GOVERNMENT POLYTECHNIC BHUBNESWAR-2023

DEPARTMENT OF MODERN OFFICE MANAGEMENTLECTURER NOTES

SEMESTER-3rd, PAPER- Corporate Accounting

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Unit 1

Share capital and loan capital Share

In simple words, a share indicates a unit of ownership of the particular company. If you are a shareholder of a company, it implies that you as an investor, hold a percentage of ownership of the issuing company. As a shareholder you stand to benefit in the event of the company's profits, and also bear the disadvantages of the company's losses.

Types Of Shares

Now that you know share definition, you must understand that broadly share can be of two types:

- Equity shares
- Preference shares

Equity Shares Meaning

These are also known as ordinary shares, and it comprises the bulk of the shares being issued by a particular company. Equity shares are transferable and traded actively by investors in stock markets. As an equity shareholder, you are not only entitled to voting rights on company issues, but also have the right to receive dividends. However, the dividends - issued from the profits of the company - are not fixed. You must also note that equity shareholders are subject to the maximum risk - owing to market volatility and other factors affecting stock markets - as per their amount of investment. The types of shares in this category can be classified on the basis of:

Share Capital

Equity financing or share capital is the amount raised by a particular company by issuing shares. A company can increase its share capital by additional Initial Public Offerings (IPOs). Here is a look at the classification of equity shares on the basis of share capital:

• Authorised Share Capital: Every company, in its Memorandum of Associations, requires to prescribe the maximum amount of capital that can be raised by issuing equity shares. The limit, however, can be increased by paying additional fees and after completion of certain legal procedures. • Issued Share Capital: This implies the specified portion of the company's capital, which has been offered to investors through issuance of equity shares. For example, if the nominal value of one stock is Rs 200 and the company issues 20,000 equity shares, the issued share capital will be Rs 40 lakh.

• Subscribed Share Capital: The portion of the issued capital, which has been subscribed by investors is known as subscribed share capital. • Paid-Up Capital: The amount of money paid by investors for holding the company's stocks is known as paid-up capital. As investors pay the entire amount at once, subscribed and paid-up capital refer to the same amount.

Classification Of Equity Shares On The Basis Of Definition

Here is a look at the equity share classification on the basis of definition:

• Bonus Shares: Bonus share definition implies those additional stocks which are issued to existing shareholders free-of-cost, or as a bonus. • Rights Shares: Right shares meaning is that a company can provide new shares to its existing shareholders - at a particular price and within a specific time-period - before being offered for trading in stock markets. • Sweat Equity Shares: If as an employee of the company, you have made a significant contribution, the company can

reward you by issuing sweat equity shares. • Voting And Non-Voting Shares: Although the majority of shares carry voting rights, the company can make an exception and issue differential or zero voting rights to shareholders.

Classification Of Equity Shares On The Basis Of Returns

On the basis of returns, here is a look at the types of shares:

• Dividend Shares: A company can choose to pay dividends in the form of issuing new shares, on a pro-rata basis. • Growth Shares: These types of shares are associated with companies that have extraordinary growth rates. While such companies might not provide dividends, the value of their stocks increase rapidly, thereby providing capital gains to investors. • Value Shares: These types of shares are traded in stock markets at prices lower than their intrinsic value. Investors can expect the prices to appreciate over a period of time, thus providing them with a better share price.

Preference Shares Meaning

These are among the next types of shares issued by a company. Preferential shareholders receive preference in receiving profits of a company as compared to ordinary shareholders. Also, in the event of liquidation of a particular company, the preferential shareholders are paid off before ordinary shareholders. Here is a look at the different types of shares in this category:

• Cumulative And Non-Cumulative Preference Shares Meaning: In the case of cumulative preference shares, if a particular company doesn’t declare an annual dividend, the benefit is carried forward to the next financial year. Non-cumulative preference shares don't provide for receiving outstanding dividends benefits. • Participating/Non-Participating Preference Share Definition: Participating preference shares allow shareholders to receive surplus profits, after payment of dividends by the company. This is over and above the receipt of dividends. Non-participating preference shares carry no such benefits, apart from the regular receipt of dividends.

• Convertible/Non-Convertible Preference Shares Meaning: Convertible preference shares can be converted into equity shares, after meeting the requisite stipulations by the company’s Article of Association (AoA), while non-convertible preference shares carry no such benefits.

Redeemable/Irredeemable Preference Share Definition: A company can repurchase or claim redeemable preference share at a fixed price and time. These types of shares are sans any maturity date. Irredeemable preference shares, on the other hand, have no such conditions.

Debenture

The word ‘debenture’ itself is a derivation of the Latin word ‘debere’ which means to borrow or loan. Debentures are written instruments of debt that companies issue under their common seal. They are similar to a loan certificate.

Debentures are issued to the public as a contract of repayment of money borrowed from them. These debentures are for a fixed period and a fixed interest rate that can be payable yearly or half-yearly. Debentures are also offered to the public at large, like equity shares. Debentures are actually the most common way for large companies to borrow money.

Let us look at some important features of debentures that make them unique,

• Debentures are instruments of debt, which means that debenture holders become creditors of the company

• They are a certificate of debt, with the date of redemption and amount of repayment mentioned on it. This certificate is issued under the
• company seal and is known as a Debenture Deed
• Debentures have a fixed rate of interest, and such interest amount is payable yearly or half-yearly
• Debenture holders do not get any voting rights. This is because they are not instruments of equity, so debenture holders are not owners of the company, only
• creditors
• The interest payable to these debenture holders is a charge against the profits of the company. So these payments have to be made even in case of a loss. Types of Debentures
There are various types of debentures that a company can issue, based on security, tenure, convertibility etc. Let us take a look at some of these types of debentures.
• Secured Debentures: These are debentures that are secured against an asset/assets of the company. This means a charge is created on such an asset in case of default in repayment of such debentures. So in case, the company does not have enough funds to repay such debentures, the said asset will be sold to pay such a loan. The charge may be fixed, i.e. against a specific assets/assets or floating, i.e. against all assets of the firm.
• Unsecured Debentures: These are not secured by any charge against the assets of the company, neither fixed nor floating. Normally such kinds of debentures are not issued by companies in India.
• Redeemable Debentures: These debentures are payable at the expiry of their term. Which means at the end of a specified period they are payable, either in the lump sum or in installments over a time period. Such debentures can be redeemable at par, premium or at a discount.
• Irredeemable Debentures: Such debentures are perpetual in nature. There is no fixed date at which they become payable. They are redeemable when the company goes into the liquidation process. Or they can be redeemable after an unspecified long time interval.
• Fully Convertible Debentures: These shares can be converted to equity shares at the option of the debenture holder. So if he wishes wishes then after a specified time interval all his shares will be converted to equity shares and he will become a shareholder.
• Partly Convertible Debentures: Here the holders of such debentures are given the option to partially convert their debentures to shares. If he opts for the conversion, he will be both a creditor and a shareholder of the company.
• Non-Convertible Debentures: As the name suggests such debentures do not have an option to be converted to shares or any kind of equity. These
debentures will remain so till their maturity, no conversion will take place. These are the most common type of debentures. Forfeiture? Forfeiture means the loss of a right, claim, or property as a result of failure to meet legal obligations. In accounting for share, it assumes special meaning. Forfeiture of a share means cancellation of the shares held by the defaulting member in a company. After an applicant is allotted shares, a contract is entered into between the company and the shareholder. The shareholder is bound to contribute to the capital of the company to the extent of the price of shares he has agreed to take.
Where the amount of share money is payable in installments, the shareholders are under obligation to pay the installments as and when he/ she is asked to pay by the company.

If he/she fails to pay allotment/call money within the time mentioned in the allotment/call letters, his /her shares may be forfeited by the directors if authorized by the Articles of Association.

Effect of Forfeiture of Shares First, the directors must observe strictly all the legal formalities required by the Articles of Association, before forfeiting the shares. When the directors forfeit the shares, the person loses his membership in the company.
Further, the amount already paid by him/her towards the share capital is also forfeited. Therefore, on forfeiture of shares, the name of the member is removed from the Register of Members. In the financial books of the company also necessary entries are passed, canceling the shares allotted to the member. The amount already paid by the defaulting member is not refunded and is transferred to an appropriate account. Summarily the following are the effects of forfeiture:

1. Termination of membership of the shareholder.

2. Seizure of money paid by the shareholder.

3. Ownership of forfeited shares lies with the company.

4. The money received on the forfeited shares becomes the property of the company.

5. The defaulting shareholder shall remain liable to pay the amount in respect of his/ her shares, till the company receives the payment in full of such shares.

6. On forfeiture of shares, the share capital account is reduced to the extent of amount called up on account of capital till the forfeited shares are reissued.

Disclosure in the Balance Sheet: The balance of the Forfeited Shares Account is shown as an addition to the total paid-up share capital of the company under the head “Share Capital” under title “Equity and liabilities” of the Balance Sheet till the forfeited shares are reissued. Accounting Treatment on Forfeiture of Shares The accounting treatment relating to the forfeiture of shares may be discussed under the following heads:
1. Forfeiture of Shares Issued at Par 2. Forfeiture of Shares Issued at a Discount 3. Forfeiture of Shares Issued at a Premium Forfeiture of Shares Issued at Par Forfeiture of Shares originally issued at par:

Note: Instead of using the term Forfeited Shares A/c, Shares Forfeited A/c or Share Forfeiture Account may also be used.

Note: Respective Calls mean if there were arrears only on Allotment, Allotment Account will be credited. If there were arrears both on Allotment and First Call, both the Allotment Account and

First Call Account will be credited and again if the arrears were on Allotment, First Call and Second Call, then the Allotment Account, First Call Account and Second Call Account will be credited and so on.

Forfeiture of Shares Issued at a Discount If shares to be forfeited were issued at a discount, the discount applicable to such shares shall be cancelled at the time of forfeiture of such shares.

Forfeiture of Shares Issued at a Premium

Journal entries to be passed

Reissue of Forfeited Shares Shares are forfeited because only a part of the due amount of such shares is received and the balance remains unpaid. On forfeiture the membership of the original allottee is cancelled. He/she cannot be asked to make payment of the remaining amount. Such shares become the property of the company.

Therefore company may sell these shares. Such sale of shares is called 'reissue of shares'. Thus reissue of shares means issue of forfeited shares. Once the Board of directors has forfeited the shares, the defaulting share holder is asked to return the share certificate which is cancelled thereafter.

The board of directors passes a resolution allotting the forfeited shares to the new purchaser/ purchasers of such shares. In case of reissue of shares neither a prospectus is issued nor any offer is otherwise made to the general public.

Though the amount of such shares may be called in more than one installment but usually the entire amount is called in one installment i.e. lump sum. The board of directors of the company while reissuing the shares decide the price of reissue. These shares can be reissued at par, at premium or at discount.

Generally, these shares are reissued at a discount i.e. at a price which is less than its nominal value. The amount of discount allowed at the time of reissue in no case should be more than the amount forfeited on such shares.

Unit 2

Company final account Final Accounts: Definition
The accounts prepared at the final stage of the accounting cycle to illustrate the profit or loss and financial position of a business concern are known as the final accounts. Final Accounts: Explanation
Every businessman enters into business activities to make a profit. The role of accounting is to compile the financial records of a business in such a manner that yields its profit or loss. All transactions of a business are, in the first instance, recorded in the books of original entry.
These transactions are posted into ledgers in classified form and summarized before arithmetical accuracy is checked by means of a trial balance. After the preparation of the trial balance, the next step is preparing the final accounts.
These accounts consist of the following:
1. Trading Account 2. Profit and Loss Account 3. Balance Sheet
Objectives of Preparing Final Accounts
The objectives of preparing final accounts are:
1. To Ascertain the Results of Transactions
Final accounts show the profit earned or loss sustained by the business in a particular period. The preparation of a trading, profit, and loss account or income statement shows the profit or loss.
2. To Know the Financial Position of the Business
Besides determining profit and loss, the financial position of the business is shown with the help of a balance sheet. Trial Balance: The Basis of Final Accounts
The basis of final accounts is the trial balance. The trial balance includes all the balances of the ledger accounts, including the account balances of expenses, revenue, assets, liabilities, capital, and drawings.
A trial balance has two columns: debit and credit. Debit balances usually represent expenses and assets drawings that appear in the debit column of the trial balance. Credit balances represent revenue, capital, and liabilities: these appear in the credit column of the trial balance. From the trial balance, expenses and revenues are transferred to the trading and profit and loss account. Assets, liabilities, and drawings are transferred to the balance sheet.
How to Prepare Final Accounts?
Introduction
Final accounts are the end results of the whole accounting process. Final Accounts or annual accounts includes the following statements
▪ Trading & Profit & Loss Account and ▪ Balance Sheet. In case of manufacturing concerns the final accounts may include the following statements.
▪ Manufacturing A/c., ▪ Trading, Profit & Loss A/c., ▪ Balance Sheet The above final a/c's are prepared with the help of trial balance and additional information/adjustments.
Trading and Profit & Loss A/c shows the result of the operations that is profits earned or loss incurred during that year. Therefore expense should be recognized when incurred means services/benefits are received and income should be recognized when earned. This is also referred as Mercantile system of accounting or recognition of accrual principle. Due to this, we

make adjustments for outstanding expenses, Outstanding Incomes, prepaid expenses, Advance Incomes, closing stock etc.

Balance sheet shows the Assets & Liabilities of the organization as on a particular date. It is not an account. It is not for any period or year. It shows the financial position of the entity as of a particular date (at a particular point of time).

Manufacturing account if prepared shows the cost of goods manufactured during that period. This cost is transferred to Trading A/c.

Components of Final Accounts & Their Meanings Trading account:

▪ Trading account shows the profit/loss made on a gross basis that is including only the direct cost of the goods. ▪ In trading a/c, we credit the trading income like sale and debit the cost of goods sold (opening stock + purchases (-) closing stock).

▪ Alternatively Opening Stock & purchases is debited & Closing stock is credited to trading account. ▪ Other direct expenses related to purchase or manufacture of goods like carriage inward, wages, etc. are also debited here. ▪ Purchase return & Sales returns will be deducted/adjusted from the purchases & sales respectively. ▪ The balance is known as the gross profit or gross loss, which is transferred to profit and loss a/c. Profit and loss account:

▪ It shows the performance of the entity i.e. profit earned or loss suffered considering all indirect expenses and incomes. ▪ Gross profit or gross loss from trading account is transferred to P&L a/c. ▪ Other incomes like discount, interest, etc. are credited. ▪ Administrative expense, selling and distribution expense, financial expense, income tax, losses, etc. are debited to it. ▪ The net profit/ net loss is transferred to P&L appropriation a/c (if made) otherwise to capital a/c. ▪ If trading a/c is not prepared then in place of gross profit/ gross loss all items of trading a/c will come in P&L a/c itself. Profit & loss appropriation account:

▪ The net profit/ net loss is transferred to P&L appropriation A/c. ▪ Interest charged on drawings is credited to it. ▪ Interest allowed on capital, salary/ commission to proprietor/ partner and transfer to reserves are debited to it. ▪ The net balance then left is transferred to capital a/c. Manufacturing account:

▪ Raw material consumed (Op. stock + Purchases – Closing stock), carriage inward, wages, power, depreciation of factory building, machinery, etc and other manufacturing (factory) expense are debited to it. ▪ Opening WIP stock is debited and closing WIP stock credited.

▪ Balance is the cost of goods manufactured and is then transferred to trading account. ▪ When manufacturing a/c is not prepared, these items will come in trading a/c. Sometimes depreciation a/c may be directly taken to P&L a/c instead of trading a/c. ▪ Manufacturing a/c is also a period statement. Balance sheet:

▪ Balance sheet shows the financial position of the entity as at a particular point of time. ▪ It shows what and how much entity owns (i.e. its assets) and how much it owes to others (i.e. its liabilities), the balance (i.e. asset – liability) is the owners equity. ▪ It is not an account, hence does not have debit and credit side. ▪ On one side assets like fixed assets (building, machinery, furniture, etc), current assets (like stock, debtors, cash bank balance, advances, prepared a/c) and investments if any are shown. ▪ On the other side in addition to owner's capital and reserves, the outside liabilities like loans taken, creditors ▪ expenses payable etc are shown. ▪ The total of the two sides must be the same. Trial balance:

▪ Trial balance is a statement containing the balances of all accounts as at the end of certain period usually classified into debit and credit. ▪ The total of debit and credit side must tally

because whole accounting is done by double entry principle, otherwise it indicates arithmetical inaccuracies. ▪ It has balance of expenses, incomes, assets and liabilities. ▪ With the help of trial balance and adjustments the final accounts are prepared. ▪ All expenses and incomes will go into Manufacturing, Trading, P&L and P&L app. a/c depending upon its nature and all assets and liabilities will go into balance sheet.

Other information/ Additional information

▪ When the trial balance is prepared, there may still be some accounts which are not yet final and may need some adjustments, some corrections etc. ▪ Such information is given together with trial balance and commonly referred as adjustment/ additional information/ other information etc. ▪ It is basically a transaction which needs to be entered in the account books or some errors which needs to be rectified, hence we give double entry effect i.e. Debit & Credit both for such adjustments. ▪ Some times indirect information is contained, in the trial balance, which when interpreted results into an adjustment (known as adjustment derived).

Unit 3
Valuation of share and goodwill

Methods of Valuation of Goodwill

Goodwill is an intangible asset which is not visible or cannot be touched but can be purchased and traded and is real. The value of an enterprise's brand name, solid consumer base, functional consumer associations, good employee associations and any patents or proprietary technology represent some instances of goodwill. In other words, goodwill is a firm worth or reputation established over time. In partnership, the valuation of goodwill is very significant. In this article, we will discuss the meaning of the valuation of goodwill and its different methods of assessment. Also Check: What is Goodwill?

What is the valuation of Goodwill?

The valuation of goodwill is based on the assumption obtained by the valuer. A successful business earns a reputation in the industry, develops trust with its clients, and has more extensive

business links, unlike new companies. All these points contribute while evaluating the business, and its financial worth that a customer is eager to give is known as goodwill. Customers who buy a company looking at its goodwill hopes to gain super-profits. Hence, goodwill applies to only firms that make super-profits and not to those who earn regular losses or profits.

Methods of Valuation of Goodwill

Various ways are used in the valuation of goodwill. However, the valuation methods are based on the situation of an individual company and different practices of the trade. The top three processes of valuation of goodwill are mentioned below. ⇨ Average Profits Method – This method is divided into two sub-division.

• Simple Average – In this process, goodwill evaluation is done by calculating the average profit by the number of years it is called years purchase. It can be calculated by using the formula. Goodwill = Average Profit x No. of years' of purchase.

• Weighted Average – Here, last year's profit is calculated by a specific number of weights. It is used to obtain the value of goods, which is divided by the total number of weights for determining the average weight profit. This technique is used when there is a change in profits and giving high importance to the present year's profit. It is evaluated by using the formula. Goodwill = Weighted Average Profit x No. of years' of purchase, where Weighted Average Profit = Sum of Profits multiplied by weights/ Sum of weights ⇨ Super Profits Method – It is a surplus of expected future maintainable profits over normal profits. The two methods of these methods are.

• The Purchase Method by Number of Years – The goodwill is established by evaluating super-profits by a specific number of the purchase year. It can be estimated by applying the below formula. Super Profit = Actual or Average profit – Normal Profit

• Annuity Method –Here, the average super profit is taken as an annuity value over a definite number of years. A discounted amount of super profit calculates the current value of an annuity at the given rate of interest. The formula to be used here is. • Goodwill = Super Profit x Discounting Factor ⇨ Capitalisation Method – Under this method, goodwill can be evaluated by two methods.

• Average Profits Method – In this process, goodwill is measured by subtracting the original capital applied from the capitalised amount of the average profits based on the average return rate. The formula used is mentioned below. • Capitalised Average profits = Average Profits x (100/average return rate)

• Super Profits Method- Here, the super profit is capitalised, and the goodwill is calculated. The formula applied is. Goodwill = Super Profits x (100/ Normal Rate of Return) The above mentioned is the concept that is explained in detail about methods of valuation of goodwill.

What is Share Valuation? In the simplest terms, share valuation is a system of determining the value of a business by estimating the value of its shares.

Suppose you are the CEO of a company, and your company has decided to take over one of its competitors.

So then how do you decide the price at which the shares of the other company must be taken over?

We can even consider buying its shares at the market price (the price at which they're being traded) if it's a listed entity, but how do we do so for a private company?

Therefore, in such circumstances, it is better to evaluate the net worth of the company's ownership through separate methods and assumptions.

This evaluation is known as Share Valuation

When is Valuation of Shares Required? The valuation of shares is usually required in the following situations –

▪ When a business is being sold to another business;

▪ When a business offers its shares as security to get a loan;

▪ When companies undergoes mergers, demergers, acquisitions or reconstruction;

▪ When a company is implementing an Employee Stock Option Plan (ESOP); and/or

▪ When a company plans to convert its shares from preference to equity shares. What are the Types of Stock Valuation? On the basis of the value derived in the methods used, there are two types of share valuations – Absolute Valuation – Absolute valuation is the type used to calculate the "intrinsic" value of the shares, which has been discussed above.

This method only focuses on the fundamentals of the company – dividends, cash flow, and the growth rate of the concerned business. Relative Valuation – The method under relative valuation uses ratio analysis, among others, to ascertain the value of a stock in comparison to its peers.

The methods under this type are numerous and are easy to use as well. What are the Methods of Stock Valuation? Following are some of the popular methods of share valuation –

The Assets Approach – This approach is based on the value of the company's NAV and shares. Here, the company's Net Asset Value (NAV) is divided by the number of shares to arrive at the value of each share. The Net Asset Value of a company is the difference between the net value of all the assets and liabilities of a business.

The net value of assets determined has to be divided by the number of equity shares for finding out the true value of the share.

Following are some of the important points to be considered while valuing shares under this method: ▪ All of the assets of the company, including current assets and current liabilities such as trade receivables and payables, provisions, etc. have to be considered.

▪ Fixed assets have to be considered at their realizable value.
▪ Valuation of goodwill as a part of intangible assets is essential to the calculation.
▪ The fictitious assets such as preliminary expenses, discount on issue of shares and debentures, accumulated losses etc. should be eliminated. The Income Approach – This approach focuses on the expected benefits from the business investment, i.e., what the business generates in the future.

One of the popular methods under this approach is the Value per Share method.

Here, the value per share is calculated on the basis of the profit of the company which is available for distribution to the shareholders. This profit can be determined by deducting reserves and taxes from the net profit. You can follow these steps to determine the value per share: 1. Calculate the company's profit, which is available for dividend distribution; 2. Obtain the rate of normal rate of return for the relevant industry; and 3. Calculate the capitalized value as (profit for distribution*100/rate of return)

4. Divide this value by the number of shares.

Unit 4
Amalgamation and reconstruction

Amalgamation:
Accounting Standard 14, deals with Amalgamation. Amalgamation is a combination of one or more companies into a new entity. In financial terms, Amalgamation is a fusion between two or more companies to consolidate their business activities by establishing a new company having a separate legal existence.

Types or methods of Amalgamation and Method of accounting of amalgamation:

There are two types or methods of amalgamation :
Methods or types of Amalgamation
1. a) Amalgamation in the nature of Merger 2. b) Amalgamation in the nature of Purchase 3. a) Amalgamation in the nature of Merger: AS 14 provides following conditions for amalgamation in the nature of merger:
1) Assets and Liabilities: All Assets and liabilities of the transferor company after amalgamation become the assets and liabilities of the transferee company.
2) Share Capital: Shareholders holding not less than 90% of the face value of equity share capital in the transferor company become shareholders of the transferee company after amalgamation.
3) Discharge of Purchase consideration: The purchase consideration is discharged by the transferee company fully by way of equity shares except the fractions which are issued by way of cash.
4) Business: The business of the transferor company is intended to be carried out by the transferee company.
5) Book Value: No adjustments are to be made at book values of assets and liabilities except to ensure the uniformity of the accounting policies.
1. b) Amalgamation in the nature of Purchase: Amalgamation in the nature of purchase is described as an amalgamation which does no satisfies one or more conditions of amalgamation in the nature of merger. In purchase method one company makes an complete purchase of interests of the equity shareholders of another company.
Types or Methods of Accounting for Amalgamation:
types or Methods of Amalgamation
a) Pooling of Interests Method:
This method is used when amalgamation is in the nature of Merger. This method has the following features
1) Reserves, Assets and liabilities: All the reserves, assets and liabilities of the transferor company should be recorded at the existing carrying amounts and in the same manner as at the date of amalgamation in the transferee company’s financial statements.
2) Profit and Loss account: The balance of profit and loss account both companies should be merged or transferred to general reserve account.

3) Accounting Policies: Uniform accounting policies should be followed in case of variation among both the companies. The effect on the financial statement of such changes should be reported in accordance with AS 5.
4) Share capital: The difference between the amount recorded as share capital issued (purchase consideration) and the amount of share capital of the transferor company should be adjusted in Reserves.
b) Purchase Method:
Methods of Amalgamation
As per guidelines of AS 14, the accounting of amalgamation is in nature of purchase is done by "Purchase Method" having the following features:
1) Assets and liabilities: In this method the transferee company records the assets and liabilities on the basis of either book value or fair value as agreed by them.
2) Profit and Loss account: The balance of profit and loss account of the transferor company need not be carried forward.
3) Statutory Reserve: All statutory reserves of the transferor company should be recorded in financial statement of the transferee company.
4) Purchase consideration and Net Assets: The excess amount of the purchase consideration and Net Assets is debited to Goodwill account whereas the deficit is credited to Capital Reserve. However, AS 14 specifies that the amount of Goodwill should be written off within 5 years.
Amalgamation Absorption & External reconstruction (Continue…)
Q2) What is Purchase consideration? Explain the various methods of calculating Purchase consideration.
Purchase Consideration: Purchase consideration refers to the consideration payable by the transferee company to the transferor company for taking over the assets and liabilities of the company.
AS 14 defines the term purchase consideration as the "aggregate of the 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".
There are various methods of Computations of Purchase Considerations, which are given below:
Lumpsum Method: Under this method purchase consideration will be paid in lumpsum as per the agreement of the companies valuations.
Eg: Y ltd takes over Z ltd for the amount of Rs. 20,00,000. Here Rs. 20,00,000 is he purchase consideration.
2) Net Asset Method: Under the Net Assets Method, Purchase consideration is calculated by adding up all the taken over assets on agreed value of the transferor company and deducting the taken over liabilities at agreed value. If agreed value is not mentioned the value appearing in the books of the transferor company should be taken into consideration. All Fictitious assets should be ignored
Purchase Consideration – Net Asset Method
Particulars Rs
Agreed Value of Assets taken over XXX
Less: Agreed Value of Liabilities taken over XXX
Purchase Consideration XXX

3) Net Payment Method: In this method, all payments made by the transferee company like Preference shares, Equity shares and cash are added together to find out the purchase considerations
Eg: X ltd had taken over Y ltd and agreed to pay Equity shares of Rs. 4,00,000, Preference shares for Rs. 2,00,000 and cash Rs. 50,000
Purchase Consideration – Net Payment Method
Mode of Discharge of Purchase consideration
Rs.
Preference Shares XXX
Equity Shares XXX
Cash to Equity /Preference Shares XXX
Purchase Consideration XXX

4) Intrinsic Worth Method: Under this method, purchase consideration is derived on the proportion in which the shares of the transferee company are exchanged for the shared of the transferor company. The ratio of exchange is usually determined on the basis of the Intrinsic or yield of shares.
Eg: A Ltd is absorbed by B ltd. It was decided that the holder of every 3 shares in A ltd was to receive 5 shares in B ltd
Reconstruction of Company:
When a company is suffering loss for several past years and suffering from financial difficulties, it may go for reconstruction. In other words, when a company's balance sheet shows huge accumulated losses, heavy fictitious and intangible assets or is in financial difficulties or is to over capitalized, and then the process of reconstruction is restored.
Types Of Reconstruction:
Reconstruction may be external or internal which are described below:
1. External reconstruction:
When a company is suffering losses for the past several years and facing financial crisis, the company can sell its business to another newly formed company. Actually, the new company is formed to take over the assets and liabilities of the old company. This process is called external reconstruction. In other words, external reconstruction refers to the sale of the business of existing company to another company formed for the purposed. In external reconstruction, one company is liquidated and another new company is formed. The liquidated company is called "Vendor Company" and the new company is called "Purchasing Company". Shareholders of vendor company become the shareholders of purchasing company.
2. Internal Reconstruction:
Internal reconstruction refers to the internal re-organization of the financial structure of a company. It is also termed as re-organization which permits the existing company to be continued. Generally, share capital is reduced to write off the past accumulated losses of the company. The accounting procedure of internal reconstruction is distinct from that of amalgamation, absorption and external reconstruction.

Unit 5
Funds flow statement and cash flow statement

Meaning of fund flow statement:
A company prepares a Profit and Loss (P&L) statement and balance sheet, then what is the need for funds flow statement? The P&L Statement and Balance sheet are two statements that portray the financial position for the past and current year. They do not explain why the financial position has changed. That's where the fund flow statement is required and its need for long and shortterm funds. It also explains the following:
• Fund Sources or where the funds came in from with their sources. • Fund application or where the long or short-term funds have been used.

Example of fund flow statement:
Companies have long-term funds in non-current assets like patents, other investments in various companies, plant and machinery, intellectual property rights, equipment, buildings etc. Thus, noncurrent assets are created in a financial year whose monetary value is not fully realised in that accounting and financial year. Due to this, two situations arise, such as:
• When the long-term funds finance the non-current assets: The fund flow statement will reflect these assets utilised from the long-term funds. These changes can be understood if the company is using only long-term funds to finance the non-current assets. It is deemed as a healthy organisational behaviour that is growing positively with the proper fund usage. • When the short term funds finance the non-current assets: The changes in the fund flow statement reflect usage of short-term funds. This is undesirable as it indicates the dangerous use of short-term funds on a long-term investment which is risky. Especially when the company is likely to be cash strapped for its short-term needs and financial obligations since the investments are long-term and cannot be easily liquidated.
Thus, the fund flow analysis can pinpoint the change and application of working capital, be it long or short term funds, through its utilisation and is an index of its financial health. It is widely used to interpret the impact of changes in funds position and its uses in the interim period between two balance sheets through its proper interpretation. Components of the funds flow statement: The components of a fund flow statement are its sources of funds which may be from the outside, and capital brought in by the owners, and details on how the funds are utilised namely whether they've been used on Fixed Assets or on Current Assets. Fund flow Statement Benefits: From the above discussion, one can easily enumerate the benefits of a fund flow statement as:
• An aid to fund managers in explaining the strain on working capital and liquidity of a company, though the P&L Statement may declare it to be profitable. • It helps the fund managers explain the financial strengths of a company despite its operational losses. • It helps the fund managers analyse the fund flow and risk level when misusing shortterm funds to finance long-term assets. Usually, this is a grey area that is not reflected in either the company's balance sheet or P&L statement.
Who uses the Funds flow Statement? Of course, the lenders of funds want to know the company's health before investing in it. The funds flow statement would be of a significant area

of interest since they assess the utilisation of funds rather than focusing on the operational losses or profits declared in a company's financial statements. An excellent example of this is bankers who utilise the funds flow statement to assess the companies' overdraft and cash credit facilities. Fund flow statement proforma: The general format of the fund flow statement would be as below.
Sources of Funds   Application of Funds

Capital Funds
Loans and Debts Operations generated Funds
Sale of assets (if any)
*(Bal fig) Excess of sources minus funds used.

[Working capital Decrease]

xxx
xxx xxx
xxx

Funds utilised in Fixed assets.
Funds utilised in other Non- current assets.
Funds used for repaying loans existing.
Funds used for paying taxes, dividends, etc.
*(Bal fig) Funds minus the application of funds shortage. [Working capital increase]

xxx
xxx xxx

xxx

Total xxx   xxx
Blog / Accounting and Inventory
Fund Flow Statement - Meaning, Format And Examples The funds flow statement definition is a statement that explains the working capital change in a company. It is an analytical statement of the changes presenting its financial position between two balance sheet statements. It depicts the monetary outflow and inflow of the sources and the applications of funds during a particular period. Meaning of fund flow statement: A company prepares a Profit and Loss (P&L) statement and balance sheet, then what is the need for funds flow statement? The P&L Statement and Balance sheet are two statements that portray the financial position for the past and current year. They do not explain why the financial position has changed. That’s where the fund flow statement is required and its need for long and short-term funds. It also explains the following:
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Example of fund flow statement:

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*(Bal fig) Excess of sources minus funds used.

[Working capital Decrease]

xxx
xxx
xxx xxx

Funds utilised in Fixed assets.
Funds utilised in other Non- current assets.
Funds used for repaying loans existing.
Funds used for paying taxes, dividends, etc.
*(Bal fig) Funds minus the application of funds shortage.
[Working capital increase]

xxx
xxx
xxx

xxx

Total xxx xxx What is working capital? Working capital is the money used and available for a company's day to day expenses on business operations. It shows the fluid financial liquidity of the enterprise and is crucial to the continuity and growth of the business. Hence, working capital is required to be used judiciously and managed well. We have just seen how the working capital impacts the funds flow statement and the business's health.
In the definition of fund flow statement, the working capital is shown as the current liabilities and assets and long term or short term capital funds. Let's explore what these are.
Current assets mean the assets that you can easily convert to cash in the short run. Similarly, current liabilities are those that need to be paid within a year. Current assets are composed of the following:
• Bank balances • Cash in hand • Inventories • Short-term receivables • Accounts receivable or to be paid from goods sold.
Current liabilities include the following:
• Accounts to be paid or payable to suppliers • Short-term owed debts/loans.
Therefore, the working capital formula is the excess or deficit between the Current Assets and the Current Liabilities of a company. Working Capital = Excess or Deficit between Current Assets and Current Liabilities. Working capital is positive when the assets are greater and negative when the liabilities are greater.
The working capital ratio is also an essential metric providing insight into the company's health and is simply expressed as: Working Capital Ratio = Current Assets divided by the Current Liabilities.

If the ratio of the working capital is more than 1, it is called positive capital, and the company has sufficient cash to pay its short-term debts. If the ratio of working capital is less than 1, it is termed negative capital which means that the company has issues in paying its short-term debts and needs a fresh infusion of working capital. Cash Flow Statement The main components of the cash flow statement are:

• Cash from operating activities • Cash from investing activities • Cash from financing activities • Disclosure of non-cash activities, which is sometimes included when prepared under generally accepted accounting principles (GAAP).

It's important to note that the CFS is distinct from the income statement and the balance sheet because it does not include the amount of future incoming and outgoing cash that has been recorded as revenues and expenses. Therefore, cash is not the same as net income—which, on the income statement, includes cash sales as well as sales made on credit. Cash from Operating Activities The operating activities on the CFS include any sources and uses of cash from business activities. In other words, it reflects how much cash is generated from a company's products or services.

Generally, changes made in cash, accounts receivable, depreciation, inventory, and accounts payable are reflected in cash from operations.

These operating activities might include:

• Receipts from sales of goods and services • Interest payments • Income tax payments • Payments made to suppliers of goods and services used in production • Salary and wage payments to employees • Rent payments • Any other type of operating expenses

In the case of a trading portfolio or an investment company, receipts from the sale of loans, debt, or equity instruments are also included because it is a business activity. Cash from Investing Activities Investing activities include any sources and uses of cash from a company's investments. A purchase or sale of an asset, loans made to vendors or received from customers, or any payments related to a merger or acquisition are included in this category. In short, changes in equipment, assets, or investments relate to cash from investing.

The only time that income from an asset is accounted for in CFS calculations is when the asset is sold. Usually, changes in cash from investing are a "cash-out" item because cash is used to buy new equipment, buildings, or short-term assets such as marketable securities. However, when a company divests an asset, the transaction is considered "cash-in" for calculating cash from investing. Cash from Financing Activities Cash from financing activities includes the sources of cash from investors or banks, as well as the uses of cash paid to shareholders. Payment of dividends, payments for stock repurchases, and repayment of debt principal (loans) are included in this category.

Changes in cash from financing are "cash-in" when capital is raised and "cash-out" when dividends are paid. Thus, if a company issues a bond to the public, the company receives cash financing. However, when interest is paid to bondholders, the company is reducing its cash. How Cash Flow Is Calculated There are two methods of calculating cash flow: the direct method and the indirect method. Direct Cash Flow Method The direct method adds up all of the various types of cash payments and receipts, including cash paid to suppliers, cash receipts from customers, and cash paid out in salaries. This method of CFS is easier for very small businesses that use the cash basis accounting method. These figures can also be calculated by using the

beginning and ending balances of a variety of asset and liability accounts and examining the net decrease or increase in the accounts. It is presented in a straightforward manner. Indirect Cash Flow Method Most companies use the accrual basis accounting method, where revenue is recognized when it is earned rather than when it is received. This causes a disconnect between net income and actual cash flow because not all transactions in net income on the income statement involve actual cash items. Therefore, certain items must be reevaluated when calculating cash flow from operations.

With the indirect method, cash flow is calculated by adjusting net income by adding or subtracting differences resulting from non-cash transactions. Non-cash items show up in the changes to a company's assets and liabilities on the balance sheet from one period to the next. Therefore, a company's accountant will identify the increases and decreases to asset and liability accounts that need to be added back to or removed from the net income figure, in order to identify an accurate cash inflow or outflow.

The indirect cash flow method allows for a reconciliation between two other financial statements: the income statement and balance sheet. Changes in accounts receivable (AR) on the balance sheet from one accounting period to the next must be reflected in cash flow. If AR decreases, this implies that more cash has entered the company from customers paying off their credit accounts—the amount by which AR has decreased is then added to net earnings.

If AR increases from one accounting period to the next, then the amount of the increase must be deducted from net earnings because, although the amounts represented in AR are in revenue, they are not cash.

On the other hand, an increase in inventory signals that a company has spent more money to purchase more raw materials. If the inventory was paid with cash, then the increase in the value of inventory is deducted from net earnings.

A decrease in inventory would be added to net earnings. If inventory was purchased on credit, then an increase in accounts payable would occur on the balance sheet, and the amount of the increase from one year to the next would be added to net earnings.

The same logic holds true for taxes payable, salaries payable, and prepaid insurance. If something has been paid off, then the difference in the value owed from one year to the next has to be subtracted from net income. If there is an amount that is still owed, then any differences will have to be added to net earnings. Limitations of the Cash Flow Statement Of course, not all cash flow statements look as healthy as our example or exhibit a positive cash flow. However, negative cash flow should not automatically raise a red flag without further analysis. Poor cash flow is sometimes the result of a company's decision to expand its business at a certain point in time, which would be a good thing for the future.

Therefore, analyzing changes in cash flow from one period to the next gives the investor a better idea of how the company is performing, and whether a company may be on the brink of bankruptcy or success. The CFS should also be considered in unison with the other two financial statements.