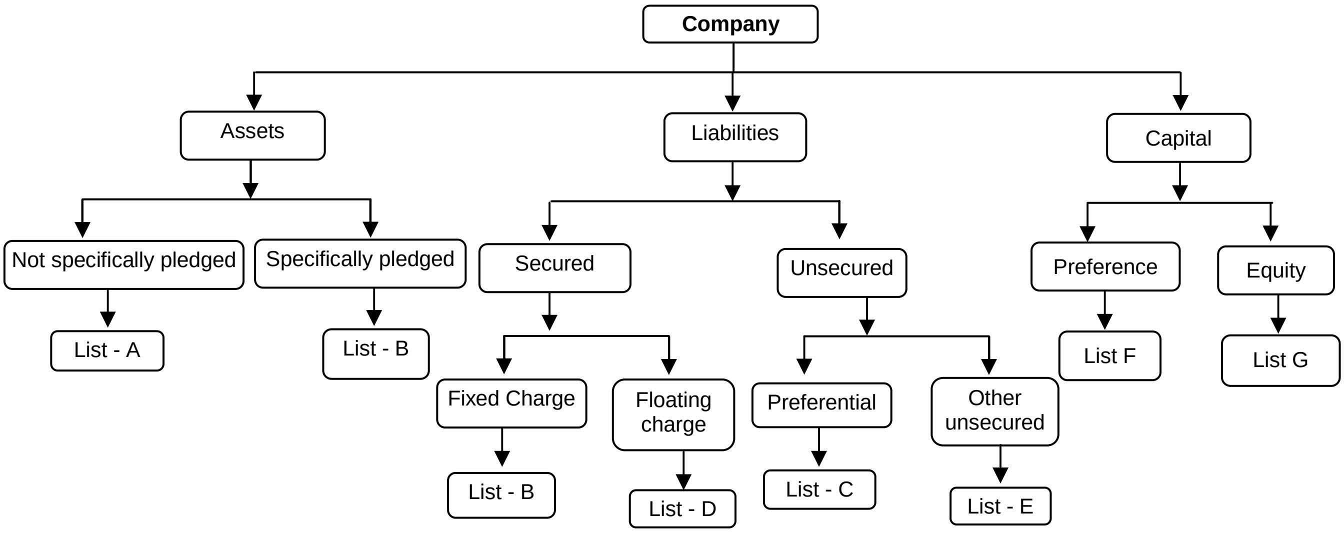
3. Summary of Gross Assets:

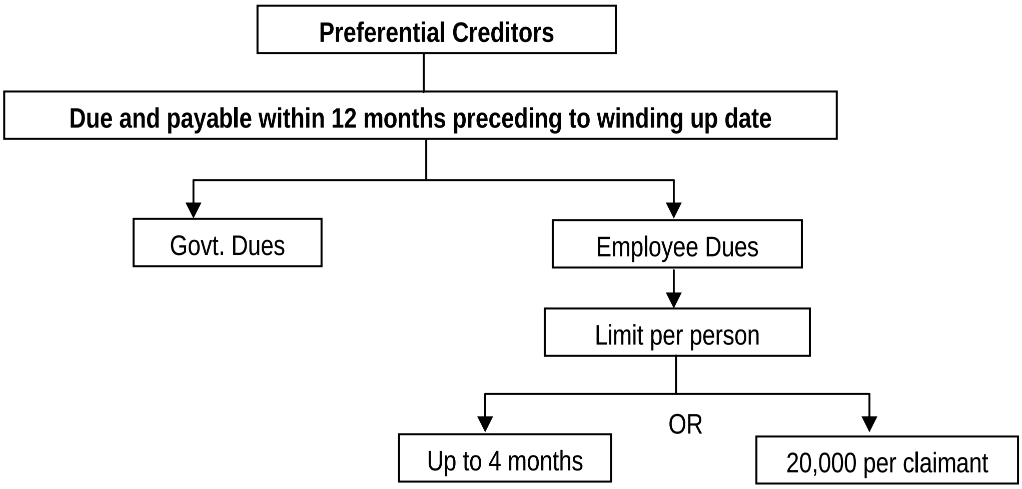
Particulars	ERV
ERV of Assets not specifically pledged	XXX
ERV of Assets specifically pledged	XXX
Total:	XXX

Gross Liabilities	Particulars	Amount (Rs.)
XXX	Secured creditors to the extent covered by security as per **List B**.	----
	Estimated assets available for preferential creditor's, creditor's with floating charge and unsecured creditors (Brought forward)(From point no 2)	XXX
	Preferential creditor's as per **List C**	
XXX	Estimated assets available for creditor's with floating charge and unsecured creditor's.	XXX
	Creditors & Debenture holders with floating charge as per **List D**	XXX
	Estimated surplus/Deficiency as regards creditor's with floating charge	
XXX	Unsecured creditors as per **List E**	XXX
	Estimated surplus/Deficiency as regards unsecured creditors	
	Preference Share capital as per **List F**	XXX
XXX	[---- shares @ ---- per share]	XXX
	Equity share capital as per **List G**	XXX
	[-----shares @ -----per share]	XXX
	Estimated deficiency/surplus as per **List H**	XXX
		XXX
XXX		

STATEMENT OF DEFICIENCY (List H): (at least 3 years information prior to the date of winding up order should be presented.)

Particulars	Amount (Rs.)
A. Items contributing to Deficiency/reducing surplus:	
a. Excess of capital & Liabilities over assets on the date of incorporation	XXX
b. Net Dividends/Bonus declared during the period	XXX
c. Net Trading losses during the period	XXX
d. Loses other than Trading Loss during the period. [Eg. Income tax penalty, Excise duty penalty]	XXX
e. Loses on account of winding up of the company [Eg. Loss in realisation of Assets]	XXX
Total A:	XXXX
B. Items reducing deficiency/contributing to surplus:	
a. Excess of Assets over capital & Liabilities on the date of incorporation.	XXX
b. Net Trading profit during the period	XXX
c. Profits other than Trading Profit during the period. [Eg. Profit on sale of Assets, investment income]	XXX
d. Other items reducing deficiency or contribute to surplus. [Eg. Profit on Realization of Assets at the time of winding up	XXX
Total B:	XXXX
Deficiency/Surplus [A-B]	**XXX**





II: LIST B CONTRIBUTORS: (Past Members Contributory)

Persons: Who transferred their shares within 12months before the date of liquidation.

Liability: Outstanding debt amount as on the date of transfer.

Amount: Least of

a) Creditors outstanding on the date of transfer. (up to his proportion)

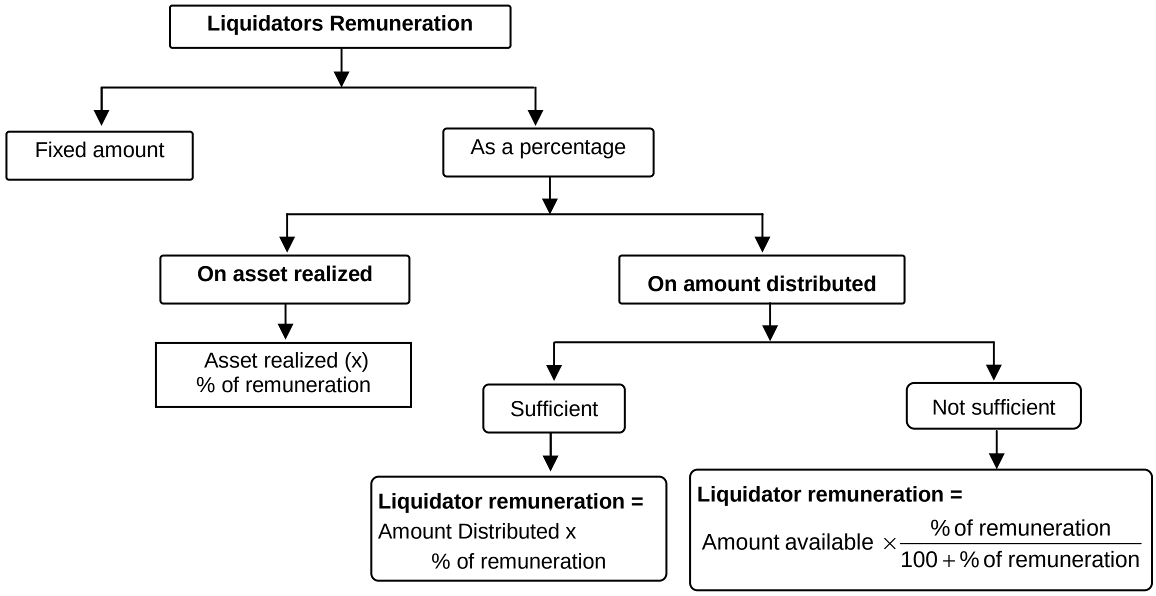
b) Unpaid amount on shares . (No. of shares held X Unpaid amount per share).

III: Liquidators Final Statement of Account

Receipts	Rs.	Payments	Rs.
To Realisation from sale of Assets [not specifically pledged]	XXX	By Legal Charges	XXX
To Realisation from Assets specifically pledged XXX		By Liquidator remuneration	XXX
Less: amount paid to Secured creditors XXX	XXX	By Expenses of Liquidation	XXX
To Receipts from contributories [to the extent of uncalled capital]	XXX	By Amt. paid to Debenture holders	XXX
		By Preferential Creditors **	XXX
		By Unsecured Creditors	XXX
		By Preference Share Holders [at the rate of --- per share]	XXX
		By Equity Share Holders [at the rate of --- per share]	XXX
	XXX		**XXX**

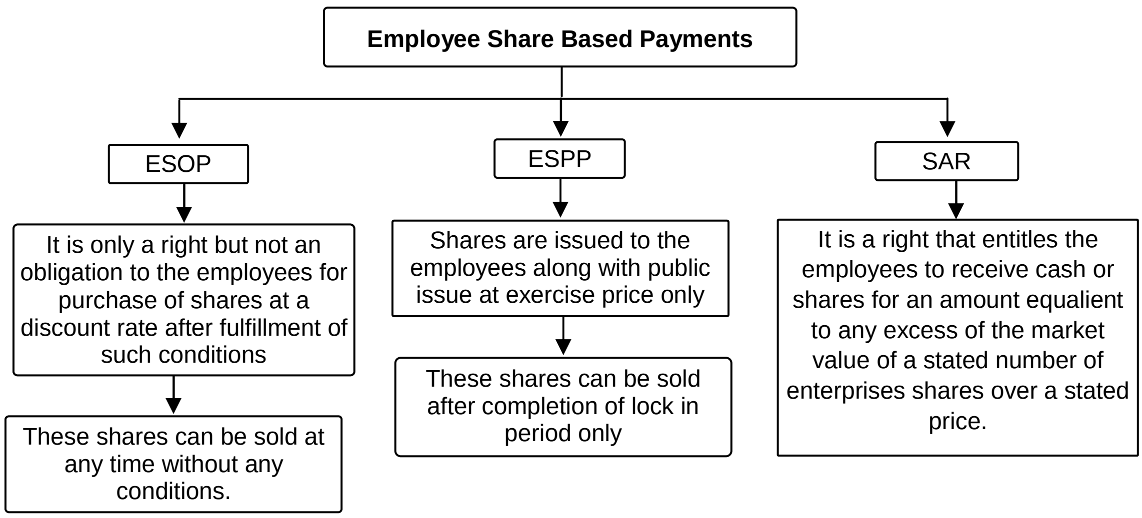
**** In actual practice preferential creditors are paid before debenture holders having a floating charge. Here this order is only for presentation sake.**

- Interest on debt is categorized in concerned debt category i.e. if debt is secured interest is also secured, if it has floating charge then interest also has floating charge.



4. ACCOUNTING FOR EMPLOYEE SHARE BASED PAYMENTS

Employee share based payments are of 3 types.



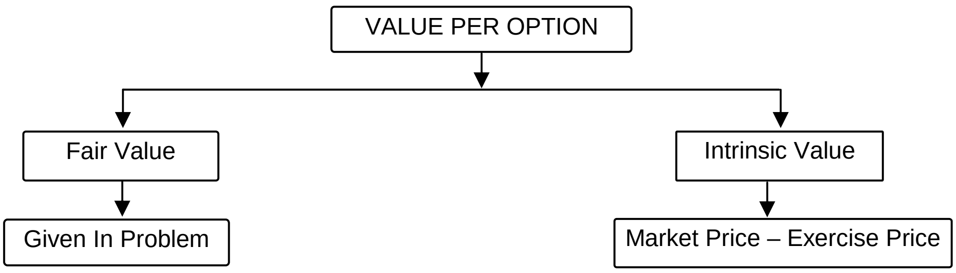
Difference between ESOP, ESPP & SAR:

S.No	Particulars	ESOP	ESPP	SAR
1.	Vesting conditions	✓	X	✓
2.	Shares issued	✓	✓	X (Paid in cash)
3.	Lock in period	X	✓	X
4.	Expenses to be written off over the vesting period.	✓	Written off immediately in the year in which it is incurred	✓
5.	Issue done as	Separately	As part of public issue	Separately

JOURNAL ENTRIES:

Date	Transactions	Journal entry	Amount
1.	When expenses recognized	**E**mployee Compensation Exepenses A/C Dr To ESOP Outstanding A/C	**As caliculated in statement**
2.	When expenses transferred to p&l A/	Profit &Loss A/C Dr To Emp. Compensation Expenses A/C	
3.	When option are exercised	Bank a/c Dr ESOP Outstanding A/C Dr To Equity Share Capital A/C To Securities Premium A/C	
4.	When vested options are lapsed.	ESOP Outstanding A/C Dr To General Reserve A/C	

NOTES: Total expenses = no of employees x option per employee x value per option



Caliculation of expense to be recognised every year (Assuming vesting period is 3 Yrs)

Particulars	Year I	Year II	Year III
1. No of employees			
2. Options per employee			
3. Value per option			
4. Total expenses (1X2 X3)			
5. Vesting period	3	3	3
6. Total expenses to be recognized till the date(4/5)	Total expenses (as per point 4)X 1/3	Total expenses (as per point 4)X 2/3	Total expenses (as per point 4)X 3/3
7. **Less:** expenses already recognized			
8. Expenses recognized in current year(6-7)			

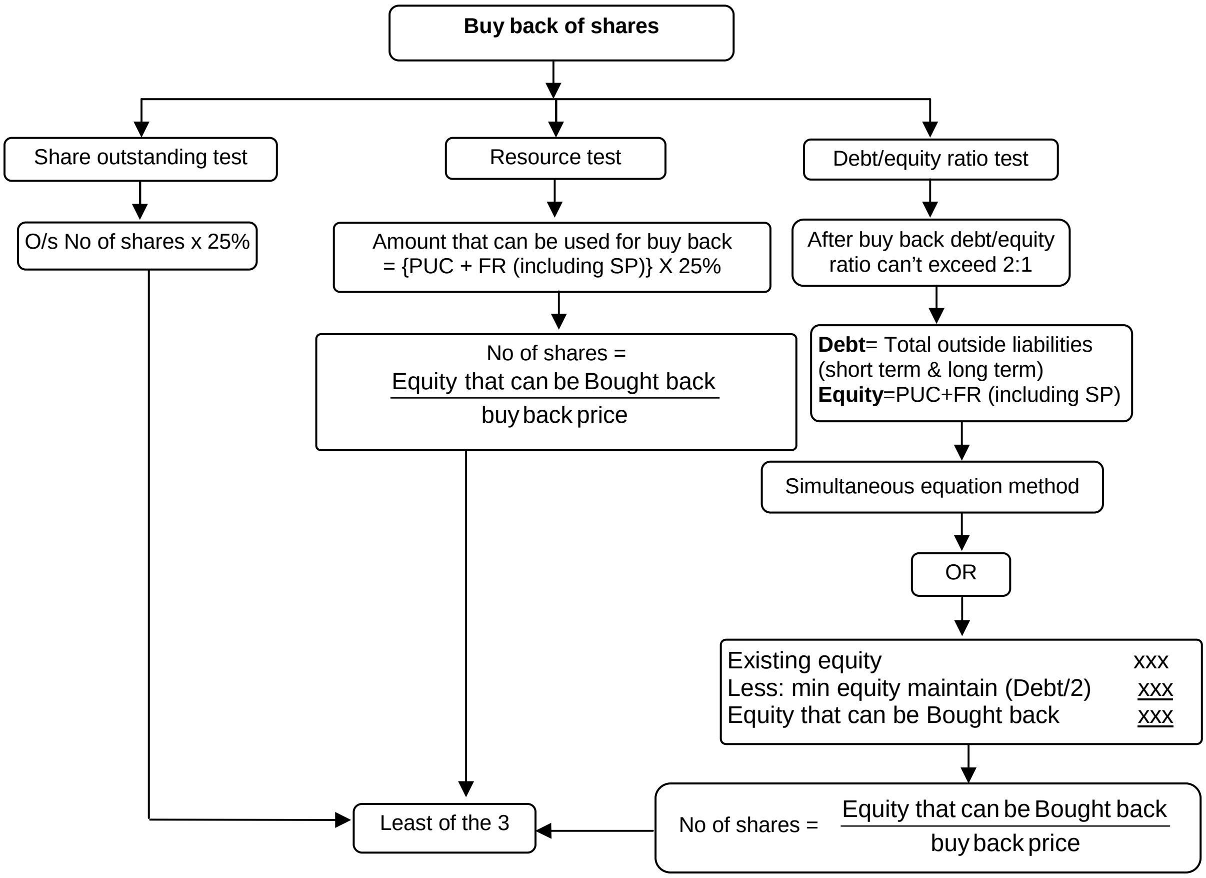
For theory (Questions asked in previous 10 Years)

1. Explain "Employee's stock option plan". (2 Marks, November, 2009) (IPCC)

2. State the conditions of issuance of Sweat Equity Shares by Joint Stock Companies.(**N12 - 4 M**) (IPCC)

5. ACCOUNTING FOR BUY BACK OF SHARES

Maximum no. of shares that can be bought back:



Journal entries:

Transactions	Journal Entries	Amounts
Face value of preference shares redeemed & equity shares bought back OUT OF FREE RESERVES has to be transferred to CRR.	Free reserves A/c Dr To CRR A/c	

For all transactions given in question is to be made. However even the question is silent we must pass the above entry

For theory (Questions asked in previous 10 Years)

1. Give four conditions to be fulfilled by a Joint Stock Company to buy back its equity Shares.

(M14 - 4 M)

6. DEPARTMENTAL ACCOUNTS

ACCOUNTING PROCEDURE: To obtain the results of each department separately, there are two accounting procedures.

1. Maintain separate set of books for each particular department. But usually this is not done, because it is very expensive and involves overlapping of accounts.
2. Maintain Day books and Nominal accounts in the ledger with analysis columns for each department so that departmental figures necessary for preparing departmental final accounts can be easily obtained.

Apportionment of Common Expenses:

No.	Items of Expenses and Income	Basis of Apportionment
1.	**Selling Expenses:** **Eg:** Salesmen's commission, discounts allowed (including provision for such discounts), bad debts, carriage outwards, advertisement, packing expenses etc.	Sales (turnover) of each department
2.	Carriage inward, discounts received (including provision for such discounts) etc.	Purchases of each department
3.	Rent, rates and taxes, repairs and maintenance of building, insurance of building etc.	Floor space of each department (if given, otherwise on Time basis)
4.	Depreciation on assets, fire insurance premium, repairs and maintenance of capital assets etc.	Asset values of each department, otherwise on Time basis.
5.	Workmen's compensation insurance, employer's contribution to Employees State Insurance, Provident fund etc.	Wages and salaries of each department
6.	Canteen expenses, medical benefits, safety measures and such other labour welfare expenses etc.	No. of workers of each department
7.	Lighting and heating expenses **Eg:** Energy expenses	Consumption of energy by each department
8.	Administrative and other expenses **Eg:** Salaries of Managers, Directors, Common advertisement expenses.	Time basis or equally among all department.
9.	Wages / Salaries	Time allowed to each department

Notes:

- Expenses incurred for the direct benefit of a particular department should be allocated to the department concerned. **E.g.:** Special Advertisement, Insurance of Stock, Departmental Salaries.
- If expenses incurred for the benefit of more than one department are not capable of accurate measurement, should be distributed on arbitrary basis (i.e., either in turnover ratio or in the cost of goods sold etc.). **E.g.,** Salary paid to the General Manager, Expenses of Accounts dept. etc.
- There are certain expenses and incomes, of financial nature, which cannot be apportioned on a suitable basis. Therefore they are recognized in the combined profit and loss account. **Eg:** Interest on loan, profit or loss on sale of investment etc.

Inter - departmental Transactions: When the department activities are inter connected then output of one department may be the input of another department. When goods or services provided by one department to another such transfers are called **Inter departmental Transactions / Transfers.**

Invoice Price / Loaded Price = Cost + Profit

Elimination of unrealized profit: When profit is added in the Inter departmental transfers the loading included in the unsold stock at the end of the year is to be excluded before final accounts are prepared so as to eliminate any anticipatory profit included there in.

1. **Weighted Average Basis:**

   Stock Reserve = $= \frac{\text{Closing stock x Profit element in Dept. opening stock and in the other dept}}{\text{Total Expenditure}}$

2. **FIFO Basis:** It is explained assuming that there are the departments A, B & C. A transfers goods to B and B transfers goods to C.

   a) **Stock of Department A:** Department A's stock will be at cost, because it does not receive goods from other departments, so no stock reserve is required.

   b) **Stock of Department B:** Department B's stock will be inclusive of profit charged by Department A in its transfer to Department B. Which will be calculated as follows:

      i) **Profit of Department A:** Element of A's material in closing stock of Department B

$$\frac{\text{Materials Transferred from Dept. A}}{\text{Total Cost of Dept. B excluding opening stock but including transfer from Dept. A}} \text{ x Closing stock of B}$$

      Stock Reserve = Element of Department A's material in closing stock of B x percentage of profit charged by department A on transfer price.

   c) **Stock of Department C:** Department C's stock will be inclusive of profit of Department B as well as profit of department A which will be calculated as follows:

      i) **Profit of Department B:** Element of B's material in closing stock of Department

$$\frac{\text{Materials Transferred from Dept. B}}{\text{Total Cost of Dept. C excluding opening stock but including transfer from Dept. B}} \text{ x Closing stock of C}$$

      Stock reserve (Department B's profit) = Element of department B's material in closing stock of C x percentage of profit charged by department B on transfer price.

      ii) **Profit of Department A**

      Element of A's material in closing stock of Department C

$$\frac{\text{Material Transferred from Dept. A to B}}{\text{Total cost of Dept. B (excluding opening stock)}} \times (\text{Element of B's material in cl. stock of Dept. C} (-) \text{Profit in it of Dept. B})$$

   Stock reserve (Department A's profit) = Element of department A's material in closing stock of C x percentage of profit charged by department A to B on transfer price.

   Total stock reserve = Profit of Dept. A + Profit of Dept. B included in closing stock of C

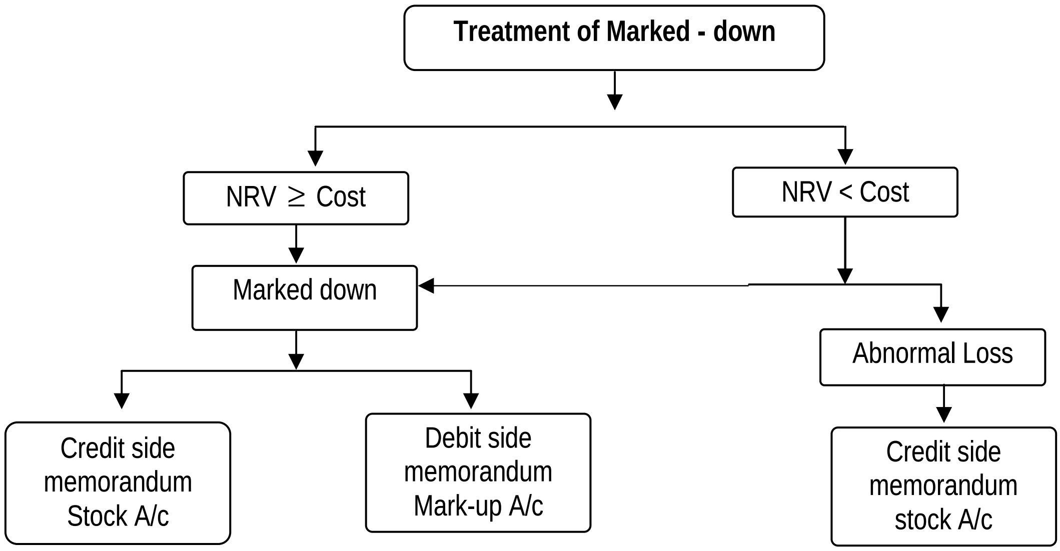
Memorandum Stock Account

Particulars	Amount	Particulars	Amount
To Balance b/d (Cost + Loading)	XXXX	By Sales (Given)	XXXX
To Purchases (Given)	XXXX	By Memorandum Mark-up A/c (Mark-down)	XXXX
To Memorandum Mark-up (Loading on Purchases)	XXXX	By Abnormal Loss (Cost Price)	XXXX
		By Balance c/d (Bal. fig.)	XXXX
	XXXX		XXXX

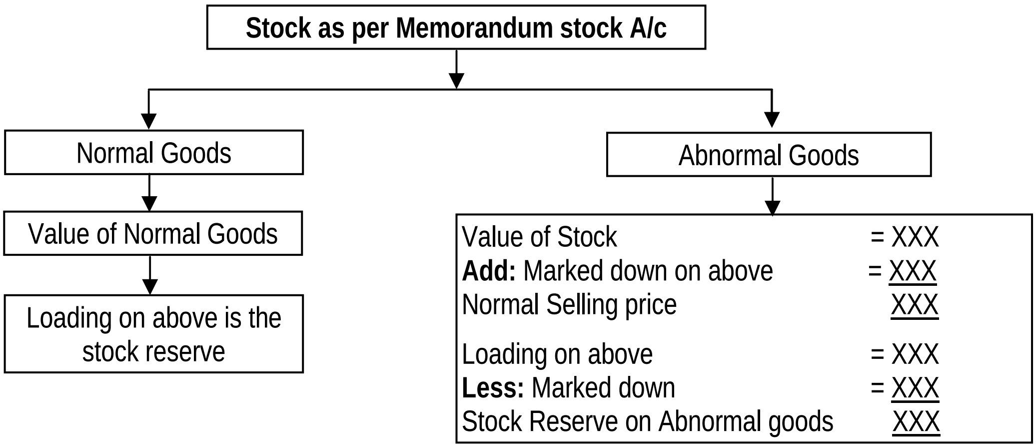
Memorandum Mark-up Account

Particulars	Amount	Particulars	Amount
To Memorandum stock A/c (Mark-down)	XXXX	By Balance b/d (Loading on stock)	XXXX
To General P & L A/c (b/f)	XXXX	By Memorandum Stock A/c (Loading on purchases)	XXXX
To Balance c/d	XXXX		
	XXXX		XXXX

Note: 1 – Treatment of Marked-down (Loss of stock and damaged goods):



Note: 2 – Calculation of Stock Reserve:



7. AMALGAMATION – II

I. <u>IN THE BOOKS OF TRANSFEREE COMPANY (PC):</u>

1. For cancellation of mutual indebtedness (or) Mutual Owings

   Sundry creditors A/c Dr

   To Sundry Debtors A/c

2. For cancellation of mutual acceptances

   Bills payable A/c Dr

   To Bills Receivable A/c

3. For cancellation of unrealized profit in stocks

   Free Reserves / Profit & Loss A/c Dr. (In case of merger)

   Capital Reserve / Goodwill A/c Dr. (In case of purchase)

   To Stock Reserve / Stock A/c

NOTE: No adjustments are required to be made in Transferor company (SC) books.

II. <u>TREATMENT OF INTER COMPANY INVESTMENTS:</u>

1. Investments held by purchasing company in selling company prior to Amalgamation.

   It is sufficient to <u>discharge PC only to the outside share holders</u> of selling company.

For Ex:- X Ltd issued 1,00,000 Equity Shares

Out of which 20,000 shares held by Y Ltd (purchasing company)

PC to be discharged in 1:1 Equity Shares @ Rs. 10 each

Then, PC Payable is (1,00,000 – 20,000) = 80,000 X $\frac{1}{1}$

80,000 Equity Shares of Rs.10 each.

$\therefore$ PC = 8,00,000.

Computation of Profit / Loss on Amalgamation:

NAV of business taken over (In case of purchase)

Paid-up share capital of SC (In case of merger)

(-) PC Agreed

(+) Value of Inter Company investments already held by PC.

If NAV of business taken over / paid-up share capital (as the case may be) is > PC agreed + Inter company investments, it is called profit on Amalgamation, then credited to 'Capital A/c'

If NAV of business taken over / paid-up share capital (as the case may be) is < PC Agreed + Inter company investments, then it is called loss on Amalgamation.

Loss should be debited to Goodwill A/c (In case of purchase)

Adjusted against (In case of merger)

a) Firstly against Free Reserves of SC

b) Secondly against Free Reserves of PC

c) Lastly debiting to Profit & Loss A/c.

2. Investments held by selling company in purchasing company prior to Amalgamation.

Step 1: Calculate No. of shares actually to be issued like general problem	XXX
Step 2: (-) No. of Shares already held by SC in PC	(XXX)
Step 3: Net No. of shares to be issued to discharge PC	XXX
$\therefore$ **Value of PC:** Net No. of shares to be issued X Issue price	XXX

Computation of Profit / Loss on Amalgamation:

Step 1: NAV of business taken over except inter company investments (In case of purchase) paid-up share capital less Inter company Investments (In case of merger)	XXX
Step 2: PC Agreed	XXX

Profit on Amalgamation:-	Step 1	>	Step 2
Loss on Amalgamation:-	Step 1	<	Step 2

Same treatment for Profit / Loss as above,

3. Investments are held by PC in SC and

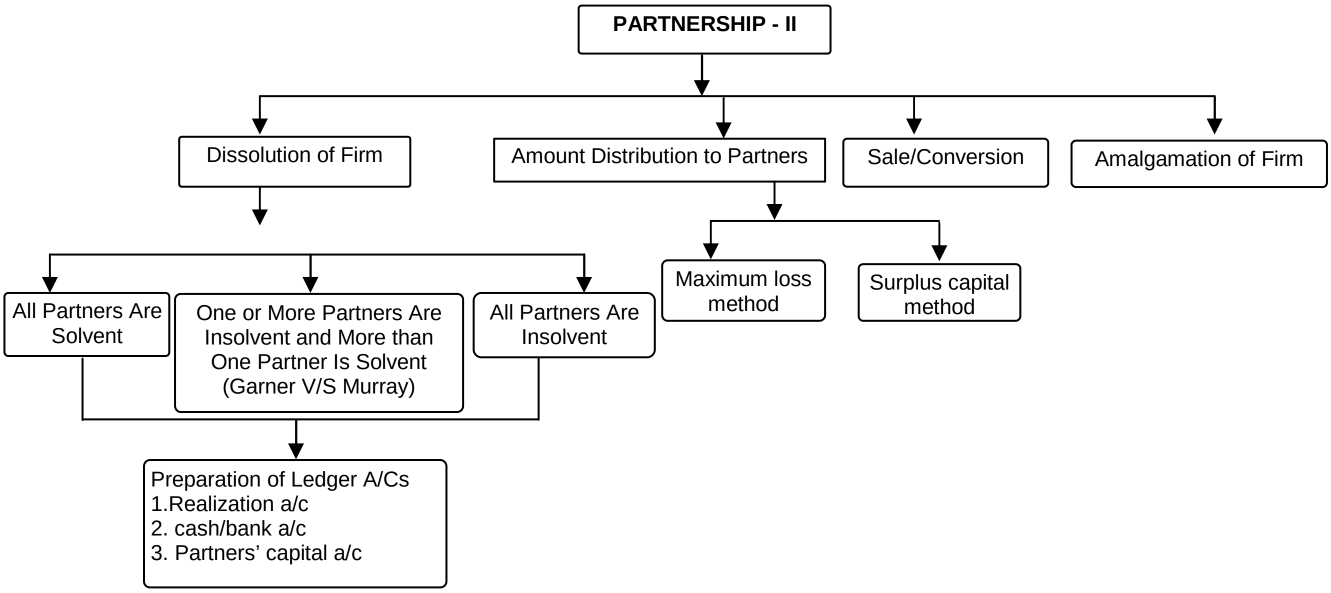
Investments are held by SC in PC.

Then it is solved by using simultaneous equation method.

NOTE: This is not covered in IPCC Syllabus.

All other information is similar to Amalgamation - I Fast Track Material.

9. PARTNERSHIP ACCOUNTS - II



DISSOLUTION OF FIRM: Procedure for closing of Books of a firm

Step	Transactions	Journal Entries	Amounts
1	**On Transfer of Assets**	Realisation A/c Dr To Sundry assets (individually)	(With the total) (Individual book values)
2	**On Transfer of Liabilities**	Sundry Liabilities (Individually) A/c Dr To Realisation A/c	(Individual book values) (With the total)
3	**On Realisation of all Assets**		
	- When assets sold for cash	Cash (or) Bank A/c Dr To Realisation A/c	with amount realized
	- assets are taken by partner	Concerned Partner's Capital A/c Dr To Realisation A/c	With amount agreed by partner
	- the assets are taken by creditors towards the full (or) partial payment of his dues which are recorded	No journal entry	
4	**On Discharge of Outsiders' Liabilities**		
	- liabilities are discharged in cash	Realisation A/c Dr To Cash (or) Bank A/c	With amount paid
	- any of the partners agree to discharge a liability**:**	Realisation A/c Dr To Concerned Partner's Capital A/c	With amount agreed by partner
5	**On Payment of Realisation Expenses**		
	- expenses are paid in cash:	Realisation A/c Dr To Cash (or) Bank A/c	With amount paid
	- for an agreed remuneration:	Realisation A/c Dr To Concerned Partner's Capital A/c	With amount Calculated
6	**On Transfer of the Balance in Realisation A/C**		
	-Profit on Realisation**:**	Realisation A/c Dr To All Partners' Capital A/cs	IN profit sharing ratio
	-Loss on Realisation:	All Partners' Capital A/cs Dr To Realisation A/c	
7	**On Payment of Partner's Loan/Advances:**	Partner's Loan/Advance A/c Dr To Cash/Bank A/c	With balance outstanding amount including interest

8	**On Transfer of the Accumulated Profits & Losses:**		
	- accumulated profits & reserves	Profit & Loss A/c Dr General Reserve A/c Dr To All Partners' Capital A/cs	in profit sharing ratio
	-accumulated los-ses	All Partners' Capital A/cs Dr To Profit & Loss A/c To Deferred Revenue Expenditure A/c	
	On Transfer of the Balance in Current A/c(s) (if any) to capital account		
	- debit balance in a Current A/c	Concerned Partner's Capital A/c Dr To concerned Partner's Current A/c	With balance available
	- credit balance in a current A/c	Concerned Partner's Current A/c Dr To Concerned Partner's Capital A/c	
9	**On Making Payment to/by a Partner:**		
	- payment by a partner having a debit balance in his Capital A/c:	Cash (or) Bank A/c Dr To Concerned Partner's Capital A/c	With balance due
	payment to a partner having a credit balance in his Capital A/c:	Concerned Partner's Capital A/c Dr To Cash (or) Bank A/c	

In case of Garner V/s Murray

i. contribute loss on Realisation in cash - solvent partners –his share only and

ii. loss of insolvent partner- solvent partners- in the ratio of capitals

- **a.** Fixed capital –direct ratio
- **b.** Fluctuating capital –Adjust up to Realisation (i.e. reserves, undrawn profits or accumulated losses, drawings etc.)

In case, all partners are insolvent

i. Transfer of Liabilities and Discharge of Liabilities not to be made as part of Realisation

ii. All liabilities are to be paid directly through in account only.

iii. Balance will be transferred to Deficiency A/c

iv. This account will be settled with partner capital (Dr) balance

Distribution of Amounts:

1. Realisation expenses
2. Preferential creditors
3. Secured creditors
4. Un secured creditors
5. Partner's loan

No separate method applicable

6. Partners capitals
   - Maximum loss method
   - Surplus capital method

Maximum Loss Method	Surplus Capital Method
Step 1: Calculate maximum loss at every point of Realisation Maximum loss = total partners' capital – Amount available for distribution	**Step 1:** Divide adjusted capital (Capital A/c + Current A/c + Share of Reserve) of each partner by his profit-sharing ratio. The smallest quotient should be taken as **Base Capital.**

Step 2: Distribute the loss to the partners in profit sharing ratio	**Step 2:** Calculate relative capital by multiplying base capital & profit-sharing ratio of each partner.
Step 3: Adjust the negative balance in their capital ratio (garner v/s murry)	**Step 3:** Calculate surplus capital by deducting relative capital (Step 2) from adjusted capital of each partner.
Step 4: After adjustment pay off the Balance	**Step 4:** Divide surplus capital (Step 3) by profit-sharing ratio of each partner. The smallest quotient should be taken as **Revised Base Capital.**
Step 5: Continue the procedure till complete all realisations	**Step 5:** Again, calculate relative surplus capital by multiplying revised base capital and profit-sharing ratio.
	Step 6: Calculate absolute surplus capital by deducting relative surplus capital from surplus capital (Step 3).

Accounting Treatment for Conversion / Sale

Selling firm books

I. Prepare Realisation Account
   a. Close all the books of accounts
   b. PC due entry to be passed
   c. PC Received

II. The division of shares among partners is as per their adjusting capital ratio standing before PC is discharging.

Purchasing Company books

Incorporate all assets and liabilities

Accounting Treatment for Amalgamation

Selling firm books

- Prepare revaluation Account -profit /loss transfer to partner capital
- Rise of goodwill - credited to Partners Capital Account
- Transfer reserves and accumulated profits to Partners capital Account
- Transfer all assets and liabilities accounts taken over -to new firm account
- Transfer all assets and liabilities accounts not taken over -to new firm account
- Partners' Capital Accounts -transfer to firm account

Purchasing firm books

- Incorporate all assets and liabilities taken over at agreed values
- Difference transfer to Partners Capital Accounts individually

For theory (Questions asked in previous 10 Years)

1. Explain Garner v/s Murray rule applicable in the case of partnership firms. State, when is this rule not applicable. (2 Marks, May, 2008 - PCC) and (2 Marks, IPCC May, 2013)

2. What is Piecemeal Payments method under partnership dissolution? Briefly explain the two methods followed for determining the order in which the payments are made? (2 Marks, May, 2010) (IPCC)

11. INSURANCE COMPANY ACCOUNTS

Insurance: Insurance is contract of indemnity the insurer is called indemnifier and the insured is called indemnified.

All and Sundry can not enter into contract of insurance:

- A Cannot insure the life of B who is a total stranger
- But where D is a relative or debtor A has insurable interest and can insure B's life.
- Contract of utmost good faith

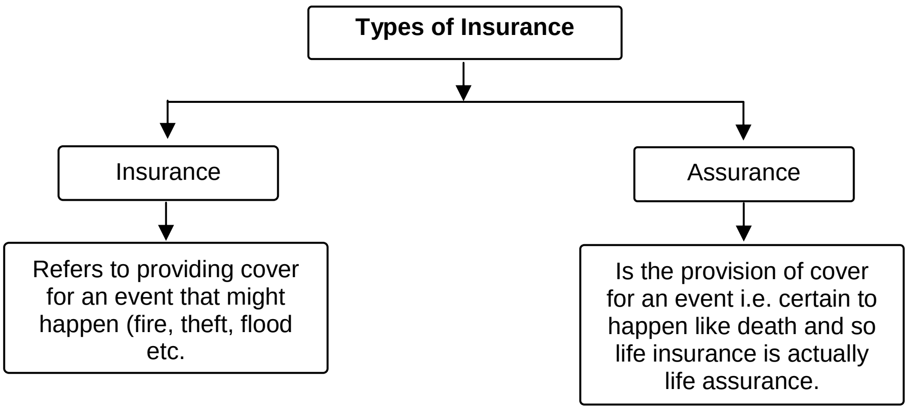
Types of Insurance:

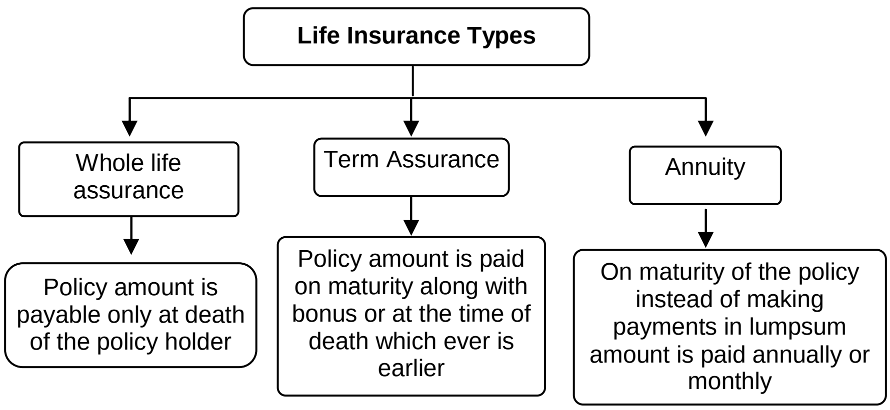
1. Life Insurance

2. General Insurance

1. Life Insurance:

- It covers the life risk of the insured person incase of death the nominee will get the insurance policy.
- The payment can be either on maturity of the policy or may be in installment called annuity of on death





Important terms

- Paid up policy
  - If an insured is unable to pay premium on his policy, he may discontinue the policy and convert it into paid up policy
- Surrender value
  - Is the provision of cover for an event i.e. certain to happen like death and so life insurance is actually life assurance.
  - When holder wishes to realize the amount of policy before expiry of period, he surrender his right and he is paid an amount by a fixed formula

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

Important terms

- Bonus
  - Policy hold is of with profit policies are entitled to received bonus at the declare rate
  - In cash
  - Bonus in reduction of premium
  - Revisionary bonus on maturity
- Interim Bonus
  - It is a bonus declared between two dates of valuation balance sheets
- Consideration for annuities granted.
  - It refers to the lumpsum amount paid to the insurer as consideration for the payment of annuities. It is an income to life insurance business
- Life Assurance fund
  - It refers to the fund which is retained to meet the aggregate liability on all policies outstanding
  - A life insurance business is said to have earned profit only if its life assurance fund exceeds its net liability on all outstanding policies

Valuation Balance Sheet:

For the purpose of ascertaining profit and losses of a life insurance company, a valuation balance sheet is prepared once in every two years.

Particulars	Amount	Particulars	Amount
To Net liability	XXX	By Life Insurance fund balance	
To Surplus	XXX	as on date	XXX
	XXX		XXX

- Disposal of surplus
  - 95% of surplus for policy holders
  - 5% of surplus for share holders
- Net Liability
  - As per actuarial valuation it is the excess of the expected future liability on all outstanding policies over the premium payable paid by the insured.

Statement showing Calculation of Net Profit:

Particulars	Amount
Surplus valuation as per valuation balance sheet	XXX
Add: Interim Bonus	XXX
Less: Expenses to be written off	XXX
Less: Provision for Tax	XXX
Surplus after Tax	XXX
Less: Surplus at the beginning of the period	XXX
Net profit for the valuation period	XXX

Statement showing distribution of Surplus:

Particulars	Amount
Total surplus after tax (after adding interim bonus)	XXX
Less: Surplus to be carried forward	XXX
Surplus available for distribution	XXX
Share of shareholders at 5%	XXX
Share of policy holders at 95%	XXX
Less: Interim Bonus paid	XXX
Amount due to Policy holders	XXX

Method I

Journal Entries

1. **For Transfer of total profits as per valuation Balance Sheet:**
   Life Assurance Fund A/c Dr
   To Profit and Loss A/c
2. **For Tax Provision:**
   Profit and Loss A/c Dr
   To Provision for Tax A/c
3. **For Bonus payable in cash:**
   Profit and Loss A/c Dr
   To Bonus payable in cash A/c
4. **For Reversionary Bonus:**
   Profit and Loss A/c Dr
   To Life Assurance Fund A/c
5. **For making reserve for unexpired risk:**
   Revenue A/c Dr
   To Reserve for unexpired risk A/c

Method II: Under this method, P& L A/c is not opened. All the entries are passed to the Life Assurance Fund A/c (or) Revenue A/c itself (but not to the P & L A/c

Dividend to shareholders, Income Tax, Bonus in cash are all debited to Revenue A/c itself. No entries are required for Reversionary Bonus.

Note: Additional journal entry is required for provision for tax

Format for Revenue Account
Form B – RA
Name of the Insurance Company
Revenue Account for the year ended

Particulars	Schedule	Current Year
Premiums earned	1	XXX
Change in provision for unexpired risk		XXX
Other Income (Profit on sale of asset etc.)		XXX
Interest, Dividend and Rent		XXX
Total (A)		XXX

Claims insured	2	XXX
Commission	3	XXX
Operating expenses for Insurance Business	4	XXX
Total (B)		XXX
Operating profit or loss from fire / marine / miscellaneous business		XXX

Form B – PL

Name of the Company profit and loss account

for the year ended

Particulars	Amount
Profit before Tax (From Revenue Account)	XXX
Less: Provision for Tax	XXX
Profit after Tax	XXX
Less: Catastrophe Reserve	XXX
Profit available for appropriation	XXX
Less: Appropriation	XXX
Interim dividend paid during the year	XXX
Proposed Final dividend	XXX
Balance of net profit for the current year	XXX
Balance of profit carried forward from last year	XXX
Balance of profit carried to Balance Sheet	XXX

Commission:

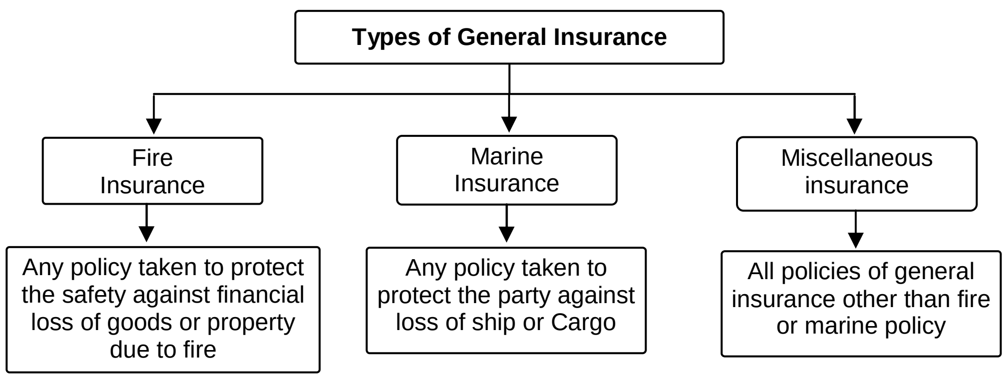
Particulars	Amount
Direct business	XXX
Add: On Re-insurance accepted	XXX
Less: On Re-insurance ceded	XXX
	XXX

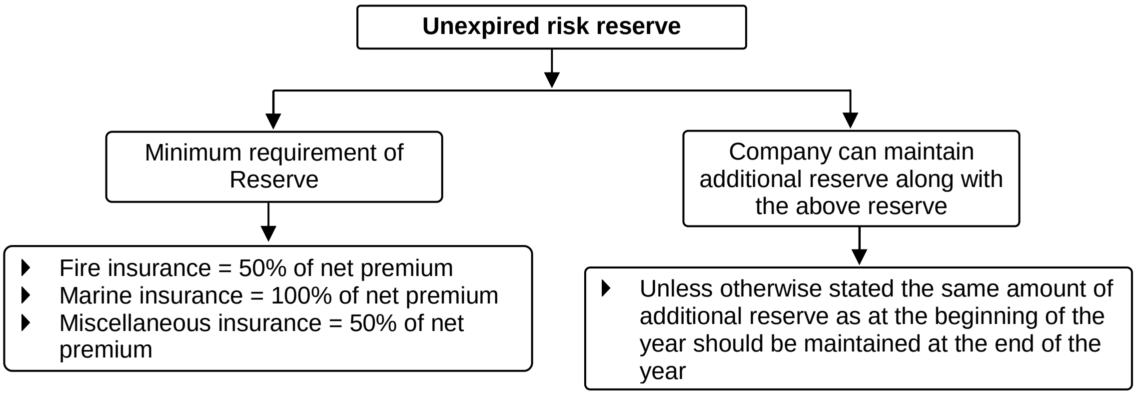
Premium earned:

Particulars	Amount
Direct business	XXX
Add: On Re-insurance accepted	XXX
Less: On Re-insurance ceded	XXX
	XXX

Claims incurred:

Particulars	Amount
Direct business	XXX
Add: Claim on re-insurance accepted	XXX
Less: Claim on Re-insurance ceded	XXX
Add: Surveyor Expenses	XXX
Add: All other expenses related to claim	XXX
	XXX





Accepting Company: An insurance company that accept part of a risk which was earlier insured by another insurance company.

Unexpired risk reserve: This reserve is created to meet the claim which may arise in respect of the policies which may remain unexpired at year end

Ceding Company: An insurance company that gives part of a risk it has assumed to another insurance company (re-insurer). The ceding company pays premium and receives commission from re-insurer.

Premium: The payment made by the insured to the insurance company in consideration of the contract of insurance.

Claims: The claim arises only when loss occurs claim outstanding included both claim intimated and accepted.

Commission: Commission is paid to the agent for getting insurance business. It is expense in revenue account.

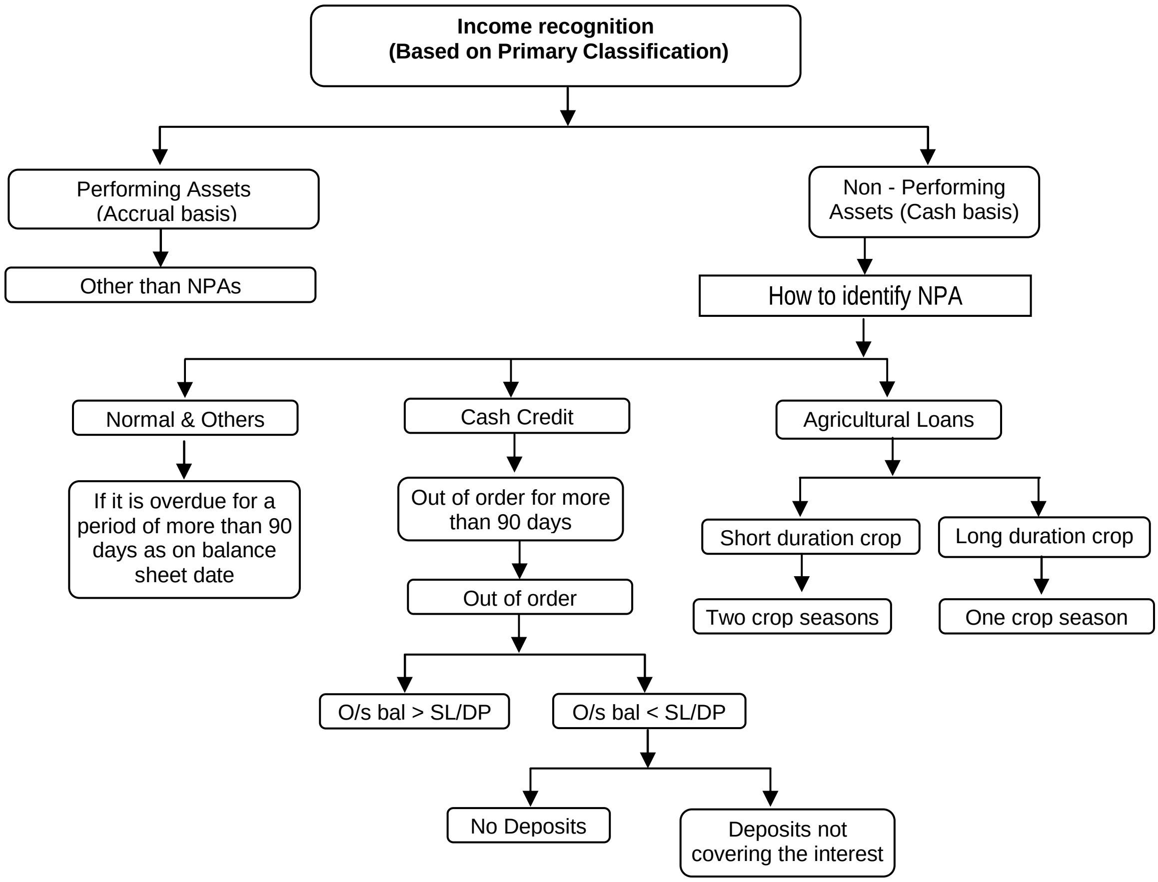
Reinsurance: An arrangement under which the insurance company insures the whole or part of the subject matter already insured by another insurance company.

Insurance Policy: It is the document issued by the insurance company containing terms of the insurance contract. It specifies the losses that are covered by the policies and also the maximum amount that can be paid in the event of loss.

Form B-PL, Profit & Loss A/c for the year ended DD-MM-YYYY

Particulars	Amount
1. Operating Profit (Loss):	
a. Fire Insurance	xxx
b. Marine Insurance	xxx
c. Miscellaneous Insurance	xxx
2. Income From Investments (Gross)	xxx
3. Other Income (to be specified)	xxx
Total (A):	xxx
4. Provisions (Other than taxation):	
a. For diminution in the value of investments	xxx
b. For doubtful debts	xxx
c. Others (to be specified)	xxx
5. Other Expenses:	
a. Expenses other than those related to Insurance Business	xxx
b. Bad debts written off	xxx
c. Others (to be specified)	xxx
Total (B):	xxx
Profit before tax (A – B)	xxx

11. BANK ACCOUNTS



SL: Sanctioned limit

DP: drawing power

Important Points:

- Net worth of the borrower or security provided is irrelevant for identification of NPA
- If one facility (Loan) is NPA, then other facilities provided to that borrower are also treated NPA.
- Separate legal entity concept will not be applicable to partnership firms for classification of NPA.

  Example:

  Mr. X has taken a housing loan, it is NPA now. Mr. X & Co is a partnership firm taking a term loan which is performing asset whether the term loan is treated as NPA or not?

  Ans: Yes, it has to be treated as NPA as there is no separate legal entity

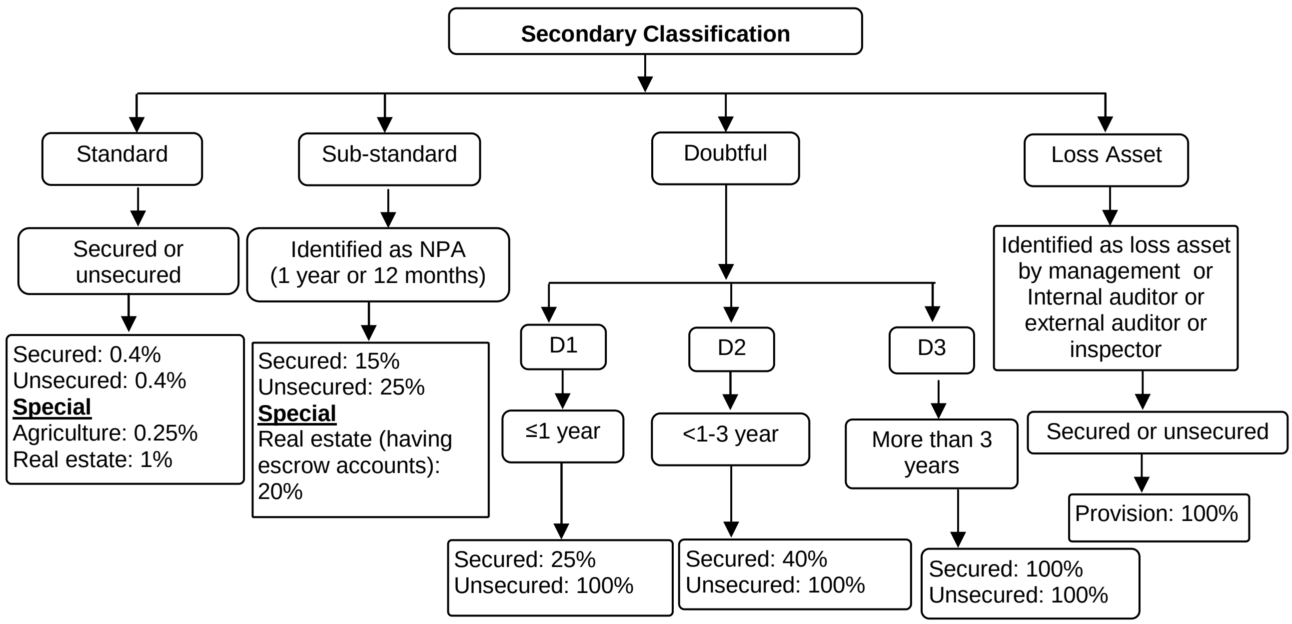
Regularization of Accounts: If any amount is paid on or before 31st March, from genuine source then the loan need not be treated as NPA.

Note: If a customer takes another loan from the same bank to repay that previous loan of that bank then it is not a genuine source.

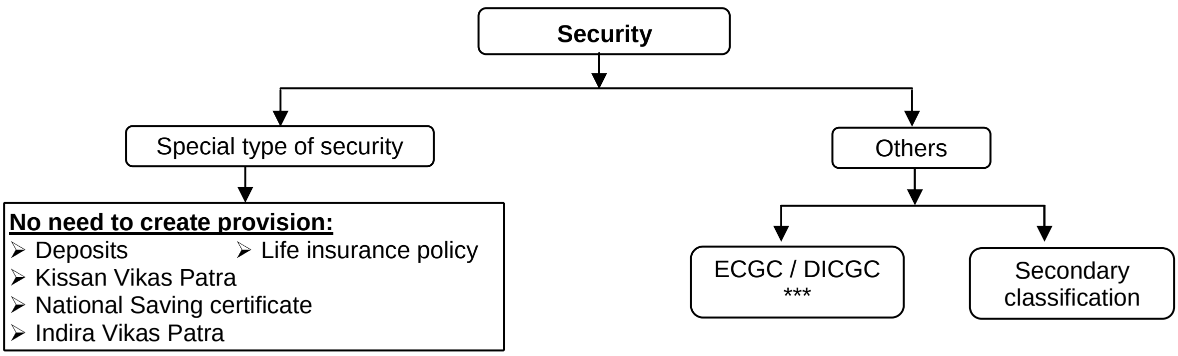
Application of Amount collected from the borrowed by bank:

It will be adjusted against

- Last period interest
- Current period interest
- Last period principal
- Current period principal

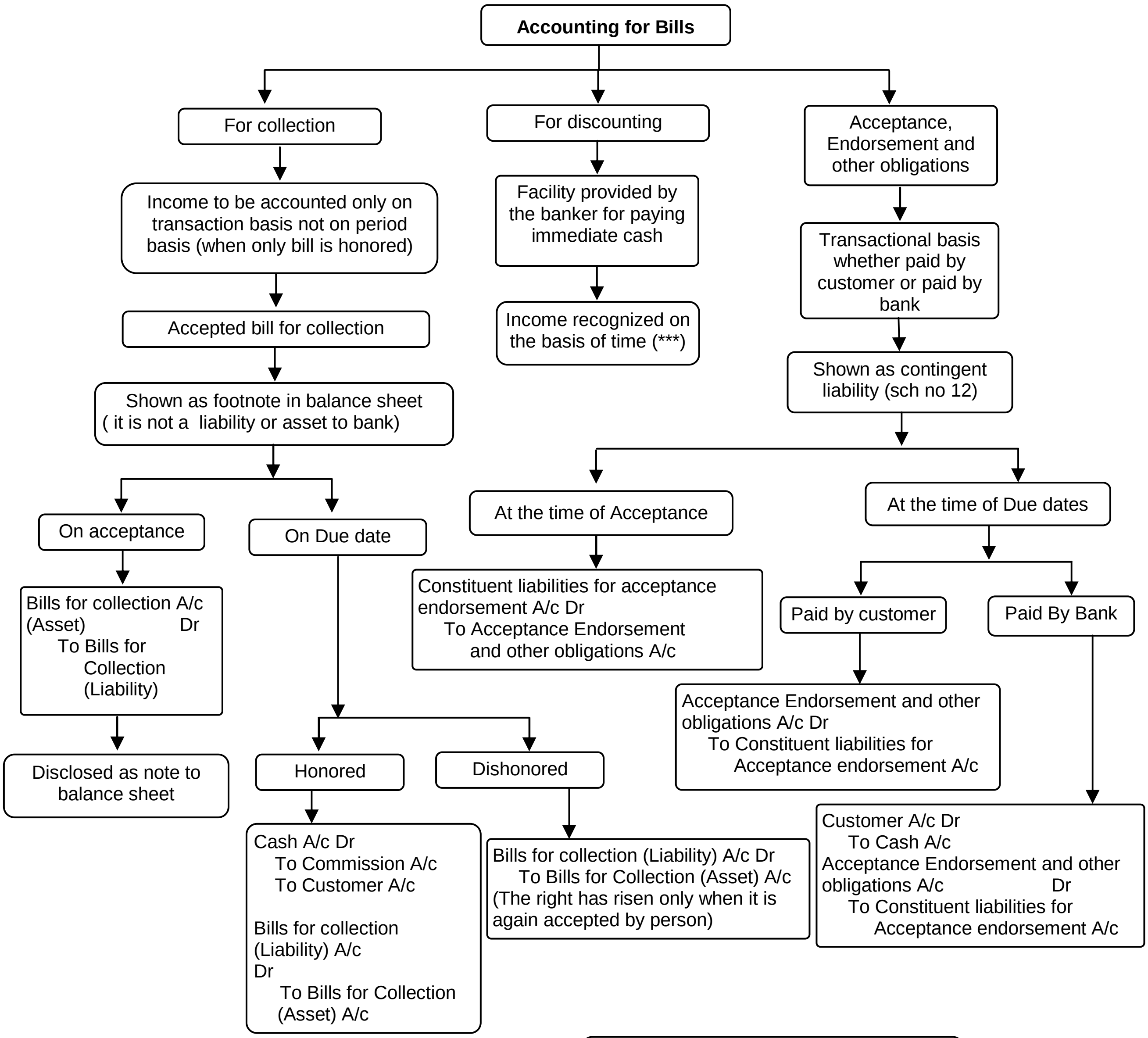


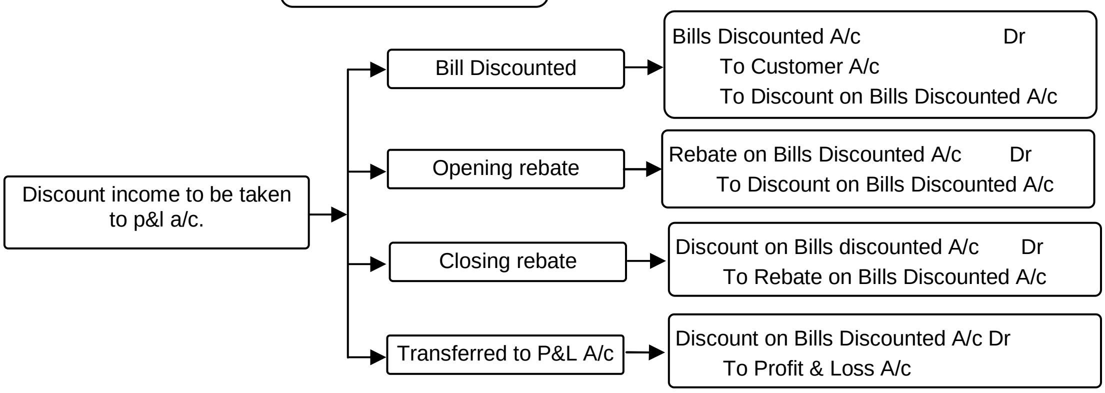
All provisions are made on the basis of security



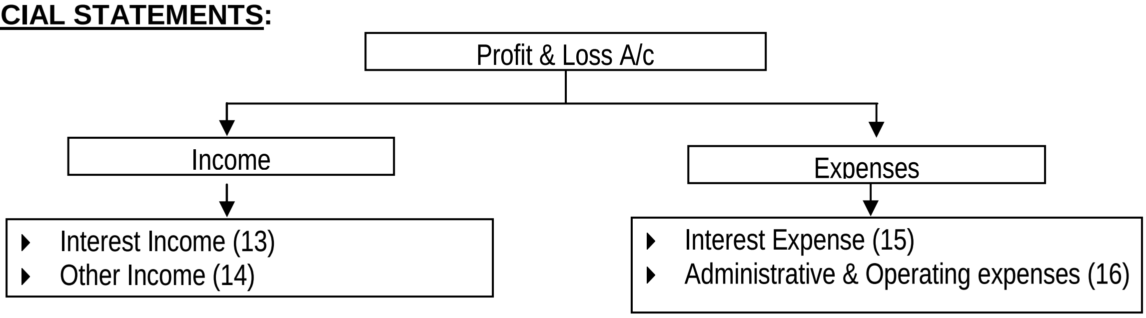
(***)…**Advances Guaranteed by ECGC/DICGC:** In case advances are guaranteed by ECGC/DICGC then the provision should be created as follows:

Particulars	Rs.
Balance Outstanding	XXX
Less: Realisable Value of Security	(XXX)
Unsecured Portion	**XXX**
Less: ECGC/DICGC Cover	(XXX)
Net Unsecured Portion	**XXX**
Provisioning Required:	
For net Unsecured Portion (100% X Net Unsecured Portion)	XXX
For Portion covered by security	
Provision as per secondary classification	XXX
Total Provision Required	**XXX**





<u>FINANCIAL STATEMENTS</u>:



Adjustments while preparing P&L: Transfer 25% of current year profits to statutory reserves

Balance Sheet

Liabilities

- Share capital (1)
- Reserves and surplus (2)
- Deposits (3)
- Borrowings (4)
- Other liabilities (5)

Assets

- Cash& Balance with RBI (6)
- Balance with other banks(7)
- Investments (8)
- Loans & advances (9)
- Fixed Assets (10)
- Other Assets (11)
- Contingent liability (12)

Adjustment in Balance Sheet:

- 4% - CRR should be maintained on Net demand and time liabilities in the form of Balance with RBI
- 21.5% - SLR should be maintained on Net demand and time liabilities in the form of Balance of cash, gold ,approved investments (w.e.f 07/02/2015)

Bank can lend only 74.5% deposits that they got from depositors.

Profit & Loss A/c

Income

- Interest Income (13)
- Other Income (14)

Expenses

- Interest Expense (15)
- Administrative & Operating expenses (16)

CAPITAL ADEQUACY RATIO

$$\text{Capital adequacy norms} = \frac{\text{Capital Funds}}{\text{Risk adjusted assets}}$$

Capital Funds

Tier – I

Share capital
ADD: Reserves and surplus:
- Statutory reserve
- Securities premium
- Capital Reserve (In cash)
- Other disclosure free reserves

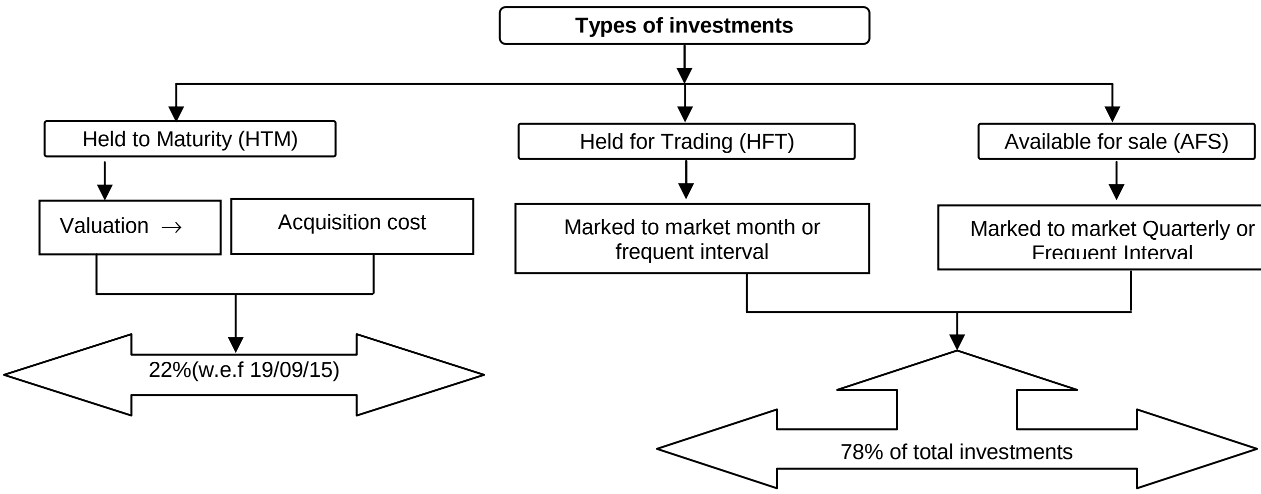
Less: Adjustments
- Current and brought forward losses
- Intangible assets (having no value)
- Equity investment in subsidiaries

Tier – II
(Maximum 100% of tier I capital)

- Revaluation Reserve
  Less 55% (net to be considered 45%)
- Hybrid debt capital instruments
- Sub-ordinate debts (50% of Tier – I)
- General Provisions and losses (1.25% of risk weighted assets)

Funded Risk Assets

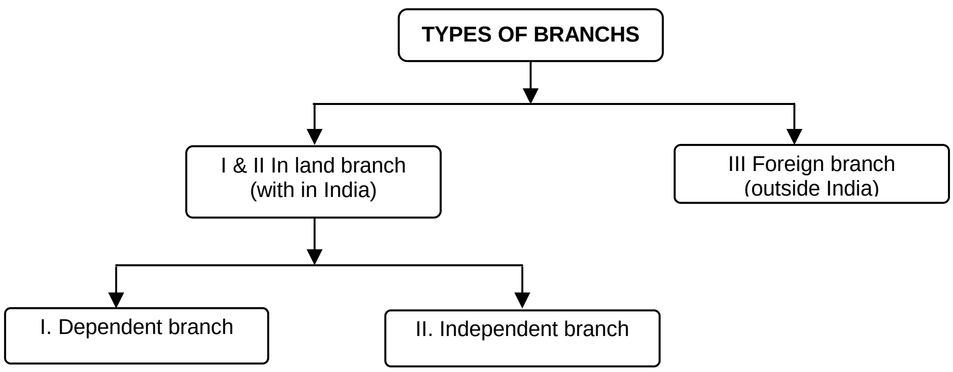
Type	Item of Asset	Risk %
Related to Government	Cash balance with RBI	0
	Investment in Govt. Securities	
	Loans & advances guaranteed by Govt.	
Related to Bank	Balance in Current A/c with other Banks	20
Residential Assets	Investment in Mortgage based securities of Residential Assets	50
All other type of assets	Other investments	100
	Other loan & advances	
	Bank Premises, Furniture & Fittings	
	All off – Balance sheet item (LC'S, LG's, Bills acceptances)	
Real Estate	Non funded Exposure to Real Estate	150

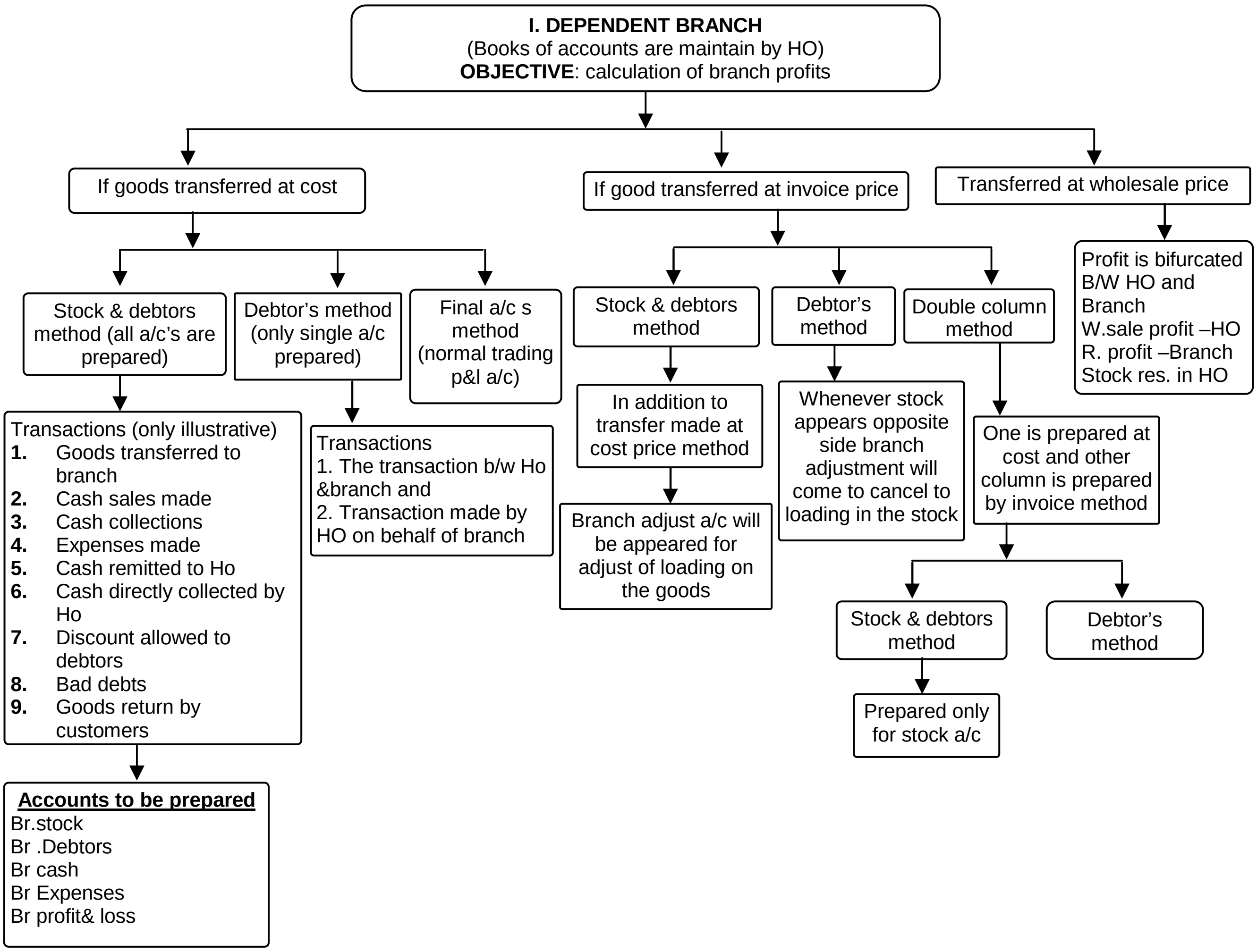


For theory (Questions asked in previous 10 Years)

1. What is the percentage of NPA provision to be made by banks in respect of fully secured doubtful advances of more than 3 years old? (2 Marks, November, 2007) (PCC)
2. Mention the conditions when a cash credit overdraft account is treated as 'out of order' (2 Marks, May, 2010) (IPCC)

12. BRANCH ACCOUNTS

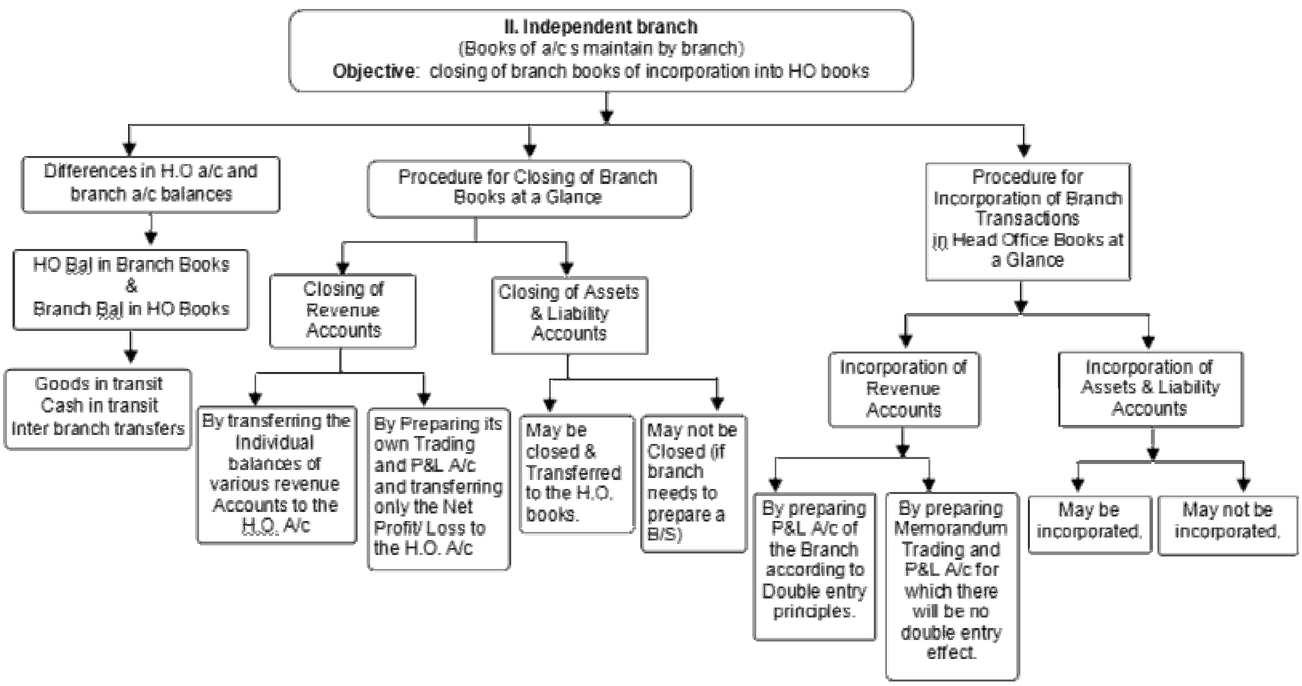


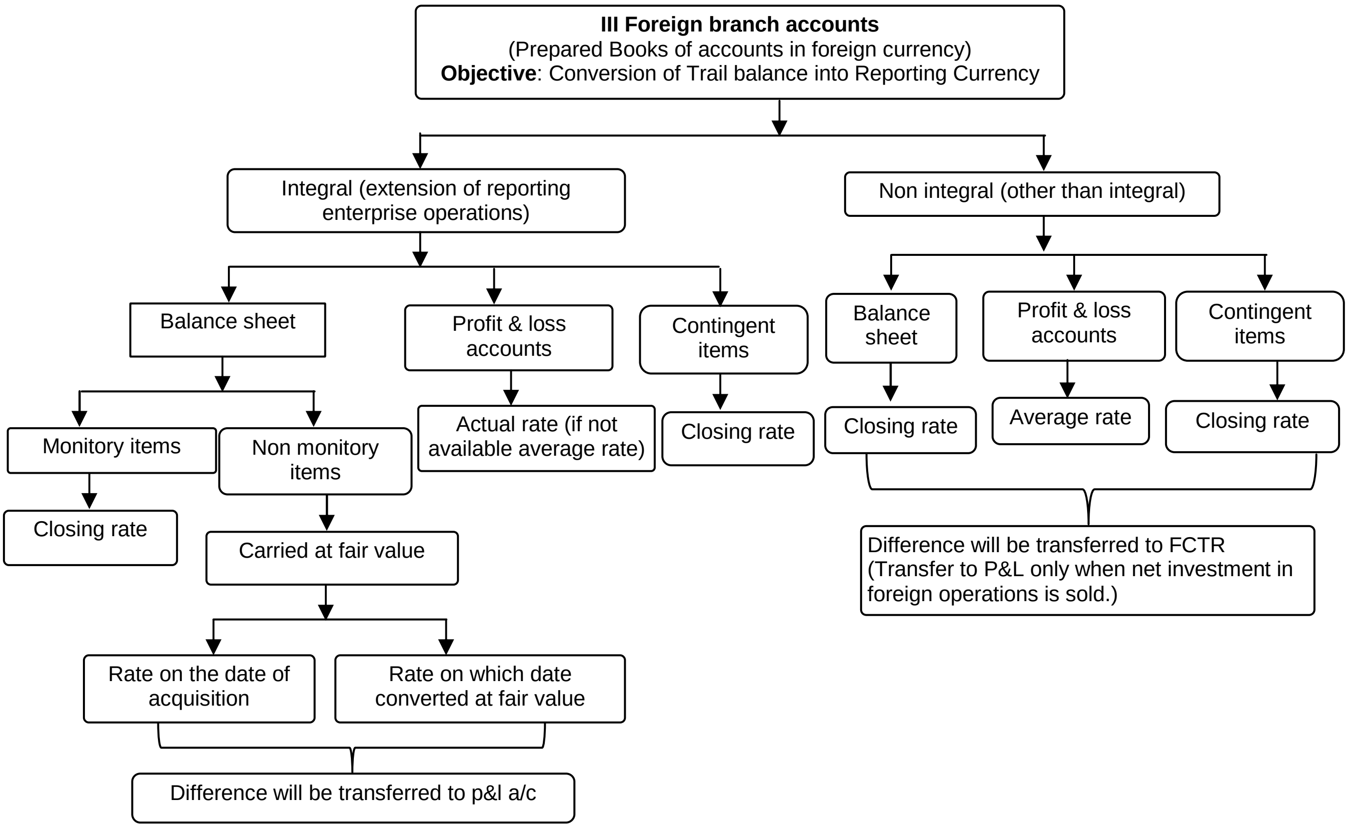


Journal entries in case of Dependent Branches (Stock and debtors method)

Transaction	Transfer at cost price	Transfer at Invoice Price
1. Opening Balance	Br.stock Br.Debtors Br cash	Br.stock Br.Debtors Br cash Br. adjustment (loading on Stock)
2. For Goods sent to Branch:	Branch Stock A/c Dr To Goods Sent to Branch A/c	Branch Stock A/c Dr To Goods Sent to Branch A/c To Branch Adjustment A/c
3. For Goods returned by Branch:	Goods Sent to Branch A/c Dr To Branch Stock A/c	Goods Sent to Branch A/c Dr Branch Adjustment A/c Dr To Branch stock
4. For remittance to Branch for expenses	Branch Cash A/c Dr To Bank A/c	Branch Cash A/c Dr To Bank A/c
5. For cash sales at Branch:	Bank A/c Dr Branch cash A/c Dr (if money is not immediately remitted) To Branch Stock A/c	Bank A/c Dr Branch cash A/c Dr (if money is not immediately remitted) To Branch Stock A/c
6. For credit sales at Branch:	Branch Debtors A/c Dr To Branch Stock A/c	Branch Debtors A/c Dr To Branch Stock A/c
7. For Goods returned to Branch by customers:	Branch Stock A/c Dr To Branch Debtors A/c	Branch Stock A/c Dr To Branch Debtors A/c
8. For Cash collected from Branch Debtors:	Bank A/c Dr Branch cash A/c Dr (if money is not immediately remitted) To Branch debtors A/c	Bank A/c Dr Branch cash A/c Dr (if money is not immediately remitted) To Branch debtors A/c

9. For Discount & Allowances to Debtors & Bad Debts:	Branch Profit & Loss A/c Dr To Branch Debtors A/c	Branch Profit & Loss A/c Dr To Branch Debtors A/c
10. For remittances to Head Office:	Bank A/c Dr To Branch Cash A/c	Bank A/c Dr To Branch Cash A/c
11. For Branch expenses:	Branch Expenses A/c Dr To Bank A/c To Branch cash A/c, (if met by branch)	Branch Expenses A/c Dr To Bank A/c To Branch cash A/c, (if met by branch)
12. For Purchase of any Fixed Asset at Branch:	Branch Asset A/c Dr To Bank A/c To Branch cash A/c, (if met by branch)	Branch Asset A/c Dr To Bank A/c To Branch cash A/c, (if met by branch)
13. For Depreciation on Branch Assets:	Branch Profit & Loss A/c Dr To Branch Assets A/c	Branch Profit & Loss A/c Dr To Branch Assets A/c
14. For abnormal Loss and Goods:	Branch Profit & Loss A/c (cost) Dr Insurance Claim A/C (if covered Insurance) Dr To Branch Stock A/c	Branch Profit & Loss A/c (cost) Dr Insurance Claim A/C (if covered Insurance) Dr Branch adjustment A/c(loading) To Branch Stock A/c
15. Closing Balance	Br.stock(Giving result to Gross Profit) Br. Debtors Br cash Br. Profit and loss (results Net profit)	**Br.stock**(at invoice price) **Br. Debtors**(same as cost price) **Br cash(**same as cost price) **Br. adjustment** (loading on Stock)(results gross profit) **Br. Profit and loss** (results Net profit)





FCTR: foreign currency transactions reserve.

For theory (Questions asked in previous 10 Years)

1. Why goods are marked on invoice price by the head office while sending goods to the branch?

(M11 - 4 M) (IPCC)

THE END