VALUATION

1. **Valuation of Goodwill**
2. **Valuation of Shares**
3. **Valuation of Brand**
4. **Valuation of Business**

VALUE OF GOODWILL

Methods of Valuation of Goodwill:-

1. **Average Profits Method**: - FMP After Tax X No. Of Years Of Purchase.

2. **Super Profits Method**:-Super Profits X No. Of Years of Purchase

3. **Capitalisation Method**: - FMP after Tax /Normal Rate Of Return

4. **Capitalisation Of Super Profits Method**: - Super Profits/Normal Rate Of Return

* For Capitalisation Method Use Closing Capital Employed And For Capitalisation Of Super Profits Method Use Average Capital Employed.

5. **Annuity Method:-** Super Profits Or FMP(As The Case May Be In The Question)* Present Value Of Annuity Factor.

ITEM TO BE COMPUTED

A). Future Maintainable Profits (FMP)

B).Normal Rate of Return (NRR)

C).Capital Employed

D).Average Capital Employed

E). Number Of Years Of Purchase

FMP REPRESENT PROFITS OF FUTURE PERIODS BASED ON CERTAIN ASSUMPTIONS:-

Ist PREFERENCE (PROJECTION METHOD).

IInd PREFERENCE (PAST PROFITS METHOD).

1.**Projection Method:-**Sales, Cogs And Expenses Are Projected Based Upon Expectations.

2.**Past Profits Method**(Mostly Preferred Method).

Past Profit Method

Particular	**Amount**
PROFITS AFTER TAX (PAT)	xxxxxx
+Tax Expense	
PBT (Profits Before Tax)	
(+) Abnormal Losses (E.G Loss On Sale Of Fixed Assests)	
(-) Abnormal Profit (E.G Profit On Sale Of Fixed Assests)	
(-) Income From Non Trade Investment/Non Operating Income	
(-) Capital Receipt Credited To Revenue(Sale Of Fixed Assets Wrongy Credited To P&L)	
(+) Depreciation On Above Fixed Assets Which Is Charged Even Assets Had Sold.	
(+) Capital Expenditure Charged To Revenue (E.G Purchase Of Machine Wrongly Charged To P & L)	
(-) Depreciation On Above Machine Which Was Not Charged Before	
(+) Revenue Income Relating To Previous Years Not Yet Credited.	
(-) Revenue Exp Relating To Previous Years Not Yet Provided.	
(+) Over Valuation Of Opening Stock	
(-) Over Valuation Of Closing Stock	
+ -Revaluation Of Current Assets/Current Liabilities (This Is Done Because Goodwill Should Be Based On Correct Value.)	
(+) Goodwill Amortization	
PAST ADJUSTED PROFITS:-	**YEAR 1 YEAR 2 YEAR 3**

NOW COMPUTE AVERAGE ADJUSTED PROFITS:- <u>Adjusted Profit of all years</u>		
Average Past Adjusted Profits		xxx
Add:Income not earned in the past but earned in future(advantage of New contract)		xx
Add:Expenses incurred in the past but not incurred in future		xx
Less:Exp not incurred In past but incurred in future(increase in remuneration, add.dep on increase in value of fixed assets)		
Less:Income earned in past but not likely to earned in future		
FMP Before Tax	xxx	
Less Future Tax	(xxx)	
FMP After Tax	**xxxx**	

Note-Additional deprecation on increase in value of Fixed assets is not deductible for calculation FMP Tax.

- **Computation of Past Profit Before Tax when more than 1 year Balance Sheet Given in question.**

Closing Balance of P& L A/c		XX
Add:	Goodwill Written off	XX
	Interim Dividend	XX
	Proposed Pref. Dividend	XX
	Proposed Equity Dividend	XX
	Dividend Distribution Tax	XX
	Transferred to General Reserve/Reserve	XX
Less: Opening Balance of P& L A/c		(XX)
Profit After Tax		**XX**
Add:Tax at Actual Rate		XX
Profit Before Tax		**XX**

Important Points to Remembers

1.Past Adjusted profit ke upar Fixed Assets or investment ke revaluation ka koi effect nhi hota.

2.Increase/Decrease in Debtor/Creditors due to exchange rate should be adjusted in FMP calculation

3.Future tax: - this will either be given or average of previous years profits is taken.

4.If question is silent then assume:- all investments will be assumed as non trade

5.Dont consider abnormal loss year while calculating past adjusted profits.

6.If Trend exist use weighted average otherwise simple average is taken.

7.Profit /Loss on sale of F.A or Investment is non operating income it deduct from Past Profits.

8.Savdhan-If Fixed assets is **revalued upward** then **Additional depreciation on increased amount shall be deducted from Future Maintainable profits**

HOW TO COMPUTE CAPITAL EMPLOYED

SUNDRY ASSETS	XXXXX
LESS: SUNDRY LIABILITIES	XXXXX
CAPITAL EMPLOYED	XXXXX

SOME IMPORTANT NOTES TO BE KEPT IN MIND WHILE COMPUTING CAPITAL EMPLOYED

1. **Savdhan**- All Assets And Liabilities Should Be taken After Revaluation, After Rectification and after Change in Accounting Policies.

2. Sundry Assets Should **Not Include** Goodwill, Misc Expenditure, Discount on Issue of Shares etc.

3. **Preliminary Expenses** Should Also **Not Be Included** In Sundry Assets.

4. Non Trade Assets/Non Trade Investment **Should Not** Be Included In Sundry Assets.

5. Sundry Liabilities **Does Not Include Proposed Dividend and Pref. Share Capital** (It Is Treated As Part Of Reserve & Surplus).

6. Unclaimed dividend is considered as outside liability it is different from proposed dividend.

7. Gratuity fund, workmen's compensation fund is a outside liability.

8. Tangible Capital Employed Means Closing Capital Employed

9. Average Capital Employed:- Opening Capital Employed + Closing Capital Employed/2

How to Calculate Average Capital Employed:-

Closing Capital Employed	**xxxx**
(+) Dividend & Dividend Tax Paid at Current Year	**xxxx**
Adjusted Closing Capital Employed	
(-) ½ of{(Current Year Adjusted Profit before Tax+Income from Non Trade Invst)-Tax}	**(XXX)**
Average Capital Employed	xxxxx

If more than one year assets and liabilities are given then

(Adjusted Closing Capital Employed+Opening Capital Employed)/2

Liabilities Side Approach for Capital Employed = Equity Share Capital + Reserves and Surplus+Pref Share Capital – Non Trading Assets – Misc Expenditure (+/-) Net Profit/Loss on revaluation of Assets or Liabilities

**Whenever We Use Weighted Avg In Fmp--------------Then Use Closing Capital Employed.

****When We Use Simple Avg In Fmp.............................Then Use Avg Capital Employed.

HOW TO COMPUTE NORMAL RATE OF RETURN(NRR).

Normal Rate of Return = Average Dividend Earnings/Average Market Price

*NRR Should Be After Tax.

How To Compute No Of Years Of Purchase?

If Number of Year Purchase Is Missing:- Use Capialisation Method And Capitalisation Of Super Profits Method.

If NYP Is Missing And Question Requires NYP Then Estimate NYP From 3-5 Years By Giving Notes.

Leverage effect of Goodwill

Leverage effect=**Value of G.W as per Shareholder Approach – Value of G.W as per Long term Approach**

1. Long term Approach me Long term debts total assets me se nhi minus karte

2. Long term Approach me Interst on Long term debts FMP me se nhi minus karte.

VALUATION OF SHARES

Method for Valuation

a) Net Assets basis for LIQUIDATING COMPANY

b) Yield Basis (Earning Yield & Dividend Yield)

i) Earning Yield-Large block of Share under trf

ii) Dividend Yield-Small Block of Share under trf

c) Price Earning basis, Fair Value basis, Productivity basis

Sundry Assets:-	Xxxxx
Less:-Sundry Liabilities	Xxxxx
Balance	Xxxxx
Less:	
Preference Share Capital	Xxxxx
Proposed Dividend	Xxxxx
Net Assets Available For Equity Shareholders	Xxxxxx
+ Notional Calls/Unpaid Calls	Xxxxxx
Total Assets Available For Equity shareholders	Xxxxxx

So,

Intrinsic Value Per Share:- $\dfrac{\text{Total Assets Available To Equity shareholders}}{\text{Equity Share Capital (After Calls).}}$

***** **Other Names Of Intrinsic Value**

Net Assets Breakup Value Per Share/Net Worth Per Share/Book Value Per Share

* We Always Calculate I.Value Ex-Divividend And Then Add Dividend Per Share To Arrive At Cum-Dividend I.Value. Ea

Value of Partly Paid Up Shares

1. When Paid up Value is Rs.8 and Face Value Rs.10

Value of Share at Rs.10 Paid up	30
Less:Not Paid up /Not Called up amount	(2)
Value of Rs. 8 Paid up Face Value Rs.10	28

2. When Paid up Value is Rs.8 and Face Value Rs.8

Value of Rs.8 Share=

$$\frac{30 \times 8}{10} = \text{Rs.24 Per Share}$$

Important Points

1. **SAVDHAN** -Sundry Assets also includes- Goodwill, FA, CA, Non trade Investment, Patent copyright etc

2. Sundry Liab also includes- Proposed Dividend, CL, DDT, unrecorded Liab Prov for Tax, Debenture etc.

3. IF Notional Calls/Calls in arrears for partly paid equity or pref shares given then ADD it in Net Assets.

4. Value of Partly Paid Shares=Value of Share of Rs.10 fully Paid up - Notional Call of Rs.2

2). CAPITALISATION METHOD

Earning Capitalisation Method(Used For Large Lot Of Shares, Preferred Method In Comparison To Dividend Capitalisation Method.)

FORMULAE:

VALUE OF SHARE:- (AVERAGE EARNING RATE x PAID UP CAPITAL)/ NRR (NORMAL RATE OF RETURN

*EARNING RATE:- $\frac{\text{EARNING ATTRIBUTABLE TO EQUITY SHAREHOLDERS* 100}}{\text{TOTAL PAID UP VALUE OF EQUITY SHARE CAPITAL.}}$

Savdhan-Total Paid up value of equity share capital **does not include** notional calls, unpaid calls,reserve & Surplus etc. ONLY PAID UP VALUE OF EQUITY SHARE CAPITAL SHOULD BE TAKEN

** EARNING ATTRIBUTABLE TO EQUITY SHAREHOLDERS :-

FMP AFTER TAX	XXXXXX
LESS: - PREFERENCE DIVIDEND/Trf to Reserve/DDT	(XXXX)
EARNING ATTRIBUTABLE TO EQUITY Shareholder	**XXXXXX**

Value of Partly Paid Up Shares

1. When Paid up Value is Rs.5 and Face Value Rs.10

$\frac{30 \times 5}{10}$ =Rs.15 Per Share

2. When Paid up Value is Rs.8 and Face Value Rs.8

Value of Rs.8 Share =

$\frac{30 \times 8}{10}$ =Rs.24 Per Share

3.) DIVIDEND CAPITALISATION MODEL: - USED FOR SMALL LOT OF SHARES (NON PREFERRED METHOD.)

VALUE OF SHARES:- $\frac{\text{DIVIDEND RATE} * \text{PAID UP CAPITAL}}{\text{NRR}}$

This Method Is Applied For Valuation Of Both Equity & Preference Shares,
Where Dividend Rate Would Be Given In Question Or Calculated By Using Average Of Past-Dividends.

Value of Partly Paid Up Shares

1. When Paid up Value is Rs.5 and Face Value Rs.10

$\frac{30 \times 5}{10}$ =Rs.15 Per Share

2. When Paid up Value is Rs.8 and Face Value Rs.8

Value of Rs.8 Share=

$\frac{30 \times 8}{10}$ =Rs.24 Per Share

4).FAIR VALUE METHOD

(Used Whenever Controlling Interest(More Than 50% Is Being Transferred)

FORMULAE:-

VALUE OF SHARES:- (Value as per Net Assets Method + Earning Capitalisation Method)/2

5.Price Earning Valuation

Market Price=Earning Per Share (EPS x P/E Ratio)

6.Value of Pref Shares

(Rate of Pref.Dividend x Paid up Value)/Normal Rate of Expectation

How to Compute N.R.R(Normal Rate of Return)

1). Best Method Is Capm (Capital Asset Pricing Model.) Ke=D1/Po
2).Alternate Method For Estimate NRR

NRR For Industry	Xxxxx
+ - Risk Factors/Non Risk Factors	Xxxxx
NRR Of The Company	Xxxxx

Risk Factors Generally Considered By Shareholders

Risk Factor 1 :- Dividend Track Record Of The Company Vs Track Record Of Industry.

Risk Factor 2:- Debt-Equity Ratio Or Capital Gearing Ratio.

Debt-Equity Ratio: - $\frac{\text{Long Term Debt}}{\text{Equity Shareholder Funds+ Preference Shareholders}}$

Capital Gearing Ratio: - $\frac{\text{Long Term Debt+ Pref Share Capital}}{\text{Equity Shareholder Funds}}$

Decision :- Low Ratios Low Risk.

Risk Factor 3:- Asset Pricing Ratio

Formulae: - $\frac{\text{Intrinsic Value Per Share}}{\text{Paid Up Value Per Share}}$

Decision:- High Ratio High Risk

Risk Factor 4:-
Coverage Ratio
A). **Preference Dividend Coverage Ratio:-** $\frac{\text{Profit After Tax}}{\text{Preference-Dividend}}$
Decision: High Ratio Low Risk.

B). **Equity Dividend Coverage Ratio:-** $\frac{\text{Pat-Pref Dividend}}{\text{Equity Dividend}}$
Decision:- High Ratio Low Risk.
****Non Risk Factors Can Be Ignored For Adjustments In Normal Rate of Return.
****Risk Premium Shall Be Assumed As ½%
***Profit= Net Profit= Profit Before After Tax.

Capital Gearing Ratio = (Long term debts + Preference Capital) / Equity shareholder funds. High capital gearing ratio more risky.

High Interest dividend coverage ratio less risky.

Net Assets Backing Ratio:- Net Assets for Shareholders/Pref. Share Capital

High Ratio low risk.

BUSINESS VALUATION

Statement of Maximum Value that can be paid

Particulars	Amount
Present Value of Incremental Cash Flow (DCF)	XXXX
Add:Goodwil if any Given in Question	XXXX
Add:Proceed from realization of Assets(Fixed Assets,Inventories,Debtors	XXXX
Less:Liability Paid(Creditors,Employee Compensation,Bank Loan & other liab)	(XXXX)
Maximum Value that can be Paid	XXXX

Incremental Cash Flow=

Cash Flow of Merged Entity - Cash flow of Company before Merged

Discounted Cash Flow= Incremental Cash Flow X PVF

Important Note-

1.Assets and Liabilities each item shall be taken only when question specifies each item.

2.Goodwill will be taken only when question specifies it.

Brand Valuation Under Potential Earning Model

A)Profit After Tax	XXXX
B)**Less**:Profit Allocated to Tangible Fixed Assets	(XXX)
C)Profit relating to Identifiable Intangible Assets(A-B)	XXXX
D)Capitalisation	25%for eg
E)Capitalisation Value (D/E)	XXXX
F)**Less** -Identifiable Intangible Other than Brand	(XXX)
G)Value of Brand	**XXXX**

VALUATION OF FIXED ASSETS

Quoted Price		**XXXX**
Less:Discount normally calculated on quoted Price	XXX	
Add:Vat/ Sales Tax		XXX
Transportation Charges		XXX
Installation Cost		XXX
Material /Trial Run Cost		XXX
Wages		XXX
Finance Cost Capitalisation up to machine ready to use	XXX	
Cost of Machine to be Capitalised	**XXXX**	

Important Notes

1.If an Assets sold out which has loss on sale and such assets was revalued upward in past then, loss will be transferred to revaluation reserve instead of profit & Loss account.

2.If method of depreciation change then depreciation will be calculated from the 1st year till the change, deficiency or surplus will be transferred to Profit & Loss.

ECONOMIC VALUE ADDED (EVA)

EVA = Net Operating Profit After Tax – Weighted Average Cost of Capital X **Operating** Capital Employed
= NOPAT – WACC X **Operating Capital Employed**

Where :-

NOPAT = PAT + Interest (+/-) Extraordinary Items - Non Operating Income if any

WACC = (Equity/Total Capital Employed) * Ke + (Pref Shares/Total Capital Employed Emp) * Kp + (Debt/Total Capital Employed) * Kd

Where:-

Ke = Cost of Equity = RF + Beta (RM – RF)

Kd = Cost of Debt = [Interest(1-Tax Rate)/Long Term Borrowings] * 100

Or

Kd= Interest Rate(1-Tax Rate)

How to Compute Operating Capital Employed

Total Capital Employed(Equity+Debt+Pref+ Reserve)		XX
Less:Non Operating Capital Employed		
Non Trade Investment	XX	
Immovable Property held as Investments	XX	
Advance for Purchase of Assets	XX	
Capital Work in Progress	XX	(XX)
Operating Capital Employed		**XX**

Financial Leverage = EBIT/EBT
Combined Leverage = Finan.LevX Operating Lev
Operating=Contribution/EBIT

Capital Gearing Ratio= $\frac{\text{Long Term Debts+Pref Share Cap}}{\text{Equity Shareholder Funds}}$

Important Points

1.Total Capital Employed = Assets – Outside Liabilities (or) Total capital i.e Equity + Pref + Debt+Reserve-Preliminary Exp-Discount of Issue of Share or Debenture

2.Savdhan-Total Capital Employed used for calculating WACC, and Operating Capital Employed used for calculate economic Value added

3.If multiple Beta are given take Highest beta

4.Ke is used for Equity and Reserve.

MARKET VALUE ADDED

Market value added is the market value of capital employed in the firm less the book value of capital employed.

Market Value Added=

Market Value of Equity,Preference and Debt - **Paid up/Book** Value of Equity,Pref Share Capital,Retained Earning,Reserves and Debts

Shareholder Value added =NOPAT-WACC X Cost of Capital from the Issuance of Debt+Equity

VALUE ADDED STATEMENTS

VALUE ADDED STATEMENT FOR THE YEAR ENDED XX.XX.XXXX

Particulars	Rs	Rs		%	
Sales		xxx			
Less : Cost of Bought in materials & services					
Production & Operational Exp	xx				
Administration Exp	xx				
Interest on Working Cap Loan					
(Cash Credit,Bank Overdraft,Temporary Loan)		xx			xx
Value added by mfg and trading activities			xxx		
Add : Other Income		xx			
Gross Value Added		xxx			
Application of Value Added :					
To Pay Employees					
Salaries, Wages,, Bonus, Gratuities			xx		
To Pay Directors					
Remuneration, Sitting Fee,Commision			XX		
To Pay Government					
Cess Local Taxes,Income Tax, Dividend Distribution Tax					
Wealth Tax including Interest & Penalties but excluding Deferred Tax					
To Pay Provider of Capital					
Interest on Loans/Debenture					
Interim or Final Dividend			xx		
To Provide for Maintainence & Expansion Of Company					
- Depreciation					
- General Reserve (Increase)					
- Retained Profit (Closing-Opening					
- Fixed Assets Replacement Reserve					
Deferred Tax					
Debenture Redemption Reserve			xx		
Total			XX		

RECONCILATION BETWEEN GROSS VALUE ADDED AND PROFIT BEFORE TAXATION

Profit Before Income Tax	XX
Add:	
Depreciation	
Wages,Salaries,Bonus.Gratuities	
Adminstrative Staff,Staff welfare Exp	
Salaries,Comission and Sitting Fee of Director	
Cess & Local Tax	
Interest on Debenture/Fixed Loans	
Gross Value Added	XX

<u>Important Formulas</u>

1.Value Added Per Employee = Value Added/No. of Employee

2.Average Earning Per Employee = Employee Cost/No. of Employee

3.Sales Per Employee = Sales/No. of Employee

4.Payroll Value Added Ratio = Employee Cost/Value Added*100

5. Bonus to Employee = (Target Index - Payroll Value Added Ratio for Current Year)Value lAdded*Share of Employee in Bonus

Important Notes :

1.Reconciliation statement shall be prepared between GVA and PBT if asked.
GVA and Application total should be tallied and % shall be provided for the application each item.
2.Net Value Added (NVA) = GVA – Depreciation
3.Excise Duty if Recoverable then part of Cost of Bought Material & Services, Non Recoverable then it is part of Application of Gross Value Added.

AMALGAMATION, ABSORPTION & RECONSTRUCTION

Method to calculate Purchase Consideration:

Net Asset method	Intansic value method	Net payment method
Agreed value of assets taken over xxx **Less:** Agreed value of Liab. taken over xxx **PC** xxx	MV of total assets xxx **Less:** MV of total Liab. xxx Net intrinsic value xxx Intrinsic Value Per share = Net Intrinsic value / No. of equity share **PC**= No. of equity shares purchased **X** Intrinsic value per share of vendor company	Amalgamation in nature of: - **Merger:** Amount paid to Equity shareholders only in the form of equity shares in purchasing company except cash for fraction of shares. **Purchase Method :** (Pref Shares x Issue Price) xx Cash for Pref. Holders xx (Equity Shares x Issue Price) xx Cash for Equity Shareholders xx Total Purchase Consideration- xx

Note: If information about all the three method is given in the question then we should follow Net payment method.

SAVDHAN -Cost of amalgamation Realisation Exp, Discharge of debenture holders and other outside liab paid by purchasing co shall not be included in purchase consideration.

Amalgamation in nature of merger: Amalgamation deemed to be in the nature of merger if following conditions are satisfied: -

(BARED)

Business of vendor company must be carried on by the purchasing company.

All assets and liabilities of vendor company transferred to purchasing company.

Recorded in new company of assets and liabilities taken over at Book Value of vendor company. (Except to comply with accounting policy)

Equity shareholders holding 90% shares (except already held) agree to become shareholders in new company.

Disbursement of Purchase Consideration only in shares except cash for fraction of shares.

Entries in books of vendor company:

Realisation account: We have to follow the following procedure

Transfer all **real** assets to debit side at **Gross Book Value** including goodwill but excluding fictitious assets.

Transfer all **outside** liabilities to credit side at **Gross Book Value** but excluding accumulated reserves and surplus.

If any asset/liabilities not taken over than only Profit /Loss on realisation on sale of such asset or payment on disbursement of such liabilities is credited/debited to realisation account.

Amount of Purchase Consideration is credited to realisation account.

Liquidation expenses debited to realisation account if born by vendor company

The Cash & Bank Balances should not transferred to realisation if they are not taken by purchasing co.

Realisation account is balanced and the balance of this account is profit or loss on realisation, which is transferred to Equity Shareholders Account.

Important Notes:

Assets not taken over if transferred to shareholders account: it must be shown on debit side of shareholders account at **Current Value** of such asset and a corresponding credit is made to realisation account.

What are outside liabilities: Preference shareholders and Debenture holders are treated outside liabilities INKE ALAG A/C BANEGE. But proposed dividend is not treated outside liabilities.

If against any reserve there is any expected liabilities: then to the extent of that expected liability the amount of reserve is transferred to realisation account and balance to shareholders account as usual.

Example:

Workmen compensation reserve given in Balance sheet = 8000

Expected liability to workmen =5000.

Therefore Rs 5000 will be transferred to the credit side of realisation account and balance Rs 3000 to the credit side of shareholders account.

Any inter company owings or adjustments: is ignored while preparing vendor company books, it is considered only while preparing purchasing company books.

Equity Shareholders Account:

Credit side: Equity Share Capital, Accumulated profits and reserves, balance of realisation account.

Debit side: Accumulated losses**,** Fictitious asset, amount of Purchase Consideration, balance of realisation account.

Purchasing Company Account:

Credit side: Amount of Purchase Consideration due.

Debit side: Discharge of Purchase Consideration.

Entries in books of Purchasing Company

Three basic entries

For purchase consideration due	
Business purchase a/c	Dr.
To liquidator of vendor company	
For assets and liabilities taken over	
Assets taken over	Dr.
Goodwill A/c (B.F) Dr.	
To Liabilities taken over	
To Business purchase a/c	
To Capital reserve a/c (B.F)	
For discharge of purchase consideration	
Liquidator of vendor company a/c	Dr.
To Equity share capital a/c	
To Share premium a/c	
To Debentures a/c	
To Preference share capital a/c	
To Cash	

For liquidation expenses paid by purchasing company

Goodwill/Capital reserve a/c	Dr.
To cash a/c	

For cancellation of mutual owings

Creditor /Bills payable a/c	Dr.
To Debtors/Bills receivable a/c	

For adjustment of unrealised profit

Goodwill/Capital reserve a/c	Dr.
To Stock a/c	

For carry forward of statutory reserves

Amalgamation adjustment a/c	Dr.
To Statutory reserve a/c	

If both capital reserve and goodwill appears in books

Capital reserve a/c	Dr.
To Goodwill a/c	

Note:

Amalgamation in nature of merger: The entries in the case of amalgamation in the nature of merger is almost similar to the entries given above, the only difference is:

In the second basic entry above, instead of opening the Goodwill/Capital reserve a/c, the difference between purchase consideration paid and book value of the share capital of vendor company is adjusted in general reserve. If general reserve is not sufficient then balance adjusted in profit & loss account. Similarly any difference in actual debenture value and the amount paid to them is also adjusted to general reserve. If general reserve is not sufficient then balance adjusted in profit & loss account.

Where ever Goodwill/Capital reserve a/c is debited or credited in above entries we will have to debit or credit general reserve account.

Following will remain same in both the methods of amalgamation

Calculation of Purchase consideration.

Discharge of Purchase consideration.

Entries in books of vendor company.

Inter company holding

Purchasing company held shares in vendor company (P→V)	Vendor company held shares in purchasing company (V→P)	Both vendor and purchasing company held shares in each other (P<→V)
Calculation of purchase consideration		
PC (Given/calculated) xxx Less: % reduction for shares Held by purchasing company in vendor company xxx Net PC xxx	PC (Given/calculated) xxx Less: Value of shares Held by vendor company in purchasing company xxx Net PC xxx	PC (Given/calculated) xxx Less: % reduction for shares Held by purchasing company in vendor company xxx Less: Value of shares Held by vendor company in purchasing company xxx Net PC xxx
$\% = \frac{\text{Shares held by purch. comp.}}{\text{Total shares of vendor comp.}} \times 100$	Value= No of shares held X Intrinsic value per share	

Pooling of Interests method: (Merger method)
1.The assets, liabilities and reserves of Transferor Company are recorded by the transferee company at existing carrying amounts after adjusting for uniform accounting principles.

The reserves are preserved in case of this method in the same form as it appeared in financial statements of transferor company. The difference between share capital issued and amount of share capital of transferor company is adjusted in reserves.

Purchase method:
Transferee company Incorporates assets and liabilities of transferor company on basis of fair values.
The identity of reserves other than statutory reserves like investment allowance reserve, development allowance reserve is not preserved. Difference may be termed as goodwill/capital reserve.
The amount of consideration is deducted from the value of net assets of transferor company if result is negative it is goodwill otherwise capital reserve.
The statutory reserve is recorded by giving a debit to amalgamation adjustment account under misc. expenditure on assets side.

Treatment of Goodwill on amalgamation:

Goodwill shall be written off over a period of 5 years unless justified for longer period.

Balance of Profit and Loss account:

In case of merger balance is aggregated with corresponding balance in transferee company.

In case of purchase it loses its identity.

OTHER IMPORTANT NOTES:

1.In case the two companies are merged into another third company which becomes holding company then while showing the balance sheet of holding company we have to be careful as all assets and liabilities will not be amalgamated into C Ltd. Show the share capital issued to Transferee Company on liabilities side and show as investments on the assets side.

2.When holding company takes over subsidiary company it is merger whereas if subsidiary company takes over holding company it is reverse merger.

3.If exchange ratio is not given in the problem then we have to find out by simultaneous equation method.

4.Goodwill or capital reserve will arrive only if goodwill is there in valuation of net assets.

5.Replacement value is always the highest and realizable value is least.

6.In case of *Reconstruction*, we open capital reduction account and transfer all gains and reduction of loans and creditors, shares claims and then transfer of opposite entry of losses brought forward and balance shall be transferred to capital reserve account if any.

DEMERGER

Demerger:-One new company “B Ltd” will form known as resulting company, old company “A Ltd” known as demerged company.”DEMERGER ME “ A Ltd” COMPANY APNI EK UNIT/DIVISION “B Ltd” KO TRF KAR DEGI AUR “B Ltd” ISKE BADLE ONLY SHARES ISSUE KAREGI” Cash nhi dengi

Entry in the book of A Ltd(Demerged Co.)

A)For Trf. Of Assets and Liab

Current Liab A/c	Dr.
Non Current Liab A/c	Dr.
Prov. For Dep A/c	Dr.
Loss on Demerger (B.F)	Dr.
To Current Assets	
To Non Current Assets	
To Profit on Demerger	

B) Trf of Profit/loss on Demerger

Profit on Demerger A/c	Dr.
To Capital Reserve A/c	

ii)

Capital Reserve A/c	Dr.
General Reserve A/c	Dr
P& L A/c	Dr
Other Free Reserve A/c	Dr
To Loss on Demerger	

SAVDHAN Important Note- A Ltd ki books me Sari entry book value se hogi

Entry in the Books of Resulting Company B Ltd

Current Assets	Dr.
Non Current Assets	Dr
Goodwill (B.F)	Dr.
To Current Liab	
To Non Current Liab	
To Shareholder of Demerged Co(Consideration Amount)	
To Capital Reserve (B.F)	

Shareholder of Demerged Co.	Dr.
To Equity Shares Capital A/c	
To Pref. Share Capital A/c	
To Debenture A/c	
To Securities Premium A/c	
To Bank A/c	
(Being Discharge of Purchase consideration)	

Important Note-B Ltd ki books me Sari entry Agreed value se hogi

Impact on Wealth of Shareholder

i) Intrinsic Value per Share of **A Ltd after Demerger**		xxx
ii) Add: Intrinsic Value per share of B Ltd x No. of Share issued in exchange of one share		xxx
iii) **Less** Intrinsic Value per share of **A Ltd before Demerger**		
Net Gain/Loss	XXX	

RESTRUCTURING /SALE PURCHASE OF DIVISION

Meaning :-A Ltd transferor company trf its Unit/Division to B Ltd called transferee Company. "A Ltd" known as transferor company."ISME **A Ltd" COMPANY APNI EK UNIT/DIVISION "B Ltd" KO TRF KAR DEGI AUR "B Ltd" ISKE Against SHARES,CASH OTHER SECURITIES ETC degi"**

Entry in the book of A Ltd(Seller Co.)

A)On sale of Division

Current Liab A/c Dr.
Non Current Liab A/c Dr.
Prov. For Dep A/c Dr.
Purchase Company A/c Dr. (With Purchase Consideration)
Loss on Sale (B.F) Dr.
To Current Assets
To Non Current Assets
To Profit on Sale

B) Trf of Profit/loss on Sale

Profit on Sale A/c Dr.
To Capital Reserve A/c

ii) Capital Reserve A/c Dr.
General Reserve A/c Dr
P& L A/c Dr
Other Free Reserve A/c Dr
To Loss on Sale

C)Receipt of Purchase Consideration

Invest. In Equity Shares A/c Dr.
Invest. In Pref. Shares A/c Dr.
Invest. In Debenture A/c Dr.
To Purchasing Company B Ltd A/c

SAVDHAN Important Note- A Ltd ki books me Sari entry book value se hogi

Entry in the Books of Purchsing Company B Ltd

Current Assets Dr.
Non Current Assets Dr
Goodwill (B.F) Dr.
To Current Liab
To Non Current Liab
To Vendor Co A Ltd (Consideration Amount)
To Capital Reserve (B.F)

Vendor Co A Ltd A/c . Dr.
To Equity Shares Capital
To Pref. Share Capital
To Debenture
To Securities Premium
To Bank A/c
(Being Discharge of Purchase consideration)

Important Note-B Ltd ki books me Sari entry Agreed value se hogi

BUY BACK OF SHARES

1.Outstanding Share Test =25% of Total Outstanding Shares
2.Resources Test = 25% of (Paid up Capital+Free Reserve)/Buy Back Price
3.Debt Equity Ratio Test = it should be at Least 2:1 after buy back AGAR NHI HA TO NO BUY BACK

Maximum No of Equity Shares Buy Back is LEAST OF ABOVE THREE TEST.
Important Notes-If Company is Listed, point no. 2 Resources test shall be 15% instead of 25%, rest tests no change.

To Make Partly Paid Equity Shares Fully Paid

Equity Share Final Call A/c Dr.
To Equity Share Capital

Bank A/c Dr.
To Equity Share Final Call A/c

To Realize Investment to Provide Cash for Buy Back

Bank A/c Dr
Profit & Loss A/c Dr
To Investment A/c
To Profit & Loss A/c

Equity Shares Buy Back A/c Dr
To Bank A/c

To Cancel the Shares Bought Back

Equity Share Capital A/c Dr.
Securities Premium A/c Dr.
General Reserve A/c Dr.
To Equity Share Buy Back A/c

To Transfer the Free Reserve to C.R.R Account Equal to Nominal Value of Equity Share buy Back

Revenue Reserve A/c Dr.
P & L A/c Dr.
To Capital Redemption Reserve A/c

Important Notes-

1. Capital Redemption Reserve can be utilized for issuing fully paid bonus shares

2.Infrastructure Development Reserve,Capital Redemption reserve,Revalaution Reserve are not free reserve

3.**P & L ,Revenue reserve,securities premium three are free reserve**

4.IF Pref Shares are issued then following amount transferred to C.R.R
CRR Amount =Nominal Value of Buy Back-Nominal Value of Pref Share Capital

5.IF Pref Shares are Redemeed then Following Amount transferred= Nominal Value of Buy Back+Nominal Value of Pref Share Capital Redemeed.

BONUS ISSUE

Journal Entry for Bonus Shares

Capital Redemption Reserve A/c	Dr.
Securties Premuim A/c	Dr.
To Bonus Issue	
Bonus Issue A/c	Dr.
To Equity Share Capital A/c	

INTERNAL RECONSTRUCTION

Reconstruction of Company :-

What is Reconstruction: Reconstruction is an exercise of restating assets & liabilities by company / entity whose financial position as reflected by its balance sheet is not healthy but future is promising.

This exercise is done to gain the confidence of different stake – holders (creditors, lenders, customers, share holders etc) whose support is required for revival of the operations.

Objectives: 1. To generate surplus for writing off accumulated losses & writing down over – stated assets.

2. To generate cash for working capital needs, replacement of assets, to add balancing equipments, modernaise plant & machinery etc.

Type of Reconstruction: Broadly it is of two types such as –

Internal Reconstruction – Recognisation with in the entity.

External Reconstruction – Transfer of business to another company (usually new company) persuing to a scheme of amalgamation – Accounting is same as amalgamation.

Assets. a) Revaluation of assets.

Assets A/c	Dr.	(Incremental Value)
To Reconstruction A/c.		

b) Transfer of assets to creditors in discharge of liability.

(i) Book value of assets transferred is less than liability settled.

Liability A/c	Dr.	
To Asset A/c	(Book value)	
To Reconstruction A/c.		

(ii) **Book value of assets transferred is greater than liability settled.**

Liability A/c	Dr.	
Reconstruction A/c	Dr.	
To Asset A/c.		

c) Sale of unproductive assets.

(i) At profit.

Bank A/c	Dr.	(Sale proceeds)
To Asset A/c	(Book value)	
To Reconstruction A/c.	(Profit)	

(ii) At loss.

Bank A/c	Dr.	(Sale proceeds)
Reconstruction A/c Dr.	(Loss)	
To Asset A/c.	(Book value)	

Outside Liabilities. a) Settlement at discount.

Liabilities A/c	Dr.	
To Bank A/c		
To Reconstruction A/c.	(Discount amount)	

b) Conversion of liability from one class to another (e.g. unsecured to secured) usually for lower amount.

Unsecured Loan A/c	Dr.	
To Secured Loan A/c		
To Reconstruction A/c.		

c) Waiver of liability.

Liability A/c	Dr.
To Reconstruction A/c.	

Share Holders. a) Issue of fresh share.

-General entry-

b) Capital reduction.

Old Share Capital A/c	Dr.
To New Share Capital A/c	
To Reconstruction A/c.	

Utilisation of reconstruction surplus.

Reconstruction A/c	Dr.
To P & L A/c	
To Asset A/c.	
Transfer of Reconstruction surplus unutilized (if any) to capital reserve.	
Reconstruction A/c	Dr.
To Capital Reserve A/c.	

Note: (i) The name of the company after capital reduction should end with the phrase "And reduced" (Sec. 104, Companies Act).

(ii) The narration to journal entry should specify the approval of High Court.

Surrender of Share :-

What is Surrender of Share : Surrender of share is an alternative to capital reduction. In this case the share holders volunteer to return some of the shares back to the company along with duly signed transfer deed.

Journal Entries: Surrender.

Share Capital A/c	Dr.
To Share Surrender A/c.	

Note: The share surrender can be either equity or preference share.

Reissue of surrendered shares.

For discharge of liability.

Issue of share out of Share Surrender in the name of creditor.

Share Surrender A/c	Dr.
To Share Capital A/c.	

Cancellation of liability pursuant to issue of above share.

Liability A/c	Dr.
To Reconstruction A/c.	

Reissue for cash.

Receipt of cash.

Bank A/c	Dr.
To Reconstruction A/c.	

Note: Cash receipt represents profit since there is no increase in liability.

Issue of share to applicants out of Surrender Share.

Share Surrender A/c	Dr.
To Share Capital A/c.	

Note: The share surrender may be either reissued by same share of same class or a different class subject to approval of the High Court.

Cancellation of Share Surrender not reissued.

Share Surrender A/c	Dr.
To Reconstruction A/c.	

For Payment of Pref. Dividend	
Reconstruction A/c	Dr.
To Bank A/c	
No entry for cancelation of arrear of preference dividend.	

NON BANKING FINANCIAL INSTUTION

Income Recognisation Principal	
Non Performing Assets-	Receipt Basis
Performing Assets-	Accrual Basis

Statement of Provision Requirement for Loan & Advances

Particulars	% of Provision
Standard Assets	0.25%
Sub Standard Assets	10%
Doubtful Assets (Unsecured Portion)	100%
Doubtful Assets (Secured Portion)	
Up to 1 Years	20%
More than 1 but up to 3 Years	30%
More than 3 Years	50%
Loss Assets	100%

How to Calculate Provision for Lease Assets

Overdue Installment	xxx
Installment Not yet Due	xxx
(-)Finance Charges not matured and not credited to P & L	(xxx)
(-) Depreciated Value (Cash Price-Dep at 20% rate SLM)	(xxx)
Provision to be Created	xxx

Additional Provision on Net Book Value(PROV. NET BOOK VALUE PAR CALCUALTE KARNA HA)

Amount Overdue for the Period	% of Prov	Type of Assets
0-12 Month	Nil	Standard Assets
More than 12 Months but up to 24 Months	10%	Sub Standard Assets
More than 24 months but up to 36 Months	40%	Doubtful Assets
More than 36 months but up to 48 Months	70%	Doubtful Assets
More than 48 Months	100%	Loss Assets

Valuation of Investment

Equity Shares - Valued at lower of Cost or Market Value

Mutual Fund---- Always valued at Market Price

Government Securities Bonds etc - Always at Cost

Commercial Papers- Carrying Cost

Quoted Current Investment-Cost or Market Price whichever is lower. Valued Script wise not item wise

Long term Investment- At Cost

FINANCIAL INSTRUMENT

Financial Instrument Meaning- A financial instrument is any contract that gives rise to a Financial Asset of one entity and a Financial Liability or equity instrument of another entity. Relevant Accounting Standards.

AS-30 Financial Instrument Recognition and Measurement

AS-31 Financial Instrument Presentation

AS-32 Financial Instrument Disclosure

Topic Covered in Practical.

1)Staff Loan Accounting

2) Securitisation or Transfer of Loan

3) Forward Contract Accounting

4) Debt and Equity Portion

1) Staff Loan Accounting

1.Calculate Fair Value of Loan i. e Present Value of Loan with PV Factor (Note use lower rate or Concessional rate i.e Rate of interest of Staff for interest calculation)

2.Staff Cost= **Loan Amount** - **Present Value or Fair Value** of Loan Calculate in step 1

3.Calculate the **interest on Fair value** for each year (Use higher interest Rate)

Journal Entries

1.Staff Loan Given

Staff Loan A/c Dr.

To Bank A/c

2.Loan Recognise at Fair Value

Staff Cost A/c Dr.

To Staff Loan A/c

3.On Booking of Interest Income

Staff Loan A/c Dr.

To Interest on Loan A/c

4.On Payment of Installment

Bank A/c	Dr.	
To Staff Loan A/c		
(Being Installment Paid)		

5. For Transfer of Interest and Staff Cost to P& L

Interest on Loan A/c	Dr.	
Staff Cost A/c	Dr.	
To Profit & Loss A/c		
(Being Exp Trf.)		

2) Securitization or Transfer of Loan

Journal Entries in Lender Company Books.

1.

Cash/Bank A/c	Dr.	(Consideration Received)
To Loan A/c		(Apportioned Carrying Amount)
To Profit & Loss A/c		(Fair Value-Apportioned Carrying Amt)
To Credit Enhancement A/c		(Consideration-Fair Value)

2.

Service Assets A/c	Dr.	(Apportioned Carry amt on basis of Fair Value)
Interest Strip A/c	Dr.	(Apportioned Carry amt on basis of Fair Value)
Principal Strip A/c	Dr.	(Apportioned Carry amt on basis of Fair Value)
To Loans A/c		(Total)
(Being the service assets and interest and principal strip retained at fair value)		

Fair Value of Components

Interest Transferred	X PVAF	XX
Service Fee	X PVAF	XX
Interest Retained	X PVAF	XX
Principal Transf	X PVF of Last Year	XX
Total		**XXX**

Apportionment of Carrying Amount

Particulars	Fair Value	Apportioned Carrying Amount
Principal Transferred	XX	**Fair Value/Total Value*Loan Amount**
Interest Transferred	XX	**Fair Value/Total Value*Loan Amount**
Service Assets	XX	**Fair Value/Total Value*Loan Amount**
Interest Strip	XX	**Fair Value/Total Value*Loan Amount**

3)Forward Contract Accounting

1. Record the Forward Contract at Nil Fair Value		
Forward Contract A/c	Dr.	**With NIL Amount**
To Bank A/c		**NIL**

2.Revalued Forward Contract at Year End and Book Gain/Loss	
If Loss	
Profit & Loss A/c	Dr. (Rate on 31 march - Rate on Contract taken date)
To Forward Contract	

If Gain	
Forward Contract A/c	Dr. (Rate on 31 march-Rate on Contract taken date)
To Profit & Loss A/c	

3.Settlement of Forward Contract when Consideration received from Bank

Bank A/c	Dr.	(With Difference received)
Forward Contract A/c*	Dr.	(With Carrying Amount)

Profit & Loss A/c**	Dr.	(Loss on Settelment)
To Forward Contract A/c*		(With Carrying Amount)
To Profit & Loss A/c**	(Profit on Settelment)	

(Being Difference received on settlement)

*Only one figure will appear

**only one figure will appear

Note-Reverse entry in case of payment of Differences

4) Debt Equity Portion

Present Value of Interest		XXXX
(Interest X PVAF)		
Present Value of Principal		XXXX
(Principal X PV factor of Last Year)		
Fair Value of Liabilities Component	XXXX	
Less: Issue Proceeds (Issue Value)	(XXX)	
Fair Value of Equity Component	**XXXX**	

Journal Entry

Cash/Bank A/c	Dr.
To Equity Component A/c	
To Liabilities Component A/c	

Important Notes

1.If Interest is payable half yearly then rate of PV factor shall be **Rate/2** and time will be **yearsX2**

2.If Debenture redeemed at discount /premium, then principal should be adjusted according to rate of premium or discount.

3.When all Debenture converted into shares at the time of redemption in the last year then **present value of principal shall be NIL.** No effect on present value of interest.

4.If some portion of Debenture is convertible into shares between the period then interest calculation shall be adjusted according to conversion time.

SHARE BASED PAYMENTS

1.Stock Appreciation Rights (SAR)

2.Employee Stock Purchase Plan

3.Employee Stock option Plan

1.Stock Appreciation Rights(SAR)

Employee's are entitled to cash based on market price of share. Fair value or intrinsic value shall be revised every year.

Journal Entries

Employee 's Compensation Expenses A/c	Dr.
To Provision for Liability (SAR)	
Provision for Liability (SAR) A/c	Dr.
To Bank A/c	
Profit & Loss A/c	Dr.
To Employee Compensation Exp	

2.**Employee Stock Purchase Plan**

Under this plan sweat equity shares gives to employee at concessional price and do not have performance conditions.

Bank A/c(No. of OptionXExcercise Price)	Dr.
Employee Compensation Exp A/c(Benefit Given to Employee)	Dr.
To Equity Share Capital A/c(No. of OptionX Face Value)	
To Securities Premium A/c (B.F)	

Note-If due to post vesting restriction or conditions, fair value is decreasing then We should take Reduced Value and avoid previous high value.

3.**Employee Stock Option Plan**

1.For Provide Option Expenses to every year.

Employee Compensation Exp A/c Dr.

To Employee Stock Option Outstanding A/c

2.For Expenses Transferred

Profit & Loss A/c Dr.

To Employee Compensation Exp A/c

3.On the date when option exercised

Bank A/c (No. of Options X Exercised Price) Dr.

Employee Stock Option Outstanding A/c Dr. (No. of Options X Fair Value)

TO Equity Share Capital A/c (No. of Option X Face Value)

To Securities Premium A/c (B.F)

4.For Cancel the Options not Exercised.

Employee Stock options Outstanding A/c Dr.

To General Reserve A/c

Market Price:- Price of Share on Grant Date

Exercise Price:- Concessional Price paid by employee if he want to get shares

Intrinsic Value:- Market Price—Exercise Price

Important Notes-

1.Option expenses can be negative

2.**How to Calculate Option expenses:-**

(No. of Option expected to be availedXFair Value or Intrinsic Value)Expired Period/Total Period

-Expenses already recognized in early years.

3.If Option available to employee's is depend on earning, then option should be taken according to earning conditions.

4.ESOP is shown in Balance Sheet as part of Reserve & Surplus.

5.If Employee given in question is last year employee, then reverse calculation shall be made.

Varriation in Vesting Period

1.If vesting period is based on market price or market conditions then such conditions would not be considered whether market price is achieved or not, it does not effect on vesting period.

2.If vesting condition based on earning then it would be considered.

Modification in Fair Value

1.If modification reduced fair value then it will be ignored.

2.if modification increased the Fair value then increased fair value should be taken.