MAR GREGORIOS COLLEGE
OF ARTS & SCIENCE

Block No.8, College Road, Mogappair West, Chennai – 37

Affiliated to the University of Madras
Approved by the Government of Tamil Nadu
An ISO 9001:2015 Certified Institution

DEPARTMENT OF COMMERCE

SUBJECT NAME: ADVANCED CORPORATE ACCOUNTING

SUBJECT CODE: CPZ4A

SEMESTER: IV

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ADVANCED CORPORATE ACCOUNTING

OBJECTIVES **No. of Credits: 4**

- To provide the students with an understanding of accounting procedure for corporate restructuring.
- Tomakethestudentsunderstandtheapplicationsof Accounting Transactions in Corporate Sector.
- The students will be able to understand the procedures of corporate restructuring and to prepare the various accounting statements

UNIT I: Internal Reconstruction

Meaning - Alteration of share capital – Accounting Procedures.

UNIT II: Amalgamation, Absorption & External Reconstruction

Meaning- Amalgamation in the nature of Merger, Purchase - External Reconstruction – Applicability of AS 14- Calculation of Purchase consideration (all methods) – Journal Entries in the books of Transferor and Transferee Companies, Revised Balance Sheet (excluding inter - company holdings)

UNIT III: Liquidation

Meaning – Preparation of Liquidator's Final Statement of Accounts – Calculation of Liquidator Remuneration.

UNIT IV: Consolidation

Holding Company –Subsidiary company - Meaning – Preparation of Consolidated Final Statement of Accounts.

UNIT V: Accounting For Banking Companies

Bank accounts - Concept of Non-Performing Assets (NPA)-Preparation of Profit and Loss Account - Asset classification - Preparation of Balance Sheet

UNIT -I

- **AMALGAMATION**
- **INTERNAL RECONSTRUCTION**
- **LIQUIDATION OF COMPANIES**

AMALGAMATION OF COMPANIES
Introduction

There are many forms of business combinations to obtain the economies of large scale production or to avoid the cut throat competition. They are amalgamation, absorption, external reconstruction etc.

The term amalgamation is used when two or more existing companies go into liquidation and a new company is formed to take over the business of liquidated Companies . The term absorption is used when an existing company takes over the business of one or more existing companies which go into liquidation. In external reconstruction, one existing company goes into liquidation and a new company is formed to take over the former company.

Definitions as per Accounting Standard 14 (AS-14)

a. ***Amalgamation*** – means an amalgamation pursuant to the provisions of the Companies Act 1956 or any other statute which may be applicable to companies.
b. ***Transferor Company*** – means the company which is amalgamated into another company.
c. ***Transferee Company*** – means the company to which a 6ransferor company is amalgamated.
d. ***Reserve*** – means the portion of earnings, receipts or other surpluses of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than provision for depreciation or diminution in the value of assets or for a known liability

Types of Amalgamation

As per AS-14 there are two types of amalgamation (1) Amalgamation in the nature of merger and (2) Amalgamation in the nature of purchase.

Amalgamation in the nature of Merger (Pooling Interest Method)

An amalgamation should be considered to be an amalgamation in the nature of merge when all the following conditions are satisfied:

a. All the assets and liabilities of the Transferor Company or companies before amalgamation should become the assets and liabilities of the transferee company.

b. Shareholders holding not less than 90% of the face value of the equity shares of the
Transferor Company (excluding the proportion held by the transferee company) should become the shareholders of the transferee company.

c. The consideration payable to the above mentioned shareholders should be discharged by the transferee company by the issue of the equity shares and cash can be payable in respect of fractional shares.

d. The business of the Transferor Company/ companies is intended to be carried on by the transferee company.

e. No adjustment is intended to be made to the book values of the assets and liabilities of the Transferor Company/ companies when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Difference between Amalgamation in the nature of merger and Amalgamation in the nature of purchase

Merger	Purchase
1. There is a genuine pooling of assets and liabilities of the transferor companies as well as the share holders' interest. As such the shareholders of all the transferor companies continue to have substantial or proportionate share in the equity or management of Transferee Company.	1. One company acquires another. As a consequence, the shareholders of the transferor company normally do not continue to have a proportionate share in the equity management of the transferee company.
2. Assets, liabilities and reserves of the transferor company are recorded by the transferee company at their book values.	2. Assets, liabilities and reserves of the transferor company are recorded by the transferee company either at book value or at values revised on the basis of their fair values.
3. The balance of P&L A/c of the transferor company aggregated with the balance of the P&L A/c of the transferee company.	3. The balance of P&L A/c of the transferor company is not included in the books of the transferee company.
4. All reserves whether capital or revenue 0of Transferor Company are merged into the reserves of Transferee Company.	4. Only statutory reserves of Transferor Company are taken in the books of Transferee Company in order to preserve their identity.
5. It is always intended to continue the business of transferor company.	5. It may not be intended to continue the business of Transferor Company.
6. All the assets of Transferor Company become the assets of the transferee company.	6. All the assets of transferor company may or may not become the assets of the transferee company.
7. Purchase consideration is usually valued at the par value of the shares issued.	7. Purchase consideration is usually valued at the market price of the shares issued.

Purchase Consideration

Purchase consideration is the amount which is paid by the transferee company for the purchase the business of Transferor Company. As per AS-14, consideration for amalgamation means the aggregate of shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Purchase consideration does not include any payment to outsiders including debenture holders. The purchase consideration may be calculated in the following ways:

1. ***Lump Sum Method***: When the transferee company agrees to pay a fixed sum to the transferor company, it is called lump sum payment of purchase consideration. For example, X Ltd purchases the business of Y Ltd for a consideration of 1000000.

2. ***Net Worth (Net Assets) Method***: Under this method, the net worth of the assets taken over by the transferee company is taken as purchase consideration.

Here, Purchase consideration = Assets taken over at agreed values – Liabilities taken over at agreed values.

The following points are noted while calculating purchase consideration under his method:

a. Cash balance is usually included in assets. But if it is not taken over, it will not be included.

b. Fictitious assets should never be added.

c. Accumulated profits and reserves should not be considered.

d. The term 'liabilities' include all liabilities to third parties. But 'trade liabilities' include only trade creditors and bills payable.

e. The term 'businesses' will always mean both the assets and liabilities.

Illustration 1: The following are the liabilities and assetsof Amrita Ltd

Liabilities	Rs.	Assets	Rs.
Share capital	60000	Goodwill	28000
Debentures	10000	Land & building	16000
Sundry creditors	6000	Plant & Machinery	28000
General reserve	4000	Stock	16000
Profit & Loss A/c	20000	Debtors	8000
		Cash	2000
		Preliminary expenses	2000
	100000		100000

Bangalore Ltd takes over the business of Amrita Ltd. the value agreed for various assets are: Goodwill Rs.22000, Land & Building Rs.25000, Plant and Machinery Rs.24000, Stock Rs.13000 and Debtors Rs.8000. Bangalore Ltd does not take over cash but agrees to assume the liability of sundry creditors at Rs.5000. Calculate the purchase consideration.

Solution:

<u>Calculation of purchase consideration</u>

Value of assets taken over:

Goodwill	22000
Land & Building	25000
Plant and Machinery	24000
Stock	13000
Debtors	<u>8000</u>

		92000
Less: Liabilities taken over:		
Sundry creditors	5000	
Debentures	10000	15000
Purchase consideration		77000

3. ***Net Payment method***: Under this method, purchase consideration is the aggregate of all payments in the form of cash, shares, securities etc. to the shareholders of the transferor company by the transferee company. The following points are considered while calculating purchase consideration under this method:

a. The assets and liabilities taken over by the transferee company are not considered.
b. Purchase consideration includes the payments to shareholders only.
c. Any payments made by the transferee company to some other party on behalf of the transferor company are to be ignored.

Illustration 2: The liabilities and assets of Jay Ltd as on 31 March 2015 is as follows:

Liabilities	Rs.	Assets	Rs.
Share capital	200000	Goodwill	40000
General reserve	35000	Land & building	90000
Profit & Loss A/c	20000	Plant & Machinery	75000
Debentures	50000	Stock	52000
Sundry creditors	25000	Debtors	58000
		Cash	15000
	330000		330000

Jay Ltd decides to amalgamate into a new company New Ltd which will take over the assets and liabilities of Jay Ltd in the term that holders of each share of Rs.10 in the company would receive one share of Rs.10 each, Rs.5 paid up and Rs.4 in cash. The liquidation expense of Rs.5000 is met by New Ltd. calculate purchase consideration.

Solution:

Calculation of purchase consideration

Holder of each share of Rs.10 each will get one share of Rs. 10 each Rs.5 paid up = 100000

Holder of each equity share will get Rs.4in cash (2000x4) = 80000

Purchase consideration = 180000

(Note: Liquidation expense is not included in purchase consideration)

d. ***Share exchange or Intrinsic value Method***: Under this method purchase consideration is calculated on the basis of intrinsic value of shares. The intrinsic value of a share is calculated by dividing g the net assets available le for equity shareholders by the number of equity shares. This value determines the ratio of exchange of the shares between the transferee and transferor companies.

Steps in accounting procedure of amalgamation, absorption and external reconstruction

a. Calculation of purchase consideration.
b. Ascertainment of discharge of purchase consideration.
c. Closing the books of transferor companies.
d. Passing opening entries in the books of purchasing or Transferee Company.

Accounting entries in the books of Transferor Company

1. For transferring assets to Realisation A/c:
   Realisation A/c Dr
   To Assets A/c (individually at book value)

(Note :(a). Fictitious assets should not be transferred to Realisation A/c (b). If cash in hand and bank are not taken over by transferee company should not be transferred to Realisation A/c. But it can be taken as opening balance of cash or bank A/c and (c). Other assets, even if they are not taken over, should be transferred to Realisation A/c)

2. For transferring liabilities(outside liabilities only) to Realisation A/c:
   Liabilities A/c Dr (individually at book value)
   To Realisation A/c

(Note :(a). If any liability is not taken over by transferee company should not be transferred to Realisation A/c, (b). Items in the nature of provisions are to be transferred to Realisation A/c and (c). Any fund which denotes both liability and reserve, the portion of liability should be transferred to Realisation A/c).

3. For purchase consideration due from transferee company:
   Transferee Company A/c Dr
   To Realisation A/c
4. On receiving or discharging purchase consideration:
   Equity shares in Transferee company A/c Dr
   Preference shares in Transferee company A/c Dr
   Debentures in Transferee company A/c Dr
   Cash/ Bank A/c Dr
   To Transferee company A/c
5. For sale of assets not taken over by transferee company:
   Cash/ Bank A/c Dr (Sale proceeds)
   To Realisation A/c

6. For discharging liabilities not taken over by transferee company:

Liability A/c Dr
Realisation A/c Dr (if excess amount paid)
To Cash/ Bank A/c
To Realisation A/c (If less payment is made)

7. For liquidation (realisation) expenses:

a. If liquidation expenses are met by transferor company.
Realisation A/c Dr
To Cash/ Bank A/c

b. If liquidation expenses are met by transferee company.
No entry is required.

8. For closing preference share capital:

Preference share capital A/c Dr
Realisation A/c Dr (if excess amount paid)
To Preference shareholders A/c
To Realisation A/c (if less amount paid)

9. For paying off Preference shareholders:

Preference shareholders A/c Dr
To Preference shares in Transferee company A/c
To Cash/ Bank A/c (if any)
To Debentures A/c (if any)

10. For transferring equity share capital, reserves etc.

Equity share capital A/c Dr
General reserve A/c Dr
P&L A/c Dr
Dividend equalization reserve A/c Dr
Security premium A/c Dr
To equity shareholders A/c

11. For transferring fictitious assets:

Equity shareholders A/c Dr
To P&L A/c
To preliminary expenses
To Discount/ expense on issue of shares/ debentures

12. For closing Realisation A/c:

a. For loss on realisation (if debit > credit).
Equity shareholders A/c Dr
To Realisation A/c

b. For profit on realisation (if credit > debit).
Realisation A/c Dr
To Equity shareholders A/c

13. For payment to equity shareholders:

Equity shareholders A/c Dr
To Equity shares in Transferee company A/c
To Cash/ Bank A/c (if any)

Illustration: A Ltd agrees to sell their undertaking to B Ltd on the following terms. B Ltd will pay them Rs.600000 in cash and allot them two fully paid share of Rs.6 each (market value Rs. 7.50 per share) in exchange of every three shares in their own company. The liabilities and assets of A Ltd on the date of amalgamation stood as follows:

	Rs.		Rs.
Share Capital		*Fixed Assets*	
120000 equity shares of Rs.6		Land & Building	450000
Each, fully paid up	720000	Plant & Machinery	218700
Reserves & Surplus		*Current Assets*	
General Reserve	360000	Stock	273450
P & L A/c	34168	Sundry Debtors	229500
Creditors	132500	Bank	74280
		Cash	738
	1246668		1246668

A ltd will pay their liquidation expenses themselves which amounted to Rs.9000. close the books of A Ltd and give opening entries in the books of B Ltd assuming that the amalgamation is in the nature of purchase.

Solution:

Calculation of purchase consideration

In cash		600000
In equity shares (120000x2/3x7.50)	600000	
Purchase Consideration		1200000

Closing entries in the books of A Ltd

			Rs.	Rs.
	Realisation A/c Dr		1246668	
	To Land & Building A/c			450000
	To Plant & Machinery A/c			218700
	To Stock A/c			273450
	To Sundry Debtors A/c			229500
	To Bank A/c			74280
	To Cash A/c			738
	(transfer of various assets to Realisation A/c)			

	Sundry creditors A/c Dr		132500	
	To Realisation A/c			132500
	(transfer of sundry creditors to Realisation			
	A/c)		1200000	
	B Ltd A/c Dr			1200000
	To Realisation A/c			
	(purchase consideration due from B Ltd)		600000	
	Cash A/c Dr		600000	
	Equity Shares in B Ltd A/c Dr			1200000
	To B Ltd A/c			
	(purchase consideration received)		720000	
	Equity share capital A/c Dr		360000	
	General reserve A/c Dr		34168	
	P&L A/c Dr			1114168
	To equity shareholders A/c			
	(transfer of equity shareholders' funds)		9000	

	Realisation A/c Dr			9000
	To Cash A/c			
	(liquidation expenses paid)		76832	
	Realisation A/c Dr			76832
	To Equity shareholders A/c			
	(transfer of profit on realisation)		1191000	
	Equity shareholders A/c Dr			600000
	To Equity shares in B Ltd A/c			591000
	To Cash A/c			
	(distribution of equity shares and cash received)			

Opening entries in the books of B Ltd

			Rs.	Rs.
	Land & Building A/c		450000	
	Dr		218700	
	Plant & Machinery A/c Dr		273450	
	Stock A/c		229500	
	Dr		74280	
	Sundry Debtors A/c Dr		738	
	Bank A/c		85832	
	Dr			132500
	Cash A/c			1200000
	Dr			
	Goodwill A/c (Bal. Fig)			
	Dr		1200000	
	To Sundry Creditors A/c			480000
				120000

	To Liquidators of A Ltd A/c (purchase consideration due and assets and liabilities taken over)			600000
	Liquidators of A Ltd A/c Dr To Equity Share capital A/c To Security premium A/c To Cash A/c (payment of purchase consideration)			

Inter-company Owings or Debts

Generally amalgamation or absorption takes place between companies having mutual transactions. One company may purchase goods on credit from the other. Sometimes, one company accepts the bills of exchange drawn by the other.

Mutual Debts

At the time of amalgamation or absorption, inter-company debts must be eliminated because after amalgamation or absorption both companies become one entity and nothing will be payable or receivables between them. The adjusting entry in the books of transferee company for the elimination is:

Sundry Creditors A/c Dr
To Sundry Debtors A/c

Note: No adjusting entry is required in the books of transferor company.

Mutual Acceptance

There may be mutual acceptance of bills of exchange between the companies. For such mutual acceptance the following adjusting entry is passed in the books of Transferee Company:

Bills Payables A/c Dr
To Bills Receivables A/c

Note: No adjusting entry is required in the books of Transferor Company.

Shares held by transferor company in transferee company

The following steps are involved:

1. Calculate the purchase consideration, depending on the method applicable. However,

a) If purchase consideration is calculated under 'net assets method', investment Held by Transferor Company in Transferee Company must not be considered as an asset.

b) If purchase consideration is calculated under 'net payment method', deduct the number of shares of Transferee Company held by Transferor Company from total number of shares to be discharged by the transferee company.

2. In the books of transferor company:

a) Shares held by Transferor Company in Transferee Company must not be transferred to Realization Account. It must be shown as the balance in the Shares in Transferee Company Account (Investment Account).

b) The shares received from Transferee Company as a part of purchase consideration must be debited to Shares in Transferee Company Account (Investment Account).

c) Transfer the profit or loss on revaluation of investment to the Realization Account.

d) Transfer the balance in Shares in Transferee Company Account (Investment Account) to the Shareholders Account.

3. In the books of Transferee Company – There will be no specific entry.

UNIT – II

ACCOUNTS OF HOLDING COMPANIES

Holding Companies

A holding company is the company that holds either the whole of the share capital or a majority of the shares in one or more companies so as to have a controlling interest in such companies. Such other companies are known as subsidiary companies. Unlike in amalgamation or absorption, the subsidiary companies retain their identities because they do businesses in their own names.

Group of Companies

A Holding company together with its Subsidiaries can be called as the Group of companies.

Need for Group of Companies

The following are the advantages for a company to operate as a group:

1. *Decentralization of financial risk*: If one entity fails, it does not affect the other companies in the group. The other companies can continue even if one or two companies in the group fail.

2. *Lawful obligation*: In some cases, the formation of a subsidiary company is a legal requirement.

3. *Diversification possible at lower cost*: One company acquires controlling

interest of another company. It helps the company to diversify its business activities at least cost.

Legal Definition

Subsidiary Company– Sec 2(87) of the Companies Act 2013 defines a company. As per this section, a company shall be deemed to be a subsidiary company of another if and only if:

(a) that other company controls the composition of its board of directors ; or

(b) when the first mentioned company is another company, holds more than half in nominal value of its equity share capital; or

(c) the company is a subsidiary of any company which is that other company's subsidiary.

A Subsidiary company may be either Wholly Owned Subsidiary or Partly Owned Subsidiary.

Accounts

The following documents in respect of a subsidiary or subsidiaries should be attached with the balance sheet of a holding company:

(a) A copy of Balance Sheet of Subsidiary.
(b) A copy of its Statement of Profit and Loss.
(c) A copy of Report of its Board of Directors.
(d) A copy of Report of its Auditors.
(e) A Statement of Holding Company's interest in Subsidiary.

According to section 129(3) of the Companies Act 2013, a holding company shall prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own, which shall also be laid before the annual general meeting of the company along with the laying of its financial statements.

Consolidated Balance Sheet

In addition to the legal balance sheet as prescribed in Schedule III, the holding company may also publish a Consolidated Balance Sheet in which the assets and liabilities of all the subsidiaries are shown along with its own assets and liabilities as the Balance Sheet of a head office incorporates the assets and liabilities of its branches. By way of Consolidated Balance Sheet, the investments of the holding company in the subsidiary company are replaced by net assets.

Minority Interest

When some of the shares of the subsidiary company are held by outsiders (other than the holding company), their interest in the subsidiary company is called as Minority Interest in subsidiary company. The minority interest is shown on the liabilities side of the Balance Sheet of the holding company under the head 'Share Capital'. The minority interest can be calculated as follows:

Paid up value of shares held by outsiders	xxx
Add: Proportionate share of capital/ revenue profit and/or reserves	xxx
	xxx
Less: Proportionate share of capital/ revenue losses	xxx
Value of Minority Interest	xxx

If the preference shares are held by outsiders, paid up value of such shares together with dividend thereon(if there is profit)is added to the value of minority interest.

Cost of Control (Goodwill) or Capital Reserve

If the holding company purchases the shares of the subsidiary company at a price more than their paid up value, the excess is ***cost of control or goodwill***, if there is no reserve or profit or loss balance in the subsidiary company on date of acquisition of shares of the subsidiary company.

If the shares are purchased at a price which is less than the paid up value of the shares, the difference is taken as ***capital reserve or profit***.

The goodwill or cost of control is shown on the assets sideand the capital reserve or profit is shown on the liabilities sidein the Consolidated Balance Sheet.

Illustration 1: The following are the liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital:			Sundry Assets	260000	240000
Shares of Rs. 10 Each	400000	200000	Investments:		
Profit and Loss Account	80000	20000	20000 shares in S Ltd.	300000	
General Reserve	40000	16000			
Current Liabilities	40000	4000			
	560000	240000		560000	240000

H Ltd. acquired the shares of S Ltd. on 31st December 2014. Prepare the Consolidated Balance Sheet.

Solution:

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as on 31st December 2014

Particulars	Note No.	Amount (Rs.)
A. Equity and Liabilities		
Shareholders' Fund		
a. Share Capital	1	400000
b. Reserves and Surplus	2	120000
Current Liabilities		

H Ltd. 40000		
S Ltd. 4000		44000
Total		***564000***
B. Assets		
Non-current Assets		
Fixed Assets		
Tangible Assets – Sundry Assets		
H Ltd. 260000		
S Ltd. 240000		500000
Intangible Assets – Goodwill		64000
Current Assets		Nil
Total		***564000***

Notes to Accounts

Note No.	Particulars	Amount (Rs.)
1.	**Share Capital**	
	Issued and Subscribed	
	40000 Equity shares of Rs. 10 each	**400000**
2.	**Reserves and Surplus**	
	General Reserve	40000
	P & L A/c	80000
		120000

Working Note:

Calculation of Goodwill or Cost of Control:

	Rs.	Rs.
Cost of Shares in S Ltd.		300000
Less: Face value of shares in S Ltd.	200000	
Profit and Loss Account	20000	
General Reserve	16000	236000
Goodwill or Cost of Control		64000

Pre-Acquisition Profits or Capital Profits

Any profit or reserve standing in the Balance Sheet of subsidiary company on the date of purchase of shares by holding company is called pre-acquisition profit or capital profit. The outsiders' share of such capital profit is added to the minority interest and the balance (to holding company) are shown as Capital Reserve or adjusted in Cost of Control or Goodwill and shown in the Consolidated Balance Sheet.

Any losses, share of loss of outsiders is deducted from the minority interest and the share of loss to the holding company is added to the Cost of Control or Goodwill or deducted from the Capital Reserve, and shown in the Consolidated Balance Sheet.

Post-Acquisition Profits or Revenue Profits

Profits of the subsidiary company made after the date of purchase of shares in the subsidiary company by the holding company are called as post-acquisition profits or revenue profits. The share of revenue profit of the holding company is added to the

profit of the holding company. The share of profit due to the outsiders in the subsidiary company is added to the minority interest and shown in the Consolidated Balance Sheet.

- The date of purchase of shares in the subsidiary company by the holding company is the basis for determination of profit, whether it is Capital Profit or Revenue Profit.

Issue of Bonus Shares

Sometimes, the bonus shares are issued by the subsidiary companies. It enhances the number of shares held by the holding company. Its treatment depends upon the sources (Capital Profit or Revenue Profit) from which bonus shares are issued out.

a) ***Bonus shares issued out of Capital Profit or Pre-acquisition Profit*** – No effect in the accounting treatment in the books of accounts.

b) ***Bonus shares issued out of Current Profit or Post-acquisition Profit*** – The holding company's share in the current profit of the subsidiary company should be calculated after making proper adjustments for bonus issue. Ultimately, it reduces the amount of holding company's share in the post-acquisition profit. It will affect the cost of goodwill.

Illustration 10: The liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014 are as follows:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital:			Fixed Assets	506000	256000
120000 Shares of			Investments:		
Rs.	600000	……	12000 shares in S	200000	……
5 each	……		Ltd.	60000	20000
16000 Shares of		160000	Stock		
Rs. 10	……	68000	Bills Receivables	4000	……
each	40000	20000	(Incl.	40000	34000
Capital Reserve	100000	20000	2000 from S Ltd.)		
General Reserve			Bank		
Profit and Loss	……	7000			
Account	70000	35000			
Bills Payables (Incl. Rs. 2000 to H Ltd.)	810000	310000		810000	310000

H Ltd. acquired 12000 shares of Rs. 10 each from S Ltd. on 31st December 2014. S Ltd. utilised a part of its Capital Reserve to make bonus issue of one share for every four shares held. Prepare the Consolidated Balance Sheet.

Solution:

Share of holdings by H Ltd.in S Ltd. = 12000 shares out of 16000 shares = 75%

Share of holdings by Outsiders in S Ltd. = 4000 shares out of 16000 shares = 25%

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as on 31st December 2014

Particulars		Note No.	Amount (Rs.)
A. Equity and Liabilities			
Shareholders' Fund			
a. Share Capital		1	600000
b. Reserves and Surplus		2	141000
Minority Interest			67000
Current Liabilities			
Sundry Creditors:			
H Ltd.	70000		
S Ltd.	35000		105000

Bills Payables (7000 – 2000)			5000
Total			**918000**
B. Assets			
Non-current Assets			
Fixed Assets			
a. Tangible		3	762000
b. Intangible			Nil
Current Assets			
Stock:			
H Ltd.	60000		
S Ltd.	20000		80000
Bills Receivables (4000 – 2000)			2000
Cash and Cash Equivalents – Bank			
H Ltd.	40000		
S Ltd.	34000		74000
Total			**918000**

Notes to Accounts

Note No.	Particulars		Amount (Rs.)
1.	**Share Capital**		
	Issued and Subscribed		
	12000 Shares of Rs. 5 each		**600000**
2.	**Reserves and Surplus**		
	Capital Reserve		1000
	General Reserve		40000
	P & L A/c		100000
			141000
3.	**Fixed Assets – Tangible**		
	H Ltd.	506000	
	S Ltd.	256000	**762000**

Working Notes:
Revenue Profit in S Ltd. = Nil

	Rs.
Profit and Loss Account	20000
General Reserve	20000
Capital Reserve	68000
Capital Profit	108000

Calculation of Capital Profit in S Ltd.:

Share of capital profit due to H Ltd. = 108000x75% = Rs. 81000
Share of capital profit due to Outsiders in S Ltd. = 108000x25% = Rs. 27000
Calculation of Capital Reserve:

	Rs.	Rs.
Cost of Shares in S Ltd.		200000
Less: Face value of shares in S Ltd. (12000x10)	120000	
Capital Profit	81000	201000
Capital Reserve		1000

Calculation of Minority Interest:

	Rs.
Paid up value of Shares held by outsiders in S Ltd. (4000x10)	40000
Add: Share of capital profit due to Outsiders in S Ltd.	27000
Minority Interest	67000

Illustration 11: The liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014 are as follows:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital:			Fixed Assets	262500	75000
Shares of Rs.10 each	300000	75000	Investments:		
General Reserve	75000	30000	6000 shares in S Ltd.	75000	
Profit and Loss Account	37500	22500	Current Assets	112500	60000
Sundry Creditors	37500	7500			
	450000	135000		450000	135000

On the date of acquisition of shares in S Ltd. by H Ltd., S Ltd. had a General Reserve balance of Rs. 30000. S Ltd. capitalised Rs. 15000 out of profit earned after acquisition of its shares by H Ltd. by making a bonus issue of one share for every five shares held. Prepare the Consolidated Balance Sheet.

Solution:

Share of holdings by H Ltd.in S Ltd. = 6000 shares out of 7500 shares = 80%
Share of holdings by Outsiders in S Ltd. = 1500 shares out of 7500 shares = 20%

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as on 31st December 2014

Particulars		Note No.	Amount (Rs.)
A. Equity and Liabilities			
Shareholders' Fund			
a. Share Capital		1	300000
b. Reserves and Surplus		2	139500
Minority Interest			25500
Current Liabilities			
Sundry Creditors:			
H Ltd.	37500		
S Ltd.	7500		45000
Total			**510000**
B. Assets			
Non-current Assets			
Fixed Assets			
a. Tangible		3	337500
b. Intangible			Nil
Current Assets			
H Ltd.	112500		
S Ltd.	60000		172500
Total			**510000**

Notes to Accounts

Note No.	Particulars	Amount (Rs.)
1.	**Share Capital**	
	Issued and Subscribed	
	30000 Shares of Rs. 10 each	**300000**
2.	**Reserves and Surplus**	
	Capital Reserve	21000
	General Reserve	75000
	P & L A/c (37500 + 6000)	43500

			139500
3.	**Fixed Assets – Tangible**		
	H Ltd.	262500	
	S Ltd.	75000	**337500**

Working Notes:
Calculation of Revenue Profit in S Ltd.:

	Rs.
Profit and Loss Account balance for the year2014	22500
Less: Bonus Shares	15000
Revenue Profit	7500

Share of revenue profit due to H Ltd. = 7500x80% = Rs. 6000
Share of revenue profit due to Outsiders in S Ltd. = 7500x20% = Rs. 1500

Calculation of Capital Profit in S Ltd.:
General Reserve = 30000
Share of capital profit due to H Ltd. = 30000x80% = Rs. 24000
Share of capital profit due to Outsiders in S Ltd. = 30000x20% = Rs. 6000
Calculation of Capital Reserve:

	Rs.	Rs.
Cost of Shares in S Ltd.		75000
Less: Face value of shares in S Ltd. (6000x10)	60000	
Capital Profit	24000	
Face value of Bonus Shares (15000x80%)	12000	96000

Capital Reserve		21000

Calculation of Minority Interest:

		Rs.
Paid up value of Shares held by outsiders in S Ltd. (1500x10)		15000
Add: Share of revenue profit due to Outsiders in S Ltd.	1500	
Share of capital profit due to Outsiders in S Ltd.	6000	
Bonus Shares (15000x20%)	3000	10500
Minority Interest		25500

Revaluation of Assets and Liabilities

Sometimes, the fixed assets of subsidiary companies are revalued at the time of acquisition of shares. There may be revaluation profit (capital profit) or revaluation loss (capital loss). The share of holding company in revaluation profit is added to the capital reserve or deducted from the goodwill. The revaluation profit due to outsiders in subsidiary company is added to the minority interest. The share of revaluation loss to holding company is added to goodwill or deducted from capital reserve. The share of revaluation loss to outsiders in subsidiary company is deducted from minority interest. Depreciation is also adjusted while calculating the revenue profit in subsidiary company.

Illustration 12: The following are the liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital:			Investments:		
Shares of Re. 1 each	300000	240000	192000 shares in S Ltd.	210000	
General Reserve	120000	60000	Other Assets	300000	330000
Profit and Loss Account (Current Year)	90000	30000			
	510000	330000		510000	330000

On 1st January 2014 H Ltd. acquired the shares in S Ltd., when the plant and machinery were revalued to Rs. 240000 from Rs. 180000 and furniture of S Ltd. was revalued to Rs. 45000 from Rs. 60000. Depreciation for plant and machinery and furniture are 10% and 5% respectively. The balance sheet of S Ltd. showed these assets on revalued basis. Prepare the Consolidated Balance Sheet.

Solution:

Share of holdings by H Ltd.in S Ltd. = 192000 shares out of 240000 shares = 80%
Share of holdings by Outsiders in S Ltd. = 48000 shares out of 240000 shares = 20%

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as on 31st December 2014

Particulars	Note No.	Amount (Rs.)
A. Equity and Liabilities		
Shareholders' Fund		
a. Share Capital	1	300000
b. Reserves and Surplus	2	295800
Minority Interest		73950
Current Liabilities		Nil
Total		**669750**
B. Assets		
Non-current Assets		
Fixed Assets	3	258750
a. Tangible		Nil
b. Intangible		
Current Assets		
Other Assets		411000
Total		**669750**

Notes to Accounts

Note No.	Particulars		Amount (Rs.)
1.	**Share Capital**		
	Issued and Subscribed		
	300000Shares of Re. 1 each		**300000**
2.	**Reserves and Surplus**		
	Capital Reserve		66000
	General Reserve		120000
	P & L A/c (90000+19800)		109800
			295800
3.	**Fixed Assets – Tangible**		
	Plant and Machinery of S Ltd.	216000	

	Furniture of S Ltd.	42750	**258750**

Working Notes:
Calculation of Profit on Revaluation:

	Rs.
Plant and Machinery (240000-180000)	60000
Less: Loss on Furniture (60000-45000)	15000
~~*Total Profit on Revaluation*~~	
	Rs.
Profit and Loss Account balance for the year	30000
Less: Additional Depreciation on Plant & Machinery (60000x10%)	6000
	24000
Add: Excess Depreciation on Furniture (15000x5%)	750
Revenue Profit	24750
	45000

Calculation of Revenue Profit in S Ltd.:

Share of revenue profit due to H Ltd. = 24750x80% = Rs. 19800
Share of revenue profit due to Outsiders in S Ltd. = 24750x20% = Rs. 4950

Calculation of Capital Profit in S Ltd.:

	Rs.
General Reserve	60000
Revaluation Profit	45000
Capital Profit	105000

Share of capital profit due to H Ltd. = 105000x80% = Rs. 84000
Share of capital profit due to Outsiders in S Ltd. = 105000x20% = Rs. 21000
Calculation of Capital Reserve:

	Rs.	Rs.
Cost of Shares in S Ltd.		210000
Less: Face value of shares in S Ltd.	192000	
Capital Profit	84000	276000
		66000
Capital Reserve		

Calculation of Minority Interest:

		Rs.
Paid up value of Shares held by outsiders in S Ltd.		48000
Add: Share of revenue profit due to Outsiders in S Ltd.	21000	
Share of capital profit due to Outsiders in S Ltd.	4950	25950
Minority Interest		73950

Plant and Machinery of S Ltd.:

	Rs.
Plant and Machinery	240000
Less: Depreciation @ 10%	24000
Plant and Machinery of S Ltd.	216000

Furniture of S Ltd.:

	Rs.
Furniture	45000
Less: Depreciation @ 5%	2250
Furniture of S Ltd.	42750

Other Assets in Consolidated Balance Sheet:

		Rs.
Total Other Assets as per Balance Sheet		330000
Less: Plant and Machinery (180000 – Depn. 18000)	162000	
Furniture (60000 – Depn. 3000)	57000	219000
Other Assets		73950

Debentures of the Subsidiary Company

Sometimes, the holding company takes the investment in debentures of the subsidiary company. It shows under the head 'Investments' in the Balance Sheet of the holding company. If there is any difference between the costs and paid up value of debentures, adjusted against the cost of control or goodwill. If there is any debenture interest, it will also be adjusted.

Preference Shares in Subsidiary Company

a) ***Preference Shares held by the Holding Company*** – The accounting treatment is the same as in the case of holdings of equity shares. Dividend accrued after the acquisition is taken as revenue profit.

b) ***Preference Shares held by the Outsiders in the Subsidiary Company*** – The share holdings by the outsiders are included in the minority interest by the amount of paid up value of shares held (including arrears of dividend accrued to the date of consolidation). If the balance sheet of the subsidiary company shows debit balance of profit and loss account, preference shareholders are not required to bear the proportionate loss and the whole loss should be borne by the equity shareholders.

Illustration 13: The following are the liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital:			Fixed Assets	1000000	150000
12500 Equity			Investments:		
Shares of	1250000		10000 Equity		
Rs. 100 each			Shares	125000	
12500 Equity		125000	in S Ltd.	312500	81250
Shares of			Current Assets		
Rs. 10 each		62500			
6250, 8%	125000	25000			
Preference	62500	12500			
Shares of Rs. 10					
each		6250			
General Reserve	1437500	231250		1437500	231250
Sundry Creditors					
Dividend due on					
Preference Shares					

S Ltd. had Rs. 18750 in general reserve as on the date of acquisition on 1st January 2014. No dividend has been declared by S Ltd. in 2014. Prepare the Consolidated Balance Sheet.

Solution:

Share of holdings by H Ltd.in S Ltd. = 10000 shares out of 12500 shares = 80%

Share of holdings by Outsiders in S Ltd. = 2500 shares out of 12500 shares = 20%

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as on 31st December 2014

Particulars	Note No.	Amount (Rs.)
A. Equity and Liabilities		
Shareholders' Fund		
a. Share Capital	1	1250000
b. Reserves and Surplus	2	130000

Minority Interest			98750
Current Liabilities			
Sundry Creditors:			
H Ltd. 62500			
S Ltd. 12500			75000
Total			**1553750**
B. Assets			
Non-current Assets			
Fixed Assets			
a. Tangible		3	1150000
b. Intangible - Goodwill			10000
Current Assets			
H Ltd. 312500			
S Ltd. 81250			393750
Total			**1553750**

Notes to Accounts

Note No.	Particulars	Amount (Rs.)
1.	**Share Capital** Issued and Subscribed 12500Equity Shares of Rs. 100 each	**1250000**
2.	**Reserves and Surplus** General Reserve (125000+5000)	**130000**
3.	**Fixed Assets – Tangible** H Ltd. 1000000 S Ltd. 150000	**1150000**

Working Notes:

Revenue Profit in S Ltd.:

General Reserve = 25000-18750

= Rs. 6250

Share of revenue profit due to H Ltd. = 6250x80% = Rs. 5000

Share of revenue profit due to Outsiders in S Ltd. = 6250x20% = Rs. 1250

Capital Profit in S Ltd.:

General Reserve = 18750

Share of capital profit due to H Ltd. = 18750x80% = Rs. 15000

Share of capital profit due to Outsiders in S Ltd. = 18750x20% = Rs. 3750

Calculation of Goodwill:

	Rs.	Rs.
Cost of Shares in S Ltd.		125000
Less: Face value of shares in S Ltd. (10000x10)	100000	
Capital Profit	15000	115000
Goodwill		10000

Calculation of Minority Interest:

		Rs.
Paid up value of Shares held by outsiders in S Ltd. (2500x10)		25000
Add: 8% Preference Shares	62500	
Share of revenue profit due to Outsiders in S Ltd.	1250	
Share of capital profit due to Outsiders in S Ltd.	3750	
Dividend to Preference Shares	6250	73750
Minority Interest		98750

UNIT - IV

LIQUIDATION OF COMPANIES

Introduction

A company comes into existence through a legal process and also a company can comes to an end by law. Some legal formalities are required to close the affairs of a company. Such legal procedures can be called as liquidation of companies.

Meaning of Liquidation

Simply, liquidation or winding up is the legal procedure by which a company comes to its end. Liquidation or winding up of a company can be defined as "the process whereby its life is ended and its property is administered for the benefit of its creditors and members". An administrator, namely a Liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.

Unlike an insolvent individual or partnership firm, insolvency proceedings are not applicable to a company. A solvent as well as insolvent company may be liquidated.

Modes of Winding up or Liquidation

According to section 271 of the Companies Act, 2013 a company can be liquidated or wound up in the following ways:

a) By the Tribunal
b) Voluntary

Notwithstanding anything contained in any other Act, the provisions of this Act with respect to winding up shall apply to the winding up of a company in any of the modes specified under this section.

Winding up by the Tribunal

As per section 271 of the Companies Act 2013, in the following circumstances a company may be wound up by the Tribunal:

(1) A company may, on a petition under section 272, be wound up by the Tribunal
(a) if the company is unable to pay its debts;
(b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
(d) if the Tribunal has ordered the winding up of the company under Chapter XIX (of the Companies Act, 2013 dealing with revival and rehabilitation of sick companies);

(e) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company we wound up;
(f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
(g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

Contributory

Contributoryis a person liable to contribute to the assets of the company in the event of winding up. A contributory's liability is legal, not contractual. A contributory can be either a present member or a past member.

1. Present Members ('A' List of Contributories)

A present member is that member whose name is included in the register of members when the company is wound up. He is liable to contribute the amount remaining unpaid on the shares held by him if the amount is needed to make the payment to the legal claimant. In the case of company limited by guarantee, he is liable for the payment of guaranteed amount at the time of winding up.

2. Past Members ('B' List of Contributories)

Past members are those members who ceased to be shareholders (except by death) within one year of winding up of the company and can be called upon to pay, if the present contributories are not able to pay the liabilities of the company. Section

285 of the Companies Act, 2013 provides that:

(a) A past member is not liable to contribute in respect of any liability of the company contracted after he ceased to be a member of the company.

(b) A past member is not liable to contribute if he ceased to be a member of the company for one year or upward before the commencement of the winding up.

(c) A past member is liable to contribute only if it appears to the Tribunal that present members are unable to make the contributions required to be made by them in pursuance of the Companies Act.

(d) In the case of a company limited by shares, no contribution is required from any member excluding the amount (if any) unpaid on the shares in respect of which he is liable as such member.

(e) In the case of a company limited by guarantee, no contribution is required from any member excluding the amount undertaken to be contributed by him in the event of the company being wound up.

Liquidator

A liquidator is the person who is appointed for the purpose of liquidating the company. The main job of a liquidator is to realise all assets of the liquidating company, collects the amount due from the contributories and distribute the sale proceeds of assets of the company among the right claimants. The company must submit a Statement of Affairs to the liquidator within 21 days of the passing of the winding up order.

In case of winding up of a company by the Tribunal, the Tribunal at the time of passing of the order of winding up, shall appoint an Official Liquidator or a liquidator from the panel maintained by the Central Government consisting of the names of the Chartered Accountants, advocates, Company Secretaries, Cost Accountants and such other professional as may be notified by the Central Government having atleast 10 years' experience in company matters.

In case of voluntary winding up, the voluntary liquidator is appointed by resolution in general body meeting of the members and or of the creditors.

Order of Payment

The amounts realised from the assets not specifically pledged and the amounts contributed by the contributories must be distributed in the following order of preference:

1. Expenditure of winding up incl. liquidator's remuneration.
2. Creditors (Debentures etc.) secured by a floating charge on the assets of the company.
3. Preferential Creditors.
4. Unsecured Creditors.

5. Surplus, if any among contributories (Preference shareholders and equity shareholders) according to their respective rights and interests

Preferential Creditors

Preferential creditors are unsecured creditors, having priority of claims over other unsecured creditors, not because of any security held by them but because of the provisions in the Companies Act. They are:

a) All revenues, taxes, cesses and rates, payable to the Government or local authority, due and payable by the company within 12 months before the date of commencement of winding up.

b) All wages or salaries (including commission) of any employee in respect of services rendered to the company and due for a period not exceeding four months within the said 12 months before the relevant date.

c) All sums due as compensation under Workmen Compensation Fund Act, from a provident fund, pension fund, gratuity fund or any other employee welfare fund.

Statement of Affairs

Where the court has made a winding up order or appointed the official liquidator as provisional liquidator unless the court in its otherwise order, a statement as to the affairs of the company shall be made out and submitted to the official liquidator. This statement is known as a statement of affairs. This statement is to be submitted to the liquidator within 21 days from the date of winding up order. It is always open to inspection to the contributories or creditors of the company, on payment of a prescribed fee.

Lists to be attached to the Statement of Affairs

As per the Companies Act, the following lists are to be attached to the Statement of Affairs:

1. **List 'A'** – A complete list of assets not specifically pledged.
2. **List 'B'** – A list of assets which are specifically pledged in favour of fully secured and partly secured creditors.
3. **List 'C'** – A list of preferential creditors.
4. **List 'D'** – A list of debenture holders and other creditors having a floating charge on the assets of the company.
5. **List 'E'** – A list containing the names, addresses and occupations of unsecured creditors and the amount due.
6. **List 'F'** – A list containing names and number and value of shares held by various preference shareholders.

7. **List 'G'**- A list showing the names and holdings of equity shareholders.
8. **List 'H'** – A list showing the surplus or deficiency in the Statement of Affairs that has been arrived at.

Procedure for preparation of the Statement of Affairs

The following points are to be kept in mind while preparing the Statement of Affairs:

1. Assets which are not specifically pledged are taken first. These assets are to be taken at realisable values. Calls in arrears are also treated as assets not specifically pledged. The uncalled capital is not shown as an asset.
2. If there is any surplus from assets specifically pledged that should be added with the realisable value of assets not specifically pledged.
3. From the resulting figure deduct the amount of preferential creditors.
4. Then deduct the amount of creditors having floating charge (E.g. Debenture holders). The balance will be surplus or efficiency as regards debenture holders.
5. From the balance amount obtained, deduct the amount of unsecured creditors. The resultant figure will be either surplus or deficiency as regards unsecured creditors.
6. If the balance amount is surplus, the share capital is to be deducted out of that amount or if it is deficiency, the share capital is to be added with the amount. The resultant figure may be surplus or deficiency as regards members or contributories.

Deficiency or Surplus Account

The official liquidator will specify a date for period (not less than three years) beginning with the date on which information is supplied for preparation to an account, to explain the deficiency or surplus. On that date either assets could exceed capital plus liabilities (or reserve) or there could be deficit or negative balance in Surplus Account. Deficiency Account is divided into two parts as follows:

1. The first part starts with the deficit on the given date, and contains every item that increases deficiency or reduce surplus such as losses, dividend etc.
2. The second part starts with the surplus on the given date and indicates all profits.

If the total of the first exceeds that of the second, there could be a deficiency to the extent of the difference and if the total of the second part exceeds that of the first, there could be a surplus.

Form of Deficiency or Surplus Account (List H)

	Rs.
Items contributing to Deficiency or Reducing Surplus:	
1. Excess (if any) of Capital and Liabilities over Assets on the ….20.. as shown by Balance Sheet(copy annexed)	
2. Net dividend and bonus declared during the period from……20.. to the date of statement.	
3. Net trading losses (after charging items shown in note below) for the same period.	
4. Losses other than trading losses written off or for which provision has been made in the books during the same period (give particulars or annex schedule)	
5. Estimated losses now written off or for which provision has been made for purposes of preparing the statement (give particulars or annex schedule)	
6. Other items contributing to Deficiency or reducing Surplus	
Total	
Items reducing Deficiency or Contributing to Surplus:	
7. Excess (if any) of Assets over Capital and Liabilities on the …20… as shown in the Balance Sheet (copy annexed)	
8. Net trading profit (after charging items show in note below) for the period from the ….20… to the date of statement.	
9. Profits and income other than trading profits during the same period (give particulars or annex schedule)	
10. Other items reducing Deficiency or contributing to Surplus	
Total	
Deficiency or Surplus as shown by the Statement	

Note: as to Net Trading Profits and Losses:
1. Provision for depreciation, renewals or diminution in value of fixed assets.
2. Charges for Indian income tax and other Indian taxation on profits.
3. Interest on debentures and other fixed loans.
4. Payments to directors made by the company and required by law to be disclosed in the accounts.

Exceptional or non-recurring expenditure	Rs……….	
Less: Exceptional non-recurring receipts	Rs ………	
Balance being other trading profits or losses		Rs……….
Net trading profits or losses as shown in Deficiency or Surplus Account above.		

Note: In case the company in liquidation has not maintained proper books of accounts after a certain date, a trial balance should be prepared with the available information by taking items at their book values. Any difference found in the trial balance is the profit or loss made by the company during the period the company did not maintain books of accounts.

Liquidator's Final Statement of Account

The main job of liquidator is to collect the assets of the company and realise them and distribute it among right claimants. He maintains a cash book for recording the receipts and payments and submit an abstract of cash book to the court (incase winding up by the Tribunal), and to the company (in case of voluntary winding up). The liquidator also prepares an account of winding up. Such an account is called as Liquidator's Final Statement of Account.

All the receipts are shown on the debit side of this account. They include the following:

a) Amount realised on sale of assets.
b) Amount received from delinquent directors and other officers of the company.
c) Contributions made by the contributories.

On the credit side of this account the following payments are shown in the given order:

a) Payment of secured creditors and dues to workmen upto their claim or upto the amount of securities held by secured creditors.
b) Cost of winding up (legal charges).
c) Liquidator's remuneration.
d) Payment to creditors having a floating charge on the assets of the company.
e) Payment of preferential creditors.
f) Payment of unsecured creditors.
g) Amount paid to preference shareholders.
h) Amount paid to equity shareholders.

In the preparation of Liquidator's Final Statement of Account, the principle of double entry is not involved. It is only a statement although presented in the form of an account.

Form of Liquidator's Final Statement of Account

Receipts	Amount	Payments	Amount

	Rs.		Rs.
Assets: Cash at Bank Cash in Hand Marketable Securities Bills Receivables Trade Debtors Loans and Advances Stock in Trade Work in Progress Freehold Property Leasehold Property Plant and Machinery Furniture, Fittings, Utensils etc. Patents, Trade Marks etc. Investments other than Marketable Securities Surplus from Securities Unpaid calls at commencement of winding up Amount received from calls on contributories made in the winding up Other Property		Legal Charges Liquidator's remuneration: % on amount realised % on amount distributed Liquidation Expenses or Cost of Winding up Debenture holders or other creditors having a floating charge on the assets of the company Preferential Creditors Other Unsecured Creditors Preference Shareholders (Refund of Capital) Equity Shareholders (Refund of Capital)	

Liquidator's Remuneration or Commission

A liquidator gets remuneration in the form of commission. It is paid as a percentage of the assets realised as well as a certain percentage of the payments made to unsecured creditors. The following points are relevant while calculating liquidator's remuneration:

1. **Commission on assets given as securities to secured creditors** – The liquidator gets commission on the surplus from such assets left after making the payment of secured creditors because he makes an effort of realising the surplus of such assets from secured creditors. However, if he sells the assets himself, he gets commission on the total proceeds of such assets.
2. **Cash and Bank Balance** – If the liquidator is to get a commission on cash and bank balance unless otherwise stated.

3. **Unsecured Creditors** – If the liquidator is to get a commission on amount paid to unsecured creditors, unsecured creditors will also include preferential creditors for the purpose of calculation of remuneration unless otherwise stated.

If amount available is sufficient to make the full payment of unsecured creditors, the commission can be calculated as follows:

$$= \frac{\%}{100}$$

If the amount available is not sufficient to make the full payment on secured creditors, the commission can be calculated as follows:

$$= \frac{\%}{100 + \%}$$

Illustration 4: A liquidator is entitled to receive remuneration @ 3% of the assets realised and 2% on the amount distributed among the unsecured creditors. The assets realised Rs. 8400000 against which payment was made as under:

Cost of liquidation Rs. 60000, Preferential Creditors Rs. 180000, Secured Creditors Rs. 4800000 and Unsecured Creditors Rs. 3600000.

Calculate the liquidator's remuneration.

Solution:

Calculation of Liquidator's Remuneration

	Rs.
a. Liquidator's commission on assets realised (8400000x3/100)	252000
b. Liquidator's commission on amount paid to preferential creditors (180000x2/100)	3600
c. Liquidator's commission on amount distributed among unsecured creditors (3104400x2/102)	60871
Total Liquidator's Remuneration	316471

Working Note:

Calculation of amount available to Unsecured Creditors

	Rs.	Rs.
Total assets realized		8400000
Less: Cost of liquidation	60000	
Preferential creditors	180000	
Secured creditors	4800000	
3% commission on assets realized	252000	
2% commission on amount paid to preferential creditors	3600	5295600
Amount available to unsecured creditors		3104400

Illustration 5: Prepare the Liquidator's Final Statement of Account of a limited

company went into voluntary liquidation, with the following liabilities:

	Rs.	Rs.
Trade Creditors		16800
Bank Overdraft		28000
Capital:		
14000 Preference shares of Rs. 100 each, Rs.7 called up		98000
14000 Equity shares of Rs. 10 each, Rs. 9 called up	126000	
Less: Calls in arrears	2800	123200
Cash received in anticipation of calls:		
On preference shares	33600	
On equity shares	5600	39200

The assets realised Rs. 280000. Cost of liquidation amounted to Rs. 2800. Liquidator's remuneration Rs. 4200.

Solution:

Liquidator's Final Statement of Account

Receipts	Amount Rs.	Payments	Amount Rs.
Assets Realised	280000	Cost of Liquidation	2800
Calls in Arrears	2800	Liquidator's Remuneration	4200
		Bank Overdraft	28000
		Trade Creditors	16800
		Calls in advance	39200
		Preference Shareholders	98000
		Equity Shareholders @ Rs. 6.70 per share (Bal. Fig)	93800
	282800		282800

UNIT – V

- **HUMAN RESOURCE ACCOUNTING (HRA)**
- **ACCOUNTING FOR PRICE LEVEL CHANGES (INFLATION ACCOUNTING)**

HUMAN RESOURCE ACCOUNTING (HRA)

Meaning and Definition of Human Resource Accounting

Human resource accounting is the process of identifying and reporting investments made in the human resources of an organization that are presently unaccounted for in the conventional accounting practices. It is an extension of standard accounting principles. Measuring the value of human resources can assist organizations in accurately documenting their assets.

The American Accounting Association's (AAA) has defined Human Resource Accounting as "the process of identifying and measuring data about human resources and communicating this information to interested parties".

Eric Flamholtz has defined Human Resource Accounting as "the measurement and reporting of the cost and value of people in organizational resources"

Stephen Knauf defined Human Resource Accounting as "the measurement and quantification of human organizational inputs such as recruiting, training, experience and commitment."

Thus HRA not only involves measurement of all the costs or investments associated with the recruitment, placement, training and development of employees, but also the quantification of the economic value of the people in an organization.

Objectives of Human Resource Accounting

1. To furnish cost value information for making proper and effective management decisions about acquiring, allocating, developing, and maintaining human resources in order to achieve cost effective organizational objectives.
2. To monitor effectively the use of human resources by the management.
3. To have an analysis of the Human Asset, i.e. whether such assets are conserved, depleted, or appreciated.
4. To aid in the development of management principles and proper decision making for the future, by classifying financial consequences of various practices.

Development of Human Resource Accounting (HRA)

Research during the early stages of development of HRA was conducted at the University of Michigan by a research team including the late organizational psychologist Rensis Likert, R. Lee Brummet, William C. Pyle and Eric Flamholtz. The group worked on a series of research projects designed to develop concepts and methods of accounting for human resources. One outcome of this research was a paper representing one of the earliest studies dealing with human resource measurement and the one in which the term "Human Resource Accounting" was used for the first time. They focused on HRA as a tool for increasing managerial effectiveness in the acquisition, development, allocation, maintenance, and utilization of its human resources. But the traces of a rudimentary HRA can be found in the Medieval European practice of calculating the cost of keeping a prisoner versus the expected future earnings from him.

Need and Importance of Human Resource Accounting

In the recent decades concentration is switching from manufacturing organization to service rendering organization, where human is the main resource. But not only for the service organization but also human resource accounting is also necessary for the manufacturing organization to measure their production personnel's expertise. The necessities of the HRA can be as follows.

1. Measuring the expertise of the employees and management of the organization.
2. Find out the true value of the assets and liabilities hold by the organization. As the expertise of the employees is considered as assets and value to be provided to the employees are considered as liabilities.
3. Applying a strong monitoring process on the human resources of the

organization.

4. It provides the management a sound basis for controlling the human resource.

5. Provide a better basis of determining organizational goal and ways of achieving these goals.

6. Provide the investors of the organization, shareholders and debt holders, accurate information for better decision making

Methods of Human Resource Accounting

There are different models in the valuation of human resources. They can be discussed under the two heads as follows:

A. Cost Based Models:

1. Historical Cost Model
2. Replacement Cost Model
3. Opportunity Cost Model
4. Standard Cost Model

B. Value Based Models:

1. Present Value of Future Earnings Model or Lev and Schwartz Model
2. Rewards Valuation Model or Flamholtz Model
3. Certainty Equivalent Net Benefit Model
4. Chakraborty Model
5. Dasgupta Model

Historical Cost Model

This approach is also called an acquisition cost model. This approach was developed by Brummet, Flamholtz and Pyle. But the first attempt towards employee valuation was made by a footwear manufacturing company, R. G. Barry Corporation of Columbus,Ohio with the help of Michigan University in 1967.

This method measures the organization's investment in employees using the five parameters: recruiting, acquisition, formal training and familiarization, informal training and informal familiarization, and experience and development. This model suggests that instead of charging the costs to profit and loss statement, it should be capitalized in the balance sheet. The process of giving a status of asset to the expenditure item is called capitalization. In human resource accounting, it is necessary to amortize the capitalized amount over a period of time. The unamortised cost is shown as investments in the human assets. If an employee leaves the firm (i.e. human assets expire) before the expected service life period, then the net value to that extent is charged to the current revenue.

Merits of Historical Cost Model

i. This model is very simple to understand and easy to work out.
ii. It meets the traditional accounting concept of matching cost with revenue.
iii. It provides a basis for evaluating a company's return on its investments in human resources.

Limitations of Historical Cost Model

i. The valuation method is based on the false assumption that the rupee is stable.
ii. This method measures only the costs to the organization, but ignores completely any measure of the value of the employee to the organization.
iii. It takes only the cost of acquisition of employees and thus ignores the aggregate value of their potential services.
iv. It is too tedious to gather the related information regarding the human values.
v. It is difficult to determine the number of years over which the capitalised expenditure is to be amortised.

Replacement Cost Model

The historical cost model was highly criticised as it only considers the sunk costs which are irrelevant for decision making. Thus a new model for HRA was conceptualised which took into the account, the costs that would be incurred to replace its existing human resources by an identical one. This model measures the cost of replacing an employee. According to Rensis Likert, replacement cost includes recruitment, selection, compensation, and training cost (including the income foregone during the training period). The data derived from this method could be useful in deciding whether to dismiss or replace the staff.

Merits of Replacement Cost Model

i. This model is more realistic as it considers the current value of human resources in a company.
ii. It is more representative and logical.

Limitations of Replacement Cost Model

i. This method may also lead to an upwardly biased estimate because an inefficient firm may incur a greater cost to replace an employee
ii. There may be no similar replacement for a similar certain existing asset.

Opportunity Cost Model

This model was advocated by Hekiman and Jones in 1967. This model is also called as Market Value Model. This model of measuring human resources is based on the concept of opportunity cost (i.e. the value of an employee in its alternative best use, as a basis of estimating the value of human resources). The opportunity cost value may be established by competitive bidding within the firm, so that in effect, managers bid for any scarce employee. A human asset therefore will have a value, only if it is a scarce resource.

Limitations of Opportunity Cost Model

i. This model excludes the employees who are not scarce.
ii. Under this model, valuation on the basis of opportunity cost is restricted to alternative use within the organisation.

Standard Cost Model

This model was developed by David Watson. This model envisages establishment of a standard cost per grade of employee updated every year. Replacement costs can be used to develop standard costs of recruitment, selection, training and developing individuals. Such standards can be used to compare result with those planned. Variance should be analysed and would form a suitable basis for control. But under this model, determination of standard cost for each grade of employee is a difficult process.

Present Value of Future Earnings Model or Lev and Schwartz Model

In 1971, Lev and Schwartz proposed an economic valuation of employees, based on the present value of future earnings, adjusted for the probability of employees' death, separation or retirement. This method helps in determining what an employee's future contribution is worth today.

According to this model, the value of human capital embodied in a person who is 'r' years old, is the present value of his or her future earnings from employment and can be calculated by using the following formula:

$$V_r = \frac{I(t)}{(1+R)^{t-r}}$$

Where, V_r = expected value of a 'r' year old person's human capital

t = the person's retirement age

I(t) = expected annual earnings of the person upto the retirement

R = discount rate.

Limitations of Present Value of Future Earnings Model

i. This model ignores the possibility and probability that an individual may leave an organisation for reasons other than death or retirement.
ii. This model also ignores the probability that people may make role changes during their careers.

Rewards Valuation Model or Flamholtz Model

This model was developed by Flamholtz. He advocated that an individual's value to an organisation is determined by the services he is expected to render. This model is an improvement to the Present Value of Future Earnings Model. The model is based on the presumption that a person's value to an organisation depends upon the positions to be occupied by him in the organisation. The movement of people from one organisational role to another is a stochastic process with rewards. As people move and occupy different organisational roles, they render services (i.e. rewards) to the organisation. However, the roles they will occupy in future will have to be determined probabilistically for each individual.

This model suggests a five steps approach for assessing the value of an individual to the organisation.

1. Forecasting the period a person will remain in the organisation, i.e. his expected service life.
2. Identifying the service states, i.e. the roles that he might occupy, of course, the time at which he will leave organisation.
3. Estimating the value derived by the organisation when a person occupies a particular position for a specified time period.
4. Estimation of the probability of occupying ach possible mutually exclusive state at specified future times.
5. Discounting the value at a predetermined rate to get the present value of human resources.

Limitations of Rewards Valuation Model

1. It is difficult to estimate the probabilities of likely service states of each employee.
2. Determining the monetary equivalent of service states is also very difficult and costly affair.
3. Since the analysis is restricted to individuals, it ignores the value added element of individuals working as groups.

Certainty Equivalent Net Benefit Model

This model was suggested by Pekin Ogan in 1976. Under this model, the value of human resources is determined by taking into consideration the certainty with which the net benefits in future will accrue to the enterprise. The model involves the following steps:

1. Net benefit from each employee.
2. Certainty factor at which the benefits will be available in future.
3. The certainty equivalent benefits will be calculated by multiplying the certainty actor with the net benefits from all employees. This will be the value of human resources of the enterprise.

Chakraborty Model or Aggregate Payment Model

This model was suggested by Prof. S.K. Chakraborty in 1976. He was the first Indian to suggest a model on human resources of an enterprise. Under this model the value of human resources can be calculated by dividing the employees into two groups – Managerial and non-managerial, and then multiplying average tenure of group of employees with their average salary. The value thus obtained is discounted at the expected average after tax return on investment (ROI) over the average tenure period, so that value of human asset does not fluctuate frequently.

Dasgupta Model or Total Cost Model

Prof. N. Dasgupta suggested this model in 1978. According to this model the total cost incurred by the individual upto that position in the organisation should be taken as the value of a person which is further adjusted by his intelligence level. The value thus calculated is revised time to time on the basis of age, performance, experience and other capabilities.

Benefits of Human Resource Accounting

The following are the important benefits of Human Resource Accounting.

1. Helpful in proper implementation of Return on Capital Employed
2. Improves managerial decision making by maintaining detailed records relating to internal human resources.
3. It serves social purpose by identifying human resource as a valuable asset.
4. It helps to increases the productivity of human resources.
5. It is very essential where human element is the prime factor.
6. Helps in investment decisions.

Limitations of Human Resource Accounting

Although there are various advantages to an organisation by HRA it is not free from the limitations. The following are the important limitations of HRA.

1. There are no clear cut and specific procedures or guidelines for finding costs and value of human resources of an organization. The systems that are being adopted have certain drawbacks.
2. The period of existence of human resources is uncertain and hence valuing them under uncertainty in the future seems to be unrealistic.
3. The much needed empirical evidence is yet to be found to support the hypothesis that HRA as a tool of management facilitates better and effective management of human resources.
4. Since human resources are incapable of being owned, retained, and utilized, unlike physical assets, this poses a problem to treat them as assets in the strict sense.
5. There is a constant fear of opposition from the trade unions as placing a value on employees would make them claim rewards and compensations based on such valuations.
6. In spite of all its significance and necessity, Tax Laws don't recognize human beings as assets.
7. There is no universally accepted method of the valuation of human resources.