# Financial Accounting

**Q. 1 Conditions for Buy-Back of Shares?**

➢ No Company shall purchase its own shares or other specified securities unless-

1. The Buy-back is **authorised by** its **Articles of Association**.
2. A **Special resolution** has been passed in general meeting of the company authorising the buy-back.
3. The buy-back is of less than **25%** of the **total paid up Capital & free Reserves** of the company
4. Buy-back of equity shares in any financial year shall **not exceed 25% of its total paid up capital** in that financial year.
5. The **ratio of the debt** owed by the company is **not more than twice** the capital & its free reserves of the such buy-back.
6. **All the shares** or other specified securities for buy-back are **fully paid up**.
7. The buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the **SEBI** in this behalf

**Q. 2 Explain objectives/benefits of buy-back of Equity shares.**

➢ Buy-back of equity shares may be done with the following objectives:

1. To increase the intrinsic value of the shares
2. To increase the earnings per share (EPS)
3. To reduce the excess share capital
4. To use surplus cash lying idle in the business
5. To increase the shareholding of the promoters or the present management
6. To prevent take over attempts of companies
7. To effect financial restructuring of companies or compromise or arrangement or amalgamation.

**Q. 3** Amalgamation in the nature of Merger?

➢ As per AS-14 amalgamation is in the nature of merger provided the following conditions are satisfied:

a) **All assets & liabilities** of the transferor company. become after amalgamation the asset & liabilities of the transferee company

b) Shareholders holding **not less than 90%** of the face value of the equity shares of the transferor company become equity shareholders of the transferee company by virtue of amalgamation.

c) The **consideration** for the amalgamation is discharged by the transferee co. **wholly by** the issue of **equity shares** except that cash may be paid for any fractional shares.

d) The **business** of the transferor co. is intended to be **carried on** by the transferee co. after the amalgamation.

e) **No adjustment** is intended to be made to the book values of assets & liabilities of the transferor co. when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

**Q. 4** Distinguish between Merger Method and Purchase Method.

➢ Distinction Between the Two Methods:-

| Point of Distinction | Pooling of Interest Method (Merger Method) | Purchase Method |
|---|---|---|
| **1.** Applicability | It is applicable in the case of an amalgamation in the nature of merger. | It is applicable in the case of an amalgamation in the nature of purchase. |
| **2.** Recoding of assets & liabilities & reserves | Assets, liabilities & reserves of the transferor company in its books of accounts. | Assets, & liabilities which are taken over are recorded in the books of the transferee company. The reserves except the statutory reserves of the transferor company are not aggregated with those of the transferee company. |
| **3.** Value at which recoded | As per **book value** in the books of transferor company. | At the revised or **agreed value**. |
| **4.** Adjustment of difference | The difference between the consideration paid & the share capital of the transferor company is **adjusted in general reserve** or other reserves of the transferee company | The difference between the consideration paid & the net assets taken over is treated by the transferee company as **goodwill or capital reserve** as the case may be. |
| **5.** Statutory reserve | Statutory reserve such as Foreign Projects Reserve Account under Section 80 of the Income Tax Act of the transferor company are incorporated in the books of the transferee company like all other reserves. **No Amalgamation Adjustment A/c is required to be opened.** | Statutory reserves of the transferor company are incorporated in the books of the transferee company under the account, "Amalgamation Adjustment Account". |

**Q. 5** What is the meaning of External Reconstruction of Companies?

➢ External Reconstruction:-

1. **Need for Reconstruction**:- When an existing company has been **making losses for a long time**, its assets, liabilities & capital no longer reflect the true financial position of the company. The company needs to be reconstructed to enable it to survive in future.

2. **Meaning of External Reconstruction**:- It involves the liquidation of the old company & formation of a new company to take over the assets & liabilities of the old company exchange for shares in the new company or cash. The new company takes over the assets & liabilities at their true or **realistic values**. The capital issued by the new company to the shareholders of the old company also reflects the true & fair value of the net assets taken over.

Thus, the Assets, Liability & Capital items of the new company are exactly the same as those of the old company except that the values now reflect the 'true & fair' position. The new company is nothing but the 'reconstructed' old company. Therefore this is called 'External Reconstruction.' In Internal Reconstruction the same purpose is achieved internally. i.e. without involving any outside company.

3. **Special Points in External Reconstruction**:- In addition, External Reconstruction may involve some special points. The new company may instead of taking over, directly pay the creditors of the old company. The new company may also satisfy the contingent liability of the old company, which has materialized (i.e. become payable) at the time of reconstruction.

**Q. 6 Internal Reconstruction Scheme**

- An Internal Reconstruction or Capital Reduction scheme covers the entire area of assets, liabilities & capital of a company. The scheme, in essence, involves **writing down the assets to their true values by reducing the capital** & in some cases reducing the external liabilities. The scheme expects all the participants to make some sacrifice. The shareholders may have to accept reduction in the paid up value of the share capital. For example, ₹ 10 paid up shares may be reduced to ₹ 5 paid up shares. The Debentureholders, Preference shareholders, Creditors etc. may have to give up their claims to some extent. If Debentures or other liabilities are required to be actually paid, shareholders may have to bring in cash by taking up more shares or by paying balance amount on partly paid up shares.

  The amounts becoming available through such sacrifice are utilised to write off the accumulated losses, preliminary expenses, Goodwill etc. The fixed Assets, Investments & the Current Assets like Inventory & Sundry Debtors are brought down to their real values. Once the Reconstruction is complete, the value of Assets, Liabilities & the Capital in the Balance sheet of the Company will reflect the 'True & fair' financial position of the company.

  Such scheme may involve

**a.** Alternation of share capital
**b.** Variation of shareholders rights
**c.** Reduction of share capital
**d.** Compromise arrangement with creditors.

**Q. 7 Distinguish between Internal Reconstruction V/S External Reconstruction**

| No. | Internal Reconstruction | External Reconstruction |
|---|---|---|
| 1 | Company is not liquidated | Company is liquidated |
| 2 | Rights of shareholders & creditors are altered. | A new company is formed to take over the business of the liquidated company. |
| 3 | IR involves reduction of capital & liabilities | ER does not involve reduction in capital |
| 4 | IR is governed by sec. 100 of the Companies Act, 1956. | ER is governed by sec. 494 of the Companies Act, 1956. |

**Q. 8 Explain different types of Liquidation?**

- **Types of liquidation:**

1. **Compulsory liquidation (By the order of the court)** : In this case the liquidator would be appointed by the court and would be called as an official liquidator.

   Section 433 of Companies Act provides that a company may be wound up compulsorily on the following grounds:
   **(a)** Defaults in delivering Statutory Report or Default in holding statutory meeting
   **(b)** If the company does not commence its business within a year of incorporation
   **(c)** If the number of members is reduced below 7 in case of public company and below 2 in case of a private company
   **(d)** If the company is unable to pay its debts
   **(e)** If the court is of opinion that is just and proper to wind up the company.
   In case of compulsory winding up counts appoints a "Official Liquidator"

2. **Voluntary liquidation**:
   A Voluntary winding up can take place **without the intervention of the court**. It is brought about by the company itself. In this case, the company and its creditors settle their affairs without going to the court.

   There are two types of Voluntary Winding up: (a) by Members and (b) by Creditors
   In this case the shareholders would decide at their meeting (extraordinary) that the company has to be wound up by passing a special resolution. The shareholders would appoint the liquidator who would prepare a statement which would consist of the estimated realisable value of assets and estimated payments towards liabilities. This statement is termed as 'Liquidators statement of Affairs'. On the basis of this statement the directors of the company would make a declaration of solvency. A copy of this statement has to be submitted to the court for obtaining its permission. Once the permission is granted the liquidation would commence.

   On the completion of the liquidation proceedings. The liquidator would call a final meeting of the shareholders. At this meeting a statement of accounts would be submitted to the shareholders. This statement would summarize the actual amounts realised from the sale of the assets and the amounts paid towards expenses & liabilities. This statement is called as "Liquidators Final Statement of Account."

   A copy of this statement has to be submitted to the ROC. On this submission, the company's name would be deleted and the company is said to be liquidated.

   Liquidators Statement of affairs is prepared before the commencement of liquidation on an Estimated Basis,

   Liquidators Final Statement of Account prepared after the completion of the liquidation on an Actual Basis.

**Q. 9 Explain sequence (order) of payments on Liquidation?**

- **Legal order of payments** : When the amounts are realised from the disposal of assets it should be applied towards the payment of expenses & liabilities in a specified order which is as follows :

  **1.** Legal Expenses
  **2.** Liquidator's Remuneration
  **3.** Liquidation Expenses
  **4. Secured Creditors** : It would only include liabilities which are secured by a specific charge, hypothecation or mortgage. The specific asset should be given as a security against the liability. For the purpose of liquidation secured loans would not include the liabilities which are secured by a floating charge.

  **Note** : If the amount realised from the sale of the asset exceeds the secured liability than the surplus can be utilised towards the payment of other liabilities. Alternatively if there is a deficiency then the balance would be treated as unsecured and it would be paid along with all other unsecured liabilities in step 7.

  **5. Preferential Creditors : (Unsecured Creditors)**
  i. The payment of **Government dues for taxes** provided they have arisen within the period of **12 months before** the date of liquidation.
  ii. The payment of **wages & salaries** to employees and workers (**not directors** and officers) for a maximum period of **4 month**. The salaries and wages should have arisen within a period of 12 months before the date of liquidation. However the amount payable to **an individual** should not exceed **₹20,000**/-.
  iii. The payment of **provident fund**, gratuity, pension as per the provision of the relevant acts.
  iv. Any **leave salary** which is payable to the employees and workers.
  v. **Compensation** paid as per the provisions of the workmen compensation Act and Industrial Disputes Act.
  vi. **Cost of investigation** as per the provisions of Sec. 235 or 237 of the Co's act. 1956.
  **NOTE** : All preferential creditors rank equal.

  **6.** The amount of those liabilities which are secured by a **floating charge**, for e.g. Debentures and Interest accrued upto the date of liquidation.
  **7.** The payment of **unsecured creditors** together with the deficiency of secured creditors which arose in point 4.
  **8. Preference shareholders** (Preference share capital + Arrears of dividend upto the date of liquidation).
  **9. Equity shareholders**

1. **Cash deficit:** If there is a cash deficit and the shares are partly paid than the liquidator can make a call on such shares and utilise the amount received towards the payment of the liabilities. If there are partly paid equity shares and partly paid preference share then firstly the liquidator would make a call on the partly paid equity shares.

2. **Cash Surplus :** should be distributed amongst equity shareholders based on their respective paid up value.

**Q. 10 What is Liabilities of "B" Contributories**:

- All those persons who ceased to be shareholders (other than death) within a year before the date of winding up of the company, are place in the "B" list of contributories. These contributories are required to pay the unpaid amount of shares held by them.

  However, they are required to pay only those debts which existed at the time they ceased to be members. This means such former members are not liable to contribute for debts incurred after they ceased to be members. They are liable only if amount collected from "A" list contributories is not sufficient to pay liabilities.

**Q. 11 Explain Marked and Unmarked Application**

1. **Marked Application:-** Underwriters who have taken obligation, often refers their clients to subscribe the shares of company whose issue is underwritten by the underwriters. The forms of such clients are marked i.e. stamped with underwriters name. Such firms are known as marked applications. Marked applications are helpful in determining net liability.
2. **Unmarked Application:-** The applications forms received by the company without any stamp of any of the underwriters are known as unmarked Application. They are filled by people and directly sent to Co. The benefit of unmarked applications is given to all underwriters in the ratio of gross liability.

**Q. 12 Explain different forms of underwriting.**

1. **Firm Underwriting:-** It is a definite commitment to take up a specified number of shares irrespective of the number of shares subscribed be the public. In such a case the net liability should be determined without taking into account the number of shares taken up in firm underwriting.
   To find the total liability of the underwriters this firm underwriting should be added to the net liability.

2. **Full Underwriting:-** When the entire issue is underwritten, such underwriting is called as 'full underwriting'.
   For example Baba Ltd. decided to make a public issue of 2,00,000 Equity shares of ₹ 10 each which is entirely underwritten by Anita, Babita, Chandu & Dinesh in the ratio of 1/3 : 1/3 : 1/6 : 1/6.

3. **Partial Underwriting :-** When only a part of issue is underwritten such underwriting is called as "Partial Underwriting".
   For Example Baba Ltd. decided to make a public issue of 2,00,000 Equity shares of ₹ 10 each out of which 1,80,000 shares are underwritten by X : Y : Z in equal proportion.

4. **Sole Underwriting:-** When the issue is underwritten, by one underwriter, it is called as 'Sole Underwriting'. For Example, Baba Ltd. issued 2,00,000 shares which are underwritten by Mr. Yogesh in such a case the distinction between marked and unmarked applications is not relevant.

5. **Joint Underwriting:-** When the issue is underwritten by two or more underwriters it is called as 'Joint Underwriting'.
   For example, Baba Ltd issued 2,00,000 shares which are underwritten by X, Y, and Z in the equal proportion.