Corporate Accounting

ABOUT THE AUTHORS

Dr. P. Radhika is currently working as an Associate Professor at the postgraduation department of Corporate Secretaryship, Anna Adarsh College for Women, Chennai. She has more than 30 years of teaching experience at the undergraduate level and 17 years of teaching experience at postgraduate level. She has specialisation in the areas of Financial, Corporate, Cost and Management Accounting and Corporate Restructuring. She has published many research articles in international, national and state level seminars, conferences and symposiums. She has received the Best Paper Award for the paper presentation in the National Seminar organised by DG Vaishnav College, in 2010. She is a member of the Board of Examiners for various leading autonomous colleges and Universities across Tamil Nadu. She holds Master's degree in Commerce, M.Phil. degree from Annamalai University and Master's degree in Corporate Secretaryship from Alagappa University. She has been awarded Ph.D. by the University of Madras. She is a recipient of 'Acharya Ratna Award' in recognition of her exemplary teaching services for over 25 years by Punjab Association, in 2012 on the joyous occasion of its Platinum Jubilee Celebrations, and also received 'My Guru Award' from Rotaract Club in the same year. She was the NSS Programme Officer, Anna Adarsh College for Women, from 2006 to 2012. She has received a Certificate of Appreciation for her contribution in the XXII Inter-University National Youth Festival 'KALAI SARAL' organised by the University of Madras, in 2007. She is the faculty for CS Foundation Course. She is an editorial board member for the in-house Annual Journal 'FOCUS' of the Department of Corporate Secretaryship.

Dr. Anita Raman is currently working as an Associate Professor, and Research Guide & Supervisor at the Postgraduate and Research Department of Commerce, Anna Adarsh College for Women, Anna Nagar, Chennai. She has 30 years of teaching experience at the undergraduate level and 27 years at the postgraduation level. She has specialisation in the areas of Human Resource Management, Corporate Accounting, Entrepreneurial Development, Services Marketing and Direct Taxation. She has presented papers in many national and international conferences and has published articles in the Journals of Business and Management Research, having high impact factor. She is the author of the Full Course Material of the Distance Education of Tamil Nadu Open University for the subjects, Statistical Methods and Operations Research and Treasury Management. She is a member of Board of Studies and Board of Examiners, for various leading autonomous colleges and universities across Tamil Nadu. She is also a member of the Editorial Board of an in-house Annual Journal *Anvesh – The Quest,* in the Department of Commerce. She holds Master's degree in Commerce from the University of Madras and is a gold medalist from Madras Christian College. She obtained her M.Phil. degree from the University of Madras, B.Ed. degree from Annamalai University, MBA degree from Tamil Nadu Open University and Ph.D. from the University of Madras. She is a Research Guide and Supervisor for M.Com., M.Phil. and Ph.D. courses. She has participated in SIFE (Students in Free Enterprise) International Competition and has been awarded 'Faculty Recognition Award' by Syntel Ltd. and KPMG. She has been awarded with 'My Guru Award' by Rotract Club of Presidency Candles and Ethiraj College for Women and 'Acharya Ratna Award' by Punjab Association, in recognition of exemplary teaching services for over 25 years in Anna Adarsh College for women.

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P Radhika
Associate Professor
Department of Corporate Secretaryship
Anna Adarsh College for Women
Chennai

Anita Raman
Associate Professor, and Research Guide & Supervisor
Department of Commerce
Anna Adarsh College for Women
Chennai

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Senior Portfolio Manager: *Suman Sen*
Associate Portfolio Manager: *Laxmi Singh*

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Manager—Production: *Reji Kumar*

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Write to us at: info.india@mheducation.com

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Toll Free Number: 1800 103 5875

Dedicated to

Our Parents

PREFACE

We deem it a great privilege to present the first edition of our book *Corporate Accounting* to the academic community. Corporate Accounting is generally considered to be a complex subject in the commerce stream. So, the syllabus has been divided into two volumes and this text is the first volume.

This book shall enable self-learning and facilitate the students to understand the subject matter in a simple, systematic and lucid manner. It contains illustrations and exercises ranging from easy to comprehensive problems. The exercises are categorised as theory questions comprising of Short-Answer Questions and Long-Answer Questions, Objective-Type Questions in the nature of Multiple-Choice Questions, Fill in the Blanks, and True or False Questions and the Standard Exercise Problems.

We are thankful to our Management, Punjab Association, Principal, colleagues and students for their constant encouragement and support.

We are also grateful to the editorial staff of McGraw Hill Education (India), especially Mr. Suman Sen, Ms. Laxmi Singh and Ms. Jagriti Kundu for bringing out this book well in time.

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Authors

ROADMAP TO THE SYLLABUS

CORPORATE ACCOUNTING
Madras University B.Com Semester-III

CORPORATE ACCOUNTING (Semester-III)	Chapter in the Book
Unit I: Share Capital Issue of Shares—Types of Shares—Forfeiture of shares—Re-issue of shares—Underwriting of shares—Stock split—Meaning of Redemption—Redemption of Preference Shares.	1, 2, 3
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1

ISSUE, FORFEITURE, AND RE-ISSUE OF SHARES

A company is an organisation developed to overcome the limitations and drawbacks of the other forms of business organisations, namely sole proprietorship business, partnership business, etc. It represents the third stage in the evolution of business organisations. The earlier organisations could not fulfil the increased need of modern industry and commerce. Thus, most of the large-scale industries and business organisations have organised themselves as Joint Stock Companies.

1.1 JOINT STOCK COMPANY

A joint stock company is a voluntary association of persons formed for the purpose of some business for profit with common capital, divisible into transferable shares and possessing a corporate legal entity and a common seal.

A joint stock company is created by a process of law and can be put to an end only by the process of law. It is an artificial person. It has a separate legal existence and is distinct from the persons who have formed it and are its members. It is capable of acting on its own name but since it does not have a physical existence, it has to act through its agents and the contracts entered into by its agents must be under the seal of the company.

1.2 COMPANY

Lord Justice Lindley defines a Company as "An association of many persons who contribute money or money's worth to a common stock, and employ it in some common purpose (trade or Business), and who share the profit or loss (as the case may be) arising therefrom".

According to Section 3(1)(i) of the Companies Act, 1956, "Company" refers to a company formed and registered under this Act or an existing company. An existing company means a company formed and registered under any of the former Companies Acts.

❍ Salient Features of a Company

1. It is a voluntary association of persons, i.e. no law can compel persons to form a company.

2. It is an artificial person, created by law. A company, being a separate body, can sue and be sued in its name.
3. A company is a separate and distinct legal entity. It is independent of members and its existence is not affected by the coming and going out of the members. Further, it can hold, purchase and sell properties, can open bank account in its name and can enter into contracts.
4. A company has a common seal. Since a company is an artificial person, it can act only through the natural persons, called Directors and a common seal evidences its distinct existence.
5. A company has a perpetual succession. Its continuity is not affected by the changes in the membership.
6. Most of the companies are limited companies. In such cases, the liability of the members is limited to the extent of the unpaid value of the shares held by them.
7. It can be dissolved only by the law, which creates it.

❍ Difference between a Company and a Partnership Firm

Company	Partnership Firm
1. A company is governed by the Companies Act, 1956.	A partnership firm is governed by the Partnership Act, 1932.
2. A company must be registered.	Partnership firm is not legally obliged to be registered.
3. A company has a separate legal existence from its shareholders.	A partnership has no separate legal existence distinct from its partners.
4. The minimum number of members required to form a private company is 2 and a public company is 7. The maximum membership of a private company is restricted to 50 while there is no such limit for membership of a public company.	The minimum number of persons required to form a partnership is 2 and maximum number of partners in a banking firm can be 10 and in a trading firm 20.
5. The decrease or increase in share capital can be done only in accordance to the provisions of the Indian Companies Act.	The capital of the partnership firm can be altered only by mutual agreement with partners.
6. The death or insolvency of a shareholder does not affect the existence of a company.	A partnership firm ceases to exist if any partner retires, dies or declared insolvent.
7. Shares in a public company is freely transferrable.	Partners cannot transfer their shares or interest in the firm without the consent of the co-partners.
8. The liability of a shareholder is limited to the extent of unpaid amount of shares held by him.	The partners are personally liable for all the actions of the partnership firm.

(*Contd.*)

9. A company is managed by the elected Representatives, called the Board of Directors.	A partnership firm is managed by every partner.
10. A shareholder is not an agent to make a contract.	Each partner is an agent of the firm to make a contract.
11. Audit of accounts is compulsory.	Audit of accounts is not compulsory.
12. A company can be wound up only in accordance with the provisions of the Companies Act, 1956.	A partnership firm can be dissolved at any time by the partners.

1.3 TYPES OF COMPANIES

Companies can be classified on the following basis:

1. **On the basis of incorporation:**
   (i) Chartered companies
   (ii) Statutory companies
   (iii) Registered companies
2. **On the basis of liability:**
   (i) Companies limited by shares
   (ii) Companies limited by guarantee
   (iii) Unlimited companies
3. **On the basis of public investment :**
   (i) Private companies
   (ii) Public companies

The features of various kinds of company are stated in the next section.

❍ Types of Companies on the Basis of Incorporation

Chartered Companies

Chartered companies are those, which are established by the special grant of Royal Charter (i.e. by the king or queen) that lays down objectives, rights and duties, etc., of the companies; for example, The East India Company. But, after independence, such companies are not found in India.

Statutory Companies

Statutory companies are those, which are created and governed by special Acts of the legislature. For example, The Reserve Bank of India, Life Insurance Corporation of India, The Unit Trust of India, etc.; these companies are mainly concerned with public utilities such as railways, gas, electricity, etc., and are the enterprises of national importance and interest. These companies are also bestowed with special powers, unlike the registered companies, because they are monopoly organisations and they supply services, which are vital to meet the needs of the public.

Registered Companies

Registered companies are those, which are formed and registered under the Indian Companies Act of 1956. These registered companies are of three types, which are divided on the basis of liability.

❍ Types of Companies on the Basis of Liability

Companies Limited by Shares

A company limited by shares refers to those companies in which the liability of each member or shareholder is limited up to the nominal value or face value of the shares held by them, i.e. the shareholders can be called upon to pay only up to the face value of the shares. In other words, the members' liability cannot exceed the unpaid amount, on the shares held by them.

Companies Limited by Guarantee

Companies limited by guarantee refers to those companies in which the liability of the members is limited by the Memorandum to a fixed amount, for which the members undertake to contribute towards the assets of the company in the case of its winding up. These companies may or may not have Share Capital. Examples for these types of companies are clubs, trade associations and the societies constituted for promoting social objects.

Unlimited Companies

Unlimited companies are those companies in which there is no limit on the liability of members, i.e. in the event of winding up of the company, the shareholders or members are liable to the fullest extent of their fortunes to meet the obligations of the company.

❍ Types of Companies on the Basis of Public Investment

Private Company

The Companies Act defines a private company as a company, which by its articles:

(i) restricts the right of transfer of its shares.

(ii) limits the number of its members to fifty.

(iii) prohibits any invitation to the public to subscribe for any share or debenture of the company.

Public Company

The Companies Act defines a public company as "a company, which is not a private company". Hence, the public company does not have the restrictions as is imposed upon a private company, as listed above.

1.4 COMPANY FORMATION

The following steps are involved in the formation of a company:

1. Promotion
2. Obtaining the Certificate of Incorporation
3. Obtaining the Certificate of Commencement of Business
4. Issue of Prospectus

❍ Promotion

Promotion may be defined as the discovery of business opportunities and to investigate whether the idea is practicable and profitable. The person or the groups of persons who conceive the business idea and take steps to organise and undertake the investigation process are called as Promoters. If the promoters are of the opinion that the discovered business idea will run successfully then, they prepare the following documents:

- ***The Memorandum of Association:*** This document is also called as the charter of the company. It consists of name clause, place clause, objects clause, liability clause, capital clause and the association or subscription clause. This document is required to be signed by at least seven persons in the case of a public company and by at least two persons in the case of a private company.

- ***The Articles of Association:*** This document contains the rules and regulations of the company. The details relating to the internal management of the company is stated in this document such as division of the share capital, issue of shares, calls on shares, transfer of shares, forfeiture of shares, re-issue of shares, directors' qualification, appointment, removal, rights, duties, remuneration, voting rights, meeting of directors and shareholders, audit, etc.

- ***A List of Directors:*** It contains the consent of the Directors along with an undertaking given by them to take up and pay for the qualification shares.

- ***A Statement of Nominal Capital:*** It shows the sanctioned authorised capital of the company.

- ***A Declaration Certificate:*** It shows the declaration stating that all the requirements of the Companies Act and other formalities relating to registration has been complied with.

❍ Obtaining the Certificate of Incorporation

On filing the above documents by the promoters and on fulfilling all the legal requirements by the company with the Registrar of the companies, a Certificate of Incorporation is issued by the Registrar denoting the formation of the company.

This certificate is the legal evidence for having registered the company under the Companies Act.

❍ Obtaining the Certificate of Commencement of Business

A Public company has to obtain the certificate of commencement of business after obtaining the certificate of incorporation to commence its business. Whereas a Private company can commence its business soon after its incorporation.

To obtain a certificate of commencement of business the following conditions are to be fulfilled and filed with the Registrar:

1. A copy of the Prospectus or a statement in lieu of prospectus
2. The minimum number of shares paid in cash, have to be subscribed and allotted.
3. The Directors have to take up and pay for their qualification shares in cash.
4. There is no liability to repay the application money.
5. The share payable in cash is to be allotted with an equal amount not less than the minimum subscription.
6. An advocate or any officer of the company should give a declaration that all the conditions of the Act have been satisfied.

On thorough scrutiny of the above-mentioned conditions, the Registrar on being fully satisfied, issues the Certificate of Commencement of Business and only on receiving this certificate a public company can commence its business.

❍ Issue of Prospectus

A Prospectus issued by a company aims to invite the public to take up the shares and debentures of the company so that the company collects the necessary funds. It is the basis of contract between the company and the person who buys the shares on the strength of the prospectus. A prospectus is not an offer but it is an invitation to offer.

Section 2(36) of the Companies Act defines a prospectus as "Any document described or issued as a prospectus and includes any prospectus, notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for subscription or purchase of any share in or debenture of, a body corporate."

The following are the contents of a company prospectus:

- A brief summary of the Memorandum of Association
- Names and addresses of the Bankers, Auditors, Share-brokers and Underwriters
- Names and addresses of the Directors
- The minimum subscription, i.e. the minimum amount of share capital for which the company should receive applications
- Preliminary expenses, and
- The details of properties purchased.

1.5 DIFFERENCE BETWEEN A PRIVATE COMPANY AND A PUBLIC COMPANY

Private Company	Public Company
1. The minimum number of members required to form a company is two.	The minimum number of members required to form a company is seven.
2. The maximum number of members should not exceed fifty.	There is no limit for maximum number of members.
3. It must have two directors.	It must have three directors.
4. Shares are not freely transferable.	Shares are freely transferable.
5. It can commence business by obtaining a Certificate of Incorporation.	It can commence business only after obtaining a Certificate of Commencement of Business.
6. No public subscription for shares and debentures.	Calls for public subscription by issuing Prospectus.
7. Statutory meeting is not compulsory.	Statutory meeting is compulsory to be held.
8. Filing of statutory report with Registrar is not mandatory.	Filing of statutory report with Registrar is mandatory.
9. It must have the words Private Limited in its name.	It must have only the word Limited in its name.
10. It cannot issue share warrant.	It can issue share warrant.
11. No restriction regarding remuneration of Directors.	There are legal restrictions on remuneration of Directors.
12. No restriction on allotment of shares.	There are legal restrictions on allotment of shares.
13. Directors can borrow from company.	Directors cannot borrow from company.

1.6 BOOKS MAINTAINED BY COMPANIES

Every company is required to maintain the following books:

1. Proper Books of Accounts as per Section 209
2. Statistical Books
3. Statutory Books

❍ Proper Books of Accounts

The proper books of accounts to be maintained by every company are:

1. All sums received and expended by the company, i.e. receipts and expenditures.
2. All sales and purchases of goods by the company.

3. All assets and liabilities of the company.
4. Particulars relating to the utilisation of material or labour or other items of costs, as may be prescribed by the central government, if the company is engaged in production, processing, manufacturing or in mining activities.

❍ Statistical Books

1. Application and Allotment Book for Shares and Debentures
2. Call Book
3. Register of Share Warrant and Share Certificates
4. Register of Transfers of Shares and Debentures
5. Register of Sealed Documents
6. Register of Power of Attorney
7. Register of Probates
8. Register of Directors' Attendance
9. Dividend or Interest Book
10. Register of Transfer Certificates of Shares and Debentures.

❍ Statutory Books

1. Register of Investment (Section 49)
2. Register of Charges (Section 143)
3. Register of Members (Section 150)
4. Register of Debentureholders [Section 152 (1)]
5. Minute Books (Section 193)
6. Books of Accounts and Annual Reports (Section 209 and 211)
7. Register of Contracts (Section 301)
8. Register of Directors, Manager, Secretary, etc. (Section 303)
9. Register of Directors' Shareholdings (Section 307)
10. Register of Loans made, guarantees given or securities provided to companies (Section 370)
11. Register of Investments in Shares and Debentures (Section 372).

1.7 SHARES AND STOCKS

Capital is the major element for any trading concern. A company raises capital by inviting the public to buy its shares through a document called as Prospectus. The prospectus must reveal the actual state of affairs of the company. The capital of a company is usually divided into different units of fixed amount. These units are called as Shares.

Under Section 2(46) of the Companies Act of 1956, a share is defined as "Share means a share in the capital of a company, and includes stock except where a distinction between stock and share is expressed or implied".

Further, a share indicates an interest of the shareholder in the company, measured by a sum of money, in order to know the liability of the shareholder in the first place and of interest in the second place. A share is not a sum of money but is an interest measured by a sum of money and made up of various rights contained in the contract. Thus, a share also represents the interest of the shareholders and also their rights and liabilities.

The capital raised by the company by the issue of shares is called as "Share Capital". The capital of the company, which is divided into different units with a definite value are called as "Shares".

A stock also refers to the shares of a company but in a different form. Stock is the sum of fully paid-up shares consolidated and divided into different parts in order to make it convenient to hold shares.

❍ Differences between Shares and Stocks

Share	Stock
1. A share is one of a number of individual units into which a capital of a company is divided.	Stock is the capital in the form of a fund, which may be divided into any desired amount.
2. Shares may be partly or fully paid-up.	Stock must be fully paid-up.
3. Shares can be directly issued.	Stock cannot be directly issued.
4. Shares have a nominal value.	Stock does not have a nominal value.
5. Shares must have specific number.	Stocks are never numbered.
6. Shares are of equal denominations.	Stocks may be split into unequal amounts.
7. Shares cannot be transferred in fractional amounts.	Stocks can be transferred in fractional amounts, as provided by the Articles.

1.8 TYPES OF SHARES

The shares, which can be issued by the company, are of two types—Preference Shares and Equity Shares.

❍ Preference Shares

According to Section 85(1) of the Companies Act, Preference Shares are those shares, which have some preferential rights over the other types of shares, i.e. for a share to be called as a preference share, it must have the following two preferential rights:

1. The right to be paid dividend during the life-time of the company
2. The right to the return of capital when the company goes into liquidation.

The following are the types of preference shares:

1. Cumulative Preference Shares
2. Non-cumulative Preference Shares
3. Participating Preference Shares
4. Non-participating Preference Shares
5. Convertible Preference Shares
6. Non-convertible Preference Shares
7. Redeemable Preference Shares
8. Irredeemable Preference Shares
9. Guaranteed Preference Shares

Cumulative Preference Shares

The dividend payable on these kinds of preference shares keeps getting accumulated till it is fully paid off by the company. That is, if a company is not able to pay dividend in any year due to inadequate profit, then the fixed dividend rate on preference share gets accumulated and the dividend becomes payable as arrears of dividend to the cumulative preference shareholders out of the profit earned in the subsequent year. A company has to pay the arrear of dividend first, to the cumulative preference shareholders, before anything is paid out of profits to the holders of any other class of shares. These types of shareholders have a right to get a fixed percentage as dividend every year. Generally, a preference share is treated as a cumulative preference share, unless stated otherwise.

Non-cumulative Preference Shares

A company shall give preference in the matter of payment of dividend at a fixed rate in any year only if there is any profit available for distribution in that year. If there are no profits in a particular year, the right to claim dividend will lapse by the non-cumulative preference shareholder. Also, the shareholders cannot claim arrears of dividends of any year out of the profits of the subsequent year. Hence, if the dividend is not paid, it does not get accumulated and it cannot be carried forward.

Participating Preference Shares

These kinds of shares are entitled both for a fixed percentage of dividends and also to a share in the surplus profits, which remain after the claims of the equity shareholders. But, this type of shares should be expressly mentioned or provided in the Articles of Association of the company.

Non-participating Preference Shares

These kinds of shares are entitled only for fixed percentage of dividend and not to a share in the surplus profits. However, if the Memorandum and Articles of Association remain silent, then all preference shares are deemed to be non-participating preference shares.

Convertible Preference Shares

Within a certain period of time, the holders of these shares have a right to get their preference shares converted into equity shares.

Non-convertible Preference Shares

These shares cannot be converted into equity shares.

Redeemable Preference Shares

Generally, shares are not redeemable (refundable), i.e. the amounts paid on shares are not refundable, except when the company is liquidated. But, if the Articles of Association states the authority held by the company, then the company can issue shares for a fixed term and they are paid off on the expiry of the term. Such shares are called Redeemable Preference shares.

Irredeemable Preference Shares

The shares, which cannot be redeemed during the lifetime of the company, are called as Irredeemable Preference Shares.

Guaranteed Preference Shares

To the holders of such shares, dividend at fixed rates are guaranteed, irrespective of the fact whether the company has earned any profit or not. Such guarantee is not given by the company itself but by some third-party, like a bank, an individual or an institution.

❍ Equity Shares

Equity Shares are also called as Ordinary Shares. According to Section 85(2), the equity shares, with reference to any company limited by shares, are those that are not preference shares. The following are the features of these shares:

- Equity shares do not enjoy any preferential rights.
- There is no fixed rate of dividend on equity shares.
- The rate of dividend is dependent on the profits earned by the company, year to year.
- Equity shares are given returns, i.e. dividend when the company earns more profits, i.e. if profits are insufficient, equity shareholders may not get dividend at all.
- The rate of dividend is determined by the directors of the company.

1.9 SHARE CAPITAL

The share capital denotes, in monetary terms, the amount raised by the issue of shares by a company. The share capital of a company is, however, divided into the following categories:

1. ***Authorised Share Capital:*** It is the maximum amount, which the company is authorised to raise by issuing the shares, given by the Registrar of the Companies. It is also called as Nominal Capital or Registered Capital. It is also the capital, which is stated in the Company's Memorandum of Association with which the company intends to be registered. This capital can be increased or decreased by passing an ordinary resolution.
2. ***Issued Share Capital:*** It refers to that part of the authorised capital, which is offered to the public for subscription. The company can issue whole or part of the authorised share capital. Thus, the shares, which are issued for public subscription, are called Issued Share Capital. The balance of shares, if any, which are not issued, are called as Unissued Share Capital. However, the issued share capital cannot be more than the authorised share capital.
3. ***Subscribed Share Capital:*** It refers to that part of the issued share capital, which is purchased or taken up by the public, i.e. it is the share capital for which share application money is received and shares are allotted to the public. If the issued shared capital is partly taken up by the public, then the balance of shares are called as Unsubscribed Share Capital.
4. ***Called-up Share Capital:*** It refers to that part of the subscribed capital for which the company makes a call to collect the remaining portion of the share money called as call money. According to the needs of the company, the amount may be called up. Hence, the difference between the subscribed capital and the called-up share capital are called as Uncalled Share Capital.
5. ***Paid-up Share Capital:*** It refers to the amount received against the calls made on the shares. The unpaid balance of the called-up capital is known as Uncalled Capital or Calls-in-Arrears.

1.10 ISSUE OF SHARES

Issue of Share by a company can be classified based on the manner of receiving consideration as follows:

1. Issue of shares for immediate full consideration.
2. Issue of shares for consideration receivable in instalments, which are called as "Calls".
3. Issue of shares without any consideration, i.e. issue of bonus shares.
4. Issue of shares through other methods such as:
    - Rights Issue
    - Employee Stock-Option Schemes
    - Sweat Equity
    - Private Placement, etc.

❍ Issue of Shares for Immediate Full Consideration

Under this type of issue of shares, the considerations are received immediately in full. So, the transaction gets completed in one stroke and there is no need for further follow-up action in future. However, the consideration receivable can be in the following two forms—Non-Cash Consideration and Cash Consideration

Non-cash Consideration

Non-cash consideration means that a company may issue shares for consideration other than cash, i.e. in the form of acquiring the fixed assets or may purchase the business from a sole trader or partnership firm or even some other company. The following journal entries are to be passed to record such transactions as follows:

1. **Issue of shares for acquisition of fixed assets:**

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Fixed Asset A/c	Dr.	xxx	
To Share Capital A/c			xxx
(*Being allotment of shares made in consideration of the purchase of fixed assets*)			

2. **Issue of shares for a purchase or acquisition of business:**

Journal Entries

Particulars		Debit (₹)	Credit (₹)
Assets A/c	Dr.	xxx	
Goodwill A/c	Dr.	xxx	
To Liabilities A/c			xxx
To Vendors A/c			xxx
To Capital Reserve A/c			xxx
(*Being assets and liabilities of the business taken over and the difference in purchase price is debited to goodwill A/c if the purchase price is higher and is credited to capital reserve A/c if the purchase price is less*)			
Vendors A/c	Dr.	xxx	
To Share Capital A/c			xxx
(*Being the issue of shares made to vendors for the net amount payable*)			

3. **Issue of shares to promoters, etc., for services rendered by them:** The idea of promoting a business as a company is developed by promoters. In order to recognise their services and other business associates, the company may issue shares for which there is no tangible consideration. Therefore, goodwill account is debited.

Journal Entry

Date	Particulars	Debit (₹)	Credit (₹)
	Goodwill A/c Dr.	xxx	
	To Share Capital A/c		xxx
	(*Being shares issued to promoters for their services*)		

Illustration 1

A Ltd. issued shares for non-cash consideration in the following cases. Pass the necessary journal entries to record the transactions:

1. Issued 20,000 shares of ₹ 10 each in consideration for plant and machinery purchased on 10th January 2017.
2. Issued 30,000 shares of ₹10 each to B Ltd. for taking over the business by acquiring the following assets and liabilities at the following values on 15th January 2017:

   Plant and Machinery—₹1,00,000; Land and Buildings—₹1,50,000; Furniture—₹50,000; Sundry Creditors—₹50,000.
3. Issued 10,000 shares of ₹10 each to the promoters in consideration for their services on 30th January 2017.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
10.01.2017	Plant & Machinery A/c Dr.		2,00,000	
	To Share Capital A/c			2,00,000
	(*Being shares issued for plant and machinery purchased*)			
15.01.2017	Plant & Machinery A/c Dr.		1,00,000	
	Land & Buildings A/c Dr.		1,50,000	
	Furniture A/c Dr.		50,000	
	Goodwill A/c Dr.		50,000	
	(Bal. Fig)			
	To Sundry Creditors A/c			50,000
	To B Ltd. A/c			3,00,000
	(*Being assets and liabilities taken over from B Ltd. for Rs 3,00,000*)			
	B Ltd. A/c Dr.		3,00,000	
	To Share Capital A/c			3,00,000
	(*Being shares issued to B Ltd. for the assets purchased*)			

(*Contd.*)

03.01.2017	Goodwill A/c Dr. To Share Capital A/c (*Being issue of 10,000 shares ₹10 each made to the promoters for their services*)		1,00,000	1,00,000

Cash Consideration

The most common practice adopted by the companies relate to the issue of shares for cash consideration. The issue may be at par or at a premium or at a discount. The following are the journal entries to be passed to record such transactions:

Journal Entries

Particulars	Debit (₹)	Credit (₹)
When shares are issued at par:		
Bank A/c Dr.	xxx	
To Share Capital A/c		xxx
(*Being issue of shares for cash, at par*)		
When shares are issued at premium:		
Bank A/c Dr.	xxx	
To Share Capital A/c		xxx
To Securities Premium A/c		xxx
(*Being issue of shares for cash, at premium*)		
When shares are issued at discount:		
Bank A/c Dr.	xxx	
Discount on Issue of Shares A/c Dr.	xxx	
To Share Capital A/c		xxx
(*Being issue of shares for cash, at discount*)		

Illustration 2

Sumathi Ltd. issued 2,00,000 equity shares of ₹10 each to the public. The issue was fully subscribed by the public and the amount has been paid in one single instalment. Pass the required journal entries in the book of the company, if:

(a) the shares were issued at par

(b) the shares were issued at a premium of 10%

(c) the shares were issued at a discount of 10%

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Shares issued at par			
	Bank A/c Dr.		20,00,000	
	To Equity Share Capital A/c			20,00,000
	(*Being issue of 2,00,000 shares of ₹10 each issued at par*)			
	Shares issued at premium			
	Bank A/c Dr.		22,00,000	
	To Equity Share Capital A/c			20,00,000
	To Securities Premium A/c			2,00,000
	(*Being issue of 2,00,000 shares of ₹10 each issued at a premium of 10 %*)			
	Shares issued at discount			
	Bank A/c Dr.		18,00,000	
	Discount on Issue of Shares A/c Dr.		2,00,000	
	To Equity Share Capital A/c			20,00,000
	(*Being issue of 2,00,000 equity shares of ₹10 each at a discount of 10 %*)			

Illustration 3

Rajan Ltd. purchased the business of Raghu Bros. for ₹45,00,000, payable in fully paid shares of ₹100 each. What entries will be made in the books of Rajan Ltd., if such an issue is made:

(a) at par

(b) at a premium of 10%

(c) at a discount of 10%

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Shares issued at par			
	Business Purchase A/c Dr.		45,00,000	
	To Raghu Bros. A/c			45,00,000
	(*Being acquisition of business from Raghu bros. for ₹45,00,000*)			
	Raghu Bros. A/c Dr.		45,00,000	
	To Equity Share Capital A/c			45,00,000
	(*Being shares allotted for ₹45,00,000 in acquiring the business*)			

(*Contd.*)

	Shares issued at 10% premium Raghu Bros. A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being shares allotted at a premium of 10% for acquisition of business*)		45,00,000	 40,90,910 4,09,090
	Shares issued at 10% discount Raghu Bros. A/c Dr. Discount on Issue of Shares A/c Dr. To Equity Share Capital A/c (*Being shares allotted at a discount of 10% for acquisition of business*)		45,00,000 5,00,000	 50,00,000

Issue of Shares at par, premium and at discount for Non-Cash Consideration (in the nature of acquisition or purchase of a fixed asset):

Illustration 4

Satish Ltd. purchased land and buildings costing ₹5,00,000 and as payment towards purchase price, allotted equity shares of ₹10 each as fully paid. Pass journal entries in the books of Satish Ltd., if the company had issued shares at par, at a premium of 10% and at a discount of 10%.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Shares issued at par Land and Buildings A/c Dr. To Equity Share Capital (*Being issue of 50,000 shares @ ₹10 each for purchase of land and buildings*)		5,00,000	 5,00,000
	Shares issued at a premium Land and Buildings A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of 50,000 shares of ₹10 each at a premium of 10% for purchase of land and buildings*)		5,00,000	 4,54,545 45,455
	Shares issued at a discount Land and Buildings A/c Dr. Discount on Issue on Shares A/c Dr. To Equity Share Capital A/c (*Being issue of 50,000 shares of ₹10 each at a discount of 10% for purchase of land and buildings*)		5,00,000 50,000	 5,50,000

❍ Issue of Shares for Consideration Receivable in Instalments, called as "Calls"

All public limited companies mostly issue shares for consideration receivable in instalments. This method is considered to be more flexible and convenient by the prospective investors because they need not pay the full value of the shares immediately. Sometimes, the company may not require the entire amount in the short run from the investors. Hence, it enables the company to make calls as and when it is required. And, they receive the share capital in instalments over a period of time. The instalments are: Application Money, Allotment Money and Call Money. Payment of money in instalments is also convenient to the shareholders. The following are the stages involved in the issue of shares to the public:

1. ***Issue of prospectus:*** When a company decides to raise capital through issue of shares, an official invitation, called as Prospectus, has to be given to the public, for subscription. The Prospectus contains details about the company, such as names of the Directors, Auditors, Annual Report, etc. It also states the amount payable as application money and allotment money on the shares.

   Section 69(3) of the Companies Act requires payment of at least 5 per cent of the nominal value of share as application money. Further, SEBI regulations stipulate that the application money in the case of a public issue should be at least 25 per cent of the issue price of the shares.

2. ***Receiving of share application:*** In this stage, the interested investors express their willingness to purchase the shares. The investor, thus, fills in the application form and sends the application along with the application money to the company. The company may receive the share applications in any one of the following ways:

   - ***Full Subscription:*** If the total number of share application forms received is equal to the total number of shares issued by the company, then it is called as full subscription.

   - ***Under-Subscription:*** If the total number of share application forms received are less than the total number of shares issued by the company, then it is called as under-subscription.

   - ***Over-Subscription:*** If the total number of share application forms received are more than the total number of shares offered by the company, then it is called as over-subscription.

   The share application money received by the company is recorded in the books of accounts as follows:

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Bank A/c	Dr.	xxx	
To Share Application A/c			xxx
(*Being application money received*)			

3. ***Allotment of shares**:* The company scrutinises all the application forms received and then decides the application forms that are to be accepted. This is called allotment of shares.

   The Board of Directors make the allotment of shares, provided the following conditions are satisfied:

   1. The company receives the minimum subscription.
   2. The prospectus or statement in lieu of prospectus is filed with the Registrar of Companies.
   3. At least 5 per cent of the nominal value of shares is received as application money (25 per cent in the case of public issue of shares).

   A Letter of Allotment is then issued to the successful applicants, mentioning the number of shares allotted and the amount payable as allotment money. However, in the case of over-subscription, the company follows certain norms stipulated by SEBI. The company consults the stock exchange to finalise the allotment process.

   The company may adopt any of the following methods for allotment of shares:

   - ***Full allotment:*** The board of directors may make full allotment to the required number of applicants and reject the other applications. The company either adopts the lottery method or evolves a criteria in consultation with the stock exchange if the shares are listed.

     The application money on shares allotted is transferred to Share Capital Account and, the application money on applications rejected is refunded. These transactions are recorded in the Books of Accounts, as follows:

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	For transfer of application money on shares allotted		
	Share Application A/c Dr.	xxx	
	To Share Capital A/c		xxx
	(*Being transfer of application money on allotted shares*)		
	For refund of rejected application money		
	Share Application A/c Dr.	xxx	
	To Bank A/c		xxx
	(*Being refund of application money to rejected applicants*)		

   - ***Partial allotment:*** In this case, the applicants are divided into groups based on the number of shares applied for. After that, the company allots shares to different groups in different ratios. For example, those who have applied for 300 shares may be allotted 75 shares (25 per cent) and those who have applied for 400 shares may be allotted 120 shares (30 per cent).

The application money on shares allotted is transferred to Share Capital Account. There may be surplus application money because of partial allotment. The surplus application money may be adjusted towards sums due on allotment or even calls if so, authorised by the Articles of an Association.

- ***Pro-rata allotment:*** When there is over-subscription, a company may allot shares to the applicants on a pro-rata basis. The shares are allotted in proportion to the number of shares applied. For example, A Ltd. made an issue of 3,00,000 shares to the public but it received applications for 4,00,000 shares. The company allotted the shares on a pro-rata basis, as there was over-subscription.

For 4,00,000 shares applied, number of shares allotted is 3,00,000, i.e. for every four shares applied, allotment is three shares. If a person applies for 400 shares, he will be allotted 300 shares.

The application money on shares allotted is transferred to Share Capital Account in this case also. Further, the surplus application money shall be adjusted towards sums due on allotment or even calls if so authorised by the Articles of Association.

Allotment letters are sent to the allottees, who have been allotted shares by the company and the amount payable is also stated in the letter within the stipulated date. The allottees become shareholders of the company. Letters of Regret are sent to those who have not been allotted shares. The application money paid by them is refunded. These transactions are recorded, as follows, in the Books of Accounts for partial and pro-rata allotment:

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	For transfer of excess application money on partial and pro-rata allotment		
	Share Application A/c Dr.	xxx	
	To Share Allotment A/c		xxx
	To Calls-in-Advance A/c		xxx
	(*Being transfer of excess application money to share allotment and calls-in-advance A/c if articles permit for calls*)		
	Note: Any excess application money beyond the issue value of shares cannot be transferred to Calls-in-Advance and should be refunded to the applicants.		

(*Contd.*)

	For allotment money due Share Allotment A/c Dr. To Share Capital A/c (*Being allotment money due*)	xxx	 xxx
	For allotment money received Bank A/c Dr. To Share Allotment A/c (*Being allotment money received*)	xxx	 xxx

Illustration 5

R.K. Ltd. invited applications for 40,000 shares of ₹10 each, payable as on application ₹5; on allotment ₹5. The issue was fully subscribed. The amount was received in full. Give journal entries in the books of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Equity Share Application A/c (*Being share application money received on 40,000 equity share @ ₹5 each*)		2,00,000	 2,00,000
	Equity Share Application A/c Dr. To Equity Share Capital A/c (*Being share application money transferred to share capital A/c*)		2,00,000	 2,00,000
	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (*Being share allotment money due*)		2,00,000	 2,00,000
	Bank A/c Dr. To Equity Share Allotment A/c (*Being share allotment money received*)		2,00,000	 2,00,000

4. ***Making of calls:*** The issue value of shares is received in the form of application money and then, allotment money and the balance amount is collected by making of one or more calls. While making calls, the company sends a call notice to the shareholders, indicating the balance amount payable by the shareholders as "call money". If the call money is received in full, the process of issue of shares gets completed. In such cases, the following journal entries are passed in the Books of Accounts of the company:

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	For first call money due Share First Call A/c Dr. To Share Capital A/c (*Being first call money due*)	xxx	xxx
	For receiving first call money Bank A/c Dr. To Share First Call A/c (*Being share first call money received*) **Note:** The above two journal entries need to be passed for all the calls made by the company, i.e. like second call, third call, etc.	xxx	xxx

Illustration 6

Under subscription

Vikram Ltd. issued 10,000 shares of ₹10 each to the public. The public has applied for 9,000 shares. The shares are payable as follows:

On application	₹4
On allotment	₹4
On call	₹2

Give journal entries in the book of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being share application money received on 9,000 shares*)		36,000	36,000
	Share Application A/c Dr. To Share Capital A/c (*Being the transfer of share application money*)		36,000	36,000
	Share Allotment A/c Dr. To Share Capital A/c (*Being share allotment amount due*)		36,000	36,000
	Bank A/c Dr. To Share Allotment A/c (*Being share allotment money received*)		36,000	36,000

(*Contd.*)

	Share Final Call A/c Dr. To Share Capital A/c (*Being share final call amount due*)		18,000	18,000
	Bank A/c Dr. To Share Final Call A/c (*Being the receipt of share final call money*)		18,000	18,000

Illustration 7

Over subscription and refund of application money

R.R. Ltd. issued 10,000 shares of ₹10 each, payable as under:

On application	₹3 per share
On allotment	₹4 per share
On first and final call	₹3 per share

30,000 shares were applied for. The directors accepted applications for 10,000 shares. All moneys due were fully received. Give journal entries and prepare the Balance Sheet of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being share application money received on 30,000 shares*)		90,000	90,000
	Share Application A/c Dr. To Share Capital A/c To Bank A/c (*Being the transfer of share application money to share capital and excess application money refunded*)		90,000	30,000 60,000
	Share Allotment A/c Dr. To Share Capital A/c (*Being the amount due on share allotment A/c*)		40,000	40,000
	Bank A/c Dr. To Share Allotment A/c (*Being the amount received on share allotment A/c*)		40,000	40,000
	Share First and Final Call A/c Dr. To Share Capital A/c (*Being the final call due*)		30,000	30,000

(*Contd.*)

	Bank A/c Dr. To Share First and Final Call A/c (*Being the final call amount received*)		30,000	30,000

Balance Sheet of R.R. Ltd., as on …

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	1,00,000
Reserves and Surplus	—	
(ii) Non-current Liabilities	—	
(iii) Current Liabilities	—	
Total: (i) + (ii) + (iii)		1,00,000
II. Assets:		
(i) Non-current Assets	—	
(ii) Current Assets		
Cash at Bank		1,00,000
Total: (i) + (ii)		1,00,000

Note No.	(₹)
1. Share Capital	
Issued and Subscribed Capital	
10,000 shares of ₹10 each fully paid	1,00,000

Illustration 8

Over subscription and pro-rata allotment

Lakshmi Ltd. invited applications for 20,000 shares of ₹10 each, payable as follows: on application ₹4; on allotment ₹4; on final call ₹2. Applications were received for 25,000 shares. The directors made pro-rata allotment. Excess application money was adjusted towards allotment and call was received. Make the necessary journal entries in the book of Lakshmi Ltd.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being share application money received on 25,000 shares*)		1,00,000	1,00,000

(*Contd.*)

	Share Application A/c Dr. To Share Capital A/c To Share Allotment A/c (*Being transfer of share application money to share capital A/c and excess money adjusted towards allotment*)		1,00,000	 80,000 20,000
	Share Allotment A/c Dr. To Share Capital A/c (*Being shares allotment amount due*)		80,000	 80,000
	Bank A/c Dr. To Share Allotment A/c (*Being the receipt of share allotment money*)		60,000	 60,000
	Share Final Call A/c Dr. To Share Capital A/c (*Being amount due on final call*)		40,000	 40,000
	Bank A/c Dr. To Share Final Call A/c (*Being the receipt of share final call money*)		40,000	 40,000

Illustration 9

AA Ltd. invited applications for 20,000 shares of the value of ₹100 each. The amount payable is ₹30 on application, ₹30 on allotment, ₹20 on first call and ₹20 on final call. The whole of the above issue was applied for and cash was duly received. Give journal entries in the book of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being the receipt of the share application money on 20,000 shares*)		6,00,000	 6,00,000
	Share Application A/c Dr. To Share Capital A/c (*Being the transfer of share application money to share capital A/c*)		6,00,000	 6,00,000
	Share Allotment A/c Dr. To Share Capital A/c (*Being allotment money due*)		6,00,000	 6,00,000
	Bank A/c Dr. To Share Allotment A/c (*Being allotment money received*)		6,00,000	 6,00,000

(*Contd.*)

	Share First Call A/c Dr. To Share Capital A/c (*Being share first call amount due*)		4,00,000	4,00,000
	Bank A/c Dr. To Share First Call A/c (*Being share first call amount received*)		4,00,000	4,00,000
	Share Final Call A/c Dr. To Share Capital A/c (*Being share final call amount due*)		4,00,000	4,00,000
	Bank A/c Dr. To Share Final Call A/c (*Being share final call amount received*)		4,00,000	4,00,000

Calls-in-Arrears: The allotment money and the call moneys have to be paid by the shareholders on the due dates. If the shareholders fail to pay the amount within the due date, then it is called as "Calls-in-Arrears". Thus, the difference between call money due and call money received is the calls in arrears.

No separate entry is passed for Calls-in-Arrears. However, if the accounts are to be closed before such arrears are settled, then, a separate account is opened, called 'Calls-in-Arrears Account' and all the call money dues are transferred to the account and the following journal entry is passed:

Journal Entry

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Calls-in-Arrears A/c Dr. To Share Allotment A/c To Share First Call A/c To Share Second Call A/c (*Being transfer of amounts due on all the calls*)		xxx	 xxx xxx xxx

The balance of the Calls-in-Arrears Account is subtracted from the "Called-up capital" in the liabilities side of the Balance Sheet to arrive at the "Paid-up Capital". The directors of a company may forfeit shares on which there are Calls-in-Arrears, after giving due notice.

If the company has adopted Table A as its articles or the company's article provide for it, an interest of 5% per annum can be charged on Calls-in-Arrears from the date the amount was due till the date the amount is collected. Journal Entry for receiving the interest on Calls-in-Arrears is:

Journal Entry

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Interest on Calls-in-Arrears A/c (*Being interest collected on Calls-in-Arrears*)		xxx	 xxx

Illustration 10

AB Ltd. invited application for 10,000 shares of ₹10 each. The amount payable is ₹3 on application, ₹4 on allotment and ₹3 on first and final call. The whole of the above issue was applied for and all money up to allotment were duly received. As regards call, a shareholder holding 300 shares did not pay the amount due. Show the necessary journal entries to record the above transactions and how the capital would appear in the Balance Sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being share application money received*)		30,000	 30,000
	Share Application A/c Dr. To Share Capital A/c (*Being transfer of application amount to Share Capital*)		30,000	 30,000
	Share Allotment A/c Dr. To Share Capital A/c (*Being amount due on allotment*)		40,000	 40,000
	Bank A/c Dr. To Share Allotment A/c (*Being amount received on allotment*)		40,000	 40,000
	Share First and Final Call A/c Dr. To Share Capital A/c (*Being amount due on share first and final call*)		30,000	 30,000
	Bank A/c Dr. Calls-in-Arrears A/c Dr. To Share Capital A/c (*Being amount received on first and final call*)		29,100 900	 30,000

Balance Sheet of AB Ltd., as on…

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	99,100
Reserves and Surplus		—
(ii) Non-current Liabilities		—
(iii) Current Liabilities		—
Total: (i) + (ii) + (iii)		99,100
II. Assets:		
(i) Non-current Assets		—
(ii) Current Assets		
Cash at Bank		99,100
Total: (i) + (ii)		99,100
Note No.		
1. Share Capital		
Issued and Subscribed and Paid-up Capital		
10,000 shares of ₹10 each		1,00,000
Less: Calls-in-Arrears		900
		99,100

Calls-in-Advance: Sometimes, the shareholders pay the call money before the company makes the call, such amount is accepted by the company as "Calls-in-Advance". Section 92 of the Companies Act stipulates that the company's articles should permit the company for accepting Calls-in-Advance. Calls-in-Advance may be received in two ways:

1. The shareholders may pay cash towards calls not yet made at the time of allotment or at any other later date.

Journal Entry

Date	Particulars	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Calls-in-Advance A/c (*Being the amount received in advance towards calls not yet made*)	xxx	xxx

2. The company may transfer excess application money of pro-rata allottees towards allotment and Calls-in-Advance.

Journal Entry

Date	Particulars	Debit (₹)	Credit (₹)
	Share Application A/c Dr. To Calls-in-Advance A/c (*Being transfer of excess application money towards Calls-in-Advance*)	xxx	 xxx

The Calls-in-Advance is to be adjusted whenever the calls are made by the company in both the above mentioned cases. Then, the following journal entry is passed on the due date of each call.

Journal Entry

Date	Particulars	Debit (₹)	Credit (₹)
	Calls-in-Advance A/c Dr. To Share Call A/c (*Being the adjustment of Calls-in-Advance towards call*)	xxx	 xxx

A shareholder is not eligible for dividend on Calls-in-Advance. If Table A has been adopted by the company or a specific provision is made in the articles, interest at the rate of 6% per annum has to be paid from the date of receiving Calls-in-Advance till the due date of the call concerned. The journal entry will be:

Journal Entry

Date	Particulars	Debit (₹)	Credit (₹)
	Interest on Calls-in-Advance A/c Dr. To Bank A/c (*Being payment of interest on Calls-in-Advance*)	xxx	 xxx

Illustration 11

Damodram Co. Ltd. issued 3,000 equity shares of ₹100 each, at a premium of ₹20 per share, payable as follows:

On application—₹20; on allotment—₹40; on first call—₹30; on final call—₹30.

The amount due on allotment and first call were received. A shareholder holding 200 shares paid the final call money along with first call. Pass journal entries to record the above.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being share application money received*)		60,000	 60,000

(*Contd.*)

	Share Application A/c Dr. To Share Capital A/c (*Being transfer of share application money to share capital*)		60,000	 60,000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being amount due on allotment*)		1,20,000	 60,000 60,000
	Bank A/c Dr. To Share Allotment A/c (*Being amount received on share allotment*)		1,20,000	 1,20,000
	Share First Call A/c Dr. To Share Capital A/c (*Being amount due on share first call A/c*)		90,000	 90,000
	Bank A/c Dr. To Share First Call A/c To Calls-in-Advance A/c (*Being first call money received along with Calls-in-Advance for 200 shares*)		96,000	 90,000 6,000
	Share Final Call A/c Dr. To Share Capital A/c (*Being final call money due*)		90,000	 90,000
	Bank A/c Dr. Calls-in-Advance A/c Dr. To Share Final Call A/c (*Being final call amount received*)		84,000 6,000	 90,000

Illustration 12

Under subscription with Calls-in-Arrears

JJ Co. Ltd. offered 2,500 shares of ₹10 each to the public on the following terms:

₹3 to be paid on application, ₹3.50 to be paid on allotment, ₹1.50 to be paid three month after allotment and ₹2 to be paid four months after the first call.

The public applied for ₹2,300 shares for which allotment took place on 1st June 2014. All money due on allotment was received by 15th July 2014. Calls were duly made but a shareholder holding 500 shares failed to pay both the calls. Pass journal entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being application money received*)		6,900	 6,900

(*Contd.*)

	Share Application A/c Dr. To Share Capital A/c (*Being transfer of application money to share capital A/c*)		6,900	6,900
	Share Allotment A/c Dr. To Share Capital A/c (*Being amount due on allotment*)		8,050	8,050
	Bank A/c Dr. To Share Allotment A/c (*Being amount received on allotment*)		8,050	8,050
	Share First Call A/c Dr. To Share Capital A/c (*Being amount due on first call*)		3,450	3,450
	Bank A/c Dr. To Share First Call A/c (*Being first call amount received*)		2,700	2,700
	Share Final Call A/c Dr. To Share Capital A/c (*Being amount due on final call*)		4,600	4,600
	Bank A/c Dr. To Share Final Call A/c (*Being final call amount received*)		3,600	3,600

Illustration 13

Over subscription, pro-rata and Calls-in-Arrears

Kasturi Ltd. issued 10,000 shares of ₹10 each at a premium of ₹2 per share. The amount was payable as under.

On application ₹2 per share
On allotment ₹5 per share
On first call ₹2 per share
On second call ₹3 per share

The company received applications for 15,000 shares and the allotment was made as under:

Applicants for 1,000 shares Nil
Applicants for 5,000 shares Full
Applicants for 9,000 shares 5,000 shares

All money was duly received, except from Mr. Mohan, who has been allotted 500 shares on pro-rata basis. And he failed to pay the allotment money and both the calls. Pass journal entries and prepare the Balance Sheet of Kasturi Ltd.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being receipt of application money*)		30,000	 30,000
	Share Application A/c Dr. To Bank A/c (*Being refund of application money on 1,000 shares*)		2,000	 2,000
	Share Application A/c Dr. To Share Allotment A/c (*Being transfer of application money to share allotment A/c*)		8,000	 8,000
	Share Application A/c Dr. To Share Capital A/c (*Being transfer of application money to share capital A/c*)		20,000	 20,000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being allotment money due*)		50,000	 30,000 20,000
	Bank A/c Dr. To Share Allotment A/c(w. n.1) (*Being allotment money received*)		40,300	 40,300
	Share First Call A/c Dr. To Share Capital A/c (*Being first call money due*)		20,000	 20,000
	Bank A/c Dr. To Share First Call A/c (*Being first call money received*)		19,000	 19,000
	Share Final Call A/c Dr. To Share Capital A/c (*Being final call money due*)		30,000	 30,000
	Bank A/c Dr. To Share Final A/c (*Being final call money received*)		28,500	 28,500

Balance Sheet of Kasturi Ltd., as on…

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	95,800
Reserves and Surplus	2	20,000
(ii) Non-current Liabilities		—
(iii) Current Liabilities		—
Total: (i) + (ii) + (iii)		1,15,800

(*Contd.*)

II. Assets:		
(i) Non-current Assets		—
(ii) Current Assets		
Cash at Bank		1,15,800
Total: (i) + (ii)		1,15,800

Note No.:

1. Share Capital:		
Issued and Subscribed Capital		
10,000 shares of ₹10 each fully paid	1,00,000	
Subscribed, Called-up and Paid-up Capital		
1000 shares of ₹10 each	1,00,000	
Less: Calls-in-Arrears	4,200	95,800
2. Reserve and Surplus:		
Securities Premium		20,000
		1,15,800

Working Note 1:

		₹	₹
Amount due on allotment			50,000
Less: Application money adjusted towards allotment			8,000
			42,000
Less: Allotment money due from Mohan (500 × 5)		2,500	
Less: Excess application money adjusted			
5,000 shares – 9,000 shares			
500 shares – ?			
500/5000 × 9000 = 900 shares × ₹2	₹1,800		
Less: Application money on shares allotted (500 shares × ₹2)	₹1,000	800	1,700
Allotment money received			40,300

Illustration 14

Over subscription with Calls-in-Advance

AB Ltd. issued 5,000 equity shares of ₹10 each, at a premium of 10%, payable as follows:

₹2 per share on application;
₹4 per share on allotment;
₹3 per share on first call;
₹2 per share on final call;

Applications were received for 6,000 shares and the directors allotted 5,000 shares and refunded the application money for 1,000 shares.

The allotment money was received in full for all the shares. A shareholder, holding 200 shares, paid the final call money along with the first call itself. Pass necessary journal entries in the books of AB Ltd.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being application money received on 6,000 shares*)		12,000	 12,000
	Share Application A/c Dr. To Share Capital A/c To Bank A/c (*Being transfer of application money on 5,000 shares to share capital A/c*)		12,000	 10,000 2000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being amount due on allotment*)		20,000	 15,000 5,000
	Bank A/c Dr. To Share Allotment A/c (*Being allotment money received*)		20,000	 20,000
	Share First Call A/c Dr. To Share Capital A/c (*Being amount due on first call*)		15,000	 15,000
	Bank A/c Dr. To Share First Call A/c To Calls-in-Advance A/c (*Being first call money received and Calls-in-Advance for 200 shares*)		15,400	 15,000 400
	Share Final Call A/c Dr. To Share Capital A/c (*Being amount due on final call*)		10,000	 10,000
	Bank A/c Dr. Calls-in-Advance A/c Dr. To Share Final Call A/c (*Being amount received on final call*)		9,600 400	 10,000

Illustration 15

Interest on Calls-in-Arrears and Calls-in-Advance

On 1st January 2008, Anita Ltd. makes an issue of 20,000 equity shares of ₹10 each, payable as follows:

On application—₹2; on allotment—₹3; on first and final call—₹5 (four months after allotment).

Applications were received for 26,000 shares and the directors made allotment in full to the applicants demanding four or more shares and returned money to the applicants for 6,000 shares. One shareholder, who was allotted 40 shares, paid first and final call with allotment money and another shareholder did not pay a allotment money on his 60 shares, but which he paid with first and final call.

Directors have decided to charge and allow interest as the case may be on Call-in-Arrears and Calls-in-Advance respectively, according to the provisions of Table A. Journalise the above transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To share application A/c (*Being application money received on 26,000 shares*)		52,000	 52,000
	Share Application A/c Dr. To Share Capital A/c To Bank A/c (*Being transfer of application money on 20,000 shares to share capital A/c*)		52,000	 40,000 12,000
	Share Allotment A/c Dr. To Share Capital A/c (*Being amount due on allotment*)		60,000	 60,000
	Bank A/c Dr. To Share Allotment A/c To Calls-in-Advance A/c (*Being allotment money received on 19,940 shares at ₹3 per share and Calls-in-Advance received on 40 shares*)		60,020	 59,820 200
	Share First and Final Call A/c Dr. To Share Capital A/c (*Being first and final call amount due*)		1,00,000	 1,00,000

(*Contd.*)

	Bank A/c Dr. Calls-in-Advance A/c Dr. To Share First and Final Call A/c To Share Allotment A/c (*Being final call money received along with share allotment money for 60 shares*)		99,980 200	 1,00,000 180
	Sundry Shareholders A/c Dr. To Interest on Calls-in-Arrears A/c (*Being interest received from a shareholder from the allotment money paid along with final call after 4 months of allotment*) $180 \times 5\% \times \frac{4}{12}$		3	 3
	Interest on Calls-in-Advance A/c Dr. To Sundry Shareholders A/c (*Being interest paid for Calls-in-Advance for 40 shares*) $200 \times 6\% \times \frac{4}{12}$		4	 4

Issue of Shares at a Premium

When the shares are issued at a price higher than the face value, then it is called "Issue of shares at a premium". The excess of issue price over the face value is the "Premium". For example, if ₹10 shares are issued at ₹14, then the premium shall be ₹4.

Generally, there are no restrictions for a company to issue at a premium but according to SEBI guidelines, only the companies with good track performance can issue shares at a premium. Also, the reasons for the issue of shares at a premium are required to be justified in the prospectus of the company.

The amount of premium is credited to the Securities Premium Account, when a company issues shares at a premium. It is also shown in the liabilities side of the Balance Sheet, under the head "Reserves and Surplus".

According to Section 52 of the Companies Act, 2013, securities premium can be used only for the following purposes:

1. To issue fully paid bonus shares.
2. To provide premium on redemption of preference shares and debentures of the company.
3. To write off preliminary expenses incurred for the formation of the company.
4. To write off expenses/commission/discount on issue of shares or debentures of the company and
5. To purchase its own shares (Buy-back).

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Case I: When premium is receivable with application money		
	(a) Bank A/c Dr.	xxx	
	To Share Application A/c		xxx
	(Being the receipt of application money)	xxx	
	(b) Share Application A/c Dr.		xxx
	To Securities Premium		
	(*Being the transfer of premium on allotment*)		
	Case II: When premium is receivable along with allotment money	xxx	
	(a) Share Allotment A/c Dr.		xxx
	To Share Capital A/c		xxx
	To Securities Premium A/c		
	(*Being the amount due on allotment*)	xxx	
	(b) Bank A/c Dr.		xxx
	To Share Allotment		
	(*Being the receipt of share allotment money*)		

Issue of Shares at a Discount

When a company issues shares at a price lesser than its face value, then it is called as "Issue of shares at a discount". The difference between the face value and the issue price is called as "discount". For example, if the face value of the shares is ₹10 and when the company issues it for ₹9, then the discount is ₹1.

Section 79 of the Companies Act, 1956, states the following conditions for an issue of shares at a discount :

1. The Articles of Association must permit the issue of shares at a discount.
2. The shares to be issued at a discount must be of a class already issued by the company. The issue must be authorised by an ordinary resolution at the general body meeting of the company.
3. The resolution must specify the maximum rate of discount. The company law board generally sanctions discount up to 10 per cent of the face value.
4. Sanction for the issue from the company law board is to be obtained.
5. The issue must be made within two months from the date of sanction of the company law board or within the extended time permitted by it.
6. At least one year must have passed since the date on which the company was allowed to commence business.
7. The prospectus relating to the issue must give particulars of the discount allowed. Every balance sheet after that date must contain particulars of

discount and the amount of discount not yet written off, as on the date of Balance Sheet.

However, Section 53 of the Companies Act, 2013, prohibits the issue of shares at a discount. Only sweat equity can be issued, subject to certain conditions.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Discount on issue of shares is adjusted while recording the allotment money due		
	(a) Share Allotment A/c Dr.	xxx	
	Discount on Issue of Shares A/c Dr.	xxx	
	To Share Capital		xxx
	(*Being amount due on allotment*)		
	(b) Bank A/c Dr.	xxx	
	To Share Allotment A/c		xxx
	(*Being the receipt of allotment money*)		

The discount on issue of shares is a capital loss and is written-off over a number of years. The amount of discount not written-off is shown in the asset side of the Balance Sheet, under the head "Miscellaneous Expenditure".

Forfeiture of Shares

When a shareholder fails to pay the allotment money or call moneys to the company, the company forfeits the shares allotted to them. Forfeiture of shares, thus, mean cancellation of the shares allotted to the shareholder. From then on, he is not considered a shareholder and his name is removed from the Register of Members of the company. The amount paid by the shareholder(s) is forfeited by the company, i.e. the amount will not be refunded to him and it is a gain for the company.

The following are the necessary requirements for forfeiting the shares by the company:

1. A company may forfeit the shares only if it is authorised by the Articles of Association.
2. The company must issue a notice of forfeiture to the shareholder, who has failed to pay the amount.
3. The notice must clearly state that the shares will be forfeited , if he fails to pay the amount within the specified date.
4. The shares are forfeited if the company does not receive payment within the specified date.
5. The Board has to pass a resolution to forfeit the shares.

Accounting Treatment of Forfeiture of Shares

1. When Shares issued at par are forfeited

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Share Capital A/c Dr. (with the amount called-up) To Share Allotment A/c (allotment money not received) To Share Call A/c (call money not received) To Forfeited Shares A/c (amount already received) (*Being forfeiture of shares for non-payment of calls*)	xxx	 xxx xxx xxx

Note: The share capital A/c is debited to cancel the forfeited shares at the time of forfeiture.

Illustration 16

Mr. Guna is a shareholder in Karthick Ltd., holding 1,000 shares of ₹10 each. He has paid ₹2 and ₹4 per share on application and allotment respectively but did not pay ₹3 and ₹1 per share for first and second calls respectively. Directors forfeited the shares. Give journal entry.

Solution:

Journal Entries

date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c (1000 × 10) Dr. To Share First Call A/c (1000 × 3) To Share Final Call A/c (1000 × 1) To Forfeited Shares A/c (*Being forfeiture of 1000 shares of ₹10 each for not paying the two calls.*)		10,000	 3,000 1,000 6,000

2. When shares issued at a premium are forfeited

1. When the company receives the share premium, the premium received cannot be cancelled. Therefore, Securities Premium Account need not be debited at the time of forfeiture. The journal entry will be:

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Share Capital A/c Dr.	xxx	
	(with the amount called up)		
	To Share Allotment A/c		xxx
	(allotment money not received)		
	To Share Call A/c		xxx
	(call money not received)		
	To Forfeited Shares A/c		xxx
	(amount already received)		
	(*Being forfeiture of shares for non-payment of calls*)		

2. When the company does not receive the share premium, the premium not received should be cancelled. Therefore, Securities Premium Account should be debited at the time of forfeiture. The journal entry will be:

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Share Capital A/c Dr.	xxx	
	(with the amount called up)		
	Securities Premium A/c Dr.	xxx	
	(Premium due, but not received)		
	To Share Allotment A/c		xxx
	(allotment money not received)		
	To Share Call A/c		xxx
	(call money not received)		
	To Forfeited Shares A/c		xxx
	(amount already received)		
	(*Being forfeiture of shares for non-payment of calls including share premium*)		

Illustration 17

When shares issued at a premium are forfeited and premium fully collected

Aruna Ltd. issued 300 shares of ₹10 each at a premium of 10%, payable as follows:

₹2 on application; ₹4 on allotment; ₹3 on first call and ₹2 on final call. 2,700 shares were applied for and allotted, all the money was received with the exception of first and final call on 200 shares, held by Yamini. These shares were forfeited. Give the journal entries and also prepare the Balance Sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To share Application A/c (*Being Application money @ ₹2 per share on 27,000 shares received*)		5,400	 5,400
	Share Application A/c Dr. To Share Capital A/c (*Being application money transferred to share capital A/c*)		5,400	 5,400
	Share allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being amount due on allotment ₹3 towards share capital and ₹1 towards premium*)		10,800	 8,100 2,700
	Bank A/c Dr. To Share Capital A/c (*Being allotment money received*)		10,800	 10,800
	Share First Call A/c Dr. To Share Capital A/c (*Being amount due on first call @ ₹3 on 2,700 shares*)		8,100	 8,100
	Bank A/c Dr. To Share First Call A/c (*Being amount received on 2,500 shares @ ₹3*)		7,500	 7,500
	Share Final Call A/c Dr. To Share Capital A/c (*Being amount due on final call*)		5,400	 5,400
	Bank A/c Dr. To Share Final Call A/c (*Being final call money received on 2,500 shares*)		5,000	 5,000
	Share Capital A/c Dr. To Share First Call A/c To Share Final Call A/c To Forfeited Shares A/c (*Being 200 shares forfeited for non-payment of calls*)		2,000	 600 400 1,000

Notes to Accounts :

	(₹)	(₹)
1. Share Capital:		
Issued Capital:		
3,000 shares of ₹10 each		30,000
Subscribed Capital:		
2,700 shares of ₹10 each		27,000
Called and Paid-up Capital:		
2,500 shares of ₹10 each	25,000	
Add: Forfeited Shares	1,000	
		26,000
2. Reserve and Surplus:		
Securities Premium		2,700

Balance Sheet of Aruna Ltd.

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	26,000
Reserves and Surplus	2	2,700
(ii) Non-current Liabilities		—
(iii) Current Liabilities		—
Total: (i) + (ii) + (iii)		28,700
II. Assets:		
(ii) Non-current Assets		—
(iii) Current Assets		
Cash at Bank		28,700
Total: (i) + (ii)		28,700

Note: The balance in the Forfeited Shares Account will be shown as an addition to the paid-up capital in the Balance Sheet's Liabilities side, until it is re-issued.

Illustration 18

When shares are issued at a premium, forfeited and premium not fully collected

A company issued 5,000 equity shares of ₹10 each, at a premium of ₹2 per share, payable ₹3 on application, ₹5 (including premium) on allotment, ₹2 on first call and ₹2 on final call. All the shares offered were applied for allotment, all the money due on allotment were received, except on 200 shares. Calls were made, all the amount due thereon was received, except on 300 shares. Directors forfeited 200 shares, on which both allotment and call moneys were not received.

Pass journal entries to record the above and also show how this will appear in the Balance Sheet of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being application money received in respect of 5000 shares @ ₹3 per share*)		15,000	 15,000
	Share Application A/c Dr. To Share Capital A/c (*Being share application money transferred to share capital A/c*)		15,000	 15,000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being allotment money due*)		25,000	 15,000 10,000
	Bank A/c Dr. To Share Allotment A/c (*Being allotment money received on 4,800 shares @ ₹5 per share*)		24,000	 24,000
	Shares First Call A/c Dr. To Share Capital A/c (*Being first call money due on 5,000 @ shares ₹2 per share*)		10,000	 10,000
	Bank A/c Dr. To Share First Call A/c (*Being call money received on 4,700 shares @ ₹2 per share*)		9,400	 9,400
	Share Final Call A/c Dr. To Share Capital A/c (*Being final call money due on 5,000 shares @ ₹2 per share*)		10,000	 10,000
	Bank A/c Dr. To Share Final Call A/c (*Being final call money received on 4,700 shares @ ₹2 per share*)		9,400	 9,400

(*Contd.*)

	Share Capital A/c Dr. Securities Premium A/c Dr. To Share Allotment A/c To Share First Call A/c To Share Final Call A/c To Share Forfeiture A/c (*Being 200 shares forfeited for non-payment of allotment and call money*)		2,400 400	 1,000 400 400 600

Notes to Accounts:

1. Share Capital:		
Issued Capital		
5,000 shares of ₹10 each		50,000
Subscribed and Paid-up Capital		
4,800 shares of ₹10 each	48,000	
Less: Calls-in-Arrears	400	
	47,600	
Add: Forfeiture Shares A/c	600	
		48,200
2. Reserves and Surplus:		
Securities Premium (10,000 – 400)		9,600

Balance Sheet of …, as on…

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	48,200
Reserves and Surplus	2	9,600
(ii) Non-current Liabilities		—
(iii) Current Liabilities		—
Total: (i) + (ii) + (iii)		57,800
II. Assets:		
(i) Non-current Assets		—
(ii) Current Assets		
Cash at Bank		57,800
Total: (i) + (ii)		57,800

3. When shares issued at a discount are forfeited

The discount on issue of shares A/c is debited when the journal entry for the allotment money due is passed. If the shares issued at discount are forfeited, the discount on these shares is to be cancelled by crediting the discount on issue of shares A/c.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Share Capital A/c Dr.	xxx	
	(with the amount called up)		
	To Share Allotment A/c		xxx
	(allotment money not received)		
	To Discount on Issue of Shares A/c		xxx
	(cancellation of discount)		
	To Share Call A/c		xxx
	(call money not received)		
	To Forfeited Shares A/c		xxx
	(amount already received)		
	(*Being forfeiture of shares for non-payment of calls and cancellation of discount allowed*)		

Illustration 19

Madhu Ltd. invited applications for 3,000 shares of ₹10 each, at a discount of 10%, payable as follows:

On application	₹25
On allotment	₹30
On first and final call	₹35

The whole of the issue was subscribed and paid for, except the final call on 400 shares, which were forfeited by the company, after giving due notice. Pass journal entries for forfeiture.

Solution:

Journal Entry

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c Dr.		40,000	
	To Share First and Final Call A/c			14,000
	To Discount on Issue of Shares A/c			4,000
	To Shares Forfeited A/c			22,000
	(*Being forfeiture of 400 shares issued at a discount of 10%*)			

Note: Discount on the issue of shares has to be cancelled. Discount on issue of Shares A/c is credited by ₹4,000 on forfeiture of 400 shares, as this account was debited with a corresponding amount when the allotment entry was passed thereof.

Illustration 20

Sumathi Ltd. issued 5,000 shares of ₹10 each, at a premium of ₹3 per share. The amount was payable as under

On application	₹2 per share
On allotment	₹5 per share (including premium)
On first call	₹3 per share
On second call	₹3 per share

The company received application for 7,000 shares and the allotment was made as under

Application for 1,000 shares	nil
Application for 2,000 shares	full
Application for 4,000 shares	3,000 shares

All moneys were duly received, except from a shareholder holding 300 shares to whom pro-rata allotment was made. He failed to pay the allotment money and both the calls. The directors forfeited the shares. Pass necessary journal entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being the receipt of application money*)		14,000	 14,000
	Share Application A/c Dr. To Share Capital A/c (5000 × 2) To Bank A/c (1000 × 2) To Share Allotment A/c (excess) (*Being transfer of application money to share capital A/c and refund of application money*)		14,000	 10,000 2,000 2,000
	Share Allotment A/c (₹5 × 5000) To Share Capital A/c (₹2 × 5000) To Securities Premium A/c (₹3 × 5000) (*Being allotment money due*)		25,000	 10,000 15,000
	Bank A/c Dr. To Share Allotment A/c (*Being the receipt of allotment money*)		21,740	 21,740
	Share First Call A/c (₹3 × 5000) Dr. To Share Capital A/c (*Being amount due on share first call*)		15,000	 15,000
	Bank A/c (4700 × 3) Dr. To Share First Call A/c (*Being receipt of first call money on 4,700 shares*)		14,100	 14,100
	Share Final Call A/c (3 × 5000) Dr. To Share Capital A/c (*Being amount due on final call*)		15,000	 15,000

(*Contd.*)

	Bank A/c Dr. To Share Final Call A/c (*Being the receipt of final call money on 4,700 shares*)		14,100	 14,100
	Share Capital A/c (300 × 10) Dr. Securities Premium A/c (300 × 3) Dr. To Share Final Call A/c (300 × 3) To Share First Call A/c (300 × 3) To Share Allotment A/c (working note) To Shares Forfeited A/c (*Being 300 shares forfeited for non-payment of allotment and call money*)		3,000 900	 900 900 1,260 840

Working Note:

Allotment money due	=	₹25,000
(–) Already received in application	=	₹2, 000
		₹23,000
(–) Amount not received on 300 shares		1,260*
Allotment money received		₹21,740

Calculation for allotment money adjustments:

Step 1:

Amount due on 300 shares for allotment
(pro-rata allotment)
5,000 shares allotted – 7,000 applied
300 shares allotted – ?

$300/5,000 \times 7,000 = 420$ shares applied

Step 2:

Application money received on 420 shares (420 × ₹2)	=	₹840
Less: Adjusted for application money (300 shares × ₹2)	=	₹600
Excess application money adjusted towards allotment	=	₹240

Step 3:

Amount due on allotment for 300 shares (300 × ₹5)	=	₹1,500
Less: Excess application money as calculated in Step 2	=	₹ 240
Amount not received on 300 shares	=	₹1,260*

Re-issue of Shares

Forfeited Shares may either be cancelled or re-issued. Such forfeited shares can be re-issued to any person within a reasonable time at a reasonable price. They can be re-issued at par, at premium or at discount. The re-issue price, together with the amount already received on such shares, should not be less than the called-up amount on each share. Hence, it means that if the forfeited shares are re-issued at a discount, the amount of discount should not exceed the amount already paid by the defaulter. That is, the maximum amount of discount on re-issue should not be more than the original discount plus the amount paid by the defaulter.

If a company makes any loss on re-issue of shares, such loss is adjusted by debiting the forfeited shares A/c. The balance remaining in the shares forfeited A/c is a Capital Profit and it should be transferred to capital reserve A/c. However, it is to be noted that the amount forfeited in respect of those shares, which are not yet re-issued, must be kept in the shares forfeited A/c itself.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
	(a) When shares are issued at par forfeited and re-issued			
	Bank A/c	Dr.	xxx	
	Forfeited Shares A/c	Dr.	xxx	
	(Discount on Re-issue)			
	To Share Capital A/c			xxx
	(*Being re-issue of Shares Forfeited Account at discount*)			
	(b) When shares are issued at premium, forfeited and re-issued			
	1. If premium on original issue was collected originally			
	Bank A/c	Dr.	xxx	
	Forfeited Shares A/c	Dr.	xxx	
	(Any discount)			
	To Share Capital A/c			xxx
	(*Being re-issue of Shares Forfeited Account at discount*)			
	2. If premium on original issue was not collected and original premium is restored			
	Bank A/c	Dr.		
	Forfeited Shares A/c	Dr.	xxx	
	(Any discount on re-issue and original premium not collected)		xxx	
	To Share Capital			
	To Securities Premium			xxx
	(*Being re-issue of forfeited shares originally issued at premium and premium being reinstated*)			xxx
	3. If premium on original issue was not collected and original premium is not restored			
	Bank A/c	Dr.		
	Forfeited shares A/c	Dr.	xxx	
	(Any discount)		xxx	
	To Share Capital A/c			
	(*Being re-issue of shares forfeited*)			xxx

(*Contd.*)

	(c) For re-issue of forfeited shares originally issued at discount Bank A/c Dr. Discount on issue of share A/c Dr. (Discount originally allowed) Forfeited Shares A/c Dr. (Discount on Re-issue) To Share Capital A/c (*Being re-issue of forfeited shares originally issued at discount*)	 xxx xxx xxx	 xxx
	(d) For profit on re-issue of forfeited shares Forfeited Shares A/c Dr. To Capital Reserve A/c (*Being transfer of profit on re-issue of forfeited shares*)	 xxx	 xxx

Illustration 21

When shares are issued at par, forfeited and re-issued

Mr. Raghu was holding 4,000 shares of ₹10 each of Jayanthi Ltd. The shares were issued at par and he had paid ₹3 on application and ₹4 on allotment. He did not pay the call money of ₹3 per share. The directors forfeited the shares and then, re-issued by the company to Madan at ₹8 per share. Pass journal entries with narration to record the forfeiture and re-issue of shares.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c Dr. To Share Final Call A/c To Shares Forfeited A/c (*Being the forfeiture of 4,000 shares for non-payment of final call at ₹3*)		40,000	 12,000 28,000
	Bank A/c Dr. Shares Forfeited A/c Dr. (Discount on re-issue) To Shares Capital A/c (*Being the re-issue of forfeited shares at ₹8 per share*)		32,000 8,000	 40,000
	Shares Forfeited A/c Dr. To Capital Reserve A/c (*Being the transfer of shares forfeited A/c to capital reserve A/c*)		20,000	 20,000

Illustration 22

When shares are issued at premium, forfeited and all the forfeited shares are not re-issued

Gomathi Ltd. issued 25,000 shares of ₹10 each, at a premium of ₹2 per share. The share were payable as follows:

₹3 on application
₹5 on allotment (including premium)
₹4 on first and final call

All the shares were applied for and allotted. All money were received with the exception of first and final call on 2,000 shares, which were forfeited. Of these, 800 were re-issued as fully paid at ₹8 per share.

Give the necessary journal entries, prepare the Bank A/c and the Balance Sheet of the company.

Solution:

Journal Entries

Date	Particulars	L.F	Debit (₹)	Credit (₹)
	Bank A/c Dr.		75,000	
	To Share Capital A/c			75,000
	(*Being the receipt of share application money on 25,000 shares @ ₹3 each*)			
	Share Application A/c Dr.		75,000	
	To Share Capital A/c			75,000
	(*Being share application money transferred to share capital A/c*)			
	Share Allotment A/c Dr.		1,25,000	
	To Share Capital A/c			75,000
	To Securities Premium A/c			50,000
	(*Being allotment money due on 25,000 shares, including premium*)			
	Bank A/c Dr.		1,25,000	
	To Share Allotment A/c			1,25,000
	(*Being the receipt of share allotment money*)			
	Share First and Final Call A/c Dr.		1,00,000	
	To Share Capital A/c			1,00,000
	(*Being the amount due on share first and final call*)			
	Bank A/c Dr.		92,000	
	To Share First and Final Call A/c			92,000
	(*Being the receipt of first and final call amount on 23,000 shares*)			

(*Contd.*)

	Share Capital A/c Dr. To Share First and Final Call A/c To Shares Forfeited A/c (*Being 2,000 shares forfeited @ ₹10 each per share for non-payment of first and final call*)		20,000	 8,000 12,000
	Bank A/c Dr. Shares Forfeited A/c Dr. To Shares Capital A/c (*Being re-issue of 800 shares @ ₹8 per share as fully paid*)		6,400 1,600	 8,000
	Shares Forfeited A/c Dr. To Capital Reserve A/c (*Being proportional amount from shares forfeited A/c is transferred to capital reserve A/c*)		3,200	 3,200

Working Notes:

Calculation of amount transferred to Capital Reserve	(₹)	(₹)
Amount credited to shares forfeiture A/c with respect to 2,000 shares forfeited.		12,000
Proportionate amount for 800 shares re-issued ₹10,000/2,000 × 800	4,800	4,800
Less: Discount on re-issue of shares	1,600	
Transferred to Capital Reserve	3,200	
Amount relating to 1,200 shares not received to be shown in Balance Sheet		7,200

Bank A/c

Particulars	(₹)	Particulars	(₹)
To Share Application A/c	75,000	By Balance c/d	2,98,400
To Share Allotment A/c	1,25,000		
To Share First and Final Call A/c	92,000		
To Share Capital A/c	6,400		
	2,98,400		2,98,400

Notes to Accounts:

1. Share Capital:	
Subscribed and Paid-up Capital	
23,800 shares of ₹10 each	2,38,000
Add: Shares Forfeited A/c	7,200
	2, 45,200
2. Reserve Surplus:	
Securities Premium	50,000
Capital Reserve	3,200
	2,98,400

Balance Sheet of Gomati Ltd. as on…

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	2,45,200
Reserves and Surplus	2	53,200
(ii) Non-current Liabilities		—
(iii) Current Liabilities		—
Total: (i) + (ii) + (iii)		2,98,400
II. Assets:		
(i) Non-current Assets		—
(ii) Current Assets		
Cash at Bank		2,98,400
Total: (i) + (ii)		2,98,400

Illustration 23

When shares are issued at premium, forfeited and re-issued (premium not received)

Ambika Ltd. issued a prospectus, inviting applications for 20,000 shares of ₹10 each, at a premium of ₹3 per share, payable as follows:

On application ₹3 per share
On allotment ₹5 per share (Including premium)
On first call ₹3 per share
On final call ₹2 per share

Applications were received for 30,000 shares and allotment was made on pro-rata to the applicants of 24,000 shares, the remaining applications being refused. Money received in excess on the application was adjusted towards the amount due on allotment.

Devi, to whom 4,000 shares were allotted, failed to pay allotment money and on her failure to pay the first call, her shares were forfeited. Mani, the holder of 600 shares, failed to pay the two calls and so his shares were also forfeited, all these shares were sold to Rahim, credited as fully paid for ₹8 per share. Pass journal entries to record the above issue of shares by the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being the receipt of application money @ ₹3 on 30,000 shares*)		90,000	 90,000

(*Contd.*)

	Share Application A/c Dr. To Share Capital A/c (*Being the transfer of share application money on 20,000 shares to Share Capital*)		60,000	 60,000
	Share Application A/c Dr. To Share Allotment A/c To Bank A/c (*Being the transfer of share application money on 4000 shares @ ₹3 to share allotment A/c and the refund of money to applicants of 6,000 shares to whom shares were not allotted*)		30,000	 12,000 18,000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being the share allotment money due*)		1,00,000	 40,000 60,000
	Bank A/c (W.N.1) Dr. To Share Allotment A/c (*Being the receipt of share allotment money due*)		86,240	 86,240
	Share First Call A/c Dr. To Share Capital A/c (*Being first call money due*) Bank A/c Dr. To Share First Call A/c (*Being the receipt of first call money on 19,000 shares @ ₹3 per share*}		60,000 57,000	 60,000 57,000
	Share Capital A/c Dr. Securities Premium A/c Dr. To Share Allotment A/c To Share First Call A/c To Forfeited Shares A/c (*Being forfeiture of 400 shares held by Devi for non-payment of allotment money and the first call. Share capital debited by ₹8 per share called-up and share premium debited @ ₹3 per share*)		3,200 1,200	 1,760 1,200 1,440
	Share Final Call A/c Dr. To Share Capital A/c (*Being final call @ ₹2 per share due on 19,600 shares*)		39,200	 39,200
	Bank A/c Dr. To Share Final Call A/c (*Being the receipt of share final call on 19,000 shares*)		38,000	 38,000

(*Contd.*)

	Share Capital A/c Dr. To Share First Call A/c To Share Final Call A/c To Shares Forfeited A/c (*Being the forfeiture of 600 shares held by Mani for non-payment of both the calls*)		6,000	 1,800 1,200 3,000
	Bank A/c Dr. Forfeited Shares A/c Dr. (Discount on Re-issue) To Share Capital A/c (*Being re-issue of 1000 shares to Rahim at a discount of ₹2 per share*)		8,000 2,000	 10,000
	Forfeited Shares A/c Dr. To Capital Reserve A/c (*Being transfer of balance amount in shares forfeited A/c to capital reserve A/c*)		2,440	 2,440

Working Notes:

1. Calculation of amount received on allotment		**(₹)**
Amount due on allotment		1,00,000
Less: Surplus money on application adjusted to share allotment		12,000
		88,000
Less: Amount not received on 400 shares allotted to Devi		
If allotted 20,000 shares, then applied 24,000 shares		
If alloted 400 shares, then applied ?		
400/20,000 × 24,000 = 480 shares		
Therefore, surplus money on application = 80 × ₹3 = ₹240		
Amount due on allotment = 400 shares × 5 = ₹2,000		
Less: Surplus on application	240	1,760
Cash received on allotment		86,240
2. Calculation of amount transferred to Capital Reserve:		
Total forfeited money on 1,000 shares		
For 400 shares from Devi		1,440
For 600 shares from Mani		3,000
		4,440
Less: Discount allowed on		
re-issue of forfeited shares (1,000 × 2)		2,000
Amount transferred to Capital Reserve		2,440

Illustration 24

When shares are issued at discount, forfeited and re-issued

Anu Ltd. invited application for 12,000 shares of ₹100 each, at a discount of 5%, payable as follows:

On application	₹25
On allotment	₹35
On first and final call	₹35

Applications were received for 10,000 shares and all of these were accepted. All money due were received, except the first and final call on 100 shares, which were forfeited. Of the shares forfeited, 50 shares were re-issued at the rate of ₹90 as fully paid. Pass journal entries in the books of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being application money received on 10,000 shares @ ₹25 per share*)		2,50,000	 2,50,000
	Share Application A/c Dr. To Share Capital A/c (*Being share application money transferred to share capital A/c*)		2,50,000	 2,50,000
	Share Allotment A/c Dr. Discount on Issue of Shares A/c Dr. To Share Capital A/c (*Being allotment money due on 10,000 shares*)		3,50,000 50,000	 4,00,000
	Bank A/c Dr. To Share Allotment A/c (*Being allotment money received*)		3,50,000	 3,50,000
	Share First & Final call A/c Dr. To Share Capital A/c (*Being share first and final call money due*)		3,50,000	 3,50,000
	Bank A/c Dr. To Share First and Final Call A/c (*Being first and final call money received on 9,900 shares @₹35 per share)*		3,46,500	 3,46,500

(*Contd.*)

	Share Capital A/c Dr. To Share First and Final Call A/c To Discount on Issue of Shares A/c To Forfeited Shares A/c (*Being 100 shares forfeited for non-payment of first and final call money due issued previously at 5% discount*)		10,000	 3500 500 6,000
	Bank A/c Dr. Discount on Issue of Shares A/c Dr. Forfeited Shares A/c Dr. To Share Capital A/c (*Being re-issue of 50 shares forfeited at ₹90 each*)		9,000 500 500	 10,000
	Forfeited Shares A/c Dr. To Capital Reserve A/c (*Being proportional amount from share forfeited A/c transferred to capital reserve A/c*)		2,500	 2,500

Note: When shares originally issued at discount are forfeited, the discount is cancelled. When they are re-issued, the original discount on them is restored.

Working Notes:
Calculation of amount of shares forfeited transferred to capital reserve A/c

Amount credited to shares forfeited A/c in respect of 100 shares forfeited		6,000
Proportionate amount for 50 shares re-issued		
$\frac{6,000}{100}$ shares × 50 shares =	3,000	3,000
Less: Discount on re-issued shares =	500	
	2,500	
Amount relating to 50 shares not received to be shown in Balance Sheet =		3,000

❍ Issue of Shares Without Consideration: Issue of Bonus Shares

Bonus issue is the issue of shares to the existing shareholders without any consideration. In other words, they are issued free of cost. Further, the shares that are issued by the company to the existing equity shareholders in settlement of the bonus declared are called Bonus Shares. The Bonus Shares issued, however, become a part of the issued share capital and this process is called as Capitalisation of Profits or Reserves.

The issue of bonus shares becomes essential in the following circumstances:

- When the company wants to capitalise the large capital or revenue profits that it possesses;

- When the company does not have sufficient cash available to pay the cash bonus;
- When the company wants to exhibit its exact earning capacity as a relationship between its capital structure and the true earning capacity to both shareholders and the outsiders;
- When the values of fixed assets are more than the amount of capital;
- When the market value of shares exceeds the paid-up value of shares of the company;
- When it becomes difficult for the company to declare high rate of dividend every year out of the accumulated reserves, the bonus issue is made to facilitate the payment of regular dividend year after year, in proportion to the profits earned by the company.

Conditions for the Issue of Bonus Shares

According to the Companies Act, a company is permitted to issue bonus shares only if the following conditions are fulfilled:

1. A company should be authorised by the Articles of Association to make an issue of bonus shares.
2. The proposal of the Board of Directors relating to the issue of bonus shares should be approved by the members in the General Body Meeting;
3. The company should have sufficient profits and reserves to make the issue of bonus shares. Bonus shares can be issued only out of the following:
    - Current-year profits and the carried-forward profits of the earlier years;
    - General Reserve;
    - Other accumulated reserves created out of profits such as Dividend Equalisation Fund, Insurance fund, etc.;
    - Out of the balance available in the Debenture Redemption Fund, after the redemption of debentures;
    - Capital Profits consisting of Profits Prior to incorporation, Profit on Acquisition of Business, Profits on Sale of Fixed Assets, Premium on Issue of Debentures, etc.
4. The company should fulfil the **SEBI guidelines**, as stated below, to make an issue of bonus shares:
    - The bonus issue must be made only out of free reserves and not out of reserves created by revaluation of fixed assets, etc.;
    - The bonus issue cannot be made in lieu of dividend;
    - Bonus issue can be made only fully paid-up shares;
    - The proposal of bonus issue should be implemented within six months from the date of approval of Board of Directors;
    - No bonus issue should overpower the rights of the debentureholders;
    - Reserves created by revaluation of fixed assets are not available for bonus issue;

- If the Articles of Association of a company is silent about the issue of bonus shares, then the company must pass a resolution at its General Body Meeting, giving effects for capitalisation;
- If the subscribed and paid-up capital exceeds the authorised capital of the company because of the issue of bonus shares, then also a resolution has to be passed in the General Body Meeting to increase the authorised capital;
- To calculate the minimum residual reserves, all contingent liabilities are to be disclosed in the audited accounts, which have a bearing on the net profits;
- The residual reserves should be at least 40 per cent of the increased paid-up capital after the proposed capitalisation;
- 30 per cent of the average profits before tax of the company for the previous three years should yield a rate of dividend on the expanded capital base of the company at 10 per cent;
- The company that issues bonus shares should not have made any default in the payment of interest or principal in respect of fixed deposits, and should not have any debenture or statutory dues with respect to contribution to PF, Gratuity, etc.
- The issue of bonus shares can be made only after giving similar benefit to the holders of convertible FCDs/PCDs.

Note: Since no information is given in SEBI guidelines with regard to the ratio of bonus share, the company can issue bonus shares in any ratio but the criteria of residual reserves and profitability test must be complied with.

Accounting Treatment of Bonus Shares

The journal entries for the issue of bonus shares are passed as follows:

(1) When the payment of bonus is made by the issue of free fully-paid bonus share:

(a) Profit & Loss A/c	Dr.	xxx	
Or			
General Reserve A/c	Dr.	xxx	
Or			
Capital Redemption Reserve A/c	Dr.	xxx	
Or			
Securities Premium A/c	Dr.	xxx	
Or			
Capital Reserve A/c	Dr.	xxx	
Or			
Any other Reserve A/c	Dr.	xxx	
To Bonus to Shareholders			xxx

(*Being the amount transferred for issue of shares based on the available balance in the above accounts*)

(b) Bonus to Shareholders A/c	Dr.	xxx	
To Share Capital A/c			xxx
To Securities Premium A/c			xxx
(if bonus shares are issued at premium)			
(*Being the issue of shares*)			

Illustration 25

Following are the extracts from the Balance Sheet of Chitra Ltd., as on 31st March 2009.

Authorised Capital	5, 00,000 equity shares of ₹10 each ₹50, 00,000.
Issued and Subscribed Capital	1, 50,000 equity shares of ₹10 each fully paid-up ₹15, 00,000.
Reserve Fund	₹3, 00,000
Profit & Loss A/c	₹3,50,000

A resolution was passed declaring the issue of bonus of 25% on equity shares to be provided as to ₹2,00,000 from the Profit & Loss A/c and the balance from Reserve Fund. The bonus issue is to be satisfied by issue of fully-paid equity shares.

Pass journal entries to give effect to the resolution and show how they would affect the Balance Sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31.03.2009	Profit & Loss A/c Dr. Reserve Fund A/c Dr. To Bonus to Shareholders A/c (*Being 30% on Equity Share Capital declared as bonus by utilising Profit & Loss A/c and reserve fund balance as per board's resolution, dated.........*)		2,00,000 1,75,000	 3,75,000
	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (*Being issue of 37,500 bonus shares of ₹10 each fully paid-up to be distributed in the ratio of 1 bonus share for every 4 shares held*)		3,75,000	 3,75,000

Balance Sheet (Extract), as on … (after bonus issue)

Liabilities	(₹)
Authorised Capital 5,00,000 equity shares of ₹10 each	50,00,000
Issued and Subscribed Capital 1,87,500 equity shares of ₹10 each fully paid-up (of the above shares, 37,500 shares are alloted as fully paid-up by way of bonus shares out of Profit & Loss A/c & Reserve Fund)	18,75,000
Reserve and Surplus:	
Reserve Fund	1,25,000
Profit & Loss A/c	1,50,000

Illustration 26

Sai Ltd. has an authorised capital of ₹10,00,000, divided into 10,000 equity shares of ₹100 each. Its subscribed capital is ₹7,20,000 being 9,000 shares of ₹10 each, ₹80 per share paid up out of the General Reserve, it decided to:

(a) Declare a divided of ₹20 per share;

(b) Utilise such dividend for making partly paid-up shares as fully paid-up ; and

(c) Issue 3,000 bonus shares fully paid-up in the ratio of 1 bonus share to 3 existing shares.

Pass the journal entries with proper narrations in the book of the company.

Solution:

Journal Entries

Date	Particulars	L.F	Debit (₹)	Credit (₹)
1.	General Reserve A/c Dr. To Dividend A/c (*Being a dividend of ₹20 per share declared on 9,000 shares out of General Reserve*)		1,80,000	 1,80,000
2.	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (*Being the final call on 9,000 shares @ ₹20 each was made*)		1,80,000	 1,80,000
3.	Dividend A/c Dr. To Equity Share Final Call A/c (*Being dividend due to shareholder adjusted against the final call money due from them*)		1,80,000	 1,80,000

(*Contd.*)

4.	General Reserve A/c Dr. To Bonus to Shareholders A/c (*Being bonus shares of ₹3,00,000 declared out of General Reserve*)		3,00,000	3,00,000
5.	Bonus to Shareholders A/c To Equity Share Capital A/c (*Being bonus to shareholders satisfied by the issue of 3,000 equity shares of ₹100 each fully paid*)		3,00,000	3,00,000

❍ Other Methods of Issue of Shares

Rights Issue

Rights issue is the issue of shares only to the existing shareholders. The right to apply for shares is given only to the existing shareholders. Hence, it is called as rights issue. Generally, rights shares are issued at a price, which is lesser than the market price.

Procedure for Rights Issue of Shares

Whenever the directors decide to issue rights shares, they have to send a 'Letter of Offer' to the exiting equity shareholders. The Letter of Offer should specify the number of shares offered. It should also specify the time within which the shareholder may accept the offer or reject the offer. The shareholders should be given a time of not less than 15 days from the date of the offer for acceptance or rejection of the offer.

On receipt of Letter of Offer, the shareholders have to intimate the directors of their acceptance of rights or 'nominees' to whom they want to 'renounce their rights'. If the rights shares are not fully taken up, the directors may dispose the shares left over in such a manner as that is most beneficial to the company.

According to Section 81(1A), instead of offering new shares to the existing equity shareholders, the directors can issue the new shares to outsiders. This may happen if:

- a special resolution is passed by the company to that effect, (or)
- an ordinary resolution is passed to the effect that such an offer to the outsiders is most beneficial to the company and the approval of the central government is obtained.

Calculation of Value of Rights

As indicated earlier, an existing equity shareholder, who is entitled to the rights issue made by a company, has the right to renounce or dispose of his right to receive the new share to somebody else for some value. The value, which a shareholder gets for the sale of his 'right to receive new shares' to others, is known as the Value of Rights. The value of rights should be determined on the basis of market value of shares. In order to determine the value of the rights, the following steps may be taken:

1. The market value of shares held by the existing shareholders should be ascertained. For example, if a company makes a rights issue of one share for every three equity shares held by a shareholder, then, each shareholder is required to hold three shares to be entitled to receive one new share and so, the market value of the three shares required to be held by the shareholder should be ascertained.
2. The price of the new shares to be paid to the company should be added to the market value of shares held by the existing equity shareholders to find the total price of all the shares.
3. The average price of the share has to be found out by dividing the total price of all the shares by the total number of shares.
4. Finally, the average price of the share has to be subtracted from the market price of the share. The excess of the market price over the average price of the share is the 'Value of the Right '.

Alternatively, Value of the Right can be ascertained by applying the following formula:

$$Value\ of\ Right = \frac{Market\ price - Issue\ price}{No.\ of\ old\ shares\ entitled\ for\ one\ rights\ share + 1}$$

(or)

$$Value\ of\ Right = \frac{No.\ of\ new\ shares\ offered}{Total\ no.\ of\ shares} \times \begin{matrix} Market\ price \\ of\ the\ share \end{matrix} - \begin{matrix} Issue\ price\ of \\ new\ share \end{matrix}$$

Illustration 27

Arita Ltd. has a share capital of 50,000 equity shares of ₹100 each. Market value is ₹300 per share. The company decides to make a right issue to the existing shareholders in the proportion of one new share for every five shares held by the shareholders. The company has decided to give one share of ₹100 each, at a premium of ₹20 each. Calculate the value of right.

Solution:

	(₹)
Computation of Value of Right	
Market value of 5 shares required to be held by a shareholder (5 × ₹300)	1,500
Add: Issue price of rights issue (1 × 120)	120
	1,620

Average price of one share = ₹1,620/6 = ₹270

Therefore, Value of Right = Market value of the share – Average price of the share

= ₹300 – ₹270 = ₹30

(or)

$$Value\ of\ Right = \frac{Market\ price - Issue\ price}{No.\ of\ shares\ entitled\ for\ one\ right\ share + 1}$$

$$= \frac{300 - 120}{5 + 1} = \frac{180}{6} = ₹30$$

$$Value\ of\ Right = \frac{No.\ of\ new\ shares\ offered}{Total\ no.\ of\ shares} \times \begin{matrix} Market\ price \\ of\ the\ shares \end{matrix} - \begin{matrix} Issue\ price\ of \\ new\ share \end{matrix}$$

$$1/6 \times (300 - 120)$$
$$= 1/6 \times 180 = ₹30$$

Employees' Stock Option Scheme

Employees' Stock Option means the option given to the full-time directors, officers and employees of a company, which gives such directors, officers or the employees the benefit or the right to purchase or to subscribe, at a future date, to the securities offered by the company at a predetermined price. This scheme is offered to them in order to encourage the employees of the company to have more participation. The scheme is purely voluntary and the employees are not compelled to avail the facility. The company may reserve a certain percentage of shares to make an issue of shares for the employees. The shares allotted under this scheme may not be transferable for a few years.

No journal entries are required when option is received from the employees. Whenever shares are allotted under this scheme, usual journal entries are to be passed for the issue of shares.

Illustration 28

A company issued for public subscription 60,000 shares of ₹10 each, payable: on application—₹3, on allotment—₹4, on call—₹3.

Applications were received for 80,000 shares. Applicants for 60,000 shares paid the application money in cash while the rest paid the money through stock-invests. The shares were allotted on pro-rata basis. All allottees paid the allotment and call money on due dates.

Pass journal entries in the books of the company assuming that the surplus application money was refunded.

Solution:

Journal Entries

Date	Particulars	L.F	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being application money received in cash on 60,000 shares @ ₹3 per share*)		1,80,000	1,80,000

(*Contd.*)

	Share Application A/c Dr. To Share Capital A/c (45,000 × 3) To Bank A/c (15,000 × 3) (*Being application money for shares transferred to share capital and balance amount refunded*)		1,80,000	 1,35,000 45,000
	Bank A/c (15,000 × 3) Dr. To Share Capital A/c (*Being application money received on 15,000 shares from applicants who applied through stock invests*)		45,000	 45,000
	Share Allotment A/c Dr. To Share Capital A/c (*Being allotment money due on shares @ ₹4 each*)		2,40,000	 2,40,000
	Bank A/c Dr. To Share Allotment A/c (*Being allotment money received*)		2,40,000	 2,40,000
	Share First and Final Call A/c Dr. To Share Capital A/c (*Being call money due on shares @ ₹3 each*)		1,80,000	 1,80,000
	Bank A/c Dr. To Share First and Final Call A/c (*Being call money received*)		1,80,000	 1,80,000

Note: Stock invests are encashed by the company only to the extent of shares allotted to the beneficiaries in the scheme. So, the question of recording refund does not arise on them, though unused stock invests are physically returned to the applicants.

Working Note:

Computation of number of shares allotted to applicants, who applied through stock-invest:

Total no. of applications received = 80,000
No. of shares allotted = 60,000
Ratio of pro-rata allotment = 80,000:60,000
= 4:3

No. of applications received (applied through cash) = 60,000
No. of applications received through stock invest = 20,000
No. of shares allotted to applicants, who applied through cash:

$$60{,}000 \times \frac{3}{4} = 45{,}000 \text{ shares}$$

No of shares allotted to applicants, who applied through stock invest:

$$20{,}000 \times \frac{3}{4} = 15{,}000 \text{ shares}$$

Sweat Equity Shares

Section 79A of the Companies (Amendment) Act, 1999, introduced a new type of equity shares, called Sweat Equity Shares. These equity shares are issued to its employees or directors at a discount or for consideration other than cash, either for providing know-how or making available an intellectual property.

Private Placement

Private placement refers to the issue and allotment of shares to a select group of persons (say friends, relatives and business associates) It is not a public issue. Companies prefer private placement when the required amount can be raised from a few persons. Moreover, it is a convenient method of issue of shares.

Buy-back of Shares

The Companies (Amendment) Act, 1999, has introduced Sections 77A and 77B in the Companies Act, 1956, permitting companies to buy back their shares from the open market for cancellation. The buy-back of shares results in capital reduction.

Buy-back of shares means repurchase of its own shares or other specified securities by a company out of:

- its free reserves; or
- the Securities Premium Account; or
- the proceeds of any shares or other specified securities.

No buy-back of any kind of share or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or the same kind of other specified securities.

The buy-back of shares may be done at par or premium or discount. The face value of shares bought is to be subtracted from the Equity Capital, if it is purchased at par. If it is purchased at premium, the excess amount paid on it is debited to Reserves or Surplus. If it is purchased at a discount, the gain on purchase will be transferred to Capital Reserve. The following are the important reasons for a company to resort to buy-back of its shares:

1. Buy-back may improve the value of the company when the prevailing market rate of its shares is much lesser than its true value.
2. The number of outstanding shares get reduced due to buy-back and this shall improve the earnings per share.
3. A company can prevent “hostile takeover bids” through buy-back of shares.
4. A company can restructure its capital by utilising cash surplus due to buy-back of shares. Further, a company need not pay corporate dividend tax on buy-back.

COMPREHENSIVE PROBLEMS

Forfeiture and re-issue of shares without pro-rata allotment

Illustration 29

A Ltd. issued 10,000 equity shares of ₹10 each, payable as under:

₹2 on application
₹5 on allotment
₹3 on first and final call

The public applied for 8,000 shares, which are allotted. All the money due on shares was received except the first and final call on 100 shares. These shares were forfeited and re-issued at ₹8 per share. Show the journal entries in the books of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being share application money received on 8,000 shares*)		16,000	 16,000
	Share Application A/c Dr. To Share Capital A/c (*Being share application money transferred to share capital A/c*)		16,000	 16,000
	Share Allotment A/c Dr. To Share Capital A/c (*Being allotment money due*)		40,000	 40,000
	Bank A/c Dr. To Share Allotment A/c (*Being allotment money received*)		40,000	 40,000
	Share First and Final Call A/c Dr. To Share Capital A/c (*Being share first and final call money due on 8,000 shares*)		24,000	 24,000
	Bank A/c Dr. To Share First and Final Call A/c (*Being first and final call money received on 7,900 shares*)		23,700	 23,700
	Share Capital A/c Dr. To Share First and Final Call A/c To Forfeited Shares A/c (*Being 100 shares forfeited for non-payment of first and final call*)		1,000	 300 700

(*Contd.*)

	Bank A/c Dr. Forfeited Shares A/c Dr. (Discount on re-issue) To Share Capital A/c (*Being 100 shares are re-issued at ₹8 per share*)		800 200	 1,000
	Forfeited Shares A/c Dr. To Capital Reserve A/c (*Being balance in the shares forfeited A/c transferred to capital reserve A/c*)		500	 500

Illustration 30

M Ltd. issued a prospectus offering 10,000 equity shares of ₹20 each, at ₹22 per share, payable as follows:

On application ₹3 per share
On allotment ₹8 per share (including premium)
On first call ₹6 per share
On final call ₹5 per share

Applications were received for 10,000 shares and all money on allotment, first call, and final call were received except the final call amount on one holding of 400 shares. These shares were forfeited and 300 of these were subsequently re-issued at ₹20 per share, fully paid up. Give the journal entries (including for cash).

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being share application money received on 10,000 shares*)		30,000	 30,000
	Share Application A/c Dr. To Share Capital A/c (*Being share application money transferred to share capital A/c*)		30,000	 30,000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being allotment money due*)		80,000	 60,000 20,000
	Bank A/c Dr. To Share Allotment A/c (*Being allotment money received*)		80,000	 80,000

(*Contd.*)

	Share First Call A/c Dr. To Share Capital A/c (*Being share first call money due on 10,000 shares*)		60,000	 60,000
	Bank A/c Dr. To Share First Call A/c (*Being first call money received on 10,000 shares*)		60,000	 60,000
	Share Final Call A/c Dr. To Share Capital A/c (*Being share final call money due on 10,000 shares*)		50,000	 50,000
	Bank A/c Dr. To Share Final Call A/c (*Being final call money received on 9,600 shares*)		48,000	 48,000
	Share Capital A/c Dr. To Share Final Call A/c To Forfeited Shares A/c (*Being 400 shares forfeited for non-payment of final call*)		8,000	 2,000 6,000
	Bank A/c Dr. To Share Capital A/c (*Being 300 shares re-issued at ₹20 per share*)		6,000	 6,000
	Forfeited Shares A/c Dr. To Capital Reserve A/c (*Being balance in the shares forfeited A/c on 300 shares transferred to capital reserve A/c) (Working Note 1*)		4,500	 4,500
	Working Note 1: **Amount transferred from shares forfeited A/c to capital reserve on 300 shares:** Amount in shares forfeited A/c For 400 shares: ₹6,000 Amount considered for 300 shares re-issued: $\frac{300}{400} \times 6000 =$ ₹4,500			

Illustration 31

Kavitha Industries Ltd. issued 20,000 6% preference shares of ₹10 each, payable ₹2 on application, ₹3 on allotment (including premium), ₹3 on first call and ₹3 on final call. The shares were called up to the first call stage. All the amounts due were received except the following:

A, holding 300 shares paid only the application money.
B, holding 200 shares paid upto the allotment.

The shares of both A and B were forfeited. Out of the forfeited shares, 400 shares (whole of A's holding included) were re-issued to R on payment of ₹6 per share and as paid up to the same extent as other shares. Journalise the transaction in the books of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c *(Being application money received on 20,000 shares)*		40,000	 40,000
	Share Application A/c Dr. To Share Capital A/c *(Being share application money transferred to share capital A/c)*		40,000	 40,000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c *(Being amount due on allotment)*		60,000	 40,000 20,000
	Bank A/c Dr. To Share Allotment A/c *(Being allotment money received)*		59,100	 59,100
	Share First Call A/c Dr. To Share Capital A/c *(Being amount due on first call)*		60,000	 60,000
	Bank A/c Dr. To Share First Call A/c *(Being amount received on first call for 19,500 shares @ ₹3 per share)*		58,500	 58,500
	Share Capital A/c Dr. Securities Premium A/c Dr. To Share Allotment A/c To Share First Call A/c To Forfeited Shares A/c *(Being forfeiture of 500 shares @ ₹7 called up)*		3,500 300	 900 1,500 1,400
	Bank A/c Dr. Forfeited Shares A/c Dr. (Discount on re-issue) To Share Capital A/c *(Being re-issue of 400 shares @ ₹6 per share called up)*		2,400 400	 2,800

(*Contd.*)

	Forfeited Shares A/c Dr. To Capital Reserve A/c *(Being profit transferred to capital reserve)*		600	600
	Working Note 1: **Amount transferred from shares forfeited A/c to Capital Reserve:** Amount in shares forfeited A/c ₹ For 300 shares of A: 600 (+)Amount to be considered from shares forfeited A/c of B on 100 shares: For 200 – ₹800 For 100 – ? 100/200 × 800 = ₹400 400 1,000 (–) Discount on Re-issue 400 Transferred to Capital Reserve 600			

Illustration 32

Forfeiture and re-issue, over subscription and pro-rata allotment

A Ltd. invited application for 10,000 equity shares of ₹100 each, at a premium of ₹10 per share. Payment was to be made as follows:

On application ₹20
On allotment ₹40 (including premium)
On first call ₹30
On final call ₹20

Application totalled for 13,000 shares. Application for 2,000 shares were rejected and allotment of shares was made proportionately to the remaining applicants. The directors made both the calls and all the money received, except the final call on 300 shares, which were forfeited after the required notices were served. Later, 200 of the forfeited shares were re-issued as fully paid at ₹85 per share. Journalise the transactions and prepare the balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c *(Being share application money received on 13,000 shares)*		2,60,000	2,60,000

(*Contd.*)

	Share Application A/c Dr. To Bank A/c (*Being refund of share application money for 2000 shares*)		40,000	 40,000
	Share Application A/c Dr. To Share Capital A/c (*Being share application money transferred to share capital A/c*)		2,00,000	 2,00,000
	Share Application A/c Dr. To Share Allotment A/c (*Being share application money adjusted towards share allotment*)		20,000	 20,000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being allotment money due on 10,000 shares*)		4,00,000	 3,00,000 1,00,000
	Bank A/c Dr. To Share Allotment A/c (*Being allotment money received*)		3,80,000	 3,80,000
	Share First Call A/c Dr. To Share Capital A/c (*Being share first call money due*)		3,00,000	 3,00,000
	Bank A/c Dr. To Share First Call A/c (*Being amount received on share first call*)		3,00,000	 3,00,000
	Share Final Call A/c Dr. To Share Capital A/c (*Being amount due on final call*)		2,00,000	 2,00,000
	Bank A/c Dr. To Share Final Call A/c (*Being final call money received on 9,700 shares*)		1,94,000	 1,94,000
	Share Capital A/c Dr. To Share Final Call A/c To Forfeited Shares A/c (*Being 300 shares forfeited for non-payment of final call*)		30,000	 6,000 24,000
	Bank A/c Dr. Forfeited Shares A/c Dr. (Discount on re-issue) To Share Capital A/c (*Being re-issue of 200 shares @₹85 per share*)		17,000 3,000	 20,000
	Forfeited Shares A/c Dr. To Capital Reserve A/c (*Being profit transferred to capital reserve A/c on 200 shares re-issued*)		13,000	 13,000

Working Note:

Amount transferred from shares forfeited A/c to Capital Reserve:			
Amount in shares forfeited A/c for 300 shares			**(₹)**
Amount considered for 200 shares re-issued			24,000
$\frac{200}{300} \times 24{,}000 =$	₹16,000		16,000
Less: Discount on re-issue	₹3,000		
Capital Reserve	₹13,000		
Balance amount in shares forfeited A/c			8,000

Balance Sheet of A Ltd., as on….

	Particulars	Note No .	(₹)
I.	Equity and Liabilities:		
	(i) Shareholders' Funds		
	Share Capital	1	**9.98,000**
	Reserve and Surplus	2	**1,13,000**
	(ii) Non-Current Liabilities		**—**
	(iii) Current Liabilities		**—**
	Total: (i) + (ii) + (iii)		**11,11,000**
II.	Assets:		
	(i) Non-current Assets		—
	(ii) Current Assets		
	Cash at Bank		**11,11,000**
	Total: (i) + (ii)		**11,11,000**

Notes to Accounts:

	Particulars	(₹)	(₹)
1.	Share Capital:		
	Subscribed and Paid-up Capital:		
	9,900 shares of ₹10 each	9,90,000	
	Add: Shares Forfeited A/c	8,000	**9,98,000**
2.	Reserves and Surplus:		
	Securities Premium	1,00,000	
	Capital Reserve	13,000	**1,13,000**
			11,11,000

Illustration 33

A limited company issued a prospectus inviting application for 2,000 shares of ₹10 each, at a premium of ₹2 per share, payable as follows:

	(₹)
On application	2
On allotment	5 (including premium)

On first call	3
On second call	2

Applications were received for 3,000 shares and allotment was made pro-rata to the application for 2,500 shares. The remaining applications being refused. Money overpaid on applications was employed on account of sum due on allotment.

P, to whom 80 shares were allotted, failed to pay allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Q, the holder of 40 shares, failed to pay the two calls and his shares were forfeited, after the second call had been made. Of the shares forfeited, 100 shares were sold to R, credited as fully paid, for ₹9 per share, the whole of P per share being included.

Show the journal and cash book entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr.		6,000	
	To Share Application A/c			6,000
	(*Being share application money received on 3,000 shares*)			
	Share Application A/c Dr.		6,000	
	To Share Capital A/c			4,000
	To Share Allotment A/c			1,000
	To Bank A/c			1,000
	(*Being share application money transferred to share capital A/c for 2,000 shares and balance adjusted towards allotment A/c for 500 shares and refunded for 500 shares*)			
	Share Allotment A/c Dr.		10,000	
	To Share Capital A/c			6,000
	To Securities Premium A/c			4,000
	(*Being allotment money due*)			
	Bank A/c Dr.		8,640	
	To Share Allotment A/c			8,640
	(*Being allotment money received*)			
	Share First Call A/c Dr.		6,000	
	To Share Capital A/c			6,000
	(*Being share first call money due*)			
	Bank A/c Dr.		5,760	
	To Share First Call A/c			5,760
	(*Being first and final call money received on 1,880 shares*)			

(*Contd.*)

	Share Capital A/c Dr. Securities Premium A/c Dr. To Share First Call A/c To Share Allotment A/c To Forfeited Shares A/c (*Being 80 shares forfeited for non-payment of allotment and first call*)		640 160	 240 360 200
	Share Final Call A/c Dr. To Share Capital A/c (*Being share final call money due on 1,920 shares*)		3,840	 3,840
	Bank A/c Dr. To Share Final Call A/c (*Being share final call received on 1,880 shares*)		3,760	 3,760
	Working Note 1: **Calculation of amount received on allotment:** Amount due on allotment *Less:* Application money adjusted *Less:* Amount due on allotment from 80 shares (80 shares x 5) *Less:* Application money adjusted since prorata allotment (20 x 2) [2,000 shares – 2,500 80 shares - ? 80/2000 × 2500 = 100 shares 100 x 2 = 200 *Less:* Application money on 80 shares allotted 160 Excess application money 40 Amount received on allotment		 400 40	 10,000 1,000 9,000 360 8,640
	Share Capital A/c Dr. To Share First Call A/c (40×3) To Share Final Call A/c (40×2) To Shares Forfeited A/c (*Being forfeiture of 40 shares of Q for non-payment of final call*)		400	 120 80 200
	Bank A/c (100×9) Dr. Shares Forfeited A/c Dr. (Discount on Re-issue) To Share Capital A/c (*Being re-issue of 100 shares to" R "at ₹9 each fully paid*)		900 100	 1,000
	Shares Forfeited A/c Dr. To Capital Reserve (*Being profit transferred to Capital Reserve from shares forfeited A/c*)		200	 200

(*Contd.*)

	Working Note 2: **Amount transferred to Capital Reserve**			
	Amount in shares forfeited A/c of P (80 shares)			200
	Amount in shares forfeited A/c of Q (40 shares)			200
				400
	Amount considered for re-issue of 100 shares from shares forfeited A/c			
	Whole of P shares, i.e. 80 shares			200
	50% of R shares, i.e. 20 shares			100
	For 40 shares, it is 200			300
	Therefore, for 20 shares, amount considered 20/40 × 200			
	(-) Discount on Re-issue of Shares			100
	Capital Reserve			200

Cash Book

	(₹)		(₹)
To Share Application A/c	6,000	By Share Application	1,000
To Share Allotment A/c	8,640	By Balance c/d	24,060
To Share First Call A/c	5,760		
To Share Final Call A/c	3,760		
To Share Capital A/c	900		
	25,060		**25,060**

Illustration 34

Subhas Ltd. invited applications for 20,000 shares of ₹10 each, at a premium of ₹2 per share, payable ₹3 on application; ₹7 on allotment including premium and the balance on first and final call.

Applications for 25,000 shares were received. It was decided:

(a) To refuse allotment to the applicants of 1,000 shares.

(b) To allot in full to the applicants for 4,000 shares.

(c) To allot the balance of the shares pro-rata among the applicants of the remaining applications.

(d) To utilise excess application money in part payment of allotment money.

Mr. A, holding 200 shares, which were allotted pro-rata, failed to pay the amount due on allotment and call. Mr. B, holding 100 shares, to whom full allotment was made, failed to pay the call money. Shares of A and B were forfeited. 160 forfeited shares of A and 40 forfeited shares of B were re-issued to Mr. C at ₹9 per share. Journalise the transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Share Application A/c (*Being share application money received on 25,000 shares*)		75,000	 75,000
	Share Application A/c Dr. To Share Capital A/c To Bank A/c To Share Allotment A/c (*Being share application money transferred to share capital A/c for 20,000 shares, refunded to applicants on 1,000 shares and balance adjusted towards allotment*)		75,000	 60,000 3,000 12,000
	Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c (*Being allotment money due on 20,000 shares*)		1,40,000	 1,00,000 40,000
	Bank A/c (W.N.1) Dr. To Share Allotment A/c (*Being allotment money received*)		1,26,750	 1,26,750
	Share First and Final Call A/c Dr. To Share Capital A/c (*Being share first and final call money due*)		40,000	 40,000
	Bank A/c Dr. To Share on First and Final Call A/c (*Being amount received on share first and final call on 19,700 shares*)		39,400	 39,400
	Share Capital A/c Dr. (200 x 10) Securities Premium A/c Dr. (200 x 2) To Share Allotment A/c To Share First and Final Call A/c To Shares Forfeited A/c (*Being forfeiture of 200 shares allotted to A for non-payment of allotment and call money*)		2,000 400	 1,250 400 750
	Share Capital A/c (100 x 10) Dr. To Share First and Final Call A/c To Shares Forfeited A/c (*Being forfeiture of 100 shares allotted to B for non-payment of allotment and call money*)		1,000	 200 800

(*Contd.*)

	Bank A/c Dr. Shares Forfeited A/c Dr. (Discount on Re-issue) To Share Capital A/c (*Being 200 shares re-issued @ ₹9 per share*)		1,800 200	 2000
	Shares Forfeited A/c (W.N.2) Dr. To Capital Reserve A/c (*Being profit transferred from shares forfeited A/c to Capital Reserve on 200 shares re-issued to Mr. C*)		720	 720

Working Note 1:

Amount due on allotment		1,40,000
Less: Application money adjusted		12,000
		1,28,000
Less: Amount due on allotment from A who did not pay the allotment.		
200 shares × 7 =	1,400	
Less: Application money adjusted for allotment	150	
	1,250	1,250

(Note: No. applied 16,000 shares – 20,000 shares
200 shares – ?

$$\frac{200}{16,000} \times 20,000 = 250 \text{ shares.}$$

Application money received on 250 shares	= 250 × 3 = 750	
Less: Adjusted on shares allotted	= 200 × 3 = 600	
Excess application money adjusted towards allotment	150	
Amount received on allotment =		₹1,26,750

Working Note 2:
Calculation of amount transferred from Shares Forfeited Account to Capital Reserve on shares re-issued

Amount considered from Shares Forfeited Account of Mr. A
200 shares – ₹750
160 shares – ?
(160/200 × 750 = 600) ₹600

Amount considered from Shares Forfeited Account of Mr. B
100 shares – ₹800
40 shares – ?

$$\left(\frac{40}{100} \times 800 = 320\right)$$ ₹320

	₹920
Less: Discount on Re-issue	200
Capital Reserve	₹720

THEORY QUESTIONS

I. Short-Answer Questions

1. Define a share. What are the different kinds of shares that can be issued by a company?
2. Illustrate with an example how does a company issue shares at ‘par’, at ‘premium’ and at ‘discount’?
3. What do you mean by allotment of shares?
4. Explain ‘pro-rata’ allotment of shares.
5. State the legal provisions relating to allotment of shares?
6. What is a Call? What is the maximum amount of call according to “Table A”?
7. What is meant by “Over subscription” ? How do you treat the excess application money in accounts?
8. What are Calls-in-Arrears? Explain the accounting treatment for Calls-in-Arrears.
9. Explain Calls-in-Advance? What is the accounting treatment for Calls-in-Advance?
10. How does Calls-in-Arrears and Calls-in-Advance appear in balance sheet?
11. What are the purposes for which securities premium amount can be used?
12. Explain forfeiture of shares? Can forfeited shares be re-issued at discount?
13. What are the journal entries to be passed in the books of the company on forfeiture of shares?
15. What are the journal entries to be passed on re-issue of forfeited shares?

II. Long-Answer Questions

1. Explain the different types of shares.
2. Explain briefly the provisions of the Indian Companies Act 1956 regarding issue of shares at discount and at premium.
3. Can a new company issue shares at discount? If no, explain the provisions.
4. What are the provisions of the Companies Act under section 78 for the use of shares premium?
6. Explain forfeiture and re-issue of shares
7. Write short notes on:
   i. Bonus shares
   ii. Minimum subscription
   iii. Surrender of shares
   iv. Rights issue
   v. Stock- invest scheme
   vi. Sweat equity
   vii. Issue of shares for consideration other than cash.

OBJECTIVE-TYPE QUESTIONS

I. Multiple Choice Questions

1. A share allotment is classified as:
   (a) Personal A/c (b) Real A/c
   (c) Fictitious A/c (d) Nominal A/c
2. The minimum share application money is:
   (a) 5% of the face value of shares
   (b) 10% of the face value of shares
   (c) 20% of the face value of shares
   (d) 15% of the face value of shares
3. Securities Premium A/c is shown on:
   (a) Assets side of Balance Sheet
   (b) Liabilities side of Balance Sheet
   (c) Credit side of Profit and Loss A/c
   (d) Debit side of Trading A/c
4. The amount in the Securities Premium can be used for:
   (a) Distribution of dividend
   (b) Writing of capital losses
   (c) Transferring to general reserve
   (d) Paying fees to directors
5. The rate of discount on shares cannot exceed:
   (a) 4% (b) 6%
   (c) 10% (d) 8%
6. Discount on issue of shares A/c is shown on:
   (a) Assets side of B/s (b) Liabilities side of B/s
   (c) Debit side of Profit & Loss A/c (d) Credit side of Trading A/c
7. Discount on issue of shares is a:
   (a) Capital loss (b) Revenue loss
   (c) Deferred revenue expenditure (d) Neither of the above
8. 6% is the rate of interest:
   (a) Calls in arrear (b) Calls in advance
   (c) Discount on issue of shares (d) Share allotment
9. Interest at __________ is charged on Calls-in-Arrears according to table A of the Companies act.
   (a) 5% (b) 10%
   (c) 6% (d) 12%
10. When shares are forfeited, the share capital A/c is debited by:
    (a) Paid-up capital (b) Called-up amount
    (c) Issue price (d) Nominal value of such shares

11. Discount on re-issue of forfeited share should not exceed:
    (a) 5% of the paid up capital
    (b) 10% of the re-issued capital
    (c) The amount received so far on forfeiture of shares
    (d) Nominal value of the shares
12. The profit on re-issue of forfeited shares is transferred to:
    (a) Reserve fund
    (b) Capital redemption reserve
    (c) Capital reserve
    (d) Goodwill
13. If a share of ₹10, on which ₹9 has been collected and ₹6 has been received is forfeited share capital A/c in this will be debited with:
    (a) ₹3 (b) ₹9
    (c) ₹6 (d) ₹10
14. Rights shares are those shares which are:
    (a) Issued to the public
    (b) First offered to the existing shareholders
    (c) Issued to the promoters
    (d) Issued to preference shareholders
15. The Paid-up capital is the:
    (a) Difference between subscribed capital and called up capital
    (b) Authorised Capital
    (c) Uncalled capital
    (d) Issued capital

[*Ans:* 1. (a); 2. (a); 3. (b); 4. (b); 5. (c); 6.(a); 7 (a); 8.(b); 9 (a); 10.(b); 11.(c); 12.(c); 13 (b); 14 (b); 15. (a)]

II. True or False

1. Equity Shareholders get dividend at fixed rate.
2. A shareholder of the company is not liable for the act of the company
3. Equity shares and Preference shares are the two types of shares issued by a registered company in India.
4. A public limited company having share capital can start its operation after getting its incorporation certificate.
5. Dividend is declared and paid on the called-up capital.
6. Share premium amount can be used to write off premium on redemption of preference shares or debentures of the company.
7. When shares originally issued at discount are forfeited, the discount in respect of them is to be canceled
8. A company cannot ‘buy back’ partly paid up shares.

[*Ans:* True: 2,3, 6, 7, 8. False: 1, 4, 5]

III. Fill in the Blanks

1. Shareholders are called as __________ of the company.
2. Shareholders receive dividend as return for their ____________.
3. Companies are now permitted to issue equity shares with disproportionate________ rights
4. Paid-up capital does not ________________.
5. A call money on shares should not exceed ________of the face value of shares.
6. Preference shareholders have got preference as regards _______________.
7. Unless otherwise stated, a preference shares is always deemed to be cumulative, non-participating and __________
8. The name of the company are given in the ______ of the association
9. A company cannot issue shares at _________.
10. The allotment of shares should not be completed within__________ days of the issue of the prospectus.

[*Ans:* 1. Owners; 2. Investment ; 3. voting ; 4. Calls-in-Advance; 5. 1/4 ; 6. Dividend and return of capital 7. Non-convertible ; 8. Memorandum; 9. Discount ; 10. 120]

EXERCISE PROBLEMS

1. Ram Limited purchased assets of ₹10,00,000 from Rahul Limited. The company issued equity shares of ₹10 each fully paid up to the satisfaction of their claim. Pass journal entries to record these transactions.
2. Vaishali Ltd., purchased the business of Vikram Ltd., for ₹4,00,000 payable in fully paid up shares of ₹100 each. What entries will be made in the books of Vaishali Ltd., if such issue is: (i) at Par; (ii) at a premium of 10% and (iii) at a discount of 10%?
3. Anandhi Ltd., purchased Plant and Machinery worth ₹2,30,000 from Rajan Traders. Payment was made to ₹20,000 by cheque and the balance amount by issue of equity shares of ₹10 each fully paid at ₹10.50 each. Pass necessary journal entries.
4. 10,000 equity shares of ₹20 each are issued for public subscription at a premium of 10%. The full amount is payable on application. Applications were received for 20,000 shares and pro rata allotment was made to the applicants. Journalise the transactions.
5. A company issued 30,000 shares of ₹10 each at a discount of ₹1 per share payable ₹2 on application, ₹3 on allotment and the balance on the final call. All the shares offered were applied and allotted. Give journal entries.
6. A company issued 30,000 shares of ₹10 each payable ₹2 on application, ₹3 on allotment, ₹2 on first call and the balance on the final call. All the shares offered were applied and allotted. Final call money on 2000 shares were not received. Give journal entries.
7. A limited company having a pai-up capital of ₹5,00,000 in shares of ₹10 each had a Reserve of ₹1,20,000. It was resolved to capitalize ₹1,00,000 of the Reserve by issuing 10,000 fully paid Bonus shares of ₹10 each. Each shareholder to get one share for every ten shares held by him in the company. Give journal entries.

8. A company offers to its existing equity shareholders the right to buy one share of ₹100 each at ₹120 for every three shares held. The cum rights quotation in the market for the company's share is ₹180. Calculate the value of the right.
9. Y Ltd. forfeited 1,000 equity shares of ₹10 each for non-payment of the first call of ₹2 and the final call of ₹3 per share. Pass necessary journal entry.
10. The directors of A Ltd., resolved on 1st May 2010 that 4,000 ordinary shares of ₹10 each, ₹7.50 paid, be forfeited for non - payment of final call of ₹2.50. On June 10, 2010, out of the above, 3,600 shares were re-issued for ₹6 per share. Give necessary journal entries.
11. MN Ltd., forfeited 200 equity shares of ₹10 each issued at a discount of 10% for non-payment of the 1st call of ₹2 and final call of ₹3 per share. Out of these 100 shares were re-issued at ₹8 per share and the balance at ₹7 per share. Pass journal entries.
12. A company forfeited 50 shares of ₹10 each issued at a premium of 10% for non-payment of the final call of ₹3 per share. Out of these, 35 shares were re-issued at ₹8peer share as fully paid up. Pass journal entries for forfeiture and re-issue.
13. D Ltd. forfeited its 200 shares of ₹10 each on which ₹5 per share was received. Pass entry regarding re-issue of all the shares if:
    (i) Shares are re-issued at ₹8 per share, fully paid up.
    (ii) Shares are re-issued for ₹4.50 as ₹7 called up.
14. X Ltd. forfeited 10 shares of ₹10 each (₹6 called up) issued at a discount of 10% to Neeru, on which she had paid ₹2 per share. Out of these, 8 shares were re-issued to Meera as ₹8 called up, for ₹6 per share. Journalise.
15. Raj Ltd. issued 40,000 equity shares of ₹10 each payable ₹5 on application and ₹5 on allotment. Applications were received for 50,000 shares and the allotment was made on pro-rata basis. Krithika to whom 400 shares were allotted, failed to pay the allotment money and his shares were forfeited.

    These shares were re-issued to Chandini at ₹8 per share.

    Give journal entries for forfeiture and re-issue.

OTHER EXERCISES

1. Journalise the following transactions:
    a. A Ltd. issued 40,000 shares of ₹10 each for cash. The whole amount is duly received.
    b. AB Ltd. issued 10,000 shares of ₹10 each for cash at premium of ₹2 each. The whole amount is duly received.
    c. ABC Ltd. issued 1,00,000 shares of ₹10 each for cash at a discount of 10 percent. The whole amount is duly received.
    d. N Ltd. issued 20000 shares of ₹10 each to a promoter for services rendered.
2. Bala Co Ltd. was registered with a share capital of ₹10,00,000 in shares of ₹100 each. The company acquired the business of M/s Sundari and Sons for ₹2,00000 payable as to ₹1,50,000 in fully paid shares and the balance in cash. The directors also decided to allot 150 shares credited as fully paid to the promoters for their service. Pass entries in the books of the company.

3. Ganesh Ltd. issued prospectus inviting applications for 10,000 equity shares of ₹10 each, payable as follows:

On application	₹2 per share
On allotment	₹4 per share
On first call	₹4 per share

   The issue is fully subscribed. Pass journal entries in the books of Ganesh Ltd., assuming that all payments due as stated above were received.

4. A company offered for public subscription 20,000 equity shares of ₹100 each payable as ₹20 per share on application, ₹30 on allotment, ₹20 three months after allotment and the balance six months after allotment. The offer was oversubscribed by 5,000 shares and the amount due on allotment was received in full. ₹3,80,000 and ₹5,55,000 were received on first, second and final calls respectively. You are required to give the journal entries for the above information.

   [*Ans:* Amount due on 1st call: ₹20,000 and on final call: ₹45,000]

   [**Hint:** Assume that 5000 applications are rejected since there is no mention of pro-rata allotment.]

5. On 1st April 2015, A Ltd. issued 50,000 shares of ₹100 each payable as follows:

   ₹20 on application

   ₹30 on allotment

   ₹25 on first Oct. 2015 and

   ₹25 on first Feb. 2016

   By 20th May, 40,000 shares were applied for and all applications were accepted. Allotment was made on 1st June. All sums due on allotment were received on 15th July. Those on 1st call were received on 20th October. When accounts were closed on 31st March 2016, the 2nd and final call on 400 shares had not been received. Journalise the transactions.

   [*Ans:* Calls-in-Arrears: ₹10,000]

   [**Hint:** Transfer the dues on call to Calls-in-Arrears A/c since accounts are closed.]

6. CD Ltd. offered to the public 20,000 equity shares of ₹100 each at a premium of ₹10 per share. The payment was to be made as follows:

   On application ₹20; on allotment ₹40 (including premium); on 1st call ₹25; on 2nd call ₹25.

   Applications totalled for 35,000 shares; applications for 10,000 shares were rejected; those totalling 15,000 shares were allotted 10,000 shares and the remaining applications were accepted in full. The directors made both the calls

   One shareholder, holding 500 shares (full allottee) failed to pay the calls. Expenses of the issue amounted to ₹10,000.

   Pass journal entries and relevant extracts from the balance sheet relating to the above transactions.

   [*Ans:* Calls-in-Arrears: ₹25,000]

7. Rakesh Ltd. issued to public 5,000 equity shares of ₹100 each at a premium of ₹10 per share payable as follows:

   On application ₹20

   On allotment ₹40

   On 1st and final call ₹50

Applications were received for 4,000 shares and all were accepted. All moneys due were fully received except the 1st and final call on 300 shares. Pass journal entries and prepare the balance sheet.

[*Ans:* B/S Total: ₹4,25,000]

8. A company issued 5,000 equity shares of ₹10 each at a discount of ₹1 per share payable as follows:

   ₹2 on application

   ₹3 on allotment (excluding discount)

   ₹3 on 1st call and balance on 2nd call.

   All the amounts were duly received. Pass the necessary journal entries in the books of the company.

9. A Ltd. company with an authorised capital of ₹2,00,000 in shares of ₹100 each issued 1,000 of such shares payable ₹25 per share on application, ₹25 on allotment, ₹20 three months later, and the balance as and when required. All moneys payable on application and allotment were duly received. But when the call of ₹20 per share was made, one shareholder holding 50 shares failed to pay the amount due and another shareholder holding 100 shares paid them in full. You required to pass journal entries and prepare ledger accounts and also show how the capital account will appear in the company's balance sheet.

   [*Ans:* Calls-in-Advance: ₹3000; Calls-in-Arrears: ₹1000]

10. On 1st Jan 2008 XY Ltd. makes an issue of 10,000 equity shares of ₹10 each payable as follows:

    On application ₹2; on allotment ₹3; on 1st and final call ₹6 (three months after allotment).

    Applications were received for 13,000 shares and directors made allotment in full to the applicants demanding five or more shares and returned money to the applicants for 3,000 shares. One shareholder who was allotted 20 shares paid 1st and final call with allotment money and another shareholder did not pay allotment money on his 30 shares but which he paid with 1st and final call. Directors have decided to charge and allow interest, as the case may be, on Calls-in-Arrears and Calls-in-Advance respectively according to the provisions of Table A. Journalise the above transactions.

    [*Ans:* Amount received on allotment: ₹30,030; Amount received on 1st and final call: ₹59,970; Interest on Calls-in-Arrears: ₹1.13; Interest on Calls-in-Advance: ₹1.80].

11. Blue Star company issued 50,000 shares of ₹10 each payable as under:

    ₹2 on application

    ₹2.50 on allotment

    ₹3.00 on 1st call

    ₹2.50 on final call

    The public applied for 90000 shares. The allotment was made as follows on 1st August 2015.

    To the applicants of 45,000 shares: full

    To the applicants of 20,000 shares: 25%

    To the remaining applicants: nil

    The 1st call was made on 1st Nov 2015 and the final call on 1st February 2016. According to the terms of issue the surplus application money could be kept by the company against the money due on allotment and against subsequent calls. One shareholder to whom 5,000 shares were allotted paid on allotment the full amount due on shares.

The interest at 5% p.a on Calls-in-Advance was paid on 1st February 2016. Give cash book and journal entries in the books of the company, assuming that all moneys were duly received. Also prepare Calls-in-Advance A/c.

[*Ans:* Calls-in-Advance: ₹27,500; Interest on Calls-in-Advance: ₹344 on ₹27,500 for three months and ₹156 on 12,500 for three months; Refund ₹50,000; Bank A/c: ₹4,99,500; Transfer from share application A/c to share allotment: ₹12,500, to share 1st call A/c: ₹15,000 and to share final call ₹2,500]

12. A company issued for public subscription 40,000 shares of ₹10 each payable:

    On application: ₹2

    On allotment: ₹5

    On call: ₹3

    Applications were received for 60,000 shares. Applicants for 45,000 shares paid the application money in cash while the rest paid that money through stock-invests. The shares were allotted on the pro-rata basis. All allottees paid the allotment and call money on due dates. Pass journal entries in the books of the company, if surplus application money was refunded.

13. A company has decided to increase its existing share capital by making a rights issue to the existing shareholders in the proportion of one new share for every two old shares held. You are required to calculate the value of the right, if the market value of the share at the time of announcement of rights issue is ₹24. The company has decided to give one share of ₹10 each at a premium of ₹2 each.

    [*Ans:* Value of right: ₹4 (i.e., 24-20)]

14. The following are extracts from the balance sheet of AB Ltd. as on 31-12-2003:

Authorised Capital:	
10,000 equity shares of ₹10 each	1,00,000
Issued and subscribed Capital:	
5,000 equity shares of ₹10 each fully paid-up	50,000
Reserve Fund	35,000
Profit & Loss A\c	10,000

A resolution was passed to issue 1,000 bonus shares of ₹10 each by providing ₹5,000 out of Profit & Loss A\c and the balance out of Reserve fund.

Set out journal entries to give effect to the resolution and show how they would affect the balance sheet.

[*Ans:* After Bonus issue: Capital A\c: ₹60,000; Reserve fund A\c: 30,000; Profit & Loss A\c: ₹5000]

15. Gopu Industries Ltd. issued 50,000 shares of ₹20 each at par. The following are the details of the amounts payable.

	Date	Call	₹Per share
1997	June 30	Application	4
1997	Sept 30	Allotment	5
1997	Dec 31	First call	3

Except Rajan, a shareholder holding 1,000 shares who failed to pay the allotment amount and the first call, all the other amounts were received. On 15th March 1998, the shares of Rajan were forfeited.

Show the journal entries in the books of the company for the above transactions.

[*Ans:* Forfeited shares account balance: ₹4,000; Calls-in-Arrears: ₹8,000(5,000 + 3,000)]

16. Bhooma Ltd. issued 50,000 shares of ₹100 each payable as follows:

    ₹20 on application; ₹30 on allotment;

    ₹25 on first call and ₹25 on final call.

    The company received applications for 40,000 shares and all these applications were accepted. All sums due on allotment, first and final calls were received except the final call on 400 shares. These 400 shares were subsequently forfeited by the company and re-issued at ₹80 per share.

    Give journal entries in the books of the company.

    [*Ans:* Amount transferred to capital reserve A/c: 22,000]

17. Raj Ltd. issued 10,000 shares of ₹100 each at ₹120 payable as follows:

    ₹25 on application; ₹45 on allotment(including premium);

    ₹20 on first call and ₹30 on final call.

    9,000 shares were applied for and were allotted. All moneys were received with the exception of the first and final calls on 200 shares held by Alagammai. These shares were forfeited.

    Give journal entries to record the above transactions.

    [*Ans:* Forfeited shares account balance: ₹10,000]

18. Bright Ltd., invited applications for 10,000 shares of ₹100 each at a discount of 6% payable as follows:

    On application ₹30

    On allotment ₹24

    On first and final call ₹40

    Applications were received for 9,500 shares and all these were accepted. All moneys due were received except the final call on 250 shares which were forfeited. 150 of the forfeited shares were re-issued at ₹80 per share as fully paid.

    Assuming that all requirements of the law have been complied with, pass journal entries in the books of the company and also prepare the balance sheet.

    [*Ans:* Capital reserve: ₹6,000; Forfeited shares account: ₹5,400; Discount: ₹56,400; Bank: ₹8,95,000; Balance sheet total: ₹9,51,400]

19. A limited company issued 10,000 shares of ₹10 each payable as follows:

    ₹3 on application; ₹3 on allotment;

    ₹4 on first call and final call.

    The company received 13,000 applications from the public. Applications for 1,500 shares were rejected and the excess application money received on the other 1,500 shares was adjusted towards allotment.

    All the amounts due on the shares were received except the call money on 500 shares which were forfeited after due notice. Later 400 of the forfeited shares were re-issued at ₹8 per share.

    Pass necessary journal entries

    [*Ans:* Amount transferred to capital reserve A/c: ₹1,600; Cash received on allotment: ₹25,500]

20. X Ltd. issued for public subscription 20,000 shares of ₹10 each at a premium of ₹2 per share payable as under:

₹2 per share on application;

₹5 per share on allotment (including premium)

₹2 per share on first call

₹3 per share on final call

Applications for 30,000 shares were received. Allotment was made pro rata to the applicants for 24,000 shares, the remaining applications being rejected. Money over paid was used towards allotment. Y to whom 800 shares were allotted failed to pay the allotment money, 1st and 2nd calls and Z to whom 1000 shares were allotted failed to pay the last two calls. These shares were subsequently forfeited after the 2nd call was made. All these forfeited shares were re-issued to W as fully paid at ₹8 per share. Give journal entries to record the above transactions

[*Ans:* Amount transferred to capital reserve A/c: ₹3,320; Cash received on allotment: ₹88,320; Forfeited shares A/c: ₹6,920]

21. Aparna Ltd. issued 10,000 shares of ₹100 each at ₹110 payable as ₹30 on application; ₹50 on allotment(including premium) and the balance on call. The issue was subscribed to the extent of 2.5 times. Applications for shares below 20 (5000 in all) were rejected. An applicant for 5000 shares was given 1000 shares. The remaining shares were issued pro-rata. The excess amount to the full extent of share value was retained. A shareholder holding 300 shares failed to pay allotment money. Another shareholder holding 450 shares failed to pay call money. All these 750 shares were forfeited. Show the journal entries including those for cash.

    [*Ans:* Cash received on allotment: ₹2,61,000; Refund of application money: ₹40,000; Forfeited shares A/c: ₹46,500]

22. A Ltd. company issued a prospectus inviting applications for 2,000 shares of ₹10 each at a premium of ₹2 per share payable as follows:

    On application ₹2 per share

    On allotment ₹5 per share (including premium)

    On 1st call ₹3 per share

    On final ₹2 per share

    Applications were received for 3,000 shares and pro-rata allotment was made on applications for 2,400 shares. Money over paid on applications was employed towards the sum due on allotment. Ramesh who took 40 shares failed to pay the allotment money and his shares were forfeited on his failure to pay the first call also. Mohan the holder of 60 shares failed to pay the two calls and his shares were forfeited after the second call. Of the shares forfeited 80 shares were sold to Krishna credited as fully paid for ₹9 per share the whole of Ramesh's shares being included. Show the journal entries.

    [*Ans:* Amount received on allotment: ₹9,016; Amount transferred to capital reserve: ₹216]

23. Man Mohan Ltd. issued 1,00,000 shares of ₹10 each payable as follows:

    ₹3 on application

    ₹4 on allotment

    ₹3 on 1st call

    ₹2 on final call

    Applications were received for 1,60,000 shares out of which letters of regret were issued for 30,000 applications. Full allotment was made to applicants for

40,000 shares and the balance of shares were allotted pro-rata to the remaining applicants.

A shareholder holding 100 shares to whom full allotment was made failed to pay allotment money. Another shareholder holding 200 shares to whom pro-rata allotment was made also failed to pay allotment money. On the 1st call there was a further default on 300 shares.

All the shares with arrears were forfeited. The first lot of 300 shares (100 + 200) were re-issued at the rate of ₹8 per share as fully paid up. Pass the necessary journal entries.

[*Ans:* Amount transferred to capital reserve A/c: ₹600; Amount received on allotment: ₹3,09,100]

24. N Ltd. offered to the public 10,000 equity shares of ₹10 each at a premium of ₹2 per share payable on application ₹2; on allotment(including premium) ₹4 ; on 1st call ₹3; on 2nd and final call ₹3.

    Applications were received for 15,000 shares. All applicants were placed under 4 categories and allotment was made as follows:

    Category A: To applicants of 5,000 shares in full

    Category B: To applicants of 6,000 shares: 4,000 shares

    Category C: To applicants of 3000 shares: 1,000 shares

    Category D: To applicants of 1,000 shares: Nil

    Except in the cases where applications were wholly rejected excess application money was not to be refunded but to be adjusted against money due on allotment and calls.

    S an applicant under category B to whom 400 shares were allotted failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited.

    T an applicant under category C to whom 300 shares were allotted failed to pay the two calls and his shares were also forfeited.

    500 of the shares thus forfeited were issued to V as fully paid for ₹8 per share. Show the journal entries in the books of N Ltd. You are to assume that the whole of S share were re-issued.

    [*Ans:* Amount received on allotment: ₹30,800; Amount transferred to capital reserve A/c: ₹600]

25. Vijay Co. Ltd. issued 20,000 equity shares of ₹10 each at a premium of ₹2 per share, payable as ₹3 on application ; ₹4 on allotment(including premium) and ₹5 on call.

    Applications were received for 32,000 shares, out of which letters of regret were issued for applicants of 6,000. Full allotment was made to applicants for 8,000 shares and pro-rata allotment was made on the balance.

    A shareholder holding 20 shares to whom full allotment was made failed to pay the allotment money. Another shareholder holding 40 shares to whom pro-rata allotment was made also failed to pay allotment money. On call there was a further default on 60 shares. All the shares in addition to the above defaulters. All these shares were forfeited. The first lot of 60 shares (20 + 40) were re-issued at the rate of ₹8 per share as fully paid up

    Pass the necessary journal entries in the books of the company.

    [*Ans:* Amount transferred to capital reserve A/c: ₹120; Cash received on allotment: ₹61,820]

2

UNDERWRITING OF SHARES AND DEBENTURES

In case of public limited companies, the minimum required subscription must be received in order to obtain a Certificate of Commencement of Business. In order to ensure minimum subscription, companies may resort to underwriting. Underwriters enter into an agreement with the company, which ensures the company that in case the shares and debentures offered to the public are not subscribed by the public fully, the balance of shares and debentures will be taken over by them. The underwriters charge an agreed commission for ensuring this on the issue price of shares and debentures. Thus, underwriting is a kind of guarantee given by the underwriters to the company that the shares or debentures offered to the public will be subscribed in full.

2.1 UNDERWRITING

According to the Institute of Company Secretaries of India, “Underwriting may be defined as a contract entered into by the company with persons or institutions, called underwriters, who undertake to take up the whole or a portion of such offered shares or debentures, as may not be subscribed for by the public, in consideration of remuneration called underwriting commission”.

The above definition indicates the following features:

- It is an agreement between a company and its underwriters, who may be individuals or institutions.
- The guarantee to subscribe to an agreed number of shares for consideration is called underwriting.
- The persons or institutions, who or which underwrite the issue are called underwriters.
- The underwriters undertake to take-up shares or debentures, which may not be subscribed for by the public.
- The consideration for underwriting is called “Underwriting Commission”.

Whenever large issues are made by companies, arrangements are made by companies with several underwriters with a specified amount. The company pays special attention while selecting underwriters because their names are not only printed in the prospectus but are also analysed carefully by the public at the time of applying shares and debentures.

❍ Significance of Underwriting

The prospectus of the company states that the public has to subscribe 90 per cent of the shares or debentures offered by it, within 120 days from the date of opening of the issue called as minimum subscription. If the company does not receive the minimum subscription amount within the stipulated days, it cannot proceed with the allotment and must refund the subscription amount to the applicants. The company incurs a huge expenditure and the time spent for the issue is also wasted. The goodwill of the company also suffers to a large extent. Underwriting safeguards the company in this circumstance, where it need not bother about the 90 per cent subscription.

Underwriting acts as a sort of insurance or guarantee against the danger of not receiving the minimum subscription.

Underwriting provides an assurance to a company that the stipulated amount of a public issue will be received definitely. This enables the company to go ahead with its investment programme.

The capital market of a country is vital for mobilisation of funds by companies. Underwriting is like a lubricant, which enables smooth functioning of capital markets.

In India, the business of underwriting is carried out by institutions like IDBI (Industrial Development Bank of India), LIC (Life Insurance Corporation of India), UTI (Unit Trust of India), IFCI (Industrial Finance Corporation of India), and ICICI (Industrial Credit and Investment Corporation of India), as well as by other commercial bank investment trusts and financial houses, as they realised the importance of underwriting function.

2.2 UNDERWRITING COMMISSION

The commission is the consideration payable to the underwriters for the services rendered by them. This commission is paid to them for the risk taken in placing the shares or debentures before the public.

Underwriting Commission is paid at specified rates, as per the agreement, subject to limits fixed by the Companies Act. The commission is payable whether an underwriter was called upon to take any shares or debentures or not. It is usually paid as a percentage of the total issue price of the shares or debentures underwritten.

❍ Payment of the Underwriting Commission

Section 76 of the Companies Act has laid down the following conditions pertaining to the payment of underwriting commission:

1. The payment of commission should be authorised by the Articles of Association.

2. The commission paid, or agreed to be paid, should not exceed 5 per cent of issue price for shares and 2.5 per cent for debentures, or the amount/rate authorised by the articles, whichever is less.
3. The commission paid or agreed to be paid should be disclosed in the prospectus.
4. The commission is payable on shares or debentures offered to the general public only. The commission is not payable on shares or debentures taken by promoters, employees, directors, their friends and business associates.

According to the guidelines of the Ministry of Finance, Department of Economic Affairs, Stock Exchange Division (reference No. F 14/1/SE/85, 7th May 1985), the rate for underwriting commission, at any given time, should not exceed 2.5 per cent for shares.

	On Amount Devolving on the Underwriters	On Amount Subscribed by the Public
On Equity Shares	2.5%	2.5%
On Preference Shares/Convertible and Non-convertible Debentures		
For amounts up to ₹5 lakh	2.5%	1.5%
For amounts above ₹5 lakh	2%	1%

The rates of underwriting commission, mentioned above are the maximum ceiling rates. A company may, however, give an underwriting commission lesser than the ceiling rates. Generally, institutions charge lesser rates of underwriting commission in view of the competitors.

❍ Underwriters, Sub-underwriters, Brokers and Managers to Issues

1. ***Underwriters:*** Underwriters are persons who agree to buy a specified number of shares or debentures in the event that the public has not applied and received commission for the shares or debentures underwritten to sell. Underwriting commission is paid with a view to guarantee subscription.
2. ***Sub-underwriters:*** An underwriter himself/herself may appoint one or more underwriters, who work under him in case of underwriting larger issues. The sub-underwriters have no privity of contract with the company. These sub-underwriters are directly answerable only to the main underwriter who has appointed them. Their remuneration is as per the terms of contract with the underwriter.
3. ***Brokers:*** A broker is one who agrees to procure subscription for the shares or debentures of a company without any commitment or responsibility or risk. Brokers are eligible for remuneration from the company, which

is called ‘brokerage’. The payment of brokerage is legal according to Sec.76(3) of the Companies Act. The stock exchange division of the Department of Economic Affairs, had issued guidelines on 07 May 1985 regarding brokerage. The guidelines state that the brokerage allowed is 1.5 per cent on the issue value of the shares or debentures, in addition to the underwriting commission.

4. ***Managers to the issue:*** Companies can appoint one or more individuals or institutions as managers to the issue. They are responsible for the issue, right from the planning stage to the closing of all formalities relating to the issue. The commission payable to the issue managers is as follows:
   - For issues upto ₹5 crore: 0.5 per cent
   - For above ₹5 crore: 0.2 per cent

2.3 TYPES OF UNDERWRITING

An underwriting agreement can be broadly classified into two types—Pure Underwriting and Firm Underwriting.

❍ Pure Underwriting

In this type of contract, the liability of underwriters is limited only to the extent of shares or debentures that are not subscribed by the public. There is no liability on the part of the underwriters, if the public has subscribed the entire issue made by the company. Pure underwriting can further be divided into:

Complete Underwriting

If the entire issue of shares or debentures of a company is underwritten, it is known as complete underwriting. The underwriting contract may be signed by a single underwriter, based on his financial position. He agrees to take the entire risk. However, it is good to share the risk by involving more than one underwriter.

Partial Underwriting

If only a part of the issue of shares or debentures of a company are underwritten, it is termed as partial underwriting. The company is treated as ‘underwriter’ for the remaining part of the issue in case of partial underwriting. This underwriting may be undertaken by a single underwriter or more than one underwriter, each agreeing to take risk only to a limited extent.

❍ Firm Underwriting

In this type of underwriting contract, the liability of underwriters is partly definite and partly contingent. The contract signifies a definite commitment to take up a specified number of shares, irrespective of the number of shares subscribed by the public. Upon oversubscription, underwriter gets priority over the general public for allotment. Their liability is computed in addition to the shares firmly underwritten. The underwriter has to take:

- the number of shares he has applied for firm, and also
- the number of shares he is obliged to take up on the basis of the underwriting contract.

However, if the underwriting contract has provided that an 'abatement' would be allowed with respect to the shares taken up by'firm', the firm underwriting can be adjusted against his normal underwriting liability.

2.4 STATUS OF APPLICATIONS IN UNDERWRITING

Both the company and the underwriters supply the application forms for a company's issue to the general public. The application forms that are directly issued by the company does not bear any marking or stamp. The forms that are supplied by the underwriters, bear their stamp or 'marking'. The public, who are applying, have to fill up the forms and submit them along with the application money to the company.

❍ Marked Applications

Application forms, received by the company from the public, duly filled and bearing the 'stamp' or 'marking' of a particular underwriter, are called marked applications. They were issued to the public by the underwriter or his agent originally. The marked applications are deemed to be received 'through the underwriters,' even if they are directly submitted by the applicant to the company.

❍ Unmarked Applications

Application forms that are duly filled and received by the company, from the public, do not bear any 'stamp' or 'marking,' are called unmarked applications. They were originally issued by the company to the public directly and are termed as 'direct applications'.

❍ Firm Underwriting Applications

The underwriters of an issue may agree to take up a specified number of shares (called as firm), in addition to the shares underwritten. In such cases, the underwriters have to fill up and submit application forms to the company just like any other applicant and pay the application money. The application forms filled by the underwriters personally are called firm underwriting applications.

The marking of application forms helps in identifying the applications received through different underwriters. This information is relevant and essential for determining the liability of each underwriter.

2.5 DETERMINING THE LIABILITY OF UNDERWRITERS WITH RESPECT TO AN UNDERWRITING CONTRACT

It is necessary to determine the number of shares or debentures to be taken by the underwriters as per the underwriting contract. Based on the liability determined and the commission payable, a final settlement can be made between the company and the underwriters.

❍ Complete Underwriting

Single Underwriter

If the issue is fully subscribed by the public, the underwriter is free from any liability. He gets his commission without taking any shares or debentures.

If the issue is not fully subscribed, the underwriter has to take all the shares or debentures, which are not applied for by the public. Then, the underwriter has to pay for such shares or debentures, after adjusting the commission due to him.

Two or more Underwriters

If the issue is fully subscribed by the public, the underwriters are completely free from any liability. They receive commission on the portion of the issue that each of them has underwritten. If the issue is not fully subscribed by the public, the underwriters have to take the balance of shares or debentures. Liability of each underwriter is determined as follows:

Particulars	No. of Shares
Gross Liability of each Underwriter, as per Agreed Ratio	xxx
Less: Marked applications	xxx
Balance Left	xxx
Less: Unmarked Applications in the Ratio of Gross Liability	xxx
Net Liability	xxx
Transfer:	
Any Surplus of one Underwriters to others (in their gross liability ratio)	xxx
Net Liability	xxx

An alternative method is to divide the unmarked applications among the underwriters, in the ratio of 'gross liability, as reduced by marked applications'.

The final liability is different under the above two alternative methods, both of which seem to be logical. It is advisable that the underwriting contract is clear about the method of dividing unmarked applications, to avoid any disputes later on.

Illustration 1

A company issues 15,000 equity shares of ₹10 each at par. The issue was underwritten by S & Co. for maximum commission permitted by law. The public applied for and received 12,000 shares. Give journal entries in the company's books and also prepare balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Equity Shares Capital A/c (*Being 12,000 equity shares issued to the public @ ₹10 each*)		1,20,000	1,20,000
	S & Co. A/c Dr. To Equity Shares Capital A/c (*Being shares to be taken by the underwriters as per underwriting agreement*)		30,000	30,000
	Underwriting Commission A/c Dr. To S & Co. A/c (*Being commission payable @ 2.5% to underwriters on the issue value of ₹1,50,000*)		3,750	3,750
	Bank A/c Dr. To S & Co. A/c (*Being balance amount received from underwriters*)		26,250	26,250

	Notes to Accounts	(₹)
1.	Share Capital: Issued and Paid-up Capital 15,000 shares of ₹10 each	1,50,000
2.	Other Current Assets: Underwriting Commission	3,750

Balance Sheet of …, as on …

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	1,50,000
(ii) Non-current Liabilities		—
(iii) Current Liabilities		—
Total: (i) + (ii) + (iii)		1,50,000

(*Contd.*)

II. Assets:		
(i) Non-current Assets		—
(ii) Current Assets		
Cash at Bank		1,46,250
Other Current Assets	2	3,750
Total: (i) + (ii)		1,50,000

Illustration 2

Good Luck Ltd. issued 6,000 equity shares of ₹100 each and 2,000 8% debentures of ₹100 each; the debentures were issued at a discount of 6%. The whole of the issue was underwritten by M/s. Tulasingam & Co., for a commission of 2.5%, on the issue price of shares and 2½ % on the issue prices of debentures. The public applied for 5,400 shares and 1,800 debentures. These were immediately paid for. The underwriters fulfilled their obligations. Pass journal entries and also prepare balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr.		5,40,000	
	To Equity Share Capital A/c			5,40,000
	(*Being 5,400 shares allotted to the public @ ₹100 each and payment received in full*)			
	Bank A/c Dr.		1,69,200	
	Discount on Issue of Debenture A/c Dr.		10,800	
	To 8% Debentures A/c			1,80,000
	(*Being 1,800 debentures allotted to the public @ ₹100 each, at a discount of 6%*)			
	M/s. Tulasingam & Co. A/c Dr.		60,000	
	To Equity Shares Capital A/c			60,000
	(*Being 600 shares allotted to the underwriters which are not applied by the public*)			
	M/s. Tulasingam & Co. A/c Dr.		18,800	
	Discount on Issue of Debenture A/c Dr.		1,200	
	To 8% Debentures A/c			20,000
	(*Being 200 debentures allotted to the underwriters since not applied by the public*)			

(*Contd.*)

	Underwriting Commission on Shares A/c Dr.		15,000	
	Underwriting Commission on Debentures A/c Dr.		4,700	
	To M/s. Tulasingam & Co. A/c			19,700
	(*Being commission due to the underwriters on shares @ 2.5% [₹6,00,000 × 2.5% = ₹15,000 and on debentures ₹1,88,000 × 2.5% = ₹4,700]*)			
	Bank A/c Dr.		59,100	
	To M/s. Tulasingam & Co. A/c			59,100
	(*Being amount due from underwriters*)			

	Notes to Accounts	**(₹)**
1.	Share Capital:	
	Issued and Paid-up Capital	
	6,000 equity shares of ₹100 each	6,00,000
2.	Long-term Borrowings:	
	8% Debentures	2,00,000
3.	Other Current Assets:	
	Underwriting Commission on Shares	15,000
	Underwriting Commission on Debentures	4,700
	Discount on Issue of Debentures	12,000
		31,700

Balance Sheet of Good Luck Ltd. as on …

	Note No.	**(₹)**
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	6,00,000
(ii) Non-current Liabilities		
Long-term Borrowings	2	2,00,000
(iii) Current Liabilities		—
Total: (i) + (ii) + (iii)		8,00,000
II. Assets:		
(i) Non-current Assets		—
(ii) Current Assets		
Cash at Bank		7,68,300
Other Current Assets		31,700
Total: (i) + (ii)		8,00,000

Illustration 3

R.R. Ltd. issued 1,00,000 preference shares of ₹10 each. The whole issue was underwritten by Madhu for maximum commission permitted by law. Applications for 90,000 shares were received in all. Determine the net liability of Madhu and commission payable to her.

Solution:

Net Liability of Madhu

Particulars	No. of Shares
Gross Liability (i.e. the entire issue)	1,00,000
Less: Total Applications (Marked and Unmarked) Received and Credited to the Underwriters	90,000
Net Liability of the Underwriter	10,000

Computation of Underwriting Commission

Underwriting commissions has been calculated as per the rates applicable in force:

(a)	On amount subscribed by the public (when value exceeds ₹5,00,000) 1% on issue price of 90,000 preference shares 90,000 × ₹10 × 1%	9,000
(b)	On amount devolved on underwriters (when value is below ₹5,00,000) 2.5% on issue of 10,000 preference shares –10,000 × ₹10 × 2.5%	2,500
	Total Commission payable to Madhu	₹11,500

Illustration 4

When the whole issue is underwritten by two or more underwriters, in an agreed ratio

Super India Ltd. issued 75,000 equity shares. The whole of the issue was underwritten as follows:

A: 50%; B: 25%; and C: 25%

Applications for 60,000 shares were received in all; out of which, applications for 15,000 shares had the stamp of A, 7,500 shares that of B and 15,000 shares had the stamp of C. The remaining applications for 22,500 shares did not bear any stamp. Determine the liability of the underwriters.

Solution:

Liability of the Underwriters

Particulars	No. of Shares			
	A	B	C	Total
Gross Liability *Less:* Marked Applications	37,500 15,000	18,750 7,500	18750 15,000	75,000 37,500
Less: Unmarked Applications in the ratio of Gross Liability	22,500 11,250	11,250 5,625	3,750 5,625	37,500 22,500
C's surplus transferred to A and B in the Gross Liability Ratio of 2:1	11,250 1,250	5,625 625	–1,875 +1875	15,000 —
Net Liability	10,000	5,000	—	—

Illustration 5

Excellent Ltd., incorporated on 1 January, issued a prospectus in writing application for 5,00,000 equity shares of ₹10 each, at a premium of 10%. The whole issue was fully underwritten by A, B, C, and D as follows:

A: 2,00,000 shares

B: 1,50,000 shares

C: 1,00,000 shares

D: 50,000 shares

Applications were received for 4,50,000 shares; of which, marked applications were as follows:

A: 2,20,000 shares

B: 90,000 shares

C: 1,10,000 shares

D: 10,000 shares

You are required to find out the liabilities of individual underwriters.

Solution:

Net Liability of Underwriters

Particulars	No. of Shares				
	A	B	C	D	Total
Gross Liability *Less:* Marked Applications	2,00,000 2,20,000	1,50,000 90,000	1,00,000 1,10,000	50,000 10,000	5,00,000 4,30,000
	(–)20,000	60,000	–10,000	40,000	70,000

(*Contd.*)

Less: Unmarked Applications in the ratio of Gross Liability (4:3:2:1)	8,000	6,000	4,000	2,000	20,000
	(–)28,000	54,000	–14,000	38,000	50,000
Less: Surplus of A and C distributed to B and D in Gross Liability Ratio of 3:1	28,000	–31,500	14,000	–10,500	—
Net Liability	Nil	22,500	Nil	27,500	50,000

The final allotment of shares will be as follows:

To the public:	4,50,000
To B:	22,500
To D:	27,500
Total:	5,00,000 shares

Illustration 6

Kalyan Kumar Ltd. was formed with a capital of ₹10,00,000 in ₹10 shares, the whole amount being issued to the public. The underwriting of these shares was as follows:

A: 35,000

B: 30,000

C: 20,000

D: 10,000

E: 3,000

F: 2,000

All the marked application forms were to go in relief of the underwriters, whose stamp they bear. The application forms marked by the underwriters were:

A: 10,000

B: 22,500

C: 20,000

D: 7,500

E: 5,000

F: NIL

Applications for 20,000 shares were received on forms not marked. Draw up a statement showing the number of shares each underwriters had to take up.

Solution:

Net Liability of Underwriters

Particulars	No. of Shares						
	A	B	C	D	E	F	Total
Gross Liability *Less:* Marked Applications	35,000 10,000	30,000 22,500	20,000 20,000	10,000 7,500	3,000 5,000	2,000 NIL	1,00,000 65,000
 Less: Unmarked Applications in the ratio of Gross Liability (35:30:20:10:3:2)	25,000 7,000	7,500 6,000	NIL 4,000	2,500 2,000	–2,000 –600	2,000 400	35,000 20,000
 Less: Surplus of C and E transferred to A, B, F and D in Gross Liability Ratio	18,000 –3,000	1,500 –2,571	–4,000 +4,000	500 –857	–2,600 +2,600	1,600 –172	15,000 —
 B and D's surplus transferred to A and F in Gross Liability Ratio (35:2)	15,000 –1,351	–1071 +1071	— —	–357 +357	— —	1428 –77	15,000 —
Net Liability	13,649	—	—	—	—	1,351	15,000

❍ Partial Underwriting

When a Part of the Issue is Underwritten by one Underwriter

One underwriter may underwrite a part of the issue, say 70 per cent. The company becomes responsible for the balance of 30 per cent of the issue and is deemed as the underwriter for that portion.

In this circumstance, the underwriter is given credit for all the marked applications. Unmarked applications are treated as adjusted towards the portion of the issue for which the company is responsible. Underwriter's liability is determined as follows:

Particulars	No. of Shares
Total Issue *Less:* The portion of the issue for which the company is responsible	xxx xxx
gross Liability of the Underwriter *Less:* Marked Applications	xxx xxx

(*Contd.*)

Balance Left *Less:* Surplus Unmarked Applications (if any)	xxx xxx
Net Liability of the Underwriter	xxx

If marked applications exceed the gross liability of the underwriter, he cannot be called upon to take any shares or debentures, even if there is shortage of applications towards the portion of the issue for which the company is responsible.

When a Part of the Issue is Underwritten by two or more Underwriters

The company is deemed as the underwriter for the portion of the issue which is not underwritten. Liability of each underwriter is determined as follows:

Particulars	No. of Shares		
Gross Liability of the Underwriters *Less:* Marked Applications	xxx xxx	xxx xxx	xxx xxx
Balance Left *Less:* Surplus unmarked application in gross liability ratio	xxx xxx	xxx xxx	xxx xxx
Balance Left *Less:* Surplus from other underwriters divided in Gross Liability Ratio of the recipients	xxx xxx	xxx xxx	xxx xxx
Net Liability of Underwriters	xxx	xxx	xxx

Illustration 7

Swetha Ltd. issued 40,000 equity shares of ₹100 each. Of the issue, 80% was underwritten by Prem. Applications for 28,000 shares were received in all by the company. Determine the liability of Prem.

Solution:

Liability of Prem

Particulars	No. of Shares
Gross Liability (80% of the total issue of 40,000 shares) *Less:* Marked Applications (80% of the total applications received, i.e. 28,000 × 80%)	32,000 22,400
Net Liability of Prem	9,600

Note: In the absence of specific information about the marked applications of Prem, it is assumed that 80% of total number of applications received, i.e. 28,000 × 80% = 22,400 share applications, are marked applications.

Illustration 8

Charulatha Ltd. issued 80,000 8% debentures of ₹100 each. Of the issue, 75% were underwritten by Prabhu Brothers. Applications for 60,000 shares were received in all; out of which, applications for 38,000 were marked. Determine the liability of Prabhu Brothers.

Solution:

Liability of Prabhu Brothers

Particulars	Prabhu Brothers	Company
Gross Liability	60,000	20,000
Less: Unmarked Applications credited to the company (60,000 – 38,000)	—	22,000
	60,000	–2,000
Less: Credit given to Prabhu Brothers, with respect to the surplus applications accruing to the company.	–2,000	+2,000
Balance Left	58,000	Nil
Less: Marked Applications	38,000	—
Net Liability	20,000	—

Illustration 9

XY Ltd. issued 50,000 equity shares of ₹10 each, at a premium of 10% and 2,500 7% debentures of ₹100 each, at a discount of 5%. Of the issue, 75% are underwritten by M/s Gopi & Co., at the maximum rate of commission allowed by law, on the issue price. Application were received for 40,000 equity shares and 2,000 debentures, which are accepted and payment for these was received in full. Journalise the above transaction and show how they would appear in the balance sheet. Also determine the net liability of the underwriters.

Solution:

Net Liability of Underwriters

Particulars	No. of Shares		No. of Debentures
(i) Issued by the Company	50,000		2,500
(ii) Application received for	40,000		2,000
(iii) Issue underwritten by Gopi & Co. 50,000 × 75%	37,500	2,500 × 75%	1,875
Less: Marked Applications 40,000 × 75%	30,000	2,000 × 75%	1,500
Net Liability of Underwriters	7,500		375

Note: In the absence of specific information about the applications, 40,000 equity shares and 2,000 debentures should be treated as marked, 75 per cent in favour of M/s Gopi & Co.

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Equity Shares Capital A/c To Securities Premium A/c (*Being 40,000 shares allotted @ ₹10 each, at a premium of ₹1 (10%), as per Director resolution, dated...*)		4,40,000	 4,00,000 40,000
	Bank A/c Dr. Discount on Issue of Debenture A/c Dr. To 7% Debentures A/c (*Being 2,000 debenture allotted @ ₹100 each, at a discount of ₹5 (5%), as per Director resolution, dated...*)		1,90,000 10,000	 2,00,000
	M/s. Gopi & Co. A/c Dr. To Equity Shares Capital A/c To Securities Premium A/c (*Being 7,500 shares allotted @ ₹10 each, at a premium of 10% to underwriters*)		82,500	 75,000 7,500
	M/s. Gopi & Co. A/c Dr. Discount on issue of debenture A/c Dr. To 7% Debentures A/c (*Being 375 debentures allotted @ ₹100 each, at a discount of (5%) to underwriters*)		35,625 1,875	 37,500
	Underwriting Commission on Issue of Shares A/c Dr. Underwriting commission on debentures A/c Dr. To M/s Gopi & Co. A/c (*Being commission payable to the underwriters @ 2.5% on ₹4,12,000 (i.e., 37,500 shares × ₹11 × 2.5% = ₹10,313) and 2.5% on ₹35,625 (devolving on underwriters for debentures i.e., 375 deb × ₹95 × 2.5% = ₹891 and (1.5% on ₹1,42,500 subscribed by the public i.e., 1,500 deb × ₹95 × 1.5% = ₹2,138 (i.e., ₹891 + ₹2,138 = ₹3,029)*)		10,313 3,029	 13,342
	Bank A/c Dr. To M/s Gopi & Co. A/c (*Being amount received from underwriters in settlement*)		1,04,783	 1,04,783

Notes to Accounts

1.	Share Capital: Issued and Paid-up Capital 47,500 equity shares of ₹10 each	4,75,000
2.	Reserve and Surplus: Securities Premium	47,500
3.	Long-term Borrowings 2,375 7% Debentures of ₹100 each	2,37 ,000
4.	Other Current Assets: Underwriting Commission on Shares Underwriting Commission on Debentures Discount on Issue of Debentures	 10,313 3,029 11,875
		25,217

Balance Sheet of XY Ltd. as on …

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	4,75,000
Reserves and Surplus	2	47,500
(ii) Non-current Liabilities		
Long-term Borrowings	3	2,37,500
Total: (i) + (ii)		7,60,000
II. Assets:		—
(i) Non-current Assets		
(ii) Current Assets		
Cash at Bank		7,34,783
Other Current Assets	4	25,217
Total: (i) + (ii)		7,60,000

Illustration 10

AB Ltd. issued 10,000 shares of ₹10 each. These shares were underwritten as follows:

X: 3,000 shares; Y: 5,000 shares.

The public applied for 7,000 shares, which included marked applications, as follows:

X: 1,000 shares; Y: 2,000 shares.

Determine the liability of X and Y.

Solution:

Liability of the Underwriters

Particulars	No. of Shares		
	X	Y	Company
Gross Liability *Less:* Unmarked Application credited to the company (7,000–1,200)	3,000 —	5,000 —	2,000 5,800
	3,000	5,000	(–)3,800
Less: Credit given to the underwriters with respect to surplus accruing to the company, i.e. 3,800 shares in their Gross Liability Ratio of 3:5	1,425	2,375	+3,800
	1,575	2,625	Nil
Less: Marked Applications	1,000	200	—
Net Liability of the Underwriters	575	2,425	

Illustration 11

Ashok Ltd. issued 40,000 shares of ₹100 each for public subscription. The issue was underwritten as follows:

P: 25%; Q:30; and R: 25%

The company received a total number of 28,000 applications; of which, marked applications were as follows:

P: 8,000 shares; Q: 6,000 shares; and R: 8,000 shares. Determine the liability of each of the underwriters.

Solution:

Liability of the Underwriters

Particulars	No. of Shares			
	P	Q	R	Company
Gross Liability *Less:* Unmarked Applications credited to the company (28,000–22,000) (Total Applications received – Marked Applications)	10,000 —	12,000 —	10,000 —	8,000 6,000
 Less: Marked Applications	10,000 8,000	12,000 6,000	10,000 8,000	2,000 —
Net Liability of the Underwriters	2,000	6,000	2,000	—

Note 1: The column for 'company' is opened to ascertain whether there is any surplus accruing to the company because of the credit given to it, with respect to unmarked applications. In this case, there is no surplus accruing to the company, because of the credit given to it for unmarked applications.

Note 2: The gross liability of each of the underwriter and the company is as follows:

Total shares offered: 40,000 shares

Gross Liability:

P: $40,000 \times 25\% = 10,000$ shares

Q: $40,000 \times 30\% = 12,000$ shares

R: $40,000 \times 25\% = 10,000$ shares

Company's Responsibility $= 40,000 – (10,000 + 12,000 + 10,000)$

$= 8,000$ shares

Note 3: The company itself should be considered as an underwriter for the remaining 20% shares, i.e 8,000 shares, since it is a partial underwriting.

❍ Firm Underwriting

The shares or debentures underwritten as 'firm' must be subscribed by the underwriter. The underwriter gets priority over the general public for the shares or debentures underwritten as 'firm,' even when there is oversubscription.

If nothing is specially mentioned in the underwriting agreement, there are two alternative methods of dealing 'firm underwriting' applications:

- The full benefit of applications for shares that are 'firm underwritten' is given to the respective underwriters. In effect, they are treated like 'marked forms'.
- The benefit of applications for shares that are 'firm underwritten' is divided between all the underwriters, in their gross liability ratio. In effect, they are treated like 'unmarked applications'. In both the methods, underwriters' liability as per the underwriting contract is ascertained. The shares or debentures underwritten as 'firm' are added to find the total liability of the underwriters. The total liability of the underwriters can be ascertained by the following methods.

When Applications for Firm Underwriting are Treated like Marked Form

Particulars	No. of Shares			
	X	Y	Z	Total
Gross Liability *Less:* Firm Underwriting	xxx xxx	xxx xxx	xxx xxx	xxx xxx
	xxx	xxx	xxx	xxx

(*Contd.*)

Less: Marked Applications	xxx	xxx	xxx	xxx
	xxx	xxx	xxx	xxx
Less: Unmarked Applications in Gross Liability Ratio	xxx	xxx	xxx	xxx
Transfer: Surplus of any underwriter to the others in their Gross Liability Ratio	xxx	xxx	xxx	xxx
Net Liability	xxx	xxx	xxx	xxx
Add: Firm Underwriting	xxx	xxx	xxx	xxx
Total Liability	xxx	xxx	xxx	xxx

When Applications for Firm Underwriting are Treated like Unmarked Form

Particulars	No. of Shares			
	X	Y	Z	Total
Gross Liability	xxx	xxx	xxx	xxx
Less: Marked Applications	xxx	xxx	xxx	xxx
	xxx	xxx	xxx	xxx
Less: Unmarked and Firm Underwriting Applications in Gross Liability Ratio	xxx	xxx	xxx	xxx
	xxx	xxx	xxx	xxx
Transfer: Surplus of any underwriter to others in their gross liability ratio	xxx	xxx	xxx	xxx
Net Liability	xxx	xxx	xxx	xxx
Add: Firm Underwriting	xxx	xxx	xxx	xxx
Total Liability	xxx	xxx	xxx	xxx

If no specific instructions are given, the students may follow any one of the above two methods and state the assumption clearly.

In the underwriting contract, the method of dealing with ‘firm’ underwriting applications should be clarified to avoid confusion at a later stage.

2.6 MODEL JOURNAL ENTRIES

❍ In the Books of Company

Journal Entries

	Particulars	Debit (₹)	Credit (₹)
1.	For Shares Subscribed by the public Bank A/c Dr. To Share Capital A/c (*Being shares allotted to the public*) **Note:** If details about application money, allotment money, etc., are given, entries must be written accordingly.	xxx	xxx
2.	For Underwriters' Liability Underwriter's A/c Dr. To Share Capital A/c (*Being shares to be taken by the underwriters, as per underwriting contract*)	xxx	xxx
3.	For Underwriting Commission payable Underwriting Commission A/c Dr. To Underwriter's A/c (*Being commission payable as per agreement*)	xxx	xxx
4.	For Net Amount receivable from Underwriters Bank A/c Dr. To Underwriter's A/c (*Being amount received in settlement from the underwriters*)	xxx	xxx

❍ In the Books of Underwriter

Journal Entries

	Particulars	Debit (₹)	Credit (₹)
1.	For Shares to be taken as Underwriting Obligation Share in Company A/c Dr. To Company A/c (*Being share received from company, as per the underwriting contract*)	xxx	xxx
2.	For Commission receivable Company A/c Dr. To Underwriting Commission A/c (*Being commission receivable, as per the terms of underwriting contract*)	xxx	xxx
3.	For Payment of Cash in settlement Company A/c Dr. To Bank A/c (*Being payments made in settlement to the company*)	xxx	xxx

4.	If there is any decline in the market value of shares for debentures acquired from company Profit & Loss A/c Dr. To Shares or Debentures in Company A/c (*Being decline in the market value taken into account*)	xxx	xxx

Illustration 12

Firm underwriting: Only one underwriter

ABC Ltd. issued 30,000 shares of ₹100 each. The whole issue was underwritten by Gokul.

In addition, there is a firm underwriting of 4,000 shares by Gokul. Applications for 20,000 shares were received by the company in all. Calculate the liability of Gokul.

Solution:

Liability of Gokul

Particulars	No. of Shares
Gross Liability *Less:* Total Applications Received by the Company (i.e. Marked and Unmarked Applications)	30,000 20,000
Net Liability under Normal Underwriting Agreement *Add:* Firm Underwriting of the Underwriter	10,000 4,000
Total Liability of the Underwriter	14,000

Note: It is assumed that applications for the 20,000 shares received do not include firm underwriting applications.

Illustration 13

Firm underwriting: Two or more underwriters

Swiss Ltd. issued 40,000 shares of ₹10 each at par, and the entire issue was underwritten as follows:

A: 24,000 shares(firm underwriting 3,200 shares)

B: 10,000 shares(firm underwriting 4,000 shares)

C: 6,000 shares (firm underwriting 1,200 shares)

The total applications, including firm underwriting, were for 28,400 shares. The marked applications were as under:

A: 7,200 shares; B: 9,000 shares; & C: 3,200 shares

The underwriting contract provides that credit for unmarked applications be given to the underwriters, in proportion to the shares underwritten.

Determine the liability of each underwriter and the amount of commission payable to them, assuming it is the maximum allowed by law.

Solution:

When the benefit of firm underwriting is not given to individual underwriters

Liability of Underwriters

Particulars	No. of Shares			
	A	B	C	Total
Gross Liability	24,000	10,000	6,000	40,000
Less: Marked Applications	7,200	9,000	3,200	19,400
	16,800	1,000	2,800	20,600
Less: Unmarked Application (including firm) in Gross Liability Ratio	5,400	2,250	1,350	9,000
	11,400	(–)1,250	1,450	11,600
Transfer: Surplus of B to A and C in their Gross Liability Ratio (12:3)	1,000	+1,250	250	—
Net Liability of the Underwriter	10,400	—	1,200	11,600
Add: Firm Underwriting	3,200	4,000	1,200	8,400
Total Liability of the Wnderwriters	13,600	4,000	2,400	20,000

Note: Application for firm underwriting is treated like unmarked forms:

Working Note 1:

Total Subscription	–	28,400 shares
Less: Marked Applications Shares	–	19,400 shares
Unmarked Applications, including firm		9,000 shares

Allotment of shares will be as follows:

Particulars		
To the public (Issued –Total liability of underwriters)		20,000 shares
To A's Net Liability	10,400	
To A's Firm Underwriting	3,200	13,600 shares
To B's Net Liability	Nil	
To B's Firm Underwriting	4,000	4,000 shares
To C's Net Liability	1,200	2,400 shares
To C's Firm Underwriting	1,200	
		40,000 shares

Calculation of total underwriting commission payable to underwriters @2.5%, the maximum rate permitted by law: (SEBI guidelines)

A: 24,000 shares × ₹10 × 2.5% = 6,000

B: 10,000 shares × ₹10 × 2.5% = 2,500

C: 6,000 shares × ₹10 × 2.5% = 1,500

10,000

Illustration 14

A Co. Ltd. has an authorised capital ₹50,00,000, divided into 1,00,000 equity shares of ₹50 each. The company issued for subscription 50,000 shares, at a premium of ₹10 each. The entire issue was underwritten as follows:

X: 30,000 shares (firm underwriting 5,000 shares)

Y: 15,000 shares (firm underwriting 2,000 shares)

Z: 5,000 shares (firm underwriting 1,000 shares)

Out of the total issue, 45,000 shares, including firm underwriting, were subscribed. The following were the marked forms:

X: 16,000 shares; Y: 10,000 shares; Z: 4,000 shares;

Calculate the liability of each underwriter.

(a) If the benefit of firm underwriting applications is given to individual underwriters by treating them like 'marked forms.'

(b) If the benefit of firm underwriting is not given to individual underwriters by treating them like 'unmarked forms.'

Solution:

(a) If the benefit of firm underwriting applications is given to individual underwriters by treating them like 'marked forms'

Liability of Underwriters

Particulars	X	Y	Z	Total
Gross Liability *Less:* Firm Underwriting	30,000 5,000	15,000 2,000	5,000 1,000	50,000 8,000
	25,000	13,000	4,000	42,000
Less: Marked Applications	16,000	10,000	4,000	30,000
	9,000	3,000	—	12,000
Less: Unmarked Applications in Gross Liability Ratio (45,000 – 30,000 – 8,000) = 7,000	4,200	2,100	700	7,000
	4,800	900	– 700	5,000
Surplus of Z transferred to X and Y 700 6:3	–467	–233	+ 700	—
	4,333	667	—	5,000
Add: Firm Underwriting	5,000	2,000	1,000	8,000
Net Liability	9,333	2,667	1,000	

(b) If the benefit of firm underwriting is not given to individual underwriters by treating them like 'unmarked forms.'

Liability of Underwriters

Particulars	X	Y	Z	Total
Gross Liability	30,000	15,000	5,000	50,000
Less: Marked Applications	16,000	10,000	4,000	30,000
	14,000	5,000	1,000	20,000
Less: Unmarked Applications	9,000	4,500	1,500	15,000
	5,000	500	– 500	5,000
Surplus of Z transferred to X and Y (2:1) 500 × 2/3 and 500 × 1/3	–333	–167	+500	—
	4,667	333	—	5,000
Add: Firm Underwriting	5,000	2,000	1,000	8,000
Net Liability	9,667	2,333	1,000	13,000

Illustration 15

Chaitanya Chemical Ltd. planned to set up a unit for manufacture of bulk drugs. For the purpose of financing the unit, the Board of Directors have issued 15,00,000 equity shares of ₹10 each. Of the issue, 30% were reserved for promoters and the balance was offered to the public. M, N, and L have come forward to underwrite the public issue in the ratio of 3:1:1 and also agreed for firm underwriting of 30,000, 20,000 and 10,000 shares respectively. The underwriting commission was fixed at 2%. The amount payable on application was ₹2.50 per share. The details of subscription are:

Marked forms of M: 5,50,000 Shares

Marked forms of N: 2,00,000 Shares

Marked forms of L : 1,50,000 Shares

Unmarked forms: 50,000 Shares

(a) You are required to show the allocation of liability among underwriters and pass journal entries in the books of Chaitanya Chemical Ltd. for underwriters' net liability and receipt or payment of cash to or from underwriters.

(b) Determine the liability towards the payment of commission to the underwriters.

Solution:

Benefit of firm underwriting given to underwriters

(a) Statement of Allocation of Liability among Underwriters

Particulars	No. of Shares			
	M	N	L	Total
Gross Liability	6,30,000	2,10,000	2,10,000	10,50,000
Less: Marked Applications	5,50,000	2,00,000	1,50,000	9,00,000

(*Contd.*)

	80,000	10,000	60,000	1,50,000
Less: Unmarked Application (in Gross Liability Ratio 3:1:1)	30,000	10,000	10,000	50,000
	50,000	—	50,000	1,00,000
Less: Firm Underwriting	30,000	20,000	10,000	60,000
	20,000	–20,000	40,000	40,000
N's surplus transferred to M and N in their Gross Liability Ratio of 3:1	–15,000	20,000	–5,000	—
Net Liability	5,000	—	35,000	40,000
Add: Firm Underwriting	30,000	20,000	10,000	60,000
Total Liability of Underwriters	35,000	20,000	45,000	1,00,000

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	M A/c Dr.		12,500	
	L A/c Dr.		87,500	
	To Equity Share Capital A/c			1,00,000
	(*Being allotment of shares to underwriters; 5,000 shares to M and 35,000 shares to L*)			
	Underwriting Commission A/c Dr.		2,10,000	
	To M A/c			1,26,000
	To N A/c			42,000
	To L A/c			42,000
	(*Being underwriting commission payable @ 2% on the value of shares underwritten*)			
	M A/c Dr.		1,13,500	
	N A/c Dr.		42,000	
	To Bank			1,55,500
	(*Being amount paid to M and N in final settlement*)			
	Bank A/c Dr.		45,500	
	To L A/c			45,500
	(*Being amount received from "L" on shares allotted less underwriting commission*)			

(b) Calculation of Underwriting Commission payable:

M = 63,00,000 × 2/100 = ₹1,26,000
N = 21,00,000 × 2/100 = ₹42,000
L = 21,00,000 × 2/100 = ₹42,000

Illustration 16

Partial and firm underwriting: Only one underwriter

Raja Ltd. issued 50,000 equity shares of ₹10 each. Of the issue, 70% was underwritten by Sarvan. In addition, there is a firm underwriting of 4,500 shares by marked application, totalled for 22,000 shares. Determine the liability of Sarvan.

Solution:

Liability of Sarvan

Particulars	Sarvan	Company
Gross Liability *Less:* Firm Underwriting	35,000 4,500	15,000 —
	30,500	15,000
Less: Unmarked Application (directly recorded by the company 42,000 – 22,000 – 4,500)	—	15,500
	30,500	–500
Less: Surplus transferred to him	500	+500
	30,000	—
Less: Marked Application	22,000	—
	8,000	—
Add: Firm Underwriting	4,500	—
Net Liability	12,500	—

Illustration 17

United India Co. Ltd. issued 1,00,000 shares, which were underwritten as follows:

A: 40%; B: 30%; C: 20%

The underwriters made firm underwriting as follows:

A: 7,500 shares; B: 5,000 shares; C: 12,500 shares

The total subscription, excluding firm underwriting but including marked applications, were for 50,000 shares. The marked applications were as under:

A: 20,000 shares; B: 12,500 shares; C: 5,000 shares. Prepare a statement showing the liability of underwriters when the benefit of 'firm applications' is given to them.

Solution:

Liability of Underwriters

Particulars	No. of Shares			
	A	B	C	Company
Gross Liability *Less:* Firm Underwriting	40,000 7,500	30,000 5,000	20,000 12,500	10,000 —
	32,500	25,000	7,500	10,000
Less: Unmarked Application (50,000 – 37,500)	—	—	—	12,500
	32,500	25,000	7,500	–2,500
Less: Surplus transferred to A,B,C 4:3:2 2,500 × 4/9; 2,500 × 3/9; and 2,500 × 2/9	1,111	833	556	+2,500
	31,389	24,167	6,944	—

(*Contd.*)

Less: Marked Application	20,000	12,500	5,00	—
	11,389	11,667	1,944	—
Add: Firm Underwriting	7,500	5,000	12,500	—
Net Liability	18,889	16,667	14,444	—

THEORY QUESTIONS

I. Short-Answer Questions

1. What is Underwriting?
2. What is meant by Marked Applications?
3. Explain the term Firm Underwriting.
4. What do you mean by Unmarked Applications?
5. What do you mean by Gross Liability Ratio?

II. Long-Answer Questions

1. Explain the different types of Underwriting.
2. State the provisions of the Companies Act, 1956, relating to underwriting of shares and debentures.
3. What are the different methods of dealing with Unmarked Applications, in relation to an Underwriting Contract?
4. How do you calculate Underwriters' Liability in Complete Underwriting and Partial Underwriting?
5. Write a note on Underwriting Commission.

OBJECTIVE-TYPE QUESTIONS

I. Multiple Choice Questions

1. When the entire issue is underwritten by only one person, his liability will be equal to:
   (a) Number of the shares underwritten
   (b) Number of Shares underwritten minus number of shares applied for by the public
   (c) Number of shares applied for by public
   (d) None of the above
2. Marked application refers to:
   (a) Application bearing the stamp of the underwriters
   (b) Applications bearing the signature of the applicants
   (c) Applications bearing the stamp of the company
   (d) None of the above

3. Unmarked application refers to:
   (a) Application bearing the stamp of the underwriters
   (b) Application received from the public without bearing the stamp of underwriters and also received directly by the company.
   (c) Applications issued by the company to underwriters
   (d) Firm underwriting
4. The remuneration of the underwriter is calculated on:
   (a) The issue price of the shares underwritten
   (b) The face value of shares actually purchased
   (c) The marked applications
   (d) None of the above
5. Complete underwriting means:
   (a) The whole of the issue of shares or debentures is not underwritten
   (b) The whole of the issue of shares or debentures is underwritten
   (c) Only a part of the shares or debentures is underwritten.
   (d) None of the above
6. If a part of the issue of shares or debenture is underwritten, it is termed as:
   (a) Partial underwriting
   (b) Firm underwriting
   (c) Complete underwriting
   (d) None of the above
7. In firm underwriting, the underwriter:
   (a) Does not agree to buy a definite number of shares in addition to unsubscribed shares
   (b) Agrees to buy a definite number of shares in addition to unsubscribed shares
   (c) Agrees to buy all the shares issued by the company
   (d) None of the above
8. The Department of Economic Affairs, Ministry of Finance (F 14/1/SE/85-7-5-85) and SEBI guidelines stipulates that the underwriting commission on shares should not exceed:
   (a) 5% (b) 2.5%
   (c) 10% (d) 1.5%
9. The underwriting commission on debentures as per Companies Act 1956, should not exceed:
   (a) 5% of the issue price of debentures
   (b) 4% of the issue price of debentures
   (c) 2.5% of the issue price of debentures
   (d) None of the above
10. As per SEBI guidelines, commission payable to underwriters for underwriting preference shares or debentures beyond Rs.5 lakhs, should not exceed:
    (a) 2% (b) 2.5%
    (c) 5% (d) 1.5%

[*Ans:* 1. (b) ; 2. (a) ; 3. (b) ; 4. (a) ; 5. (b) ; 6.(a) ; 7. (b); 8. (b) ; 9. (c) ; 10.(a)]

II. True or False

1. Cash alone is paid as underwriting commission.
2. The underwriters do not agree to purchase any shares in firm underwriting.
3. The underwriters may be an individual, partnership firm, banks financial institutions or joint stock companies.
4. The application received directly by the company which bears the stamp of the underwriters are called 'marked application'
5. The net liability of underwriters, under complete underwriting, can be ascertained by deducting total applications received from shares or debentures offered.
6. Unmarked application can be distributed among the underwriters in the ratio of gross liability.
7. Marked applications are also known as direct application.
8. Issue managers are responsible for the issue of shares right from the planning stage to the closing of all formalities related to the issue.

[*Ans:* True: 3,4,5,6,8 ; False: 1,2,7]

III. Fill in the Blanks

1. Under partial underwriting, the company itself becomes the underwriter for the shares _________.
2. When an underwriter enters into an agreement with another person, he is known as __________.
3. A company issued 30,000 equity shares which were underwritten by *X*. The company received application for 36,000 shares. Hence, *X* will get his commission on the issue price of ___________ shares.
4. When _________ are allotted to the underwriters, the underwriters A/c is debited.
5. When commission is payable to the underwriters, underwriters' A/c is __________.
6. Bank A/c is debited when the _________ due from the underwriters on the shares taken up by them is received.
7. The underwriting commission on shares should not exceed _____ per cent as per SEBI guidelines.
8. __________ is the contract by each underwriter to sell a specified number of shares to the public.
9. The number of shares which are taken by each underwriter when the public has not subscribed is called as _________.
10. The underwriters' liability is nil in case of __________ if the public has subscribed all the shares issued by the company.

[*Ans:* 1. Not underwritten; 2.Sub underwriter; 3. 30,000;
4. Shares or Debentures; 5. Credited; 6. Net amount; 7. 2.5 per cent;
8. Gross Liability; 9. Net liability; 10. Complete underwriting]

EXERCISE PROBLEMS

1. The Chennai motors Ltd. issued 4,00,000 equity shares of Rs.10 each. The whole issue was underwritten by Malar. Applications for 3,20,000 shares were received in all. Determine the liability of the Underwriter.

   [*Ans:* Net liability: 80,000 shares]

2. The following underwriting of shares takes place: A—6,000 shares; B—2,500; C—1,500 shares. The issue consists of 10,000 shares. The total subscription was 7,100 shares and the forms included the following marked forms: A—1,000 shares; B—2,000 shares; C—500 shares. Show the allocation of liability of underwriters. **(Madras University, B. Com., April 1999)**

   [*Ans:* Net liability: A—2,520 shares; B—Nil; C—380 shares]

3. Raj Ltd., issues 20,000 equity shares of Rs. 10 each at par. The issue was underwritten by Kala & Co. for maximum commission permitted by law. The public applied for and received 16,000 shares. Calculate the commission payable to the underwriter. **(Madras University, B.Com., Nov 2004 (1/2 Figs)**

   [*Ans:* Net liability: 4,000 shares; Commission: Rs 5,000 (i.e. 2,00,000 x 2.5%]

4. Excel Ltd. issued 4,000 10% debentures of Rs.100 each at a discount of 6%. The whole of the issue was underwritten by M/s Mani & Co. for maximum commission permitted by law. The public applied for 3,200 debentures. Determine the Net Liability. [*Ans:* Net liability: 800 debentures]

5. Gopu underwrites the new issue of 4,000 Preference shares of Rs.100 each at a premium of 10% of K.R. Ltd. The underwriting commission was payable as per the maximum rate allowed by law. The Public subscribed for 1,600 shares and the rest had to be taken by the underwriter. Calculate the commission payable to Gopu.

   [*Ans:* Net Liability: 2,400 shares. Commission: Rs. 9,240 i.e., on amount subscribed by Public: 1,600 × 110 x 1.5% = Rs.2,640 and on amount devolved on underwriters: 2,400 × 110 × 2.5% = Rs.6,600]

6. From the following details, compute the Net Liability of Underwriters:

   Total Number of shares offered to the Public: 10,000

   Number of Shares Underwritten by X—5,000; Y—3,000; Z—2,000

   Marked Applications (shares) X—1,500; Y—900; Z—600

   Unmarked Applications: 3,000 shares

   [*Ans:* Net liability: X—2,000 shares; Y—600 shares; Z—800 shares]

7. Manu Ltd., issued 2,00,000 equity shares of which only 60% was underwritten by Gomathi. Applications for 1,80,000 shares were received in all out of which application for 1,04,000 were marked. Determine the liability of Gomathi.

   [*Ans:* Net liability of Gomathi: 16,000 shares (i.e., 1,20,000 – 1,04,000]

8. Sathya Ltd., issued 12%, 10,000 preference shares of Rs.10 each. The issue was underwritten as follows: Arul—30%; Madan—30%; Ganga—20%. Applications for 8,000 shares were received by the company in all. Determine the liability of the respective underwriters.

   [*Ans:* Net liability: Arul: 600 shares; Madan: 600 shares; Ganga: 400 shares]

OTHER EXERCISES

1. Nazar Ltd., issued 10,000 equity shares of ₹100 each at par. The whole issue has been underwritten by John & Co. for a commission of 2%. The company received applications only for 5,000 shares. All the applications were accepted. Give journal entries, assuming that all amounts due have been received.

   [*Ans:* Net liability of underwriter: ₹5,00,000; Commission: ₹20,000; Net amount receivable after adjusting commission: ₹4,80,000]

2. Good luck Ltd. issued 1,000 equity shares of ₹100 each and 1,000 6%debentures of ₹100 each. The debentures were issued at a discount of 6%. The whole of the issue was underwritten by Wisdom &Co. for a commission of 4% on the issue price of shares and 2% on the issue price of debentures. The public applied for 900 shares and 800 debentures. These were immediately paid for. The underwriters fulfilled their obligations.

   Pass journal entries.

   [*Ans:* Commission on shares: ₹4,000; Commission on debentures: ₹1,880; Underwriter's liability for shares: ₹10,000; for debentures: ₹18,800; Net cash receivable from underwriters: ₹22,920]

3. A company issued 20,000 equity shares of ₹100 each at par and 1,000 debentures of ₹1,000 each at ₹950. The whole of the issue has been underwritten by Paul & Co. The whole of the shares are applied for but applications were applied only for 800 debentures. All the applications were accepted. Commission payable to the underwriter is the maximum amount permissible.

   Give journal entries to record the above transactions and prepare the balance sheet at this stage, assuming that all amounts due have been received.

   [*Ans:* Underwriting commission on shares: ₹50,000 (20,00,000 × 2.5%); on debentures: ₹11,400 (7,60,000 × 1% + 1,90,000 × 2%); Underwriter's liability: ₹1,90,000; Net cash liability: ₹1,28,600; Balance sheet total: ₹30,00,000]

4. Velu Ltd. issued 1,00,000 equity shares. The whole of the issue was underwritten as follows:

   A: 40%; B: 30%; C: 30%

   Applications for 80,000 shares were received in all; out of which, applications for 20,000 shares had the stamp of A, those for 10,000 shares that of B, and 20,000 share that of C. The remaining applications for 30,000 shares did not bear any stamp.

   Show the net liability of the underwriters.

   [*Ans:* Net liability: A: 8,000 shares; B: 11,000 shares; and C: 1,000 shares]

5. ABC Ltd., incorporated on 1 January 1985, issued prospectus inviting applications for 6,00,000 equity shares of ₹10 each.

   The whole issue was fully underwritten by A, B, C and D as follows;

   A: 2,00,000 shares, B: 1,50,000 shares, C: 1,50,000 and D: 1,00,000 shares

   Applications were received for 6,50,000 shares; of which, marked applications were as follows:

   A: 2,50,000 shares, B: 1,70,000 shares; C: 1,40,000 and D: 40,000 shares

   Find out the liabilities of individual underwriters.

   [*Ans:* No liability for any underwriters]

6. Arun Ltd. issued 1,00,000 equity shares. The whole of the issue was underwritten as follows:

   X: 40%; Y: 40%; Z: 20%

   Applications for 80,000 shares were received in all; out of which, applications for 20,000 shares had the stamp of X, those for 10,000 shares that of Y and 20,000 shares that of Z.

   The remaining applications did not bear any stamp.

   Show the liability of the underwriters.

   [*Ans:* Net liability of X: 5,000 shares; Y: 15,000 shares and Z: nil]

7. Tamil Nadu Co. Ltd. was formed with a capital of ₹10,00,000 in ₹10 shares, the whole amount being issued to the public. The underwriting of these shares was done as follows:

   A: 30,000; B: 35,000; C: 10,000; D: 15,000; E: 2,000 and F: 8,000. All the marked applications forms were to go in relief of the underwriters whose name they bore.

   The applications marked by the underwriters were:

   A: 25,000 ; B: 23,500; C: 6,500; D:1,000; E: 2,000; F: 7,000.

   Applications for 20,000 shares were received on forms not marked. Draw up a statement showing the number of shares each underwriter had to take up.

   [*Ans:* Net liability of A: Nil; B: 3,333 shares; C: 1,167 shares; D: 10,500 shares]

8. H Company issued 20,000 shares of ₹10 each at par, which were underwritten as follows:

   X: 10,000 shares; Y: 6,000 shares; Z: 4,000 shares.

   Applications were received for 18,000 shares, which included marked applications also, as follows:

   X: 4,000 shares; Y: 2,000 shares; Z:10,000 shares.

   You are required to prepare a statement showing how many shares underwriters will have to take under the underwriting contract.

   [*Ans:* Net liability: X: 1,000 shares; Y: 1,000 shares; Z:nil]

9. X Ltd. issued 10,000 shares of ₹100 each at a premium of ₹15 each. Of the issue, 90% was underwritten by M/s. Broker &Co. at commission of 1% on the nominal face value.

   Applications were received for 8,000 shares and allotment was fully made. All the moneys due from allottees were received in one instalment. The accounts with Broker &Co. were settled. Show the journal entries to record the transactions.

   [*Ans:* Net liability of Brokers & Co.: 1,800 shares;
   Cash received from underwriters: ₹1,98,000]

10. A Company issued 50,000 equity shares of ₹10 each at a premium of 10% and 2,000 debentures of ₹100 each at ₹95. Of the issue, 80% is underwritten by Sing &Co. at the maximum rate of commission allowed by law. Applications were received for 40,000 equity share and 1,500 debentures, which were accepted and payments for these were received in full. Journalise the above transactions and show the entries in the balance sheet, assuming that the amount due from the underwriter has been received.

    [*Ans:* Commission on shares: ₹11,000; On debentures: ₹2,660 (1,710 + 950);
    Cash received from underwriter: ₹1,12,340;
    Total cash in balance sheet: ₹6,94,840; Balance sheet total: ₹7,18,000]

11. X Ltd. issued 10,000 equity shares of ₹10 each. The issue was underwritten as follows:

    A: 30%; B: 30%; C: 20%

    However, the company received applications for 8,000 shares only. Determine the liability of the respective underwriters and write the journal entries in the company's books.

    [*Ans:* A takes 600 shares; B takes 600 shares and C takes 400 shares]

12. Neeraj Ltd. issued 10,000 shares of ₹10 each, at a premium of 10%. The shares were underwritten by Joseph and Jaleel to the extent of 5,000 shares and 3,000 shares respectively.

    The total applications received by the company were 8,000; of which, the marked applications were:

    Joseph: 1,200 shares

    Jaleel: 300 shares

    You are required to determine the liability of the underwriters.

    [*Ans:* Net liability of Joseph: 987 shares; Jaleel: 1,013 shares]

Firm Underwriting

13. T.T. Ltd. issued 50,000 equity shares of ₹10 each at par. The entire issue was underwritten as follows:

    A: 30,000 shares (firm underwriting 4,000)

    B: 10,000 shares (firm underwriting 5,000)

    C: 5,000 shares (firm underwriting 1,000)

    The total applications including firm underwriting were for 40,000 shares. The marked applications were as follows:

    A: 10,000 shares

    B: 7,000 shares

    C: 3,000 shares

    The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten.

    Determine the liability of each underwriter and amount of commission payable to them, assuming the rate to be 2% on issue price.

    [*Ans:* Net liability of A: 12,000 shares; B: 7,000 shares; C:1000 shares; D: 20,000 shares; Underwriting Commission payable: A: ₹6,000; B: ₹3,000 and C: ₹1,000]

14. The following underwriting took place:

    A: 5,000 shares

    B: 3,000 shares

    C: 2,000 shares

    In addition, there was firm underwriting:

    A: 1,000 shares

    B: 500 shares

    C: 1,500 shares

    The share issue was for 10,000 shares. Total subscription including firm underwriting was 8,500 shares and the forms included the following marked forms:

A: 2,000 shares

B: 1,000 shares

C: 1,000 shares

Show the allocation of liability of the underwriters.

[*Ans:* Total liability including firm underwriting:

	A	B	C
'Firm' treated as marked	1,750	1,250	1,500
'Firm' treated as unmarked	1,750	1,150	1,600

15. A Co. Ltd. has an authorised capital of ₹50,00,000, divided into 1,00,000 equity shares of ₹50 each. The company issued for subscription 50,000 shares at a premium of ₹10 each. The entire issue was underwritten as follows:

X: 30,000 shares (firm underwriting 5,000 shares)

Y: 15,000 shares (firm underwriting 2,000 shares)

Z: 5,000 shares (firm underwriting 1,000 shares)

Out of the total issue, 45,000 shares including firm underwriting were subscribed. The following were the marked forms:

X: 16,000 shares

Y:10,000 shares

Z: 4,000 shares

Calculate the liability of each underwriter.

[*Ans:* Final liability including firm underwriting:

	X	Y	Z
'Firm' treated as marked	9,333	2,667	1,000
'Firm' treated as unmarked	9,667	2,333	1,000

16. R. Ltd. issued 10,000 shares of ₹100 each, at a premium of ₹20 per share. The entire issue was underwritten as follows:

A: 5,000 shares (firm underwriting 1,000 shares)

B: 3,000 shares (firm underwriting 500 shares)

C: 2,000 shares (firm underwriting 500 shares)

The number of shares applied for were 9,000. The following were the marked applications:

A: 3,500 shares

B: 1,400shares

C: 1,600 shares including firm underwriting. Prepare a statement showing their net liability.

[*Ans:* Final liability including firm underwriters:

	A	B	C
'Firm' treated as marked	1,188	1,312	500
'Firm' treated as unmarked	1,125	1,375	500

Partial and Firm Underwriting

17. ABC Ltd. issued 30,000, 9% Preference shares of ₹10 each. Of the issue, 80% was underwritten by Palani. In addition, there is a firm underwriting of 5,000 shares by Palani. Applications for 27,000 shares were received by the company

in all. The marked applications totalled 13,000 shares. Determine the liability of Palani. [*Ans:* Liability of Palani: 8,000 shares]

18. Akbar Ltd. issued 1,00,000 equity shares of ₹10 each. Of the issue, 75% was underwritten by Kumar. In addition, there was a firm underwriting of 9,000 shares by Kumar. In all, applications for 84,000 shares were received by the company. The marked applications totalled 44,000 shares. Determine the liability of Kumar. [*Ans:* Liability of Kumar: 25,000 shares]

19. P, K and R underwrote 80% of an issue of 20,000 preferene shares of ₹10 each in the ratio of 2:2:1. The 'firm' and 'marked' applications of the underwriters are as follows:

	Firm	**Marked**
P	2,400	4,000
K	2,000	3,000
R	1,600	1,000

Applications for 16,000 shares were received in all. Prepare a statement showing the liability of each of the underwriters.

[*Ans:* If firm underwriting applications are treated as unmarked: A: 3,200; B: 3,800; C: 3,000]

20. A, B and C underwrite 75% of an issue of 40,000 equity shares of ₹10 each in the ratio of 2:2:1. The 'firm' and 'marked' applications of the underwriters are as follows:

	Firm	**Marked**
A	4,800	8,000
B	4,000	6,000
C	3,200	2,000

Applications for 35,000 shares were received in all. Prepare a statement showing the liability of each of the underwriters.

[*Ans:* If firm underwriting applications are treated as marked: Total Liability of A: 4,800 shares; B: 5,467 shares; C: 3,733 shares; If firm underwriting applications are treated as unmarked: A: 5,200; B: 6,400; C: 5,400]

3

REDEMPTION OF PREFERENCE SHARES

A company cannot return its share capital to the shareholders without the permission of the Court of Law, as per Section 100 of the Companies Act, 1956. The issue and redemption of redeemable preference shares are dealt in Section 80 and 80A of the Companies Act. The permission of the court is not required for redeeming the redeemable preference shares.

3.1 PROVISIONS OF THE COMPANIES ACT

The following important provisions of Section 80 of the Companies Act, 1956, relating to issue and redemption of redeemable preference shares have to be adopted:

1. A company, limited by shares, may, if authorised by its Articles of Association, issue preference shares, which are liable to be redeemed as per the terms of the issue. However, with effect from 1^{st} March 1997, a company cannot issue irredeemable preference shares or shares, which can be redeemed beyond a period of 20 years [Companies (Amendment) Act, 1996, Section 80 5(A)].
2. Such shares cannot be redeemed unless they are fully paid-up.
3. Such shares can be redeemed either out of the profits of the company, which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of redemption.
4. If any premium is payable on redemption of preference shares, such premium has to be provided out of the profits of the company or out of the securities premium account.
5. When shares are redeemed out of profit, as sum equal to the nominal amount of the shares so redeemed must be transferred, out of the profit of the company, which would otherwise be available for dividend, to a reserve account called '*Capital Redemption Reserve Account*'.
6. Capital redemption reserve can be utilised to issue fully-paid bonus shares to the equity shareholders. Unless otherwise sanctioned by the court, it cannot be used for any other purpose.
7. Redemption of preference shares by a company shall not be taken as reduction of its Authorised capital.

3.2 COMPANIES (AMENDMENT) ACT, 1988, AND COMPANIES (AMENDMENT) ACT, 1996

The Companies (Amendment) Act, 1988, gives the following provisions relating to issue and redemption of preference shares.

❍ Prohibition of Irredeemable Preference Shares

No company shall, after the commencement of the Companies (Amendment) Act, 1988, issue any preference shares, which are irredeemable or are redeemable after the expiry of ten years from the date of issue (Section 80 A).

Companies (Amendment) Act, 1996 [Section 80 5(A)], has modified the above provision of the 1988 Act as follows:

"With effect from 1st March 1997, a company cannot issue irredeemable preference share which can be redeemed beyond a period of 20 years."

The result of this amendment is that any company can issue, hereafter, only redeemable preference shares, which also must be repaid within twenty years.

❍ Redemption of Existing Irredeemable Preference Shares

All existing irredeemable preference shares, are to be redeemed within 5 years, i.e. on or before 14th June 1993 [Section 80 A(1)].

❍ Redemption of Existing Redeemable Preference Shares

All the existing redeemable preference shares must be redeemed on their due dates or within 10 years, i.e. on or before 14th June 1998.

❍ Issue of Further Redeemable Preference Shares for Redemption of Earlier Shares

If any company is not in a position to redeem its preference shares as provided in Section 80A, with the permission of the company Law Board, it can issue fresh redeemable preference shares (including arrears of preference dividend) equal to the amount due, as a special case.

3.3 IMPLICATIONS OF SECTION 80 AND SECTION 80 A OF THE COMPANIES ACT

The following implications are derived from the above sections:

1. Articles of Association of the company should provide for the issue of redeemable preference shares. If not, a special resolution should be passed to amend the Articles for making such issue. The shares should have been issued as redeemable preference shares. With the passage of Companies (Amendment) Act, 1998, issue of no other preference shares is possible.

2. Only fully paid-up preference shares can be redeemed. Partly-paid preference shares can be redeemed if a call has been made to make them fully paid. Then only, such shares can be redeemed. The purpose of the provision is to protect the security available to the creditors.
3. Profits available for dividend refers to revenue profits of a company. Thus, all the capital profits are not taken into consideration for the purpose of redemption.

   'Proceeds' of a fresh issue of shares clearly denotes that amount received from fresh issue of debentures or loan arranged or asset sold cannot be taken into account for the redemption of redeemable preference shares.

   The word 'proceeds' implies the amount received, excluding the amount of share premium on the new shares. Similarly, when the new issue is at par or at discount, the net amount received from the issue should be deemed as 'proceeds'.

   The main objective of Section 80 of the Companies Act is to protect the interest of the creditors of the company. So, 'proceeds' of fresh issue keeps the capital structure of the company intact. The amount paid is replaced by 'proceeds' of fresh issue.
4. Premium on redemption is a capital loss, which can be provided out of 'Securities Premium Account'. If securities premium does not exist or is insufficient, other profits of the company such as Profit & Loss A/c, general reserve, etc. can be used to write off the premium on redemption.
5. Profits available for dividend that are used for redemption have to be transferred to 'Capital Redemption Reserve'.

   The capital redemption reserve account will take the place of the Redeemable Preference Share Capital, after the redemption. If new issue of shares was made, the new issue of share capital takes the place of the redeemable preference shares. Thus, Section 80 of Companies Act ensures that the preference shares redeemed are completely replaced.
6. Capital redemption reserve can be used to issue only fully-paid bonus shares.
7. Redemption of preference shares has no effect on the authorised share capital. So, in the balance sheet, the authorised share capital remains same.

3.4 REVENUE AND CAPITAL PROFIT

Revenue Profit Or Profits available for Dividend Or Profit transferable to Capital Redemption Reserve	Capital Profits Or Profits not available for Dividend Or Profits not to be transferred to Capital Redemption Reserve
1. General reserve 2. Dividend equalisation reserve 3. Reserve fund 4. Profit on sale of investment and fixed assets 5. Workmen's compensation fund 6. Workmen's accident fund 7. Insurance fund 8. Debenture redemption fund (voluntary) 9. Debenture redemption account (voluntary) 10. Profit and loss account	Capital reserve Capital redemption reserve (already existing) Development rebate reserve Depreciation reserve Forfeited shares account Profits prior to incorporation Profit on sale of fixed assets (capital portion) Securities premium account

3.5 MINIMUM FRESH ISSUE OF SHARES

Companies can decide to utilise all the permissible reserves for the redemption of preference shares and make new issue of shares for any balance amount required. The purpose is to minimise the new issue of shares for any balance amount required. Such minimum new issue may be made at par, at a premium or at a discount.

The following formula can be used to determine the amount of new issue:

$$\left.\begin{array}{l}\text{Minimum}\\ \text{new issue}\\ \text{to be made}\end{array}\right\} = \left[\begin{array}{l}\text{Face value of}\\ \text{redeemable}\\ \text{preference}\\ \text{shares}\end{array} + \begin{array}{l}\text{Premium}\\ \text{payable on}\\ \text{redemption}\end{array} - \begin{array}{l}\text{Securities}\\ \text{premium}\\ \text{in Balance}\\ \text{Sheet (upto}\\ \text{premium}\\ \text{payable)}\end{array} - \begin{array}{l}\text{Revenue}\\ \text{reserve}\\ \text{in Balance}\\ \text{Sheet}\end{array}\right]$$

$$\times \frac{100}{\begin{array}{c}100 + \text{Premium \% on new issue}\\ \text{(or)}\\ 100 - \text{Discount \% on new issue}\end{array}}$$

3.6 STEPS INVOLVED IN PROBLEM SOLVING

The following steps can be adopted to solve problems relating to redemption of preference shares.

Step 1: Determination of capital redemption reserve

Preference shares can be redeemed out of revenue reserves or out of the proceeds of a fresh issue of shares or a combination of both. If revenue reserves are used, an equal amount should be transferred to Capital Redemption Reserve (CRR).

It is essential to determine the amount of transfer to CRR. The following formula can be used for the purpose.

$$\left.\begin{matrix}\text{Transfer to}\\ \text{CRR}\end{matrix}\right\} = \begin{pmatrix}\text{Face value of}\\ \text{preference shares}\\ \text{to be redeemed}\end{pmatrix} - \begin{pmatrix}\text{Amount received from}\\ \text{new issue of shares}\\ \text{[excluding premium]}\end{pmatrix}$$

Note: If new issue is not given and minimum fresh issue has to be calculated then, it has to be ascertained, before determining the transfer to CRR.

Step 2: Sources for premium on redemption of preference shares

If any premium is payable on the redemption of preference shares, the following order of different sources can be used:

1. Securities premium given in balance sheet
2. Premium on new issue of shares or debentures
3. Revenue reserves

Step 3: Maintaining sufficient cash for redemption

When the redemption is out of revenue profits the availability of cash has to be ascertained. The following is the method of determining the cash position:

Particulars	(₹)
Face Value of Preference Shares to be Redeemed	xxx
Add: Premium Payable on Redemption	xxx
Total Cash Required	xxxx
Less: Final Call Received on partly-paid Redeemable Preference Share	xxxx
Less: Cash Received from New Issue of Shares or Debentures	xxxx
Less: Bank or Cash Balance given in the Balance Sheet	xxxx
Shortage of Cash for Redemption	xxxxx

The Shortage of cash for redemption can be made up in the following order:

1. Assuming that any investments in balance sheet are sold at par.
2. Assuming that trade debtors are realised at par
3. Assuming that bank overdraft is arranged to the extent needed.

Step 4: Providing for transfers and payment

1. Revenue reserve used for redemption must be transferred to Capital Redemption Reserve account.
2. Premium on redemption should be provided out of appropriate source of accumulated profits.

3. Redeemable preference share capital and the premium payable on redemption must be transferred to the preference shareholders.
4. Finally, cash payment should be made to the shareholders.

Step 5: Issue of bonus shares, if given in the problem
Bonus issue is primarily out of capital redemption reserve. If that is not sufficient, capital reserve, any other capital profits and even revenue profits can be used for issue of bonus shares. Usually, bonus issue is made to the equity shareholders in a specified ratio.

3.7 MODEL JOURNAL ENTRIES FOR REDEMPTION OF PREFERENCE SHARES

Particulars	(₹)	(₹)
1. Entries for receiving cash		
a. For making final call on partly paid preference shares:		
Redeemable Preference Share Final Call A/c Dr.	xxx	
To Redeemable Preference Share Capital A/c		xxx
(*Being the final call receivable*)		
b. For receiving final call amount:		
Bank A/c Dr.	xxx	
To Redeemable Preference Share Final Call A/c		xxx
(*Being the final call amount received*)		
c. For sale of investment etc., at a loss		
Bank A/c (cash received) Dr.	xxx	
Profit & Loss A/c (loss on sale)	xxx	
To Investment A/c		xxx
Or		
To Asset A/c (book value)		xxx
(*Being the sale of investment/asset at a loss*)		
Note: If sale is at profit, profit and loss account can be credited with the profit on sale.		
d. For a new issue of debentures or bonds:		
Bank A/c Dr.	xxx	
To ____% Debentures A/c		xxx
To ____% Bonds A/c		xxx
(*Being issue of bonds/ debentures*)		
e. For new issue of shares at a premium		
Bank A/c Dr.	xxx	
To Share Capital A/c		xxx
To Securities Premium A/c		xxx
(*Being the new issue of shares at a premium made for the purpose of redemption of preference shares*)		

(*Contd.*)

2. Entries for transfers		
a. For transfer to capital redemption reserve		
General Reserve A/c Dr.	xxx	
Profit & Loss A/c Dr.	xxx	
To Capital Redemption Reserve A/c		xxx
(*Being the transfer of revenue reserve used for redemption to CRR as per Section 80 of the Companies Act*)		
b. For redeemable preference share capital and premium payable on redemption		
Redeemable Preference Share Capital A/c Dr.	xxx	
Premium on Redemption A/c Dr.	xxx	
To Redeemable Preference Shareholders A/c		xxx
(*Being the transfer of share capital and premium payable to shareholder*)		
c. Adjustment of premium payable on redemption		
Securities Premium A/c Dr.	xxx	
Profit & Loss A/c Dr.	xxx	
To Premium on Redemption A/c		xxx
(*Being the premium payable adjusted from securities premium/ Profit & Loss A/c*)		
3. Entry for cash payment		
Redeemable Preference Shareholders A/c Dr.	xxx	
To Bank A/c		xxx
(*Being the final payment to the shareholders*)		
4. Entries for bonus issue		
a. *For declaration of bonus*		
Capital Redemption Reserve A/c Dr.	xxx	
General Reserve A/c Dr.	xxx	
Profit & Loss A/c Dr.	xxx	
To Bonus to Shareholders A/c		xxx
(*Being bonus payable to the shareholders as per board resolution dated…..*)		
b. For issue of bonus shares:		
Bonus to Shareholders A/c Dr.	xxx	
To Equity Share Capital A/c		xxx
(*Being issue of bonus shares to the equity shareholder in the ratio of ………. Shares for…… shares held*)		

3.8 SPECIFIC POINTS TO BE CONSIDERED

1. ***Untraceable shareholders:*** Some shareholders may become untraceable due to change of address or some other reasons. It is not possible to make payment to them at the time of redemption.

   In the journal entry the amount due to the 'untraceable shareholders' should not be included while making payment to shareholders. Their balance appears in the balance sheet's liabilities side, under the heading current liabilities till they claim their dues.

2. ***Calls-in-Arrears:*** As per Section 80 of the Companies Act, only fully-paid preference shares can be redeemed. So, any redeemable preference shares on which one or more calls are outstanding cannot be redeemed. However, unless the company forfeits their shares, the holders of such shares can pay their arrears and become eligible for redemption.

   If the redemption is proposed to be carried through, a fresh issue must be made presuming that the Calls-in-Arrears can be collected. So, the new issue must provide for redemption of such shares also.

   If the redemption is to be made out of revenue reserves, sufficient reserves must be left in the accounts of the reserves concerned so that the shares on which arrears exist can be redeemed in future. This becomes essential when it is decided by the company to make minimum fresh issue of shares.

3. ***Sale or realisation of assets:*** If any fixed assets or current assets are sold or realised as the case may be at the time of redemption of preference shares, the effect is two-fold; the sale improves the cash position of the company. Any loss or profit on sale or realisation of the assets alters the position of revenue reserves. These changes have to be kept in mind while determining minimum new issue, transfer of capital redemption reserve, etc.

4. The asset side of the balance sheet may show the aggregate current assets. The position of cash or bank balance may not be given. In such problems, it may be assumed that "current asset" includes necessary cash balance.

Illustration 1

Redemption at par out of revenue reserves

RKT Ltd. issued 40,000 equity shares of ₹10 each and 10,000 9% redeemable preference shares of ₹100 each being fully called and paid up on 31st March 2002. Profit and loss account showed undistributed profits of ₹8,00,000 and general reserves stood at ₹3,00,000. On 1st April 2002, the directors decided to redeem the existing preference shares at par utilising as much profits as would be required for the purpose. Pass journal entries in the books of the company.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
01.04.2002	General Reserve A/c	Dr.		3,00,000	
	Profit & Loss A/c	Dr.		7,00,000	
	To Capital Redemption Reserve A/c				10,00,000
	(*Being amount transferred from general reserve and Profit & Loss A/c to capital redemption reserve account for redemption purpose*)				

(*Contd.*)

	Redeemable Preference Share Capital A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount due to preference shareholders*)		10,00,000	10,00,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being payment made to preference shareholders on redemption*)		10,00,000	10,00,000

Illustration 2

Redemption at premium out of revenue reserves

AB Ltd. has decided to redeem its preference shares, at a premium of 5%, with the following details, as on 31st December 2004.

Share Capital:	**(₹)**
20,000 Equity Shares of ₹100 each	20,00,000
3,00,000 7% Redeemable Preference Shares of ₹10 each	30,00,000
General Reserve	10,00,000
Capital Reserve	5,00,000
Profit & Loss A/c	27,50,000

Give journal entries to record the above transaction.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31.12.2004	Profit & Loss A/c Dr. General Reserves A/c Dr. To Capital Redemption Reserve A/c [W.N. (ii)] (*Being the transfer of an amount equal to the nominal value of shares redeemed*)		26,00,000 4,00,000	30,00,000
	7% Redeemable Preference Share Capital A/c [(W.N.(i)] Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being the amount due to preference shareholders*)		30,00,000 1,50,000	31,50,000

(*Contd.*)

	Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being the premium on redemption adjusted out of Profit & Loss A/c*)		1,50,000	1,50,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholder on redemption*)		31,50,000	31,50,000

Working Notes:

		₹
(i)	Face Value of Redeemable Preference Share Capital	30,00,000
	Add: Premium on Redemption 30,00,000 × 5/100	1,50,000
	Due to Preference Shareholders	31,50,000
	Less: Premium on Redemption is adjusted from Profit & Loss A/c	1,50,000
	Face Value of Preference Shares Capital to be Redeemed	30,00,000
(ii)	Profit & Loss A/c	26,00,000
	General Reserve	4,00,000
	Capital Redemption Reserve	30,00,000

Illustration 3

Redemption at par out of fresh issue

Manu Ltd. has 10% 10,000 preference shares of ₹10 each fully paid. The shares became due for redemption and the company decided to redeem the whole amount out of a fresh issue of equity shares of ₹10 each fully paid.

Show the necessary journal entries in the book of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Equity Share Capital A/c (*Being equity shares issued for the purposes of redemption*)		1,00,000	1,00,000
	10% Preference Share Capital A/c Dr. To Preference Shareholders A/c (*Being amount payable on redemption*)		1,00,000	1,00,000
	Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		1,00,000	1,00,000

Illustration 4

Redemption through Revenue Reserves & fresh issue of shares

Find out in each case what amount shall be transferred to capital redemption reserve account.

Redeemable Preference Shares Redeemed	Fresh Issue of Share Capital
(a) ₹2,00,000 at par	(a) ₹80,000 at par
(b) ₹2,00,000 at 5% premium	(b) ₹80,000 at par
(c) ₹2,00,000 at par	(c) ₹80,000 at 10% premium
(d) ₹2,00,000 at par	(d) ₹80,000 at 10% discount
(e) ₹2,00,000 at 5% premium	(e) ₹80,000 at 10% premium

Solution:

In case (d) ₹1,28,000 and in rest of the cases ₹1,20,000 must be transferred to capital redemption reserve account.

Illustration 5

From the following information, find out how much minimum fresh issue is necessary in order to comply with the provisions of Section 80 of the Companies Act, 1956.

Redeemable Preference Shares Redeemed	Profit Shown in the Balance Sheet
(a) ₹2,00,000 at par	(a) Profit ₹30,000; security premium ₹10,000
(b) ₹2,00,000 at 10% premium	(b) Profit ₹30,000; security premium ₹10,000
(c) ₹2,00,000 at 10% premium	(c) Profit ₹30,000; security premium 8,000; general reserve 20,000; dividend equalisation fund ₹50,000

Solution:

(a) Securities premium of ₹10,000 (as it is not available for dividend) cannot be used to redeem the face value of preference shares.
The minimum number of fresh issue is as follows:

Face Value of Redeemable Preference Share Capital	2,00,000
Less: Profit & Loss A/c (Capital Redemption Reserve Account)	30,000
Balance to be Redeemed out of Fresh Issue of Share Capital	1,70,000

(b)

Face Value of Redeemable Preference Share Capital	2,00,000
Add: Premium on Redemption @10%	20,000
	2,20,000

Less: Premium on Redemption adjusted		
(i) Security Premium		10,000
(ii) Profit & Loss A/c		10,000
		20,000
Face Value of Preference Shares to be Redeemed		2,00,000
Less: Profit & Loss A/c (30,000 – 10,000)		20,000
Balance to be Transferred out of Fresh Issue of Share Capital		1,80,000
(c) Face Value of Redeemable Preference Share Capital		2,00,000
Add: Premium on Redemption @10%		20,000
Due to Preference Shareholders		2,20,000
Less: Premium on Redemption adjusted		
(i) Security Premium	8,000	
(ii) Profit & Loss A/c	12,000	20,000
Face Value of Preference Shares to be Redeemed		2,00,000
Less: Profit & Loss A/c (30,000 – 12,000)	18,000	
Less: General Reserve A/c	20,000	
Less: Dividing Equalisation Fund	50,000	88,000
Balance to be Redeemed out of Fresh Issue of Share Capital		1,12,000

Illustration 6

A company issued ₹1,80,000 redeemable preference shares at par on 1st January 1988, redeemable at the option of the company on or after 31st December 1992 in whole or in part.

The following redemption was made from out of profits;

On 30th June 1993 ₹60,000

On 30th June 1994 ₹40,000

In December 1994, the company issued equity shares of the value of ₹60,000 at a premium of 2% and on 31st December in the same year, it redeemed the balance of preference shares. Pass the necessary journal entries to record the above transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
30.06.1993	Redeemable Preference Share Capital A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount payable on redemption*)		60,000	60,000

(*Contd.*)

	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		60,000	60,000
	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred to CRR A/c*)		60,000	60,000
30.06.1994	Redeemable Preference Share Capital A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount payable on redemption*)		40,000	40,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		40,000	40,000
	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred to CRR A/c*)		40,000	40,000
31.12.1994	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of equity shares at a premium of 2%*)		61,200	 60,000 1,200
	Redeemable Preference Share Capital A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount payable on redemption*)		80,000	80,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		80,000	80,000
	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred to CRR A/c*)		20,000	20,000

Illustration 7

Redemption at a premium, partly out of profits and partly out of fresh issue

SJ Ltd. has part of their share capital in 3,000 8% redeemable preference shares of ₹100 each. The company decided to redeem the preference shares at premium of 10%. The general reserve of the company shows a balance of ₹4,00,000. The directors decided to utilise 70% of the reserve in redeeming the preference share and the balance is to be met from the proceeds of fresh issue of sufficient number of shares of ₹10 each. The premium is to be met from the profit and loss. Pass journal entries to record the above transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	General Reserve A/c Dr. To Capital Redemption Reserve A/c (*Being 70% of general reserve transferred to capital redemption reserve account for redemption of preference shares*)		2,80,000	2,80,000
	Bank A/c Dr. To Equity Share Capital A/c (*Being 2000 equity shares issued @ ₹10 each for redemption purpose*)		20,000	20,000
	Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being premium on redemption of preference shares written off out of Profit & Loss A/c*)		3,00,000 30,000	3,30,000
	Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium on redemption of preference shares written off out of Profit & Loss A/c*)		30,000	30,000
	Redeemable Preference Shareholders A/c Dr To Bank A/c (*Being amount paid to the redeemable preference shareholders on redemption*)		3,30,000	3,30,000

Illustration 8

Redemption at a premium and fresh issue at premium

A company has 10,000 9% redeemable preference shares of ₹100 each, fully paid. The company decides to redeem the shares on 31st December 2004 at a premium of 10%. The company makes the following issues:

(a) 7,000 equity shares of ₹100 each, at a premium of 10%

(b) 3,000 8% debentures of ₹100 each.

The issue was fully subscribed and allotments were made. The redemption was duly carried out. The company has sufficient profits.

You are required to give the necessary entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31.12.2004	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c *(Being issue of 7,000 equity shares of ₹100 each, at a premium of 10%, for redeeming preference shares)*		7,70,000	 7,00,000 70,000
	Bank A/c Dr. To 8% Debentures A/c *(Being issue of 3,000 debentures of ₹100 each.)*		3,00,000	 3,00,000
	Profit & Loss Appropriation A/c Dr. To Capital Redemption Reserve A/c (*Being the transfer of requisite amount from Profit & Loss appropriation A/c to capital redemption reserve A/c for redemption of preference shares*)		3,00,000	 3,00,000
	9% Redeemable Preference Shares Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being the amount due to preference shareholders on redemption of 10,000 preference shares of ₹100 each at a premium of 10%*)		10,00,000 1,00,000	 11,00,000
	Securities Premium A/c Dr. Profit & Loss Appropriation A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being the transfer of the requisite amount from securities premium and Profit & Loss A/c appropriation A/c to provide for redemption*)		70,000 30,000	 1,00,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being payment of amount due to preference shareholders*)		11,00,000	 11,00,000

Illustration 9

Redemption at par and fresh issue at premium

On 31st December 1993, the balance sheet of Sundaram Ltd. stood as follows:

Liabilities	(₹)	Assets	(₹)
Equity Share Capital	5,00,000	Sundry Assets	7,60,000
Redeemable Preference Share Capital	2,00,000	Bank	1,90,000
General Reserve	1,50,000		
Sundry Creditors	1,00,000		
	9,50,000		9,50,000

On the above date, the preference shares had to be redeemed. For this purpose, 1,000 equity shares of ₹100 each were issued at ₹110. The shares were immediately subscribed and paid for. The preference shares were duly redeemed. Give journal entries and balance sheet after redemption.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr.		1,10,000	
	To Equity Share Capital A/c			1,00,000
	To Securities Premium A/c			10,000
	(*Being issue of equity shares at a premium for redemption*)			
	General Reserve A/c Dr.		1,00,000	
	To Capital Redemption Reserve A/c			1,00,000
	(*Being amount transferred to capital redemption reserve A/c from general reserve to redeem preference shares*)			
	Redeemable Preference Share Capital A/c Dr.		2,00,000	
	To Preference Shareholders A/c			2,00,000
	(*Being amount due to preference shareholders*)			
	Preference Shareholders A/c Dr.		2,00,000	
	To Bank A/c			2,00,000
	(*Being amount paid to preference shareholders for redemption*)			

Bank Account

Particulars	(₹)	Particulars	(₹)
To Balance b/d	1,90,000	By Preference Shareholders A/c	2,00,000
To Equity Share Capital A/c	1,00,000	By Balance c/d	1,00,000
To Securities Premium A/c	10,000		
	3,00,000		3,00,000

Notes to Accounts:

1. Share Capital:	
Equity Share Capital	6,00,000
2. Reserves and Surplus:	
Securities Premium	10,000
Capital Redemption Reserve	1,00,000
General Reserve	50,000
	1,60,000

Balance Sheet of Sundaram Ltd. as on 31.12.1993

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	6,00,000
Reserve and Surplus	2	1,60,000
(ii) Non-current Liabilities	—	—
(iii) Current Liabilities		
Trade Payables		
Sundry Creditors		1,00,000
Total: (i) + (ii) + (iii)		8,60,000
II. Assets:		
(i) Non-current Assets		
Tangible Assets		
Sundry Assets		7,60,000
(ii) Current Assets		
Cash at Bank		1,00,000
Total: (i) + (ii)		8,60,000

Illustration 10

Redemption at premium and fresh issue at premium

The following is the balance sheet of Sundari Ltd., as on 31^{st} December 2006.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets:	
500 Redeemable Preference Shares of ₹100 each, fully paid	50,000	Land and Building	1,00,000
		Plant	30,000
9000 Equity Shares of ₹10 each, fully paid	90,000	Furniture	2,000
		Current Assets:	
Reserve & Surplus:		Stock	30,000
Securities Premium	10,000	Debtors	15,000
General Reserve	20,000	Investment	28,000
Profit & Loss A/c	25,000	Bank	20,000
Current Liabilities	30,000		
	2,25,000		2,25,000

The company decided to redeem its preference shares at a premium of 5% on 31st January 2007. A fresh issue of 1,000 equity share of ₹10 each was made at ₹12 per share, payable in full on 31st January 2007. These were fully subscribed and paid for. All the investments were sold for ₹27,000. The directors wish that only a minimum reduction should be made in the revenue reserve. You are required to give the journal entries to record the above transactions and draw up the balance sheet after the redemption of preference shares.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. Profit & Loss A/c Dr. To Investment A/c (*Being investments sold for redemption*)		27,000 1,000	 28,000
	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of equity shares for redemption of preference shares*)		12,000	 10,000 2,000
	General Reserve A/c Dr. Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being transfer of general reserve and Profit & Loss A/c to capital redemption reserve A/c for redemption of preference shares*)		20,000 20,000	 40,000
	Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (*Being amount due to preference shareholders*)		50,000 2,500	 52,500
	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium on redemption is adjusted out of securities premium*)		2,500	 2,500
	Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		52,500	 52,500

Bank Account

Particulars	(₹)	Particulars	(₹)
To Balance b/d	20,000	By Preference Shareholders	52,500
To Equity Share Capital	10,000	By Balance c/d	6,500
To Securities Premium	2,000		
To Investment	27,000		
	59,000		59,000

Notes to Accounts:

1. Share Capital:	
Equity Share Capital	1,00,000
2. Reserves and Surplus:	
Securities Premium	9,500
Capital Redemption Reserve	40,000
Profit & Loss A/c	4,000
	53,500
3. Non-current Assets:	
Tangible Assets	
Land and Buildings	1,00,000
Plant and Machinery	30,000
Furniture	2,000
	1,32,000
4. Current Assets:	
Stock	30,000
Debtors	15,000
Bank	6,500
	51,500

Balance Sheet of Sundari Ltd. as on 31.01.2007

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	1,00,000
Reserve and Surplus	2	53,500
(ii) Non-current Liabilities	—	—
(iii) Current Liabilities		
Trade Payables		
Sundry Creditors	—	30,000
Total: (i) + (ii) + (iii)		1,83,500
II. Assets:		
(i) Non-current Assets		
Tangible Assets	3	1,32,000
(ii) Current Assets	4	51,500
Total: (i) + (ii)		1,83,500

Illustration 11

Redemption at premium partly out of fresh issue of preference shares and partly out of profits

XYZ Ltd. has issued 20,000 equity shares of ₹100 each, fully paid, and 12,000 redeemable preference shares of ₹100 each, fully paid. On 31st December 2007, the Profit & Loss A/c showed an undistributed profit of ₹2,00,000 and the general reserve account stood at ₹5,60,000.

On 1st January 2008, the directors decided to issue 6,000 9% preference shares of ₹100 each and to redeem the existing redeemable preference shares at ₹110 each, utilising as less profits as possible for the purpose.

Pass necessary journal entries to record the above transactions. There was a bank balance of ₹8,00,000 on that date.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To 9% Preference Share Capital A/c (*Being issue of 6,000 preference shares of ₹100 each*)		6,00,000	 6,00,000
	General Reserve A/c Dr. Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being transfer of amount from general reserve and Profit & Loss A/c for redemption purposes*)		5,60,000 40,000	 6,00,000
	Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shareholders A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount due to preference shareholders on redemption*)		12,00,000 1,20,000	 13,20,000
	Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium provided out of Profit & Loss A/c in the absence of securities premium A/c*)		1,20,000	 1,20,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being payment made to redeemable preference shareholders on redemption*)		13,20,000	 13,20,000

Illustration 12

Issue of Bonus Shares

Swathi Ltd. issued 10,000 9% redeemable preference shares of ₹100 each, at par on 1st June 2000, redeemable at the option of the company on or after 30th June 2006, partly or fully.

Redemption were made out of profits as follows:

(a) 1,500 shares on 30th June 2006 at par.

(b) 2,000 shares on 31st December 2006 at 10% premium.

(c) Remaining shares on 30th June 2007 at a premium of 10%, by making a fresh issue of 80,000 equity shares of ₹10 each, at a premium of ₹1 each.

On 30th June 2007, the company also decided to capitalise 80% of its capital redemption reserve by issuing bonus shares of ₹10 each, fully paid at a premium of ₹4.00 per share.

Pass necessary journal entries to record the above transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
30.06.2006	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred from Profit & Loss A/c for redemption*)		1,50,000	 1,50,000
30.06.2006	9% Redeemable Preference Share Capital A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount due to preference shareholders on redemption*)		1,50,000	 1,50,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders on redemption*)		1,50,000	 1,50,000
31.12.2006	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c To Premium on Redemption of Preference Shares A/c (*Being amount transferred to capital redemption reserve A/c on nominal value of 2000 shares and premium on redemption is adjusted*)		2,20,000	 2,00,000 20,000

(*Contd.*)

	9% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shareholders A/c Dr. To Preference Shareholders A/c (*Being amount due to preference shareholders on redemption*)		2,00,000 20,000	 2,20,000
	Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		2,20,000	 2,20,000
30.06.2007	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of 80,000 equity share of ₹10 each, at a premium of ₹1*)		8,80,000	 8,00,000 80,000
30.06.2007	9% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Share A/c Dr. To Preference Shareholders A/c (*Being amount due to preference shareholders on redemption*)		6,50,000 65,000	 7,15,000
	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium on redemption of preference shares adjusted with securities premium*)		65,000	 65,000
	Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders on redemption*)		7,15,000	 7,15,000
	Capital Redemption Reserve A/c Dr. To Bonus to Shareholders A/c (*Being application of 80% of capital redemption reserve account for issue of bonus share*)		2,80,000	 2,80,000
	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of 20,000 bonus shares of ₹10 each, at a premium of ₹4 per share*)		2,80,000	 2,00,000 80,000

Working Notes:

Calculation of Bonus Issue	
Transfer to capital redemption reserve on 30.06.2006	1,50,000
Transfer to capital redemption reserve on 30.12.2006	2,00,000
	3,50,000
Bonus at 80% of Capital Redemption Reserve = $3{,}50{,}000 \times \frac{80}{100}$ = ₹2,80,000	

Illustration 13

Bonus Issue and Balance Sheet after redemption

The following is the balance sheet of Harbhajan Singh Ltd., as on 30th June 2003.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	5,00,000
15,000 6% Redeemable Preference Shares of ₹10 each, fully paid-up	1,50,000	Investment	1,05,000
		Current Assets:	
		Stock	2,20,000
30,000 Equity Shares of ₹10 each, fully paid	3,00,000	Sundry Debtors	80,000
		Cash at Bank	1,10,000
Securities Premium	4,45,000		
General Reserve	2,00,000		
Profit & Loss A/c	1,22,500		
Sundry Creditors	97,500		
	10,15,000		10,15,000

The company exercised its option to redeem, on 1st July 2003, the whole of the preference shares at a premium of 5%.

To assist in financing the redemption, all the investments were sold, realising ₹97,500. On 1st September 2003, the company made a bonus issue of seven equity shares fully paid for every six equity shares held on that date.

The appropriate resolutions were passed and the above transactions were duly completed.

You are required to show the journal entries and the balance sheet of the company, as it would appear after completion of the transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.07.2003	Bank A/c Dr.		97,500	
	Profit & Loss A/c		7,500	
	To Investments A/c			1,05,000
	(Being sale of investment for ₹97,500 and the loss debited to Profit & Loss A/c)			

(*Contd.*)

	6% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being the amount payable on redemption of preference shares transferred to preference shareholders A/c)*		1,50,000 7,500	1,57,500
01.07.2003	General Reserve A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred to capital redemption reserve on redemption of preference shares)*		1,50,000	1,50,000
	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium payable on redemption of preference shares charged to securities premium*)		7,500	7,500
	Preference Shareholders A/c Dr. To Bank A/c (*Being payments made to carry out the redemption*)		1,57,500	1,57,500
01.09.2003	Capital Redemption Reserve A/c Dr. General Reserve A/c Dr. Securities Premium A/c Dr. Profit & Loss A/c Dr. To Bonus to Shareholders A/c (*Being amount appropriated to issue 35,000 bonus shares to the existing equity shareholders in the ratio of 6:7)*		1,50,000 50,000 1,37,500 12,500	3,50,000
	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (*Being issue of 35,000 bonus shares of ₹10 each, fully paid*)		3,50,000	3,50,000

Note to Accounts:

1. Share Capital: Issued and Subscribed Capital 65,000 Equity Shares of ₹10 each (35,000 shares issued as Bonus)	6,50,000
2. Reserves and Surplus: Profit & Loss A/c	1,02,500
3. Trade Payables: Creditors	97,500
4. Tangible Assets: Fixed Assets	5,00,000

Balance Sheet of Harbhajan Singh Ltd. as on 01.09.2003

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	6,50,000
Reserve and Surplus	2	1,02,500
(ii) Non-current Liabilities	—	—
(iii) Current Liabilities		
Trade Payables		
Sundry Creditors	3	97,500
Total: (i) + (ii) + (iii)		8,50,000
II. Assets:		
(i) Non-current Assets		
Tangible Assets		
Fixed Assets	4	5,00,000
(ii) Current Assets		
Cash at Bank		50,000
Stock		2,20,000
Trade Receivable		80,000
Total: (i) + (ii)		8,50,000

Working Notes:

Securities Premium Account

Particulars	(₹)	Particulars	(₹)
To Premium on Redemption A/c	7,500	By Balance b/d	1,45,000
To Bonus to Shareholders A/c	1,37,500		
	1,45,000		1,45,000

Profit & Loss A/c

Particulars	(₹)	Particulars	(₹)
To Investment	7,500	By Balance b/d	1,22,500
To Bonus to Shareholders	12,500		
To Balance c/d	1,02,500		
	1,22,500		1,22,500

Bank Account

Particulars	(₹)	Particulars	(₹)
To Balance b/d	1,10,000	By Redeemable Preference Shareholders	1,57,500
To Investments	97,500	By Balance c/d	50,000
	2,07,000		2,07,500

Illustration 14

Restrictions for utilization of Profit & Loss A/c Balance for redemption

The following is the summarised balance sheet of Shobha Ltd. as on 31st December 2011.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	17,00,000
2,00,000 equity share of ₹10 each, fully paid	20,00,000	Investment	1,75,000
		Cash at Bank	1,75,000
30,000 6% redeemable preference shares of ₹20 each, fully paid	6,00,000	Other Current Assets	14,50,000
Profit & Loss A/c	3,50,000		
Creditors	5,50,000		
	35,00,000		35,00,000

On 1st January 2012, the company decided to redeem the preference shares at a premium of 5%.

In order to facilitate to redemption of preference shares, it was decided:

(a) to sell the investments for ₹1,50,000

(b) to finance part of the redemption from the company's funds subject to leaving balance on Profit & Loss A/c of ₹1,00,000.

(c) to issue sufficient equity shares of ₹10 each, at a premium of ₹2 per share, to raise the balance of funds required.

The preference shares were redeemed on due date and equity shares were fully subscribed.

Give necessary journal entries and prepare the balance sheet after redemption.

Solution:

Working Note:

Calculation of number of new equity shares to be issued for redemption:

Profit & Loss A/c balance		3,50,000
Less: Loss on sale of investment	25000	
Amount to be retained in the Profit & Loss A/c	1,00,000	1,25,000
Available for transfer to capital redemption reserve		2,25,000

Nominal amount of new equity shares to be issued = 6,00,000 – 2,25,000 = 3,75,000

No. of new equity shares to be issued = $\frac{3,75,000}{10}$ = 37,500 shares

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. Profit & Loss A/c Dr. To Investments A/c (*Being investments sold for redemption of preference shares*)		1,50,000 25,000	 1,75,000
	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of 37,500 equity shares @ ₹10 each for redemption of preference shares*)		4,50,000	 3,75,000 75,000
	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred from Profit & Loss A/c to capital redemption reserve A/c to redeem preference shares*)		2,25,000	 2,25,000
	6% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (*Being amount due to preference shareholders for redemption*)		6,00,000 30,000	 6,30,000
	Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		6,30,000	 6,30,000
	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium on redemption of preference shares adjusted out of securities premium*)		30,000	 30,000

Bank Account

Particulars	(₹)	Particulars	(₹)
To Balance b/d	1,75,000	By Preference Shareholders	6,30,000
To Investments	3,75,000	By Balance c/d	1,45,000
To Equity Share Capital	3,75,000		
To Securities Premium	75,000		
	7,75,000		7,75,000

Note to Accounts:

1. Share Capital:	
Equity Share Capital	23,75,000
2. Reserves and Surplus:	
Profit & Loss A/c	1,00,000
Capital Redemption Reserve	2,25,000
Securities Premium	45,000
	3,70,000
3. Trade Payables:	
Creditors	5,50,000
4. Tangible Assets:	
Fixed Assets	17,00,000

Balance Sheet of Shobha Ltd. as on 01.01.2012

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	23,75,000
Reserve and Surplus	2	3,70,000
(ii) Non-current Liabilities	—	—
(iii) Current Liabilities		
Trade Payables		
Sundry Creditors	3	5,50,000
Total: (i) + (ii) + (iii)		32,95,000
II. Assets:		
(i) Non-current Assets		
Tangible Assets		
Fixed Assets	4	17,00,000
(ii) Current Assets		
Cash at Bank		1,45,000
Other Current Assets		14,50,000
Total: (i) + (ii)		32,95,000

Illustration 15

Unclaimed amount on preference shares redeemed or untraceable shareholders

Following is the summarised balance sheet of GCL Ltd. as on 30th September 2009.

Liabilities			**Assets**	
Share Capital	**Authorised (₹)**	**Issued (₹)**		**(₹)**
8% Redeemable Preference Shares of ₹100 each	64,000	56,000	Fixed Assets	2,00,000
			Current Assets	1,20,000
Equity Shares of ₹10 each, fully paid	2,04,000	1,68,000		
	2,68,000	2,24,000		
Securities Premium		7,000		
Profit & Loss A/c		61,000		
Creditors		28,000		
		3,20,000		3,20,000

The preference shares were redeemed on 10th October 2009 at a premium of 10%. No trace could be found of the holders of 12 preference shares.

You are required to give the journal entries in the books of the company and prepare the balance sheet after redemption.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
10.10.2009	8% Redeemable Preference Share Capital A/c Dr.		56,000	
	Premium on Redemption of Preference Shares A/c Dr.		5,600	
	To Preference Shareholders A/c			61,600
	(*Being amount due to preference shareholders on redemption*)			
10.10.2009	Securities Premium A/c Dr.		5,600	
	To Premium on Redemption of Preference Shares A/c			5,600
	(*Being premium on redemption is written off from securities premium*)			
10.10.2009	Profit & Loss A/c Dr.		56,000	
	To Capital Redemption Reserve A/c			56,000
	(*Being amount transferred to CRR A/c from Profit & Loss A/c for redemption*)			
10.10.2009	Preference Shareholders A/c Dr.		60,280	
	To Bank A/c			60,280
	(*Being amount paid to preference shareholders on redemption*)			

Working Note:

Calculation of Amount due to untraceable preference shareholders	
Amount due: 12 Preference Shares × ₹100 =	₹1,200
Add: Premium on redemption of pref. sh @10% $\left(\frac{10}{100} \times 1{,}200\right)$ =	₹120
Total	₹1,320

Notes to Accounts:

1. Share Capital:	
Authorised Capital:	
20,400 Equity Shares of ₹10 each	2,04,000
Issued and Subscribed Capital:	
16,800 Equity Shares of ₹10 each	1,68,000
2. Reserves and Surplus:	
Securities Premium (7,000–5,600)	1,400
Profit & Loss A/c (61,000–56,000)	5,000
Capital Redemption Reserve	56,000
	62,400
3. Trade Payables:	
Creditors	28,000
4. Other Current Liabilities:	
Amount due to untraceable Preference Shareholders	1,320
5. Tangible Assets:	
Fixed Assets	2,00,000

Balance Sheet of GCL Ltd. as on 10.10.2009

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	1,68,000
Reserves and Surplus	2	62,400
(ii) Non-current Liabilities		
Long-term borrowings	—	—
(iii) Current Liabilities:		
Trade Payables	3	28,000
Other Current Liabilities	4	1,320
Total: (i) + (ii) + (iii)		2,59,720
II. Assets:		
(i) Non-Current Assets:		
Tangible Assets	5	2,00,000
(ii) Current Assets (1,20,000 – 60,280) (amount paid on redemption of preference shares)		59,720
Total: (i) + (ii)		2,59,720

(i) Minimum Fresh Issue of shares (ii) Determining Usage of Equation for fresh issue of shares

Illustration 16(A)

Usage of equation not necessary

Calculate the minimum issue of shares, the necessity of applying the formula, and the amount of issue for: Redeemable preference shares to be redeemed ₹15,000; premium on redemption at 10 per cent. Divisible profit available is ₹3,000. The fresh issue of equity shares is to be brought out at 25%.

Solution:

(i) Minimum Issue = (Face Value of redeemable Preference shares to be redeemed) – (Divisible profit available)

= ₹15,000 – ₹3,000 = ₹12,000

(ii) The necessity of applying the formula

Premium on redemption	₹1,500
(a) Security premium in balance sheet	Nil
(b) Security premium out of new issue $\left(12{,}000 \times \frac{25}{100} = ₹3{,}000\right)$	₹3,000

Premium on redemption can be adjusted from the security premium out of the new issue and it cannot be used to redeem the face value of redeemable preference share capital. Here, securities premium from the new issue ₹3,000 is more than the premium on redemption ₹1,500 to be written off. So, there is no need to use the formula.

(iii) The minimum issue to be made will be ₹12,000.

Verification

Face Value of Preference Share Capital	15,000
Add: Premium on Redemption to Preference Shareholders	1,500
	16,500
Less: Premium on Redemption adjusted	
(a) Securities Premium in Balance Sheet	Nil
(b) Securities Premium out of new issue	1,500
Face Value of Preference Share Capital to be Redeemed	15,000
Less: Divisible Profit (CRR)	3,000
	12,000
Less: Real Value of Fresh Issue of Capital	12,000
	Nil

Illustration 16(B)

Usage of Equation necessary

Redeemable Preference Shares	:	₹6,00,000
Premium on Redemption	:	10%
Divisible Profits Available	:	₹1,80,000
Balance in General Reserve	:	₹1,20,000
Securities Premium	:	₹45,000

Fresh issue is to be made at 5% premium.

From the above data, calculate: (a) minimum fresh issue; (b) the necessity of using equation; and (c) the amount of issue.

Solution:

(a) **Computation of Minimum Fresh Issue**

Minimum Fresh Issue = Redeemable preference shares to be redeemed – Divisible Profits – General Reserve – Securities Premium

= ₹6,00,000 – ₹1,80,000 – ₹1,20,000 – ₹45,000

= ₹2,85,000

(b) **Use of Equation:**

Premium on Minimum Issue (2,85,000 × 5%) =	₹14,250
Add: Existing Securities Premium =	₹45,000
	₹59,250

The total premium is not adequate enough to pay off premium on redemption of preference shares of ₹60,000. Therefore, it is necessary to apply the equation to ascertain the amount of fresh issue.

(c) **Computation of Amount of Fresh Issue**

The fresh issue can be ascertained by using the following formula, assuming the new issue to be made as 'x':

[Face Value of Redeemable Preference Shares + Premium Payable on Redemption] = [Securities Premium in B/S + General Reserve + Divisible Profits + $x + x \times$ Premium % on new issue]

$$(6,00,000 + 60,000) = 45,000 + 1,20,000 + 1,80,000 + x + 0.05x$$
$$= 6,60,000 - 45,000 - 1,20,000 - 1,80,000 = 1.05x$$
$$= 3,15,000 = 1.05x$$
$$x = \frac{3,15,000}{1.05} = ₹3,00,000$$

Therefore, Fresh Issue of Shares = ₹3,00,000

Illustration 16(C)

Usage of equation necessary

Determine the amount of fresh issue of shares from the information given below relating to R.R. Ltd.:

Redeemable Preference Shares	:	₹60,000
Premium on Redemption	:	5%
Profit & Loss A/c Balance	:	₹20,000
General Reserve	:	₹14,000
Securities Premium A/c	:	₹2,000

Fresh issue is to be made at a discount of 10%.

Solution:

Assume New issue to be made as '*x*'

$$\begin{pmatrix}\text{Face value of}\\ \text{Redeemable}\\ \text{Preference Shares}\end{pmatrix} + \begin{pmatrix}\text{Premium on}\\ \text{redemption}\end{pmatrix}$$

$$= \begin{pmatrix}\text{Securities}\\ \text{Premium}\end{pmatrix} + \begin{pmatrix}\text{General}\\ \text{Reserve}\end{pmatrix} + \begin{pmatrix}\text{Profits \&}\\ \text{Loss A/c}\end{pmatrix} + x - 0.1x$$

$\Rightarrow$ $(60{,}000 + 3{,}000) = 2{,}000 + 14{,}000 + 20{,}000 + x - 0.1x$

$\Rightarrow$ $63{,}000 = 2{,}000 + 14{,}000 + 20{,}000 + x - 0.1x$

$\Rightarrow$ $63{,}000 - 2{,}000 - 14{,}000 - 20{,}000 = x - 0.1x$

$\Rightarrow$ $27{,}000 = 0.9x$

$$x = \frac{27{,}000}{0.9} = ₹30{,}000$$

Therefore, Fresh issue to be made = ₹30,000

Illustration 17

The following balances were extracted from the books of Revathi Ltd.

	(₹)
9% Redeemable Cumulative Preference Shares 2,000 shares of ₹100 each fully called-up	2,00,000
Less: Calls unpaid at ₹25 per share	1,000
Amount Paid-up	1,99,000
Securities Premium	28,000
General Reserve	68,000
Cash at Bank	1,10,000
Proposed Dividend on Cumulative Preference Shares (since sanctioned)	15,680

The directors redeemed the preference shares at a premium of 10% and for that purpose, brought out a fresh issue of equity shares for the amount necessary after utilising the available source to the maximum extent, and satisfied the amount of preference dividend. Pass necessary journal entries including cash transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c (W.N.1) Dr. To Equity Share Capital A/c (*Being issue of new equity shares for ₹1,32,000 to redeem the preference shares*)		1,32,000	1,32,000
	8% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount due to redeemable preference shareholders*)		1,96,000 19,600	2,15,600
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		2,15,600	2,15,600
	Security Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium on redemption of preference shares adjusted with securities premium*)		19,600	19,600
	Proposed Dividend on Cumulative Preference Shares A/c Dr. To Preference Dividend Payable A/c (*Being dividend declared on cumulative preference shares*)		15,680	15,680
	Preference Dividend Payable A/c Dr. To Bank A/c (*Being dividend paid on preference shares (income tax ignored)*)		15,680	15,680
	General Reserve A/c Dr. To CRR A/c (*Being amount transferred from general reserve to CRR A/c*)		64,000	64,000

Working Note: 1

Calculation of Number of Fresh Equity Shares:

		₹
Face Value of 1,960 (2000 – 40) Redeemable Preference Shares of ₹100 each fully paid		1,96,000
Add: Premium on Redemption @ 10%		19,600
Amount due to Preference Shareholders		2,15,600
Less: Premium on Redemption is adjusted from Securities Premium	(₹19,600)	19,600
Face Value of Redeemable Preference Shares		1,96,000
Less: General Reserve (68,000 – 4,000 set aside for 40 Redeemable Preference Shares)		64,000
Balance to be redeemed out of fresh issue of share capital		1,32,000

Illustration 18

Minimum fresh issue of shares

Balance sheet of XY Ltd. as on 31st March 2007 is as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	22,00,000
Issued, subscribed and fully paid-up 10,000 ordinary shares of ₹100 each	10,00,000		
5,000 Pref. shares of ₹100 each	5,00,000		
Capital Reserve	1,00,000	Current Assets	8,00,000
Securities Premium	1,00,000		
General Reserve	2,00,000		
Profit & Loss A/c	1,00,000		
Current Liabilities	10,00,000		
	30,00,000		30,00,000

The preference shares are to be redeemed at 10% premium. Fresh issue of equity shares is to be made to the extent required under the Companies Act for the purpose of this redemption. The shortfall in funds for the purpose of redemption after utilising the proceeds of the fresh issue are to be met by taking a bank loan. Show journal entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c (W.N.1) Dr. To Equity Share Capital A/c (*Being issue of 2,000 equity shares of ₹100 each for redemption*)		2,00,000	 2,00,000

(*Contd.*)

	General Reserve A/c Dr. Profit & Los A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred to CRR A/c for redemption*)		2,00,000 1,00,000	 3,00,000
	Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Pref. Shares A/c Dr. To Preference Shareholders A/c (*Being amount due to preference shareholders*)		5,00,000 50,000	 5,50,000
	Securities Premium A/c Dr. To Premium on Redemption of Pref. Shares A/c (*Being premium on redemption adjusted from securities premium*)		50,000	 50,000
	Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		5,50,000	 5,50,000
	Bank A/c Dr. To Bank Loan A/c (*Being arrangement of bank loan for redemption*)		3,50,000	 3,50,000

Working Note: 1

Calculation of Fresh Issue of Equity Share Capital

Face Value of Redeemable Preference Share Capital		5,00,000
Add: Premium on Redemption of Preference Shares @ 10%		50,000
		5,50,000
Less: Premium on Redemption adjusted from Securities Premium		50,000
Face Value of Preference Shares to be redeemed		5,00,000
Less: General Reserve	2,00,000	
Profit & Loss A/c	1,00,000	3,00,000
Balance to be redeemed out of fresh issue of equity shares		2,00,000

Bank Account

	(₹)		(₹)
To Equity Share Capital A/c	2,00,000	By Preference Shareholders	5,50,000
To Bank Loan A/c	3,50,000		
	5,50,000		5,50,000

Illustration 19

Minimum fresh issue of shares at a premium

The balance sheet of AK Co. Ltd., as on 31st March 2012 was as follows:

Liabilities	(₹)	Assets	(₹)
20,000 Equity Shares of ₹10 each, fully paid up	2,00,000	Fixed Assets	2,37,500
10% Redeemable Preference Shares of ₹100 each, fully paid up	1,00,000	Investment	12,500
Securities Premium	4,850	Current Assets	95,000
Profit & Loss A/c	60,000	Share Issue Expenses	48,750
Current Liabilities	28,900		
	3,93,750		3,93,750

On the above date, it was decided to redeem the preference shares at a premium of 10%. The directors wish that only the minimum number of fresh equity shares of ₹10 each, at a premium of 5%, be issued to provide for redemption of such preference shares as could not be redeemed. Give the necessary journal entries and prepare the balance sheet after redemption.

Solution:

Working Notes: 1

Computation of Minimum Fresh Issue of Shares:

Assuming minimum fresh issue as 'x'

Face Value of Redemption of Shares + Premium Payable on Redemption = Securities Premium + Profit & Loss A/c + x + 0.05x

$$1{,}00{,}000 + 10{,}000 = 4{,}850 + 60{,}000 + x + 0.05x$$

$$1{,}10{,}000 = 64{,}850 + 1.05x$$

$$1{,}10{,}000 - 64{,}850 = 1.05x$$

$$45{,}150 = 1.05x$$

$$\frac{45{,}150}{1.05} = x$$

$$x = ₹43{,}000$$

Minimum fresh issue of shares = ₹43,000 (or) 4300 shares @ ₹10 each

Journal Entries

Date	Particulars	L.F	Debit (₹)	Credit (₹)
	Bank A/c (W.N.1) Dr.		45,150	
	To Equity Share Capital A/c			43,000
	To Securities Premium A/c			2,150
	(*Being issue of 4,300 equity shares @ ₹10 each at a premium of 5%*)			

(*Contd.*)

	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being provision created out of Profit & Loss A/c for redemption of preference shares as required by Section 80 of the Companies Act, 1956, ₹1,00,000 – ₹43,000*)		57,000	 57,000
	Securities Premium A/c Dr. Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium payable on redemption of preference shares*)		7,000 3,000	 10,000
	10% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount payable on redemption of 1,000 preference shares of ₹100 each at 10% premium*)		1,00,000 10,000	 1,10,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		1,10,000	 1,10,000

Notes to Accounts:

1. Share Capital: Paid-up Capital 24,300 Equity Shares of ₹10 each	 2,43,000
2. Reserves and Surplus: Capital Redemption Reserve	 57,000
3. Tangible Assets: Fixed Assets	 2,37,500
4. Non-current Assets: Investment	 12,500
5. Other Current Assets: Share Issue Expenses	 48,750

Balance Sheet of AK Co. Ltd. as on 31.03.2012

	Note No.	(₹)
1. Equity and Liabilities:		
(i) Shareholders' Fund		
Share Capital	1	2,43,000
Reserves and Surplus	2	57,000

(*Contd.*)

(ii) Non-current Liabilities		
Long-term Borrowings	—	—
(iii) Current Liabilities		28,900
Total: (i) + (ii) + (iii)		3,28,900
2. Assets:		
(i) Non-current Assets		
Tangible Assets	3	2,37,500
Non-current Assets:		
Investment	4	12,500
(ii) Current Assets (95,000 + 45,150 – 1,10,000)		30,150
Other Current Assets	5	48,750
Total: (i) + (ii)		3,28,900

Illustration 20

Minimum fresh issue of shares at a discount

XYZ Ltd. decided to redeem its preference shares as on 31st March 2001. On the same date, their position was as follows:

Balance Sheet of XYZ Ltd. as on 31.03.2001

Liabilities		(₹)	Assets	(₹)
Share Capital:			Cash and Bank Balance	1,40,000
4,000 Equity Shares of ₹100 each		4,00,000		
4,000, 6% Redeemable Preference Shares of ₹50 each ₹25 per share paid		1,00,000		
2000, 7% Redeemable Preference Shares of ₹100 each, fully paid		1,00,000		
Reserves and Surplus:				
Share Premium	10,000		Other Assets	8,60,000
CRR	90,000			
Dividend equalisation reserve	1,10,000	2,10,000		
Sundry Liabilities		90,000		
Total		10,00,000		10,00,000

The redemption is to be at a premium of 5%. The CRR appearing in the balance sheet is the reserve brought into being as a result of a redemption that took place in 1996. To enable the redemption to be carried out, the company decides to issue sufficient number of equity shares at a discount of 10%. The redemption is duly carried out. Show journal entries relating to the redemption and new issue and also the balance sheet after redemption.

Solution:

Face Value of 6% Redeemable Preference Share Capital	₹2,00,000
Face Value of 7% Redeemable Preference Share Capital	₹2,00,000
	₹4,00,000
Add: Premium on Redemption (4,00,000 × 5%)	₹20,000
	4,20,000

(*Contd.*)

Less: Premium on Redemption Adjusted		
(a) Security Premium in Balance Sheet	10,000	
(b) Dividend Equalisation Reserve	10,000	20,000
Face Value of Preference Shares to be Redeemed		4,00,000
Less: Dividend Equalisation Reserve (1,10,000 – 10,000)		1,00,000
Balance		3,00,000

$$2,00,000 + 2,00,000 + 20,000 = 10,000 + 1,10,000 + 100x - 10x$$
$$= 1,20,000 + 90x$$
$$x = 3,00,000/90$$
$$= 3333.33 \text{ (Rounded off to 3334 shares)}$$

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	6% Redeemable Pref. Share Call A/c Dr. To 6% Redeemable Pref. Share Capital A/c (*Being amount due on call*)		1,00,000	1,00,000
	Bank A/c Dr. To 6% Redeemable Pref. Share call A/c (*Being amount received on call*)		1,00,000	1,00,000
	Bank A/c Dr. Discount on Issue of Shares A/c Dr. To Equity Share Capital A/c (*Being issue of equity shares at a discount for redemption*)		3,00,060 33,340	3,33,400
	6% Redeemable Pref. Share capital A/c Dr. Premium on Redemption of Pref. Shares A/c Dr. To 6% Preference Shareholders A/c (*Being amount due to pref. shareholders on redemption*)		2,00,000 10,000	2,10,000
	7% Redeemable Pref. Share Capital A/c Dr. Premium on Redemption of Pref. Shares A/c Dr. To 7% Preference Shareholders A/c (*Being amount due to preference shareholders on redemption*)		2,00,000 10,000	2,10,000
	Security Premium A/c Dr. Dividend Equalisation Reserve A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium on redemption adjusted*)		10,000 10,000	20,000

(*Contd.*)

	6% Preference Shareholders A/c Dr. 7% Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		2,10,000 2,10,000	 4,20,000
	Dividend Equalisation Reserve A/c Dr. To CRR A/c (*Being amount transferred to CRR A/c*)		1,00,000	 1,00,000

Notes to Accounts:

1. Share Capital: 7,334 Equity Shares of ₹100 each	 7,33,400
2. Reserves and Surplus: Capital Redemption Reserve (90,000 + 1,00,000)	 1,90,000
3. Current Liabilities: Sundry Liabilities	 90,000
4. Tangible Assets: Other Assets	8,60,000

Cash and Bank Account

	(₹)		(₹)
To Balance b/d	1,40,000	By 6% Preference Shareholders A/c	2,10,000
To 6% Redeemable Preference Share Call A/c	1,00,000	By 7% Preference Shareholders A/c	2,10,000
To Equity Share Capital A/c	3,00,060	By Balance c/d	1,20,060
	5,40,060		5,40,060

Balance Sheet of XYZ Ltd. as on 31.03.2001

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	7,33,400
Reserves and Surplus	2	1,90,000
(ii) Non-current Liabilities		—
(iii) Current Liabilities		
Sundry Liabilities	3	90,000
Total: (i) + (ii) + (iii)		10,13,400
II. Assets:		
(i) Non-current Assets		
Tangible Assets	4	8,60,000
(ii) Other Current Assets		
Cash and Bank balance		1,20,060
Discount on Issue of Shares		33,340
Total: (i) + (ii)		10,13,400

Illustration 21

Preparation of Ledger Accounts

Bull Lock Co. Ltd. has issued 30,000 7% redeemable preference shares of ₹100 each. Under the terms of the issue of shares, redemption was to take place on 1st April 2008. A general reserve of ₹18,75,000 had already been build up out of past profits. For the purpose of redemption, 11,250 new 6% preference shares 11,250 of ₹100 each were offered to the public at a premium of ₹20, payable in full on application. The new issue was fully subscribed and paid for. Thereupon, 7% redeemable preference share were redeemed. Show the ledger account to record the above transactions.

Solution:

Ledger of Bull Lock Co. Ltd.

7% Redeemable Preference Share Capital A/c

		(₹)			(₹)
01.04.2008	To Bank A/c	30,00,000	01.04.2008	By Balance b/d	30,00,000
		30,00,000			30,00,000

6% Preference Share Capital Account

		(₹)			(₹)
01.04.2008	To Balance c/d	11,25,000	01.04.2008	By Bank A/c	11,25,000
					11,25,000
		11,25,000		By Balance b/d	11,25,000

Securities Premium Account

		(₹)			(₹)
01.04.2008	To Balance c/d	2,25,000	01.04.2008	By Bank A/c	2,25,000
					2,25,000
		2,25,000		By Balance b/d	2,25,000

General Reserve Account

		(₹)			(₹)
01.04.2008	To Capital Redemption Reserve A/c	18,75,000	01.04.2008	By Balance b/d	18,75,000
		18,75,000			18,75,000

Capital Redemption Reserve Account

		(₹)			(₹)
01.04.2008	To Balance c/d	18,75,000	01.04.2008	By General Reserve A/c	18,75,000
		18,75,000			18,75,000
				By Balance b/d	18,75,000

Illustration 22

Forfeiture and Re-issue of Redeemable Preference Shares

The balance sheet of Renu Ltd., as at 31st March 2007 is as follows:

Liabilities		(₹)	Assets	(₹)
10,000 Equity Shares of ₹10 each fully paid		1,00,000	Fixed Assets	2,62,000
11% Redeemable Preference Shares of ₹100 each fully called-up	1,00,000		Debtors	90,000
Less: Calls-in-arrear at ₹20 per share	6,000	94,000		
10% Preference Shares of ₹10 each fully paid		1,00,000	Stock	30,000
General Reserve		40,000	Investments	30,000
Profit & Loss A/c		20,000	Bank	4,000
Securities Premium		5,000		
Capital Reserve		30,000		
Creditors		27,000		
		4,16,000		4,16,000

Redeemable preference shares were due for payment on 1st April 2007 at a premium of 10%. The company sent reminders for the final call on the remaining 300 redeemable preference shares, could collect money from shareholders holding 200 shares at ₹20 per share and forfeited the defaulting 100 shares. These 100 shares were subsequently reissued at ₹80 per share as fully paid. The company sold all the investments and could recover 90% of the cost of such investments. The company issued adequate number of new equity shares at par, to the extent available profits were insufficient to backup the redemption.

Draft journal entries and prepare the balance sheet of the company after redemption.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Equity Share Capital A/c (*Being 15,800 equity shares issued for redemption*)		1,58,000	 1,58,000
	Bank A/c Dr. Profit & Loss A/c Dr. To Investments A/c (*Being investments sold for redemption*)		27,000 3,000	 30,000
	Bank A/c Dr. To Calls-in-Arrear A/c (*Being amount due on final call for 200 shares at ₹20 per share received*)		4,000	 4,000
	11% Redeemable Preference Share Capital A/c Dr. (100 × 100) To Calls-in-Arrear A/c To Forfeited Shares A/c (*Being forfeiture of 100 shares for non-payment of final call*)		10,000	 2,000 8,000
	Bank A/c (100 × 80) Dr. Forfeited Shares A/c (100 × 20) Dr. (Discount on reissue) To 11% Redeemable Preference Share Capital A/c (*Being reissue of 100 shares forfeited at ₹80 each as fully paid*)		8,000 2,000	 10,000
	Forfeited Shares A/c Dr. To Capital Reserve A/c (8,000 – 2,000) (*Being profit on shares forfeited transferred to capital reserve A/c*)		6,000	 6,000
	11% Redemption Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To 11% Preference Shareholders A/c (*Being amount due to preference shareholders*)		1,00,000 10,000	 1,10,000

(*Contd.*)

	10% Red. Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To 10% Preference Shareholders A/c (*Being amount due to preference shareholders*)		1,00,000 10,000	1,10,000
	Securities Premium A/c Dr. Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium on redemption of preference shares written off from the above*)		5,000 15,000	20,000
	General Reserve A/c Dr. Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred to CRR A/c*)		40,000 2,000	42,000
	11% Preference Shareholders A/c Dr. 10% Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		1,10,000 1,10,000	2,20,000

Calculation of Fresh Issue of Share Capital

Face value of 11% Redemption of Preference Share Capital		1,00,000
Add: Premium on Redemption of Preference Shares		10,000
Face value of 10% Redemption of Preference Share Capital		1,00,000
Add: Premium on Redemption of Preference Shares		10,000
		2,20,000
Less: Premium on Redemption is adjusted from		
Securities Premium	5,000	
Profit & Loss A/c	15,000	20,000
Face value of Redemption Preference Shares to be redeemed		2,00,000
Less: General Reserve	40,000	
Balance in Profit & Loss A/c	2,000	42,000
Balance to be redeemed out of fresh issue		1,58,000

Calculation of Balance in the Profit & Loss A/c transferred to CRR A/c

Profit & Loss A/c Balance	20,000
Less: Loss on Sale of Investments	3,000
	17,000
Less: Amount used for premium on Redemption of Preference Shares written off	15,000
Balance transferred to CRR A/c	2,000

Bank Account

	(₹)		(₹)
To Balance b/d	4,000	By 11% Preference Shareholders A/c	1,10,000
To Equity Share Capital	1,58,000	By 10% Preference Shareholders A/c	1,10,000
To Investments A/c	27,000		
To Calls-in-Arrears A/c	4,000		
To 11% Redeemable Preference Share Capital A/c	8,000		
To Bank o/d	19,000		
	2,20,000		2,20,000

Notes to Accounts:

1. Share Capital:	
Issued & Paid-up Capital	
25,800 Shares of ₹10 each, fully paid	2,58,000
2. Reserves and Surplus:	
Capital Reserve (30,000 + 6,000)	36,000
Capital Redemption Reserve	42,000
	78,000
3. Current Liabilities	
Creditors	27,000

Balance Sheet of Renu Ltd. as on 01.04.1997

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	2,58,000
Reserves and Surplus	2	78,000
(ii) Non-current Liabilities		
Bank Overdraft		19,000
(iii) Current Liabilities		
Creditors		27,000
Total: (i) + (ii) + (iii)		3,82,000
II. Assets:		
(i) Non-current Assets		
Fixed Assets		2,62,000
(ii) Current Assets		
Debtors		90,000
Stock		30,000
Total: (i) + (ii)		3,82,000

Illustration 23

Forfeiture and Re-issue of Redeemable Preference Shares

The following is the summarised balance sheet of Mahendran & Co. Ltd., as on 31st December 2007.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Sundry Assets	8,00,000
60,000 equity shares of ₹10 each fully paid	6,00,000	Bank	5,51,600
5,000 redeemable preference shares of ₹100 each fully called up 5,00,000			
Less: Calls-in-arrear (final call of ₹20 on 120 shares) (5,00,000 – 2,400)	4,97,600		
General Reserves	2,24,000		
Securities Premium	30,000		
	13,51,600		13,51,600

On 1st July 2008, the company decided to redeem the preference shares at a premium of 10%.

On getting a reminder about payments of Calls-in-Arrears, shareholders holding 100 shares paid their dues by 31st May 2008. The shareholders, holding the remaining 20 shares on which calls were due, died on 3rd April 2008, and his legal heirs regretted their inability to pay the amount due thereon. Consequently, the directors forfeited those shares and reissued them fully-paid on 10th June 2008 on receiving ₹1,000.

Repayments were completed by 30th September 2008 except in the case of one shareholder holding 80 shares, who was out of India.

Further, 30,000 equity shares of ₹100 each were issued at par, for the purpose of the above redemption.

You are required to pass journal entries (on a basis which would effect the minimum reduction of revenue reserves) and also prepare balance sheet after redemption.

Solution:

Journal Entries

Date	Particulars	L.F	Debit (₹)	Credit (₹)
31.05.2008	Bank A/c Dr.		2,000	
	To Preference Share Final Call A/c			2,000
	(*Being Calls-in-Arrears received on 100 shares at ₹20 per share*)			

(*Contd.*)

10.06.2008	Redeemable Preference Share Capital A/c Dr. To Preference Share Final Call A/c To Forfeited Shares A/c (*Being forfeited 20 preference shares for non-payment of final call of ₹20 per share*)		2,000	 400 1,600
	Bank A/c Dr. Forfeited Shares A/c Dr. To Redeemable Preference Share Capital A/c (*Being 20 forfeited shares reissued for ₹1,000*)		1,000 1,000	 2,000
	Forfeiture Shares A/c Dr. To Capital Reserve A/c (*Being profit on reissue of forfeited shares transferred to capital reserve A/c*)		600	 600
	Bank A/c Dr. To Equity Share Capital A/c (*Being issue of 30,000 equity shares at ₹10 each for the purpose of redemption of preference shares*)		3,00,000	 3,00,000
	Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount payable on 5,000 redeemable preference Shares at ₹110 each*)		5,00,000 50,000	 5,50,000
	General Reserve A/c Dr. To Capital Redemption Reserve A/c (*Being amount transferred to the CRR A/c*)		2,00,000	 2,00,000
	Share Premium A/c Dr. General Reserve A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being transfer of requisite amount from share premium A/c and general reserve A/c to provide 10% premium*)		30,000 20,000	 50,000
	Redeemable Preference Shareholder A/c Dr. To Bank A/c (*Being amount due to preference shareholder paid off, except to a holder of 80 shares*)		5,41,200	 5,41,200

Working Note 1:

Amount due to Preference Shareholder	
80 shares × ₹100	₹8,000
Add: Premium on redemption @ 10%	₹800
	₹8,800

Notes to Accounts:

1. Share Capital:	
Issued, Subscribed and Paid-up Capital	
90,000 Equity Shares of ₹10 each	9,00,000
2. Reserves and Surplus:	
Capital Redemption Reserve	2,00,000
Capital Reserve	600
General Reserve (2,24,000 – 20,000 – 2,00,000)	4,000
	2,04,600
3. Other Current Liabilities:	
Amount Due to Preference Shareholders (W.N.1)	8,800
4. Tangible Assets:	
Sundry Assets	8,00,000

Balance Sheet as on 30.09.2008

	Note No.	(₹)
I. Equity and Liability:		
(i) Shareholder's Fund		
Share Capital	1	9,00,000
Reserves and Surplus	2	2,04,600
(ii) Non-current Liabilities		
Long-term Borrowings		—
(iii) Current Liabilities		
Other Non-current Liabilities	3	8,800
Total: (i) + (ii) + (iii)		11,13,400
II. Assets:		
(i) Non-current Assets		
Tangible Assets	4	8,00,000
(ii) Current Assets:		
Cash at bank (5,561,600 + 2,000 + 1,000 + 3,00,000 – 5,41,200)		3,13,400
Total: (i) + (ii)		11,13,400

Illustration 24

What entries can be made for the following redemption made by the company?

(a) In 2006, X Ltd. redeemed ₹1,00,000 preference shares by converting them into equity shares of ₹10 each, issued at 25% premium.

(b) In 2007, X Ltd. redeemed ₹95,000 preference shares by converting them into equity shares issued at 5% discount.

(c) In 2008, X Ltd. redeemed 10,000 preference shares of ₹10 each at a premium of ₹1.25 per share by converting into equity shares of ₹10 each issued at 10% discount.

Solution:

Journal Entries

Date	Particulars	L.F	Debit (₹)	Credit (₹)
2006	(a) Redeemable Preference Share Capital A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being the redeemable preference shares of ₹1,00,000 by converting them into equity shares of ₹10 each, at 25% premium*)		1,00,000	 80,000 20,000
	(b) Profit & Loss Appropriation A/c Dr. To Capital Redemption Reserve A/c (*Being the transfer of ₹20,000 from Profit & Loss appropriation A/c to capital redemption reserve A/c*)		20,000	 20,000
2007	Redeemable Preference Share Capital A/c Dr. Discount on Issue of Shares A/c Dr. To Equity Share Capital A/c (*Being the redemption of ₹95,000 preference shares by converting them into equity shares issued at 5% discount*)		95,000 5,000	 1,00,000
2008	(a) Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being the redemption of 10,000 preference shares of ₹10 each, at a premium of ₹1.25 per share*)		1,00,000 12,500	 1,12,500

(*Contd.*)

	(b) Redeemable Preference Shareholders A/c Dr. Discount on Issue of Share A/c Dr. To Equity Share Capital A/c (*Being the issue of 12,000 shares of ₹10 each at a discount of 10%*)		1,12,500 12,500	 1,25,000
	(c) Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being the transfer of ₹12,500 from Profit & Loss A/c to premium on redemption of Preference Shares)*		12,500	 12,500

Illustration 25

Redemption at a Premium and Bonus Issue Out of General Reserve

X Co. Ltd. had 10,000 equity shares of ₹10 each, fully paid, and 5,000 7% redeemable preference shares of ₹10 each, fully paid, redeemable at a premium of 10%. It had a credit balance of ₹40,000 on Profit & Loss A/c and ₹50,000 on general reserve.

The company resolved:

(a) To issue 3,000 equity shares of ₹10 each at ₹12 per share in order to provide part of the funds for the redemption of the preference shares.

(b) To redeem the preference shares.

(c) To make a bonus issue of one share for every two held by the existing equity shareholders from the general reserve. The resolutions were carried into effect.

You are required to pass journal entries.

Solution:

Journal Entries

Date	Particulars	L.F	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of 3,000 equity shares @ ₹10 each at a premium of ₹2 per share*)		36,000	 30,000 6,000
	7% Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Redeemable Preference Shareholders A/c (*Being amount due to preference shareholders*)		50,000 5,000	 55,000

(*Contd.*)

	Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (*Being transfer of profits to capital redemption reserve A/c*)		20,000	20,000
	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being transfer to premium on redemption out of securities premium*)		5,000	5,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being payment to preference shareholders*)		55,000	55,000
	General Reserve A/c Dr. To Bonus to Shareholders A/c (*Being declaration of bonus out of general reserve*)		50,000	50,000
	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (*Being issue of bonus shares of one equity share for every two held*)		50,000	50,000

Illustration 26

Sree Optics Ltd. has an authorised capital of ₹2,50,000, comprising 50,000 6% redeemable cumulative preference shares of ₹1 each and 2,00,000 ordinary shares of ₹1 each. The preference shares are redeemable on 1st July 2003 at ₹1.05 per share. The summarised balance sheet of the company as on 31st December 2002 was as follows.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Sundry Assets	1,96,700
Issued and fully paid-up:		Investments	14,000
Preference	50,000	Bank Balance	28,000
Ordinary	1,00,000		
Capital Reserve	9,500		
General Reserve	20,000		
Profit & Loss A/c	42,500		
Creditors	16,700		
	2,38,700		2,38,700

The necessary resolutions were duly passed and the following transactions carried through on the dates stated:

On 31st May 2003, in order to provide cash toward the redemption of the preference shares:

(a) all the investments were sold for ₹18,000 and

(b) 20,000 ordinary shares of ₹1 each were issued to existing shareholders at ₹1.25 per share payable in full forthwith and duly paid.

On 1st July 2003, the preference shares were duly redeemed and on 30th September 2003, a bonus issue of ordinary shares was made at the rate of one new share for every ten shares. You are required to give necessary journal entries and prepare the balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of equity shares for redemption*)		25,000	 20,000 5,000
	Bank A/c Dr. To Investments A/c To Profit & Loss A/c (*Being investments sold at a profit of ₹4,000 for redemption*)		18,000	 14,000 4,000
	Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (*Being amount due on redemption of preference shares*)		50,000 2,500	 52,500
	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being premium on redemption of preference shares written off*)		2,500	 2,500
	General Reserve A/c Dr. Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (CRR) (*Being amount transferred to CRR A/c from the above for redemption*)		20,000 10,000	 30,000
	Preference Shareholders A/c Dr. To Bank A/c (*Being amount paid to preference shareholders*)		52,500	 52,500
	Capital Redemption Reserve A/c Dr. To Bonus to Shareholders A/c (*Being 1 share as bonus issue @ ₹1 for every 10 shares*)		12,000	 12,000

(*Contd.*)

	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (*Being bonus shares transferred to equity share capital A/c*)		12,000	12,000

Calculation of Bonus Issue:

For 10 equity shares, 1 share as bonus issue $\frac{1,20,000}{10}$ = 12,000 shares

Therefore, for 1,20,000 shares?
(including the new issue)

Bank Account

Particulars	(₹)	Particulars	(₹)
To Balance b/d	28,000	By Preference Shareholders	52,500
To Equity Share Capital	20,000	By Balance c/d	18,500
To Securities Premium	5,000		
To Investments	18,000		
	71,000		71,000

Notes to Accounts:

1. Share Capital:	
Issued and fully paid-up	
1,32,000 shares of ₹1 each (including bonus issue of 12,000 shares)	1,32,000
2. Reserve & Surplus:	
Capital Reserve	9,500
Profit & Loss A/c (42,500 + 4,000 – 10,000)	36,500
Capital Redemption Reserve	
(30,000 – 12,000)	18,000
Securities Premium (5,000 – 2,500)	2,500
3. Current Liabilities	66,500
Creditors	16,700

Balance Sheet of Sree Optics Ltd. as on 30.09.2003

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	1,32,000
Reserves and Surplus	2	66,500
(ii) Non-Current Liabilities		—
(iii) Current Liabilities		
Creditors	3	16,700
Total: (i) + (ii) + (iii)		2,15,200

(*Contd.*)

II. Assets:		
(i) Non-Current Assets:		
Fixed Assets		1,96,700
(ii) Current Assets:		
Bank Balance		18,500
Total: (i) + (ii)		2,15,200

Illustration 27

Right issue for redemption

The balance sheet of Chandran & Co., as on 31st March 2008, disclosed the following information:

	(₹)
Authorised Share Capital:	
2,500 6% Redeemable Preference Shares of ₹100 each	2,50,000
50,000 Equity Shares of ₹10 each	5,00,000
Paid-up Capital:	
1,250 6% Redeemable Preference Shares of ₹100 each	1,25,000
30,000 Equity Shares of ₹10 each	3,00,000
Capital Reserve	50,000
General Reserve	1,75,000
Securities Premium	6,000
Profit & Loss A/c	62,500

On 5th April 2008, the preference shares were redeemed at a premium of 5% for the purpose of redemption, the company decided to:

(a) Issue 2,000 8% debentures of ₹100 each.

(b) Convert the partly paid-up equity shares into fully paid-up without requiring the shareholders to pay for the same

(c) Issue of fully paid rights shares of ₹10 each, at a premium of ₹2 per share, in the proportion of one share for every four shares held.

Give necessary entries to record the above transaction.

Solution:

Journal Entries

Date	Particulars	L.F	Debit (₹)	Credit (₹)
05.04.2008	6% Redeemable Preference Share Capital A/c Dr.		1,25,000	
	Premium on Redemption of Preference Shares A/c Dr.		6,250	
	To Redeemable Preference Shareholders A/c			1,31,250
	(*Being the amount due on redemption*)			

(*Contd.*)

05.04.2008	General Reserve A/c Dr. To Capital Redemption Reserve A/c (*Being transfer of the amount to CRR A/c*)		1,25,000	 1,25,000
05.04.2008	Securities Premium A/c Dr. Profit & Loss A/c Dr. To Premium on Redemption of Preference Shares A/c (*Being providing premium on redemption out of existing securities premium and balance from Profit & Loss A/c*)		6,000 250	 6,250
05.04.2008	Bank A/c Dr. To 8% debentures A/c (*Being issue of 2,000 debentures @ ₹100 each*)		2,00,000	 2,00,000
05.04.2008	Redeemable Preference Shareholders A/c Dr. To Bank A/c (*Being redemption of preference shares*)		 1,31,250	 1,31,250
05.04.2008	Equity Shares Final Call A/c Dr. To Equity Share Capital A/c (*Being amount due on final call*)		1,00,000	 1,00,000
05.04.2008	Capital Redemption Reserve A/c Dr. To Bonus to Equity Shareholders A/c (*Being issue of bonus shares*)		1,00,000	 1,00,000
05.04.2008	Bonus to Equity Shareholders A/c Dr. To Equity Share Final Call A/c (*Being adjusting bonus to equity shareholders against final call*)		1,00,000	 1,00,000
05.04.2008	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being issue of rights share in proportion of 1:4 at a premium of ₹2 per share*)		1,20,000	 1,00,000 20,000

THEORY QUESTIONS

I. Short-Answer Questions

1. What are Redeemable Preference Shares? How are such shares redeemed?
2. Briefly explain the meaning of 'Proceeds of Fresh Issue of Shares'.

3. Enumerate the profits, which are eligible to be transferred to Capital Redemption Reserve.
4. What do you mean by Capital Redemption Reserve?
5. Can partly paid-up redeemable preference shares be redeemed? If not, why?
6. What do you mean by Bonus Issue?
7. State the significance of 'Minimum New Issue of shares'.
8. State the provisions of the Companies Act for Premium on Redemption of Preference Shares.

II. Long-Answer Questions

1. State the conditions and procedures for the Issue of Redeemable Preference Shares.
2. What are the implications of Section 80 and Section 80 A of the Companies Act for redemption of preference shares?
3. What are the profits, which cannot be transferred to Capital Redemption Reserve? State the reasons.
4. How do you calculate the 'Minimum Fresh Issue of Shares'? Illustrate with an example.
5. What are the steps to be followed to redeem the preference shares?
6. How do you create Capital Redemption Reserve? How can it be utilised?
7. Who are Untraceable Shareholders? State the accounting treatment for them in redemption.
8. Discuss the provisions of the Companies Act in Section 80, which protects the interest of the creditors.

OBJECTIVE-TYPE QUESTIONS

I. Multiple Choice Questions

1. Redeemable preference shares can be redeemed out of:
   (a) Amount realized on sale of current assets
   (b) Profits prior to incorporation
   (c) Proceeds of fresh issue of shares
   (d) Both b and c
2. When preference shares are redeemed out of the profits otherwise available for dividend, the sum equal to the nominal number of shares must be transferred to:
   (a) Capital redemption reserve (b) Reserve fund
   (c) Profit & Loss A/c (d) Depreciation fund
3. Capital redemption reserve is created:
   (a) Out of shares forfeited A/c
   (b) Out of profits available for dividend
   (c) Out of securities premium
   (d) Out of capital reserve

4. Amount can be transferred to capital redemption reserve from:
   (a) Capital reserve (b) Dividend equalization fund
   (c) Development rebate reserve (d) Securities premium A/c
5. Amount cannot be transferred to capital redemption reserve A/c from:
   (a) Profit & Loss A/c
   (b) Debenture Redemption Fund
   (c) Workmen's Accident Fund
   (d) Capital portion of Profit on sale of fixed assets
6. Capital redemption reserve A/c is used:
   (a) To write off past losses (b) To issue fully paid bonus shares
   (c) To declare dividends (d) To Capital Reduction A/c
7. The premium on redemption of preference shares can be provided out of:
   (a) Securities premium A/c (b) Capital redemption reserve A/c
   (c) Capital reserve (d) Depreciation reserve
8. X Ltd. has issued 20,000 equity shares of ₹10 each at a premium of ₹2 for the redemption of preference shares. Which of the following amount would be considered as 'proceeds of fresh issue'?
   (a) ₹2,00,000 (b) ₹2,20,000
   (c) ₹2,40,000 (d) None of the above
9. Y Ltd. has made a public issue of 1,000 6% preference shares of ₹100 each at a discount of 6% providing fund for redemption of preference shares. Which of the following amount would be considered as 'proceeds of fresh issue'?
   (a) ₹1,00,000 (b) ₹94,000
   (c) ₹1,06,000 (d) None of the above
10. Redemption of preference shares does not affect:
   (a) Issued capital (b) Paid up capital
   (c) Authorised capital (d) Subscribed capital

[*Ans:* 1. (c); 2. (a); 3. (b); 4. (b); 5. (d); 6. (b); 7. (a); 8. (c); 9. (b); 10. (c)]

III. True or False

1. A company cannot redeem its partly paid preference shares.
2. The main purpose of creating capital redemption reserve is to maintain the capital structure of the company intact after redemption.
3. The proceeds of fresh issue of debenture cannot be used for redemption of redeemable preference shares.
4. Capital redemption reserve can be used to write off past losses of the company.
5. Workmen's compensation fund can be transferred to capital redemption reserve A/c at the time of redemption of preference shares, if there is no liability for workmen for compensation.
6. Capital redemption reserve can be used for converting partly paid shares into fully paid.
7. The premium on redemption of preference shares cannot be debited to securities premium A/c.

8. Premium on issue of debentures can be used to pay premium on redemption of preference shares.
9. Fully paid up preference shares can be redeemed.
10. Redemption of preference shares can be considered as reduction of capital of the company.

[*Ans:* True: 1, 2, 3, 5, 8, 9; False: 4, 6, 7, 10]

II. Fill in the Blanks

1. Preference shares cannot be redeemed when they are ________ paid.
2. If ______ shares are issued for the purpose of redemption of preference shares, it will not be treated as increase of capital.
3. If any premium is to be payable on redemption, such premium has to be provided out of the securities premium A/c or ____________.
4. Companies (Amendment) Act 1988 prohibits issue of _________ preference shares.
5. Capital Profits are __________ to be transferred to capital redemption reserve A/c.
6. General Reserve is _________ to be transferred to capital redemption reserve A/c.
7. Capital redemption reserve can be used for issuing fully paid _________ shares.
8. Profits which would otherwise be available for dividend is known as __________.
9. The word 'proceeds' implies the _____________ excluding the amount of share premium on the new issue of shares.
10. An amount equal to redemption of preference shares must be transferred to CRR A/c when it is ________.

[*Ans:* 1. Partly, 2. New, 3. Out of other profits, 4. Irredeemable, 5. Not allowed, 6. Allowed, 7. Bonus, 8. Divisible profits, 9. Amount received, 10. Out of profits]

EXERCISE PROBLEMS

1. Redemption of 10,000 preference shares of ₹100 each was carried out of reserves and out of the issue of 4,000 shares of ₹100 each @ ₹95. What is the amount of capital redemption reserve account that is required?

   [*Ans:* CRR: ₹6,20,000]
2. A company having free reserves of ₹1,20,000 wants to redeem ₹4,00,000 preference shares. Calculate the face value of fresh issue of shares of ₹10 each to be made at a premium of 10%. [*Ans:* ₹2,80,000]
3. X co ltd has to redeem redeemable preference shares of the value of ₹2,00,000 at a premium of 10% for which the company has issued 10,000 equity shares of ₹10 each at a premium of 20. You are required to calculate the amount to be transferred to capital redemption reserve account. [*Ans:* CRR: 1,00,000]

4. From the following data, calculate the amount of fresh issue of shares:

Redeemable preference shares:	₹80,000
Premium on redemption:	5%
Divisible profits available:	₹15,000
General reserve balance:	₹6,500
Securities premium A/c:	₹4,000

Fresh issue is to be made at a discount of 10%

[*Ans:* Fresh issue of shares: ₹65,000]

i.e., 80,000 + 4,000 = 15,000 + 6,500 + 4,000 + x-0.1x. Therefore x = ₹65,000)

5. Y Ltd. wishes to redeem its redeemable preference shares of ₹2,00,000 at a premium of 20%. For this purpose, it has decided to make a fresh issue of ₹100 shares at 10% premium and utilize the profits of ₹42,000 available for dividend. You are required to calculate the minimum fresh issue of shares that the company has to make to the public.

[*Ans:* No. of fresh shares to be issued: 1,800]

6. 'P' Company Ltd. redeems 20,000 8% preference shares of ₹100 Each at a premium of 10% out of the profits otherwise available for dividend.

[*Ans:* Amount transferred to CRR A/c: ₹20,00,000 from Profit & Loss A/c]

7. A company had decided to issue 5,000 equity shares of ₹100 Each at a premium of 10% and utilize the proceeds to redeem 50,000 12% preference shares of ₹10 each at a premium of 5%. The New issue was fully subscribed and paid up. The preference shares were duly redeemed. Journalize.

8. The following extract from the balance sheet of Vimala Ltd as on 31st December 1997 is given to you.

Share capital:	₹
2,00,000 equity shares of ₹10 Each	20,00,000
2,00,000 6% Redeemable preference shares of ₹10 Each:	20,00,000
Capital reserve:	10,00,000
General Reserve:	6,00,000
Profit & Loss account:	17,00,000

The company exercises its option to redeem the preference shares on 1st January 2010.

[*Ans:* Amount transferred to CRR A/c: ₹20,00,000]

9. The following is the balance sheet of Ramani company limited as on 31.12.96:

Liabilities	₹	Assets	₹
Share capital:			
1,000 6% Redeemable		Fixed assets	3,10,000
preference shares of ₹100		Cash at Bank	1,40,000
Each fully paid	1,00,000		
20,000 equity shares of ₹10			
Each	2,00,000		
Profit & Loss A/c	1,20,000		
Sundry creditors	30,000		
	4,50,000		4,50,000

The company resolved to redeem its preference shares at a premium of 2% out of profits. Give the necessary journal entries.

[*Ans:* CRR A/c: 1,00,000]

10. Sam Ltd. had as part of the share capital 20,000 preference shares of ₹100 each fully paid up. When the shares became due for redemption, the company had ₹12,00,000 in its reserve fund. The company issued necessary equity shares of ₹25 each specially for the purpose of redemption and carried out the redemption. Make necessary journal entries to record the above transactions.

(Madras University, B.Com., Oct. 2003)

[*Ans:* New Issue : 32,000 shares i.e., ₹8,00,000]

OTHER EXERCISES

1. The balance sheet of Wallace Ltd., as on 31st December 2009 was as under:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Sundry Assets	3,65,000
1,000 Redeemable Preference Shares of ₹100 each	1,00,000	Bank Balance	1,40,000
2,000 Equity Shares of ₹100 each, fully paid	2,00,000		
General Reserve	80,000		
Profit & Loss A/c	50,000		
Sundry Creditors	75,000		
	5,05,000		5,05,000

On this date, the preference shares were redeemed at par. Journalise and prepare balance sheet after redemption.

[*Ans:* Transfer to CRR: ₹1,00,000 (i.e. from general reserve ₹80,000 & Profit & Loss ₹20,000); Total of amended balance sheet: ₹4,05,000]

2. The summarised balance sheet of Gaur Ltd. on December 2004 was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Sundry Assets	9,80,000
2,000 9% Redeemable Preference Shares of ₹100 each, fully paid	2,00,000	Bank Balance	4,20,000
80,000 Equity Shares of ₹10 each, fully paid	8,00,000		
Profit & Loss A/c	2,60,000		
Sundry Creditors	1,40,000		
	14,00,000		14,00,000

On the above date, the preference shares were redeemed at a premium of 10%. You are required to pass journal entries and give the amended balance sheet.

[*Ans:* Transfer to CRR: ₹2,00,000; Balance sheet: ₹11,80,000]

3. The following is the balance sheet of Raj Ltd., as on 31st December 2009:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Sundry Assets	6,00,000
2,000 8% Redeemable Preference Shares of ₹100 each, fully paid	2,00,000	Bank Balance	4,40,000
50,000 Equity Shares of ₹10 each, fully paid	5,00,000		
Profit & Loss A/c	2,40,000		
Sundry Creditors	1,00,000		
	10,40,000		10,40,000

The company resolved to redeem its preference shares at a premium of 20% out of profits. Pass the necessary journal entries and show the important ledger accounts and the company's balance sheet after completion of redemption.

[*Ans:* Transfer to capital redemption reserve account: ₹2,00,00; Total of balance sheet: ₹8,00,000]

4. A company wishes to redeem its preference shares amounting to ₹1,00,000 at a premium of 5% and for this purpose, issued 5,000 equity shares of ₹10 each at a premium of 5%. The company also has a balance of ₹1,00,000 on general reserve and ₹50,000 on profit and loss account. Pass the necessary journal entries to record the above transaction.

[*Ans:* Transfer to capital redemption reserve account from general reserve: ₹50,000]

5. B Ltd. had issued 50,000 redeemable preference shares of ₹10 each, ₹8 paid. In order to redeem these shares, the company issued for cash 30,000 equity shares of ₹10 each, at a premium of ₹2 per share. Out of the cash proceeds, the redeemable preference shares were paid and the balance was met out of the reserve fund, which stood at ₹2,50,000. Give journal entries in the books of the company.

[*Ans:* CRR: ₹2,00,000]

6. The following is the summarised balance sheet of a company as on 30th April 2001.

Liabilities	(₹)	Assets	(₹)
Issued, Subscribed and Paid-up Capital:		Sundry Assets	18,00,000
		Cash at Bank	6,60,000
4,000 8% Redeemable Preference Shares of ₹100 each. fully called-up & paid-up	4,00,000		
3,000 9% Redeemable Preference Shares of ₹100 each, ₹80 paid-up	2,40,000		
1,00,000 Equity Shares of ₹10 each, fully paid-up	10,00,000		
Securities Premium A/c	50,000		
Revenue Reserve	5,00,000		
Current Liability	2,70,000		
	24,60,000		24,60,000

It was decided to redeem both the classes of preference shares on 30th June at a premium of 5%. In May 2001, the company issued for cash so many equity shares of ₹10 each, as were necessary to provide for redemption of both classes of preference shares, which could not otherwise be redeemed. The issue was fully subscribed and all moneys were received. Give journal entries in the books of the company.

[*Ans:* Capital redemption reserve account: ₹5,00,000; New issue: ₹2,00,000; Securities premium used for premium on redemption: ₹35,000]

7. A company, in a series of operations:
   (a) Issues at par 45,000 redeemable preference shares of ₹10 each, redeemable at a premium of 5%.
   (b) Redeems 15,000 of the redeemable preference shares out of the profit of the company.
   (c) Issues for cash 30,000 equity shares of ₹10, each at a premium of ₹1 per share and out of the proceeds, redeems the balance of the redeemable preference shares.

   Journalise these transactions.

   [*Ans:* Capital redemption reserve account: ₹1,50,000]

8. A company has 4,000 7% redeemable preference shares of ₹100 each, fully paid. The company decides to redeem the shares on 31st December 2004, at a premium of 5% .The company has sufficient profits but in order to augment liquid funds and redeem the shares, it makes the following issues:
   (a) 1,000 equity shares of ₹100 each, at a premium of 10%
   (b) 1,000 5% debentures of ₹100 each

   The issue was fully subscribed and all the amounts were received. The redemption was duly carried out. Give journal entries to record the above.

   [*Ans:* Capital redemption reserve account: ₹3,00,000]

9. The following is the summarised balance sheet of a company:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Sundry Assets	8,10,000
10% Redeemable Preference Shares of ₹100 each	1,00,000	Cash at Bank	90,000
50,000 Equity Shares of ₹10 each, fully paid	5,00,000		
General Reserve	1,00,000		
Capital Reserve	50,000		
Creditors	1,50,000		
	9,00,000		9,00,000

   For the purpose of redemption of preference shares, the company made a fresh issue of 4,500 equity shares of ₹10 each, at a premium of 10%. The preference shares were redeemed at a premium of 10%. Show journal entries and prepare the balance sheet after redemption.

   [*Ans:* Capital redemption reserve account: ₹55,000; Bank balance: ₹29,500; Balance sheet total: ₹8,39,500]

10. On 31st December 1993, the balance sheet of Sundaram Ltd., stood as follows:

Liabilities	(₹)	Assets	(₹)
Redeemable Preference Shares Capital	5,00,000	Sundry Assets	7,60,000
		Cash at Bank	1,90,000
Equity Share Capital	2,00,000		
General Reserve	1,50,000		
Sundry Creditors	1,00,000		
	9,50,000		9,50,000

On the above date, the preference shares had to be redeemed. For this purpose, 1,000 equity shares of ₹100 each were issued at ₹110. The shares were immediately subscribed and paid for. The preference shares were duly redeemed. Give journal entries and balance sheet after redemption.

[*Ans:* Capital redemption reserve account: ₹1,00,000; Bank balance: ₹1,00,000; Balance sheet total: ₹8,60,000]

11. The balance sheet of ABC & Co. Ltd. on 31st March 2009 stood as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	8,00,000
9% Redeemable Preference Shares of ₹100 each	3,00,000	Investment	1,00,000
		Bank Balance	2,00,000
Equity Shares of ₹100 each	5,00,000	Other Current Assets	5,00,000
Securities Premium	50,000		
Capital Reserve	1,00,000		
Profit & Loss A/c	2,00,000		
10% Debentures	3,00,000		
Creditors	1,50,000		
	16,00,000		16,00,000

Both the redeemable preference shares and debentures were due for redemption on 1st April 2009. The company arranged for the following:

(a) It issued 2,000 equity shares of ₹100, at a premium of 10%.

(b) It sold the investments for ₹90,000.

(c) It arranged a bank overdraft to the extent necessary.

The redemption was carried out. Give entries for redemption of preference shares and debentures and balance sheet after redemption.

[*Ans:* Capital redemption reserve account: ₹1,00,000; Balance sheet total: ₹13,00,000; Bank overdraft: ₹90,000]

12. Following is the balance sheet of Raja Ltd., as on 31st December 1998.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Sundry Assets	6,10,000
5,000 Equity Shares of ₹100 each, fully paid.	5,00,000	Cash	4,40,000
2,000 6% Preference Shares of ₹100 each, fully called-up 2,00,000			

(*Contd.*)

Less: Calls-in-Arrears on 100 shares 2,000	1,98,000		
1,000 7% Preference Shares of ₹100 each, ₹60 paid	60,000		
Profit & Loss A/c	2,40,000		
Creditors	52,000		
	10,50,000		10,50,000

On the above date, preference shares are redeemed to the extent possible at a premium of 5%. Journalise and give the amended balance sheet.

[*Ans:* CRR: ₹1,90,000; Balance sheet: ₹2,40,500]

13. Balance sheet of X Ltd., as on 31st March 2007 is as follows.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	22,00,000
Issued, subscribed and fully paid-up 10,000		Current Assets	8,00,000
Ordinary Shares of ₹100 each	10,00,000		
5,000 Preference Shares of ₹100 each	5,00,000		
Capital Reserve	1,00,000		
Securities Premium	1,00,000		
General Reserve	2,00,000		
Profit & Loss A/c Current	1,00,000		
Liabilities	10,00,000		
	30,00,000		30,00,000

The preference shares are to be redeemed at 10% premium. Fresh issue of equity shares is to be made to the extent required under the Companies Act for the purpose of this redemption. The short fall in funds for the purpose of redemption after utilising the proceeds of the fresh issue are to be met by taking a bank loan. Show journal entries.

[*Ans:* New issue of equity shares: ₹2,00,000; Bank loan: ₹3,50,000]

14. A company wants to redeem its 10,000 6% preference shares of ₹10 each, fully paid at 10% premium. The ledger accounts show the following balances:

Securities Premium	₹2,000
Profit & Loss (Cr.)	₹10,000

The directors redeemed the shares by making minimum fresh issue of equity shares of ₹10 each, at a premium 5%. Give journal entries.

[*Ans:* Capital redemption reserve account: ₹6,660; Proceeds of fresh issue: ₹98,007 (including premium ₹4,667)]

15. The following balances were extracted from the books of S Ltd., as on 31st December 1992.

	(₹)
2,000 8% Redeemable Preference Shares of ₹100 each, fully called-up	2,00,000
Less: Calls-in-Arrears at ₹20 per share on 300 shares	6,000
	1,94,000
General Reserve	50,000
Capital Reserve	10,000

The preference shares were redeemed on 1st January 1993 at a premium of ₹5 per share. The company issued such further equity shares of ₹10 each, as were necessary for the purpose of redeeming the preference shares, which were fully subscribed and duly allotted. You are required to show journal entries in the books of S Ltd.

[*Ans:* CRR: ₹40,000; New issue: ₹1,30,000]

16. The balance sheet of Raman Ltd., as on 31st March 1987, is as follows:

Liabilities	(₹)	Assets	(₹)
10,000 Equity Shares of ₹10 each, fully paid-up	1,00,000	Fixed Assets	2,62,000
11% Redeemable Preference Shares of ₹100 each, fully paid-up 1,00,000		Debtors	90,000
Less: Calls-in-Arrears at ₹20 per share 6,000	94,000	Investment	30,000
10% Preference Shares of ₹10 each, fully paid	1,00,000	Stock	30,000
Capital Reserve	30,000	Bank	4,000
Securities Premium	5,000		
General Reserve	40,000		
Profit & Loss A/c	20,000		
Creditors	27,000		
	4,16,000		4,16,000

Redeemable preference shares were due for payment on 1st April 1987 at a premium of 10%. The company sent a reminder for the final call on the remaining 300 redeemable preference shares and could collect money from shareholders holding 200 shares at ₹20 per share, and forfeited the defaulting 100 shares. The company sold all investments and could recover 90% of the cost of such investment. The company issued adequate number of new equity shares at par, to the extent available profits were insufficient to backup the redemption.

[*Ans:* Capital redemption reserve account: ₹43,000; New issue of equity shares: ₹1,47,000; Balance sheet total: ₹3,82,000; Bank overdraft: ₹27,000]

17. Following was the balance sheet of Brite Ltd., as on 31st December 1996.

Liabilities	(₹)	Assets	(₹)
7,500 Ordinary Shares of ₹100 each	7,50,000	Fixed Assets	7,80,000
2,000, 15% Preference Shares of ₹100 each	2,00,000	Debenture Redemption Fund Investment	88,500
General Reserve	6,30,000	Stock	6,00,000
Profit & Loss A/c	50,000	Debtors	2,60,700
Debenture Redemption Fund	88,480	Cash at Bank	3,00,000
12% Debentures	1,00,000		
Sundry Creditors	2,11,520		
	20,30,000		20,30,000

On this date, the company redeemed, at a premium of 5%, all of its preference shares and debentures. For this purpose, it sold all the investments for ₹90,000 and allotted to its equity shareholders, 1,500 equity shares of ₹100 each at par, the entire amount being received immediately. After redemption of preference shares and debentures, the company issued one fully-paid bonus share of ₹100 for every three shares held. Show journal entries for the above and prepare the balance sheet thereafter.

[*Ans:* Capital redemption reserve account: ₹50,000; Bank balance: ₹2,25,000; Balance sheet total: ₹18,66,500]

18. The balance sheet of PQ Ltd. on 31st December 1985 is as under:

Liabilities	(₹)	Assets	(₹)
9,000 8% Redeemable Preference Shares of ₹100 each, fully paid	9,00,000	Fixed Assets	20,00,000
		Current Assets	3,80,000
		Investment	2,70,000
Equity Shares of ₹10 each, fully paid	9,00,000	Bank	2,00,000
General Reserve	3,60,000		
Securities Premium	27,000		
Profit & Loss A/c	5,40,000		
Creditors	1,23,000		
	28,50,000		28,50,000

The preference shares are to be redeemed at 10% premium along with dividend due for 1985. The company issued 45,000 equity shares of ₹10 each, at a premium of ₹5 per share. All shares were subscribed and cash was duly received. The investments were sold for ₹3,50,000. Payment was made to the preference shareholders and thereafter, the directors decided to issue bonus shares in the ratio of one share for every four shares held. For this purpose, the free reserve were utilised to the minimum extent necessary. Give journal entries with narrations and the balance sheet after redemption.

[*Ans:* CRR Account: ₹4,50,000; Bonus issue: ₹3,37,500; Profit & Loss account balance: ₹4,58,000; Bank balance: ₹1,63,000; Balance sheet total: ₹25,43,000]

19. The balance sheet of Suraj Ltd., as on 31st December 2011, was as under.

Liabilities	(₹)	Assets	(₹)
5,000 6% Redeemable Preference Shares of ₹10 each, fully paid	50,000	Fixed Assets	1,00,000
		Current Assets	62,000
		Investment	20,000
6,000 Equity Shares of ₹10 each fully paid	60,000	Bank	18,000
General Reserve	40,000		
Securities Premium	20,000		
Profit & Loss A/c	5,000		
Creditors	25,000		
	2,00,000		2,00,000

The company passed the following resolutions on 1st January 2012.

(a) To redeem the entire preference share capital at a premium of 10%.

(b) To issue 2,000 equity shares of ₹10 each, at a premium of ₹2 per share, which have been fully subscribed.

(c) To sell the investment at ₹15,000.

(d) To issue the bonus shares as fully paid in the ratio of 2:1 to the existing shareholders, including the fresh issue.

Draft the journal entries and prepare the balance sheet, as on 1st January 2012.

[*Ans:* CRR Account: ₹30,000; Balance sheet total: ₹1,64,000; Bank balance: ₹2,000]

20. Following is the balance sheet of Manish Ltd., as on 31st December 2011.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	5,20,000
Authorised:		Current Assets	3,22,000
20,000 6% Redeemable Preference Shares of ₹10 each	2,00,000		
70,000 Equity Shares of ₹10 each	7,00,000		
	9,00,000		
Issued & Subscribed:			
16,000 6% Redeemable Preference Shares of ₹10 each	1,60,000		
39,000 Equity Shares of ₹10 each, fully paid	3,90,000		
Reserves and Surplus:			
Profit & Loss A/c	2,00,000		
Sundry Creditors	92,000		
	8,42,000		8,42,000

The preference shares were redeemed on 1st January 2012 at a premium of ₹2 per share, whereabouts of the holders of 1,200 such shares not being known. At the same time, a bonus issue of equity shares was made at par, one share being issued for every three shares held out of the capital redemption reserve account. Draw up the journal entries to record the above transactions and show the balance sheet after redemption.

[*Ans:* CRR Account: ₹1,60,000; Bonus shares: ₹1,30,000; Cash paid: ₹1,77,600; Balance sheet total: ₹6,64,400]

21. Following is the balance sheet of Nisha Ltd., as on 31st December 2011.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	4,00,000
Authorised:		Investment	1,00,000
10,000 8% Redeemable Preference Shares of ₹10 each	1,00,000	Current Assets:	
		Stock	40,000
20,000 7% Redeemable Preference Shares of ₹10 each, ₹5 per share, paid up	1,00,000	Debtors	60,000
		Cash at Bank	2,00,000
			3,00,000
20,000 Equity Shares of ₹10 each	2,00,000		
Reserves and Surplus:			
Capital Reserve	70,000		
Securities Premium	80,000		
General Reserve	60,000		
Profit & Loss A/c	90,000		
Current Liabilities	1,00,000		
	8,00,000		8,00 ,000

On 1st January 2012, the company redeemed the preference shares at a premium of 10%. In order to pay-off the preference shareholders, it sold investments realising ₹95,000. All payments were made except to shareholders of 60 shares, who could not be traced.

On 1st May 2012, the company issued fully paid bonus shares in the ratio of one for every share held on that date.

Draw up the journal entries to record the above transactions and show the balance sheet after redemption.

[*Ans:* CRR Account: ₹1,00,000; Bonus shares: ₹2,00,000; Bank balance: ₹1,85,660; Balance sheet total: ₹6,85,660]

22. Following is the balance sheet of Pankaj Cements Ltd.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	12,00,000
5,000 Preference Shares of ₹100 each,fully called-up	5,00,000	Investment	1,00,000
		Bank	1,80,000
Less: Final call of ₹20 per share, unpaid	4,000		
	4,96,000		
Equity Share Capital of 60,000 Shares of ₹10 each, fully paid-up	6,00,000		
Profit & Loss A/c	3,00,000		
Creditors	54,000		
Securities Premium	30,000		
	14,80,000		14,80,000

On 30th June 2003, the board of directors decided to redeem the preference shares at a premium of 10% and to sell the investment at its market price of ₹8 0,000. They also decided to issue sufficient number of equity shares of ₹10 each, at a premium of ₹1 per share, required after utilising the profit and loss account, leaving a balance of ₹1,00,000. The premium on redemption is required to be sent off against security premium account. Repayments on redemption were made in full except one shareholder holding 100 shares who left India. Draw up the journal entries to record the above transactions and show the balance sheet after redemption. Assumptions made should be shown in the working.

[*Ans:* Issue of new equity shares: ₹30,000; CRR: ₹1,80,000; Balance sheet total (after redemption): ₹12,73,000]

23. Following is the balance sheet of Dragon Co. Ltd.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Sundry Assets	9,20,000
10,000 7% Redeemable Preference Shares of ₹100 each	10,00,000	Investments	10,20,000
		Bank	16,00,000
6,000 8% Redeemable Preference Shares of ₹100 each, ₹50 paid up	3,00,000		
8,000 Equity Shares of ₹100 each	8,00,000		

(*Contd.*)

Reserves and Surplus:			
Profit & Loss A/c	40,000		
Securities Premium	1,00,000		
Capital Redemption Reserve	2,00,000		
Dividend Equalisation Fund	8,20,000		
Current Liabilities			
Sundry Creditors	2,80,000		
	35,40,000		35,40,000

The company decided to redeem its fully paid 7% redeemable preference shares, at a premium of 10%. For the purpose of redemption, the company issued 2,000 equity shares of ₹100 each, at a discount of 10%, and sold investments for ₹9,80,000. The capital redemption reserve appearing in the balance sheet pertains to redemption of redeemable preference shares in the past. Assuming that the company's decision is given effect, journalise the transactions in the books of the company and show the balance sheet after redemption.

[*Ans:* CRR A/c: ₹8,20,000; Balance sheet total: ₹26,00,000]

4

ISSUE AND REDEMPTION OF DEBENTURES

A company may raise the funds required for various purposes from different sources. Issue of shares fulfils the long-term financial needs of a company usually. The funds, which are raised by way of medium-term are called as 'Debentures'. These debentures are offered to the public in the same way as shares are issued to them. Debenture is issued under the common seal of the company acknowledging the receipt of money.

Debenture is a long-term debt instrument issued by the company under its common seal, to the debenture holder, showing the indebtedness of the company. The capital raised by the company is the borrowed capital. Hence, the debenture holders are called as the creditors of the company. The interest on debentures is at a fixed rate and this is specified at the time of issue itself. Moreover, this is considered as the return on investment to the debenture holders.

4.1 DEBENTURE

Debenture is a promissory note or a corporate bond, which is backed generally by the reputation and integrity of the borrower and by the borrower's specific assets.

The Companies Act defines debentures as "Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of a company or not".

4.2 CLASSIFICATION OF DEBENTURES

The different ways of classifying debentures are as follows:

1. On security basis:

(i) ***Mortgage debentures:*** These debentures are secured by the assets of the company, which may be a 'fixed charge' or a 'floating charge'. A charge created on the specific asset is called as 'fixed charge,' whereas a charge created on all the assets is called 'floating charge'.

(ii) ***Naked or simple debentures:*** Naked or simple debentures are unsecured.

2. On permanence basis:

(i) ***Redeemable debentures:*** Debentures that are redeemed at a future date and are specified at the time of issue itself by the company.

(ii) ***Irredeemable debentures:*** Debentures that cannot be redeemed at a future date by specifying the time of redemption. These debentures may be repayable at the time of winding up of the company.

3. On priority basis:

Debentures are repayable on the basis of their order of repayment, like 'first debentures', 'second debentures' and so on.

4. On convertibility basis:

(i) ***Convertible debentures:*** Debentures converted into equity shares or preference shares or new debentures and are specified at the time of issue itself. They may be partly convertible debentures (PCDs) and fully convertible debentures (FCDs). The unconvertible portion in case of PCDs is termed as 'KHOKA,' which is repaid in cash.

(ii) ***Non-convertible debentures:*** These debentures cannot be converted into equity shares or preference shares or new debentures.

5. On recording basis:

(i) ***Registered debentures:*** The names and addresses of debenture holders are registered in the record maintained by the company.

(ii) ***Bearer debentures:*** No record is maintained for transfer of these debentures. These debentures can be transferred by mere physical delivery.

4.3 DISTINCTION BETWEEN 'DEBENTURE' AND 'SHARE'

Basis of Comparison	Shares	Debentures
Meaning	The shares are the owned funds of the company.	The debentures are the borrowed funds of the company.
Representation	Shares represent the capital of the company	Debentures represent the debt of the company.
Holder	The holder of shares is known as shareholders.	The holder of debentures is known as debenture holders.
Status of Holders	Owners	Creditors
Return on Investment	Dividend is received by the shareholders	Debenture holders receive interest.
Voting Rights	Shareholders have voting rights.	Debenture holders have no voting rights.
Conversion	Shares can never be converted into debentures.	Debentures can be converted into shares.

(*Contd.*)

Repayment in the event of winding up	Shareholders are repaid after the payment of all liabilities.	Debenture holders are repaid before making payment to shareholders.
Quantum	Dividend paid is an appropriation of profit.	Interest paid is a charge in the profit and loss account.
Trust Deed	There is no trust deed executed.	Trust deed must be executed when debentures are issued to the public.
Tax Advantage	There is no tax advantage to the company since dividend is paid from profit and loss appropriation.	There is a tax advantage to the company since interest paid is a charge against profit and loss account.

4.4 ACCOUNTING FOR DEBENTURES

The accounting process for debentures is classified into two stages—issue of debentures and redemption of debentures

❍ Issue of Debentures

Recording of entries for issue of debentures can be made in the same way as for issue of shares. The legal restrictions relating to the issue of shares at discount or premium do not apply to the debentures. The accounting treatment for recording issue of debentures is influenced by certain aspects, as explained:

Consideration for Issue of Debentures

Consideration for issue of debentures may be cash or assets or the issue may be made as collateral security for loans.

Model Journal Entries

	₹	₹
(a) Issue of debentures for cash: Here, the issue price is receivable in the form of cash. It may be received immediately in one instalment or it may be received in two or more stages like application, allotment and calls. **(i) If full amount is received in one lump sum** Bank A/c Dr. To ____% Debentures A/c (*Being issue of ... debentures for cash at par*)	 xxx	 xxx
(ii) If cash is received in two or more stages For receiving debenture application money Bank A/c Dr. To Debenture Application A/c (*Being application money received on…debenture application*)	 xxx	 xxx

At the time of allotment, for the application money on the allotted debentures: Debenture Application A/c Dr. To % Debentures A/c (*Being transfer of debenture application money of allotted debentures*)	xxx	xxx
For excess debenture application money Debenture Application A/c Dr. To Bank A/c (if returned) To Debenture Allotment A/c (if adjusted towards allotment) (*Being return and transfer of excess application money*)	xxx	xxx
For allotment amount receivable Debenture Allotment A/c Dr. To ____% debentures A/c (*Being allotment amount receivable*)	xxx	xxx
For receiving allotment money Bank A/c Dr. To Debenture Allotment A/c (*Being amount received on allotment*)	xxx	xxx
For call amount receivable Debenture Call A/c Dr. To ____% Debentures A/c (*Being call amount due*)	xxx	xxx
For receiving the call amount Bank A/c Dr. To Debenture Call A/c (*Being call amount received*)	xxx	xxx
(b) Issue of debentures for consideration other than cash: Debentures may be issued for purchase of assets or purchase of the business of vendors. In the latter case, it is called 'purchase consideration'. When assets are acquired Sundry Assets Account Dr. To Vendors A/c (*Being purchase of assets from vendors*)	xxx	xxx
When assets and liabilities are acquired Sundry Assets A/c Dr. Goodwill A/c Dr. To Sundry Liabilities A/c To Vendors A/c (*Being assets and liabilities taken over and the purchase consideration payable, including goodwill*)	xxx xxx	xxx xxx
When debentures are issued to the vendors Vendors A/c Dr. To % Debentures A/c (*Being settlement of the vendors account by issue of debentures*)	xxx	xxx

Issue of debentures for cash

Different examples of issue of debentures for cash (Illustrations 1 and 2) and issue of debenture for consideration other than cash (Purchase of assets and Purchase of business of vendors) (Illustrations 3, 4 and 5) are explained as follows:

Illustration 1

M Ltd. issued 40,000 10% debentures of ₹10 each to the public at par, to be paid ₹3 on application and the balance on allotment. Applications were received for 35,000 debentures. Allotment was made to all the applicants and the amount due was received.

Pass journal entries to record the transactions and show how they appear in the balance sheet of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr.		1,05,000	
	To Debenture Application A/c			1,05,000
	(*Being application money received @ ₹3 per share for 35,000 debentures*)			
	Debenture Application A/c Dr.		1,05,000	
	To 10% Debentures A/c			1,05,000
	(*Being transfer of application money to debentures account*)			
	Debentures Allotment A/c Dr.		2,45,000	
	To 10% Debentures A/c			2,45,000
	(*Being amount due on allotment*)			
	Bank A/c Dr.		2,45,000	
	To Debentures Allotment A/c			2,45,000
	(*Being amount received on allotment*)			

Balance Sheet of M Ltd. (Includes)

Liabilities	(₹)
Non-current Liabilities:	
Long-term Borrowings: 10% Debentures	3,50,000
Assets	**(₹)**
Current Assets:	
Cash at Bank	3,50,000

Illustration 2

AB Ltd. issued 20,000 12% debentures of ₹100 each for public subscription, at a premium of 10% payable as to ₹20 on application, ₹50 on allotment (including premium) and the balance in one call. 30,000 applications were received. 5,000 applications were rejected and debentures were allotted to the remaining applicants on pro-rata. Allotment amount was received from all the allotters; one of whom paid the call amount due on his own 1,000 debentures along with allotment money. The call amount was also collected on the due date.

Give journal entries in the books of the company.

Solution:

Journal Entries

S. No.	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr. To Debenture Application A/c (*Being application money received on debentures*)		6,00,000	 6,00,000
2	Debenture Application A/c Dr. To 12% Debentures A/c To Bank A/c To Debenture Allotment A/c (*Being application money transferred to debenture account, refunded to applicants and balance adjusted towards allotment*)		6,00,000	 4,00,000 1,00,000 1,00,000
3	Debenture Allotment A/c Dr. To 12% Debenture A/c To Securities Premium A/c (*Being amount due on allotment including premium*)		10,00,000	 8,00,000 2,00,000
4	Bank A/c Dr. To Debenture Allotment A/c To Calls-in-Advance A/c (*Being allotment money received and Calls-in-Advance received for 1,000 debentures*)		10,40,000	 10,00,000 40,000
5	Debenture Call A/c Dr. To 12% Debenture A/c (*Being amount due on 20,000 debentures @ ₹40 per debentures*)		8,00,000	 8,00,000
6	Bank A/c Dr. Calls-in-Advance A/c Dr. To 12% Debenture A/c (*Being call money received and the Calls-in-Advance adjusted*)		7,60,000 40,000	 8,00,000

Illustration 3

Pass journal entries in the books of S Ltd., if:

(a) it purchases assets of ₹6,00,000 and agreed to pay the price by issuing 10% debentures of ₹100 each, at premium of 20%.

(b) it purchased assets of ₹4,00,000 and liabilities of ₹40,000. It issued 9% debentures of ₹100 each, at a discount of 10% to satisfy the net purchase price.

(c) it purchased assets and liabilities of a firm for ₹5,00,000. The assets acquired were valued at ₹7,00,000 and the liabilities taken over were ₹3,00,000. The purchase price is to be satisfied by issue of 10% debentures of ₹100 each at par.

Solution:

Journal Entries

S. No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(a)	Sundry Assets A/c Dr. To 10% Debentures A/c (W.N. a) To Securities Premium A/c (*Being issued of 5,000 debentures of ₹100 each, at a premium of 20% for purchasing the assets*)		6,00,000	 5,00,000 1,00,000
(b)(i)	Assets A/c Dr. To Liabilities A/c To Vendor A/c (*Being assets and liabilities acquired and the net amount payable to the vendor*)		4,00,000	 40,000 3,60,000
(ii)	Vendor A/c Dr. Discount on Issue of Debentures A/c Dr. To 9% Debentures A/c (W.N. b) (*Being issue of 4,000 debentures of ₹100 each at a discount of 10%*)		3,60,000 40,000	 4,00,000
(c)(i)	Assets A/c Dr. Goodwill A/c (Bal. Fig.) Dr. To Liabilities A/c To Vendor A/c (*Being assets and liabilities acquired and the amount payable to vendor including goodwill*)		7,00,000 1,00,000	 3,00,000 5,00,000
(ii)	Vendor A/c Dr. To 10% Debentures A/c (*Being amount settled to vendors by issue of 5,000 debentures of ₹100 each at par*)		5,00,000	 5,00,000

Working Notes:

(a) Purchase Price = ₹6,00,000
Issue Price of Debentures = 100 + 20 = ₹120

∴ Number of debentures to be issued = $\frac{6,00,000}{120}$ = 5000

Face Value of Debentures = 5000 × 100 = ₹5,00,000

(b) Purchase Price = ₹4,00,000 – 40,000 = ₹3,60,000
Issue Price of Debentures = 100 – 10 = ₹90

∴ Number of debentures to be issued = $\frac{3,60,000}{90}$ = 4,000

Face Value of debentures = 4000 × 100 = ₹4,00,000
Discount on Issue of Debentures = 4000 × 10 = ₹40,000

Illustration 4

A company purchased land & building of the book value of ₹4,50,000 from Mr. Anand. It was agreed that the purchase consideration be paid by issuing 10% debentures of ₹100 each. Pass journal entries if the debentures have been issued: (i) at par; (ii) at discount of 10%; and (iii) at a premium of 10%.

Solution:

Journal Entries

S. No.	Particulars	L.F.	Debit (₹)	Credit (₹)
	Land & Building A/c Dr.		4,50,000	
	To Anand A/c			4,50,000
	(*Being land & building purchased from Anand*)			
(i)	Anand A/c Dr.		4,50,000	
	To 10% Debentures A/c			4,50,000
	(*Being 4,500 debentures of ₹100 each allotted to the vendor – Anand*)			
(ii)	Anand A/c Dr.		4,50,000	
	Discount on Issue of Debentures A/c		50,000	
	To 10% Debentures A/c			5,00,000
	(*Being 5,000 (4,50,000/90) debentures of ₹100 each issued at a discount of 10% to the vendor –Anand*)			
(iii)	Anand A/c Dr.		4,50,000	
	To 10% Debentures A/c			4,09,090
	To Securities Premium A/c			40910
	(*Being 4,091 (4,50,000/110) debentures of ₹100 each, issued at premium of 10% to the vendor – Anand*)			

Illustration 5

ABC Ltd. issued 200 10% debentures of ₹100 each on 1st April 2007 to settle a creditor, who supplied a machine on credit at ₹18,000. The above issue is redeemable at par. Pass necessary journal entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2007	Machine Vendor A/c Dr. Discount on Issue of Debentures A/c Dr. To 10% Debenture A/c (*Being issue of 200 debentures of ₹100 each at a discount of 10% to settle the account of the creditor, who supplied machine on credit*)		18,000 2,000	 20,000

Issue of debentures as collateral security

When debentures are issued as secondary security in addition to the main security for a bank loan or mortgage loan obtained by the company, then such an issue is termed as Issue of Debentures as Collateral Security. When the value of main security falls down, the bank depends on the collateral security. If the principal or interest or both are not paid in due time, the bank can recover its loan and interest not only from the main security, but also from the sale of the debentures issued as collateral security. No interest is payable on the debentures issued as collateral security.

Debentures issued as collateral security can be treated in either of the following ways:

1. ***First method:*** Issue of the debentures is not at all recorded in the journal or ledger. The debentures will become a real liability only when the loan is not repaid as per the agreed terms. However, in the balance sheet liabilities side, the following notations are made.

Balance Sheet of … Ltd., as on … (includes)

Liabilities	(₹)
Non-current Liabilities: Bank loan (secured by issue of ____% debentures of ₹__ each as collateral security)	xxx

2. ***Second method:*** Issue of debentures as collateral security is recorded as follows:

	(₹)	(₹)
At the time of issuing the debentures Debenture Suspense A/c Dr. To ____% Debentures A/c (*Being debentures issued as collateral security for bank loan*)	 xxx	 xxx

(*Contd.*)

When the loan is repaid and the debentures are returned by the lender, the following entry is passed. ____% Debentures A/c Dr. To Debenture Suspense A/c (*Being cancellation of debentures issued as collateral security*)	xxx	xxx

Balance Sheet of … Ltd. as on … (includes)

Liabilities	(₹)
Long-term borrowings: ____% debentures of ₹___ each issued as collateral security as per contra. Bank loan (secured by issue of ____ debentures of ₹___ each, as collateral security)	 xxx xxx
Assets	**(₹)**
Other Current Assets : Debenture Suspense A/c as per contra	 xxx

Illustration 6

XY Ltd. issued 10% debentures of ₹100 each, to the bankers as collateral security for a loan of ₹80,000.

Pass necessary journal entry in the books of the company and show how the items would appear in the balance sheet.

Solution:

1. ***First method:*** Issue of debentures is not recorded in the journal or ledger. However, in the balance sheet liabilities side, the following note is to be mentioned:

Balance sheet of XY Ltd. as on … (includes)

Liabilities	(₹)
Non-current Liabilities: Bank loan (secured by issue of 10% 1.000 debentures of ₹100 each as collateral security)	 80,000

2. ***Second method:*** Issue of debentures as collateral security is recorded in journal as follows:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Debenture Suspense A/c Dr. To 10% Debentures A/c (*Being issue of 1000 debentures at ₹100 each issued as collateral security to bankers against loan of ₹80,000*)		1,00,000	 1,00,000

Balance Sheet of XY Ltd. as on … (includes)

Liabilities	(₹)
Long-term Borrowings: 1,000 10% debentures of ₹100 each, issued as collateral security as per contra. Bank loan (secured by issue of 1,000 debentures of ₹100 each, as collateral security)	 1,00,000 80,000
Assets	**(₹)**
Other Current Assets: Debenture Suspense A/c as per contra	 1,00,000

4.5 REDEMPTION OF DEBENTURES

Terms Relating to Issue Price and Condition of Redemption of Debentures

Terms of issue of debentures may relate to *the price of issue*. The issue may be made at 'par' or at 'discount' or at 'premium'. Terms of issue may also relate *to condition of redemption.* Debentures may be repayable at 'par', or 'repayable at discount' or 'repayable at premium'.

The following are the journal entries for different combinations of price of issue and condition of redemption.

Particulars	(₹)	(₹)
(1) When the issue is at par, repayable at par: Bank A/c Dr. To ____% Debentures A/c (*Being issue of ____% debentures of ₹__ each at par, repayable at par*)	 xxx	 xxx
(2) When the issue is at discount of ____%, repayable at par: Bank A/c Dr. Discount on Issue of Debentures A/c Dr. To ____% Debentures A/c (*Being issue of ____% debentures of ₹___ each at ____% discount, repayable at par*)	 xxx xxx	 xxx
(3) When the issue is at premium ____%, repayable at par: Bank A/c Dr. To ____% Debentures A/c To Securities Premium A/c (*Being issue of ____% debentures of ₹_ each, at ____% premium, repayable at par*)	 xxx	 xxx xxx

(*Contd.*)

(4) When the issue is at par , repayable at ____% premium: Bank A/c Dr. Loss on Issue of Debentures A/c Dr. To ____% Debentures A/c To Premium on Redemption of Debentures A/c (*Being issue of ____% debentures of ₹__each at par, repayable at ____% premium*)	 xxx xxx	 xxx xxx
(5) When the issue is at discount of ____%, repayable at ____% premium: Bank A/c Dr. Discount on Issue of Debentures A/c Dr. Loss on Issue of Debentures A/c Dr. To ____% Debentures A/c To Premium on Redemption of Debentures A/c (*Being issue of ____% debentures of ₹___ each, at ____% discount, repayable at ____% premium*)	 xxx xxx xxx	 xxx xxx
(6) When the issue is at premium ____%, repayable at ____% premium: Bank A/c Dr. Loss on Issue of Debentures A/c Dr. To ____% Debentures A/c To Securities Premium A/c To Premium on Redemption of Debentures A/c (*Being issue of ____% debentures of ₹___ each, at ____% premium, repayable at ____% premium*)	 xxx xxx	 xxx xxx xxx

Illustration 7

Saranya Ltd. issued 200 10% debentures of ₹100 each. Pass journal entries in the books of the company, if the debentures were issued as follows:

(a) issued at par, redeemable at par
(b) issued at discount of 5%, repayable at par
(c) issued at a premium of 10%, repayable at par
(d) issued at par, redeemable at a premium of 10%
(e) issued at a discount of 5%, repayable at a premium of 10%
(f) Also show how the items would appear in the balance sheet in each of the above cases.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1.	Bank A/c Dr. To 10% Debentures A/c (*Being issue of 200 debentures of ₹100 each at par, repayable at par*)		20,000	 20,000

(*Contd.*)

2.	Bank A/c Dr. Discount on Issue of Debentures A/c Dr. To 10% Debentures A/c (*Being issue of 200 debentures of ₹100 each at 5% discount, repayable at par*)		19,000 1,000	 20,000
3.	Bank A/c Dr. To 10% Debentures A/c To Securities Premium (*Being issue of 200 debentures of ₹100 each, at 10% premium, repayable at par*)		22,000	 20,000 2,000
4.	Bank A/c Dr. Loss on Issue of Debentures A/c Dr. To 10% Debenture A/c To Premium on Redemption of Debentures A/c (*Being issue of 200 debentures of ₹100 each at par, repayable at premium of 10%*)		20,000 2,000	 20,000 2,000
5.	Bank A/c Dr. Discount on Issue of Debentures A/c Dr. Loss on Issue of Debentures A/c Dr. To 10% Debentures A/c To Premium on Redemption of Debentures A/c (*Being issue of 200 debentures at ₹100 each at a discount of 5%, repayable at premium of 10%*)		19,000 1,000 2,000	 20,000 2,000

(1) Balance Sheet of Saranya Ltd. (includes)

Liabilities	(₹)
Non-current Liabilities: Long-term Borrowings: 10% Debentures	 20,000
Assets	**(₹)**
Current Assets: Cash at Bank	 20,000

(2) Balance Sheet of Saranya Ltd. (includes)

Liabilities	(₹)
Non-current Liabilities: Long-term Borrowings: 10% Debentures	 20,000

(*Contd.*)

Assets	(₹)
Current Assets:	
Cash at Bank	19,000
Other Current Assets:	
Discount on Issue of Debentures	1,000

(3) Balance Sheet Saranya Ltd. (includes)

Liabilities	₹
Reserves and Surplus:	
Securities Premium	2,000
Non-current Liabilities:	
Long-term Borrowings:	
10% Debentures	20,000
Assets	**₹**
Current Assets:	
Cash at Bank	22,000

(4) Balance Sheet of Saranya Ltd. (includes)

Liabilities	(₹)
Non-current Liabilities:	
Long-term Borrowings:	
10% Debentures	20,000
Premium on Redemption of Debentures	2,000
Assets	**(₹)**
Current Assets:	
Cash at Bank	20,000
Other Current Assets:	
Loss on Issue of Debenture	2,000

(5) Balance Sheet of Saranya Ltd. (includes)

Liabilities	(₹)
Non-current Liabilities:	
Long-term Borrowings:	
10% Debentures	20,000
Premium on Redemption of Debentures	2,000
Assets	**(₹)**
Current Assets:	
Cash at Bank	19,000
Other Current Assets	
Loss on Issue of Debenture	2,000
Discount on Issue of Debentures	1,000

Treatment of Different Items Relating to Debentures in Final Accounts

1. ***Debentures:*** Debentures are usually secured. They are shown in the balance sheet's liabilities side, under the heading 'Long-term Borrowings,' as per Schedule VI.
2. ***Discount on issue of debentures:*** This is a capital loss and shown on the assets side of the balance sheet under the heading 'Other Current Assets,' as per Schedule VI . It must be written off before the debentures are redeemed.
3. ***Loss on issue of debentures:*** This is also a capital loss and is shown on the assets side of the balance sheet under the heading 'Other Current Assets,' as per Schedule VI. It should also be written off before the debentures are redeemed.
4. ***Expenses of issue of debentures:*** Different expenses like advertisement, brokerage, printing, etc., may be incurred for issue of debentures.

		(₹)	(₹)
When expenses are paid, journal entry is Debenture Issue Expenses A/c To Bank A/c (*Being expenses incurred for issue of debenture*)	Dr.	xxx	xxx
When expenses are written off Profit & Loss A/c To Debenture Issue Expenses A/c (*Being issue expenses written off*)	Dr.	xxx	xxx

5. ***Premium on issue of debentures:*** This is a capital profit. It has to be shown under the heading of 'Reserves and Surplus' on the liabilities side of the balance sheet, as per Schedule VI. It may be used to write off any capital expenses or losses.
6. ***Premium on redemption of debentures:*** This is a liability, payable to the debenture holders, at the time of redemption of the debentures. It appears on the liabilities side of the balance sheet along with debentures till the date of redemption. At that time, it is closed by transferring to the debenture holders account.
7. ***Debenture interest:*** Interest has to be paid regularly on debentures, usually once in six months.

		(₹)	(₹)
At the time of payment, journal entry is Debenture Interest A/c To Bank A/c (*Being payment of debenture interest*)	Dr.	xxx	xxx
At the end of the financial year for transfer Profit & Loss A/c To Debenture Interest A/c (*Being transfer of interest to Profit & Loss A/c*)	Dr.	xxx	xxx

Illustration 8

Sekar Ltd. issued 2,000 10% debentures of ₹100 each on 1st January 2014, redeemable at a premium of 10%. Pass necessary journal entries relating to issue of debentures and debenture interest for the period ending 31st December 2014 assuming that the interest was payable half-yearly on 30th June and 31st December and tax deducted at source rate is 10%. Calendar year is the accounting year of Sekar Ltd.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2014	Bank A/c Dr. Loss on Issue of Debenture A/c Dr. To 10% Debentures A/c To Premium on Redemption of Debenture A/c (*Being issue of 2,000 debentures and redeemable at 10% premium*)		2,00,000 20,000	 2,00,000 20,000
30.06.2014	Debenture Interest A/c Dr. (2,00,000 × 10% × 6/12) To Income Tax Payable (10,000 × 10%) To Debenture holders A/c (*Being the interest due for 6 months and income tax deducted at source thereon @10%*)		10,000	 1,000 9,000
30.06.2014	Debenture holders A/c Dr. To Bank A/c (*Being amount paid to debenture holders*)		9,000	 9,000
30.06.2014	Income Tax Payable A/c Dr. To Bank A/c (*Being amount deposited to the government for income tax deducted at source*)		1,000	 1,000
31.12.2014	Debenture Interest A/c Dr. To Income Tax Payable A/c To Debenture holders A/c (*Being interest amount due to debenture holders*)		10,000	 1,000 9,000
31.12.2014	Debenture holders A/c Dr. To Bank A/c (*Being amount paid to debenture holders*)		9,000	 9,000

(*Contd.*)

31.12.2014	Income Tax Payable A/c Dr. To Bank A/c (*Being amount paid to government as tax deducted at source*)		1,000	1,000
31.12.2014	Profit & Loss A/c Dr. To Debenture Interest A/c (*Being interest on debentures transferred to Profit & Loss A/c*)		20,000	20,000

Methods of Dealing with Discount and Loss on Issue of Debentures

When the debentures are issued at discount or they are repayable at premium, it is a loss, being a capital loss. They must be shown under the heading 'Other Current Assets' in the assets side of the balance sheet.

This capital loss can be written off out of capital profits like premium on issue of debentures, share premium, profit on cancellation of debentures, etc., or it can be written off from the revenue profits. There is no legal compulsion but it is prudent to write off the discount and loss on issue of debentures before the debentures are redeemed.

When the loss is written off through profit and loss account, the following methods are followed to ascertain the annual amount to be written off.

(a) Where the debentures are redeemable on a fixed future date: The amount of discount and loss on issue of debentures is written off from the profit and loss account equally, considering the date and year of redemption. The balance amount will be nil at the time of redemption in discount and loss on issue of debentures.

(b) Where the debentures are redeemable in instalments or at the option of the company: The available amount in the debentures gets reduced because of redemption of debentures every year. The outstanding amount in the debentures is taken into consideration for writing off the discount and loss on issue of debentures. The effective utilisation of funds is considered in this method.

Illustration 9

Aswin Ltd. issued 5,000 12% debentures of ₹100 each at a discount of 10%. The expenses of issue amounted to ₹20,000. The debentures are to be repaid in five equal annual instalments starting from the end of the fifth year. Calculate the discount and issue expenses to be written off under the fluctuation instalment method.

Solution:

Particulars	(₹)
Discount to be written off = $5,00,000 \times \frac{10}{100}$	50,000
Expenses to be written off	20,000
	70,000
Annual Instalments to be repaid = $\frac{5,000 \times 100}{5}$	1,00,000

The amount utilised by the company each year will be as follows:

1st year - ₹5,00,000 2nd year- ₹5,00,000 3rd year- ₹5,00,000 4th year- ₹5,00,000 5th year- ₹5,00,000	6th year- ₹4,00,000 7th year- ₹3,00,000 8th year- ₹2,00,000 9th year- ₹1,00,000

Statement Showing Discount to be Written Off

Year	Amount Used	Ratio	Discount to be Written Off (₹)
1	5,00,000	5	$70,000 \times \frac{5}{35} = 10,000$
2	5,00,000	5	$70,000 \times \frac{5}{35} = 10,000$
3	5,00,000	5	$70,000 \times \frac{5}{35} = 10,000$
4	5,00,000	5	$70,000 \times \frac{5}{35} = 10,000$
5	5,00,000	5	$70,000 \times \frac{5}{35} = 10,000$
6	4,00,000	4	$70,000 \times \frac{4}{35} = 8,000$
7	3,00,000	3	$70,000 \times \frac{3}{35} = 6,000$
8	2,00,000	2	$70,000 \times \frac{2}{35} = 4,000$
9	1,00,000	1	$70,000 \times \frac{1}{35} = 2,000$
		35	70,000

Illustration 10

Kavitha Shakthi Ltd. issued 2,500 9% debentures of ₹100 each, at a discount of 10%. The debentures are repayable by annual drawings at the end of each year, from the first year onwards at the rate of ₹50,000 per year. Calculate the amount of discount to be written off each year under: (a) fluctuating instalment method and (b) fixed instalment method.

Solution

(a) Fluctuation instalment method

Discount to be written off = $2{,}50{,}000 \times \frac{10}{100}$ = ₹25,000

If ₹50,000 is repayable at the end of each year from the first year onwards, the amount utilised by the company each year will be as follows:

1st year - ₹2,50,000 2nd year -₹2,00,000 3rd year -₹1,50,000	4th year - ₹1,00,000 5th year - ₹50,000

Statement Showing Discount to be Written Off

Year	Amount Used	Ratio	Discount to be written off
1	2,50,000	5	$25{,}000 \times \frac{5}{15} = 8{,}333$
2	2,00,000	4	$25{,}000 \times \frac{4}{15} = 6{,}667$
3	1,50,000	3	$25{,}000 \times \frac{3}{15} = 5{,}000$
4	1,00,000	2	$25{,}000 \times \frac{2}{15} = 3{,}333$
5	50,000	1	$25{,}000 \times \frac{1}{15} = 1{,}667$
		15	25,000

Fixed Instalment Method:

Discount Amount = $2{,}50{,}000 \times \frac{10}{100}$ = ₹25,000

Discount to be written off each year = $\frac{25000}{5}$ = ₹5,000

Illustration 11

Debentures issued at a discount and redemption at a premium

Jones Ltd. issued 20,000 7% debentures of ₹100 each, at a discount of 5%, payable after 5 years, at a premium of 10%. You are required to show: (i) journal entries at the time of issue and redemption of debentures; (ii) show the " Loss on issue of Debentures A/c" over the period.

Solution:

(i) **Journal Entries**

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
(A)	On issue:				
	Bank A/c	Dr.		19,00,000	
	Discount on Issue of Debentures A/c	Dr.		1,00,000	
	Loss on Issue of Debentures A/c	Dr.		2,00,000	
	To 7% Debentures A/c				20,00,000
	To Premium on Redemption of Debentures A/c				2,00,000
	(*Being issue of 20,000 7% debenture of ₹100 each, at a discount of 5% and repayable at 10% premium after 5 years*)				
(B)	On redemption:				
	7% Debentures A/c	Dr.		20,00,000	
(a)	Premium on redemption of debentures A/c	Dr.		2,00,000	
	To Debenture holders A/c				22,00,000
	(*Being amount due to debenture holders*)				
(b)	Debenture holders A/c	Dr.		22,00,000	
	To Bank A/c				22,00,000
	(*Being amount paid to debenture holders*)				

(ii) Since the debentures are redeemed at the end of the fifth year, the loss on issue of debentures should be written off equally.

$$\text{Loss to be written off annually} = \frac{2,00,000}{5} = ₹40,000$$

Loss on Issue of Debentures Account

Year		(₹)	Year		(₹)
I	To 7% Debentures	2,00,000	I	By P &L A/c	40,000
				By Balance c/d	1,60,000
		2,00,000			2,00,000

(*Contd.*)

II	To Balance b/d	1,60000	II	By P & L A/c By Balance c/d	40,000 1,20,000
		1,60,000			1,60,000
III	To Balance b/d	1,20,000	III	By P & L A/c By Balance c/d	40,000 80,000
		1,20,000			1,20,000
IV	To Balance b/d	80,000	IV	By P & L A/c By Balance c/d	40,000 40,000
		80,000			80,000
V	To Balance b/d	40,000	V	By P & L A/c	40,000

❍ Methods of Redemption of Debentures

Methods of redemption may be broadly divided into two categories:

1. Redemption without any provision made for the purpose and
2. Redemption out of provision

Redemption without Provision

The terms of debenture issue or the debenture trust deed may not provide for creating a sinking fund for redemption of the debentures. The Board of Directors also may not think it necessary to create such fund. In such circumstances, redemption of debenture is carried out without any provision for such redemption. The following are the ways of redemption without provision—redemption on specified due date, redemption in instalments and redemption by conversion. Redemption on specified due date and Redemption in instalments can be out of profits or out of capital.

Redemption on specified due date

Debentures are repaid on the specified due date as per the terms of issue—at par or at premium.

1. ***If the redemption is out of profits:*** When debentures are redeemed out of profits, an amount equal to the nominal value of debentures that are redeemed are transferred from profit and loss account to debenture redemption reserve account. After all the debentures are redeemed, the debenture redemption reserve account may be closed by transferring it to general reserve. Profits transferred to debenture redemption reserve are not used for declaration of dividend to the shareholders.

Journal Entries

		(₹)	(₹)
(1) For repayment of debentures: % Debentures A/c To Bank A/c (*Being debentures are repaid as per the agreement*)	Dr.	xxx	 xxx

(*Contd.*)

(2) For transfer of profit: Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (DRR A/c) (*Being transfer of profits to the DRR account for redemption of debenture*)	xxx	xxx
(3) For closing debentures redemption reserve, when all the debenture are redeemed: Debenture Redemption Reserve A/c Dr. To General Reserve A/c (*Being transfer of DRR amount to general reserve after all the debentures are redeemed*)	xxx	xxx

Illustration 12

Kumar Ltd. issued 1,000 10% debentures of ₹100 each on 1st April 2005 at 10% discount redeemable at a premium of 10% in equal annual drawings out of profits in 5 years. Give journal entries for both the time of issue and redemption of debentures. (Ignore the loss on issue of debentures and interest)

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2005	Bank A/c Dr. Discount on Issue of Debentures A/c Dr. Loss on Issue of Debentures A/c Dr. To 10% Debentures A/c To Premium on Redemption of Debentures A/c (*Being issue of debentures at discount of 10% and redemption at premium of 10%*)		90,000 10,000 10,000	1,00,000 10,000
31.03.2006	10% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders A/c (*Being the amount due on redemption*)		20,000 2,000	22,000
31.03.2006	Debenture Holders A/c Dr. To Bank A/c (*Being the amount paid to debenture holders A/c*)		22,000	22,000

(*Contd.*)

31.03.2006	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (*Being amount transferred to debenture redemption reserve A/c from profit & loss A/c for redemption*)		20,000	20,000
31.03.2007	10% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders A/c (*Being amount due on redemption*)		20,000 2,000	22,000
31.03.2007	Debenture Holders A/c Dr. To Bank A/c (*Being the amount paid to debenture holders A/c*)		22,000	22,000
31.03.2007	Profit & Loss Appropriation A/c Dr To Debenture Redemption Reserve A/c (*Being amount transferred to debenture redemption reserve account*)		20,000	20,000
31.03.2008	10% Debenture A/c Dr. Premium on Redemption of Debenture A/c Dr. To Debenture Holders A/c (*Being amount due on redemption debenture holders account*)		20,000 2,000	22,000
31.03.2008	Debenture Holders A/c Dr. To Bank A/c (*Being payment made to debenture holders*)		22,000	22,000
31.03.2008	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (*Being amount transferred to debenture redemption reserve account*)		20,000	20,000
31.03.2009	10% Debenture A/c Dr. Premium on Redemption of Debentures A/c To Debenture Holders A/c (*Being amount due on redemption debenture holders account*)		20,000 2,000	22,000
31.03.2009	Debenture Holders A/c Dr. To Bank A/c (*Being amount paid on redemption*)		22,000	22,000

(*Contd.*)

31.03.2009	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (*Being amount transferred to debenture redemption reserve account*)		20,000	20,000
31.03.2010	(a) 10% Debentures A/c Dr. Premium on Red of Debentures A/c Dr. To Debenture Holders A/c (*Being amount due on redemption*)		20,000 2,000	22,000
31.03.2010	(b) Debenture Holders A/c Dr. To Bank A/c (*Being payment made to debenture holders*)		22,000	22,000
31.03.2010	(c) Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (*Being amount transferred to DRR A/c*)		20,000	20,000
31.03.2010	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (*Being the amount transferred from debenture redemption reserve account*)		1,00,000	1,00,000

2. ***If the redemption is out of capital:*** When debentures are redeemed out of capital, the company makes a new issue of shares or debentures for this specific purpose. This method is preferable when the company's liquidity position is good.

Journal Entry for Redemption

	₹	₹
% Debenture A/c Dr. To Bank A/c (*Being repayment of debenture as per the terms of the agreement*)	xxx	xxx

Illustration 13

KK Ltd. has ₹2,00,000 6% debentures outstanding on 31st March 2007. The company redeemed the debentures on that date out of capital. Pass the necessary journal entry.

Solution:

Journal Entry

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
31.03.2007	6% Debentures A/c	Dr.		2,00,000	
	To Bank A/c				2,00,000
	(*Being redemption of debentures out of capital*)				

Illustration 14

Redemption of debentures at a premium-out of profit and capital

A company has 9% debentures worth ₹3,00,000 redeemable at a premium of 10%. The company decides to redeem these debentures. Pass necessary journal entries, if the company decides to redeem these debentures by:

(a) Issuing 3,000 shares of ₹100 each, at a premium of 10%.

(b) Utilising a part of its retained profit, which is ₹5,00,000 as per the books of accounts.

(c) Utilising its current sources.

Solution:

Journal Entries

SI No.	Particulars		L.F.	Debit (₹)	Credit (₹)
(a) (i)	Bank A/c	Dr.		3,30,000	
	To Share Capital A/c				3,00,000
	To Securities Premium A/c				30,000
	(*Being issue of 3,000 shares at a premium of 10%*)				
(ii)	9% Debentures A/c	Dr.		3,00,000	
	Premium on Redemption of Debentures A/c	Dr.		30,000	
	To Bank A/c				3,30,000
	(*Being redemption of ₹3,00,000 debentures at 10% premium*)				
(b) (i)	Profit and Loss Appropriation A/c	Dr.		3,30,000	
	To Debenture Redemption Reserve A/c				3,00,000
	To Premium on redemption of debentures A/c				30,000
	(*Being amount charged from profit and loss appropriation account for the redemption of debentures*)				

(*Contd.*)

(ii)	9% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Bank A/c (*Being redemption of ₹3,00,000 debentures at a premium of 10%*)		3,00,000 30,000	 3,30,000
(iii)	General Reserve A/c Dr. To Debenture Redemption Reserve A/c (*Being amount transferred to debenture redemption reserve*)		3,00,000	 3,00,000
(c)	9% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Bank A/c (*Being redemption of ₹3,00,000 debentures at a premium of 10%*)		3,00,000 30,000	 3,30,000

Redemption in instalment

The terms of issue of debenture agreement may provide for the repayment of the debenture. The following methods can be adopted for redemption in instalments—drawing by lot and open market buying.

1. ***Drawing by lot:*** By using the distinctive numbers of the debentures, a company may agree to repay, every year, a predetermined amount of debenture by conducting a lot. The debenture whose numbers are taken out in the lot will have to be repaid by the company by providing information to debenture holders about the repayment. The redemption may be at par or at premium, as per the terms of debenture issue agreement.

	(₹)	(₹)
***(1)* For debenture repayable:** Debentures A/c Dr. Premium on Redemption A/c (if any) Dr. To Debenture Holders A/c (*Being debenture repayable and premium payable thereon*)	 xxx xxx	 xxx
(2) For payment of cash: Debenture Holders A/c Dr. To Bank A/c (*Being amount paid to the debenture holders*) **Note:** Debenture can be paid off directly or they can be transferred to the debenture holders and then cash is paid The later method is generally preferable	 xxx	 xxx
(3) If redemption is out of profit: Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (*Being transfer of profits to debenture redemption reserve account on redemption of debentures*)	 xxx	 xxx

Illustration 15

Redemption in instalments out of profits and out of capital

AB Ltd. has ₹5,00,000, 9% debentures outstanding on 1st January 2006. The company has been redeeming every year on 1st January ₹1,00,000 debentures by drawings by lot, at par. Pass necessary journal entries:

(a) If the redemption is out of profits.

(b) If the redemption is out of capital.

Solution:

Journal Entries

(a) If the redemption is out of profits

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2006	9% Debentures A/c Dr. To Bank A/c (*Being redemption of debentures out of profits*)		1,00,000	 1,00,000
	Profits & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (*Being transfer of revenue profit to debenture redemption reserve account*)		1,00,000	 1,00,000

(b) If the redemption is out of capital

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2006	9% Debentures A/c Dr. To Bank A/c (*Being redemption of debentures out of capital*)		1,00,000	 1,00,000

Illustration 16

Redemption without provision-out of profit at different stages or in instalments

Pass journal entries at the time of issue on 1st January 2005 and redemption after 5 years on 31st December 2010.

(a) Aruna Ltd. issue 20,000 10% debentures of ₹100 each, at a discount of 5%, to be redeemed at par, at the end of the sixth year.

(b) Banu Ltd. issues 5,000 11% debentures of ₹100 each, at a discount of 5%, to be redeemed at a premium of 5%, to be on 31st December 2010.

(c) Valli Ltd. issues 70,000 12% debentures of ₹1000 each, at par to be redeemed at a premium of 10%, on 31st December 2010.

(d) Kalai Ltd. issues 40,000 15% debentures of ₹100 each, at a premium of 5% to be redeemed at par on 31st December 2010.

Solution:

Journal Entries
(a) Aruna Ltd.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2005	Bank A/c Dr. Discount on Issue of Debentures A/c Dr. To 10% Debentures A/c (*Being 10% debentures issued at a discount of 5% redeemable at par*)		19,00,000 1,00,000	20,00,000
31.12.2010	10% Debentures A/c Dr. To Debenture Holders A/c (*Being amount due to debenture holders*)		20,00,000	20,00,000
31.12.2010	Debenture Holders A/c Dr. To Bank A/c (*Being amount paid on redemption*)		20,00,000	20,00,000

(b) Banu Ltd.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2005	Bank A/c Dr. Discount on Issue of Debentures A/c Dr. Loss on Issue of Debentures A/c Dr. To 11% Debentures A/c To Premium on redemption of debentures A/c (*Being 11% debentures issued at discount of 5% and redeemable at a premium of 5%*)		4,75,000 25,000 25,000	5,00,000 25,000
31.12.2010	11% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture Holders A/c (*Being amount due on redemption*)		5,00,000 25,000	5,25,000
	Debenture Holders A/c Dr. To Bank A/c (*Being amount paid to debenture holders*)		5,25,000	5,25,000

(c) Valli Ltd.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2005	Bank A/c Dr. Loss on Issue of Debentures A/c Dr. To 12% Debentures A/c To Premium on Redemption of Debentures A/c (*Being 12% debentures issued at par is redeemable at premium of 10%*)		70,00,000 7,00,000	 70,00,000 7,00,000
31.12.2010	12% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture Holders A/c (*Being amount due on redemption*)		70,00,000 7,00,000	 77,00,000
	Debenture Holders A/c Dr. To Bank A/c (*Being amount paid to debenture holders account*)		77,00,000	 77,00,000

(d) Kalai Ltd.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2005	Bank A/c Dr. To 15% Debentures A/c To Securities Premium A/c (*Being 15% debentures issued at premium and redeemed at par*)		42,00,000	 40,00,000 2,00,000
31.12.2010	15% Debentures A/c Dr. To Debenture Holders A/c (*Being amount due on redemption*)		40,00,000	 40,00,000
31.12.2010	Debenture Holders A/c Dr. To Bank A/c (*Being amount paid on redemption*)		40,00,000	 40,00,000

2. Open market buying: A company may buy its own debenture in the open market and cancel, or return or re-issue them if the terms of issue permit it to do so. The company can buy its own debentures as an investment with the help of surplus funds and the market price of debentures is favourable. If there is an annual amount to be redeemed, the required number of debentures can be immediately cancelled. The balance debentures can be retained as an investment in own debenture. They can be resold whenever need for liquid funds arises.

- ***Cum-interest and Ex-interest quotations:*** Sometimes, debentures can be purchased or sold in the open market on a date other than that of the date of declaration of interest. In such a situation, distinction must be made between the capital and revenue portion of the price paid or received for the debentures. The amount paid/received towards the cost of debentures constitutes the capital portion. The amount paid/received towards the interest from the last date of interest payment to the date of purchase/sale constitutes the revenue portion. Here, the price paid/received for the debentures depends on the quotation. The price quoted includes the interest for the expired period if the quotation is cum-interest. In case of ex-interest quotation, the price quoted does not include interest for the expired period.

When purchase and sale transactions of own debentures are recorded in the books, the nature of quotation given—whether the price quoted is cum-interest or ex-interest—should be noted carefully.

- **When own debentures are purchased in the market and immediately cancelled:** A company may buy its own debentures in the open market and immediately cancel them. Any expenses related to the purchase also should be added to the purchase price.

Journal Entry

		(₹)	(₹)
% Debenture A/c (face value)	Dr.	xxx	
Debenture Interest A/c	Dr	xxx	
(Interest from the previous interest date till to date)			
To Bank A/c (total cash payable)			xxx
To Profit on Cancellation A/c (any profit on cancellation of Debentures) (Bal. Fig.)			xxx
(*Being purchase and cancellation of own Debentures and profit thereon*)			

Note: Profit on cancellation of debenture can be used to write off any capital losses relating to debenture. It may be transferred to capital reserve also.

Illustration 17

Krishna Ltd., which had ₹50,00,000 10% debentures outstanding, made the following purchases in the open market for immediate cancellation:

1st April 2007: 1,000 debentures of ₹100 each at ₹99

1st September 2007: 2 ,000 debentures of ₹100 each at ₹97

You are required to give the journal entries for purchase and cancellation of the debentures.

(a) If the above purchase rates are Ex-interest

(b) If the above purchase rates are Cum-interest. Assume that interest is payable every year on 30th June and 31st December.

Solution:

(a) If the purchase rates given are ex-interest

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2007	10% Debentures A/c Dr. Debenture Interest A/c (1,00,000 × 10/100 × 3/12) Dr. To Bank (1,000 × 99 + 2,500) To Profit on Cancellation of Debentures A/c (*Being purchase and cancellation of 1,000 debentures of ₹100 each at ₹99 ex-interest and the profit thereon*)		1,00,000 2,500	 1,01,500 1,000
01.09.2007	10% Debentures A/c Dr. Debenture Interest A/c Dr. (2,00,000 × 10/100 × 2/12) To Bank A/c (2,000 × 97 + 3,333) To Profit on Cancellation of Debentures A/c (*Being purchase and cancellation of 2,000 own debentures of ₹100 each at ₹97 ex-interest and profit thereon*)		2,00,000 3,333	 1,97,333 6,000

(b) If the purchase rates given are cum-interest

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2007	10% Debentures A/c Dr. Debenture Interest A/c Dr. (1,00,000 × 10/100 × 3/12) To Bank A/c (100 × 99) To Profit on Cancellation of Debentures A/c (*Being purchase and cancellation of 1,000 own debentures of ₹100 each at ₹99 'cum-interest' and the profit thereon*)		1,00,000 2,500	 99,000 3,500
01.09.2007	10% Debentures A/c Dr. Debenture Interest A/c (2,00,000 × 10/100 × 2/12) To Bank A/c (2,000 × 97) To Profit on Cancellation of Debentures A/c (*Being purchase and cancellation of 2000 own debentures of ₹100 each at 97 'cum-interest' and profit thereon*)		2,00,000 3,333	 1,94,000 9,333

Note: Profit on cancellation of debentures can be credited to capital reserve since it is a profit of capital nature.

Illustration 18

Palani company has 5,00,000 12% debentures of ₹1,000 each. On 1st March 2008, it purchased 200 of its own debentures at ₹960 (Ex-interest) as investment. On 31st December 2006, it cancelled the 12% debentures with own debentures. Give journal entries and show the relevant figures as on 31st December 2006. Interest is payable on 30th June and 31st December every year.

Solution:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.03.2008	Own Debentures A/c Dr. Interest on Debentures A/c Dr. To Bank A/c (*Being purchase of 200 own debentures of ₹1,000 each at ₹960 ex-interest*)		1,92,000 4,000	 1,96,000
01.03.2008	Interest on Debentures A/c Dr. To Interest on Own Debentures A/c To Bank A/c (*Being interest on own debentures ₹8,000 for one month credited to the company and the remaining interest to outsiders*)		26,000	 8000 18,000
01.03.2008	12% Debentures A/c Dr. To Own Debentures A/c To Profit on Redemption of Debentures A/c (*Being cancellation of 12% debentures at profit*)		2,00,000	 1,92,000 8,000
01.03.2008	Interest on Debentures A/c Dr. To Profit and Loss A/c (*Being interest received on debentures transferred to profit and loss account*)		8,000	 8,000
	Profit & Loss A/c Dr. To Interest on Debentures A/c (*Being interest on debentures transferred to profit and loss account*)		60,000	 60,000

- **When debentures are purchased in the market and retained as investment:** Like any other investments, Own Debentures purchased and retained should be treated in the books of the company. Such investment enables the company to save the interest payable on debentures. Interest on debenture is recorded as usual as an expense and the interest on own debentures is shown as an income.

	(₹)	(₹)
(1) When debentures are purchased:		
Own Debentures A/c (price paid for debenture) Dr.	xxx	
Debenture Interest A/c (interest till date of purchase) Dr.	xxx	
To Bank A/c (total cash paid)		xxx
(*Being purchase of own debentures and interest thereon*)		
(2) On the date of interest payment:		
Debenture Interest A/c Dr.	xxx	
To Interest on Own Debenture A/c		xxx
To Bank A/c (interest payable to outsiders)		xxx
(*Being interest paid and interest on own debentures considered*)		
(3) When own debentures are resold:		
Bank A/c Dr.	xxx	
To Own Debentures A/c		xxx
To Interest on own debenture A/c		xxx
(*Being the amount received on sale of own debentures and interest on the own debentures till the due date of the sales*)		

Note: Any loss on sale in the above entry may be debited to loss on sale of own debenture account. Similarly, profit on sale may be credited to the profit on sale of own debenture account. Since such profit and loss is revenue in nature, they are ultimately transferred to profit and loss account.

Illustration 19

Sunitha Ltd., which has ₹20,00,000 8% debentures of ₹100 each, outstanding on 1st January 2006, on which interest payable on 30th June and on 31st December each year, is permitted to purchase its own debentures in the open market and cancel them or retain them or resell them at its option. On 1st April 2006, the company purchased 1,000 debentures in the open market at ₹96 ex-interest. Give the necessary journal entries, if (a) the debentures were cancelled on the same day; and (b) the debentures were retained till 1st July 2006, on which date they were cancelled.

Solution:

Journal Entries

If the debentures purchased were cancelled on the same day

Date	Particulars	Debit (₹)	Credit (₹)
01.04.2006	8% Debentures A/c (1000 × 100) Dr.	1,00,000	
	Debenture Interest A/c (1,00,000 × 8/100 × 3/12) Dr.	2000	
	To Bank A/c (1000 × 96 + 2000)		98,000
	To Profit on Cancellation of Debentures A/c		4,000
	(*Being purchase and cancellation of 1,000 own debentures at ₹96 ex-interest and profit thereon*)		

If the debentures are retained for some time and then cancelled

Date	Particulars	Debit (₹)	Credit (₹)
01.04.2006	Own Debentures A/c (1,000 × 96) Dr. Debenture Interest A/c Dr. To Bank A/c (*Being purchase of 1,000 own debentures at ₹96 ex-interest*)	96,000 2,000	 98,000
30.06.2006	Debenture Interest A/c Dr. (20,00,000 × 8/100 × 6/12 – 2,000) To Bank A/c To Interest on Own Debentures A/c (1,000 × 100 × 8/100 × 3/12) (*Being interest paid for six month and interest on own debentures taken into account*)	78,000	 76,000 2,000
01.07.2006	8% Debentures A/c Dr. To Own Debentures A/c To Profit on Cancellation of Debentures A/c (*Being cancellation of 1,000 own debentures and profit thereon*)	1,00,000	 96,000 4,000

- **When own debentures are cancelled:** Own Debentures may be cancelled once for all, thus redeeming them. This may be as a part of annual redemption agreement or it may be independent of such agreement.

Journal Entry

	(₹)	(₹)
__% Debenture A/c (face value) Dr. To Own Debenture A/c (book value) To Profit on Cancellation of Debentures A/c (profit) (*Being cancellation of own debentures and profit thereon*)	xxx	 xxx xxx

Illustration 20

On 31st March 2008, the balance sheet of Aruna Ltd. showed 10,000, 12% debentures of ₹100 each outstanding. Interest on debentures is payable on 30th September and 31st March every year. On 1st August 2008, the company purchased 500 of its own debentures as investments at ₹97 ex-interest. Pass journal entries for purchase and disposal of own debentures in each one of the following cases: (i) The company cancels all of its own debentures on 1st March 2009; and (ii) The company resells all its own debentures at ₹105 cum-interest on 1st March 2009. Also show journal entries relating to debentures interest and interest on own debentures as on 31st March 2009.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.08.2008	Own Debentures A/c (500 × 97) Dr. Debenture Interest A/c Dr. (50,000 × 12% × 4/12) To Bank A/c (48,500 + 2000) (*Being purchase of 500 own debentures at ₹97 ex-interest*)		48,500 2,000	 50,500
30.09.2008	Debenture Interest A/c Dr. To Bank A/c (9,50,000 × 12% × 6/12) To Interest on Own Debentures A/c (9,50,000 × 12% × 2/12) (*Being debentures interest paid and interest for two months adjusted to interest on own debentures*)		58,000	 57,000 1,000

Alternative I

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.03.2009	12% Debentures A/c (500 × 100) Dr. To Own Debentures A/c To Profit on Redemption of Debentures A/c (*Being cancellation of 500 own debentures*)		50,000	 48,500 1,500
01.03.2009	Profit on Redemption of Debentures A/c Dr. To Capital Reserve A/c (*Being profit on redemption transferred to capital reserve*)		1,500	 1,500
31.03.2009	Debenture Interest A/c Dr. To Bank A/c (9,50,000 × 12% × 6/12) To Interest on Own Debentures A/c (50,000 × 12% × 5/12) (*Being interest on debentures paid except on own debentures till 1 March 1999*)		59,500	 57,000 2,500
31.03.2009	Profit & Loss A/c (2000 + 58,000 + 59,500) Dr. To Debenture Interest A/c (*Being total interest transferred to Profit & Loss A/c*)		1,19,500	 1,19,500
	Interest on Own Debentures A/c Dr. To Profit & Loss A/c (*Being interest on own debentures transferred to Profit & Loss A/c*)		3,500	 3,500

(*Contd.*)

Alternative II

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c (500 × 105) Dr. To Own Debentures A/c To Interest on Own Debentures A/c (50,000 × 12% × 5/12) To Profit on Sale of Own Debentures A/c (*Being resale of own debentures at ₹105 cum-interest on own debentures of ₹50,000 for 5 months till resale, being ₹2,500*)		52,500	 48,500 2,500 1,500
	Interest on Own Debentures A/c Dr. Profit on Resale of Own Debentures A/c Dr. To Profit & Loss A/c (*Being interest on own debentures and profit on sale transferred to Profit & Loss A/c*)		2,500 1,500	 4,000

Illustration 21

Guna Ltd. made an issue of 5,000 6% debentures of ₹1,000 each on 1st April 2005 at the issue of ₹960. The terms of issue provided that beginning with 31st March 2008, ₹2,00,000 debentures should be redeemed either by purchase in the open market or by drawing lots at par. The expenses of the issue amounted to ₹40,000, which were written of in 31st March 2006. In March 2007 and 2008, the discount on issue was written off equally.

On 31st December 2007, the company purchased ₹60,000 debentures at ₹940 cum-interest. On 29th February 2008, it purchased ₹1,00,000 debentures at ₹950 ex-interest, the expense being ₹4,000. On 31st March 2008, the debentures necessary to be redeemed were paid off at par by drawing a lot. Assume that the interest is payable on 30th September and 31st March. Pass journal entries to record these transactions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2005	Bank A/c Dr. Discount on Debentures A/c Dr. To 6% Debentures A/c (*Being the issue of 1,000 6% debentures of ₹1,000 each at ₹960*)		48,00,000 2,00,000	 50,00,000
01.04.2005	Debenture Issue Expenses A/c Dr. To Bank A/c (*Being the expenses incurred on the issue of debentures*)		40,000	 40,000

(*Contd.*)

30.09.2005	Debenture Interest A/c Dr. To Bank A/c (*Being the payment of half yearly interest at 6% p.a on ₹50,00,000*)		1,50,000	 1,50,000
31.03.2006	Debenture Interest A/c Dr. To Bank A/c (*Being the payment of half-yearly interest*)		1,50,000	 1,50,000
31.03.2006	Profit & Loss A/c Dr. To Debenture Interest A/c To Debenture Issue Expenses A/c (*Being the transfer of debenture interest and writing off the issue expenses*)		3,40,000	 3,00,000 40,000
30.09.2006	Debenture Interest A/c Dr. To Bank A/c (*Being the payment of half-yearly interest*)		1,50,000	 1,50,000
31.03.2007	Debenture Interest A/c Dr. To Bank A/c (*Being the payment of half-yearly interest*)		1,50,000	 1,50,000
31.03.2007	Profit & Loss A/c Dr. To Debenture Interest A/c To Discount on Issue of Debenture A/c (*Being the transfer of debenture interest and writing off of half of discount on issue of debentures*)		4,00,000	 3,00,000 1,00,000
30.09.2007	Debenture Interest A/c Dr. To Bank A/c (*Being the payment of half-yearly interest*)		1,50,000	 1,50,000
31.12.2007	Own Debentures A/c (1) Dr. Debenture Interest A/c Dr. To Bank A/c (*Being the purchase of own debentures at ₹940 cum-interest*)		55,500 900	 56,400
29.02.2008	Own Debentures A/c Dr. Debenture Interest A/c Dr. To Bank A/c (*Being the purchase of 20 debentures at ₹950 ex-interest and expense of ₹4,000 thereon*)		99,000 2,500	 1,01,500

(*Contd.*)

31.03.2008	6% Debentures A/c Dr. To Own Debentures A/c To Profit on Cancellation of Own Debentures A/c To Bank A/c (*Being the redemption of debentures of the nominal value ₹40,000 of which, ₹8,000 were redeemed by annual drawings*)		2,00,000	 1,54,500 5,500 40,000
31.03.2008	Debenture Interest A/c Dr. To Bank A/c To Interest on Own Debentures A/c (*Being the half-yearly interest on debentures of which ₹280 is receivable on own debentures*)		1,46,600	 1,45,200 1,400
31.03.2008	Profit & Loss A/c Dr. Profit on Cancellation of Own Debentures A/c Dr. To Debenture Interest A/c To Discount on Issue of Debenture A/c (*Being the transfer of debentures interest and writing off of remaining discount*)		3,94,500 5,500	 3,00,000 1,00,000
31.03.2008	Interest on Own Debentures A/c Dr. To Profit & Loss A/c (*Being the transfer of interest on own debentures*)		1,400	 1,400

Calculation:

1. The amount debited to own debentures on 31st December 2007 is calculated as follows:

Price paid for 6% debentures at ₹940 each	56,400
Less: Interest on ₹60,000 for 3 months at 6%	900
Amount paid towards cost of debentures	55,500

2. Amount credited to the bank on 29th February 2008 is calculated as follows:

Cost of debentures at ₹950 ex-interest	95,000
Add: Expenses of purchase	4,000
Total cost of own debentures	99,000
Add: Interest on ₹1,00,000 for 5 months at 6 percent	2,500
Total amount paid	1,01,500

3. Debenture interest on 31st March 2008 is calculated as follows:

Interest for half yearly ending 31st March		1,50,000
Less: Interest already debited at the time of purchasing Own Debenture		(₹)
31 Dec	900	
29 Feb	2,500	3,400
Balance of interest debited on 31st March		1,46,600

4. Interest on own debenture is calculated as follows:

On ₹60,000 for 3 months, i.e. from 1st January to 31st March	900
On ₹1,00,000 for 1 month, i.e. from 1st–31st March	500
Total	1,400

5. Profit on cancellation is utilised to write off discount on debenture account.

Illustration 22

On 1st April 2005, Abdul Ltd. issued 1,00,000 12% debentures of ₹100 each, redeemable at the option of the company after the second year at ₹104, upon giving two months notice to the debenture holders. The company purchased the following debentures in the open market: (i) On 12th June 2007, ₹20,000 nominal value at cum-interest cost ₹20,125; and (ii) On August 2007, ₹35,000 nominal value at ex-interest cost ₹34,375. These debentures were retained as investments till 30th September 2008, on which date they were cancelled. Show the necessary ledger accounts, as they would appear in the books of the company for 2007–08 and for 2008–09, assuming that the company closed its books of accounts every year on 31st March. Interest is payable half-yearly on 30th September and 31st March. Ignore income tax.

Solution:

Ledger Account

12% Debentures Account

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.2008	To Balance c/d	1,00,00,000	01.04.2007	By Balance b/d	1,00,00,000
		1,00,00,000			1,00,00,000
30.09.2008	To Own Debenture A/c	54,220	01.04.2008	By Balance b/d	1,00,00,000
	To Capital Reserve (Profit on redemption of debentures)	780			
31.03.2009	To Balance c/d	99,45,000			
		1,00,00,000			1,00,00,000
			01.04.2009	By Balance b/d	99,45,000

Own Debentures Account

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
12.06.2007	To Bank A/c (20,185–480)	19,645	31.03.2008	By balance c/d	54,220
24.08.2007	To Bank A/c	34,575			
		54,220			54,220
01.04.2008	To Balance b/d	54,220			
			30.09.2008	By Balance c/d	54,220
		54,220			54,220

Interest on Debentures Account

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
12.06.2007	To Bank A/c (20,000 × 12/100 × 73/365)	480	31.03.2008	By Profit & Loss A/c (transfer)	12,00,000
24.08.2007	To Bank A/c (35,000 × 12/100 × 146/365)	1,680			
30.09.2007	To Bank A/c (1,00,00,000 × 12 × 6/12) – 3,300	5,96,700			
	To Interest on Own Debentures (11,000 × 12/100 × 6/12) – (336 + 96)	1,140			
31.03.2008	To Interest on Own Debentures (11,000 × 12/100 × 6/12)	3,300			
31.03.2008	To Bank	5,96,700			
		12,00,000			12,00,000
			31.03.2009	By Profit & Loss A/c (transfer)	11,96,700
30.09.2008	To Bank A/c	5,96,700			
	To Interest on Own Debentures A/c	3,300			
31.03.2009	To Bank A/c	5,96,700			
		11,96,700			11,96,700

Interest on Own Debentures Account

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.2008	To Profit & Loss A/c (transfer)	4,440	30.09.2007	By Debenture Interest	1,140
				By Debenture Interest	3,300
		4,440			4,440
31.03.2009	To Profit & Loss A/c (transfer)	3,300		By Debenture Interest	3,300
		3,300			3,300

Illustration 23

Swathi Associates Limited has issued 10,000 12% debentures of ₹100 each on 1st January 2005. These debentures are redeemable after 3 years, at a premium of ₹5 per debenture. Interest is payable annually.

(a) On 1st October 2006, it buys 1,500 debentures from the market at ₹98 per debenture. These are sold away on 30th June 2007 at ₹105 per debenture.

(b) On 1st January 2007, it buys 1,000 debentures at ₹104 per debentures from the open market. These are cancelled on 1st April 2007.

(c) On 1st October 2007, it buys 2,000 debentures at ₹106 per debentures from the open market. These are redeemed along with other debentures on 31st December 2007.

Prepare the relevant ledger account showing these transactions. Show calculation.

Solution:

Interest on Debentures Account

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.2005	To Bank A/c	1,20,000	31.12.2005	By Profit & Loss A/c	1,20,000
		1,20,000			1,20,000
31.12.2006	To Bank To Interest on Own Debentures	1,02,000 18,000	31.12.2006	By Profit & Loss A/c	1,20,000
		1,20,000			1,20,000
01.04.2007	To Interest on Own Debentures	3,000			
30.06.2007	To Interest on Own Debentures	9,000	31.12.2007	By Profit & Loss A/c	1,11,000

(*Contd.*)

31.12.2007	To Interest on Own Debentures	6,000			
	To Bank	93,000			
		1,11,000			1,11,000

12% Debentures Account

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.2005	To Balance c/d	10,00,000	01.01.2005	By Bank	10,00,000
		10,00,000			10,00,000
31.12.2006	To Balance c/d	10,00,000	01.01.2006	By Balance b/d	10,00,000
		10,00,000			10,00,000
01.04.2007	To Own Debentures A/c	1,00,000	01.01.2007	By Balance b/d	10,00,000
31.12.2007	To Own Debentures A/c	2,00,000			
31.12.2007	To Bank A/c	7,00,000			
		10,00,000			10,00,000

12% Own Debentures A/c

Date	Particulars	(₹)	Date	Particulars	(₹)
01.10.2006	To Bank	1,47,000	31.12.2006	By balance c/d	1,47,000
		1,47,000			1,47,000
01.01.2007	To balance c/d	1,47,000	01.04.2007	By 12% Deb A/c	1,00,000
01.01.2007	To Bank	1,04,000		By Profit & Loss A/c-Loss on cancellation	4,000
30.06.2007	To Profit & Loss A/c-profit on sale of own deb	10,500	30.06.2007	By Bank	1,57,500
31.12.2007	To Bank	2,12,000	31.12.2007	By 12% Deb A/c By Profit & Loss A/c-Loss on cancellation	2,00,000 12,000
		4,73,500			4,73,500

Premium on Redemption of Debentures A/c

Dr. *Cr.*

Date	Particulars	₹	Date	Particulars	₹
31.12.2007	To Bank A/c	35,000	31.12.2007	By Profit & Loss A/c	35,000

Interest on Own Debentures Account

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.2006	To Profit & Loss A/c- transfer	18,000	31.12.2006	By Interest on own Debentures A/c	18,000
		18,000			18,000
31.12.2007	To Profit & Loss A/c- transfer	18,000	01.04.2007	By Interest on Own Debentures A/c	3,000
			30.06.2007	By Interest on Own Debentures A/c	9,000
			31.12.2007	By Interest on Own Debentures A/c	6,000
		18,000			18,000

Calculations:

1. It is presumed that all transactions are on ex-interest basis and the interest is calculated from 1st Janaury to the date of transaction.
2. Interest paid on the purchase of own debentures.

Date	Nominal Account (₹)	Period	Rate	Interest (₹)
01.10.2006	1,50,000	9 months	12%	13,500
01.10.2007	2,00,000	9 months	12%	18,000

3. Interest credited to interest on own debentures account:

31.12.2006	1,50,000	12 months	12%	18,000
01.04.2007	1,00,000	3 months	12%	3,000
30.06.2007	1,50,000	6 months	12%	9,000
31.12.2007	2,00,000	3 months	12%	6,000

4. Interest on debentures paid to outsiders for 2007.

2000 Deb – Jan. to Sept. 2007	$2{,}000 \times 100 \times 12\% \times 9/12$	18,000
1500 Deb – July to Dec. 2007	$1{,}500 \times 100 \times 12\% \times 6/12$	9,000
5,500 Deb – Jan. to Dec. 2007	$5{,}500 \times 100 \times 12\%$	66,000
	Total	93,000

Illustration 24

On 1st January 2006, Salim Ltd. issued 2000 12% debentures of ₹100 each at ₹95. The terms of issue provided that beginning in the year 2007, ₹40,000 of debentures should be redeemed either by drawing at par or by purchase in the open market every year. Interest is payable on 31st December every year. The company is to write off ₹2,000 from the discount on debentures every year. On 31st December 2007, the debentures to be redeemed were repaid at the end of the year by drawings. On 31st December 2008, it purchased for cancellation, 400 debentures at the selling price of ₹95, the expense being ₹200. Pass journal entries in the books of Salim Ltd. and show the balance sheet with the relevant items as on 31st December 2008.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2006	Bank A/c Dr. Discount on Issue of Debentures A/c Dr. To 12% Debentures A/c (*Being issue of 1,000 debentures of ₹100 each, at discount of ₹5 per debenture*)		1,90,000 10,000	 2,00,000
31.12.2006	Debenture Interest A/c Dr. To Bank A/c (*Being payment of interest for one year*)		24,000	 24,000
	Profit & Loss A/c Dr. To Discount on Issue of Debentures To Debenture Interest A/c (*Being discount written off and interest transferred to Profit & Loss A/c*)		26,000	 2,000 24,000
31.12.2007	Debenture Interest A/c Dr. To Bank A/c (Being interest paid at 12% for one year)		24,000	 24,000
	12% Debentures A/c Dr. To Bank A/c (*Being redemption of 400 debentures of ₹100 each by drawings at par as per agreement*)		40,000	 40,000
	Profit & Loss A/c Dr. To Discount on Issue of Debentures A/c To Debenture Interest A/c (*Being discount written off and interest transferred to Profit & Loss A/c*)		26,000	 2,000 24,000
31.12.2008	Debenture Interest A/c Dr. To Bank A/c (*Being payment of interest at 12% for one year for 1,600 debentures*)		19,200	 19,200

(*Contd.*)

	12% Debentures A/c Dr. To Bank A/c To Profit on Cancellation of Debentures A/c (*Being purchase and cancellation of 400 own debentures at ₹95 each, expenses incurred and profit on cancellation*)		40,000	 38,200 1,800
	Profit & Loss A/c Dr. To Discount on Issue of Debentures A/c To Debenture Interest A/c (*Being transfer of interest and discount written off*)		21,200	 2,000 19,200
	Profit on Cancellation of Debentures A/c Dr. To Capital Reserve A/c (*Being capital profit on cancellation of own debentures transferred*)		1,800	 1,800

Note: It is assumed that the redemptions of debentures are made from the capital. Otherwise, whenever debentures are redeemed, equal amounts should be transferred to debenture redemption reserve account. When all the debentures are fully redeemed, the debenture redemption reserve will be closed by transferring to general reserve account.

Notes to Accounts:

1.	Reserves and Surplus: Capital Reserve	 1,800
2.	Non-Current Liabilities: Long-term Borrowings 12% Debentures	 1,20,000
3.	Other Current Assets: Discount on Issue of Debentures	 4,000

Balance Sheet of Salim Ltd. on 31.12.2008

	Note No.	(₹)
(i) Shareholders' Funds: Reserves and Surplus	 1	 1,800
(ii) Non-Current Liabilities: Long-term Borrowings	 2	 1,20,000
(iii) Other Current assets Discount on Issue of Debentures	 3	 4,000

Redemption by conversion

When the debentures are originally issued as 'Convertible Debentures', then redemption of debentures can take place. The debentures may be partly convertible debentures or fully convertible debenture.

The debenture issue agreement or trust deed contains the relevant terms of conversion. The prospective buyers of debentures know in advance all the terms and conditions of the conversion.

- ***Conversion on the date of redemption:*** At the time of issue of debentures, a specific redemption date is fixed and on that date, the conversion takes place. It indicates that instead of repaying cash, shares are given to the debenture holders. In such case, the actual amount payable to the debenture holders has to be converted into shares. It is immaterial to consider the original issue price of the debentures. Even if the debentures were originally issued at discount, the amount payable on redemption is taken as the basis for conversion. Section 79 of the Companies Act, relating to the issue of shares at discount, does not apply here.

		(₹)	(₹)
(1) __% Debentures A/c (face value):	Dr.	xxx	
Premium on Redemption of Debenture A/c (any premium payable)	Dr.	xxx	
To Debenture Holders A/c			xxx
(*Being debentures repayable including premium on redemption*)			
(2) For conversion into shares:			
Debenture Holders A/c	Dr.	xxx	
To Share Capital A/c			xxx
To Securities Premium A/c (if any receivable)			xxx
(*Being conversion of debentures into shares and premium chargeable thereon*)			

Illustration 25

A company authorised ₹2,20,000 debenture holders to convert their debentures into preference shares. Pass necessary journal entry, if

(a) debentures were converted into 10% preference shares of ₹100 each at par.

(b) debentures were converted into 10% preference shares of ₹100 each at premium of 10%.

(c) debentures were converted into 10% preference shares of ₹100 each at discount of 10%.

Solution:

Journal Entries

	Particulars	L.F	Debit (₹)	Credit (₹)
(a)	Debentures A/c Dr.		2,20,000	
	To 10% Preference Share Capital A/c			2,20,000
	(*Being conversion of ₹2,20,000 debentures into 2,200 10% preference shares of ₹100 each at par*)			
(b)	Debentures A/c Dr.		2,20,000	
	To 10% Preference Share Capital A/c			2,00,000
	To Securities Premium A/c			20,000
	(*Being conversion of ₹2,20,000 debentures into 2,000 10% preference shares of ₹100 each at premium of 10%*)			
(c)	Debentures A/c Dr.		2,20,000	
	Discount on Issue of Preference Share A/c Dr.		24,440	
	To Preference Share Capital A/c			2,44,400
	To Bank A/c			40
	(*Being conversion of ₹2,20,000 debentures into 2,444 10% preference shares of ₹100 each at discount of 10% and ₹40 paid by bank*)			

Illustration 26

A company gave notice of its intention to redeem its outstanding ₹4,00,000 6% debenture stock at ₹102 and offered the holders the following options to apply the redemption money to subscribe for:

(a) 5% cumulative preference shares of ₹20 each at ₹22.50 per share;

(b) 6% debenture stock at 96%, or

(c) to have their holdings redeemed for cash.

Holders of ₹1,71,000 stock accepted proposal (a); holders of ₹1,44,000 stock accepted proposal (b); and the remaining stock holders accepted proposal (c).

Pass journal entries to record the above transactions.

Solution:

Journal Entries

	Particulars	L.F.	Debit (₹)	Credit (₹)
	Option (a)			
(i)	6% Debenture Stock A/c Dr.		1,71,000	
	Premium on Redemption of Debenture Stock A/c Dr.		3,420	
	To Debenture Holders A/c			1,74,420
	(*Being amount due to debenture holders for redemption*)			

(*Contd.*)

(ii)	Debenture Holders A/c Dr. To 5% Cumulative Preference Share Capital A/c To Securities Premium A/c (*Being issue of 7,752 cumulative preference shares of ₹20 each, at ₹22.50 per share on conversion*)		1,74,420	 1,55,040 19,380
	Option (b)			
(i)	6% Debenture Stock A/c Dr. Premium on Redemption of Debenture Stock A/c Dr. To Debenture Holders A/c (*Being amount due to debenture holders for redemption and option (b) is exercised*)		1,44,000 2,880	 1,46,880
(ii)	Debenture Holders A/c Dr. Discount on (new) 6% Debenture Stock A/c Dr. To (New) 6% Debenture Stock A/c (*Being issue of 1,530(new) 6% debenture stock at a discount of 4% on conversion*)		1,46,880 6,120	 1,53,000
	Option (c)			
(i)	6% Debenture Stock A/c Dr. Premium on Redemption of Debenture Stock A/c Dr. To Debenture Holders A/c (*Being amount due to debenture holders for redemption and exercised option (c)*)		85,000 1,700	 86,700
(ii)	Debenture Holders A/c Dr. To Bank A/c (*Being amount paid to debenture holders on redemption*)		86,700	 86,700
(iii)	Profit & Loss Appropriation A/c Dr. To General Reserve A/c (*Being amount transferred to general reserve on account of redemption from P& L appropriation account*)		85,000	 85,000
(iv)	Profit & Loss A/c Dr. To Premium on Redemption of Debenture A/c (*Being premium on redemption of debenture adjusted with P & L account*)		8,000	 8,000

Working Note 1: Calculation of debenture stock to be redeemed out of cash

Face Value of 6% Debenture Stock		4,00,000
Less: Debenture holders who exercised option (a)	1,71,000	
Debenture holders who exercised option (b)	1,44,000	3,15,000
Debenture holders who exercised option (c)		85,000

Working Note 2:

When debentures are redeemed out of cash, it is implied that the company has sufficient credit balance in its profit and loss appropriation account.

- ***Conversion before redemption due date:*** The debenture holders may get an option to convert their debentures into shares earlier than the due date for redemption. There is no problem if the debentures were originally issued at par or at premium. However, if the original issue of debentures was at a discount, provisions of Section 79 of the Companies Act, relating to the issue of shares at discount, are to be satisfied. Under such circumstances, the conversion must be only for the actual amount originally collected on the debentures.

Illustration 27

On 1st April 2004, Rekha Ltd. issued 3,000 8% debentures of ₹100 each, at 5% discount. Debenture holders have the option to convert their holdings into equity shares of ₹100 each, at a premium of ₹20 per share at any time within 2 years. On 31st March 2005, holders of 600 debentures intimated their intention to exercise the option.

Pass necessary journal entries in the company's books relating to issue and conversion of the debentures. Also show how the items would appear in the balance sheet of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2004	Bank A/c Dr.		2,85,000	
	Discount on Issue of Debentures A/c Dr.		15,000	
	To 8% Debentures A/c			3,00,000
	(*Being issue of 3,000 debentures of ₹100 each*)			
31.03.2005	8% Debentures A/c Dr.		60,000	
	To Discount on Issue of Debentures A/c			3,000
	To Equity Share Capital A/c			47,500
	To Securities Premium A/c			9,500
	(*Being conversion of 600 debentures of ₹100 each, issued at a discount of 5% into 475 equity shares of ₹100 each, at a premium of ₹20 per share*)			

Balance Sheet of Rekha Ltd. (includes)

Liabilities	(₹)
Shareholders' Funds:	
Share Capital	
475 Equity Shares of ₹100 each	47,500
Reserves and Surplus:	
Securities Premium	9,500
Non-current Liabilities:	
Long-term borrowings	
2,400 8% debentures of 100 each	2,40,000
Assets	**(₹)**
Other Current Assets:	
Discount on Issue of Debentures	
(15,000 – 3000)	12,000

Working Notes: ***Calculation of shares to be issued***

Conversion of debentures is not at the end of any specified period for redemption. Therefore, actual cash collected on the issue of debentures alone should be converted.

Face Value of 600 Debentures = 600 × 100	60,000
Less: Discount allowed at the time of issue = 60,000 × 5/100	3,000
Amount collected on the debentures, which are to be converted	57,000
Face Value of equity Share ₹100	
Add: Premium 20	
Issue Price per Share 120	

$$\text{Number of Shares to be Issued} = \frac{\text{Amount Collected on Debentures}}{\text{Issue Price per Share}}$$

$$= \frac{57,000}{120} = 475 \text{ shares}$$

Face Value of the Shares: 475 × 100 = 47,500
Share Premium: 475 × 20 = 9,500
57,000

Illustration 28

Redepmtion by conversion after due date

On 1st January 2006, Mani Ltd. issued 5,000 10% FCDs (fully convertible debentures) of ₹100 each at par. The debenture holders were given the call option to convert the debentures into ₹10 equity shares at a premium of ₹40 per share on or after July 2007. On 31st December 2007, debenture holders holding 4,000 debentures exercised their option. Pass necessary journal entries (ignore interest on debentures).

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2006	Bank A/c Dr.		5,00,000	
	To 10% Convertible Debentures A/c			5,00,000
	(*Being issue of 5,000 convertible debenture at ₹100 each*)			
31.12.2007	10% Convertible Debenture A/c Dr.		4,00,000	
	To Equity Share Capital A/c			80,000
	To Securities Premium A/c			3,20,000
	(*Being 4,000 debentures converted into 2 equity shares of ₹10 each at a premium of ₹40 per share ₹4,00,000/ ₹50 = 8,000 shares*)			

Illustration 29

Redepmtion by conversion before and after due date

Josephin Ltd. issued ₹10,00,000 10% debentures of ₹100 each, on 1st April 1998, at a discount of 10%. Debenture holders have an option to convert them into equity shares of ₹10 each, at a premium of 5 years (i.e. 31st March 2003). The due date to redeem the debenture at a premium of 10% is at the end of tenth year (i.e. after 31st March 2008).

Pass journal entries with regard to conversion only (ignore interest on debenture), when:

(a) 3,000 debenture holders informed that they would like to convert on 1st October 2002.

(b) 3,000 debenture holders would like to convert their debenture into shares on 1st April 2003.

(c) On 1st April 2008, 3,000 debenture holders also opted for shares.

(d) The remaining debenture holders preferred to receive in cash against their debenture holdings on 30th April 2008.

Solution:

(a)

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.10.2002	10% Debentures A/c Dr.		3,00,000	
	To Discount on Issue of Debentures A/c			30,000
	To Equity Share Capital A/c (22,500 × 10)			2,25,000
	To Securities Premium A/c (22,500 × 2)			45,000
	(*Being conversion of 3,000 debentures of ₹100 each into 22,500 equity shares of ₹10 each, at premium of ₹2*)			

Note: When debentures are converted into shares before the date of conversion, and the redemption date is specified, the actual amount received on debentures must be converted.

Calculation:

Face Value of Debentures: 30,000 × 100	3,00,000
Less: Discount on Issue: 3,00,000 × 10 / 100	30,000
Amount collected on debentures to be converted	2,70,000
No. of Equity Shares = $\frac{2,70,000}{12}$ = 22,500	

(b)

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2003	10% Debentures A/c Dr. To Equity Share Capital A/c (25,000 × 10) To Securities Premium A/c (25,000 × 2) (*Being conversion of 3,000 debentures of ₹100 each into 25,000 shares of ₹10 each, at a premium of ₹2*)		3,00,000	 2,50,000 50,000

Note: When debentures are converted into shares on the predetermined date for redemption, the full amount payable, as per the terms of redemption, can be converted into shares.

Calculation:

Face Value of 3,000 debentures: 30,000 × 100	3,00,000
Amount due to debenture holders	3,00,000
No. of Equity Shares = $\frac{3,00,000}{12}$ = 25,000	

(c)

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2008	10% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (*Being debentures are redeemed at premium and converted into equity shares issued at premium*)		3,00,000 30,000	 2,75,000 55,000

Note: As debenture holders have opted to convert debentures into shares on or after the due date of redemption, those debentures are redeemed at a premium, which has been specified at the time of issue.

Calculation:

3,000 debentures × 100	3,30,000
Add: Premium on Redemption: 30000 × 10 / 100	30,000
Due to debenture holders on conversion	3,30,000
No. of Equity Shares = $\frac{3,30,000}{12}$ = 27,500	

(d)

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
30.04.2008	10% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture Holders A/c (Money due to debenture holders on redemption at premium)		1,00,000 10,000	 1,10,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
30.04.2008	Debenture Holders A/c Dr. To Bank A/c (*Being debenture holders settled by way of cash*)		1,10,000	 1,10,000

Note: As debenture holders have opted for cash on or after the due date of redemption, those debentures are redeemed at premium, which has been specified at the time of issue .

Calculation:

Total Face Value of Debentures	10,00,000
Less: Converted at different dates: 3,00,000 + 3,00,000 + 3,00,000	9,00,000
Balance	1,00,000
The Remaining Debentures Value	1,00,000
Add: Premium on Redemption: 10% on 1,00,000	10,000
Due to Preference Shareholders and Paid in Cash	1,10,000

Illustration 30

Redepmtion by Debentures with Interest

In 2010, Kali Ltd. has issued 10,000 14% debentures each at ₹100. Interest is payable on 30th June and 31st December every year till date of redemption. It redeemed 1,000 debentures by paying back the money on 31st December 2013. On the same date, it also converted 1,000 debentures into 9,500 preference shares of ₹10 each. Give journal entries in the book of Kali Ltd., as on 31st December 2003.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31.12.2003	14% Debentures A/c Dr. Interest on Debentures A/c Dr. To Bank A/c (*Being redemption of debenture and paid interest on 1000 debentures at 14%*)		1,00,000 7,000	 107,000
31.12.2003	14% Debenture A/c Dr. To Preference Share Capital A/c To Securities Premium A/c (*Being conversion of 1,000 debentures into 9,500 preference shares of ₹10 each*)		1,00,000	 95,000 5,000
31.12.2003	Interest on Debentures A/c Dr. To Bank A/c (*Being payment of interest on 9,000 debentures for 6 months - 9000 × 100 × 14% × 6/12*)		63,000	 63,000

Illustration 31

S Ltd. issued ₹5,00,000 10% debentures of ₹100 each, at a discount of 10%. The debenture holders have an option to convert them into equity shares of ₹10 each at par after the expiry of 2 years. The due date for redemption of the debentures at par is at the end of the tenth year.

You are required to find out the number of shares a debenture holder gets and also give the necessary journal entries.

(a) if he converts his 200 debentures at the end of the second year from the date of issue;

(b) if he converts his 200 debentures at the end of tenth year, on the agreed date to redemption.

Solution:

(a)

Face Value of Debentures to be converted into Shares = 200 × 100	20,000
Less: Discount on Issue at 10%	2,000
Amount originally collected on the debentures to be converted	18000
Issue Price of share = ₹10	
…Number of Shares to be issued = 18,000/10 = 1,800 shares	

(b)

Face Value of debentures to be converted into shares = 200 × 100	20,000
Issue Price of Share = ₹10	
…Number of Shares to be issued = 20,000/10 = 2,000 shares	

Note: When debentures are converted into shares before any predetermined redemption date, the actual amount received on them alone must be converted. When debentures are converted into shares on the predetermined date for redemption, the full amount payable as per the terms of redemption can be converted into shares, because, otherwise, that much has to be paid to the debenture holders to redeem their debentures on that date.

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	(a) 10% Debentures A/c Dr.		20,000	
	To Discount on Issue of Debentures A/c			2,000
	To Equity Share Capital A/c			18,000
	(*Being conversion of the amount originally collected on 200 debentures of ₹100 each into 1,800 equity shares of ₹10 each at par*)			
	(b) 10% Debentures A/c Dr.		20,000	
	To Equity Share Capital A/c			20,000
	(*Being conversion of 200 debentures of ₹100 each into 2,000 shares of ₹10 each at par*)			

Redemption of Debentures with Provisions

At the time of issue of debentures, the company should plan the resources required for its redemption. This can be done by making provisions. Otherwise, it will be difficult for the company to repay debts. There are two methods in which a company can make provisions for redemption of debentures.

1. Insurance policy method
2. Sinking fund method

1. Insurance policy method: To make provision for redemption of the debentures, a sinking fund insurance policy is taken by companies. After taking an insurance policy for the specified amount required to redeem the debentures a fixed amount of premium is paid every year. The insurance company receives the premium at the beginning of every year and pays the agreed amount on the specified future date, which can be used to redeem the debentures.

Model Journal Entries

In the first and subsequent accounting years including the last year

	(₹)	(₹)
(1) For the amount of premium paid		
Debenture Redemption Policy A/c Dr.	xxx	
To Bank A/c		xxx
(*Being annual premium paid on the debenture Redemption policy*)		

(*Contd.*)

(2) At the end of the accounting year Profit & Loss Appropriation A/c To Debenture Redemption Fund A/c (*Being appropriation of the premium paid to the fund A/c*)	Dr.	xxx	 xxx
(3) In the last year, on realising the policy Bank A/c To Debenture Redemption Policy A/c (*Being realisation of the policy amounts*)	Dr.	xxx	 xxx
(4) For any profit on realisation of policy Debentures Redemption Policy A/c To Debenture Redemption Fund A/c (*Being transfer of profit to the fund account*)	Dr.	xxx	 xxx
(5) For redemption of the debentures Debentures A/c To Bank A/c (*Being repayment of the debentures*)	Dr.	xxx	 xxx

If Interest is taken into Account: The basic difference between sinking fund for redemption of debentures and insurance policy methods is that in the former, interest is received at the end each year on the investments previously made and the interest amount is re invested; in the latter, no interest is received in cash but the insurance policy value increases year after year, to show profit at the time of final realisation.

However, the accountants prefer to take into account the amount of interest on the insurance policy notionally. Each year, a separate entry is passed for the interest accrued. So, at the end the insurance policy, account does not show any profit at all because it is already taken into account in the form of interest.

Model Journal Entry for Interest

		(₹)	(₹)
Debenture Redemption Policy A/c To Debenture Redemption Fund A/c (*Being interest accrued for the year*)	Dr.	xxx	 xxx

Illustration 32

Kalam Company Limited issued 7500, 10% debentures of ₹100 each at par on 1st April 2000, repayable at par after 3 years, on 31st March 2003. The directors decided to take an insurance policy to provide necessary cash for the redemption of the debentures. The annual premium of the policy payable on 1st April every year was ₹2,35,875. Pass journal entries for the issue and the redemption of debentures in the books of Kalam Company Limited.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2000	Bank A/c Dr. To 12% Debentures A/c (*Being issue of 7,500 12% debentures of ₹100 each*)		7,50,000	7,50,000
	Debenture Redemption Policy A/c Dr. To Bank A/c (*Being annual premium paid for the policy to redeem the debentures*)		2,35,875	2,35,875
31.03.2001	Profit and Loss Appropriation A/c Dr To Debenture Redemption Fund (DRF) A/c (*Being transfer of profit to DRF A/c*)		2,35,875	2,35,875
01.04.2001	Debenture Redemption Policy A/c Dr. To Bank A/c (*Being annual premium paid for the policy to redeem the debentures*)		2,35,875	2,35,875
31.03.2002	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Fund A/c (*Being transfer of profit to DRF A/c*)		2,35,875	2,35,875
01.04.2002	Debenture Redemption Policy A/c Dr. To Bank A/c (*Being annual premium paid for the policy to redeem the debentures*)		2,35,875	2,35,875
31.03.2003	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Fund A/c (*Being transfer of profit to DRF A/c*)		2,35,875	2,35,875
	Bank A/c Dr. To Debenture Redemption Policy A/c (*Being policy amount received on maturity*)		7,50,000	7,50,000
	Debenture redemption policy A/c Dr (1,00,000 – 93,420) To Debenture Redemption Fund A/c (*Being transfer of accumulated interest on the policy to debenture redemption fund account*)		43,275	43,275

(*Contd.*)

	12% Debentures A/c Dr. To Debentures Holders A/c (*Being amount due on redemption*)			7,50,000	7,50,000
	Debenture Holders A/c Dr. To Bank A/c (*Being amount paid to the debenture holders*)			7,50,000	7,50,000
	DRF A/c Dr. To General Reserve A/c (*Being transfer of the balance of DRF A/c to general reserve*)			7,50,000	7,50,000

Illustration 33

Ashwin Company issued 12% debentures worth ₹5,00,000 on 1st April 2005, redeemable after three years. The company took an insurance policy of ₹5,00,000 for the redemption of debentures at an annual premium of ₹1,60,000. On 31st March 2008, the amount of the policy was received and debentures redeemed. Prepare necessary ledger account.

Solution:

Debenture Redemption Fund Account

Dr. *Cr.*

Date	Particulars	J.F	Amount (₹)	Date	Particulars	J.F	Amount (₹)
31.03.2006	To Balance c/d		1,60,000	31.03.2006	By Profit & Loss Appropriation A/c		1,60,000
			1,60,000				1,60,000
31.03.2007	To Balance c/d		3,20,000	01.04.2007	By Balance b/d		1,60,000
				31.03.2007	By Profit & Loss Appropriation A/c		1,60,000
			3,20,000				3,20,000
31.03.2008	To General Reserve		5,00,000	01.04.2007	By Balance b/d		3,20,000
				31.03.2008	By Profit & Loss Appropriation A/c		1,60,000
					By Debenture Redemption Fund Policy A/c		20,000
			5,00,000				5,00,000

Debenture Redemption Fund Policy Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
01.04.2005	To Bank A/c (premium)		1,60,000	31.03.2006	By Balance c/d		1,60,000
			1,60,000				1,60,000
01.04.2006	To Balance b/d		1,60,000	31.03.2007	By Balance c/d		3,20,000
	To Bank (premium)		1,60,000				
			3,20,000				3,20,000
01.04.2007	To Balance b/d		3,20,000	31.03.2008	By Bank		5,00,000
	To Bank A/c (premium)		1,60,000				
	To Debenture Redemption Fund A/c		20,000				
			5,00,000				5,00,000

12% Debentures Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
31.03.2006	To Balance c/d		5,00,000	01.04.2005	By Bank A/c		5,00,000
			5,00,000				5,00,000
31.03.2007	To Balance c/d		5,00,000	01.04.2006	By Balance b/d		5,00,000
			5,00,000				5,00,000
31.03.2008	To Bank A/c (transfer)		5,00,000	01.04.2007	By Balance b/d		5,00,000
			5,00,000				5,00,000

Illustration 34

Saleem Limited issued 10,000 9% debentures of ₹100 each, on 1st April 2003, repayable at par after 3 years. The company decided to take an insurance policy for the redemption of these debentures to provide necessary cash. The premium payable at the beginning of every year is ₹2,74,650 and interest at 10% compound rate is expected. The policy amount was received at the end of third year and debts were duly redeemed. Show the necessary ledger accounts in the books of Saleem Limited for all the years.

Solution:

Debenture Redemption Fund Account

Dr. *Cr.*

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.03.2004	To Balance c/d	3,02,115	31.03.2004	By Profit & Loss Appropriation A/c	2,74,650
				By Debenture Redemption Policy A/c (interest) (2,74,650 × 10/100)	27,465
		3,02,115			3,02,115
31.03.2005	To Balance c/d	6,34,441	01.04.2004	By Balance b/d	3,02,115
			31.03.2005	By Profit & Loss Appropriation A/c	2,74,650
				By Debenture Redemption Policy A/c (interest) (3,02,115 + 2,74,650) × 10/100	57,676
		6,34,441			6,34,441
31.03.2006	To General Reserve A/c	10,00,000	01.04.2005	By Balance b/d	6,34,441
			31.03.2006	By Profit & Loss Appropriation A/c	2,74,650
				By Debenture Redemption Policy A/c (interest) (6,34,441 + 2,74,650 × 10/100)	90,909
		10,00,000			10,00,000

Debenture Redemption Policy Account

Dr. *Cr.*

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
01.04.2003	To Bank (premium)	2,74,650	31.03.2004	By Balance c/d	3,02,115
31.03.2004	To Debenture Redemption Fund A/c (interest)	27,465			
		3,02,115			3,02,115
01.04.2004	To Balance b/d	3,02,115	31.03.2005	By Balance c/d	6,34,441
01.04.2004	To Bank (premium)	2,74,650			
31.03.2005	To Debenture Redemption Fund A/c (interest)	57,676			
		6,34,441			6,34,441

(*Contd.*)

01.04.2005 01.04.2005 31.03.2006	To Balance b/d To Bank (premium) To Debenture Redemption fund A/c (interest)	6,34,441 2,74,650 90,909	31.03.2006	By Bank (policy amount)	10,00,000
		10,00,000			10,00,000

9% Debentures Account

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.03.2004	To Balance c/d	10,00,000	01.04.2003	By Bank A/c	10,00,000
31.03.2005	To Balance c/d	10,00,000	01.04.2004	By Balance b/d	10,00,000
31.03.2006	To Bank (repayment)	10,00,000	01.04.2005	By Balance b/d	10,00,000

2. Sinking fund method: A sinking fund may be created for redemption of debenture. This differs from sinking fund created for replacement of assets. The sinking fund is created out of revenue profit by debiting the profit and loss appropriation account for redemption of debentures and it is not a charge against the profit. The sinking fund for replacement of assets is created by debiting profit and loss account and is a charge against profit.

Sinking fund for redeeming debenture is also called 'Debenture Redemption Fund' to differentiate it from other sinking funds.

The amount repayable on debentures, including premium on redemption, is ascertained in this method. The investment of sinking fund as securities along with the rate of interest on investment are also determined. The amount to be set aside every year from the profit as annual contribution to the sinking fund can be made with reference to Sinking Fund Table.

The annual contribution to the sinking fund is made out of the profit and loss appropriation account and it is invested in external securities at the end of the first year, after issue of debentures. At the end of the second year, interest is received on the investments. The annual contribution to the sinking fund and the interest are invested in outside securities. The same procedure is repeated every year. In the last year, interest is received and annual contribution is set aside towards sinking fund. At this stage, all the existing sinking fund investments are sold away for cash. Any loss or gain on sale is debited or credited to the sinking fund. The investment sold enables to redeem the debentures. After the redemption of debenture, the sinking fund becomes redundant. So, it is closed by transferring its balance to general reserve. The following are the model journal entries:

	(₹)	(₹)
(1) At the end of the first year, for making annual transfer to sinking fund. Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c (*Being annual transfer to sinking fund for redemption of debentures*)	xxx	xxx

(*Contd.*)

(2) For making investment: Sinking Fund Investment A/c Dr. To Bank A/c (*Being investment made for redemption of debentures*)	xxx	 xxx
At the end of the second year (3) For receiving interest on sinking fund investment: Bank A/c Dr. To Interest on sinking fund investment A/c (*Being interest received from investments*)	xxx	 xxx
(4) For transferring interest to sinking fund A/c Interest on Sinking Fund Investment A/c Dr. To Sinking Fund A/c (*Being transfer of interest to sinking fund account*)	xxx	 xxx
(5) For annual transfer to sinking fund: Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c (*Being annual transfer made from P&L appropriation account*)	xxx	 xxx
(6) For making investment, including the interest received: Sinking Fund Investment A/c Dr. To Bank A/c (*Being investment made*) **Note:** Entries 3, 4, 5 and 6 are repeated in 3rd and 4th year, and so on. At the end of last year, in which the debentures are to be redeemed: entries 3, 4 and 5 are written just like in second year. Then the following entries are passed.	xxx	 xxx
(7) For sale of investment: Bank A/c Dr. Sinking Fund A/c (for any loss on sale) Dr. To Sinking Fund Investments A/c (*Being sale of sinking fund investments at loss*)	xxx xxx	 xxx
(8) For redemption of debentures: % Debenture A/c Dr. To Bank A/c (*Being repayment of the debentures*)	xxx	 xxx
(9) For closing the sinking fund: Sinking Fund A/c Dr. To General Reserve A/c (*Being transfer of sinking fund balance to the general reserve*)	xxx	 xxx

Note:

1. Reference to sinking fund tables provides the Sinking Fund Factor. Amount required to repay the debenture on the due date should be multiplied with the sinking fund factor, to ascertain Annual Transfer to the sinking fund.
2. Unless otherwise mentioned, the sinking fund balance and sinking fund investment balance are equal.

3. All incomes, profits and losses relating to operation of the sinking fund are to be debited or credited to the sinking fund itself.
4. Sinking fund investment may be made in round figures like the nearest '100' or nearest '10,' etc. This may cause a minor difference between the sinking fund and the investment thereof.

- **Redemption before due date, out of sinking fund:** In the case where sinking fund for redemption of debenture is created debentures are repaid on a specified date. The redemption of debenture in instalments can also be made if the terms of issue of debentures allow.

Own debentures can be purchased and cancelled from the open market. The funds are arranged by sale proceeds of the sinking fund investments. It may result in profit or loss on sale of the investments. Similarly, profit or loss may be incurred on the purchase and cancellation of the own debenture. All of these losses or gains are to be debited or credited to the sinking fund account. But, any profit on cancellation of the debentures may be credited to the capital reserve instead of the sinking fund.

When some debentures are redeemed, an equal amount has to be transferred from the sinking fund to the general reserve account.

Model Journal Entries

		(₹)	(₹)
(1) For sale of investment at profit Bank A/c To Sinking Fund Investments A/c (*Being investments sold*)	 Dr.	 xxx	 xxx
Sinking Fund Investments A/c To Sinking Fund A/c (*Being profit on sale of investments*)	Dr.	xxx	 xxx
(2) For redemption of debentures __% Debentures A/c (face value of debenture) Debenture Interest A/c (interest till sale date) To Bank A/c (cash paid) To Capital Reserve A/c (profit on redemption) (*Being redemption of debentures along with interest and profit thereon*)	 Dr. Dr.	 xxx xxx	 xxx xxx
(3) For transfer to general reserve Sinking Fund A/c To General Reserve (*Being transfer of the face value of debentures redeemed to general reserve from sinking Fund account*)	 Dr.	 xxx	 xxx
(4) For closing the debenture redemption fund Debenture Redemption Fund A/c To General Reserve A/c (*Being transfer of fund on the redemption of debentures to general reserve*)	 Dr.	 xxx	 xxx

Illustration 35

On 1st April 2002, Yamini Ltd. issued 5000, 12% debentures of ₹100 each, at a premium of 10%, repayable at the end of 4 years. It was decided to institute sinking fund for the purpose. The investments were expected to realise 4% net. The sinking fund table shows that ₹0.235490 amounts to ₹1 at 4% in four years. Investments were made in multiples of hundred only.

On 31st March 2006, the balance in the bank was ₹3,12,000 and the investments realised ₹4,10,000. The debentures were paid off. Give journal entries and show ledger accounts.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2002	Bank A/c (5000 × 100) Dr. Loss on Issue of Debentures A/c Dr. To 12% Debentures A/c To Premium on Redemption of Debentures (*Being the issue of 5000, 10% debentures of ₹100 each at par, redeemable at a premium of 5%*)		5,00,000 50,000	 5,00,000 50,000
31.03.2003	Profit and Loss Appropriation A/c Dr. To Sinking Fund A/c (5,50,000 × 0.235490) (*Being amount transferred to sinking fund for the redemption of debentures*)		1,29,520	 1,29,520
31.03.2003	Sinking Fund Investment A/c Dr. To Bank A/c (*Being the investments made to the nearest hundred rupees*)		1,29,500	 1,29,500
31.03.2004	Bank A/c (1,29,500 × 4/100) Dr. To Interest on Sinking Fund Investment Fund A/c (*Being interest received on SFI*)		5,180	 5,180
31.03.2004	Interest on Sinking Fund Investment A/c Dr. To Sinking Fund A/c (*Being the transfer of interest on sinking fund investment to sinking fund account*)		5,180	 5,180
31.03.2004	Profits and Loss Appropriation A/c Dr. To Sinking Fund A/c (*Being the annual sum set aside for redemption*)		1,29,520	 1,29,520

(*Contd.*)

31.03.2004	Sinking Fund Investment A/c Dr. To Bank A/c (1,29,520 + 5,180) (*Being the sum invested (annual investment plus interest) to the nearest hundred rupees*)		1,34,700	1,34,700
31.03.2005	Bank A/c (1,29,500 + 1,34,700) × 4Dr. To Interest on Sinking Fund Investment A/c (*Being interest received on sinking fund*)		10,568	10,568
31.03.2005	Interest on Sinking Fund Investment A/c Dr. To Sinking Fund A/c (*Being interest on sinking fund investment transferred to sinking fund A/c*)		10,568	10,568
31.03.2005	Profit and Loss Appropriation A/c Dr. To Sinking Fund A/c (*Being the annual sum transferred for redemption*)		1,29,520	1,29,520
31.03.2005	Sinking Fund Investment A/c Dr. To Bank A/c (1,29,520 + 10,568) (*Being the sum invested, the annual instalment plus interest*)		1,40,100	1,40,100
31.03.2006	Bank A/c Dr. To Interest on Sinking Fund Investment A/c (1,29,500 + 1,34,700 + 1,40,100 × 4%) (*Being interest received on sinking fund investment*)		16,172	16,172
31.03.2006	Interest on Sinking Fund Investment A/c Dr. To Sinking Fund A/c (*Being the transfer of interest on sinking fund investment to sinking fund account*)		16,172	16,172
31.03.2006	Profit and Loss Appropriation A/c Dr. To Sinking Fund A/c (*Being the annual investment set aside for redemption*)		1,29,520	1,29,520
31.03.2006	Bank A/c Dr. To Sinking Fund Investment A/c (*Being sinking fund investment sold to pay off 12% debentures*)		4,10,000	4,10,000

(*Contd.*)

31.03.2006	12% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture Holders A/c (*Being the amount due to debenture holders*)		5,00,000 50,000	5,50,000
31.03.2006	Debentures holders A/c Dr. To Bank A/c (Being the payment made to debenture holders)		5,50,000	5,50,000
31.03.2006	Sinking Fund Investment A/c Dr. To Sinking Fund A/c (*Being the profit on sale of sinking fund investment transferred to sinking fund A/c*)		5,700	5,700
31.03.2006	Sinking Fund A/c Dr. To Loss on Issue of Debenture A/c (*Being the loss on issue of debentures written off against sinking fund*)		50,000	50,000
31.03.2006	Sinking Fund A/c Dr. To General Reserve A/c (*Being the sinking fund account balance transferred to general reserve*)		5,05,700	5,05,700

Ledger Accounts

Sinking Fund Account

Dr. *Cr.*

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.03.2003	To Balance c/d	1,29,520	31.03.2003	By Profit and Loss Appropriation A/c	1,29,520
		1,29,520			1,29,520
31.03.2004	To Balance c/d	2,64,220	01.04.2003	By Balance b/d By Interest on Sinking Fund Investment A/c By Profit and Loss Appropriation A/c	1,29,520 5,180 1,29,520
		2,64,220			2,64,220
31.03.2005	To Balance c/d	4,04,308	01.04.2005	By Balance b/d By Interest on Sinking Fund Investment A/c By Profit and Loss Appropriation A/c	2,64,220 10,568 1,29,520
		4,04,308			4,04,308

(*Contd.*)

31.03.2006	To Loss on Issue of Debenture A/c	50,000	01.04.2005	By Balance b/d	4,04,308
	To General Reserve A/c (Transfer)	5,05,700	31.03.2006	By Interest on Sinking Fund Investment A/c	16,172
				By Profit and Loss Appropriation A/c	1,29,520
				By Sinking Fund Investment A/c (Profit on Sale)	5,700
		5,55,700			5,55,700

Sinking Fund Investment Account

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.03.2003	To Bank A/c	1,29,500	31.03.2003	By Balance c/d	1,29,500
		1,29,500			1,29,500
01.04.2003	To Balance b/d	1,29,500	31.03.2004	By Balance c/d	2,64,200
31.03.2004	To Bank A/c	1,34,700			
		2,64,200			2,64,200
01.04.2004	To Balance b/d	2,64,200	31.03.2005	By Balance c/d	4,04,300
31.03.2005	To Bank A/c	1,40,100			
		4,04,300			4,04,300
01.04.2005	To Balance b/d	4,04,300	31.03.2006	By Bank A/c	4,10,000
	To Sinking Fund A/c	—			
	(Profit on Sale)	5,700			
		4,10,000			4,10,000

Interest on Sinking Fund Investment Account

Dr. *Cr.*

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.03.2004	To Sinking Fund A/c	5,180	31.03.2004	By Bank A/c	5,180
		5,180			5,180
31.03.2005	To Sinking Fund A/c	10,568	31.03.2005	By Bank A/c	10,568
		10568			10,568
31.03.2006	To Sinking Fund A/c	16,172	31.03.2006	By Bank	16,172
		16172			16172

Illustration 36

On 1st January 2000, the Asian Trading Co. Ltd. issued debentures for ₹5,00,000, redeemable at par on 1st January 2005. It was decided to establish a sinking fund for the purpose of redemption. Show the ledger accounts for five years, assuming the annually invested amount earns 5% interest. Sinking fund table shows that ₹0.1809748 amounts to ₹1 at 5% in five years.

Calculate what amount will be set aside if the company has agreed to pay off debentures at a premium of 10%, the rate of interest on sinking fund investment, and period of redemption remaining the same.

Solution:

The amount necessary to set aside

$$= 0.1809748 \times ₹5{,}00{,}000$$

$$= ₹90{,}487.40$$

Ledger Accounts

Debenture Sinking Fund

Dr. *Cr.*

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.12.2000	To Balance c/d	90,487.40	31.12.2000	By Profit and Loss Appropriation A/c	90,487.40
		90,487.40			90,487.40
31.12.2001	To Balance c/d	1,85,499.17	01.01.2001	By Balance b/d	90,487.40
			31.12.2001	By Profit and Loss Appropriation A/c	90,487.40
				By Bank (interest on SFI ₹(90,487.40) × 5%	4,524.37
		1,85,499.17			1,85,499.17
31.12.2002	To Balance c/d	2,85,261.53	01.01.2002	By Balance c/d	1,85,499.17
			31.12.2002	By Profit and Loss Appropriation A/c	90,487.40
				By Bank (interest on ₹1,85,499.17) × 5%	9,274.96
		2,85,261.53			2,85,261.53
31.12.2003	To Balance c/d	3,90,012.01	01.01.2003	By Balance b/d	2,85,261.53
			31.12.2003	By Profit and Loss Appropriation A/c	90,487.40
			31.12.2003	By Bank (interest on ₹2,85,261.53) × 5%	14,263.08
		3,90,012.01			3,90,012.01
31.12.2004	To Balance c/d	5,00,000.01	01.01.2004	By Balance b/d	3,90,012.01
			31.12.2004	By Profit and Loss Appropriation A/c	90,487.40
			31.12.2004	By Bank	19,500.60
		5,00,000.01			5,00,000.01
			01.01.2005	By Balance b/d	5,00,000.01

Debenture Sinking Fund Investment A/c

Dr. *Cr.*

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.12.2000	To Bank	90,487.40	31.12.2000	By Balance c/d	90,487.40
		90,487.40			90,487.40
01.01.2001	To Balance b/d	90,487.40	31.12.2001	By Balance c/d	1,85,499.17
31.12.2001	To Bank	95,011.77			
		1,85,499.17			1,85,499.17
01.01.2002	To Balance b/d	1,85,499.17	31.12.2002	By Balance c/d	2,85,261.53
31.12.2002	To Bank	99,726.36			
		2,85,261.53			2,85,261.53
01.01.2003	To Balance b/d	2,85,261.53	31.12.2003	By Balance c/d	3,90,012.01
31.12.2003	To Bank	1,04,750.48			
		3,90,012.01			3,90,012.01
01.01.2004	To Balance b/d	3,90,012.01	31.12.2004	By Balance c/d	5,00,000.01
31.12.2004	To Bank	1,09,988.00			
		5,00,000.01			5,00,000.01
01.01.2005	To Balance b/d	5,00,000.01			

The amount necessary to set aside:

$$= 5{,}50{,}000 \times 0.1809748 = ₹99{,}536.14$$

Illustration 37

Rahul Ltd. had ₹3,00,000 debentures redemption fund in its book on 31st March 2007. The fund invested was ₹4,00,000 nominal-value Port trust bond. On that day, the debentures account stood at ₹10,00,000. The company sold ₹2,00,000 nominal value investments at 90% for the purpose of redeeming ₹1,75,000 debentures at ₹100.5. Show the relevant ledger accounts in the books of Rahul Company, ignoring the interest.

Solution:

Ledger Accounts

Debentures Redemption Fund Account

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.2007	To Debenture Holders A/c (1,75,000 × 0.5%)	875	31.03.2007	By Balance b/d	3,00,000
				By DRFI (transfer)	30,000
	To general Reserve A/c (transfer)	1,75,000			
	To Balance c/d	1,54,125			
		3,30,000			3,30,000
			01.04.2007	By Balance b/d	1,54,125

Debenture Redemption Fund Investment Account

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.2007	To Balance b/d (Port Trust Bonds)	3,00,000	31.03.2007	By Bank (2,00,000 × 90/100)	1,80,000
	To Debenture Redemption Fund A/c (profit on sale) (1,80,000 – 300,000/4,00,000 × 2,00,000	30,000		By Balance c/d	1,50,000
		3,30,000			3,30,000
01.04.2007	To Balance b/d	1,50,000			

Debentures Account

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.2007	To Debenture holders A/c	1,75,000	31.03.2007	By Balance b/d	10,00,000
	To Balance c/d	8,25,000			
		10,00,000			10,00,000

Debenture Holders Account

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.2007	To Bank A/c	1,75,875	31.03.2007	By Debentures A/c	1,75,000
				By Debenture Redemption Fund A/c	875
		1,75,875			1,75,875

Illustration 38

A company issued 10% debentures of ₹4,00,000 at par but redeemable after 3 years, at 10% premium. The amount set aside for redemption of debentures was invested in 5% government securities. The amount was invested in multiples of ₹1. The debenture fund table shows that ₹0.31720855 at 5% compound interest will become ₹1 in 3 years. On the due date, the investments were sold at a loss of ₹20,000. Show the necessary ledger accounts for 3 years. Do not show ledger accounts for payment of debentures interest.

Solution:

Debenture Sinking Fund Account

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
Year I	To Balance c/d	1,39,571.80	Year I	By Profit and Loss Appropriation A/c	1,39,571.80
		1,39,571.80			1,39,571,80

(*Contd.*)

Year II	To Balance c/d	2,86,122.10	Year II	By Balance b/d	1,39,571.80
				By Bank-interest	6,978.50
				By Profit and Loss Appropriation A/c	1,39,571.80
		2,86,122.10			2,86,122.10
Year III	To Loss on Issue of Debentures	40,000	Year III	By Balance b/d	2,86,122.10
	To Sinking Fund Investment A/c (loss on sale)	20,000		By Bank - interest	14,306.10
	To General Reserve (transfer)	3,80,000		By Profit and Loss Appropriation A/c	1,39,571.80
		4,40,000			4,40,000

Debenture Sinking Fund Investment A/c

Dr. *Cr.*

Date	Particulars	(₹)	Date	Particulars	(₹)
Year I	To Bank A/c	1,39,572	Year I	By Balance c/d	1,39,572
		1,39,572			1,39,572
Year II	To Balance b/d	1,39,572	Year II	By Balance c/d	2,86,122
	To Bank A/c	1,46,550			
		2,86,122			2,86,122
Year III	To Balance b/d	2,86,122	Year III	By Bank A/c	2,66,122
				By Debenture Sinking Fund A/c (loss on sale of investments)	20,000
		2,86,122			2,86,122

10% Debentures Account

Date	Particulars	(₹)	Date	Particulars	(₹)
Year I	To Balance c/d	4,00,000	Year I	By Bank A/c	4,00,000
		4,00,000			4,00,000
Year II	To Balance c/d	4,00,000	Year II	By Balance b/d	4,00,000
		4,00,000			4,00,000
Year III	To Debenture Holder A/c	4,00,000	Year III	By Balance b/d	4,00,000
		4,00,000			4,00,000

Premium on Redemption of Debentures Account

Date	Particulars	(₹)	Date	Particulars	(₹)
Year I	To Balance c/d	40,000	Year I	By Loss on Issue of Debentures	40,000
		40,000			40,000
Year II	To Balance c/d	40,000	Year II	By Balance b/d	40,000
		40,000			40,000
Year III	To Debenture Holder A/c	40,000	Year III	By Balance b/d	40,000
		40,000			40,000

Debenture Holders Account

Date	Particulars	(₹)	Date	Particulars	(₹)
Year III	To Bank A/c	4,40,000	Year III	By 10% Debentures By Premium on Redemption of Debentures A/c	4,00,000 40,000
		4,40,000			4,40,000

Illustration 39

On 1st April 2006, balances in the books of Trust Marketing Limited were as follows:

		(₹)
(a)	12% Debentures	20,00,000
(b)	Debenture Sinking Fund (Debenture Redemption Reserve)	16,00,000
(c)	Debenture Sinking Fund Investment (Debenture Redemption Reserve Investment)	16,00,000

The investment consisted of 8% government securities of the face value of ₹17,00,000. The annual instalment to sinking fund was ₹2,64,000. The bank balance on 31st March 2007 was ₹5,60,000 (after receipt of interest on sinking fund investment). Investment realised 93% and debentures were redeemed. Show the necessary ledger accounts.

Solution:

Debenture Sinking Fund Account

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.2007	To Sinking Fund Investment A/c (transferred from debenture sinking fund investment)	1,19,000	01.04.2006	By Balance b/d	16,00,000
	To General Reserve (transfer)	18,81,000		By Profit & Loss Appropriation A/c	2,64,000
				By Interest on Sinking Fund Investment (at 8% on 17,00,000)	1,36,000
		20,00,000			20,00,000

Debenture Sinking Fund Investment Account

Date	Particulars	(₹)	Date	Particulars	(₹)
01.04.2006	To Balance b/d	16,00,000	31.03.2007	By Bank A/c (93% of 17,00,000)	14,81,000
				By Debenture Sinking Fund A/c (loss on sale of investments)	1,19,000
		16,00,000			16,00,000

12% Debenture Account

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.2007	To Bank A/c	20,00,000	01.04.2006	By Balance c/d	20,00,000
		20,00,000			20,00,000

Bank Account

Date	Particulars	(₹)	Date	Particulars	(₹)
01.04.2006	To balance b/d	5,56,000	31.03.2007	By Debenture A/c	20,00,000
31.03.2007	To Sinking Fund Investment A/c (sale of investment)	14,81,000	31.03.2007	By Balance c/d	41,000
		20,41,000			20,41,000

Illustration 40

Own Debentures and Sinking Fund

The balance sheet of X Ltd. as on 31st December 2002 disclosed the following information:

(a) 15% Debentures ₹8,00,000

(b) Debenture Sinking Fund ₹3,40,000

(c) Debenture Sinking Fund Investment
Represented by ₹80,000 own debentures
Purchased at ₹98 and the remaining amount
By ₹2,80,000 4% Stock

On the above date, directors redeemed all the debentures. For this purpose, they realised 4% stock at par. They utilised ₹1,20,000 for redemption out of current year's profits. You are required to give the necessary journal entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31.12.2002	Bank A/c Dr. To Debentures Sinking Fund Investments A/c (*Being sale of investment for the redemption of debentures*)		2,80,000	2,80,000
	Debenture A/c Dr. To Bank A/c (*Being redemption of outstanding debentures at par*)		7,20,000	7,20,000
	Debenture Sinking Fund Investments A/c Dr. (See W.N.) To Debentures Sinking Fund A/c (*Being profit on sale of investments transferred to debentures sinking fund account*)		18,400	18,400
	Debentures A/c Dr. To Debentures Sinking Fund Investments A/c (*Being cancellation of own debentures*)		80,000	80,000
	Debenture Sinking Fund Investments A/c Dr. To Debenture Sinking Fund A/c (*Being profit on cancellation transferred to debenture sinking fund account*)		1,600	1,600

(*Contd.*)

	Debenture Sinking Fund A/c Dr. To General Reserve A/c (*Being balance amount in sinking fund transferred to general reserve*)		3,60,000	3,60,000
	Profit & Loss A/c Dr. To Debenture Redemption Reserve A/c (*Being profits used for redemption transferred to D.R.R*)		1,20,000	1,20,000

Working Note:

Computation of Profit on Sale of Investment

	(₹)
Total Amount available for investment	3,40,000
Less: Amount used in purchasing own deb. (800 × 98)	78,400
Amount invested in 4% ₹2,80,000 Stock i.e., Cost Price of stock	2,61,600
Sale Price of 4% Stock at par	2,80,000
Profit on Sale of Stock	18,400

THEORY QUESTIONS

I. Short-Answer Questions

1. What is a debenture?
2. State the differences between debenture and share.
3. What do you mean by Convertible Debenture? State its significance.
4. Write short notes on Own Debenture.
5. State the accounting treatment when debentures are issued as Collateral Security.
6. Explain Ex-Interest and Cum-Interest quotation.
7. What do you understand by Redemption Drawing by Lot?
8. How do you deal with Discount on Issue of Debenture in accounts?
9. What is a Sinking Fund?
10. Explain the accounting treatment of Premium on Redemption of Debenture.
11. What do you understand by Redemption of Debenture out of Profits?
12. Write short notes on Redemption of Debentures out of Capital.

II. Long-Answer Questions

1. What are the different types of debentures? Explain them in detail.
2. Enumerate the different methods of redemption of debentures and explain them.
3. Describe the Sinking Fund Method of redeeming debentures.
4. State the merits of Insurance Policy Method of redeeming debentures.

5. Write short notes as:
   (a) Debenture redemption reserve
   (b) Partly convertible debentures
   (c) Open Market buying method of redemption
   (d) Own Debentures acquired as Investments.

OBJECTIVE-TYPE QUESTIONS

I. Multiple Choice Questions

1. Long-term borrowing of a business:
   (a) Preference share capital (b) Equity share capital
   (c) Debentures (d) None of the above
2. Creditors of the company are
   (a) Customers of the company (b) Debentureholders
   (c) Shareholders of the company (d) None of the above
3. Debentures are shown under the following heading in a company's balance sheet
   (a) Secured loan (b) Unsecured loan
   (c) Share capital (d) Current liabilities
4. According to Companies (Amendment) Act, 1999, the premium on issue of debentures should be credited to:
   (a) Share Premium A/c (b) Debentures Premium A/c
   (c) Securities Premium A/c (d) None of the above
5. Discount on issue of debentures is shown under the following heading in a company's balance sheet
   (a) Fixed assets (b) Non-current liabilities
   (c) Investments (d) Other current assets
6. Interest on debenture is normally payable
   (a) Every six months (b) Every three months
   (c) Annual payment (d) Every month
7. Debenture issue is always made with a
   (a) Fixed percentage of interest
   (b) Fixed percentage of dividend
   (c) Fixed percentage of dividend and interest
   (d) None of the above
8. Profit on cancellation of own debentures is transferred to:
   (a) Capital redemption reserve (b) General reserve
   (c) Capital reserve (d) None of the above
9. Own debenture account (at the time of purchase of own debentures) is always to be debited with:
   (a) The fair value (b) The cum-interest price
   (c) The ex-interest price (d) None of the above

10. The balance of sinking fund investment account, after the realisation of investment, is transferred to:
    (a) Profit & Loss A/c (b) Debentures A/c
    (c) Sinking Fund A/c (d) None of the above
11. After redemption of debentures, the balance in the sinking fund account is transferred to:
    (a) Debenture development reserve (b) General reserve
    (c) Profit & Loss A/c (d) Shares forfeited A/c

    [*Ans:* 1. (c); 2. (b); 3. (a); 4. (c); 5. (d); 6. (a); 7. (a) 8. (c); 9. (c); 10. (c); 11. (b)]

II. Fill in the Blanks

1. The rate of ____________ payable on debentures is always stated at the time of issue of debenture.
2. The issue of debentures to vendor is known as issue of debentures for consideration___________.
3. The term, collateral security, implies additional security given for a ___________.
4. Premium on redemption of debentures account is transferred to ___________ at the time of redemption.
5. The interest paid on debentures appears on the ____________ side of the profit and loss account the company.
6. Premium on issue of debentures can be used to write off the ______ on issue of debentures.
7. If the purchase price for the debentures does not include interest for the expired period, the quotation is said to be _____________.
8. If the purchase price for the debentures includes interest for the expired period, the quotation is said to be _____________.
9. Own debentures account will appear on the ___________ side of the balance sheet.
10. When debenture are to be repaid _______, an equal amount is transferred to debenture redemption reserve account.
11. Profit on sale of sinking fund investment is to be credited to ______________ account.

[*Ans:* 1. Interest; 2. Other than cash; 3. Loan; 4. Debentureholders A/c; 5. Debit; 6. Discount; 7. Ex-interest; 8. Cum-interest; 9. Assets; 10. Out of profits; 11. Sinking Fund A/c]

III. Indicate whether the following statements are True and False:

1. Interest on debentures cannot be paid if the company does not earn profit.
2. Debentures will not be repaid on the date of redemption.
3. Both, premium on debentures and premium on redemption of debentures, carry the same meaning.
4. Debentures can be issued at par and can be redeemed at discount.
5. A company is not allowed to buy its own debentures in the open market.
6. A company can write off discount on issue of debentures from the revenue profits.
7. Interest on sinking fund investment is credited to general reserve.
8. Gain on sale of sinking fund investment is to be credited to sinking fund account.

9. Those debentures, which are repaid before other debentures are paid out, are known as first debentures.
10. Own debentures can be cancelled only on dates when interest becomes payable on debentures.
11. When debenture are repaid out of capital, entry for the transfer of profits to debentures redemption reserve account is passed in the books.

[*Ans:* 1, 2, 3, 5, 7, 10 – False; and 4, 6, 8, 9, 11 – True]

EXERCISE PROBLEMS

1. Journalise the following issues:
   (a) A company issued 1000, 6% debentures of ₹100 Each at par.
   (b) A company issued 1000, 6% debentures of ₹100 Each at 10% premium
   (c) A company issued 1000, 6% debentures of ₹100 Each at 10% discount

   (Madras University, B.Com., Oct 2003; B.A. Corp., Sept 1988)
2. Pass journal entries for the following transactions:
   (a) Issue of debentures at a discount and redeemable at par
   (b) Issue of debentures at a premium and redeemable at par
   (c) Issue of debentures at par and redeemable at premium
   (d) Issue of debentures at a discount and redeemable at a premium.

   (Madras University, B.Com., Oct 2002; B. Com., Apr 1988)
3. A limited made the following issues of debentures:
   (a) For cash at 90% but repayable at 110%, Debentures of ₹10,000.
   (b) To a creditor who supplied machinery costing ₹1,00,000, 1100 debentures of ₹100 each.
   (c) To Bank for a loan of ₹7,00,000 as collateral security 10,000 debentures of ₹100 Each.

   Journalise the transactions. **[Madras University, B.A. Corp., Mar 1995 (old)]**
4. Give journal entries for the following transactions:

   Z limited purchased fixed assets for ₹8,00,000 from Vasan and issued 8% debentures of ₹100 each at a premium of 20% to settle the purchase price

   [*Ans:* 6,666 debentures of ₹100 each at 20% premium and ₹80 cash]
5. Y limited has taken over the business of Krishnan, the asset and liabilities having been valued at ₹80,000 and ₹30,000 respectively. Y Co., agreed to pay ₹72,000 as the purchase price, to be settled by the issue of 12% debentures of ₹10 each at a premium of 20%. Give journal entries.

   [*Ans:* Goodwill ₹22,000; 6,000 debentures of ₹10 each at premium of ₹2 per debenture]
6. MN Ltd., issued 40,000 debentures of ₹50 each at a discount of 6%. Debentures were to be redeemed at the end of five years. Pass journal entry for the issue and show the amount of discount that should be written off to Profit & Loss A/c each year.

   [*Ans:* Discount to be written off annually: ₹24,000]

7. On 1.1.2000, AB Ltd., issued ₹1,10,000, 9% debentures at a discount of 5% repayable as follows:

   On 31.12.2000: ₹20,000

   On 31.12.2001: ₹40,000

   On 31.12.2002: ₹50,000

   Calculate the amount of discount to be written off in each of the three years,

   [*Ans:* Discount to be written off: 2000: ₹2,420; 2001: ₹1,980; 2002: ₹1,100]

8. G Ltd., issued 10,00012% debentures of ₹100 each at a discount of 5% repayable after 5 years at a premium of 5%. Give journal entries both at the time of issue and redemption of debentures.

9. Zebra Ltd., redeemed ₹10,000 12% Debentures, out of capital by drawing a lot and it has also redeemed ₹20,000. 10% Debentures out of profit by drawing a lot. Journalise the transactions.

   [*Ans:* Amount of profit transferred to Debenture Redemption Reserve ₹20,000]

10. TTK Ltd. redeemed 4,000 15% Debentures of ₹100 each which were issued at a discount of 5% by converting them into equity shares of ₹10 each issued at a premium of 25%. Journalise the transactions.

    [*Ans:* No. of equity shares issued: 30,400]

11. Babu Ltd., redeemed ₹2,88,000 15% Debentures of ₹100 each at 102% by converting them into 16% Debentures at 96%. Journalise the transactions.

    [*Ans:* 3,060 Debentures to be issued]

12. A company issued at par 1,000 6% debentures of ₹1,000 each. Interest is payable half yearly on 30th September and 31st March.

    On 01.02.1983, the company purchased 20 of its own debentures as investment at ₹970. Give the necessary journal entries, assuming the books are closed on 31st March. Ignore income tax.

    (Madras University, B.A. Corp., Sep 1988)

    [*Ans:* On 1.2.83: Own debentures – ₹19,400 and interest – ₹400; assuming 'ex-interest price'. If 'cum-interest' price is assumed, own debentures – ₹19,000; Interest – ₹400)

13. X Ltd. purchases for immediate cancellation 2,000, 12% own Debentures of ₹100 each on 1st December 1998, the interest dates being 31st March and 30th September.

    Pass entries relating to the cancellation if:

    (a) Debentures are purchased at ₹92 ex-interest

    (b) Debentures are purchased at ₹92 cum-interest.

    (Madras University, II M. Com. (ICE) (Old) Oct 2002)

    [*Ans:* Profit on cancellation: (a) ₹16,000; (b) ₹20,000]

14. SS Ltd. purchased its 200 10% own debentures in the open market at ₹99 ex-interest on 1.7.99. Later, these debentures were resold on 1.1.2000 at ₹98 ex-interest. Interest is payable on 31st March and 30th September each year. Show journal entries for purchase and resale of own debentures.

    [*Ans:* On 1.7.99: Interest: ₹500; Own Debentures: ₹19,800; On 1.1.2000: Interest: ₹500; Loss on sale of Own Debntures: ₹200]

15. Amount needed after 5 years for debenture redemption: ₹60,00,000.

    Rate of Interest on investments expected: 5%

    Annual investment needed to get ₹15 after 5 years, ₹2.71462.

    Ascertain the annual transfer to Sinking Fund.

    [*Ans:* Annual Transfer: ₹10,85,848]

16. AXE Co. Ltd. issued ₹4,00,000, 10% debentures of ₹100 each, at a discount of 5%, which are repayable after 10 years, at a premium of 15%. Pass journal entry for the issue.
17. Journalise the following issues:
    (a) A company issued 2,000, 6% debentures of ₹100 each at par.
    (b) A company issued 2,000, 6% debentures of ₹100 each at 10% premium.
    (c) A company issued 2,000, 6% debentures of ₹100 each at 10% discount.
18. Pass necessary journal entries in the following cases, when debenture issue price is ₹1,00,000. Rate of interest is 8%.
    (a) Issued at par and redeemable at par.
    (b) Issued at discount of 10% and redeemable at par.
    (c) Issued at premium of 5% and redeemable at par.
19. Pass journal entries for the following transactions:
    (a) Issue of debenture at a discount and redeemable at par.
    (b) Issue of debenture at a premium and redeemable at par.
    (c) Issue of debenture at par and redeemable at premium.
    (d) Issue of debenture at a discount and redeemable at premium.
20. Sunrise Ltd. issued 10% debenture of the face value of ₹100 each as follows:
    (a) On 1st April 1996, 1,000 debentures at ₹98 each for cash to the public.
    (b) On 1st June 1996, 3,000 debenture at par to IDBI as collateral security for the term loan of ₹2,50,000 borrowed:
    (c) On 1st September 1996, 4,000 debenture to the vendors of land to settle the agreed price of ₹4,20,000.

    You are required to give journal entries to record the above issues of debentures. Ignore interest and tax.

    [*Ans:* (a) Discount on issue: ₹2,000; (b) Face value: ₹3,00,000; (c) Face value: ₹4,00,000; Premium: ₹20,000]

21. Anil Ltd. issued 5,000, 5% debenture of ₹100 each, at a premium of 10%, payable ₹30 on application and balance with premium on allotment. Pass journal entries in the books of Anil Ltd.
22. Give journal entries for the following transactions:

    Z Ltd. purchased fixed assets for ₹12,00,000 from Vasan and issued 8% debentures of ₹100 each, at a premium of 20%, to settle the purchase price.

    [*Ans:* 10,000 debentures of ₹100 each, at 20% premium]

23. On 1st January 2000, Exe Ltd. issued ₹2,20,000, 9% debentures at a discount of 5% repayable as follows:

On 31.12.2000	:	₹40,000
On 31.12.2001	:	₹80,000
On 31.12.2002	:	₹50,000

Calculate the amount of discount to be written off in each of the three years.

[*Ans:* Discount to be written off: In 2000: ₹4,840; In 2001: ₹3,960; In 2002: ₹2,200]

24. Gowtham Ltd. issued 6,000 12% debentures of ₹100 each, at a discount of 5%, repayable after 5 years at a premium of 5%. Give journal entries both at the time of issue and redemption of debentures.
25. Jeevan Ltd. issued 6,000 12% debentures of ₹100 each, redeemable after 5 years, at a premium of 10%. A sinking fund is to be opened for the purpose of redemption. Investments are expected to fetch 5% p.a. If sinking fund Table shows that ₹0.180975 invested every year will amount to ₹1 in 5 years, compute the amount of annual transfer required.

    [*Ans:* Annual transfer: ₹1,19,443.50]
26. Amount needed after 5 years for debenture redemption: ₹60,00,000.

    Rate of interest on investments expected: 5%

    Annual investment needed to get ₹15 after 5 years: ₹2.71462.

    Ascertain the annual transfer to sinking fund. [*Ans:* Annual transfer: ₹10,85,848]
27. RK Ltd. has ₹50,000 10% debentures on 1st January 2001. On 1st March 2002, the company purchased ₹10,000 debentures at ₹98 cum-interest. The debenture interest is payable half-yearly on 30th June and 31st December every year. Show journal entries for purchase and cancellation of debentures.
28. X Ltd. purchases, for immediate cancellation, 2,000 12% own debentures of ₹100 each, on 1st December 1998, the interest dates being 31st March and 30th September. Pass entries relating to the cancellation, if:
    (a) Debentures are purchased at ₹92 ex-interest
    (b) Debentures are purchased at ₹92 cum-interest

    [*Ans:* Profit on cancellation: (a) ₹16,000; (b) ₹20,000]

OTHER EXERCISES

1. Goodwill Ltd. issued 1,000 6% debentures of ₹100 each. Give the journal entries in each of the following cases:
    (a) The debentures are issued and redeemable at par.
    (b) They are issued at a discount of 6%, but redeemable at par.
    (c) They are issued at a premium of 5%, but redeemable at par.
    (d) They are issued at a discount of 10%, but redeemable at a premium of 5%.
2. You are required to set out the journal entries relating to the issue of the following debentures in the books of X Ltd.
    (a) 8%, 120 ₹1,000 debentures are issued at 5% discount and are repayable at par.
    (b) Another 7%, 150 ₹1,000 debentures are issued at 5% discount and repayable at 10% premium.
    (c) Further, 80 9% ₹1,000 debentures are issued at 5% premium.
    (d) In addition, another 400, 8% ₹100 debentures are issued as collateral securities against a loan of ₹40,000.
3. Zel Ltd. issued 1,000 9% debentures of ₹100 each payable, ₹20 on application and the balance on allotment. Applications were received for 1,500 debentures; out of

which, applications for 900 were allotted fully. Applications for 400 debentures were allotted 100 debentures and the remaining were rejected. All sums due were received.

Give journal entries and also show how these transactions will be reflected in the balance sheet of the company.

[*Ans:* Transfer of application money to debenture allotment account: ₹6,000; Return of rejected application money: ₹4,000]

4. Narayanan & Co. Ltd. purchased assets worth ₹28,80,000. It issued debentures in satisfaction of the purchase price. Calculate how many debentures will be issued:
   (a) In case the debentures are of ₹100 each and are issued at a discount of 4% and
   (b) In case the debenture are of ₹80 each and are issued at a premium of ₹10 per debenture.

   Also, pass journal entries required for the issue of debentures.

   [*Ans:* (a) 30,000 debentures of ₹100 each will be issued at 4% discount;
   (c) 32,000 debentures of ₹80 each will be issued at a premium of ₹10 per debenture]

5. A company issued debentures of the face value of ₹1,00,000 at a discount of 6%. The debentures were repayable by annual drawings of ₹20,000. How would you deal with the discount on debentures?

   Show the discount account in the company's ledger for the period of duration of debentures.

   [*Ans:* Assuming proportionate write off, discount account balance on the date of issue: ₹6,000; At the end of the 1 year: ₹4,000; At the end of the 2 years: ₹2,400; At the end of the 3 year: ₹1,200; At the end of the 4 year: ₹400; At the end of the 5 year: 0]

6. Suman Ltd. issued 40,000 debentures of ₹100 each, at a discount of 10%. The expenses of issue amounted to ₹1,00,000. The debentures were agreed to be redeemed at the rate of ₹8,00,000 each year, commencing from the end of the third year.

   Ascertain the amount of discount and expenses to be written off each year.

   [*Ans:* Total amount to be written off: ₹5,00,000;
   Amounts written off in respective year are:
   1-₹1,00,000;
   2-₹1,00,000;
   3-₹1, 00,000;
   4-₹80,000;
   5-₹60,000;
   6-₹40,000;
   7-₹20,000;]

7. Z Ltd. issued 2,000 6% debentures of ₹100 each, on 1st January 2001 at a discount of 10%, redeemable at a premium of 5%. Give journal entries relating to issue of debenture and debenture interest for the period ended 1st December 2001, assuming that the interest was payable half yearly on 30th June and 31st December and TDS is 10%. Accounts are closed on 31st December every year.

   [*Ans:* Interest transferred to P&L A/c on 31.12.2001: ₹12,000; Cash paid to debenture holders: ₹10,800 (5,400 + 5,400); T.D.S.: ₹1,200 (600 + 600)]

8. Journalise the following transactions at the time of issue of debenture and redemption of debenture:
   (a) Debenture issue at ₹95, repayable at ₹100
   (b) Debenture issue at ₹95 repayable at ₹105
   (c) Debenture issue at ₹100 repayable at ₹105
   (d) Debenture issue at ₹95 repayable at ₹100

   The face value of each debenture: ₹100.
9. X Ltd. issued 5,000 8% debentures of ₹100 each at par on 1st April 2000, which are repayable at 10% premium, at the end of 4 years. Give journal entries for issue and redemption, if
   (a) The redemption is out of profit.
   (b) The redemption is out of capital.

   [*Ans:* On 31.03.2004, amount to be repaid: ₹5,50,000; (a) Transfer to debenture redemption reserve account: ₹5,00,000 (b) No transfer to D.R.R. is needed.]
10. Eastern Plastics Ltd. issued fully convertible 10% debentures of ₹100 each, for ₹10,00,000. The following were the terms of issue:
    (a) Date of issue: 1st January 1993
    (b) 60% of the debentures issued will be convertible into equity shares of ₹10 each, at a premium of 20% on 31st December 1995.
    (c) Balance of 40% of the debenture will be converted into equity shares of ₹10 each, at a premium of ₹6 per share on 31st December 1996.

    Pass journal entries in the books of the company for conversion of the debentures.

    [*Ans:* (b) 50,000 shares of ₹10 each, at premium of ₹2 per share; (c) 25,000 shares of ₹10 each, at premium of ₹6 per share]
11. On 31st December 1996, a company had outstanding ₹50,000 6% debentures redeemable at 101%.

    On 1st January 1997, it was decided that
    (a) The debenture holders should be given option to convert their holding at par into new 7% debentures,
    (b) To redeem any unconverted debentures by cash payments;
    (c) To issue corresponding nominal amount of 7% debentures to the public at 102%.

    Holders of ₹30,000 debentures opted for conversion and the rest were paid cash.

    Draft necessary journal entries to record these transactions and show the extracts from the balance sheet, just after the above transactions are completed.

    [*Ans:* (a) Conversion: ₹30,300; (b) Cash payment: ₹20,200; (c) New issue: ₹20,000 at premium of ₹400]
12. Balaji Ltd. issued 5,000 12% debentures of ₹100 each, at a discount of 10%, holders being given the right to exercise the option of converting the debentures into 15% preference shares of ₹100 each, at a premium of 10%, before the redemption date.

    Holders of 1,650 debentures expressed their willingness to exercise the option to convert their debentures into preference shares.

Ascertain the number and amount of preference shares to be issued and give necessary journal entries for the issue and conversion of the debentures.

[*Ans:* Number of preference share to be issued: 1,350;
Face value of preference shares: ₹1,35,000,
at premium of 10%, i.e., ₹13,500]

13. On 1st July 1991, Solvents Ltd. issued 400 7% debentures of ₹1,000 each, at ₹950. The debenture holders were given the option to convert their holding into 8% preference shares of ₹100 each, at a premium of ₹20 per share, any time after 2 years. On 1st July 1993, holders of 60 debentures exercised their option of conversion. Show the journal entries for issue and conversion of the debentures, ignoring interest. Also, give relevant extracts from the company's balance sheet, after the conversion.

    [*Ans:* Conversion of 60 debentures = 475 shares of ₹100 each at premium of ₹9,500, i.e., 47,500 + 9,500 = ₹57,000]

    [**Hint**: When conversion is before specified date of redemption, actual cash collected alone must be converted in view of Section 79]

14. On 1st January, XYZ Ltd. has ₹1,00,000 10% debentures. In accordance with the power under the deed, the directors have the powers to acquire the debentures in the open market for immediate cancellation.

    The following purchases, of own debentures, were made by the company.

    1st March: ₹20,000 debentures at ₹98 cum - interest

    1st August: ₹40,000 debentures at ₹99 ex- interest

    Debentures interest is payable half-yearly, on 30th June and 31st December every year.

    Show journal entries for purchase and cancellation of the debentures.

    [*Ans:* 1st March: Cash paid: ₹19,600; Interest: ₹333;
    Profit on cancellation of debentures: ₹733; 1st August: Cash paid:
    ₹39,933; Interest: ₹333; Profit on cancellation of debentures: ₹400]

15. On 1st January, X Ltd. has ₹1,00,000 6% debentures. In accordance with the power under the deed, the directors acquire the debentures as follows in the open market for immediate cancellation.

    1st March: ₹20,000 at ₹98 cum-interest

    1st August: ₹40,000 at ₹100.25 cum-interest

    15th December: ₹10,000 at ₹98.5 ex-interest

    Debenture interest is payable half-yearly, on 30th June and 31st December every year. Show journal entries for purchase and cancellation of debentures.

    [*Ans:* 1st March: Interest: ₹200; Profit on cancellation: ₹600; 1st August:
    Interest: ₹200; Profit on cancellation: ₹100; 15th December: Interest: ₹275;
    Profit on Cancellation: ₹150]

16. Swastik Ltd. issued 500 8% debentures of ₹100 each on 1st January 1992. Interest is payable on 30th June and 31st December each year.

    On 1st April 1993, the company purchased 100 of its own debentures at ₹98 ex-interest as investment. On 1st October 1993, the company purchased another 100 of its own debentures at ₹98 cum-interest. The company cancelled all the 200 debentures on 31st December 1993.

Show the journal entries required (including entries for interest) for the year 1993.

[*Ans:* On 01.04.1993: Own debentures: ₹9,800; Interest: ₹200;
On 01.10.1993: Own debentures: ₹9,600; Interest: ₹200;
On 31.12.1993: Profit on cancellation of own debentures:
₹600 (200 + 400)]

17. On 1st February 1989, a company purchased 20 of its own debenture of ₹1,000 each, as investment, at ₹970 and cancelled them on 30th June 1990. Rate of interest is 10% and the interest is payable on 30th June and 31th December of each year.

    Give journal entries for purchase and cancellation of debentures if

    (a) The purchase price was ex-interest

    (b) The purchase price was cum-interest

    [*Ans:* (a) On 01.02.1989: Own debentures: ₹19,400; Interest: ₹167;
    On 30.06.1989: Profit on cancellation of own debenture: ₹600;
    (b) On 01.02.1989: Own debentures: ₹19,233; Interest: ₹167;
    On 30.06.1989: Profit on cancellation of own debenture: ₹767]

18. Muthu Co. Ltd. issued 10,000 10% debentures of ₹100 each on 1st July 1993. They were redeemable on 1st July 1996 at 5% premium. Interest was payable annually on 31st December. The following transactions took place on the dates mentioned below:

    (a) On 1st October 1994, the company buys 800 own debentures in the open market at ₹98 ex-interest. These debentures were resold at ₹97 each on 31st December 1994, after receiving interest.

    (b) On 1st July 1995, the company buys 600 own debentures at ₹102 cum-interest. These were cancelled on 31st December 1995.

    (c) On 1st October 1995, the company buys 500 own debentures at ₹104 cum-interest.

    These were cancelled along with the remaining debentures when they were redeemed on 1st July 1996.

    Give necessary journal entries for the year 1993 to 1996.

    [*Ans:* On 01.10.1994: Own debentures: ₹78,400; Interest: ₹6,000;
    On 31.12.1994: Interest received: ₹2,000; Loss on sale: ₹800;
    On 01.07.1995: Own debentures: ₹58,200; Interest: ₹3,000;
    On 01.10.1995: Own debentures: ₹48,250; Interest: ₹3,750;
    On 31.12.1995: Interest received: ₹4,250 (3,000 + 1,250); Profit on cancellation: ₹1,800;
    On 01.07.1996: Interest on own debentures: ₹2,500; Profit on cancellation of debentures: ₹1,750; Premium on redemption: ₹44,500]

19. X Ltd. has an authorised capital of ₹15,00,000, divided into equity shares of ₹10 each and its balance sheet as on 31st December 1994 was as follow:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	12,00,000
Issued and Fully Paid	5,00,000	Current Assets	4,20,000
Capital Reserve	1,20,000	Investment in Own	
General Reserve	2,00,000	debenture	
Profit & Loss A/c	3,50,000	(Nominal Value ₹1,00,000)	85,000
6% Debentures	4,00,000	Cash at Bank	75,000
Creditors	2,10,000		
	17,80,000		17,80,000

The 6% debentures are due for payment on 30.06.95 at a premium of 5%. The company decided

(a) To issue to the public 25,000 equity shares of ₹10 each, at ₹15 per share. The money was duly received.

(b) To redeem the debentures on 30th June 1995 together with interest for 6 months.

(c) The debentureholders accept 6% debentures at par for ₹1 lakh and the balance in cash.

(d) The debentures, which the company held as investment, were cancelled.

You are required to pass journal entries to record the above transactions.

[*Ans:* Cash from new issue of share: ₹3,75,000;
Cash payment for debentures: ₹2,00,000 + ₹10,000;
New debentures issued: ₹1,00,000 + ₹5,000;
Profit on cancellation of own debentures: ₹15,000]

20. A company issued 6% debentures of ₹10,00,000 with a condition that they should be redeemed after 3 years at 10% premium. The amount allocated for the redemption of debentures is invested in 5% State Government Securities.

The sinking fund Table shows that ₹0.317209 at 5% compound interest in 3 years will become ₹1.

Pass journal entries and prepare ledger accounts for all the three years.

[*Ans:* Annual transfer: ₹3,48,929.90; Interest at the end of 2nd year: ₹17,446.49; 3rd year: ₹35,765.31; Amount repaid: ₹11,00,000]

21. On 1st January 1994, debentures of the face value of ₹75,000 were issued at par, repayable at par at the end of 5 years. In terms of the trust deed, sinking fund was to be created for the purpose of accumulating sufficient funds. Investments were made yielding 5% interest at the end of each year. All investments, including reinvestment of interest received, were made at the end of the year.

It is ascertained that ₹2.71462 invested at the end of each year at 5% compound interest will amount to ₹15 at the end of 5 years.

You are required to show, for all the 5 years:

(a) Sinking Fund Account;

(b) Sinking Fund Investment Account

[*Ans:* Interest on 31.12.1995: ₹678.65; 31.12.1996: ₹1,391.24;
31.12.1997: ₹2,139.46; 31.12.1998: ₹2,925.09;
Annual transfer to sinking fund: ₹13,573.10]

22. On 1st January 1996, Plastic Products Ltd. issued debentures for ₹1,00,000, redeemable at par at the end of five years and it was resolved that a sinking fund should be created and invested in tax-free securities.

    Give journal entries and draw up the necessary ledger accounts for 5 years, assuming that the interest received on the investments was 5% on cost, yearly, which was immediately invested. The investments were realised at a loss of ₹300 at the end of 5 years. Reference to the sinking fund Table shows that ₹0.180975 invested at the end of each year at 5% compound interest will produce ₹1 at the end of 5 years.

    [*Ans:* Interest received at the end of 2nd year: ₹904.87; 3rd year: ₹1,854.99; 4th year: ₹2,852.63; 5th year: ₹3,900.01; Sinking fund balance at the end of 1st year: ₹18,097.50; 2nd year: ₹37,099.87, 3rd year: ₹57,052.36, 4th year: ₹78,002.49, 5th year: ₹99,700 to be transferred to general reserve]

23. The following balance are extracted from the balance sheet of M Ltd., as on 1st January 2001:

	(₹)
6% Debentures	1,00,000
Debenture Redemption Fund	85,000

    Debenture Redemption Fund Investment 90,000 (in ₹100 value 4% certificate)

    The annual investment was ₹11,400. On 31st December 2001, the investments were realised at ₹95 each and the debentures were redeemed. The bank balance on that date was ₹18,300.

    Give ledger accounts relating to the redemption of debentures.

    [*Ans:* Profit on sale of investments: ₹500; Transfer to general reserve: ₹1,00,500; Bank balance: ₹7,400]

24. The balance sheet of X Ltd., as on 31st December 1984 disclosed the following information:
    (a) 7% debentures ₹4,00,000;
    (b) Debenture sinking fund ₹1,70,000;
    (c) Debenture sinking fund investment represented by ₹40,000 own debentures at ₹98 and the remaining amount by ₹1,40,000 4% stock.

    On the above date, the directors redeemed all the debentures. For this purpose, they realised 4% stock at par. They utilised ₹60,000 for redemption out of the current year's profits.

    You are required to give journal entries.

    [*Ans:* Profit on sale of 4% stock: ₹9,200; Profit on cancellation of own debentures: ₹800]

25. Ramesh Ltd. has made an issue of ₹1,00,000 5% debentures on 1st January 1993, the terms of which include that the company must provide for a sinking fund for the redemption on 31st December each year from 1995, for three years. The directors decide to take out an insurance policy to provide the necessary cash, the annual premium being ₹31,410.80, on which the return is at 3% p.a. at compound interest. Show the ledger accounts.

    [*Ans:* Balance of debenture redemption fund account on 31.12.1995: ₹32,353.12; on 31.12.1996: ₹65,676.84; on 31.12.1997: ₹1,00,000; Balance of debenture redemption policy account on 31.12.1995: ₹32,353.12; on 31.12.1996: ₹65,676.84; on 31.12.1997, Cash realised: ₹1,00,000]

26. Selwell Ltd. issued 50,000 14% debentures of ₹10 each at par on 1st April 1996, repayable after three years at par on 31st March 1999. The company decided to take out an insurance policy to provide necessary cash for the redemption of the debentures.

    The annual premium for the policy, payable on 1st April every year was ₹1,57,050.

    Prepare ledger accounts in the company's books.

    [*Ans:* Balance in debenture redemption fund account and debenture redemption policy account at the end of each year was: First year: ₹1,57,050; Second year: ₹3,14,100; Policy realised at the end of third year: ₹5,00,000; Profit on policy: ₹28,850]

5

ACQUISITION OF BUSINESS

A limited company, after its steady establishment in the competitive corporate world, may purchase or acquire an existing business. The existing business can either be a sole proprietorship, a partnership, or even a limited company. Such a process of acquiring or purchasing the business is called as "**Acquisition of Business".** This chapter, thus, deals with the accounting treatment to be adopted by both the purchasing company and the selling company to give an effect to such transaction.

5.1 TERMS/FACTORS ASSOCIATED WITH ACQUISITION OF BUSINESS

- ***Purchaser:*** The company, which acquires or purchases the business of others are called as the 'Purchaser".
- ***Vendor/Seller:*** The organisation or the company, which sells its business is called as the Vendor/Seller.
- ***Purchase Consideration:*** The price (purchase price) paid by the acquiring/ purchasing company to the selling company is called as the 'Purchase Consideration.

5.2 COMPUTATION OF PURCHASE CONSIDERATION

Purchase price is, generally, determined at the time of negotiation and that value will be reflected in the agreement. In such cases, the value of purchase consideration will be quoted in the agreement and for accounting treatment in the books of accounts, there will not be any need to compute or calculate the value of purchase consideration, since it will already appear in the given problem.

On the other hand, if such value is not determined, then the following methods can be adopted to compute the value of purchase consideration, namely, Net Asset Method and Net Payment Method.

❍ Net Asset Method

Under this method, the Purchase Consideration is computed by adding the values of the various assets taken over by the purchasing company minus the values of the various external liabilities agreed to be taken over to be paid by the purchasing company.

It is to be noted that in the absence of an agreement, the purchasing company takes over all the assets of the selling or vendor company, namely, all the fixed assets, current assets, including cash and bank balances but does not take over the fictitious assets and miscellaneous expenses, such as discount on issue of shares and debentures, preliminary expenses, the underwriting commission and the debit balance of the profit and loss account.

Similarly, it is also to be noted that in the absence of an agreement, the purchasing company takes over all the external liabilities of the vendor company but does not take over the internal liabilities that are of shareholders, namely, share capital, reserve fund, undistributed profits (profit and loss that appears in the liabilities side of the balance sheet) and any other liabilities of the shareholders.

Note: If the value of the Purchase Consideration and the value of the liabilities taken over are more than the value of the assets of the vendor company, then the difference indicates that the purchasing company is paying more to acquire the vendor company and that the excess value denotes the Goodwill of the vendor company and the difference amount is hence, transferred to **Goodwill Account.**

On the other hand, if the value of the Purchase Consideration and the value of the liabilities taken over are less than the value of the assets of the vendor company, then it indicates that the company has been acquired or purchased by the vendor company at a profit and so, the difference amount is transferred to **Capital Reserve Account.**

❍ Net Payment Method

Under this method, the Purchase Consideration is computed by adding the values paid by the purchasing company in various modes to the vendor company. In other words, it is the sum total of the amount paid by the purchasing company to the vendor company either in cash, or by way of shares or by way of debentures.

5.3 ACCOUNTING TREATMENT

The necessary accounting treatments that are required to be made in the books of accounts that arises due to acquisition of business has been discussed under the following two heads:

1. When new sets of books are opened
2. When the same set of books are continued

❍ When New Sets of Books are Opened

In the books of Purchasing Company

The following journal entries have to be passed in the books of the purchasing company on acquisition of a business:

Particulars		(₹)	(₹)
(a) For acquisition/purchase of business			
Business Purchase A/c	Dr.	xxx	
To Vendor's A/c			xxx
(*Being amount of purchase consideration due*)			
(b) For assets and liabilities taken over			
Assets taken over A/c	Dr.	xxx	
(At the value company records in its books individually)			
To Liabilities taken over A/c			xxx
(at the values agreed upon individually)			
To Business Purchase A/c			xxx
(Amount of Purchase Consideration)			
(*Being the assets and liabilities taken over by the purchasing company*)			
Note: If the credits exceed the debits, the difference denotes the goodwill and should be debited to Goodwill A/c. If the debits exceed credits, the difference denotes Profit and should be transferred to Capital Reserve A/c.			
(c) For payment to vendor			
Vendor's A/c	Dr.	xxx	
To Cash/Bank A/c			xxx
To Share/Securities Capital A/c			xxx
To Securities Premium A/c			xxx
To Debentures A/c			xxx
To Premium on issue of Debentures A/c			xxx
(*Being the payment made to vendors' in the various modes of payment*)			
(d) For interest due on purchase price			
Interest A/c	Dr.	xxx	
To Vendor's A/c			xxx
(*Being the interest due on purchase price*)			
(e) For payment of interest			
Vendor's A/c	Dr.	xxx	
To Bank A/c			xxx
(*Being the interest due paid*)			

Illustration 1

Ashwin Limited was formed with an authorised capital of ₹10,00,000, divided into equity shares of ₹10 each, to acquire the business of A&B, whose balance sheet on the date of acquisition was as follows:

Liabilities	(₹)	Assets		(₹)
Capital	5,00,000	Freehold Premises		7,00,000
General Reserve	3,50,000	Stock		1,00,000
Sundry Creditors	1,50,000	Sundry Debtors	1,35,000	
		Less: Provision		
		for Bad Debts	10,000	1,25,000
		Cash at Bank		75,000
	10,00,000			10,00,000

The purchase price was agreed upon at ₹11,50,000 to be paid in ₹10,00,000 fully paid equity shares at ₹11 and the balance in cash.

You are required to record the above and prepare the balance sheet of Ashwin Limited, assuming that the vendor's account is fully settled.

Solution:

In the books of Ashwin Limited
Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Business Purchase A/c	Dr.		11,50,000	
	To A&B A/c				11,50,000
	(*Being the purchase consideration due to A&B*)				
	Freehold Premises A/c	Dr.		7,00,000	
	Stock A/c	Dr.		1,00,000	
	Sundry Debtors A/c	Dr.		1,35,000	
	Cash A/c	Dr.		75,000	
	Goodwill (Bal. Fig.) A/c	Dr.		3,00,000	
	To Sundry Creditors A/c				1,50,000
	To Provision for Bad Debts A/c				10,000
	To Business Purchase A/c				11,50,000
	(*Being assets and liabilities taken over and the difference shown as goodwill*)				
	A&B (vendor) A/c	Dr.		11,50,000	
	To Equity Share Capital A/c				10,00,000
	To Securities Premium A/c				1,00,000
	To Cash A/c				50,000
	(*Being the purchase consideration paid to the vendors as shares, securities premium and balance in cash*)				

Notes to Accounts:

1. Share Capital:	₹10,00,000
2. Reserves and Surplus:	
Securities Premium	₹1,00,000
3. Trade Payables:	
Sundry Creditors	₹1,50,000

(*Contd.*)

4. Tangible Assets: Freehold Premises	 ₹7,00,000
5. Intangible Assets: Goodwill	 ₹3,00,000

Balance Sheet of Ashwin Ltd. (as per revised Schedule VI)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	10,00,000
Reserves and Surplus		
Securities Premium	2	1,00,000
(ii) Non-Current Liabilities		—
(iii) Current Liabilities		
Trade Payables	3	1,50,000
Total: (i) + (ii) + (iii)		12,50,000
II. Assets		
(i) Non-Current Assets:		
Tangible Assets	4	7,00,000
Intangible Assets	5	3,00,000
(ii) Current Assets		
Stock		1,00,000
Sundry Debtors (1,35,000 – 10,000)		1,25,000
Cash at Bank (75,000 – 50,000)		25,000
Total: (i) + (ii)		12,50,000

Illustration 2

Anna Ltd. was formed to take over the assets and liabilities of Mr. Ram and to acquire the adjacent premises. The balance sheet of Mr. Ram, as on 31st December 2008 was as follows:

Liabilities	(₹)	Assets	(₹)
Trade Creditors	4,000	Cash in Hand	1,000
Capital	80,000	Cash at Bank	6,000
		Book Debts	9,000
		Stock	39,000
		Furniture	5,000
		Land and Building	24,000
	84,000		84,000

The purchase consideration was agreed at ₹1,00,000 and was to be paid as follows:

(a) 2,800 equity shares of ₹20 each, fully paid
(b) ₹34,000 in 6% preference shares of ₹100 each, issued at par
(c) ₹10,000 in cash

All the assets and liabilities were valued as per above balance sheet, except the book debts, which were subject to a bad debts provision of 5%.

The company raised further capital by issue of 7,500 equity shares of ₹20 each.

The adjoining premises were purchased for ₹50,000 and additional stock of ₹70,000 was obtained from open market.

Record the above transactions in the books of Anna Ltd., through journal entries and also draft its opening balance sheet.

Solution:

In the books of Anna Ltd.
Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
31.12.2008	Business Purchase A/c	Dr.		1,00,000	
	To Mr. Ram				1,00,000
	(*Being purchase consideration payable*)				
	Cash in Hand A/c	Dr.		1,000	
	Cash at Bank A/c	Dr.		6,000	
	Book Debts A/c	Dr.		9,000	
	Stock A/c	Dr.		39,000	
	Furniture A/c	Dr.		5,000	
	Land & Building A/c	Dr.		24,000	
	Goodwill (Bal. Fig.) A/c	Dr.		20,450	
	To Trade Creditors A/c				4,000
	To Provision for Bad Debts A/c				450
	To Business Purchase				1,00,000
	(*Being assets and liabilities taken over*)				
	Bank A/c	Dr.		1,50,000	
	To Equity Share Capital A/c				1,50,000
	(*Being issue of 7,500 equity shares of ₹20 each*)				
	Premises A/c	Dr.		50,000	
	Stock A/c	Dr.		70,000	
	To Bank A/c				1,20,000
	(*Being the payment made for the adjacent premises purchased and the additional stock purchased*)				

(*Contd.*)

	Mr. Ram A/c Dr. To Equity Share Capital A/c To 6% Preference Share Capital A/c To Bank A/c (*Being the purchase consideration paid to the vendors*)		1,00,000	 56,000 34,000 10,000

Notes to Accounts:

	(₹)
1. Share Capital	
Issued and Paid-up Capital	
10,300 equity share of ₹20 each	
(including 2,800 shares issued to vendors)	2,06,000
340 6% Preference Shares of ₹100 each	34,000
	2,40,000
2. Trade Payables:	
Trade Creditors	4,000
3. Tangible Assets:	
Land and Buildings	24,000
Premises	50,000
Furniture	5,000
	79,000
4. Intangible Assets:	
Goodwill	20,450

Balance Sheet of Anna Ltd. as on 01.01.2009 (as per revised schedule VI)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1.	2,40,000
Reserves and Surplus	—	—
(ii) Non-Current Liabilities	—	—
(iii) Current Liabilities		
Trade Creditors	2	4,000
Total: (i) + (ii) + (iii)		2,44,000
II. Assets		
(i) Non-Current Assets:		
Tangible Assets	3	79,000
Intangible Assets		
Goodwill	4	20,450
(ii) Current Assets:		
Cash at Bank (6000 + 1,50,000 – 1,30,000)		26,000
Cash in Hand		1,000

(*Contd.*)

Stock		1,09,000
Book Debts (9000 – 450)		8,550
Total: (i) + (ii)		2,44,000

Illustration 3

Fresh Ltd. was formed on 1st January 2008 with an authorised capital of ₹14,00,000, divided into 1,00,000 equity shares of ₹10 each and 4,000 preference shares of ₹100 each, to acquire the business of James as a going concern. The balance sheet of James, as on 31st December 2008 was as follows:

Liabilities	(₹)	Assets	(₹)
James' Capital	3,14,000	Cash at Bank	7,600
B's Loan A/c	31,000	Sundry Debtors	19,400
Sundry Creditors	15,000	Stock	72,000
		Furniture	7,000
		Plant & Machinery	1,40,000
		Land & Building	1,14,000
	3,60,000		3,60,000

The purchase consideration was to be discharged by Fresh Ltd. by the issue of 30,000 equity shares of ₹10 each, 1,000 preference shares of ₹100 each and ₹40,000 in cash. Fresh Ltd. also agreed to discharge the sundry creditors but declined to accept B's loan. All the assets of the old company were taken over at their balance sheet values except stock, which was valued at ₹80,000. A provision of 5% was also created against sundry debtors.

To provide necessary working capital and to pay the purchase consideration, the remaining equity shares were issued at a premium of 10% and all cash was duly received. The preliminary expenses amounting to ₹30,000 were paid by the company, immediately after the issue.

Show the opening entries in the books of the Fresh Ltd. and also the opening balance sheet.

Solution:

In the books of Fresh Ltd.
Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
01.01.2008	Business Purchase A/c	Dr.		4,40,000	
	To James A/c				4,40,000
	(*Being the purchase consideration due to James*)				

(*Contd.*)

	Cash at Bank A/c Dr.		7,600	
	Sundry Debtors A/c Dr.		19,400	
	Stock A/c Dr.		72,000	
	Furniture A/c Dr.		7,000	
	Plant & Machinery A/c Dr.		1,40,000	
	Land & Building A/c Dr.		1,14,000	
	Goodwill (Bal. Fig.) A/c Dr.		87,970	
	To Sundry Creditors A/c			15,000
	To Provision for Debts A/c			970
	To Business Purchase A/c			4,40,000
	(*Being the various assets and liabilities taken over*)			
	James A/c Dr.		4,40,000	
	To Equity Share Capital A/c (30,000 × ₹10)			3,00,000
	To Preference Share Capital A/c (1,000 × ₹100)			1,00,000
	To Bank A/c			40,000
	(*Being purchase consideration paid in the form of shares and cash*)			
	Bank A/c Dr.		7,70,000	
	To Equity Share Capital A/c			7,00,000
	To Securities Premium A/c			70,000
	(*Being 70,000 equity shares issued @₹10 per share at a premium of ₹1*)			
	Preliminary Expenses A/c Dr.		30,000	
	To Bank A/c			30,000
	(*Being the preliminary expenses paid*)			

Notes to Accounts:

	(₹)
1. Share Capital:	
Authorised Share Capital	
1,00,000 Equity Shares of ₹10 each	10,00,000
4,000 Preference Shares of ₹100 each	4,00,000
	14,00,000
Issued and Subscribed Capital 1,00,000 Equity Shares of ₹10 each (including shares issued to vendors)	10,00,000
1,000 Preference shares of ₹100 each	1,00,000

(*Contd.*)

2. Reserves and Surplus:	
Securities Premium	70,000
Less: Profit & Loss (Debit Balance)	30,000
	40,000
3. Trade Payables:	
Sundry Creditors	15,000
4. Tangible Assets:	
Furniture	7,000
Plant & Machinery	1,40,000
Land & Building	1,14,000
	2,61,000
5. Intangible Assets:	
Goodwill	87,970

Note: As per paragraph 56 of Accounting Standard 26, preliminary expenses are to be recognised as expenses as and when incurred and so, preliminary expenses should not appear in the balance sheet. These expenses have to be written off by the following journal entry:

Profit & Loss A/c	Dr.	30,000	
To Preliminary Expenses			30,000

Balance Sheet of Fresh Ltd. as on … 01.01.2008 (as per revised schedule VI)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds:		
Share Capital	1	11,00,000
Reserves and Surplus	2	40,000
(ii) Non-Current Liabilities:		—
(iii) Current Liabilities:		
Sundry Creditors	3	15,000
Total: (i) + (ii) + (iii)		11,55,000
II. Assets:		
(i) Non-Current Assets:		
Tangible Assets	4	2,61,000
Intangible Assets	5	87,970
(ii) Current Assets		
Cash at Bank		7,07,600
Stock		80,000
Debtors (19,400 – 970)		18,430
Total: (i) + (ii)		11,55,000

Working Notes:

1. **Calculation of Purchase Consideration**

	₹
Equity shares to be issued 30,000 × 10 =	3,00,000
Preference shares to be issued 1,000 × 100 =	1,00,000
Cash to be paid =	40,000
	4,40,000

2. **Calculation of Closing Cash Balance**

Cash at Bank Account

	(₹)		(₹)
To Balance b/d	7,600	By Preliminary Expenses	30,000
To Equity Share Capital	7,00,000	By James A/c	40,000
To Securities Premium	70,000	By Balance c/d	7,07,600
	7,77,600		7,77,600

In the books of the Vendor Company

The following journal entries has to be passed by the vendor company at the time of acquisition of business:

Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	1. For assets taken over by the purchasing company				
	Realisation A/c	Dr.		xxx	
	To Assets A/c (taken over)				xxx
	(*Being assets transferred to realisation A/c*)				
	2. For liabilities taken over by the purchasing company				
	Liabilities A/c	Dr.		xxx	
	To Realisation A/c				xxx
	(*Being liabilities transferred to realisation A/c*)				
	3. For purchase consideration receivable from the purchasing company				
	Purchasing Company A/c	Dr.		xxx	
	To Realisation				xxx
	(*Being purchase consideration receivable from the purchasing company*)				

(*Contd.*)

	4. For realisation expenses paid by the vendor			
	Realisation A/c Dr.		xxx	
	To Bank A/c			xxx
	(*Being realisation expenses met/paid by the vendor company*)			
	5. For the receipt of purchase consideration			
	Bank A/c Dr.		xxx	
	Shares in New Company A/c Dr.		xxx	
	Debentures in New Company A/c Dr.		xxx	
	To Purchasing Company A/c			xxx
	(*Being purchase consideration received in the form of cash, shares and debentures*)			

Illustration 4

Dolly Ltd. was formed with a nominal capital of ₹10,00,000 consisting of 50,000 equity shares of ₹20 each and 3,000 preference shares of ₹100 each to acquire, on 1st April 2012, the business of Yogi and company. The balance sheet of the Yogi and Company was as follows:

Balance Sheet

Liabilities	(₹)	Assets	(₹)
Capital	4,50,000	Land & Building	2,50,000
Trade Creditors	1,25,000	Plant & Machinery	1,50,000
Bank Overdraft	50,000	Stock	1,00,000
		Debtors	1,25,000
	6,25,000		6,25,000

The company took over all the assets and liabilities and the consideration was fixed at ₹6,50,000.

For this, the land and building were valued at ₹3,50,000; Plant and Machinery at ₹1,00,000; Stock at ₹95,000; and debtors at book value subject to an allowance of 5% to cover bad debts. The bank agreed the transfer of the bank overdraft to the company, on condition that debentures for ₹75,000 were issued to the bank as collateral security.

The purchase price was settled by the issue of 25,000 equity shares of ₹20 each at par, 1,000 preference shares of ₹ 100 each and the balance being paid in cash. Dolly Ltd. paid the preliminary expenses of ₹ 10,000.

You are required to record journal entries in the books of Yogi and Company.

Solution:

In the books of Yogi and Company (Vendor Co.)
Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.04.2012	Realisation A/c Dr.		6,25,000	
	To Land & Building A/c			2,50,000
	To Plant & Machinery A/c			1,50,000
	To Stock A/c			1,00,000
	To Debtors A/c			1,25,000
	(*Being assets transferred to realisation A/c*)			
	Trade Creditors A/c Dr.		1,25,000	
	Bank Overdraft A/c Dr.		50,000	
	To Realisation A/c			1,75,000
	(*Being liabilities transferred to realisation A/c*)			
	Dolly Ltd. A/c Dr.		6,50,000	
	To Realisation A/c			6,50,000
	(*Being purchase consideration receivable from Dolly Ltd.*)			
	Equity Shares A/c Dr.		5,00,000	
	Preference Shares A/c Dr.		1,00,000	
	Cash A/c Dr.		50,000	
	To Dolly Ltd.			6,50,000
	(*Being purchase consideration received in shares and cash from Dolly Ltd.*)			
	Realisation A/c Dr.		2,00,000	
	To Dolly Ltd.'s Capital A/c			2,00,000
	(*Being profit on realisation transferred to Dolly Ltd.'s capital A/c*)			
	Dolly Ltd.'s Capital A/c Dr.		6,50,000	
	To Equity Shares in Dolly Ltd. A/c			5,00,000
	To Preference Shares in Dolly Ltd. A/c			1,00,000
	To Cash A/c			50,000
	(*Being the books closed by the vendor company by transferring the shares and cash to the capital A/c*)			

Debtors and Creditors taken over by the purchasing company on behalf of the vendors

Generally, the purchasing company does not take over the debtors and creditors belonging to the vendor because there is all possibility that all the book debts may not be realised and the payment to be made to the creditors may not be accurately determined. From the vendor's point of view, he finds it difficult to realise the book debts and then make the payment to the creditors. Hence, the vendor signs an agreement with the purchasing company to take over the debtors and creditors as a service to be done by the purchasing company. And, for such service rendered by the purchasing company, the vendor company agrees to pay a commission to the purchasing company and also any profit or loss arising in the process, shall belong to the vendor company. Under such situations, the Purchasing Company opens a separate account called as "Vendors' Suspense A/c" to operate these transactions. The following journal entries are passed to give effect to these transactions.

Journal Entries in the books of the Purchasing Company

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	1. For debtors and creditors acquired on behalf of vendors			
	Vendor's Debtors A/c Dr.		xxx	
	To Vendor's Creditors A/c			xxx
	To Vendor's Suspense A/c			xxx
	(*Being the debtors and creditors taken over by the purchasing company on behalf of the vendors*)			
	2. On realisation of the amount from the debtors			
	Bank A/c (amount realised) Dr.		xxx	
	To Vendor's Debtors A/c			xxx
	(*Being amount of debtors realised*)			
	3. For loss on realisation from debtors due to bad debts or discount allowed to debtors			
	Vendor's Suspense A/c Dr.		xxx	
	To Vendor's Debtors A/c			xxx
	(*Being the loss on realisation of debtors considered*)			
	(Note: Reverse entry in case of profit)			
	4. On payment made to the creditors			
	Vendor's Creditors A/c Dr.		xxx	
	To Bank			xxx
	(*Being payment made to the creditors*)			

(*Contd.*)

	5. For gain made on payment to creditors due to discount received from the creditors			
	Vendor's Creditors A/c Dr.		xxx	
	To Vendor's Suspense A/c			xxx
	(*Being lesser amount paid to the vendor's creditors and profit made*)			
	6. For Commission due to the purchasing company			
	Vendor's Suspense A/c Dr.		xxx	
	To Commission A/c			xxx
	(*Being commission due to the purchasing company from the vendor company*)			
	7. For any other irrecoverable bad debts recovered by the purchasing company			
	Bank A/c Dr.		xxx	
	To Vendor's Suspense A/c			xxx
	(*Being the irrecoverable bad debts recovered by the purchasing company, on behalf of the vendor company*)			
	8. For final payment to settle vendor's debtors and creditors			
	Vendor's Suspense A/c Dr.		xxx	
	To Bank A/c			xxx
	To Share Capital A/c (Shares issued)			xxx
	To Debentures A/c (Debentures issued)			xxx
	(*Being the final settlement made for the vendor's debtors and creditors*)			

Journal Entries in the books of the Vendor Company

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	1. For closing debtors balances			
	Purchasing Co.'s Suspense A/c Dr.		xxx	
	To Debtors A/c			xxx
	(*Being the closing entry for debtors*)			

(*Contd.*)

	2. For closing provision for doubtful debts			
	Provision for Doubtful Debts A/c Dr.		xxx	
	To Purchasing Co.'s Suspense A/c			xxx
	(*Being provision for doubtful debts taken to purchasing company's suspense A/c*)			
	3. For closing creditors balances			
	Creditors A/c Dr.		xxx	
	To Purchasing Co.'s Suspense A/c			xxx
	(*Being the closing entry for creditors*)			
	4. For any loss incurred due to bad debts, discount allowed, payment of omitted liabilities, commission due to purchasing company or any other loss of the vendor company			
	Profit & Loss Adjustment A/c Dr.		xxx	
	To Purchasing Co. Suspense A/c			xxx
	(*Being the losses accounted for through the P&L adjustment A/c*)			
	(**Note:** *Reverse entry for any gain due to discount received, recovery of bad debts, which are written off*)			
	5. For distribution of net gain in P&L A/c adjustment A/c to capital A/c			
	Profit & Loss Adjustment A/c Dr.		xxx	
	To Capital A/c (Sole Proprietor)			xxx
	(or)			
	To Partner's Capital A/c			xxx
	(*Being the distribution of net gain to either the sole proprietor or to the partner's capital A/c*)			
	6. For amount received from the purchasing company as the difference between debtors and creditors			
	Bank A/c Dr.		xxx	
	To Purchasing Co.'s Suspense A/c			xxx
	(*Being the amount received from the purchasing company*)			

(*Contd.*)

	7. ***On distribution of cash to the sole proprietor or to the partners' capital***			
	Capital A/c (Sole Proprietor) Dr.		xxx	
	(or)			
	Partner's Capital A/c Dr.		xxx	
	To Bank A/c			xxx
	(*Being cash distributed to the owner or to the partner's capital*)			

Illustration 5

On 1st October 2011, Genius Ltd. purchased the business of Mr. Bhaskar, a sole trader, taking over all the assets with the exception of book debts amounting to ₹ 1,00,000 and creditors amounting to ₹ 50,000. The company undertook to collect all the book debts and pay off the creditors and for this service, it has to be paid a commission of 2 ½% on the amount collected and ½% on the amounts paid.

The debtors realised ₹ 90,000; out of which; ₹ 40,000 was paid to creditors in full settlement. The company was able to collect ₹4,000 debt, which was previously written off as bad by Mr. Bhaskar. The company was also forced to meet a contingent liability of ₹ 2,500 on account of a claim against the vendor for damages. The vendor received ₹ 10,000, 6% debentures of ₹ 100 each at ₹ 90 and the balance in cash in settlement of his account with the company.

Journalise the above transactions in the books of the purchasing company.

Solution:

Journal Entries in the Books of Genius Ltd.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.10.2011	1. ***For acquisition of debtors and creditors***			
	Vendor's Debtors A/c Dr.		1,00,000	
	To Vendor's Creditors A/c			50,000
	To Vendor's Suspense A/c			50,000
	(*Being the vendor's debtors and creditors taken over*)			
	2. ***For realisation of amount of debtors***			
	Bank A/c Dr.		90,000	
	Vendor's Suspense A/c Dr.		10,000	
	To Vendor's Debtors A/c			1,00,000
	(*Being cash realised from the debtors and the loss debited to vendor's suspense A/c*)			

(*Contd.*)

	3. For payment made to creditors			
	Vendor's Creditors A/c Dr.		50,000	
	To Bank A/c			40,000
	To Vendor's Suspense A/c			10,000
	(*Being the payment made to creditors and profit credited to vendor's suspense A/c*)			
	4. For previous debt collected now			
	Bank A/c Dr.		4,000	
	To Vendor's Suspense A/c			4,000
	(*Being the previous debt written off now collected*)			
	5. For payment of contingent liability			
	Vendor's Suspense A/c Dr.		2,500	
	To Bank A/c			2,500
	(*Being the contingent liability paid off*)			
	6. For commission due from vendor company			
	Vendor's Suspense A/c Dr.		2,562.50	
	To Commission A/c			2,562.50
	(*Being commission due on the collections made from the debtors 2½% and ½% for the payment made to the creditors*)			
	7. For final settlement with vendors regarding debtors and creditors			
	Vendor's Suspense A/c Dr.		45,892.50	
	Discount on Debentures A/c Dr.		1,000.00	
	To 6% Debentures A/c			10,000.00
	To Bank A/c			36,892.50
	(*Being vendor's A/c settled with issue of debentures and the balance in cash*)			

Illustration 6

Surya Ltd. was incorporated to take over the business of Jamuna on and from 1st January 2012. The following is the balance sheet of Jamuna, as on 31st December 2011:

Liabilities	(₹)	Assets	(₹)
Capital A/c	2,20,000	Land & Buildings	2,80,000
Loan Creditors	2,40,000	Plant & Machinery	1,60,000
Trade Creditors	80,000	Furniture	20,000
		Sundry Debtors	1,00,000
	5,60,000		5,60,000

The company took over the business with the fixed assets and loan creditors on the following basis:

(a) Depreciate land and building, plant and machinery and furniture by 10%.

(b) The value of goodwill is estimated at ₹ 1,26,000.

The company realised ₹ 96,000 from sundry debtors, as agent of the vendors in full settlement and discharged all the creditors by paying ₹ 72,000.

The loan creditors accepted 6% preference shares of ₹100 in discharge of loans. On realisation of debts and discharge of liabilities, the total amount due to vendor was settled by issue of fully-paid equity shares of ₹ 10 each.

You are required to pass the journal entries in the books of Surya Ltd.

Solution:

Since the Purchase Consideration is not given in the problem, the first step required to be done is to calculate the value of purchase consideration as follows:

Assets at book value:	(₹)
Goodwill	1,26,000
Land & Building (₹ 2,80,000 – ₹28,000)	2,52,000
Plant & Machinery (₹1,60,000 – ₹16,000)	1,44,000
Furniture (₹20,000 – ₹2,000)	18,000
	5,40,000
Less: Liabilities	
Loan Creditors taken over	2,40,000
Purchase Consideration	3,00,000

In the books of Surya Ltd.
Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
01.01.2012	Business Purchase A/c	Dr.		3,00,000	
	To Jamuna A/c				3,00,000
	(*Being purchase consideration due*)				
	Land & Building A/c	Dr.		2,52,000	
	Plant & Machinery A/c	Dr.		1,44,000	
	Furniture A/c	Dr.		18,000	

(*Contd.*)

	Goodwill (Bal. Fig.) A/c Dr.		1,26,000	
	To Loan Creditors A/c			2,40,000
	To Business Purchase A/c			3,00,000
	(*Being assets and liabilities taken over except debtors and trade creditors*)			
	Vendor's Debtors A/c Dr.		1,00,000	
	To Vendor's Creditors A/c			80,000
	To Jamuna's Suspense A/c			20,000
	(*Being vendor's debtors and creditors taken over on behalf of the vendors*)			
	Bank A/c Dr.		96,000	
	Jamuna's Suspense A/c Dr.		4,000	
	To Vendor's Debtors A/c			1,00,000
	(*Being amount realised from debtors and the loss transferred to Jamuna's suspense A/c*)			
	Vendor's Creditors A/c Dr.		80,000	
	To Bank A/c			72,000
	To Jamuna's Suspense A/c			8,000
	(*Being payment made to vendor's creditors and the profit transferred to Jamuna's suspense A/c*)			
	Loan Creditors A/c Dr.		2,40,000	
	To 6% Pref. Share Capital A/c			2,40,000
	(*Being the loan creditors discharged by the issue of preference shares*)			
	Jamuna's A/c Dr.		3,00,000	
	Jamuna's Suspense A/c Dr.		24,000	
	(₹20,000 + 8,000 – 4,000)			
	To Equity Share Capital A/c			3,24,000
	(*Being amount paid to Jamuna by issue of equity shares*)			

Illustration 7

On 31st December 2008, the following was the balance sheet of a firm:

Liabilities	(₹)	Assets	(₹)
Capital Accounts:		Fixed Assets:	
A 1,10,000		Factory building	66,000
B 1,10,000	2,20,000	Plant & Machinery	84,000
		Furniture	10,000

(*Contd.*)

Sundry Creditors	80,000	Current Assets:	
		Stock at Cost	30,000
		Sundry Debtors	70,000
		Cash in Hand & at Bank	40,000
	3,00,000		3,00,000

On 1st January 2009, the firm was converted into A Ltd. company on the following terms:

(a) Debtors and creditors of the firm were not to be taken over as well as the cash balances.

(b) Assets were revalued as to furniture at ₹6,000, Plant & Machinery at ₹80,000 and the building at ₹70,000.

(c) Preliminary expenses amounting to ₹4,000 were disbursed by the firm to be recovered from the company.

(d) As purchase consideration, the partners were to be allotted at par 26,000 equity shares of ₹10 each. They were also entitled to receive ₹40,000 in cash.

Give journal entries and submit the balance sheet as on 1st January 2009, of A Ltd. Company, assuming that the authorised capital shall be ₹4,00,000, made up wholly of equity shares of ₹10 each.

Solution:

In the books of A Ltd. Company
Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
01.01.2009	Business Purchase A/c	Dr.		3,00,000	
	To A Ltd. A/c				3,00,000
	(*Being the purchase consideration due*)				
	Factory Building A/c	Dr.		70,000	
	Plant & Machinery A/c	Dr.		80,000	
	Furniture A/c	Dr.		6,000	
	Stock A/c	Dr.		30,000	
	Goodwill (Bal. Fig.) A/c	Dr.		1,14,000	
	To Business Purchase A/c				3,00,000
	(*Being various assets and liabilities taken over except debtors, cash in hand and at bank and creditors*)				
	A Ltd. A/c	Dr.		3,00,000	
	To Equity Share Capital A/c				2,60,000
	To Bank				40,000
	(*Being purchase consideration paid as shares and cash*)				
	Preliminary Expenses A/c	Dr.		4,000	
	To Bank A/c				4,000
	(*Being preliminary expenses paid*)				

Notes to Accounts:

	(₹)
1. Share Capital:	
Authorised Capital	
40,000 Equity Shares of ₹10 each	4,00,000
Issued and Subscribed Capital:	
26,000 Equity Shares of ₹10 each	2,60,000
2. Reserves and Surplus:	
Profit & Loss (Debit Balance)	(4,000)
3. Short-term Borrowings:	
Bank Overdraft (40,000 + 4,000)	44,000
4. Tangible Assets:	
Buildings	70,000
Plant & Machinery	80,000
Furniture	6,000
	1,56,000
5. Intangible Assets:	
Goodwill	1,14,000

Balance Sheet of A Ltd. as on 01.01.2009 (as per revised schedule VI)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds:		
Share Capital	1	2,60,000
Reserves and Surplus	2	(4,000)
(ii) Non-Current Liabilities		—
(iii) Current Liabilities:		
Short-term Borrowings	3	44,000
Total: (i) + (ii) + (iii)		3,00,000
II. Assets:		
(i) Non-Current Assets:		
Tangible Assets	4	1,56,000
Intangible Assets	5	1,14,000
(ii) Current Assets:		
Stock		30,000
Total: (i) + (ii)		3,00,000

Working Note:

1. **Calculation of Purchase Consideration**

		(₹)
Equity Shares 26,000 × ₹10	=	2,60,000
Cash	=	40,000
Purchase Consideration	=	3,00,000

❍ When Same Set of Books are Maintained

The following steps are to be followed when the purchasing company decides to continue with the same set of books:

Step 1: Assets and Liabilities are to be revalued

In case the purchasing company undertakes the assets and liabilities, then they are to be revalued. The resultant profit or loss on revaluation has to be transferred to the capital account of the partners' in their old profit-sharing ratio or to the shareholder's account , if the vendor is a company.

Step 2: Assets and Liabilities not taken over are to be closed

In case a certain asset or liability is not taken over by the purchasing company, then, they have to be transferred to the capital accounts of the partners, in profit-sharing ratio.

On the other hand, if the vendor is a company, then a separate bank account has to be opened, in which the assets not taken over by the purchasing company will be realised and the liabilities not taken over by the purchasing company will be paid.

Step 3: Transfer of Undistributed/Accumulated Profits or Reserves

If there is any balance of undistributed or accumulated profits or reserves, then it will have to be transferred to the capital accounts of the partners, in profit-sharing ratio.

Step 4: Capital Accounts to be closed

The capital accounts are closed by debiting the capital accounts of partners or the shareholders' account and crediting the share capital account with the shares issued, debentures issued and bank account for the cash paid.

Step 5: Preparation of a Revised Balance Sheet

Finally, a revised balance sheet has to be prepared on the completion of the above steps.

Illustration 8

R and S, carrying on a business in partnership and sharing profits and losses in the ratio of 2:1, decide to dissolve the firm and sell the business to a ABC Ltd. Company on 31st March 2012. The balance of the firm was as follows:

Liabilities	(₹)	Assets	(₹)
Capital Accounts:		Cash at Bank	80,000
R 14,00,000		Sundry Debtors	12,00,000
S 10,00,000	24,00,000	Stock	16,20,000
Reserve Fund	4,50,000	Motor Vehicle	2,40,000
Sundry Creditors	4,50,000	Furniture	1,60,000
	33,00,000		33,00,000

ABC Ltd., was registered with an authorised capital of ₹1,00,00,000 in equity shares of ₹100, each to acquire the above business on the following terms:

(a) Goodwill is valued at ₹7,50,000.

(b) Furniture and stock valued at ₹1,45,000 and ₹17,45,000 respectively.

(c) Debtors are subject to 2 ½ % provision.

(d) Motor vehicle is no more required by the company and 'A' took over at ₹2,20,000.

The purchase price was satisfied by the issue of shares of ₹100 each at par. You are required to pass journal entries and prepare balance sheet of ABC Ltd., assuming that the same set of books is continued.

Solution:

In the books of ABC Ltd.
Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31.03.2012	Goodwill A/c Dr.		7,50,000	
	To R's Capital A/c			5,00,000
	To S's Capital A/c			2,50,000
	(*Being goodwill shared in the ratio of 2:1*)			
	Revaluation A/c Dr.		65,000	
	To Provision of Bad Debts A/c			30,000
	To Furniture A/c			15,000
	To Motor Vehicle A/c			20,000
	(*Being the assets revalued*)			
	Stock A/c Dr.		1,25,000	
	To Revaluation A/c			1,25,000
	(*Being the value of stock appreciated, i.e. 17,45,000 – 16,20,000*)			
	Revaluation A/c Dr.		60,000	
	To R's Capital A/c			40,000
	To S's Capital A/c			20,000
	(*Being profit on revaluation distributed among the partners in their profit-sharing ratio*)			

(*Contd.*)

	R's Capital A/c Dr.		2,20,000	
	To Motor Vehicle A/c			2,20,000
	(*Being motor vehicle taken over by R*)			
	Reserve Fund A/c Dr.		4,50,000	
	To R's Capital A/c			3,00,000
	To S's Capital A/c			1,50,000
	(*Being the reserve fund distributed to the partners in their profit-sharing ratio of 2:1*)			
	R's Capital A/c Dr.		20,20,000	
	(₹14,00,000 + ₹6,20,000)			
	S's Capital A/c Dr.		14,20,000	
	(₹10,00,000 + ₹4,20,000)			
	To Share Capital A/c			34,40,000
	(*Being purchase consideration paid to the partners*)			

Notes to Accounts:

	Note No.	(₹)
1. Share Capital:		
Authorised Capital		
1,00,000 Shares of ₹100 each	1	1,00,00,000
Issued and Subscribed Capital:		
34,400 Shares of ₹100 each, fully paid		34,40,000
2. Reserves and Surplus	—	—
3. Current Liabilities:		
Sundry Creditors	2	4,50,000
4. Tangible Assets:		
Furniture	3	1,45,000
5. Intangible Assets:		
Goodwill	4	7,50,000

Balance Sheet of ABC Ltd. as on 01.04.2012 (as per revised schedule VI)

	Note No.	(₹)
I. Equities and Liabilities		
(i) Shareholders Funds		
Share Capital	1	34,40,000
Reserves and Surplus	—	—
(ii) Non-Current Liabilities		—
(iii) Current Liabilities	2	4,50,000
Total: (i) + (ii) + (iii)		38,90,000

(*Contd.*)

II. Assets			
(i) Non-Current Assets:			
Tangible Assets		3	1,45,000
Intangible Assets		4	7,50,000
(ii) Current Assets:			
Stock			17,45,000
Debtors	12,00,000		
Less: Provision	30,000		11,70,000
Cash at Bank			80,000
Total: (i) + (ii)			38,90,000

Illustration 9

The following is the balance sheet of M/s Laurel and Hardy as on 31st December 2008.

Liabilities	(₹)	Assets	(₹)
Capital Accounts:		Cash at Bank	50,000
Laurel 7,00,000		Bills Receivable	50,000
Hardy 5,00,000	12,00,000	Sundry Debtors	3,00,000
Bills Payable	80,000	Stock-in-Trade	3,00,000
Sundry Creditors	2,20,000	Furniture	1,00,000
		Plant & Machinery	3,00,000
		Land & Building	4,00,000
	15,00,000		15,00,000

On 1st January 2009, the above business was purchased by Nick Ltd. for ₹14,00,000, to be paid by the issue of equity shares of ₹10 each, credited at ₹5 paid, upon the following terms:

(a) Land and Building and Plant and Machinery to be taken at ₹5,00,000 and ₹2,70,000 respectively.

(b) The company did not take over the furniture, which was disposable at ₹70,000 and also did not take bills payable, which were taken over by Laurel at an agreed value of ₹70,000.

(c) A provision for doubtful debt was also to be made @ 2.5% on debtors.

(d) There was a claim for bills discounted amounted to ₹5,000, which was taken by the company.

(e) The company did not take over a workers claim amounted to ₹6,000 due to accident.

Pass the journal entries in the books of Nick Ltd. assuming that same set of books is continued.

Solution:

In the books of Nick Ltd.
Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
01.01.2009	Revaluation A/c Dr.		89,500	
	To Plant & Machinery A/c			30,000
	To Provision for Doubtful Debts			7,500
	To Furniture A/c			30,000
	To Claim for Bills Discount A/c			10,000
	To Claim for Accident A/c			12,000
	(*Being assets and liabilities revalued*)			
	Bills Payable A/c Dr.		10,000	
	Land and Building A/c Dr.		1,00,000	
	To Revaluation A/c			1,10,000
	(*Being the decrease in the value of bills payable and increase in the value of land and building*)			
	Goodwill A/c (see W.N 1)		1,67,500	
	To Laurel's Capital A/c			83,750
	To Hardy's Capital A/c			83,750
	(*Being goodwill raised in the books of accounts*)			
	Revaluation A/c Dr.		20,500	
	To Laurel's Capital A/c			10,250
	To Hardy's Capital A/c			10,250
	(*Being profit on revaluation transferred to partners' capital A/c*)			
	Claim for Accident A/c Dr.		12,000	
	To Laurel's Capital A/c			7,112
	To Hardy's Capital A/c			4,888
	(*Being claim distributed in the final claim, i.e. 16:11*)			
	Laurel's Capital A/c Dr.		41,482	
	Hardy's Capital A/c Dr.		28,518	
	To Furniture A/c			70,000
	(*Being amount of proceeds realised from furniture shared in the ratio of 16:11*)			

(*Contd.*)

	Bills Payable A/c Dr.		70,000	
	To Laurel's Capital A/c			70,000
	(*Being bills payable taken over by Laurel*)			
	Laurel's Capital A/c Dr.		8,29,630	
	Hardy's Capital A/c Dr.		5,70,370	
	To Equity Share Capital A/c			14,00,000
	(*Being the final settlement made by the issue of shares*)			

Working Notes:

1. **Calculation of Goodwill:**

Particulars	(₹)	(₹)
Assets taken over		
Land and Building	5,00,000	
Plant and Machinery	2,70,000	
Stock-in-Trade	3,00,000	
Sundry Debtors	2,92,500	
Bills Receivable	50,000	
Cash at Bank	50,000	14,62,500
Less: Liabilities taken over:		
Creditors	2,20,000	
Claim for Bills Discounted	10,000	2,30,000
Net Assets taken over		12,32,500
Less: Purchase Consideration		14,00,000
Goodwill		1,67,500

2. **Calculation of Ratio of Final Claim**

Particulars	Laurel	Hardy
Balance b/d	7,00,000	5,00,000
Bills Payable	70,000	—
Goodwill	83,750	83,750
	8,53,750	5,83,750
Add: Revaluation Profit	10,250	10,250
	9,64,000	5,94,000
Ratio	16	11

Accounting Treatment for debtors and creditors not taken over when same set of books are continued:

When the same set of books are continued and debtors and creditors are not taken over, the following steps have to be adopted:

Step 1: Debtor's and Creditor's account must not be closed.

Step 2: Separate accounts have to be opened, namely, Debtors' Suspense A/c and Creditors' Suspense A/c

Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Vendor A/c	Dr.		xxx	
	To Debtor's Suspense A/c				xxx
	(*Being debtors not taken over transferred to debtors suspense A/c*)				
	Creditor's Suspense A/c	Dr.		xxx	
	To Vendor A/c				xxx
	(*Being the creditors not taken over transferred to creditors suspense A/c*)				
	Cash/Bank A/c	Dr.		xxx	
	Discount Allowed A/c	Dr.		xxx	
	To Debtors A/c				xxx
	(*Being amount collected from debtors*)				
	Debtor's Suspense A/c	Dr.		xxx	
	To Vendor A/c				xxx
	To Discount allowed				xxx
	(*Being debtor's suspense considered*)				
	Creditors A/c	Dr.		xxx	
	To Cash A/c				xxx
	To Discount Received A/c				xxx
	(*Being amount paid to creditors*)				
	Vendor's A/c	Dr.		xxx	
	Discount Received A/c	Dr.		xxx	
	To Creditor's Suspense A/c				xxx
	(*Being creditors suspense considered*)				

Illustration 10

Joseph Ltd. purchased the business of Mr. Rayan. Joseph Ltd. did not take over the debtors and creditors of Mr. Rayan amounting to ₹2,00,000 and ₹1,40,000 respectively, but promised to collect from debtors and pay to creditors.

Joseph Ltd. collected all debts at a discount of ₹5,000 and a bad debt of ₹2,000 and paid all creditors at a discount of ₹3,000. Show the entries assuming the same set of books is continued.

Solution:

Calculation of Amount Due to Vendor on Final Settlement:

	(₹)
Amount Received from Debtors (₹2,00,000 – 5,000 – 2,000)	1,93,000
Less: Amount Paid to Creditors (₹1,40,000 – 3,000)	1,37,000
Net Amount Due to Vendor	56,000

In the books of Joseph Ltd.
Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Rayan A/c	Dr.		2,00,000	
	To Debtors Suspense A/c				2,00,000
	(*Being new debtors A/c opened*)				
	Creditors Suspense A/c	Dr.		1,40,000	
	To Rayan A/c				1,40,000
	(*Being new creditors A/c opened*)				
	Cash A/c	Dr.		1,93,000	
	Discount Allowed A/c	Dr.		5,000	
	Bad Debt A/c	Dr.		2,000	
	To Debtors A/c				2,00,000
	(*Being amount collected from debtors*)				
	Debtors Suspense A/c	Dr.		2,00,000	
	To Discount Allowed A/c				5,000
	To Bad Debt A/c				2,000
	To Rayan A/c				1,93,000
	(*Being cancellation of debtors suspense A/c, bad debt and discount allowed A/c*)				
	Creditors A/c	Dr.		1,40,000	
	To Discount Received A/c				3,000
	To Cash A/c				1,37,000
	(*Being payment made to creditors*)				
	Rayan A/c	Dr.		1,37,000	
	Discount Received A/c	Dr.		3,000	
	To Creditors Suspense A/c				1,40,000
	(*Being cancellation of discount received A/c and creditors suspense A/c*)				
	Rayan A/c	Dr.		56,000	
	To Cash A/c				56,000
	(*Being payment of amount due to vendor*)				

THEORY QUESTIONS

I. Short-Answer Questions

1. What do you mean by "acquisition of business"?
2. What are the two accounting approaches that can be adopted by the purchasing Company?
3. How is Goodwill calculated?
4. How do you determine capital reserve?
5. What is vendor's suspense A/c?

II. Long-Answer Questions

1. Explain the steps to be taken by a purchasing company when new set of books are opened to record the transactions.
2. Explain the steps to be taken by a purchasing company when same set of books are Continued to record the transactions.
3. State the accounting treatment to be adopted when the debtors and creditors are not taken over by the purchasing company when new set of books are opened.

OBJECTIVE-TYPE QUESTIONS

I. Multiple Choice Questions

1. The purchasing company can record the transactions in their books as:
   (a) New set of books opened (b) To continue the same set of books
   (c) Any of the above two (d) None of these
2. In the absence of a contract, which of the following item is not taken over by the purchasing company at the time of acquisition of business:
   (a) Profit and Loss Debit Balance (b) Cash Balance
   (c) Bank Balance (d) None of these
3. In the absence of an agreement, which of the following is taken over by the purchasing company, at the time of acquisition of a business:
   (a) Share Capital (b) External Liabilities
   (c) Reserve Fund (d) Undistributed Profits
4. Payment of purchase consideration can be in the form of:
   (a) Shares (b) Debentures
   (c) Cash (d) All of the above
5. Goodwill A/c will be debited if:
   (a) The value of net assets is less than purchase price
   (b) The value of net assets is greater than the purchase price
   (c) (a) and (b) above
   (d) None of these

6. The excess of net assets over the purchase consideration is called as:
   (a) Goodwill
   (b) Net Loss
   (c) Capital Reserve
   (d) Balance in Suspense A/c
7. When the debtors and creditors are taken over by the purchasing company on behalf of:
   vendors, then the purchasing company opens an A/c called as:
   (a) Debtor's Suspense A/c
   (b) Creditor's Suspense A/c
   (c) (a) and (b)
   (d) Vendor's suspense A/c
8. Any profit or loss arising on account of realising book debts and discharging creditors will be borne by:
   (a) The purchasing company
   (b) The vendor
   (c) (a) and (b)
   (d) None of these
9. Capital Reserve A/c is credited with the difference amount:
   (a) When the value of net assets is less than the purchase price
   (b) When the value of net assets is greater than the purchase price
   (c) (a) and (b)
   (d) None of the above
10. When the purchasing company maintains the same set of books, then the amount realised from the proceeds of assets taken over by the partners will be distributed in the ratio of:
    (a) Profit-sharing
    (b) Capitals
    (c) 1:1
    (d) Final claim

[*Ans:* 1. (c); 2. (a); 3. (b); 4. (d); 5. (a); 6. (c); 7. (d) 8. (b); 9. (b); 10. (b)]

II. True and False

1. Purchase consideration must be paid only in cash.
2. Purchase consideration is always given in the problems, so it need not be computed.
3. Miscellaneous expenses are also taken over by the purchasing company, in the absence of a contract to the contrary.
4. The difference has to be credited to goodwill A/c, when the value of net assets is less than the purchase price.
5. Profit on acquisition has to be credited to capital reserve A/c.
6. Interest account is debited when the interest is paid on purchase price.
7. The vendor company pay commission to the purchasing company for realising book debts and making payment to the creditors.
8. The purchasing company has to bear any profit or loss that arises in collecting debts and paying creditors.
9. Realisation account has to be opened when the same set of books is continued by the purchasing company.
10. When discount is received from vendor's creditors, then it will be credited to Vendor's suspense account.

[*Ans:* 1. False 2. False 3. False 4. False 5. True 6. False 7. True 8. False 9. True 10. True.]

III. Fill in the Blanks

1. The purchase price paid by the purchasing company to the selling company is called as ____________
2. The newly formed limited companies purchase the business of ____________ or ____________ form of business concern.
3. ____________ assets are not taken over by the purchasing company.
4. All ____________ liabilities are taken over by the purchasing company.
5. The selling company is called as ____________ company in the acquisition of a business.
6. When the value of net assets is less than the purchase price, the difference is debited to ____________ A/c.
7. When the value of net assets is more than the purchase price, the difference is credited to ____________ A/c.
8. When the purchasing company takes over debtors and creditors on behalf of the vendor's then, ____________ A/c has to be opened.
9. When the same set of books is continued, a separate account for debtors should be opened under the ____________ A/c.
10. When shares of debentures are issued at a premium, ____________ A/c has to be credited with premium amount.

[*Ans:* 1. Purchase Consideration 2. Sole Proprietorship or Firm 3. Miscellaneous 4. External 5. Vendor 6. Goodwill 7. Capital Reserve 8. Vendor's Suspense A/c 9. Debtor's Suspense A/c 10. Securities Premium]

EXERCISE PROBLEMS

1. Pradeep Ltd. has taken over the business of Mr. Sandeep and agreed to pay the purchase price as given below:
   (a) 2,800 shares of ₹50 each fully paid at ₹60 per share.
   (b) ₹25,000 in 8% preference shares of ₹100 each issued at premium of 25% and
   (c) ₹20,000 in Cash.

   You are required to compute the amount of purchase consideration payable to Mr. Sandeep. **(Madras University, B.Com. (PZ3A), Nov 2008)**

   [*Ans:* Purchase consideration: ₹2,13,000]
2. A Ltd. purchased business of A & Co., and agreed to settle purchase consideration by the allotment of:

   2,000 Equity shares of ₹10 each at 10% premium to partners.

   1,000 10% Debentures of ₹100 each at par for loan creditors, and

   ₹1,00,000 in cash to partners. Calculate purchase consideration.

   [*Ans:* Purchase consideration: ₹2,22,000]
3. M/s Jain and Narang had on 31.03.09 capitals standing at ₹75,000 and ₹50,000; Sundry creditors on that date were ₹15,000. Goodwill stood in the books at ₹10,000. The partners sold their business to an existing company for 12,500 shares of ₹10 each issued at a premium of ₹2 per share. At what value the company record the goodwill on purchase and at what figure will it appear in the company's balance sheet? [*Ans:* ₹70,000 in either case]

4. Anita Co., Ltd. was formed for taking over the business of Mr. Ganapathi. The purchase consideration was ₹1,92,000 which will be settled by issue of 960 shares of ₹100 each at a discount of 5% and balance in cash. Assets taken over were ₹2,10,000 and Liabilities taken over were ₹30,000. Give journal entries in the books of Anita Co. Ltd.

[*Ans:* Goodwill: ₹12,000]

5. Pass journal entries to record the following transactions in the books of XY Ltd.

Name of the Purchasing Company:	XY Ltd.
Name of the Vendor:	Raman
Purchase price:	₹2,15,000
Mode of payment of purchase price:	10,000 equity shares of ₹10 each at a Premium of ₹2 and balance in cash.
Value of assets taken over:	₹2,60,000
Liabilities taken over:	₹30,000

[*Ans:* Capital Reserve: ₹5,000]

6. C Ltd. does not want to take over debtors and creditors of vendor. However, it agreed to collect from debtors and pay to creditors for a commission of 4% on amount collected and 2% on amount paid. The debtors realized ₹1,90,000 only, out of which ₹60,000 was paid to creditors. Calculate the amount of Commission earned and amount payable to vendor.

[*Ans:* Commission: ₹8,800; Amount payable: ₹1,21,200]

7. A Ltd. agreed to collect the debts and pay the creditors on behalf of Senthil from whom the company had acquired a running business. The firm's debtors and creditors totaled ₹1,50,000 and ₹50,000 respectively. The debtors realized ₹1,48,300 only and the creditors were paid ₹42,000 in full settlement. The company is entitled to a commission of 2.5% on amounts realized and 1% on amounts paid. Prepare Senthil's Suspense A/c assuming the final settlement was made in cash.

[*Ans:* Amount due to Senthil: ₹95,750]

8. AK Ltd. purchased the business of Anish Kanth & Brothers and decided to continue the same set of books. The company decided to make the following revaluations:
   (a) Buildings to be appreciated by ₹1,20,000.
   (b) Plant & Machinery to be depreciated by₹14,000.
   (c) Stocks to be revalued at ₹80,000 (Book value ₹50,000).
   (d) Creditors agreed to reduce their claim by ₹10,000
   (e) Outstanding expenses net provided amounted to ₹20,000

   You are required to prepare Revaluation A/c.

[*Ans:* Revaluation Profit: ₹1,26,000]

9. Shalini Ltd. purchased the business of Mr. Venkat. Shalini Ltd. did not take over the debtors and creditors of Mr. Venkat amounted to ₹65,000 and ₹40,000 respectively, but it promised to collect from debtors and pay to creditors. Shalini Ltd. collected ₹61,500 from debtors and paid all creditors ₹38,800. Calculate the net amount due to Mr. Venkat assuring that same set of books is continued.

[*Ans:* Net amount due to Venkat: ₹22,700]

10. Ashish Ltd. was formed with an authorised capital of ₹48,00,000, divided into equity shares of ₹10 each, to acquire the business of Mr. Gupta, whose balance sheet on the date of acquisition was as follows:

Liabilities	Amount (₹)	Assets		Amount (₹)
Capital	24,00,000	Freehold Premises		28,00,000
General Reserves	16,00,000	Stock		8,00,000
Sundry Creditors	8,00,000	Sundry debtors	6,40,000	
		Less: PBDD	40,000	6,00,000
		Cash at Bank		6,00,000
	48,00,000			48,00,000

The purchase consideration was agreed upon at ₹56,00,000 to be paid in ₹48,00,000.

Fully-paid equity shares at ₹11 and the balance in cash. Give journal entries and prepare the balance sheet of Ashish Ltd., assuming the vendor's account is finally settled.

[*Ans:* Goodwill: ₹16,00,000; Balance Sheet Total: ₹60,80,000]

11. Ranga Ltd. was formed with an authorised capital of ₹12,00,000, divided into equity shares of ₹10 each, to acquire the business of 'A' and 'B', whose balance sheet on the date of acquisition was as follows:

Liabilities	(₹)	Assets		(₹)
Capital	6,00,000	Freehold Premises		7,00,000
General Reserves	4,00,000	Stock		2,00,000
Sundry Creditors	2,00,000	Debtors	1,60,000	
		Less: Provision for Bad Debts	10,000	1,50,000
		Cash at Bank		1,50,000
	12,00,000			12,00,000

The purchase consideration was agreed upon at ₹14,00,000 to be paid in ₹12,00,000. Fully paid equity shares at ₹11 and the balance in cash. Give journal entries to record the above transactions and prepare the balance sheet of Ranga Ltd., assuming the vendor's account its finally settled.

[*Ans:* Goodwill: ₹4,00,000 ; Balance Sheet Total: ₹15,20,000]

12. Swami Ltd. was formed with an authorised capital of ₹20,00,000, divided into equity shares of ₹10 each, to acquired the business of P&M, whose balance sheet on the date of acquisition was as follows:

Liabilities	(₹)	Assets		(₹)
Capital	10,00,000	Freehold Premises		14,00,000
General Reserves	7,00,000	Stock		2,00,000
Sundry Creditors	3,00,000	Sundry Debtors	2,70,000	
		Less: Provision for Bad Debts	20,000	2,50,000
		Cash at Bank		1,50,000
	20,00,000			20,00,000

The purchase price was agreed upon at ₹23,00,000, to be paid in ₹20,00,000 fully-paid equity shares of ₹11 and the balance in cash.

You are required to record the above and prepare the balance sheet of Swami Ltd., assuming the vendor's account is finally settled.

[*Ans:* Goodwill: ₹6,00,000; Balance Sheet Total: ₹25,00,000]

13. D Ltd. was formed to take over the assets and liabilities of Mr. L and to acquire the adjacent premises. The balance sheet of Mr. L on 31st December 2008 was as follows:

Liabilities	(₹)	Assets	(₹)
Capital	1,60,000	Cash in Hand	2,000
Trade Creditors	8,000	Cash at Bank	12,000
		Book Debts	18,000
		Stock	78,000
		Furniture	10,000
		Land and Buildings	48,000
	1,68,000		1,68,000

The purchase consideration was agreed at ₹2,00,000 and was to be paid as under:

(a) 5,600 equity shares of ₹20 each, fully paid

(b) ₹68,000 in 6% preference shares of ₹100 each, issued at par

(c) ₹20,000 in cash

All the assets and liabilities were valued as per above balance sheet, except the book debts, which were subject to a bad debts provision of 5%.

The company raised further capital by issue of 15,000 equity shares of ₹20 each.

The adjoining premises were purchased for ₹1,00,000 and additional stock of ₹1,40,000 was obtained from open market.

Record the transactions in the books of D Ltd., through journal entries and also prepare its opening Balance Sheet.

[*Ans:* Goodwill: ₹40,900; Balance Sheet Total: ₹4,88,000]

14. The business of Mr. A was taken over by Mr. B Ltd., on 31st December 2016. The balance sheet of Mr. A was as follows:

Liabilities	(₹)	Assets	(₹)
A's Capital	43,450	Bank	2,500
Bills Payable	3,700	Stock	19,700
Creditors	12,650	Debtors	13,650
General Reserves	5,000	Computers	1,250
		Furniture	2,300
		Machinery	22,400
		Goodwill	3,000
	64,800		64,800

The company takes over the assets and liabilities. The purchase consideration was agreed at ₹40,830; out of this, ₹33,000 was in equity shares of ₹100 each, at 10% premium and for the balance, cash is to be given.

B Ltd., valued to stock and computers at 10% and 20% respectively less than the book values. Machinery was valued at ₹25,000.

Pass journal entries in the books of the purchasing company.

[*Ans:* Capital Reserve: ₹5,000]

15. Mithran Ltd. was formed to take over the assets and liabilities of Mr. Anil and to acquire the adjacent premises. The balance sheet of Mr. Anil on 31st March 2016 was as follows:

Liabilities	(₹)	Assets	(₹)
Capital	4,80,000	Cash in Hand	5,000
Trade Creditors	20,000	Cash at Bank	30,000
		Book Debts	25,000
		Stock-in-Trade	1,00,000
		Furniture	20,000
		Lands and Buildings	3,20,000
	5,00,000		5,00,000

The purchase consideration was agreed at ₹6,00,000 and was paid as follows:

(a) 4,800 equity shares of ₹50 each

(b) 3,200 10% preference shares of ₹100 each, issued at par

(c) ₹40,000 in cash

All the assets and liabilities were valued as per the above balance sheet, except the book debts, which were subject to a bad debts provision of 10%.

The company raised further capital by issue of 15,000 equity shares of ₹50 each.

The adjoining premises were purchased for ₹1,00,000 and additional stock for ₹50,000 was got from open market. You are required to record the above transactions in the books of Mithran Ltd. through journal entries and prepare its balance sheet.

[*Ans:* Good will: ₹1,22,500; Balance Sheet Total: ₹13,30,000]

16. New company Limited was formed on 1st January 1998, with an authorised capital of ₹7,00,000, divided into 50,000 equity shares of ₹10 each and 2,000 preference shares of ₹100 each, to acquire the business of William as a going concern The balance sheet of William as at 31st December 1998 is given below:

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	7,500	Cash at Bank	3,800
A's Loan A/c	15,500	Sundry Debtors	9,700
William's Capital A/c	1,57,000	Stock-in-Trade	36,000
		Furniture	3,500
		Plant & Machinery	70,000
		Land & Buildings	57,000
	1,80,000		1,80,000

The purchase consideration was to be discharged by new company by New Company Limited by the issue of 15,000 equity shares, of ₹10 each, 500 preference shares of ₹100 each, and ₹20,000 in cash. New company Limited also agreed to discharge the sundry creditors but declined to accept A's Loan. All the assets of the old company were taken over at their balance sheet values, except stock, which was valued at ₹40,000. A provision of 5% was also created against sundry debtors.

To provide necessary working capital and to pay the purchase consideration, the remaining equity shares were issued at a premium of 10% and all cash was duly received. The company paid the preliminary expenses, amounting to ₹15,000, immediately after the issue. Show the opening entries in the books of the New Company Limited and also the opening balance sheet.

[*Ans:* Goodwill ₹43,985; Balance Sheet Total: ₹1,30,500]

17. Danny Ltd. was formed with a nominal capital of ₹20,00,000, consisting of 1,00,000 equity shares of ₹20 each and 6,000 preference shares of ₹100 each, to acquire on 01 April 2016, the business of Yogi & Co.

Yogi & Co.'s balance sheet as on 31st March 2016 was as follows:

Liabilities	(₹)	Assets	(₹)
Capital	9,00,000	Land and Building	5,00,000
Trade Creditors	2,50,000	Plant and Machinery	3,00,000
Bank Overdraft	1,00,000	Stock	2,00,000
		Debtors	2,50,000
	12,50,000		12,50,000

The company took over all the assets and assumed all the liabilities and the consideration was fixed at ₹13,00,000.

In computing this amount, land and buildings were valued at ₹7,00,000; Plant & Machinery at ₹2,00,000; Stock at ₹1,90,000; and debtors at book value subject to an allowance of 5% to cover bad debts. The bank agreed the transfer of the bank overdraft to the company on condition that debentures for ₹1,50,000 were issued to the bank as collateral security.

The purchase price was settled by issue of 50,000 equity shares of ₹20 each at par, 2,000 preference shares of ₹100 each and the balance being paid in cash. Danny Ltd. paid the preliminary expenses of ₹20,000. You are required to pass journal entries in the books of Danny Ltd and Yogi & Co.

[*Ans:* Goodwill ₹3,22,500 ; Realization Profit : ₹4,00,000.]

18. Tamilnadu & Co., which was run by Saravanan and Murugan, was taken over by Anna Ltd. on 31st December 1985. The balance sheet of Tamilnadu & Co. was as follows:

Liabilities		(₹)	Assets	(₹)
Bills Payable		3,700	Bank	2,500
Creditors		12,650	Stock	19,700
General Reserve		5,000	Debtors	13,650
Capital Account			Typewriter	1,250
Saravanan	28,250		Furniture	2,300
Murugan	15,200	43,450	Machinery	22,400
			Goodwill	3,000
		64,800		64,800

The company takes over assets and liabilities. The purchase consideration was agreed at ₹40,830. Out of this, ₹33,000 in equity shares of ₹100 each at 10% premium and for the balance cash is to be given. Anna Ltd. valued the stock and typewriter at 10% and 20% respectively, less than the book values. Machinery was valued at ₹25,000. Give journal entries in the books of the purchasing company.

[*Ans:* Capital Reserve: ₹5,000]

19. The business run by Mr. R was taken over by Mr. S on 31st December 2016. The balance sheet of Mr. R was as follows:

Liabilities	(₹)	Assets	(₹)
R' Capital	43,450	Bank	2,500
Bills Payable	3,700	Stock	19,700
Creditors	12,650	Debtors	13,650
General Reserves	5,000	Typewriter	1,250
		Furniture	2,300
		Machinery	22,400
		Goodwill	3,000
	64,800		64,800

The company takes over assets and liabilities. The purchase consideration was agreed at ₹40,840. Out of this, ₹33,000 issued in equity shares of ₹100 each at 10% premium and for the balance cash is to be given. S Ltd. valued the stock and typewriter at 10% and 20% respectively less than the book values. Machinery was valued at ₹25,000. Pass journal entries in the books of the purchasing company.

[*Ans:* Capital Reserve: ₹5,000]

20. The business run by Mr. G was taken over by H Ltd. on 31st December 2016. The balance sheet of Mr. G was as follows:

Liabilities	(₹)	Assets	(₹)
G's Capital	86,900	Bank	5,000
Bills Payable	7,400	Stock	39,400
Creditors	25,300	Debtors	27,300
General Reserves	10,000	Typewriter	2,500
		Furniture	4,600
		Machinery	44,800
		Goodwill	6,000
	1,29,600		1,29,600

The company takes over assets and liabilities. The purchase consideration was agreed at ₹81,660. Out of this, ₹66,000 in equity shares of ₹100 each at 10% premium has been issued and for the balance cash is to be given. H Ltd valued the stock and typewriter at 10% and 20% respectively less than the book values. Machinery was valued at ₹50,000. Pass the journal entries in the books of the H Ltd.

[*Ans:* Capital Reserve: ₹10,000]

21. D Ltd. was formed to acquire the business from Mr. A for ₹5,00,000, payable as ₹2,50,000 in cash and the balance in shares. The capital of the company was ₹10,00,000 divided into 1,00,000 shares of ₹10 each. It issued to the public 55,000 shares as ₹3 on application, ₹4 on allotment and the balance on first and final call.

    The purchase consideration was fully satisfied. The preliminary expenses ₹22,000 were paid by the company. Shareholders holding 820 shares failed to pay the first and final call and after due notice, their shares were forfeited according to the articles of association. The shares were re-issued subsequently at a price of ₹6 per share. Give the journal entries necessary to record the transactions.

    [*Ans:* Shares Forfeited A/c Dr. to Capital Reserve: ₹2,460]

22. On 1st January 1998, Gavin Larsen Ltd. purchased all the assets and liabilities of Madan but did not take over vendors debtors of ₹47,500. It undertook the responsibility of collecting them and out of this realisation, pay vendors' creditors of ₹30,000. Company gets commission for the service @ 5% on payments and 10% on realisation. Company realised such a debt of ₹400, which was previously declared as bad debt. Company has also to pay a contingent liability of ₹2,000 on account of a claim against the vendors for damages. Realisation from debtors amounted to ₹45,000 and out of this amount, ₹28,000 was paid to creditors in full settlement of their account. Pass the necessary journal entries in the books of the purchasing company.

    [*Ans:* Commission: ₹6,040; Final Settlement of Madan by cash: ₹9,360]

23. On 1st October 2016, K Ltd. purchased the business of Mrs. Lakshmi, a sole trader, taking over all the assets with the exception of book debts amounting to ₹2,00,000 and creditors amounting to ₹1,00,000. The company undertook to collect all the book debts and pay off the creditors and for this service, it has to be paid a commission of 2½% on the amount collected and ½% on amounts paid.

    The debtors realised ₹1,80,000, out of which, ₹80,000 was paid to creditors in full settlement. The company was able to collect ₹8,000 debt, which was previously written off as bad by Mrs Lakshmi. The company was also forced to meet a contingent liability of ₹5,000 on account of a claim against the vendor for damages. The vendor received ₹20,000, 6% debentures of ₹100 each at ₹90 and the balance in cash in settlement of his account with the company. Give journal entries in the books of the purchasing company.

    [*Ans:* Commission: ₹5,125]

24. On 1st April 2016, Nattu Ltd. acquired the business of Mr. Hari, taking over all the assets with the exception of book debts, which it undertook to collect on behalf of Mr. Hari and out of the proceeds, pay the liabilities owing at the date of the transfer. On that date, the book debts amounted to ₹54,000 and creditors ₹37,000. The company agreed to do the job for vendors on 3% commission on amount collected and 1% on amount paid. The company could not collect ₹2,800 from the existing debtors and allowed ₹300 as cash discount to the remaining debtors. The company could collect the time barred debt (which was written off as bad by the vendors) of ₹2,000. The company paid ₹35,000 to creditors in satisfaction of total amount due. However, the company was forced to meet a contingent liability on bills discounted by the vendors of ₹3,000. Pass journal entries in the books of Nattu Ltd.

    [*Ans:* Commission: ₹1,967]

25. On 1st July 2016, Janu Ltd. acquired the business of Mr. Arul, taking over all the assets with the exception of book debts, which it undertook to collect on behalf of Mr. Arul and out of the proceeds pay the liabilities owing at the date of the transfer. On that date, the book debts amounted to ₹1,08,000 and creditors ₹74,000. The company agreed to do the job for vendors on 3% commission on amount collected and 1% on amount paid. The company could not collect ₹500 from the existing debtors and allowed ₹600 as cash discount to the remaining debtors. The company could collect the time barred debt (which was written off as bad by the vendors) of ₹4,000. The company paid ₹70,000 to creditors in satisfaction of total amount due. However, the company was forced to meet a contingent liability on bills discounted by the vendors of ₹6,000. Pass journal entries in the books of Janu Ltd.

[*Ans:* Commission: ₹3,934; and Cash Paid to Vendors: ₹25,866]

26. X Ltd. was incorporated for taking over the business of Y from 1st April 2016. The following was the balance sheet of Y as on 31st March 2016:

Liabilities	(₹)	Assets	(₹)
Capital	2,01,600	Land and Building	3,20,000
Loan Creditors	2,40,000	Plant and Machinery	56,000
Trade Creditors	1,42,200	Furniture	40,000
		Sundry Debtors	1,68,000
	5,84,000		5,84,000

The company took over the business with fixed assets and loans on the following terms:

(a) The fixed assets should be depreciated at 10%.

(b) The value of goodwill is estimated at ₹1,60,000.

The company realised ₹1,60,000 from sundry debtors as the agent of the vendor in full settlement and discharged all the creditors by paying ₹1,36,000 for a commission of 3% on the amount collected and 2% on the amount paid.

The loan creditors accepted 10% preference shares of ₹100 each in discharge of the loans. After realisation of the debts and discharge of the liabilities, the total amount due to the vendor was settled by payment of ₹10,880 in cash and the balance in the form of fully-paid equity shares of ₹10 each.

Calculate purchase consideration and pass journal entries in the books of the company and also prepare the balance sheet of the company.

[*Ans:* Purchase Consideration: ₹2,94,400; Balance Sheet Total: ₹5,46,520]

27. Suraj Ltd. was incorporated for taking over the business of Mrs. Kasthuri from 1st April 2016. The following is the balance sheet of Mrs. Kasthuri on 31st March 2016:

Liabilities	(₹)	Assets	(₹)
Capital	1,00,800	Land and Building	1,60,00
Loan Creditors	1,20,000	Plant and Machinery	28,000
Trade Creditors	71,200	Furniture	20,000
		Sundry Debtors	84,000
	2,92,000		2,92,000

The company takes over the business with fixed assets and loans on the following terms:

(i) The fixed assets should be depreciated at 10%.

(ii) The value of goodwill is estimated at ₹80,000.

The company realised ₹80,000 from sundry debtors as the agent of the vendor is full settlement and discharged all the trade creditors by paying ₹68,000 for a commission of 3% on the amount collected and 2% on the amount paid.

The loan creditors accepted 10% preference shares of ₹100 each in discharge of the loans.

After realisation of the debts and discharge of the liabilities, the total amount due to the vendor was settled by payment of ₹5,440 in cash and the balance in the form of fully-paid equity shares of ₹10 each.

Calculate purchase consideration and pass journal entries in the books of the company and prepare the balance sheet of the purchasing company.

28. On 31st December 1998, the following was the balance sheet of a firm:

Liabilities	(₹)	Assets	(₹)
Capital Accounts		Fixed assets	
A 55,000		Factory Building	33,000
B 55,000	1,10,000	Plant & Machinery	42,000
		Furniture	5,000
Sundry Creditors	40,000	Current assets	
		Stock at Cost	15,000
		Sundry debtors	35,000
		Cash in Hand and at Bank	20,000
	1,50,000		1,50,000

On 1st January 1999, the firm was converted into a limited company on the following terms:

(a) Debtors and creditors of the firm were not be taken over as well as the cash balances.

(b) Assets were revalued as to furniture at ₹3,000, plant and machinery at ₹40,000 and the building at ₹35,000.

(c) Preliminary expenses amounting to ₹2,000 were disbursed by the firm to be recovered from the company.

(d) As purchase consideration, the partners were to be allotted at par 13,000 equity shares of ₹10 each. They were also entitled to receive ₹20,000 in cash.

Give journal entries and submit the balance sheet as at 1st January 1999, of the limited company, assuming the authorised capital to be ₹2,00,000, made up wholly of equity shares of ₹10 each.

[*Ans:* Goodwill: ₹57,000; Balance Sheet Total: ₹1,50,000]

29. On 1st January 2016, Vincent Ltd. acquired the business of Sagar, taking all the assets with the exception of book debts, which it undertook to collect on behalf of Sagar and out of the proceeds, pay the liabilities owning at the date of transfer. At that date, the book debts amounted to ₹2,70,000 and creditors ₹1,85,000. The

company agreed to do the job for vendors on 3% commission on the amounts collected and 1% on amount paid.

The company could not collect ₹14,000 from the existing debtors and allowed ₹1,500 as cash discount to the remaining debtors. The company could collect the time-barred debt (which was written off as bad by the vendors) of ₹10,000. The company paid ₹1,75,000 to creditors in satisfaction of total amount due. However, the company was forced to meet a contingent liability on bills discounted by the vendors of ₹15,000. Give journal entries (including that of cash) in the books of Vincent Ltd.

[*Ans:* Commission: ₹9,835]

30. A and B are in partnership in computer components manufacturers. The balance sheet of A and B, as on 31st December 2016 was as follows:

Liabilities	(₹)	Assets	(₹)
Capital Accounts:		Cash at Bank	82,500
A: 7,95,100		Debtors	5,28,600
B: 7,95,100	15,90,200	Stock	4,40,900
		Plant	5,00,000
Creditors	2,62,100	Land and Building	3,00,000
	18,52,300		18,52,300

They decided to sell their business as from the above date to Chip Ltd. The company acquired the stock, plant, land and buildings and goodwill, for which the vendors receive ₹15,00,000 in fully-paid equity shares of ₹100 each. The company agrees to pay creditors and collect the book debts on behalf of the vendors for a commission of 3% on cash collected and 2% on amounts paid.

By March 2016, the creditors have all been paid and the amount so paid is ₹2,76,300. Also, the book debts have all been collected and accounted for and have realised ₹5,21,300. Accordingly, on 31st March, the vendors were paid the balance, which the company hold to credit. Pass the journal entries in the books of the company and show the vendor's suspense account.

[*Ans:* Commission: ₹21,165; Final Payment to Vendors: ₹2,23,835]

31. Marshall and Robert, carrying on business in partnership, sharing profits and losses in the ratio of 2:1, wish to dissolve the firm and sell the business to a limited company on 31st December 1998, when the firm's balance sheet stands as under:

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	45,000	Cash at Bank	8,000
Reserve Fund	45,000	Sundry Debtors	1,20,000
Capital Accounts:		Stock	1,62,000
Marshall 1,40,000		Motor Vehicle	24,000
Robert 1,00,000	2,40,000	Furniture	16,000
	3,30,000		3,30,000

Nash Co. Ltd. was registered with an authorised capital of ₹6,00,000 in equity shares of ₹10 each, to acquire the above business on the following terms:

(a) Goodwill is valued at ₹75,000.

(b) Furniture and stock are revalued at ₹14,500 and ₹1,74,500 respectively.

(c) Debtors are subject to 5% provision.

Motor vehicle is not required by the company and Marshall takes over the same at an agreed valuation of ₹22,000.

The purchase price is satisfied by the issue of equity shares ₹10 each at par.

Show journal entries and balance sheet of the company, assuming that the same set of books are continued.

[*Ans:* Revaluation Profit: ₹3,000; Balance Sheet Total: ₹3,86,000]

32. XY & Co. is converted into a limited company but the same books of accounts are desired to be continued. The balance sheet with reference to which conversion takes place is given below:

Balance Sheet

Liabilities	(₹)	Assets	(₹)
Capital Accounts		Machinery	60,000
X 1,20,000		Car	20,000
Y 80,000	2,00,000	Stock	1,00,000
Reserve	20,000	Debtors	76,000
Creditors	40,000	Cash	4,000
	2,60,000		2,60,000

Goodwill is valued at ₹50,000. Car is taken up by X at an agreed value of ₹6,000. Stock and machinery are valued at ₹1,10,000 and ₹70,000 respectively.

The partners are issued required number of equity shares of ₹10 each at par.

Pass journal entries and draft the balance sheet of the limited company

[*Ans:* Revaluation Profit: ₹6,000; Amount payable to X: ₹1,52,000; to Y: ₹1,18,000; Balance Sheet Total: ₹3,10,000; Ration of Final Claim: 152:118]

33. Taylor and Bevan were carrying on business in partnership, sharing profits and losses in the ratio 3:2. They sell their business to a limited company on 31st December 1998 and on that date, their balance sheet is as follows:

Liabilities	(₹)	Assets	(₹)
Capital A/cs		Plant and Machinery	90,000
Taylor	1,20,000	Land and Building	60,000
Bevan	90,000	Investment	30,000
Reserve Fund	30,000	Stock	60,000
Creditors	60,000	Debtors	45,000
		Cash and Bank	15,000
	3,30,000		3,30,000

Mark Waugh Ltd., a limited company having an authorised capital of ₹7,50,000 in equity shares of ₹10 each, purchases the said business under the following terms:

(i) Goodwill is valued at ₹60,000

(ii) Depreciation on plant and machinery is at 10% and appreciation of land and buildings is by 20%.

(iii) A provision for doubtful debts @ 5% on debtors is needed.

(iv) Investment is taken over by Bevan at an agreed value of ₹24,000.

(v) Total purchase consideration is to be satisfied by the issue of fully-paid equity shares of ₹10 each.

Show the journal entries and the revised balance sheet, assuming that the same set of books is continued.

[*Ans:* Revaluation Loss: ₹5,250; Purchase Consideration: ₹2,70,750, i.e. Final Payment to Taylor: ₹1,70,850 and to Bevan: ₹99,900 Balance Sheet Total: ₹3,30,750]

34. The following balance sheet is presented by M/s James and Hadley as on 31st December 1998.

Balance Sheet as on 31.12.1998

Liabilities		(₹)	Assets	(₹)
Bills Payable		40,000	Cash and Bank	25,00
Sundry Creditors		1,10,000	Bills Receivable	25,000
Capital Accounts			Sundry debtors	1,50,000
James	3,50,000		Stock in Trade	1,50,000
Hadley	2,50,000	6,00,000	Furniture	50,000
			Plant and Machinery	1,50,000
			Land and Building	2,00,000
		7,50,000		7,50,000

On 1st January 1999, the above business was purchased by Daniel Ltd. for ₹7,00,000, to be paid by the issue of equity shares of ₹10 each, credited at ₹5 upon the following terms:

(a) Land and building and plant and machinery to be taken at ₹2,50,000 and ₹1,35,000 respectively.

(b) The company did not take over the furniture, which were disposable, at ₹35,000 and also did not take bills payable, which were taken over by James at an agreed value of ₹35,000.

(c) A provision for doubtful debt was also to be made @ 2.5 % on debtors.

(d) There was a claim for bills discounted amounted to ₹5,000, which was taken by the company.

(e) The company did not take care over a workers claim amounted to ₹6,000 due to accident.

Show the entries in the books of Daniel Ltd., assuming that same set of books is continued.

[*Ans:* Revaluation Profit: ₹10,250; Goodwill: ₹83750]

35. Jasmine Ltd. purchased the business of Mr. Ram. Jasmine Ltd. did not take over the debtors and creditors of Mr. Ram, amounting to ₹1,00,000 and ₹70,000 respectively, but promised to collect from debtors and pay to creditors.

Jasmine Ltd. collected all debts at a discount of ₹2,500 and a bad debt of ₹1,000 and paid all the creditors at a discount of ₹1,500. Show the entries assuming the set of books is continued.

[*Ans:* Net Amount Due to Vendors: ₹28,000]

36. Karan Limited purchases the business of Mr. Karthick. Karan Limited did not take over the debtors and creditors of Mr. Karthick, amounting to ₹25,000 and ₹15,000 respectively, but it promised to collect from debtors and pay to creditors. Karan Limited collected all debtors at a discount of ₹1,000 and a bad debt of ₹250 and paid all creditors at a discount of ₹300. Show the entries, assuming that same set of books is continued.

[*Ans:* Net Amount Due to Vendors: ₹9,050]

37. Top Ltd. purchased the business of top and decided to continue the same set of books. However, Top Ltd., did not take its debtors ₹8,000 and creditors of ₹6,000, but it promised to collect and pay them respectively. The company collected all debts, subject to a discount of ₹300 and bad debts of ₹100 and paid all creditors subject to a discount of ₹150. Give the necessary journal entries.

[*Ans:* Amount Payable to Vendor: ₹1,750 on the absence of commission]

38. Sharma and Verma were carrying on business in partnership, sharing profits and losses in the ratio of 3:2. They sell their business to a limited company on 31st March 2016 and on that date, their balance sheet stood as follows:

Liabilities		(₹)	Assets	(₹)
Capital Accounts:			Plant and Machinery	3,60,000
Sharma	4,80,000		Land and Building	2,40,000
Verma	3,60,000	8,40,000	Investment	1,20,000
Reserve Fund		1,20,000	Stock	2,40,000
Creditors		2,40,000	Debtors	1,80,000
			Cash and Bank	60,000
		12,00,000		12,00,000

A Limited Company, having an authorised capital of ₹30,00,000 in equity shares of ₹100 each, purchased the above business under the following terms:

(a) Goodwill was valued at ₹2,40,000.

(b) Depreciation on plant and machinery was @10% and appreciation of land and building was by 20%.

(c) A provision for doubtful debts @ 5% on debtors was allowed.

(d) Investment was taken over by Verma, at an agreed value of ₹96,000.

(e) Total purchase consideration was to be satisfied by the issue of fully-paid equity shares of ₹100 each.

Show the journal entries and the revised balance sheet, assuming that the same set of books is continued.

[*Ans:* Revaluation Loss: ₹21,000; Purchase Consideration: ₹10,83,000; Balance Sheet Total: ₹13,23,000]

39. AB & Co. is converted into a limited company but the same books of accounts are desired to be continued. The balance sheet, with reference to which the conversion has taken place, is given as follows:

Liabilities	(₹)	Assets	(₹)
Capital Accounts		Machinery	15,00,000
A 30,00,000		Car	5,00,000
B 20,00,000	50,00,000	Stock	25,00,000
Reserve	5,00,000	Debtors	19,00,000
Creditors	10,00,000	Cash	1,00,000
	65,00,000		65,00,000

Goodwill is valued at ₹12,50,000. Car is taken up by A at an agreed value of ₹1,50,000. Stock and machinery are valued at ₹27,50,000 and ₹17,50,000 respectively. The partners are issued required number of shares of ₹100 each at par. Pass journal entries and draft the balance sheet of the limited company.

[*Ans:* Amount Payable to A: ₹38,00,000; B: ₹29,50,000; Balance Sheet Total: ₹77,50,000]

40. The following is the balance sheet of M/s P & Q as on 31st March 2016:

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	80,000	Land and Building	4,00,000
Mrs P's Loan	3,60,000	Plant and Machinery	3,20,000
Capital Accounts:		Stock-in-Trade	1,20,000
P: 4,80,000		Sundry Debtors	2,00,000
Q: 3,20,000	8,00,000	Investment	1,60,000
		Cash and Bank	40,000
	12,40,000		12,40,000

Profits were shared as two-thirds to P and one-thirds to Q. On 1st April 2016, PQ Ltd. purchased the business of M/s P & Q for a payment of ₹12,00,000 to be made in the form of equity shares of ₹100 each, credited as ₹80 paid. The company did not taken over the investments and Mrs. P's Loan. The company also decided to revalue land and buildings at ₹5,40,000, plant and machinery at ₹2,80,000 and to create a provision for doubtful debts at 5% on debtors. There was a claim by a worker for ₹12,000 for injuries in an accident. The company decided to admit the claim. Out of the investments, ₹24,000 worth are worthless. Mrs P agrees to receive the meaning investments and 2,800 shares of PQ Ltd., in settlement of her loan. The company decides to retain the books of account of the firm. Journalise.

[*Ans:* Goodwill: ₹1,22,000; Revaluation Profit: ₹78,000]

6

PROFITS PRIOR TO INCORPORATION

Sometimes, a company purchases a running business from a date prior to its incorporation, e.g., a company incorporated on 1st April 2014 may purchase a business from 1st January 2014, the date on which the accounting year of the vendor starts. Generally, the business is purchased from vendor on the last date of the balance sheet so that assets and liabilities are taken over on the basis of the figures given in the balance sheet. If the company has earned any profit from the date of purchase to the date of incorporation, such profit is called as profit prior to incorporation.

6.1 TREATMENT OF PROFIT OR LOSS PRIOR TO INCORPORATION

The profit or loss from the date of purchase of business till the date of incorporation belongs to the company, if the agreement with the vendor does not provide any specification. The company cannot earn profit or incur loss *before it comes into existence* and therefore, it is not regarded as *revenue profit.* The profit or loss should be considered as 'capital' in nature, increasing or decreasing the 'net assets' acquired by the company.

The profit or loss prior to incorporation is dealt in the following methods in the books of accounts of a company.

❍ Profit Prior to Incorporation

1. Being a capital profit, it is not allowed to be a part of profit and loss account.
2. It should not be used for payment of dividend to the shareholders
3. It can be credited to Capital Reserve Account*,* which is used to write off capital losses and expenses like preliminary expenses, underwriting commission, etc. The unutilised amount of capital reserve appears on the liabilities side of the balance sheet under the heading Reserves and Surpluses.

❍ Loss Prior to Incorporation

1. Being a capital loss, it is not allowed to be a part of profit and loss account.
2. It can be debited to a separate account called Loss Prior to Incorporation Account. This loss can be written off using other capital profits of the company. It appears on the assets side of the balance sheet under the heading Miscellaneous Expenditure.

3. It may be treated as goodwill and debited to goodwill account.
4. It may also be treated as 'deferred revenue expenditure' and may be written off out of profits of the company for several years.

6.2 RELEVANCE OF DATE OF CERTIFICATE TO COMMENCE BUSINESS

A public limited company has to obtain a certificate of commencement of business. This raises the issue of relevant date for ascertaining capital profit or loss in the context of business acquisition. A company's power to carry on a business relates back to the date of incorporation, once the certificate to commence business is obtained. Thus, obtaining such a certificate is purely a legal formality, without affecting computation of 'profit or loss' of capital nature at the time of acquisition of business.

6.3 METHODS OF ASCERTAINING PROFIT OR LOSS PRIOR TO INCORPORATION

There are three possible ways of ascertaining profit or loss prior to incorporation.

❍ Preparation of Trading and Profit and Loss Account for the Period up to the Date of Incorporation

A trial balance has to be prepared as on the date of incorporation of the company by balancing the books of accounts of the business. The closing stock on that date has to be valued. Trading and profit and loss account has to be prepared in the normal way.

Profit or loss prior to incorporation can be ascertained accurately in this method. At the end of the accounting year, profit or loss of the post-incorporation period may be found.

However, balancing of books and stock taking on the date of incorporation may be highly inconvenient and affect the normal functioning of the business. So, this method is not usually adopted in practice.

❍ Preparation of Trading and Profit and Loss Account for the whole Accounting Period and Apportionment of the Resulting Profit or Loss Between Pre- and Post-incorporation Periods

Under this method, trial balance is prepared and trading and profit and loss accounts are prepared at the end of the accounting period. Then, a separate note is prepared, in the form of a statement showing pre- and post-incorporation profits by apportioning the various expenses between the respective periods. These profit or loss figures are incorporated in the profit and loss account, by transferring the profit prior to incorporation to capital reserve account. Any loss prior to incorporation may be separately shown or it may be debited to goodwill account.

❍ Preparation of Common Trading Account and the Profit and Loss Account in 'Columnar Form'

Under this method, Trading Account is prepared at the end of the accounting year from the Trail balance in the usual manner. Unless otherwise mentioned, the date of incorporation does not affect the computation of gross profit.

The profit and loss account is prepared in columnar form, with separate columns for pre- and post-incorporation periods. All expenses and the gross profit are divided between the two periods in an appropriate manner.

Under methods mentioned above, profit and loss for the two periods cannot be ascertained as accurately as under the first method. These methods can only give an estimate of the profit or loss of the two periods.

Since the first method involves disruption of work, the other methods seem to be unavoidable.

6.4 BASIS OF APPORTIONMENT OF EXPENSES

The various expenses, which are shown in profit and loss account, should be divided between pre- and post-incorporation periods on some logical and appropriate basis. The following are the usual bases for such apportionment:

1. ***Time ratio:*** This is the ratio of months or days before and after incorporation, during the accounting period. For example, if business was acquired on 1st January 2006, the company was incorporated on 1st May 2006 and accounts are closed on 31st December 2006, the time ratio is 4:8 or 1:2. From 1st January 2006 till 1st May 2006, there are four months before incorporation. Similarly, there are 8 months after incorporation, i.e. from 1st January 2006 to 31st December 2006.
   All expenses of a company, which can be linked or related to *'time,'* must be divided between pre- and post-incorporation periods in *Time Ratio.* Examples are salaries, rent, stationery, postage, depreciation, bank charges, interest, etc.
2. ***'Weighted' or 'adjusted' time ratio:*** If any changes were made in the number of employees or office accommodation, etc., weightage must be given to the changes in arriving at the time ratio. Such ratio is called *Weighted Time Ratio.* Similarly, when some expenditure is incurred only for a part of the accounting period, separate ratio has to be computed based on the actual months or days in the pre- and post-incorporation periods.
3. ***Sales ratio:*** This is the ratio of sales or turnover of the company before and after incorporation. For e.g., when sales before and after incorporation were ₹2,00,000 and ₹6,00,000 respectively, the sales ratio is 1:3.
   Sales ratio is the logical basis to divide the gross profit earned by the company. Similarly, all expenses related to sales are also to be apportioned in sales ratio. Example: advertising, salesman commission, sales promotion expenses, carriage outwards, bad debts, discount allowed, etc.

4. ***Weighted sales ratio:*** If sales were not uniform throughout the accounting period, weightage must be given to the trends observed in the sales. Sales ratio adjusted for the change in trend is called weightage sales ratio.
5. ***Allocation of expenses:*** Specific expenses, which can be identified with either period, have to be fully allocated to that period. All company-related expenses like debenture interest, director's remuneration or fees, preliminary expenses written off, donations given by the company, etc., have no connection with the pre-incorporation period. So they must be fully charged to the post-incorporation period. Similarly, partner's salaries, interest on purchase price till the date of incorporation may be allotted to pre-incorporation period.
6. ***Actual expenditure:*** If specific details are available about any particular item of expenditure as to how much was spent in the pre- and post-incorporation periods, the actual amount should be charged to the respective periods.

   Note: Auditors of a company are appointed only after incorporation. So their fee may be shown as post-incorporation expenditure. However, thus audit fee can be divided in time ratio also. Whichever way is followed, alternative may be shown as a note.

6.5 STEPS INVOLVED IN ASCERTAINING PRE- AND POST-INCORPORATION PROFITS

Step 1: Trading Account has to be prepared for the accounting period and the gross profit has to be found.

Step 2: After a careful scrutiny of the sales, expenses, etc., sales ratio and ratio are to be computed and a list of expenses, which can be allotted to specific periods should be drawn up.

Step 3: A statement is preferable for ascertaining pre- and post-incorporation profit. Columns for basis of apportionment, total, pre- and post-incorporation should be provided. Statement of profit and loss is prepared to ascertain pre- and post-incorporation profits.

6.6 TABLE SHOWING TREATMENT OF DIFFERENT ITEMS

Nature of Items	Basis of Apportionment
1. Gross profit or loss	Sales ratio or weighted sales ratio
2. All fixed expenses like salaries, rent, rates, taxes, insurance, depreciation, postage, etc.	Time ratio or weighted or adjusted time ratio

(*Contd.*)

3. All variable expense directly varying with turnovers like commission, discount, salesman remuneration, advertisements, carriage outwards.	Sales ratio or weighted sales ratio
4. All expenses related to pre-incorporation period till the incorporation date	Allocation to pre-incorporation period such as vendor's salary
5. All expenses wholly applicable to post incorporation such as: Director's fees, debenture interest, discount on issue of debentures, preliminary expense or formation expenses written off, donations given by the company, etc.	Allocation to the post-incorporation period

Illustration 1

Ganesh Ltd. was incorporated on 1st May 2007 to purchase the running business of Vinayak and Co., with effect from 1st January 2007. The company obtained Certificate of Commencement of business on 24th August 2007. Calculate the time ratio, if the accounts were finalised on 31st December 2007.

Solution:

Computation of Time Ratio

Pre-incorporation period from 01.01.2007 to 01.05.2007 = 4 months
Post-incorporation period from 01.05.2007 to 31.12.2007 = 8 months
Time Ratio = 1:2

Illustration 2

You are required to calculate the time ratio for the pre- and post-incorporation periods from the following particulars:

(i) Date of incorporation: 01.06.1999
(ii) Period of financial accounts: April 1999 to March 2000
(iii) Total wages: ₹4,800
(iv) Number of workers: Pre-incorporation period: 5
Post-incorporation period: 25

Also divide the total wages between pre- and post-incorporation periods.

Solution:

Computation of Weighted Time Ratio

Number of employees in pre-incorporation period of 3 months = 5
Number of employees in post-incorporation period of 9 months = 25
Pre-incorporation period = 01.04.1999 to 01.06.1999 = 3 months
Post-incorporation period = 01.06.19999 to 31.03.1999 = 9 months
Time Ratio = 3:9 i.e., 1:3
Weighted Time Ratio = Time Ratio × Number of Employees in Respective Period

Pre-incorporation Period = 5 × 1 = 5
Post-incorporation Period = 25 × 3 = 75

5:75 = 1:15

Wages for the Pre-incorporation Period = ₹4,800 × 1/16 = ₹300
Wages for the Post-incorporation Period = ₹4,800 × 1/16 = ₹4,500

Illustration 3

Amaravathi sold her business to Komala Ltd., with effects from 1st January 2007 for ₹5,00,000. The company was incorporated on 1st April 2007 and on 31st December 2007, the accounts were finalised. The company paid off Amaravathi on 31st August 2008 with interest of ₹40,000. Salaries for the year amounted to ₹58,000. There were five employees before incorporation, but three more were recruited on the date of incorporation. You are required to calculate:

(a) Time Ratio
(b) Adjusted Time Ratio for Interest
(c) Weighted Time Ratio for Salaries

Solution:

(a) Time Ratio

Pre-incorporation Period: 01.01.2007 to 01.4.2007 = 3 months
Post incorporation Period: 01.04.2007 to 31.12.2007 = 9 months
Time Ratio = 3:9, i.e. 1:3

(b) Adjusted Time Ratio for Interest

Pre-incorporation Period: 01.01.2007 to 01.04.2007 = 3 months
Post-incorporation Period up to date of interest: 01.04.2007 to 31.08.2007 = 5 months
Adjusted Time Ratio = 3:5

(c) Weighted Time Ratio for Salaries

Weighted Time Ratio for Salaries = Time Ratio × Number of Employees in the Pre-incorporation and Post-incorporation Period
Pre-incorporation Period = 1 × 5 = 5
Post-incorporation Period = 3 × 8 = 24
Ratio = 5:24

Illustration 4

Bhavani Industries Ltd., was incorporated on 1st January 2016 to acquire the running business of M/s Padma and Latha, with effect from 1st July 2015. Accounts were finalised on 31st March 2016. You are requested to compute appropriate ratios to divide the expenditure incurred on salaries and wages between the pre- and post-incorporation periods. The following details are available:

There were 20 employees receiving salary of ₹500 each, before incorporation and 25 employees receiving ₹800 each after incorporation.

There were 100 workers before incorporation who were paid ₹400 each, but 50 more were recruited on incorporation at the same wage rate.

Solution:

(a) Ratio for Dividing Salaries

Pre-incorporation Period: 01.07.2015 to 01.01.2016 = 6 months
Post-incorporation Period: 01.01.2016 to 31.03.2016 = 3 months
Time Ratio = 6:3 = 2:1
Number of employees and amount paid in pre-incorporation = 20 × ₹500 = ₹10,000
Number of employees and amount paid in post-incorporation = 25 × ₹800 = ₹20,000
Ratio = T.R × Amount paid as salaries in the respective period
Pre-incorporation = 2 × ₹10,000 = ₹20,000
Post-incorporation = 1 × ₹20,000 = ₹20,000
= 20,000: 20,000, i.e 1:1

(b) Ratio for Dividing Wages

Number of employees and amount paid in pre-incorporation = 100 × ₹400 = ₹40,000
Number of employees and amount paid in post-incorporation = 150 × ₹400 = ₹60,000
Pre-incorporation = 2 × ₹40,000 = ₹80,000
Post-incorporation = 1 × ₹60,000 = ₹60,000
= 80,000:60,000 i.e. 4:3

Illustration 5

Calculate sales ratio from the following particulars: Total sales is ₹10,00,000 and sales during pre-incorporation period is ₹2,00,000.

Solution:

Pre-incorporation Sales: ₹2,00,000
Post-incorporation Sales = Total Sales – Pre-incorporation Sales
= 10,00,000 – 2,00,000
= ₹8,00,000
Sales Ratio = 2,00,000:8,00,000 = 1:4

Illustration 6

Ramesh and Raja, carrying on a partnership business, converted their business into a limited company with effect from 1st January 2006. However, they could complete the legal formalities and incorporate the company only on 1st May 2006. When the accounts are finalised on 31st December 2006, it was noted that sales went up by 50% on average in each month after incorporation compared to those before that date. Ascertain the sales ratio.

Solution:

Pre-incorporation Period: 01.01.2006 to 01.05.2006 = 4 months
Post-incorporation Period: 01.05.2006 to 31.12.2006 = 8 months

Time Ratio = 4:8 = 1:2

Assume Pre-incorporation Sales per month = ₹100 × 4 months = ₹400
Pre-incorporation sales have been increased by 50% on an average in each month after incorporation. Therefore,
Post-incorporation Sales = Pre-incorporation Sales + Increased by 50% of ₹100

100 + 50 = ₹150 per month

Post-incorporation Sales = Rs.150 × 8 = ₹1,200

Sales Ratio = 400:1,200 i.e. 1:3

Illustration 7

XYZ Ltd. Company was incorporated on 1st July 2008 in order to purchase a running business from 1st January 2008. From the following particulars, calculate pre-incorporation loss:

(i) Total sales for the year 2008 were ₹4,50,000
(ii) Sales from 1st January 2008 to 30th June 2008 ₹1,50,000
(iii) Gross profit for the whole year ₹1,35,000
(iii) Establishment expenses ₹92,500

Solution:

(a) Sales Ratio

Pre-incorporation Sales = ₹1,50,000
Post-incorporation Sales = Total Sales – Pre-incorporation Sales
= 4,50,000 – 1,50,000 = ₹3,00,000
Sales Ratio = 1,50,000:3,00,000 = 1:2
Gross Profit = Rs 1,35,000

Pre-incorporation Gross Profit = $1,35,000 \times \frac{1}{3}$ = ₹45,000

Post-incorporation Gross Profit = $1,35,000 \times \frac{2}{3}$ = ₹90,000

(b) Time Ratio

Pre-incorporation Period = 01.01.2008 to 1.7.2008 = 6 months
Post-incorporation Period = 01.07.2008 to 31.12.2008 = 6 months
Time Ratio = 6:6 i.e. 1:1

Statement of Profit and Loss of XYZ Ltd. for the year ended 31.12.2008

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	1,35,000	45,000	90,000
Less: Establishment Expenses	2	92,500	46,250	46,250
			(1,250)	43,750

Notes to Accounts:

1. Revenue from Operations

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	S.R. 1:2	1,35,000	45,000	90,000

2. Other Expenses

	Basis of Apportionment (₹)	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Establishment Expenses	T.R. 1:1	92,500	46,250	46,250

Illustration 8

From the following data, calculate pre-incorporation profit.
Time Ratio: 1:2; Sales Ratio: 1:3; Gross Profit: ₹1,36,400; Office Expenses: ₹55,680; Advertising: ₹14,880; Preliminary Expenses: ₹15,000.

Solution:

Calculation of Pre-incorporation Profits

1. Revenue from Operations

	Basis of Apportionment (₹)	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Establishment Expenses	S.R 1:3	1,36,400	34,100	1,02,300

2. Other Expenses

	Basis of Apportionment (₹)	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Office Expenses	T.R 1:2	55,680	18,650	37,120
Advertising	S.R. 1:3	14,880	3,720	11,160
Preliminary Expenses	Post	15,000	—	15,000
		85,560	22,280	63,280

Statement of Profit and Loss for the year ended…

Particulars	Note Number	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations (A)	1	1,36,400	34,100	1,02,300
Less: Expenses	2	85,560	22,280	63,280
Profit for the Period (A – B)		50,840	11,820	39,020

Illustration 9

Kalki Ltd. was incorporated on 1st April 2007 to take over the business of Mr. Kumaran from 1st January 2007. From the following information, calculate sales ratio and gross profit.

(i) Sales during the period January—December 2007 amounted to ₹2,40,000 and trends of sales were as under:
January and February—half the average sales in each month
May, June, July and October—average sales in each month
November and December—half the average sales in each month.

(ii) Cost of goods sold: ₹90,000

Solution:

(a) Time Ratio

Pre-incorporation Period = 01.01.2007 to 01.04.2007 = 3 months
Post-incorporation Period = 01.04.2007 to 31.12.2007 = 9 months
Time Ratio = 3:9 i.e. 1:3

(b) Sales Ratio

Average Sales = ₹2,40,000/12	=	₹20,000
January—half the average sales	=	₹10,000
February—half the average sales	=	₹10,000
March—Refer W.N.1	=	₹30,000
Pre-incorporation sales		₹50,000
April—Refer W.N.1	=	₹30,000
May—average sales	=	₹20,000
June—average sales	=	₹20,000
July—average sales	=	₹20,000
August—Refer W.N.1	=	₹30,000
September—average sales	=	₹20,000
October—average sales	=	₹20,000
November—half the average sales	=	₹10,000
December—half the average sales	=	₹10,000
Post-incorporation Sales		₹1,90,000

Working Note 1:

Calculation of sales for the months of March, April, August and September = 4 months

Total Sales – Sales effected for the month for which information is given

= 2,40,000 – 1,20,000 = ₹1,20,000

Sales for 4 months = ₹1,20,000

Therefore, for 1 month = $\frac{₹1,20,000}{4}$ = ₹30,000

Sales Ratio = 50,000:1,90,000, i.e. 5:19

(c) Gross Profit = Sales – Cost of Goods Sold

= ₹2,40,000 – 90,000 = ₹1,50,000

Illustration 10

RMK Ltd. was registered as company on 1st July 2007 to take over the running business of Kapil, with effect from 1st April 2007. The Profit and Loss A/c account was finalised on 31st March 2008. Bad debts debited to Profit and Loss A/c was ₹4,000, of which ₹1,000 to sales effected after 1st July 2007. Average monthly turnover from July 2007 onwards was double than that of previous months. Calculate sales ratio and amount of bad debts to be charged between pre- and post-incorporation periods.

Solution:

(a) Time Ratio

Pre-incorporation Period = 01.04.2007 to 01.07.2007 = 3 months
Post-incorporation Period = 01.07.2007 to 31.03.2008 = 9 months
Time Ratio = 3:9, i.e. 1:3

(b) Sales Ratio

Assume Average Monthly Sales = ₹100
From July 2007, average monthly turnover was double than that of previous months = ₹100 × 2 = ₹200

Calculation of Monthly Sales

April: 100	
May: 100	Pre-incorporation sales—April, May, June 2007 = 300
June: 100	Post-incorporation sales—July 2007 to March 2008 = 1,800
July: 200	Sales Ratio = 300:1,800 i.e. 1:6
August: 200	
September: 200	
October: 200	
November: 200	
December: 200	
January: 200	
February: 200	
March: 200	

Bad debts charged between pre-incorporation and post-incorporation periods.

Total Bad Debts	= ₹4,000
Less: Bad Debts incurred on Sales effected after 01.07.2007, i.e.	
Post-incorporation Period	= ₹1,000
Post-incorporation Bad Debts	= ₹3,000

Illustration 11

Ram Ltd. was incorporated on 1st July 2004, which took over a running concern with effect from 1st January 2004. The sales for the period upto 1st July 2004 were ₹2,70,000 and the sales from 1st July 2004 to 31st December 2004 amounted to ₹3,30,000.

The expenses debited to Profit & Loss A/c included:

(i)	Directors' Fees	15,000
(ii)	Bad Debts	1,800
(iii)	Advertisement (₹500 per month)	6,000
(iv)	Salaries and General Expenses	32,000
(v)	Preliminary Expenses written off	3,000

The gross profit was (01.01.2004 to 31.12.2004) 2,40,000

Ascertain the profit prior to incorporation.

Solution:

Computation of Ratios

(a) Time Ratio (TR)

Pre-incorporation Period = 01.01.2004 to 01.07.2004 = 6 months

Post incorporation period = 01.07.2004 to 31.12.2004 = 6 months

Time Ratio = 6:6 i.e. 1:1

(b) Sales Ratio (SR)

Pre-incorporation Sales = ₹2,70,000

Post-incorporation Sales = ₹3,30,000

Sales Ratio = 2,70,000:3,30,000 i.e. 9:11

Notes to Accounts:

1. Revenue from Operations

	Basis of Apportionment (₹)	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales Ratio 9:11	2,40,000	1,08,000	1,32,000

2. Other Expenses

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Directors' Fees	Post	15,000	—	15,000
Bad Debts	S. R. 9:11	1,800	810	990

(*Contd.*)

Advertisement	T.R. 1:1	6,000	3,000	3,000
Salaries and General Expenses	T.R. 1:1	32,000	16,000	16,000
Preliminary Expenses written off	Post	3,000	—	3,000
		57,800	19,810	37,990

Statement of Profit & Loss A/c of Ram Ltd. for the year ended 31.12.2004

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	2,40,000	1,08,000	1,32,000 —
Total (A)		2,40,000	1,08,000	1,32,000
Less: Expenses Other expenses	2	57,800	19,810	37,990
Total Expenses (B)		57,800	19,810	37,990
Profit for the Period (A – B)		1,82,200	88,190	94,010

Illustration 12

Pankajam Mills Ltd. was incorporated on 31st July 2007 to purchase the business of Hemalatha & Co., as on 1st April 2007. The books of accounts disclosed the following on 31st March 2008.

(i) Sales for the years ₹32,10,400 (1st April to 31st July 2007: ₹8,02,600; 1st July 2007 to 31st March 2008: ₹24,07,800).

(ii) Gross profit for the year ₹4,12,800: Managing Directors' salary ₹12,000: Preliminary expenses written off ₹18,000. Company Secretary's salary ₹58,000.

(iii) Bad debts written off ₹14,890 (prior to 31st July ₹4,020, after 31st July ₹10,870)

(iv) Depreciation on machinery ₹25,200; General expenses ₹51,000: Advertising ₹7,400: Interest on debentures ₹20,000.

You are required to prepare a statement apportioning properly the net profit of the company as between (a) Profits available for distribution (b) Profits prior to incorporation

Solution:

Working Notes:

(1) Time Ratio

Pre incorporation period from 01.04.2007 to 31.07.2007 = 4 months

Post incorporation period from 31.07.2007 to 31.03.2008 = 8 months

Time Ratio = 4:8 or 1:2

(2) Sales Ratio

Sales in pre-incorporation period = ₹8,02,600

Sales in post-incorporation period = ₹24,07,800

Sales Ratio = ₹8,02,600:24,07,800 or 1:3

Notes to Accounts:

1. Revenue from Operations

	Basis of Apportionment (₹)	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales Ratio 1:3	4,12,800	1,03,200	3,09,600

2. Employee Benefit Expenses

	Basis of Apportionment (₹)	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Company Secretary Salary	Post	58,000	—	58,000

3. Finance Costs

	Basis of Apportionment (₹)	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Interest on Debentures	Post	20,000	—	20,000

4. Depreciation and Amortisation Expenses

	Basis of Apportionment (₹)	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Depreciation on Machinery	Time Ratio 1:2	25,200	8,400	16,800

5. Other Expenses

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
MD Salary	Post	12,000	—	12,000
Preliminary Expenses	Post	18,000	—	18000

(*Contd.*)

Bad Debts Written Off	Actual	14,890	4,020	10,870
General Expenses	Time Ratio (1:2)	51,000	17,000	34,000
Advertising	Sales Ratio (1:3)	7,400	1,850	5,550
Total		1,03,290	22,870	80,420

Statement of Profit and Loss of Pankajam Mills Ltd.
for the year ended 31.03.2008

Particulars	Note No.	Total	Pre-incorporation	Post-incorporation
Revenue from Operations	1	4,12,800	1,03,200	3,09,600
Total (A)		4,12,800	1,03,200	3,09,600
Less: Expenses				
Employee Benefit Expenses	2	58,000	—	58,000
Finance Costs	3	20,000	—	20,000
Depreciation and Amortisation Expenses	4	25,200	8,400	16,800
Other Expenses	5	1,03,290	22,870	80,420
Total Expenses (B)		2,06,490	31,270	1,75,220
Profit for the Period (A – B)		2,06,310	71,930	1,34,380

(a) Profits available for distribution of post-incorporation profit = ₹1,34,380
(b) Profits prior to incorporation = ₹71,930

Illustration 13

Z Ltd. is incorporated on 1st May 2003 to take over the business of Y Co. as a going concern from 1st January 2003. The profit and loss account for the year ending 31st December 2003 is as follows:

Profit and Loss Account of Z Ltd. for the year ending 31.12.2003

Particulars	(₹)	Particulars	(₹)
To Salaries	72,000	By Gross Profit	3,10,000
To Rent and Taxes	24,000		
To commission	12,000		
To Insurance	6,000		
To Electric Charges	4,800		

(*Contd.*)

To Director's Fees	6,000		
To Audit Fees	3,200		
To Advertisement	8,000		
To Discount	7,000		
To Office Expenses	15,000		
To Carriage Outward	6,000		
To Interest on Loan	6,000		
To Bank Charges	3,000		
To Preliminary Charges	13,000		
To Bad Debts	4,000		
To Net Profits	1,20,000		
	3,10,000		3,10,000

Total sales for the year ending 31st December 2003 is ₹10,00,000 divided into ₹3,00,000 for the period upto 1st May 2003 and ₹7,00,000 for the remaining period. Find the net profit before incorporation of the company and after incorporation of the company.

Solution:

Working Notes:

1. **Time Ratio**
   Pre-incorporation Period: 01.01.2003 to 01.05.2003 = 4 months
   Post-incorporation Period: 01.05.2003 to 31.12.2003 = 8 months

   T.R. = 4:8 i.e. 1:2

2. **Sales Ratio**
   Pre-incorporation Sales: ₹3,00,000
   Post-incorporation Sales: ₹7,00,000

   S.R. = 3,00,000:7,00,000 i.e. 3:7

Notes to Accounts:

1. Revenue from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales ratio 3:7	3,10,000	93,000	2,17,000

2. Employee Benefit Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Salary	Time ratio 1:2	72,000	24,000	48,000

3. Finance Costs

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Interest on Loan	Time ratio 1:2	6,000	2,000	4,000

4. Other Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Rent and Taxes	Time Ratio 1:2	24,000	8,000	16,000
Commission	Sales Ratio 3:7	12,000	3,600	8,400
Insurance	Time Ratio 1:2	6,000	2,000	4,000
Electricity Charges	Sales Ratio 1:2	4,800	1,600	3,200
Directors' Fees	Post	6,000	—	6,000
Audit Fees	Time Ratio 1:2	3,200	1,067	2,133
Advertisement	Sales Ratio 3:7	8,000	2,400	5,600
Discount	Sales Ratio 3:7	7,000	2,100	4,900
Office Expenses	Time Ratio 1:2	15,000	5,000	10,000
Carriage Outward	Sales Ratio 3:7	6,000	1,800	4,200
Bank Charges	Time Ratio 1:2	3,000	1,000	2,000
Preliminary Charges	Post	13,000	—	13,000
Bad Debts	Sales Ratio 3:7	4,000	1,200	2,800
Total		1,12,000	29,767	82,233

Statement showing Profit and Loss Account of Z Ltd.
for the year ended 31.12.2003

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	3,10,000	93,000	2,17,000
Total (A)		3,10,000	93,000	2,17,000
Less: Expenses				
Employee Benefit Expenses	2	72,000	24,000	48,000
Finance Cost	3	6,000	2,000	4,000
Other Expenses	4	1,12,000	29,767	82,233
Total Expenses (B)		1,90,000	55,767	1,34,233
Profit for the Period (A – B)		1,20,000	37,233	82,767

Illustration 14

XYZ Ltd. was formed on 1st April 2004 to take over the business of a firm as from 1st January 2004. All profits made from this earlier date were to the benefit of the company but interest on the purchase price of ₹50,000 was to be paid at 6% p.a. to the vendors upto the date of settlement in full on 1st June 2004. The following was the statement of profit and loss for the year ended 31st December 2004.

Particulars	(₹)	Particulars	(₹)
To Management Expenses	3,050	By Gross Profit	20,000
To Bad Debts	200		
To Directors' Fees	1,000		
To Interest to Vendors	1,250		
To Preliminary Expenses	1,250		
To Depreciation	1,000		
To Net Profit	12,250		
	20,000		20,000

Out of the bad debts written off, ₹ 100 related to the period prior to incorporation.

Apportion the profit earned between pre-incorporation and post-incorporation periods by preparing profit and loss account.

Solution:

Working Notes:

1. **Time Ratio**
   Pre-incorporation Period: 01.01.2004 to 01.04.2004 = 3 months
   Post-incorporation Period: 01.04.2004 to 31.12.2004 = 9 months

   3:9 i.e. 1:3

2. **Sales Ratio**

   Pre-incorporation period : $20{,}000 \times \frac{1}{4} = 5{,}000$

   Post-incorporation period : $20{,}000 \times \frac{3}{4} = 15{,}000$

   5000:15,000 i.e. 1:3

3. **Adjusted time ratio**
   Pre-incorporation Period: 01.01.2004 to 01.04.2004 = 3 months
   Post-incorporation Period: 01.04.2004 to 01.06.2004 = 2 months
   $\Rightarrow$ 3:2

Notes to Accounts:

1. Revenue from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales ratio 1:3	20,000	5,000	15,000

2. Finance Costs

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Interest to Vendors	Adjusted Time Ratio 3:2	1,250	750	500

3. Depreciation and Amortisation Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Depreciation	Time Ratio 1:3	1,000	250	750

4. Other Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Management Expenses	Time Ratio 1:3	3,050	763	2,287
Bad Debts	Actual	200	100	100
Directors' Fees	Post	1,000	—	1,000
Preliminary Expenses	Post	1,250	—	1,250
Total		5,500	863	4,637

Statement showing Profit and Loss Account of XYZ Ltd.
for the year ended 31.12.2004

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	20,000	5,000	15,000
Total (A)		20,000	5,000	15,000
Less: Expenses				
Finance Costs	2	1,250	750	500
Depreciation and Amortisation Expenses	3	1,000	250	750
Other Expenses	4	5,500	863	4,637
Total Expenses (B)		7,750	1,863	5,087
Profit for the Period (A – B)		12,250	3,137	9,113

Illustration 15

Ramu and Gopu, in partnership, floated a limited company i.e., Kosal Ltd. The company was incorporated on 31st March 2004 though the partnership business was transferred to the company on 1st January 2004 itself. Business was carried on till 31st December 2004, on which date the following profit and loss was prepared.

Profit and Loss Account of Kosal Ltd. for the year ended 31.12.2004

Particulars	(₹)	Particulars	(₹)
To Office Rent	4,000	By Gross Profit	80,000
To Salaries	20,000	By Bad Debts Recovered	4,000
To Advertising	5,000		
To Partners' salary	3,000		
To Carriage	2,000		
To Provision for Doubtful Debts	1,000		
To Interest on Loan	2,000		
To Underwriting Commission	1,000		
To Insurance	3,000		
To Discount Allowed	2,000		
To Net Profit	41,000		
	84,000		84,000

Additional information:

(a) The company's sales were uniform till the end of June but thereafter recorded an increase of 50% on an average.

(b) The partners' salary was for the period before incorporation.

(c) Interest on loan included ₹500, which was on a loan taken in July 2004.

(d) Bad debts recovered were from debtors written off in the year 2001.

You are required to ascertain the amount of profit available for dividend.

Solution:

Working Notes:

1. **Time Ratio**

   Pre-incorporation Period: 01.01.2004 to 31.03.2004 = 3 months
   Post-incorporation Period: 31.03.2004 to 31.12.2004 = 9 months

   = 3:9 i.e. 1:3

2. **Sales Ratio**

   Assume Sales = ₹100 p.m.

$$\left.\begin{array}{l}\text{Jan: 100}\\ \text{Feb: 100}\\ \text{Mar: 100}\end{array}\right\}\quad \text{Pre-incorporation: 300}$$

April: 100
May: 100
June: 100
July: 150
Aug: 150
Sep: 150
Oct: 150
Nov: 150
Dec: 150

Post-incorporation: 1,200

Ratio = 300:1200 = 1:4

Notes to Accounts:

1. Revenue from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales ratio 1:4	80,000	16,000	64,000

2. Other Income

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Bad Debts Recovered	Pre-incorporation since related to 2001	4,000	4,000	—

3. Finance Costs

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Interest on Loan	Time Ratio 1:3	1,500	375	1,125
	Post (loan taken in July 2004)	1,500	—	500
Total		2,000	375	1,625

4. Other Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Office Rent	Time Ratio 1:3	4,000	1,000	3,000
Salaries	Time Ratio 1:3	20,000	5,000	15,000
Advertising	Sales Ratio 1:4	5,000	1,000	4,000
Partners' Salary	Pre-incorporation	3,000	3,000	—

(*Contd.*)

Carriage	Sales Ratio 1:4	2,000	400	1,600
Provision for Doubtful Debts	Sales Ratio 1:4	1,000	200	800
Underwriting Commission	Post	1,000	—	1,000
Insurance	Time Ratio 1:3	3,000	750	2,250
Discount Allowed	Sales Ratio 1:4	2,000	400	1,600
Total		41,000	11,950	29,250

Statement of Profit and Loss Account of Kosal Ltd.
for the year ended 31.12.2004

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	80,000	16,000	64,000
Other Income	2	4,000	4,000	—
Total (A)		84,000	20,000	64,000
Less: Expenses				
Finance Costs	3	2,000	375	1,625
Other Expenses	4	41,000	11,750	29,250
Total Expenses (B)		43,000	12,125	30,875
Profit for the Period (A–B)		41,000	7,875	33,125

Illustration 16

Kamali Ltd. was incorporated on 1st May 2006 to take over the running business of M/s Sadhu Bros. with effect from 1st January 2006. From the following details for the year ended 31st December 2006, prepare a statement showing profit or loss made during pre- and post-incorporation periods.

Particulars	(₹)	Particulars	(₹)
Gross Profit	3,00,000	Underwriting Commission	20,000
Salaries	48,000	Insurance Premium paid for the year ending 31.03.2007	12,000
Advertising	6,000	Interest on Loan Taken (including ₹2,000 on loan taken after incorporation)	14,000
Commission to Partners	8,000		
Carriage Outward	16,000		
Depreciation	18,000		
Provision for Doubtful Debts	6,000		

The following additional data is also available:

(a) Average monthly sales during the first four months of the year were twice the average monthly sales during each of the remaining eight months.
(b) 20% of the underwriting commission is to be written off.
(c) Commission to partners was paid for their work before incorporation.
(d) Salaries include salary paid to a director of the company ₹6,000.

Solution:

Working Notes:

1. **Time Ratio**
   Pre-incorporation Period, from 01.01.2006 to 01.05.2006 = 4 months
   Post-incorporation Period, from 01.05.2006 to 31.12.2006 = 8 months

   Time Ratio = 4:8 i.e. 1:2
2. **Weighted Sales Ratio**
   Average monthly sales before incorporation as twice the average sales per month of the post incorporation period. If weightage for each post incorporation month is 1,
   Weighted Sales Ratio = $4 \times 2 = 8$; $8 \times 1 = 8$ = 8:8 i.e. 1:1
3. **Adjusted Time Ratio for Insurance Premium**
   Insurance premium is for the year ending 31.03.2007, i.e. 12 months starting from April 2006.
   Number of months in the current year, starting from April are 9.
   Pre-incorporation 1 month, i.e. April.
   Post-incorporation 8 months, i.e. May to December.
   Adjusted Time Ratio 1:8.
4. **Insurance Expenditure for Current Year = 9 months and**
   Next Year = 3 months

   Amount to be shown in this year = $12{,}000 \times \frac{9}{12}$ = ₹9,000

Notes to Accounts:

1. Revenue from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales ratio 1:1	3,00,000	1,50,000	1,50,000

2. Employee Benefit Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Other Salaries	Time ratio 1:2	42,000	14,000	28,000

3. Finance Costs

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Interest on Post-incorporation Loan	Post	2,000	—	2,000

(*Contd.*)

Interest on Other Loan	Time Ratio 1:2	12,000	4,000	8,000
Total		14,000	4,000	10,000

4. Depreciation and Amortisation Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Depreciation on Machinery	Time Ratio 1:3	18,000	6,000	12,000

5. Other Expenses

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Directors' Salary	Post	6,000	—	6,000
Commission to Partners	Post	8,000	—	8,000
Advertising	Sales Ratio 1:1	6,000	3,000	3,000
Carriage Outwards	Sales Ratio 1:1	16,000	8,000	8,000
Provision for Bad Doubtful Debts	Sales Ratio 1:1	6,000	3,000	3,000
Underwriting Commission	Post	4,000	—	4,000
Insurance Premium	Adjusted Time Ratio (1:8)	9,000	1,000	8,000
Total		55,000	23,000	32,000

Statement of Profit and Loss of Kamali Ltd.
for the year ended 31.12.2006

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	3,00,000	1,50,000	1,50,000
Total (A)		3,00,000	1,50,000	1,50,000
Less: Expenses				
Employee Benefit Expenses	2	42,000	14,000	28,000
Finance Cost	3	14,000	4,000	10,000
Depreciation and Amortization Expenses	4	18,000	6,000	12,000
Other Expenses	5	55,000	23,000	32,000
Total (B)		1,29,000	47,000	82,000
Profit (A – B)		1,71,000	1,03,000	68,000

Illustration 17

X Ltd., which was incorporated on 1st May 2009, acquired a business on 1st January 2009. The first accounts were closed on 30th September 2009. The gross profit for the period was ₹42,000.

Details of other expenses:

	(₹)
General Expenses	7,200
Directors' Remuneration	12,000
Preliminary Expenses	2,000

Rent upto 30th June was 6,000 p.a., after which it was increased by 40%.

Salary of the manager, who, on formation of the company, had become a full-time director and whose remuneration has been included in the director's remuneration given above, was at ₹5,100 p.a., before incorporation.

The company earned a uniform gross profit. The sales upto September 2009 were ₹98,000. The monthly average sales for the first four months of the year was one half of that of the remaining period. Show the profit and loss account and indicate how you deal with the pre-incorporation results.

Solution:

Working Notes:

1. **Calculation of Rent**

Rent upto 30th June = ₹6,000 p.a.

Rent per month = $\frac{6,000}{12}$ = ₹500

Increase in rent by 40% from July onwards.

Rent per month = ₹500

Add: Increase by 40% = ₹200

₹700 p.m.

Pre-incorporation Rent : ₹500 × 4 = ₹2,000

Post-incorporation Rent : ₹500 × 2 = ₹1,000

₹700 × 3 = ₹2,100

₹3,100

2. **Time Ratio**

Pre-incorporation Period : 01.01.2009 to 01.05.2009 = 4 months

Post-incorporation Period : 01.05.2009 to 30.09.2009 = 5 months

Time Ratio = 4:5

3. **Sales Ratio**

Assume Sales = ₹100

Jan: 50
Feb: 50
Mar: 50
April: 50

pre-incorporation = ₹200

May: 100
June: 100
July: 100
Aug: 100
Sep: 100

} post-incorporation = ₹500

Average sales for the first four months were one half of the remaining period. Therefore, if sales is ₹100 p.m. from May to September 2009, it must have been ₹50 only from Jan to April 2009.

Pre-incorporation Sales: ₹200

Post-incorporation Sales: ₹500

200:500 i.e. 2:5

Notes to Accounts:

1. Revenue from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales ratio 2:5	42,000	12,000	30,000

2. Other Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
General Expenses	Time Ratio 4: 5	7,200	3,200	4,000
Directors' Remuneration	Post (12,000)	12,000	—	12,000
Preliminary Expenses	Post	2,000	—	2,000
Rent	Refer working note (a)	5,100	2,000	3,100
Salary of the Manager	Pre incorporation (Refer note)	1,700	1,700	—
Total		28,000	6,900	21,100

Statement of Profit and Loss Account of X Ltd.
for the year ended on 30.09.2009

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	42,000	12,000	30,000
Total (A)		42,000	12,000	30,000

(*Contd.*)

Less: Expenses Other Expenses	2	28,000	6,900	21,100
Total (B)		28,000	6,900	21,100
Profit for the Period (A – B)		14,000	5,100	8,900

Note: Directors' remuneration for 9 months = ₹12,000

Salary of the manager for 1 year = Rs 5,100

$$\text{Pre-incorporation salary} = ₹5{,}100 \times \frac{4}{12}$$

$$= ₹1{,}700$$

Illustration 18

A Public Limited Company was formed to take over a running business with effect from 1st April 2006. The company was incorporated on 1st August 2006 and the certificate of commencement of business was received on 1st October 2006.

The following is the profit and loss account for the period 1st April 2006 to 31st March 2007.

Dr. *Cr.*

Particulars	(₹)	Particulars	(₹)
To Salaries	24,000	By Gross Profit b/d	1,60,000
To Printing and Stationery	2,400		
To Advertisement	8,000		
To Travelling Expense	8,400		
To Trade Expenses	18,900		
To Rent	13,200		
To Electricity Charges	2,100		
To Director's Fees	5,600		
To Bad Debts	1,600		
To Commission to Selling Agents	8,000		
To Interest Paid to Vendors	3,000		
To Debenture Interest	1,500		
To Audit Fees	2,100		
To Selling Expenses	12,600		
To Depreciation	4,800		
To Net Profit	43,800		
	1,60,000		1,60,000

Additional information:

(a) Total sales for the year amounted to ₹9,60,000.
This was even up to the date of certificate of commencement, where after they recorded an increase of two-thirds during the rest of the year.

(b) Rent was paid @ ₹1,000 per month upto September 2006 and thereafter, it was increased by ₹200 per month.

(c) Travelling expenses include ₹2,400 towards sales promotion.

(d) Depreciation included ₹300 for assets acquired in post-incorporation period.

(e) Purchase consideration was discharged by the company on 30th September 2006 by issuing equity shares of ₹10 each.

Calculate the profits prior to incorporation and post incorporation periods.

Solution:

Working Notes:

1. **Time Ratio**

Pre-incorporation Period = 01.04.2006 to 01.08.2006 = 4 months
Post-incorporation Period = 01.08.2006 to 31.03.2007 = 8 months

4:8 i.e. 1:2

2. **Sales Ratio (Weighted Sales Ratio)**

Sales were even up to the date of certificate of commencement, i.e. 01.10.2006 and afterwards it is increased by 2/3.

Assume sales per month = ₹300 p.m. Therefore, sales ratio is to be calculated on the following basis:

April 2006	:	300	
May 2006	:	300	April to July 2006 – Pre-incorporation Sales = ₹1,200
June 2006	:	300	August 2006 to March 2007 – Post
July 2006	:	300	incorporation sales = ₹3,600
August 2006	:	300	Sales Ratio = 1200:3600 i.e. 1:3
September '06	:	300	
Oct. 2006	:	500	
Nov. 2006	:	500	
Dec 2007	:	500	
Jan. 2007	:	500	
Feb 2007	:	500	
March 2007	:	500	

3. **Rent**

Paid @ ₹1,000 p.m. up to September 2006. Increased by ₹200 p.m. afterwards, i.e. October 2006 to March 2007, it will be ₹1,200 p.m.

Pre-incorporation Rent =1,000 × 4 = 4,000
Post-incorporation Rent= 1,000 × 2 = 2,000
(Aug and September)
(Oct 2006 to March 2007) 1,200 × 6 = 7,200

∴ Post incorporation Rent = 2,000 + 7,200 = ₹9,200

4. **Travelling Expense** = ₹8,400

Less: Sales Promotion Expenses = ₹2,400

Divided in Time Ratio 6,000

5. **Sales Promotion Expenses**
   ₹2,400 to be divided in Sales Ratio, i.e. 1:3
6. **Depreciation** = ₹4,800
   Less: Depreciation for assets acquired in
   Post-incorporation = 300
   Divided in Time Ratio 4,500

   Pre-incorporation Depreciation = $4{,}500 \times \frac{1}{3}$ = 1,500

   Post-incorporation Depreciation = $4{,}500 \times \frac{2}{3}$ = 3,000

   Add: Depreciation for assets acquired in post-incorporation = 300
   3,300
7. **Adjusted Time Ratio**
   Purchase consideration discharged on 30th September 2006
   Pre-incorporation Period = 01.04.2006 to 01.08.2006 = 4 months
   Post-incorporation Period = 01.08.2006 to 30.09.2006 = 2 months
   4:2 i.e. 2:1

Notes to Accounts:

1. Revenue from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales Ratio 1:3	1,60,000	40,000	1,20,000

2. Employees Benefit Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Salaries	Time Ratio 1:2	24,000	8,000	16,000

3. Finance Costs

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Interest Paid to Vendors Debenture Interest	Adjusted Time Ratio 2:1	2,100	1,400	700
Interest on Other Loan	Post	1,500		1,500
Total		3,600	1,400	2,200

4. Other Expenses

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Printing and Stationery	Time Ratio 1:2	2,400	800	1,600
Advertisement	Sales Ratio 1:3	8,000	2,000	6,000
Travelling Expense	Time Ratio 1:2 (W.N. 4)	6,000	2,000	4,000
Sales Promotion Expense	Sales Ratio 1:3 (W.N. 5)	2,400	600	1,800
Trade Expenses	Time Ratio 1:2	18,900	6,300	12,600
Rent	(W.N. 3)	13,200	4,000	9,200
Electricity Charges	Time Ratio 1:2	2,100	700	1,400
Directors Fees	Post	5,600	—	5,600
Bad Debts	Sales Ratio 1:3	1,600	400	1,200
Commission to Selling Agents	Sales Ratio 1:3	8,000	2,000	6,000
Audit Fees	Time Ratio 1:2	3,000	1,000	2,000
Selling Expense	Sales Ratio 1:3	12,000	3,150	9,400
Total		83,800	22,950	60.850

5. Depreciation and Amortisation Expense

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Depreciation	W.N.(6)	4,800	1,500	3,300

Statement of Profit and Loss of a Ltd. Co., for the year ended 31.03.2007

Particulars	Note Number	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	1,60,000	40,000	1,20,000
Total (A)		1,60,000	40,000	1,20,000
Less: Expenses				
Employees Benefit Expenses	2	24,000	8,000	16,000

(*Contd.*)

Finance Costs	3	3,600	1,400	2,200
Depreciation	4	4,800	1,500	3,300
Other Expense	5	83,800	22,950	60,850
Total Expense (B)		4,16,200	33,850	82,350
Profit for the Period (A – B)		43,800	6,150	37,650

Illustration 19

MN Ltd. was incorporated on 1st January 2004 with an authorised capital of ₹50,000 equity shares of ₹10 each, to take over the running business of Vee Ltd., as from 1st October 2003. The following is the summarised profit and loss account for the year ended 30th September 2004.

Particulars	(₹)	(₹)
Sales: 01.10.2003 to 31.12.2003	6,000	
01.01.2004 to 30.09.2004	19,000	25,000
Cost of Sales	16,000	
Administrative Expenses	1,768	
Selling Commission	875	
Goodwill written off	200	
Interest Paid to Vendors (loan repaid on 1st February 2004)	373	
Distribution Expenses (60%variable)	1,250	
Preliminary Expenses written off	330	
Debenture Interest	320	
Depreciation	444	
Directors' Fees	100	21,600
Profit		3,340

The company deals with one type of product.

The unit cost of sales was reduced by 10% in the post-incorporation period as compared to the pre-incorporation period. Apportion the net profit between pre-incorporation and post-incorporation periods showing the basis of apportionment.

Solution:

Working Notes:

1. **Time Ratio**

   Pre-incorporation Period: 01.10.2003 to 01.01.2004 = 3 months

   Post-incorporation Period: 01.01.2004 to 30.09.2004 = 9 months

   T.R. = 3:9 i.e. 1:3

2. **Adjusted Time Ratio (up to the date of loan repaid)**

   Pre-incorporation Period: 01.10.2003 to 01.01.2004 = 3 months

   Post-incorporation Period: 01.01.2004 to 01.02.2004 = 1 months

   Adjusted time ratio = 3:1

3. **Sales Ratio**

Pre-incorporation Sales: 6,000

Post-incorporation Sales: 19,000

S.R. = 6:19

4. **Cost of Sales Ratio**

Pre-incorporation Sales: 6,000

Post-incorporation Sales: $19{,}000 \times \frac{90}{100} = 17{,}100$

(unit cost of sales reduced by 10%)

Therefore, Cost of Sales Ratio = 60:171

5. **Gross Profit**

Sales – Cost of Goods Sold

Pre-incorporation Cost of Goods Sold = $16{,}000 \times \frac{60}{231} = 4{,}156$

Post-incorporation Cost of Goods Sold = $16000 \times \frac{171}{231} = 11{,}844$

Pre-incorporation G/P = 6,000 – 4,156 = 1,844

Post-incorporation G/P = 19,000 – 11,844 = 7,156

6. **Distribution Expenses**

60% variable to be divided in Sales Ratio

i.e. 1,250 × 60% = ₹750

Pre-incorporation = $750 \times \frac{6}{25}$ = ₹180

Post-incorporation = $750 \times \frac{19}{25}$ = ₹570

40% fixed to be divided in Time Ratio

i.e. 1250 × 40% = ₹500

Pre-incorporation = $500 \times \frac{1}{4}$ = ₹125

Post-incorporation = $500 \times \frac{3}{4}$ = ₹375

Notes to Accounts:

1. Revenue from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	W.N. 5	9,000	1,844	7,156

2. Finance Costs

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Interest Paid to Vendors Debenture Interest	Adjusted Time Ratio 3:1	373	280	93
Debenture Interest	Post	320	—	320
Total		693	280	413

3. Depreciation and Amortisation Expenses

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Depreciation	Time Ratio 3:1	444	111	333
Goodwill Written Off	Post	200	—	200
Total		644	111	533

4. Other Expenses

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Administrative Expenses	Time Ratio 1 : 3	1,768	442	1,326
Selling Expenses	Sales Ratio 6 : 19	875	210	665
Distribution Expenses (fixed)	Time Ratio W.N. 6	500	125	375
Variable Expenses	Sales ratio W.N. 6	750	180	570
Preliminary Expenses Written Off	Post	330	—	330
Directors' Fees	Post	100	—	100
Total		4,323	957	3,366

Statement showing Profit and Loss Account of MN Ltd.
for the year ended 30.09.2004

Particulars	Note Number	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	9,000	1,844	7,156
Total (A)		9,000	1,844	7,156

(*Contd.*)

Less: Expenses				
Finance Costs	2	693	280	413
Depreciation and Amortisation Expenses	3	644	111	533
Other Expense	4	4,323	957	3,366
Total Expense (B)		4,550	1,348	4,312
Profit for the Period (A – B)		3,340	496	2,844

Illustration 20

Adarsh Raj Ltd., incorporated on 1st May 2003, received the Certificate to Commencement of Business on 31st May 2003. It had acquired a running business from Govind and Co. with effect from 1st January 2003. The purchase consideration was ₹50,00,000, of which Rs.10,00,000 was to be paid in cash and ₹40,00,000 in the form of fully-paid shares. The purchase price was settled on 31st May 2003, with interest.

The company also issued shares for ₹40,00,000 for cash. Machinery costing ₹25,00,000 was then installed. Assets acquired from the vendors were:

Machinery ₹30,00,000; Stock ₹6,00,000 and Patents ₹4,00,000.

During the year 2003, the total sales were ₹1,80,00,000.

The sales per month in the first half-year being one-half of what they were in the latter half-year.

The net profit of the company, after charging the following expenses, was ₹10,00,000.

	(₹)
Depreciation	5,40,000
Audit Fees	26,000
Directors' Fees	60,000
Preliminary Expenses	10,000
Office Expenses	2,40,000
Selling Expenses	1,98,000
Interest to Vendors	50,000

Ascertain the pre-incorporation and post-incorporation amounts of profit and prepare the balance sheet of the company as on 31st December 2003. The closing stock was valued at ₹7,00,000.

Solution:

Working Notes:

1. **Time Ratio**

   Pre-incorporation Period : 01.01.2003 to 01.05.2003 = 4 months

Post-incorporation Period: 01.05.2003 to 31.12.2003 = 8 months
4: 8 i.e 1:2

2. Sales Ratio

Sales per month in the first half-year being one-half of what they were in the latter half year.
Assume Sales = ₹100 p.m. Hence, sales from January to June will be ₹50 p.m. Thereafter, it is ₹100 p.m.

Jan: 50
Feb: 50
Mar: 50
April: 50
} pre-incorporation = ₹200

May: 50
June: 50
July: 100
Aug: 100
Sep: 100
Oct: 100
Nov: 100
Dec: 100
} post-incorporation = ₹700

Sales Ratio = 200:700 i.e. 2:7

3. Adjusted Time Ratio – Interest to Vendors

Pre-incorporation Period : 01.01.2003 to 01.05.2003 = 4 months
Post-incorporation Period: 01.05.2003 to 31.05.2003 = 1 month

4:1

4. Closing Balance of Machinery

Book Value of Machinery Acquired from Vendors	30,00,000
Add: Machinery Acquired by the Company	25,00,000
	55,00,000
Less: Depreciation	5,40,000
	49,60,000

5. Calculation of G/P

Net Profit after Charging expenses		10,00,000
Add: Expenses:		
Depreciation	5,40,000	
Audit Fees	26,000	
Directors' Fees	60,000	
Preliminary Expenses	10,000	
Office Expenses	2,40,000	
Selling Expenses	1,98,000	
Interest to Vendors	50,000	11,24,000
Gross Profit		21,24,000

6. Calculation of Goodwill

Purchase Consideration	—	50,00,000
Less: Assets Acquired:		
Machinery	30,00,000	
Stock	6,00,000	
Patents	4,00,000	40,00,000
		10,00,000
Less: Pre-incorporation Profit		1,28,000
		8,72,000

Notes to Accounts:

1. Revenue from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Gross Profit	Sales ratio 2:7	21,24,000	4,72,000	16,52,000

2. Finance Costs

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Interest to Vendors	Adjusted Time Ratio 4:1	50,000	40,000	10,000

3. Depreciation and Amortisation Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Depreciation	Time Ratio 1:2	5,40,000	1,80,000	3,60,000

4. Other Expenses

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Audit Fees	Post	26,000	—	26,000
Directors' Fees	Post	60,000	—	60,000
Preliminary Expenses	Post	10,000	—	10,000
Office Expenses	Time Ratio 1:2	2,40,000	80,000	1,60,000
Selling Expenses	Sales Ratio 2:7	1,98,000	44,000	1,54,000
Total		5,34,000	1,24,000	4,10,000

Notes to Balance Sheet

Particulars	(₹)	(₹)
1. Share Capital		
₹80,00,000 shares (₹40,00,000 shares issued for consideration other than cash)		80,00,000
2. Reserves and Surplus		
Profit and Loss A/c		8,72,000
3. Tangible Assets		
Machinery (W.N. 4)		49,60,000
4. Intangible Assets		
Patents	4,00,000	
Goodwill (W.N. 6)	8,72,000	12,72,000

Note: Pre-incorporation profit being a capital profit, is adjusted against goodwill.

Statement showing Profit and Loss Account of Adarsh Raj Ltd. for the year ended 31.12.2003

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	21,24,000	4,72,000	16,52,000
Total (A)		21,24,000	4,72,000	16,52,000
Less: Expenses				
Finance Costs	2	50,000	40,000	10,000
Depreciation	3	5,40,000	1,80,000	3,60,000
Other Expenses	4	5,34,000	1,24,000	4,10,000
Total Expenses (B)		11,24,000	3,44,000	7,80,000
Profit for the Period (A – B)		10,00,000	1,28,000	8,72,000

Balance Sheet of Adarsh Raj Ltd. for the year ended 31.12.2003

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds	1	80,00,000
Reserves and Surplus	2	8,72,000
(ii) Non-Current Liabilities		—
(iii) Current Liabilities		—
Total: (i) + (ii) + (iii)		88,72,000

(*Contd.*)

II. Assets:		
(i) Non-current Assets:		
Tangible Assets	3	49,60,000
Intangible Assets	4	12,72,000
(ii) Current Assets:		
Closing Stock		7,00,000
Other Current Assets – [Closing Cash Balance (Bal. Fig.)]		19,40,000
		88,72,000

Illustration 21

The following trial balance was extracted from the book of Hema Pvt. Ltd., formed by Mr. Chand of Hyderabad on 1st April 2009 but was incorporated on 1st July 2009. No entries relating to the transfer of the business were entered in the books, which was carried on until 31st March 2010.

Dr. **Trial balance as on 31.03.2010** *Cr.*

Particulars	(₹)	Particulars	(₹)
Stock (01.04.2009)	42,940	Sales	2,79,300
Purchases	1,96,780	Capital A/c of	
Carriage Outwards	1,650	Mr. Chand (01.04.2009)	2,00,000
Traveller's Commission	6,150	Current Liabilities	31,660
Office Salaries	16,640		
Rent and Taxes	1,640		
Office Expenses	2,400		
Director's Salary	15,000		
Fixed Assets	1,25,000		
Current Assets (other than stock)	1,01,200		
Preliminary Expenses	1,560		
	5,10,960		5,10,960

Additional information:

(a) Stock on 31st March 2010 amounted to ₹35,420
(b) Purchase consideration ₹2,50,000 to be paid by the issue of 25,000 equity shares of ₹10 each.
(c) Gross profit percentage is fixed, turnover is double in April, November and December
(d) Preliminary expenses are to be written off.
(e) Carriage outward and traveller's commission vary in direct proportion to sales

Prepare trading and profit and loss account for the year ended 31st March 2010 appropriating between the pre- and post-incorporation periods and a balance sheet as on 31st March 2010.

Solution:

Working Notes:

1. **Time Ratio:**
   Pre-incorporation period: 1st April 2009 to 1st July 2009 – 3 months
   Post-incorporation period: 1st July 2009 to 31st March 2010 – 9 months
   3:9 i.e. 1:3
2. **Sales Ratio:**
   Sales was double in the month of April, November and December.
   Assume sales per month = ₹100;
   ∴ For April, November and December it must be ₹200 p.m

   $$\left.\begin{array}{l}\text{April: 200}\\ \text{May: 100}\\ \text{June: 100}\end{array}\right\}\quad \text{Pre-incorporation} = ₹400$$

   $$\left.\begin{array}{l}\text{July: 100}\\ \text{Aug: 100}\\ \text{Sept: 100}\\ \text{Oct: 100}\\ \text{Nov: 200}\\ \text{Dec: 200}\\ \text{Jan: 100}\\ \text{Feb: 100}\\ \text{March: 100}\end{array}\right\}\quad \text{Post-incorporation} = ₹1,100$$

   ∴ Sales Ratio = 400:1199 i.e. 4:11

Notes to Account

1. Revenues from Operations

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Sales	Sales ratio 4:11	2,79,300	74,480	2,04,820

2. Cost of Goods Sold

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Cost of Goods Sold = Opening Stock + Purchases – Closing Stock (42,940 + 1,96,780 – 35,420)	Sales ratio 4:11	2,04,300	54,480	1,49,820

3. Employee Benefit Expenses

Particulars	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Office salaries	Time ratio 1:3	16,640	4,160	12,480

4. Other Expenses

	Basis of Apportionment	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Carriage Outwards	Sales Ratio 4:11	1,650	440	1,210
Travelling Commission	Sales Ratio 4:11	6,150	1,640	4,510
Rent and Rates	Time Ratio 1:3	1,640	410	1,230
Directors' Fees	Post	15,000	—	15,000
Preliminary Expenses	Post	1,560	—	1,560
Total		28,400	3,090	25,310

Statement of Profit and Loss of Hema (P) Ltd.,
for the year ended 31.03.2010

Particulars	Note No.	Total (₹)	Pre-incorporation (₹)	Post-incorporation (₹)
Revenue from Operations	1	2,79,300	74,480	2,04,820
Total (A)		2,79,300	74,480	2,04,820
Less: Expenses				
Cost of Goods Sold	2	2,04,300	54,480	1,49,820
Employee Benefit Expenses	3	16,640	4,160	12,480
Other Expenses	4	28,400	3,090	25,310
Total Expenses (B)		2,49,340	61,730	1,87,610
Profit		29,960	12,750	17,210

Notes to Balance Sheet

	₹
1. Share Capital	
25, 000 shares of Rs. 10 each (all the shares issued for consideration other than cash)	2,50,000

(*Contd.*)

2. Reserves and Surplus	₹
Profit and Loss A/c	17,210
3. Tangible Assets	
Other Fixed Assets	1,25,000
4. Intangible Assets	
Goodwill	50,000
Less: Profit Prior to Incorporation	12,750
	37,520

Balance Sheet of Hema (P) Ltd., as on 31.03.2010

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	2,50,000
Reserves and Surplus	2	17,210
(ii) Non-current Liabilities		—
Current Liabilities	3	31,660
Total: (i) + (ii)		2,98,870
II. Assets:		
(i) Non-current Assets		
Tangible Assets	4	1,25,000
Intangible Assets	5	37,250
(ii) Current Assets		
Closing Stock		35,420
Other Current Assets		1,01,200
Total: (i) + (ii)		2,98,870

THEORY QUESTIONS

I. Short-Answer Questions

1. Explain the term Profits Prior to Incorporation.
2. Why do you calculate Profit Prior to Incorporation?
3. State the accounting treatment for Profit Prior to Incorporation in accounts?
4. Explain the various purposes for which profit prior to incorporation can be used?
5. What is the accounting treatment for Loss Prior to Incorporation in accounts?
6. Enumerate the expenses, which are exclusively charged to post-incorporation period?
7. Give some examples of expenses, which are to be divided on 'Time basis' while computing profit prior to incorporation.

8. Write a note on Pre-incorporation Profit.
9. How do you calculate Adjusted Time Ratio and when?
10. How do you calculate Time Ratio and Sales Ratio?
11. How do you treat Interest on Purchase Consideration and Salary Paid to Partners, while ascertaining Profit Prior to Incorporation?

II. Long-Answer Questions

1. Explain the accounting treatment for Profit Prior to Incorporation in Accounts.
2. Enumerate the different methods of ascertaining Profit Prior to Incorporation.
3. What are the different ratios used in computing Profit Prior to Incorporation? Briefly describe each of them.
4. How do you apportion various expenses and incomes between Pre- and Post-incorporation Periods?
5. Discuss the treatment of the following items with appropriate reasons, while ascertaining Profit Prior to Incorporation.

   a. Rent b. Depreciation c. Directors' Fees d. Audit Fees e. Goodwill Written Off f. Debenture Interest g. Interest Paid to Vendors

OBJECTIVE-TYPE QUESTIONS

I. Multiple Choice Questions

1. Profit prior to incorporation is the profit earned:
   (a) Between the date of incorporation and the date of commencement of business;
   (b) Between the date of purchase of business and the date of incorporation.
   (c) Between the date of purchase of business and the date of commencement of business;
   (d) None of the above
2. Profit prior to incorporation belongs to:
   (a) The company (b) The vendor
   (c) Both the company and the vendor (d) None of the above
3. Profit prior to incorporation should be credited to:
   (a) Asset A/c (b) Profit and Loss A/c
   (c) Capital Reserve A/c (d) None of the above
4. Loss prior to incorporation should be credited to:
   (c) Revenue Reserve (b) Goodwill A/c
   (c) Capital Reserve A/c (d) Preliminary expenses A/c
5. Gross profit is to be apportioned between pre- and post-incorporation periods in:
   (a) Time ratio (b) Adjusted time ratio
   (c) Sales ratio (d) None of the above.
6. Bad debts are to be apportioned in:
   (a) Time ratio (b) Sales ratio
   (c) Post in pre-incorporation period (d) Post in post-incorporation period

7. Audit fees should be divided between pre- and post-incorporation periods in:
   (a) Time ratio
   (b) Time ratio or posted only in post-incorporation period
   (c) Sales ratio
   (d) Pre-incorporation period
8. The salary paid to Manager, for a period before acquisition of business, should be:
   (a) Divided in time ratio (b) Posted in pre-incorporation period
   (c) Posted in post-incorporation period (d) Divided in adjusted time ratio
9. Adjusted time ratio is used for:
   (a) Salaries (b) Interest paid to vendors
   (c) Directors' fees (d) None of the above
10. Purchase ratio is used for:
   (a) Discount received (b) Discount allowed
   (c) Wages (d) None of the above

[*Ans:* 1. (b); 2. (a); 3. (c); 4. (b); 5. (c); 6. (b); 7. (b); 8. (b); 9. (b); 10. (a)]

II. True and False

1. Pre-incorporation loss may be treated as revenue loss and debited to profit and loss account.
2. Gross profit is to be divided between pre- and post-incorporation periods in sales ratio.
3. Profits prior to incorporation are capital profits and are not available for dividend.
4. Variable expenses are to be divided in sales ratio, while computing pre-incorporation profit.
5. For calculating pre-incorporation profit, date of commencement of business is the relevant date in the case of the company over a period of time.
6. Expenses such as director's fees, discount on issue of shares, underwriting commission, interest on debentures, etc., are to be charged fully to post-incorporation period.
7. Pre-incorporation loss may be treated as deferred revenue expenditure and written off out of the profits of the company over a period of time.
8. Advertisement expenses to be paid on monthly basis are to be apportioned on time ratio to the pre- and post-incorporation periods.

[*Ans:* 1. False 2. True 3. True 4. True 5. False 6. True 7. True 8. True.]

III. Fill in the Blanks

1. Establishment expenses are apportioned in the ____________ to ascertain pre-incorporation profits.
2. The two important ratios in the calculation of pre-incorporation profit are ____________ and ____________.
3. Pre-incorporation profit should be taken as ____________ profit.

4. Interest paid to vendors should be apportioned in ____________ ratio.
5. Partner's salary is debited to the ____________ period.
6. Preliminary expenses written off are debited to ____________ period.
7. Salary is divided in ____________ ratio while calculating pre-incorporation profit.
8. The profits acquired from the date of business purchase till the date of incorporation is called ____________.
9. Capital reserve account has to be shown in the liabilities side of the balance sheet under the heading ____________.
10. Loss prior to incorporation is to be shown in the assets side of the balance sheet under the heading _________.

[*Ans:* 1. time ratio; 2. time ratio and sales ratio; 3. capital; 4. Adjusted time; 5. pre-incorporation; 6. post-incorporation; 7. time ratio; 8. profit prior to incorporation; 9. reserves and surplus; 10. miscellaneous expenditure]

EXERCISE PROBLEMS

1. Dravida Nadu Enterprise decided to convert his firm into a limited company with effect from 1st April 1996. But he obtained the certificate of incorporation on 1st August 1996 and certificate to commence business on 1st October 1996. His accounts were closed on 31st December 1996. Work out time ratio for ascertaining pre-incorporation profit.
2. Mahesh, a sole trader has decided to convert his business into a Public Ltd. Company. Calculate time ratio from the following information:
   (a) Date of sale of the business to the company 30th June 2007
   (b) Date of obtaining certificate of incorporation 1st October 2007
   (c) Date of obtaining certificate to commence business 31st October 2007
   (d) Date of closing of the accounts on 31st March 2008

   [*Ans:* Time ratio: 1:2]
3. Calculate sales ratio from the following particulars: Total sales is ₹10,00,000 and sales during pre-incorporation period is ₹2,00,000.

   [*Ans:* Sales ratio: 1:4]
4. XYZ Ltd. Company was incorporated on 1st July 2008 in order to purchase a running business from 1st January 1998. From the following particulars, calculate pre-incorporation loss:
   (a) Total sales for the year 2008 was ₹4,50,000
   (b) Sales from 1st January 2008 to 30th June 2008 ₹1,50,000
   (c) Gross profit for the whole year ₹1,35,000
   (d) Establishment expenses ₹92,500.

   [*Ans:* Pre-incorporation loss: ₹1,250]
5. ABC Ltd. was formed on 1st May 2008 and it obtained the certificate of commencement of business on 1st June 2008. It acquired a running business with effect from 1st January 2008. Books were closed on 30th September 2008 when

it was found that the net profit was ₹1,50,000 with a gross profit of ₹3,37,500. Director's remuneration was ₹34,000. Sales during the months January to June per month were half of the sales per month in the remaining months. What profit is available to the company for declaration of dividend? [*Ans:* ₹1,09,500]

6. You are required to calculate the time ratio for the pre- and post-incorporation periods from the following particulars:
   (a) Date of incorporation: 1st June 1999
   (b) Period of financial Accounts: April 1999 to March 2000
   (c) Total wages ₹4,800
   (d) Number of workers: Pre-incorporation period: 5, Pre-incorporation period: 25

   Also divide the total wages between pre- and post-incorporation periods.

   [*Ans:* Time ratio: 1:5; Weighted time ratio: 1:25; wages: pre-incorporation: ₹185; Post-incorporation: ₹4,615]

7. Rajesh sold the business to Rangan Ltd., with effect from 1st April 2007 for ₹4,00,000. The company was incorporated on 1st July 2007 and the accounts were finalised on 31st March 2008. The company paid off Rajesh on 30th November 2007 with interest of ₹32,000. Salaries for the year amounted to ₹46,400. There were five employees before incorporation but three more recruited on the date of incorporation. You are required to calculate:

   (i) Time ratio (ii) Adjusted Time ratio for interest (iii) Weighted time ratio for salaries:

   [*Ans:* (i) Time ratio: 1:3; Adjusted time ratio for interest: 3:5; Weighted time ratio: 5:24]

8. Amar and Akbar carrying on a partnership business converted their business into limited company with effect from 1st April 2006. However, they could complete all the legal formalities and incorporate the company only on 1st July 2006. When the accounts were closed on 31st March 2007, it was found that sales went up by 50% on an average in each month after incorporation compared to those before date. Ascertain the sales ratio.

   [*Ans:* Sales ratio: 2:9]

9. Ramki Ltd. was formed on 1st May 2008 to purchase the business of Mr. Ram, with effect from 1st January 2008. While preparing the final accounts on 31th December 2008, it was assumed that:
   (a) The sales for the year were ₹10,00,000.
   (b) Sales in the second half of the year were double to those in the first half on a monthly average basis.

   Calculate sales ratio from the above particulars.

   [*Ans:* Sales ratio 2:7]

10. RMK Ltd. was registered as company on 1st July 2007 to take over the running business of Kumar, with effect from 1st April 2007. The Profit & Loss A/c account was finalised on 31st March 2008. Bad debts debited to Profit & Loss A/c was ₹4,000 of which ₹1,000 to sales effected after 1st July 2007. Average monthly turnover from July 2007 onwards was double than that of pervious months. Calculate sales ratio and amount of bad debts to be charged between pre- and post-incorporation periods.

    [*Ans:* Sales ratio: 1:6; Bad debts: Pre: ₹3,000; Post ₹1,000]

11. CMS Ltd. was incorporated on 1st July 1999 to take over the running business of Selvam, with effect from 1st April 1999. The profit and loss account was prepared on 31st March 2000. Bad debts debited to profit and loss account was ₹1,250, of which ₹350 related to sales effected after 1th July 1999. Average monthly turnover from July 1999 onwards was double than that of pervious months. Calculate sales ratio and amount of ad debts to be charged between pre- and post-incorporation periods.

    [*Ans:* Sales ratio: 1:6 Bad debts: Pre: ₹900; Post: ₹350]

12. Z Ltd. was formed on 1st May 2000 and it obtained the certificate of commencement of business on 1st June 2000. It acquired a running business, with effect from 1st January 2000. Books were closed on 30th September 2000, when it was found that the net profit was ₹2,00,000 with a gross profit of ₹4,50,000. Director's remuneration was ₹34,000. Sales in the months January to June per month were ½ of the sales per month in the remaining months. What profit is available to the company for declaration of dividend?

    [*Ans:* ₹1,46,000]

    Hint: Divide ₹2,16,000 (4,50,000-2,00,000-34,000) in time ratio of 4:5.

    Divide ₹4,50,000 G/P in sales ratio 1:2.

13. A limited company was incorporated on 1st July 1998 in order to purchase a running business from 1st January 1998. From the following particulars, calculate pre-incorporation loss:
    (a) Total sales for the year 1998 was ₹1,80,000
    (b) Sales from 1st January 1998 to 30th June 1998 ₹60,000
    (c) Gross profit for the whole year ₹54,000
    (d) Establishment expenses ₹37,000

14. From the following data, calculate profit prior to incorporation:

    Time ratio: 1:2

    Sales ratio: 1:3

    Gross profit: ₹1,70,500

    Administrative expenses: ₹69,600

    Expenses relating to sales: ₹18,600

    Preliminary expenses: ₹11,560

    [*Ans:* Profit prior to incorporation: ₹14,775]

15. A company was incorporated on 1st June 1994 in order to purchase a running business from 1st January 994. The following particulars are available from its records:

(a) Total sales for 1994	80,000
(b) Sales from 1st January 1994 to 31st May 1994	20,000
(c) Gross profit for the whole year	30,000
(d) Total expenses of 1994 (including fees ₹1000)	25,000
(e) Company's share capital	75,000

Find out profit prior to incorporation and after incorporation by preparing profit and loss account.

[*Ans:* Loss prior to incorporation: ₹2,500; Profit after incorporation: ₹7,500]

OTHER EXERCISES

1. Alpha Ltd. was incorporated on 1st July 2000, to take over the business carried on by Gopal with effect from 1st April 2000. The following is the Profit & Loss A/c for the year ended 31st March 2001:

Particulars	(₹)	Particulars	(₹)
To Opening Stock	1,20,000	By Sales (upto 30.06.2000 ₹1,00,000)	3,00,000
To Purchases	1,75,000	By Closing Stock	70,000
To Gross Profit	75,000		
	3,70,000		3,70,000
To Administration Expenses	18,000		75,000
To Director's fees	3,000	By Gross Profit	
To Selling Expenses	36,000		
To Audit Fees	1,000		
To Preliminary Expenses	14,000		
To Net Profit	75,000		75,000

Ascertain profit prior to incorporation.

[*Ans:* Time ratio: 1:3; Sales ratio: 1:2 Pre-incorporation profit: ₹8,250; Post-incorporation period: ₹5,750]

2. A company was incorporated on 30th June 1994 to acquire the business of Mohan as from 1st January 1994. The accounts for the year ended 31st December 1994 disclosed the following:
   (a) There was a gross profit of ₹2,40,000.
   (b) The sales for the year amounted to ₹12,00,000 of which ₹5,40,000 was for the first six months.
   (c) The expenses debited to profit and loss account included:

Director's fees	15,000
Bad debts	3,600
Advertising (under a monthly contract of ₹1000)	12,000
Salaries	64,000
Preliminary expenses written off	5,000
Donation to political parties given by the company	5,000

Prepare a statement showing profit made before and after incorporation.

[*Ans:* Profit made before incorporation: ₹68,380; Profit made after incorporation: ₹67,020]

3. X Ltd. purchased the running business of Arun and C Ltd. on 1st January 1992 and obtained the certificate of incorporation on 1st April 1992. From the following particulars, prepare profit prior to and after incorporation.
   (a) Sales for the year 1992 ₹2,40,000. The trend of sale was as follows: Jan 1992- twice the average sales; Feb 1992- average sales; May 1992 to August 1992- ¼ times of average sales; October and November 1992–93 times of the average sales.

(b) Cost of goods sold ₹1,44,000.

(c) Other expenses

Salary ₹12,000; Rent ₹6,000; Office expenses ₹3,600; Audit fees ₹4,800; Depreciation ₹3,000; Bad debts ₹480; Discount allowed ₹960; Interest on debenture ₹9,000; Interest on purchase consideration upto 31.8.92 ₹3,200.

[*Ans:* Profit prior to incorporation ₹19,050;
Profit after Incorporation, ₹33,910]

4. A company was incorporated on 1st May 1994 to take over a business as a going concern from 1st January of the same year. The turnover for the year ended 31st December was ₹2,00,000, namely ₹60,000 for the first period upto 1st May and ₹1,40,000 for the following period. From the profit and loss account given below for the year ended 31st December 1994, you are required to ascertain profits prior to incorporation.

Particulars	(₹)	Particulars	(₹)
To Rent and Rates	3,240	By Gross Profit	70,000
To Insurance	720		
To Lighting	2,040		
To Salaries	7,800		
To Director's Fees	2,000		
To Sales Discount	5,000		
To Sales Commission	10,000		
To General Expenses	2,400		
To Carriage Outward	3,000		
To Bank Charges	420		
To Repairs	1,380		
To Bad Debts	600		
To Loan Interest	1,200		
To Net Profit	30,200		
	70,000		70,000

[*Ans:* Pre-incorporation profit: ₹9,020; Post-incorporation profit: ₹21,180]

5. Mukesh and Co. Ltd. was registered on 1st January 1999 to buy the business of M/s Mukesh Bros., as on 1st October 1998 and obtained the certificate of commencement of business on 1st February 1999. The accounts of the company for the period of 12 months ended 30th September 1999 disclosed the net profits of ₹1,25,000 after having charged the following amounts:

Salary: ₹30,000 (there were 4 employees in the pre-incorporation period and 7 in the post-incorporation period)

Wages: ₹10,920 (there were 4 workers in the pre-incorporation period and 5 in the post-incorporation period and the rate of wages were ₹160 and ₹200 per month per worker in the pre- and post-incorporation periods respectively.

Sales: ₹4,80,000 of which ₹80,000 related to pre-incorporation period.

Director's fee: ₹16,000.

You are required to calculate profit for pre- and post-incorporation periods separately.

[*Ans:* Profit prior to incorporation: ₹23,600;
Post-incorporation profit: ₹1,01,400;
Adjusted time ratio for salaries: 4:21; wages: Pre: ₹1,920; post: ₹9,000; G/P before charging wages: ₹1,81,920; sales ratio: 1:5]

6. Mohan Company Ltd. was incorporated on 30th June 1995 to take over the business of Mr. K Mohan, as from 1st January 1995. The financial accounts of the business for the year ended 31st December 1995 disclosed the following information:

	Particulars	(₹)	(₹)
Sales	January to June	1,20,000	
	July to December	1,80,000	3,00,000
	Purchases:		
	January to June	75,000	
	July to December	1,20,000	1,95,000
	Gross profit		1,05,000
	Salaries	15,000	
	Selling Expenses	3,000	
	Depreciation	1,500	
	Director's Remuneration	750	
	Debenture Interest	90	
	Administration Expenses (Rent, Rates, etc.)	4,500	24,800
	Profit for the Year		80,160

You are required to prepare a statement apportioning the balance of profit between the periods prior to and after incorporation and show the profit and loss appropriation account for the year ended 31st December 1995.

[*Ans:* Profit prior to incorporation: ₹33,300;
Profit after incorporation: ₹46,860]

7. Prabhu Private Limited was incorporated on 1st July 1994 to take over the running concern of Mr. Rowther, with effect from 1st April 1994. The following profit and loss account for the year ended 31st March 1995 was drawn up.

Dr. *Cr.*

Particulars	(₹)	Particulars	(₹)
To Commission	2,625	By Gross Profit	98,000
To Advertisement	5,250	By Bad Debts realised	500
To Managing Director's Remuneration	9,000		
To Depreciation	2,800		
To Salaries	18,000		

(*Contd.*)

To Insurance	600		
To Preliminary Expenses	700		
To Rent and Taxes	3,000		
To Discount	350		
To Bad Debts	1,250		
To Net Profit	54,925		
	98,500		98,500

The following details are available:

(a) The average monthly turnover from July 1994 onwards was double than that of pervious months.

(b) The rent for the first three months was paid @ ₹200 p.m. and thereafter at a rate increased by ₹50 p.m.

(c) Bad debts of ₹350 related to sales affected after 1st September 1994 and the realisation of bad debts was in respect of debts written off during 1992.

(d) Advertisement expenses were directly proportionate to the sales.

You are required to find out profit prior to incorporation and to state the treatment thereof in the books of the company.

[*Ans:* Profit prior to incorporation : ₹6,951, to be transferred to capital reserve; Profit after incorporation: ₹47,974; Time ratio: 1:3; Weighted sales ratio: 1:6; Rent: pre-incorporation: ₹600; post-incorporation: ₹2,250; Taxes (3000–2850) ₹150- on time basis- ₹38 and 112; Bad debts ₹350 allocated to post-incorporation ₹900 in adjusted sales ratio of 3:4 (April, May, June = 3; July, August 4); Bad debts realised to be added to pre-incorporation gross profit)]

8. From the following particulars, ascertain profit prior to and after incorporation.

(a) Time ratio: 3:5

(b) Sales ratio: 4:6

(c) Gross profit: ₹10,00,000

(d) Expenses debited to profit and loss account were:

Salaries	96,000
General Expenses	12,000
Discount on Sales	40,000
Advertisement	50,000
Preliminary Expenses	70,000
Rent and Rates	15,000
Printing and Stationery	65,000

(e) Incomes credited to profit and loss account were:

Rent Received	18,000
Interest Received	5,000

[*Ans:* Profit prior to incorporation: ₹3,19,000;
rofit after incorporation: ₹4,01,000]

Hint: Rent and interest received are to be divided in time ratio.

9. Vector Ltd. was incorporated on 1st April 1990 for the purpose of taking over the business of Shanta stores as a going concern from 1st January 1990. Purchase consideration will be paid on 31st December 1990 and the vendors will be entitled to 5% of the profits earned prior to incorporation in lieu of interest on unpaid purchase consideration. The summarized trading results on the basis of accounts prepared for the year ended on 31st December 1990 were as follows:

Particulars	(₹)	Particulars	(₹)
To Purchases (after adjusting Stocks)	7,00,000	By Sales (Jan–Mar)	2,00,000
To Gross Profit	3,00,000	(Apr–Dec.)	8,00,000
	10,00,000		10,00,000
To General Expenses	1,80,000	By Gross Profit	3,00,000
To Director's Fees	14,000		
To Formation Expenses	6,000		
To Net Profit	1,00,000		
	3,00,000		98,500

Prepare a statement showing pre- and post-incorporation profits. Gross profit should be apportioned on the basis of turnover and general expenses on time basis.

[*Ans:* Pre profit: before interest: ₹15,000; after interest: ₹13,125; post profit: before interest: ₹85,000; after interest: 79,375)]

10. X company purchased a business on 1st April 1993. The company obtained certificate of incorporation on 31st July 1993. From the following particulars for the year ending 31st March 1994, ascertain profits prior to incorporation and divisible profits.
   (a) Total sales upto 31st March 1994 to ₹10,00,000; sales from 1st April 1993 to 31st July 1993 ₹2,50,000.
   (b) Gross profit for the year ₹2,12,000
   (c) Expenses debited to profit and loss account were as under:

Particulars	(₹)	Particulars	(₹)
Rent	6,000	Interest on Debentures	4,000
Insurance	1,500	Printing and Stationery	4,200
Salaries	27,000	Depreciation on Machinery	30,000
Selling Expenses	9,000	Commission on Sales	12,600
Advertisement	8,000		
Audit Fees	1,200		
Bad Debts (₹850 related to pre-incorporation)	2,400		
General Expenses	2,400		
Directors' Fees	2,600		
Preliminary Expenses	7,200		
Interest paid to vendors upto 1st September 1993	5,000		

[*Ans:* Profit prior to incorporation: ₹15,850; Divisible profits: ₹70,650; Adjusted time ratio for interest paid to vendors: 4:1]

11. Kamakshi Ltd. was incorporated on 1st March 1991 to acquire the business of Meenakshi as from 1st January 1991. The purchase consideration was agreed at ₹90,000 to be satisfied by the issue of equity shares of ₹10 each. The following trading and profit and loss account is presented to you.

Trading and Profit and Loss Account of Kamakshi Ltd.
for the year ended 31.12.1991

Particulars	(₹)	Particulars	(₹)
To Purchases (after adjusting Stocks)	1,16,100	By Sales	2,25,000
To Gross Profit	1,08,900		
	2,25,000		2,25,000
To Salaries	45,000	By Gross Profit	1,08,900
To Office Expenses	3,750		
To Selling Expenses	12,300		
To Carriage Outwards	2,550		
To Rent and Rates	3,000		
To Director's Fees	5,025		
To Stationery	3,000		
To Interest on Purchase Price	1,350		
To Net Profit c/d	1,08,900		1,08,900

The following additional information is given

(a) Sales made after incorporation amounted to ₹2,02,500

(b) The shares were issued to the vendors on 1st April 1991 to settle the purchase price.

(c) Interest on purchase price was paid till the date of payment.

You are required to ascertain the profit earned by the company, before and after incorporation.

[*Ans:* Loss incurred before incorporation: ₹620;
Profit earned after incorporation: ₹33,545; Sales ratio: 1:9;
Adjusted time ratio for interest: 2:1]

12. Sairam Co. Ltd. was incorporated on 1st February 1997 to acquire Kumaran's business with effect from 1st October 1996. The purchase price was agreed to be ₹1,75,000. Kumaran accepted equity shares of ₹10 each, for ₹1,00,000 and 8% debentures for the balance. However, entries were not passed in the books for the acquisition. On 30th September 1997, the following trial balance was prepared.

Trial Balance

Particulars	Debit (₹)	Particulars	Credit (₹)
Purchases	1,80,000	Sales	2,60,000
Distribution Expenses	15,000	Creditors	20,000

(*Contd.*)

Office Expenses	3,000	Kumaran's Capital as on 1.10.1996	1,50,000
Postage and Telegram	2,400		
Opening Stock	26,500		
Directors' Fees	5,000		
Debenture Interest	3,000		
Machinery	1,20,000		
Debtors	50,000		
Sundry Current Assets	23,600		
Preliminary Expenses	1,500		
	4,30,000		4,30,000

The following additional information was also obtained:

(a) Stock on 30th October 1997 was valued at ₹25,000.

(b) Sales before and after incorporation were approximately in the ratio of 1:3.

(c) Preliminary expenses are to be written off.

Prepare trading and profit and loss account and the balance sheet, clearly showing the pre- and post-incorporation profits.

[*Ans:* Gross profit: ₹78,500; Profit before incorporation (to be adjusted against goodwill): ₹14,075; Profit after incorporation: ₹34,525; Goodwill (1,75,000 – 1,50,000) – ₹25,000; Balance sheet total: ₹2,29,525]

7

FINAL ACCOUNTS OF COMPANIES

The Indian Companies Act has made it mandatory on the part of all the companies to prepare their final accounts and present them before the shareholders, for their approval at every annual general meeting of the company. The final accounts of a joint stock company consists of two basic financial statements, namely, Statement of Profit & Loss or Income Statement and Statement of Balance Sheet.

7.1 FINANCIAL STATEMENTS

The statements prepared by the company, for the said period under consideration, are referred to as financial statements. It is a set of documents that record the historical transactions entered by a company during a given period or the period under consideration. Financial Statements comprise two basic statements, namely:

1. Statement of Profit & Loss (as per revised schedule VI)
2. Statement of Balance Sheet (as per revised schedule VI)

A statement, prepared to ascertain the profit earned or loss incurred during a period to indicate the financial performance, is called as the Statement of Profit & Loss. A statement prepared in order to ascertain the assets held and liabilities due at a given date, at the end of the period, i.e. financial period, is called as the Statement of Balance Sheet.

7.2 LEGAL REQUIREMENTS, AS PER COMPANIES (AMENDMENT) ACT, 1988

1. ***Section 209****:* It states that the books of accounts of the companies are to be maintained on accrual basis and the double entry system of accounting must be adopted by the companies.
2. ***Section 210:*** The Board of Directors of the company are required to lay before the company, for its consideration, a Balance Sheet, as on the end of financial year, at every Annual General Meeting of the company.
3. ***Section 211:*** It states about the contents and forms. It emphasises that the Statement of Profit & Loss and the Statement of Balance Sheet must give

true and fair view of the state of affairs of the company at the end of a financial year.

4. ***Section 215:*** It gives details pertaining to the preservation of Books of Accounts and Vouchers, i.e. books of accounts together with supporting documents, including the vouchers, need to be preserved in good condition for a period of eight years, immediately preceding the current financial year. The two financial statements, namely, the Statement of Profit & Loss and the Balance Sheet of a company should be signed.
5. ***Section 216 and 217:*** Section 216 requires an Auditor's Report to be annexed along with the Statement of Profit & Loss and Balance Sheet of a company. Section 217 requires a Director's Report to be annexed.

7.3 OBJECTIVES OF FINANCIAL STATEMENTS

1. To provide useful information to enable the investors to make rational investment and credit-related decisions.
2. To provide the necessary financial information in order to enable the users to predict cash flows of the business and for them.
3. To provide financial information relating to the business resources (i.e. assets), claims on these resources (i.e. liabilities and owner's equity) and changes in these resources.

The Statement of Profit & Loss and Balance Sheet of a company should provide a clear picture on the state of affairs of the company and shall be in the prescribed form, given in Revised Schedule VI. These two statements have to be prepared as on 31 March of every year, as per the Amendments in the Income Tax Act, 1961. The revised Schedule VI for preparing Statement of Profit & Loss and the Balance Sheet came into force from the financial year commencing on or after 1 April 2011. As per Revised Schedule VI, the Statement of Profit & Loss and the Balance Sheet have to be presented in a vertical format, as follows:

7.4 STATEMENT OF PROFIT & LOSS

Detailed Format for Statement Showing Profit & Loss for the Year Ended ________ (as per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	xxx
Other Incomes	2	xxx
Total Revenues (A)		xxxxx
Expenses:		
Cost of Goods Sold	3	xxx
Employee Benefit Expenses	4	xxx

(*Contd.*)

Finance Costs	5	xxx
Depreciation and Amortisation Expenses	6	xxx
Other Expenses	7	xxx
Total Expenses (B)		xxxxx
Profits Before Tax (A – B) *Less:* Current Tax		xxxxx xxxxx
Profit for the Period		**xxxxx**

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	**Revenue from Operations**		
	Sales	xxxxx	
	Less: Sales Returns	xxxxx	xxxxx
2.	**Other Incomes**		
	Discount Received		xxxxx
	Rent Received		xxxxx
	Transfer Fees		xxxxx
3.	**Cost of Goods Sold**		
	Opening Stock	xxxxx	
	Add: Purchases less Returns	xxxxx	xxxxx
	Carriage & Freight Inward	xxxxx	
	Less: Closing Stock	xxxxx	
4.	**Employee Benefit Expenses**		
	Wages add Outstanding		xxxxx
	Salaries add Outstanding		xxxxx
5.	**Finance Costs**		
	Debenture Interest	xxxxx	
	Add: Debenture Interest O/s	xxxxx	xxxxx
6.	**Depreciation and Amortisation Expenses:**		
	Depreciation on Fixed Asset		xxxxx
	Preliminary Expenses W/o.		xxxxx
	Goodwill W/o.		xxxxx
7.	**Other Expenses**		
	Bank Charges	xxx	
	Coal	xxx	
	Rates & Taxes add Outstanding	xxx	
	General Expenses	xxx	
	Fire Insurance less Prepaid	xxx	

(*Contd.*)

	Provision for Bad and Doubtful Debts:		xxxxx
	New Bad Debts xxx		
	Add: Old Bad Debts xxx	xxx	
	Add: New Provision xxx		
	xxx		
	Less: Old Provision xxx		

❍ Explanation for Contents of Statement of Profit & Loss

1. ***Revenue from operations:*** It indicates the revenue earned by the company from its operating activities, which can be in the form of net sales or gross profit of the manufacturing company or trading company or the fee earned by a service company and also the interest and the dividend earned by a financial company.
2. ***Other income:*** It indicates the income earned out of non-operating activities of a company, which include profit on sale of fixed assets, excess provision written back, interest on deposits, dividend earned by a non-financial company, etc.
3. ***Cost of material consumed:*** It indicates the cost of raw materials and other materials consumed in the manufacturing of a product.
4. ***Employee benefit expenses:*** It refers to all the expenses, which are incurred by a company for the benefit and welfare of its employees, such as salaries, wages, bonus, leave encashment, gratuity paid, medical expenses, etc.
5. ***Finance costs:*** These are the costs incurred by the company due to the company's borrowings, such as interest on overdraft, interest on debentures, interest on public deposits, interest on bonds, interest on bonds, cash credits, interest on loans, discount on issue of debentures written off, etc.
6. ***Depreciation and amortisation expenses:*** Depreciation refers to the fall in the value of fixed assets due to their usage and amortisation refers to the cost of intangible assets being written off over their useful life.
7. ***Other expenses:*** All those expenses, which cannot be brought under the aforementioned expenses, are treated as other expenses. These include administrative expenses, selling and distribution expenses, carriage outwards, telephone expenses, electricity expenses, rent and rates, and other sundry expenses.
8. ***Meaning of extraordinary items:*** The expenses, which are not incurred by distinct activities and which are not incurred frequently or regularly are called 'extraordinary items', such as speculation loss or gain, loss on account of fire, loss due to natural calamities like floods, cyclones, etc.

9. ***Concept of tax:*** The amount of tax payable cannot be ascertained at the time of preparing the final account of a company; so, it is essential to create a provision for taxation on the basis of an estimate. Such a provision for taxation is deducted from profit, before extraordinary items and tax, in order to find out the profit or loss for the given period.

   For holistic understanding of the concept of tax, knowledge about advance tax, tax deducted at source and the treatment of income tax is essential. These aspects are explained as follows:

   - ***Advance tax:*** It shall be payable during the financial year, by every company, whose tax payable, computed in accordance with the provisions of advance tax, exceeds ₹10,000. It is shown as 'short-term loans and advances' in the asset side of the balance sheet, under the head current assets and it is later adjusted towards income tax payable after the assessment procedure is completed.
   - ***Tax deducted at source (TDS):*** Deduction of income tax on the amount payable at the rate in force out of an income is called as 'tax deducted at source'. Whenever a company pays interest, dividend or salaries, etc., to its employees, it deducts tax at the source and TDS appears as 'other current liabilities' in the liabilities side of the balance sheet, because the company has to pay the TDS to the Government. TDS can then be adjusted towards income tax payable after the completion of the assessment. It also has the option to be reduced from the current year's provision for income tax, on the liabilities side of the balance sheet.
   - ***Income tax:*** Tax payable should be debited to income tax account and the TDS and Advance tax should be adjusted in this account.

7.5 FORMAT OF BALANCE SHEET

Detailed format for balance sheet of ________, as on ________ (as per revised schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	xxx
Reserves and Surplus	2	xxx
(ii) Non-current Liabilities		
Long-term Borrowings	3	xxx
Deferred Tax Liabilities		
Other Long-term Liabilities		
Long-term Provisions		

(*Contd.*)

(iii) Current Liabilities		
Short-term Borrowings	4	xxx
Trade Payables	5	xxx
Short-term Provisions	6	xxx
Other Current Liabilities	7	xxx
Total: (i) + (ii) + (iii)		xxx
II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	xxx
Intangible Assets	9	xxx
Non-current Investments	10	xxx
(ii) Current Assets		
Trade Receivables	11	xxx
Short-term Loans and Advances	12	xxx
Other Current Assets	13	xxx
Closing Stock	14	xxx
Cash in Hand and at Bank	15	xxx
Total: (i) + (ii)		xxx

Notes to Accounts on Balance Sheet

Note No.	Particulars		Amount (₹)
1.	Share Capital:		
	Authorised, Issued, Subscribed, Called-Up and Paid-Up Capital		xxx
	Equity Share Capital	xxx	
	Less: Calls-in-Arrears	xxx	xxx
		xxx	
	Add: Forfeited Shares	xxx	xxx
	Preference Share Capital		xxx
2.	Reserves and Surplus:		
	Opening Balance of General Reserve	xxx	
	Add: Additions made during the Year	xxx	xxx
	Securities Premium	xxx	
	Less: Premium on Redemption of Preference Shares	xxx	xxx
			xxx
	Capital Redemption Reserve		xxx

(*Contd.*)

	Capital Reserve		xxx
	Debenture Redemption Reserve		xxx
	Revaluation Reserve		
	Share Option Outstanding Reserve		xxx
	Profit & Loss A/c:		xxx
	Balance at the Beginning of the Year	xxx	xxx
	Add: Profit for the Year	xxx	
		xxx	
	Less: Appropriations:		
	Interim Dividend	xxx	
	Corporate Dividend Tax @ 17%	xxx	xxx
	General Reserves		xxx
	Capital Reserves		xxx
	Reserve Fund		xxx
3.	Long-term Borrowing:		
	Unsecured Loan		xxx
	Debentures		xxx
	Loan from Managing Director		xxx
4.	Short-term Borrowing:		
	Bank Overdraft		xxx
5.	Trade Payables:		
	Creditors (or) Trade Creditors (or) Sundry Creditors		xxx
	Accounts Payable		xxx
	Bills Payable		xxx
6.	Short-term Provisions:		
	Provision for Taxation		xxx
	Proposed Equity Dividend		xxx
	Proposed Preference Dividend		xxx
7.	Other Current Liabilities:		
	Interim Dividend Payable		xxx
	Corporate Dividend Tax Payable		xxx
	Debenture Interest Outstanding		xxx
	Outstanding Wages and Salaries		xxx
	Outstanding Expenses		xxx
	Income Received in Advance		xxx

(*Contd.*)

8.	Tangible Assets:		
	Land and Buildings less Depreciation		xxx
	Furniture, Fixtures and Fittings less Depreciation		xxx
	Plant and Machinery less Depreciation		xxx
	Freehold Properties and Premises less Depreciation		xxx
	Engineering Tools and Loose Tools		xxx
	Freehold Land		xxx
9.	Intangible Assets:		
	Goodwill		xxx
	Patent Right		xxx
	Copyright		xxx
10.	Non-current Investments:		
	Investment in Shares		xxx
	Investment in Government Securities		xxx
	Other Investments		xxx
11.	Trade Receivables:		
	Sundry Debtors (or) Book Debts	xxx	
	Less: New Bad Debts	xxx	
		xxx	xxx
	Less: New Provision for Bad and Doubtful Debts	xxx	
		xxx	xxx
	Less: New Provision for Discount on Debtors	xxx	xxx
	Bills Receivable		
	Accounts Receivable		
12.	Short-term Loans and Advances:		
	Prepaid Expenses		xxx
	Accrued Incomes or Outstanding Incomes		xxx
13.	Other Current Assets:		
	Discount on Debentures		xxx
	Technical know how		xxx
	Promotion Expenses		xxx
	Income Tax paid Under Dispute		xxx
14.	Closing Stock or Inventory:		
	Closing Stock		xxx
	Closing Inventory		xxx
	Stock at the End		xxx
	Inventory at the End		xxx

(*Contd.*)

15.	Cash in Hand and at Bank:	
	Cash in Hand	xxx
	Cash at Bank	xxx
	Bank Balance	xxx
	Cash Balance	xxx
	Bank Current A/c	xxx

❍ Explanation for Contents of Balance Sheet

Equity and Liabilities

Equity means the company's liability towards shareholders and it is also called as Shareholders' Funds**.**

Shareholders' funds consist of Share Capital, Reserves and Surplus and Money received against Share Warrants.

1. ***Share capital:*** It means the shares issued by the company to the public for subscription and the subscription money that is received against issued capital. Share capital is of two types, namely, equity share capital and preference share capital. Schedule VI of the Companies Act requires the Balance Sheet to give all the details pertaining to share capital of the company, by categorising them under the heads: Authorised Share Capital, Issued Share Capital, Subscribed Share Capital and Called-up and Paid-up Share Capital. The details of the share capital required, as per Schedule VI, are given in the Notes to Accounts.
2. ***Reserves and surplus:*** It refers to the amount set aside by the company, out of the profits earned and the purpose of reserves and surplus is to meet the losses and liabilities of the company and also to meet the future uncertainties. Such creation of reserves and surplus by the company strengthens the financial position of the company. The details of reserves and surplus are given in the Notes to Accounts.
3. ***Money received against share warrants:*** Share warrants are the financial instruments, which empower the holder of the share warrant to acquire equity shares of the company. These are the financial instruments, which will be converted into equity shares of the company at a later date, at a pre-determined price.

Liabilities refer to the external liabilities of the company, i.e. the amount, which the company has to pay to the outsiders. It is also referred as Liability towards Outsiders by the company**.** The liabilities of the company are divided into two categories: Non-Current Liabilities and Current Liabilities.

1. ***Non-current liabilities:*** The liabilities, which are payable by the company, generally after a period of one year or more, are called as 'non-current liabilities'. These liabilities can be divided into four categories, namely, Long-term borrowings, Deferred tax liabilities, Other long-term liabilities and Long-term provisions.

- ***Long-term borrowings:*** They are debentures, bonds, term loans from banks and other parties, public deposits, and other loans and advances, which are repayable after a period of 12 months.
- ***Deferred tax liabilities:*** The difference between the taxable income and the accounting income are compared every year by the company (which is temporary in nature), and the income tax on the difference is called as 'deferred tax'.

  If the accounting income is greater than the taxable income, it results in deferred tax liability, but if the accounting income is less than the taxable income, then it results in deferred tax assets. However, both deferred tax liabilities and deferred tax assets are book entries and they are neither actual liabilities nor actual assets.
- ***Other long-term liabilities:*** They are premium payable on redemption of debentures (if debentures are shown as long-term borrowings), and premium payable on redemption of preference shares (if preference shares are redeemable after 12 months of the date of balance sheet or after the period of operating cycle).
- ***Long-term provisions:*** They are provisions made for retirement benefits, payable to employees who retire after 12 months of the date of balance sheet and provision for warranty claims that relate to the period after 12 months of the date of balance sheet.

2. ***Current liabilities:*** The liabilities, which are payable by the company within a period of 12 months from the date of balance sheet are called as 'current liabilities'. These liabilities are divided into four categories, namely, Short-term Borrowings Trade Payables Other Current Liabilities and Short-term Provisions.
   - **Short-term Borrowings**: They are overdraft or cash credit from banks, deposits, and loans from other parties, which are repayable on demand or within 12 months from the date of balance sheet.
   - **Trade Payables:** It refers to the amount payable for any purchase of goods or services, taken in the normal course of business. They include trade creditors or sundry creditors and bills payable.
   - **Other Current Liabilities**: They are outstanding expenses, unpaid dividends, Calls-in-Advance, income received in advance, interest accrued but not due on borrowing, unpaid matured deposits and debentures, etc.
   - **Short-term Provisions**: They include provision for bad and doubtful debts, provision for taxation, proposed dividend, provision for employee benefits, provision for expenses, etc.

Assets

They are divided into two categories, namely, Non-current Assets and Current Assets.

1. ***Non-current assets:*** These are the assets, which are not to be realised for the purpose of operating of the business. They can be classified into five

major categories: Fixed Assets, Non-current Investments, Deferred Tax Assets, Long-term Loans and Advances and Other Non-current Assets.

- ***Fixed assets:*** These are the assets, which are held by the company to increase the earning capacity of the company and are not for regular business sale. They are used for a long period of time to earn profits. The fixed assets can be further classified as Tangible Assets, Intangible Assets, Capital Work-in-progress and Intangible Assets Under Development.

  Tangible assets are those assets, which have a physical existence, such as land, building, furniture, computer, etc. Intangible assets are those assets, which do not have a physical existence, such as goodwill, trademarks, intellectual property rights, copyrights, and patent rights, etc. Capital work-in-progress means fixed tangible assets under construction. Intangible assets under development are all those intangible assets that are under development, which include patent rights, copyrights, intellectual rights, etc.
- ***Non-current investments:*** These are the investments held with an intention to retain and not for resale. They can be classified as Trade Investments and Other Investments. Trade investments are made by the company on the shares and debentures of another company with a motive to promote their own trade or business. The other investments of the company refer to the investment made in property, equity instruments, preference shares, government securities, debentures, mutual funds, partnership firms, etc.
- ***Deferred Tax Assets:*** When the taxable income is more than the accounting income, the difference is shown in the asset side, as deferred tax asset.
- ***Long-term Loans and Advances:*** It refers to those loans and advances that are expected to be received back in cash or kind after a period of 12 months, from the date of balance sheet. These include capital advance, security deposits, and other loans and advances, such as long-term loans to employees, long-term advances to suppliers, etc.
- ***Other non-current assets:*** They are long-term receivables and other trade receivables, such as unamortised expenses/losses, insurance claim receivable, or amount due for assets sold, etc.

2. ***Current Assets:*** These are the assets, which are expected to be realised for sale or consumption in the company's normal operating cycle and are primarily held for the purpose of trading within 12 months from the date of balance sheet in cash and cash equivalents. The current assets can be classified into six heads: Current Investments, Inventories, Trade Receivables, Cash and Cash Equivalents, Short-term Loans and Advances and Other Current Assets.
   - ***Current Investments:*** The investments, which are held to be converted into cash within 12 months from the date of purchase of investments,

are called as 'current investments'. For example: investment in equity shares, preference shares, mutual funds, debentures, bonds, etc.

- ***Inventories:*** It refers to the stock held for the purposes of trade in the normal course of business. They include raw materials, work-in-progress, finished good, stock-in-trade, stores and spares, loose tools, etc.
- ***Trade Receivables:*** The amount, which is receivable for sale of goods or services by the company in the normal course of business is called as 'trade receivables'. It includes both debtors and bills receivables.
- ***Cash and Cash Equivalents:*** They are balances with banks, bank deposit, cash-in-hand cheques and drafts on hand.
- ***Short-term Loans and Advances:*** These loans and advances are those, which can be realised within 12-months' time.
- ***Other Current Assets:*** Those current assets, which cannot be classified as current assets in particular are called as 'other current assets'. For example: prepaid expenses, advance taxes and dividend receivable.

7.6 CORPORATE DIVIDEND TAX

The Finance Act, 1997 has introduced, with effect from 1st June 1997, a provision for taxation on dividend on companies. This tax is termed as 'Corporate Dividend Tax'. Any domestic company declaring, distributing or paying dividends is required to pay this tax at the 'rates applicable for the concerned year'.

It may be mentioned here that the Corporate Dividend Tax was withdrawn by the Finance Act, 2000, but has been reintroduced by the Finance Act, 2003, which has fixed the rate of corporate dividend tax at twelve and a half per cent (12.5%) from 1st April 2003. Corporate dividend tax is paid in addition to the income tax chargeable in respect of total income. Corporate dividend tax is calculated on the amount of dividend declared, including interim dividend, both on preference and equity capital.

The rate of corporate dividend tax from the assessment year 2013–14 is 15 per cent of the dividend plus 10 per cent surcharge and education cess 3 per cent thereon.

Total Current Corporate Dividend Tax, including Surcharge and Education Cess, may be taken as 17% approximately.

7.7 TRANSFER TO RESERVES

Section 205 (2A) of the Companies Act, 1956, inserted by the Companies (Amendment) Act, 1974, provides that before declaration and payment of dividend out of the current year's profit, a company is required to transfer such percentage of its profit for the current year to reserves not exceeding 10 per cent, as may be prescribed.

According to Rule 2 of Companies (Transfer of profits to reserves) Rules, 1975, prescribed by the Central Government, before payment of any dividend, the company must transfer the percentage of its profits for that year, as specified below:

Rate of Dividend	Percentage Transfer to Reserves
10% or less of the Paid-up Capital	Nil
Exceeding 10% but not 12½ %	2.5 %
Exceeding 12 ½ % but not 15%	5 %
Exceeding 15 % but not 20%	7.5 %
Exceeding 20%	10%

From the above table, it is clear that if the rate of dividend does not exceed 10 per cent, transfer to reserves is not mandatory. However, a company has the liberty to transfer a higher percentage of profits, than the ones stated above, to reserves. Therefore, transfer to reserves may be either statutory or voluntary.

7.8 MANAGERIAL REMUNERATION

The Companies Act lays down a number of restrictions on managerial remuneration payable by a public company or a private company, which is a subsidiary of a public company. The term managerial remuneration includes remuneration payable to the: (a) managing director; (b) manager; (c) part-time directors and (d) whole-time directors.

The following statement shows the maximum remuneration payable to the different categories of managerial personnel:

Managerial Personnel	Maximum % on Net Profits
(a) Maximum remuneration to all the managerial personnel	11%
(b) Manager	5%
(c) Managing director or whole-time director	5%
(d) Managing director or whole-time directors when there is more than one	10%
(e) Part-time directors when the company is not having managing director, whole time director or manager	3%
(f) Part-time directors when assisted by a managing director, whole-time director or manager	1%

❍ Calculation of Managerial Remuneration

Format for Statement of Profit for the purpose of managerial remuneration

Particulars	Amount (₹)	Amount (₹)
Net Profits (Given)		xxxxx
Add: Capital Expenditure	xxxxx	
Special Depreciation	xxxxx	
Provision for Income Tax/Taxation	xxxxx	
Ex-gratia Payment to Employee	xxxxx	xxxxx
Less: Capital Profit on Sale of Asset	xxxxx	
Profit on Sale of Investment	xxxxx	xxxxx
Net Profit for Managerial Remuneration		xxxxx

Illustration 1

Following balances have been extracted from the books of Ram Ltd. on 31st March 2016:

Equity Share Capital (1,00,000 shares of ₹10 each) ₹10,00,000; Securities Premium ₹2,00,000; 12% Debentures ₹5,00,000; Creditors ₹2,00,000; Proposed Dividend ₹50,000; Surplus, i.e., Balance in statement of Profit & Loss (debit) ₹50,000; Land and Building ₹9,00,000; Government Bonds ₹5,00,000; Capital Work-in-progress (Building) ₹3,50,000 and Discount on issue of 2% Debentures ₹10,00,000 ; Cash at Bank ₹50,000; Furniture ₹60,000; Debtors ₹20,000.

Debentures were issued on 1st March 2011, redeemable after 5 years i.e., on 31st March 2016.

Surplus i.e., Balance in statement of Profit & Loss is before writing off discount on issue of debentures.

Prepare the balance sheet of the company as per revised Schedule VI, Part I of the Companies Act.

Solution:

Notes to Accounts on Balance Sheet

Note No.	Particulars		Amount (₹)
1.	Equity Share Capital (1,00,000 shares of ₹10 each)		10,00,000
2.	Reserves and Surplus		
	Securities Premium	2,00,000	
	Profit & Loss (Dr.)	(–) 50,000	
	Discount on Debentures	(–) 20,000	1,30,000
	Shareholders' Fund		11,30,000
3.	Long-term Borrowings		
	12% Debentures		5,00,000

(*Contd.*)

4.	Short-term Borrowings		Nil
5.	Trade Payables		
	Creditors		2,00,000
6.	Short-term Provisions:		
	Proposed Dividend		50,000
7.	Other Current Liabilities		Nil
8.	Tangible Assets:		
	Land and Building	9,00,000	
	Government Bonds	5,00,000	
	Building Work-in-Progress	3,50,000	
	Furniture	60,000	18,10,000
9.	Intangible Assets		Nil
10.	Non-Current Investments		Nil
11.	Trade Receivables		Nil
12.	Short-term Loans and Advances		Nil
13.	Other Current Assets:		
	Debtors		20,000
14.	Closing Stock		Nil
15.	Cash in Hand and at Bank		50,000

Balance Sheet (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Equity Share Capital	1	10,00,000
Reserves and Surplus	2	1,30,000
(ii) Non-current Liabilities		
Long-term Borrowings	3	5,00,000
(iii) Current Liabilities		
Short-term Borrowings	4	Nil
Trade Payables	5	2,00,000
Short-term Provisions	6	50,000
Other Current Liabilities	7	Nil
Total: (i) + (ii) + (iii)		18,80,000
II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	18,10,000
Intangible Assets	9	Nil
Non-current Investments	10	Nil

(*Contd.*)

(ii) Current Assets		
Trade Receivables	11	Nil
Short-term Loans and Advances	12	Nil
Other Current Assets	13	20,000
Closing Stock	14	Nil
Cash in Hand and at Bank	15	50,000
Total: (i) + (ii)		18,80,000

Illustration 2

On 31st December 2016, the trial balance of Bharat Ltd. shows provision for tax ₹2,00,000 representing the provision of the previous year. The trial balance also shows income tax paid ₹1,80,000. It is estimated that a provision of ₹2,80,000 is required for the current year's income tax deducted at source while receiving interest on investments amounted to ₹40,000. The gross amount of the interest was shown in the Profit & Loss A/c. Write the provision for income tax account, incorporating the above details.

Solution:

Provision for Taxation Account

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.12.2016	To Income Tax Paid	1,80,000	01.01.2016	By Balance b/d	2,00,000
	To P&L Appropriation A/c	20,000			
		2,00,000			2,00,000
31.12.2016	To Tax Deducted at Source A/c	40,000	31.12.2016	By P & L A/c	2,80,000
	To Balance c/d	2,40,000			
		2,80,000			2,80,000
			01.01.2017	By Balance b/d	2,40,000

Illustration 3

From the following balances of the trial balance as on 31st December 2016 of a company, show how it would appear in the relevant accounts after considering the adjustments given under:

Particulars	Amount (₹)	Amount (₹)
Advance Tax Paid	60,000	—
Provision for Taxation	—	80,000
Tax Deducted at Source	10,000	—

Adjustments:

(a) Income tax for 2016 has been assessed at ₹1,00,000, against which the advance payment of tax and tax deducted at source are to be adjusted.
(b) Provide ₹60,000 for taxation on current profits.

Solution:

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Income Tax A/c Dr.	1,00,000	
	To Advance Tax A/c		60,000
	To Tax Deducted at Source A/c		10,000
	To Tax Payable (b/f) A/c		30,000
	(*Being advance and TDS adjusted against income tax*)		

Provision For Taxation A/c

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
	To Income Tax	1,00,000		By Balance b/d	80,000
				By P & L Appropriation A/c (b/f)	20,000
		1,00,000			1,00,000
	To Balance c/d	60,000		By P & L A/c	60,000
				(Current year provision)	
		60,000			60,000
				By Balance b/d	60,000

Illustration 4

From the following particulars, determine the maximum remuneration available to a full-time director of a manufacturing company. The Profit & Loss A/c of the company showed a net profit of ₹20,00,000 after taking into account the following items:

(a) Depreciation (including special depreciation of ₹20,000) ₹50,000
(b) Provision for income tax ₹1,00,000
(c) Donation to political parties ₹25,000
(d) Ex-gratia payment to a worker ₹5,000
(e) Capital profit on sale of assets ₹7,500

Solution:

Statement of Profit for the Purpose of Managerial Remuneration

Particulars	Amount (₹)	Amount (₹)
Net Profit, as given in the P & L A/c		20,00,000
Add: Special Depreciation	20,000	

(*Contd.*)

Provision for Income Tax	1,00,000	
Ex-gratia Payment to a Worker	5,000	1,25,000
		21,25,000
Less: Capital Profit on Sale of Assets	7,500	7,500
Net Profit for Managerial Remuneration		21,17,500

Commission to a full-time director at a maximum of 5% permitted by law

= ₹21,17,500 × 5%

= ₹1,05,875

Illustration 5

Determine the maximum remuneration payable to the part-time director and manager of B Ltd. (a manufacturing company) under Sections 309 and 387 of the Companies Act, from the following particulars:

Before charging any such remuneration, the Profit & Loss A/c showed a credit balance of ₹46,20,000 for the year ended 31st March 2016 after taking into account the following information:

Particulars	Amount (₹)
Capital Expenditure	10,50,000
Subsidy Received from Government	4,20,000
Special Depreciation	1,40,000
Multiple-shift Allowance	1,05,000
Bonus to Foreign Technicians	3,15,000
Provision for Taxation	56,00,000
Ex-gratia to an Employee	70,000
Loss on Sale of Fixed Assets	70,000
Profit on Sale of Investments	4,20,000

Solution:

Statement of Profit for the Purpose of Managerial Remuneration

Particulars	Amount (₹)	Amount (₹)
Net Profit (given)		46,20,000
Add: Capital Expenditure	10,50,000	
Special Depreciation	1,40,000	
Provision for Taxation	56,00,000	
Ex-gratia Payment to Employee	70,000	68,60,000
		1,14,80,000
Less: Profit on Sale of Investments		4,20,000
Net Profit for Managerial Remuneration		1,10,60,000

Remuneration for part-time director at 1% × 1,10,60,000 = ₹1,10,600
Remuneration to manager at 5% × 1,10,60,000 = ₹5,53,000

Illustration 6

Kashyap Ltd. is a company with an authorised capital of ₹10,00,000, divided into 10,000 equity shares of ₹100 each on 31st March 2016; of which, 5,000 shares were fully called-up. The following are the balances extracted from the ledger, as on 31st March 2016.

Trial Balance of Kashyap Ltd.

Particulars	Debit (₹)	Particulars	Credit (₹)
Opening Stock	1,00,000	Sales	6,50,000
Purchases	4,00,000	Discount Received	6,300
Wages	1,40,000	Profit & Loss A/c	12,440
Discount Allowed	8,400	Creditors	70,400
Insurance (up to 30.06.2016)	13,440	Reserves	50,000
Salaries	37,000	Loan from M.D.	31,400
Rent	12,000	Share Capital	5,00,000
General Expenses	17,900		
Printing and Stationery	4,800		
Advertisement	7,600		
Bonus	21,000		
Debtors	77,400		
Plant	3,61,000		
Furniture	34,200		
Bank	69,400		
Bad Debts	6,400		
Calls-in-Arrears	10,000		
	13, 20,540		**13,20,540**

You are required to prepare statement of Profit & Loss for the year ended 31st March 2016 and the balance sheet as on that date after considering the following information:

(a) Closing stock was valued at ₹3,83,000
(b) Depreciation on plant at 15% and on furniture at 10% should be provided.
(c) A tax provision of ₹16,000 is considered necessary.
(d) The directors declared an interim dividend for six months ending 30.09.2016 at 6%.
(e) Provide for corporate dividend tax at 17%.

Solution:

Kashyap Ltd.
Statement Showing Profit & Loss
for the Year Ended on 31.03.2016 (As per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	6,50,000
Other Incomes	2	6,300
Total Revenues (A)		6,56,300
Expenses:		
Cost of Goods Sold	3	1,17,000
Employee Benefit Expenses	4	1,98,000
Finance Costs	5	NIL
Depreciation and Amortisation Expenses	6	57,570
Other Expenses	7	67,180
Total Expenses (B)		4,39,750
Profits Before Tax (A – B)		2,16,550
Less: Current Tax		16,000
Profit for the Period		**2,00,550**

Notes to Accounts on Statement of Profit and Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations		
	Sales		6,50,000
2.	Other Incomes:		
	Discount received		6,300
3.	Cost of Goods Sold		
	Openings stock	1,00,000	
	Add: Purchases	4,00,000	
		5,00,000	
	Less: Closing Stock	3,83,000	1,17,000
4.	Employee Benefit Expenses		
	Salaries	37,000	
	Wages	1,40,000	
	Bonus	21,000	1,98,000
5.	Finance Costs		Nil
6.	Depreciation and Amortization Expenses:		
	Depreciation on Plant	54,150	
	Depreciation on Furniture	3,420	57,570

(*Contd.*)

7.	Other Expenses		
	Discount Allowed	8,400	
	Insurance (13,440 – 3,360)	10,080	
	Rent	12,000	
	General Expenses	17,900	
	Printing	4,800	
	Advertising	7,600	
	Bad Debts	6,400	67,180

Balance Sheet of Kashyap Ltd. (as per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities		
(i) Shareholders' Funds:		
Share capital	1	4,90,000
Reserves and Surplus	2	2,28,592
(ii) Non-current Liabilities:		
Long term borrowings	3	31,400
(iii) Current Liabilities		
Short term borrowings	4	Nil
Trade payables	5	70,400
Short term provisions	6	16,000
Other current liabilities	7	34,398
Total (i + ii + iii)		**8,70,790**
II. Assets		
(i) Non-current Assets: Tangible assets	8	3,37,640
Intangible assets	9	Nil
Non-current investments	10	Nil
(ii) Current Assets:		
Trade receivables	11	77,400
Short term loans and advances	12	2,360
Other current assets	13	Nil
Closing stock	14	3,83,000
Cash in hand at bank	15	69,400
Total (i + ii)		**8,70,790**

Notes to Accounts on Balance Sheet

Note No	Particulars		Amount (₹)
1.	Share Capital		
	Authorised share capital		
	10,000 equity shares of ₹100 each		10,00,000
	Issued, Subscribed, Called-up and Paid-up Capital:		
	5,000 Equity shares of ₹100 each	5,00,000	
	Less: Calls-in-Arrears	10,000	4,90,000
2.	Reserves and Surplus		
	Profit & Loss A/c		
	Balance at beginning of the year	12,440	
	Add: Profit for the year	2,00,550	
		2,12,990	
	Less: Appropriations:		
	Interim dividend 4,90,000 × 6%	29,400	
	Corporate dividend tax (29,400 × 17%)	4,998	
		34,398	1,78,592
	Reserves		50,000
			2,28,592
3.	Long Term Borrowing		
	Unsecured loan		31,400
4.	Short Term Borrowings		
	Bank overdraft		Nil
5.	Trade Payables		
	Creditors		70,400
6.	Short Term Provisions		
	Provision for taxation		16,000
7.	Other Current Liabilities		
	Interim dividend payable	29,400	
	Corporate dividend tax payable	4,998	34398
8.	Tangible Assets		
	Plant less depreciation		
	(3,61,000 – 54,150)	3,06,850	
	Furniture less depreciation		3,37,630
	(34,200 – 3,420)	30,780	
9.	Intangible Assets		Nil
10.	Non-Current Investments		Nil
11.	Trade Receivables		
	Sundry debtors		77,400
12.	Short Term Loans and Advances		
	Prepaid Insurance		3,360
13.	Other Current Assets		Nil
14.	Closing Stock		3,83,000
15.	Cash in Hand and at Bank		69,400

Illustration 7

Bharathi Ltd. was registered with an authorised capital of ₹2,12,00,000 in equity shares of ₹10 each. The following is its trial balance on 31st March 2016.

Particulars	Debit (₹)	Particulars	Credit (₹)
Goodwill	50,000	Share Capital	8,00,000
Cash	1,500	12% Debentures	6,00,000
Bank	79,800	Profit & Loss A/c	52,500
Purchases	3,70,000	Sales	8,30 000
Preliminary Expenses	10,000	Bills Payable	74,000
Calls-in-Arrears	15,000	Sundry Creditors	80,000
Premises	6,00,000	General Reserves	50,000
Plant and Machinery	6,60,000	Provision for Bad Debt	7,000
Interim Dividend	78,500		
Stock (on 01.04.2016)	1,50,000		
Furniture and Fixtures	14,400		
Sundry Debtors	1,74 000		
Wages	1 69 730		
General Expenses	13,670		
Freight and Carriage	26,230		
Salaries	29,000		
Director's Fees	11,450		
Bad Debts	4,220		
Debenture Interest Paid	36,000		
	24,93,500		24,93,500

Prepare a statement of Profit & Loss and balance sheet in revised format, as per Schedule VI, after making the following adjustments:

(a) Depreciate plant and machinery by 15%;
(b) Write off preliminary expenses;
(c) Provide for six-months' interest on debentures;
(d) Leave bad and doubtful debts provision at 5% on sundry debtors;
(e) Provide for income tax at 50%;
(f) Stock on 31st March 2016 was ₹1,90,000;
(g) Provide for corporate tax dividend tax @ 17%.

Solution:

Bharathi Ltd.
Statement Showing Profit & Loss
for the Year Ended on 31.03.2016 (As per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	8,30,000
Other Incomes	2	NIL
Total Revenues (A)		8,30,000
Expenses:		
Cost of Goods Sold	3	3,56,230
Employee Benefit Expenses	4	1,98,730
Finance Costs	5	72,000
Depreciation and Amortisation Expenses	6	109,000
Other Expenses	7	31,040
Total Expenses (B)		7,67,000
Profits Before Tax (A – B)		63,000
Less: Current Tax (31,500 × 50%)		31,500
Profit for the Period		**31,500**

Notes to Accounts on Statement of Profit or Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales		9,30,000
2.	Other Incomes:		Nil
3.	Cost of Goods Sold:		
	Opening Stock	1,50,000	
	Add: Purchases	3,70,000	
	Freight and Carriage	26,230	
	Less: Closing Stock	5,46,230	
		1,90,000	3,56,230
4.	Employee Benefit Expenses:		
	Wages		1,69,730
	Salaries		29,000
			1,98,730

(*Contd.*)

5.	Finance Costs:		
	Interest on Debentures	36,000	
	Add: Interest O/s on Debentures (3,00,000 × 12% × $\frac{6}{12}$)	36,000	72,000
6.	Depreciation and Amortisation Expenses:		
	Depreciation on Plant and Machinery		99,000
	Preliminary Expenses written off		10,000
			1,09,000
7.	Other Expenses:		
	General Expenses		13,670
	Director's Fees		11,450
	Provision for Bad and Doubtful Debts:	Nil	
	New Bad Debts	4,220	
	Add: Old Bad Debts	8,700	
	Add: New Provision for Bad & Doubtful Debts	12,920	
	Less: Old Provision for Bad & Doubtful Debts	7,000	5,920
			31,040

Bharathi Ltd.
Balance Sheet, as on 31.03.2016 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	7,85,000
Reserves and Surplus	2	42.154
(ii) Non-current Liabilities		
Long-term Borrowings	3	6,00,000
(iii) Current Liabilities		
Short-term Borrowings	4	Nil
Trade Payables	5	1,54,000
Short-term Provisions	6	31,500
Other Current Liabilities	7	49,346
Total: (i) + (ii) + (iii)		**16,62,000**
II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	11,75,400
Intangible Assets	9	50,000
Non-current Investments	10	Nil

(*Contd.*)

(ii) Current Assets		
Trade Receivables	11	1,65,300
Short-term Loans and Advances	12	Nil
Other Current Assets	13	Nil
Closing Stock	14	1,90,000
Cash in Hand and at Bank	15	81,300
Total: (i) + (ii)		**16,62,000**

Notes to Accounts on Balance Sheet

Note No.	Particulars			Amount (₹)
1.	Share Capital			
	Authorised Share Capital			
	1,20,000 Equity Shares of ₹10 each			12,00,000
	Issued, Subscribed, Called-Up and Paid-Up Capital:			
	80,000 Equity Shares of ₹10 each		8,00,000	
	Less: Calls-in-Arrears		15,000	7,85,000
2.	Reserves and Surplus			
	Profit & Loss A/c			
	Balance at Beginning of the Year		52,500	
	Add: Profit for the Year		31,500	
			84,000	
	Less: Appropriations:			
	Interim Dividend	78,500		
	Corporate Dividend Tax (68,500 × 17%)	13,346	91,846	–7,846
	General Reserve			50,000
				42,154
3.	Long-term Borrowing:			
	12% Debentures			6,00,000
4.	Short-term Borrowings			Nil
5.	Trade Payables:			
	Creditors			80,000
	Bills Payable			74,000
				1,54,000
6.	Short-tem Provisions:			
	Provision for Taxation			31,500
7.	Other Current Liabilities:			
	Outstanding Interest on Debentures			36,000
	Dividend Tax Payable			13,346
				49,346

(*Contd.*)

8.	Tangible Assets:		
	Plant and Machinery less Depreciation (6,60,000 — 99,000)		5,61,000
	Fixtures		14,400
	Premises		6,00,000
			11,74,400
9.	Intangible Assets:		
	Goodwill		50,000
10.	Non-current Investments		Nil
11.	Trade Receivables:		
	Sundry Debtors	1,74,000	
	Less: Provision for Bad and Doubtful Debts		
	(1,74,000 × 5%)	8,700	1,65,300
12.	Short-term Loans and Advances		Nil
13.	Other Current Assets		Nil
14.	Closing Stock or Inventory:		
	Closing stock		1,90,000
15.	Cash in Hand	1,500	
	Cash at Bank	79,800	81,300

Note: As the rate of interim dividend does not exceed 10%, no profits of current profits need to be transferred to general reserves.

Illustration 8

Varun Ltd. was registered with an authorised capital of ₹60,00,000 in equity shares of ₹10 each. The following is the list of balances extracted from its books on 31st December 2016.

Particulars	Amount (₹)	Particulars	Amount (₹)
Purchases	18,50,000	Sundry Debtors	8,72,000
Wages	8,48,650	General Expenses	1,68,350
Manufacturing Expenses	1,31,150	Stock (on 01.01.2016)	7,50,000
Salaries	1,40,000	Cash in Hand	2,00,000
Bad Debts	21,100	Goodwill	57,500
Director's Fees	62,250	Cash at Bank	3,99,000
Debenture Interest Paid	90,000	Subscribed and Fully Called-Up Capital	40,00,000
Preliminary Expenses	50,000	Profit & Loss A/c	1,45,000
Calls-in-Arrears	75,000	6% Debentures	30,00,000
Plant and Machinery	30,00,000	Sundry Creditors	5,80,000
Premises	33,00,000	Bills Payable	3,35,000
Interim Dividend Paid	3,75,000	Sales	41,50,000
Furniture and Fittings	70,000	General Reserves	2,50,000

You are required to prepare statement of Profit & Loss for the year ended 31st December 2016 and the balance sheet on that date, after making the following adjustments.

(a) Depreciate plant and machinery by 10%;
(b) Provide half-year's interest on debentures outstanding;
(c) Also write oil preliminary expenses;
(d) Make provision for bad and doubtful debts of ₹28,500 on sundry debtors;
(e) Stock on 31st December 2016: ₹9,10,000;
(f) Provide for corporate dividend tax at 17%.

Solution:

Varun Ltd.
Statement Showing Profit & Loss
for the Year Ended 31.12.2016 (As per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	41,50,000
Other Incomes	2	Nil
Total Revenues (A)		41,50,000
Expenses:		
Cost of Goods Sold	3	16,90,000
Employee Benefit Expenses	4	9,88,650
Finance Costs	5	1,80,000
Depreciation and Amortisation Expenses	6	3,50,000
Other Expenses	7	3,91,350
Total Expenses (B)		36,00,000
Profits Before Tax (A – B)		5,50,000
Less: Current Tax		Nil
Profit for the Period		**5,50,000**

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales		41,50,000
2.	Other Incomes:		Nil
3.	Cost of Goods Sold:		
	Opening Stock	7,50,000	
	Add: Purchases	18,50,000	
		26,00,000	
	Less: Closing Stock	9,10,000	16,90,000

(*Contd.*)

4.	Employee Benefit Expenses:			
	Wages		8,48,650	
	Salaries		1,40,000	9,88,650
5.	Finance Costs:			
	Debenture Interest Paid		90,000	
	Add: Interest O/s on Debentures (15,00,000 × 6% × 1/12)		90,000	1,80,000
6.	Depreciation and Amortisation Expenses:			
	Depreciation on Plant and Machinery		3,00,000	
	Preliminary Expenses written off		50,000	3,50,000
7.	Other Expenses:			
	Manufacturing Expenses		1,31,150	
	Director's Fees		62,250	
	General Expenses		1,68,350	
	Provision for Bad and Doubtful Debts:			
	New Bad Debts	Nil		
	Add: Old Bad Debts	21,100		
	Add: New Provision	8,500	29,600	3,91,350

Varun Ltd.
Balance Sheet, as on 31.12.2016 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	39,25,000
Reserves and Surplus	2	5.06,250
(ii) Non-current Liabilities		
Long-term Borrowings	3	30,00,000
(iii) Current Liabilities		
Short-term Borrowings	4	Nil
Trade Payables	5	9,15,000
Short-term Provisions	6	Nil
Other Current Liabilities	7	1,53,750
Total: (i) + (ii) + (iii)		**85,00,000**

(*Contd.*)

II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	60,70,000
Intangible Assets	9	57,500
Non-current Investments	10	Nil
(ii) Current Assets		
Trade Receivables	11	8,63,500
Short-term Loans and Advances	12	Nil
Other Current Assets	13	Nil
Closing Stock	14	9,10,000
Cash in Hand and at Bank	15	5,99,000
Total: (i) + (ii)		**85,00,000**

Notes to Accounts on Balance Sheet

Note No.	Particulars		Amount (₹)	Amount (₹)
1.	Share Capital			
	Authorised Share Capital			
	6,00,000 Equity Shares of ₹10 each			60,00,000
	Issued, Subscribed, Called-Up and Paid-Up Capital			
	Equity Shares of ₹10 each		40,00,000	
	Less: Calls-in-Arrears		75,000	39,25,000
2.	Reserves and Surplus:			
	Profit & Loss A/c:			
	Balance at Beginning of year		1,45,000	
	Add: Profit for the Year		5,50,000	
			6,95,000	2,56,250
	Less: Appropriations:			
	Interim Dividend Paid	3,75,000		
	Corporate Dividend Tax (3,75,000 × 17%)	63,750	4,38,750	2,56,250
	General Reserves			2,50,000
				5,06,250
3.	Long-term Borrowing:			
	6 % Debentures			30,00,000
4.	Short-term Borrowings			Nil
5.	Trade Payables:			
	Creditors		5,80,000	
	Bills Payable		3,35,000	9,15,000

(*Contd.*)

6.	Short-term Provisions		Nil
7.	Other Current Liabilities:		
	Outstanding Interest on Debentures	90,000	
	Corporate Dividend Tax Payable	63,750	1,53,750
8.	Tangible Assets		
	Plant & Machinery less Depreciation (30,00,000 – 3,00,000)	27,00,000	
	Premises	33,00,000	
	Furniture & Fittings	70,000	60,70,000
9.	Intangible Assets:		
	Goodwill		57,500
10.	Non-current Investments		Nil
11.	Trade Receivables:		
	Sundry Debtors	8,72,000	
	Less: Provision for Bad and Doubtful Debts	8,500	8,63,500
12.	Short-term Loans and Advances		Nil
13.	Other Current Assets		Nil
14.	Closing Stock or Inventory:		
	Closing Stock		9,10,000
15.	Cash in Hand and at Bank:		
	Cash in Hand	2,00,000	
	Cash at Bank	3,99,000	5,99,000

Illustration 9

The following is the trial balance of Krishna Ltd., as on 31st December 2016. The authorised capital is 1,00,000 equity shares of ₹10 each. Prepare a statement of Profit & Loss A/c and balance sheet as on that date.

Particulars	Debit (₹)	Particulars	Credit (₹)
Calls-in-Arrears	12,800	Subscribed Capital: 20,000 Shares of ₹10 each	2,00,000
Land	20,000	Bad Debts Reserve (on 01.01.2016)	2,800
Buildings	50,000	Sales	1,60,000
Machinery	30,000	Purchases Returns	6,800
Furniture	6,400	Sundry Creditors	26,400
Carriage Inwards	4,600	Securities Premium	12,000
Wages	42,800	General Reserves	48,000

(*Contd.*)

Salary	9,200		
Sales Returns	3,400		
Bank Charges	200		
Coal	1,400		
Rates and Taxes	1,600		
Purchases	1,00,000		
Bills Receivable	2,400		
General Expenses	3,800		
Sundry Debtors	85,600		
Stock (on 01.01.2016)	50,000		
Fire Insurance	800		
Cash at Bank	26,000		
Cash in Hand	5,000		
	4,56 000		4,56,000

Adjustments:

(a) Charge depreciation on buildings at 2½%, on machinery at 10%, and on furniture at 10%;
(b) Make a reserve 5% on debtors for bad debts;
(c) Carry forward the following unexpired amount fire insurance of ₹240;
(d) Provide for liabilities: Wages ₹6,400; salaries ₹1,000 and Rates ₹400;
(e) The value of stock on 31st December 2016 was ₹60,000.

Solution:

Krishna Ltd.
Statement Showing Profit & Loss
for the Year Ended 31.12.2016 (As per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	1,56,600
Other Incomes	2	NIL
Total Revenues (A)		1,56,300
Expenses:		
Cost of Goods Sold	3	87,800
Employee Benefit Expenses	4	59,400
Finance Costs	5	Nil
Depreciation and Amortisation Expenses	6	4,890
Other Expenses	7	9,440
Total Expenses (B)		1,61,350
Profits Before Tax (A – B)		–4,930
Less: Current Tax		Nil
Profit for the Period		**–4,930**

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales	1,60,000	
	Less: Sales Returns	3,400	1,56,600
2.	Other Incomes		Nil
3.	Cost of Goods Sold:		
	Opening Stock	50,000	
	Add: Purchases less Returns (1,00,000 – 6,800)	93,200	
	Carriage Inwards	4,600	
		1,47,800	
	Less: Closing Stock	60,000	87,800
4.	Employee Benefit Expenses:		
	Wages add Outstanding (42,800 + 6,400)	49,200	
	Salaries add Outstanding (9,200 + 1,000)	10,200	59,400
5.	Finance Costs		Nil
6.	Depreciation and Amortisation Expenses:		
	Depreciation on Buildings (50,000 × 2.5%)	1,250	
	Depreciation on Furniture (6,400 × 10%)	640	
	Depreciation on Machinery (30,000 × 10%)	3,000	4,890
7.	Other Expenses:		
	Bank Charges	200	
	Coal	1,400	
	Rates & Taxes Outstanding (1,600 + 400)	2,000	
	General Expenses	3,800	
	Fire Insurance less Prepaid (800 – 240)	560	
	Provision for Bad and Doubtful Debts:		
	New Bad Debts Nil		
	Add: Old Bad Debts Nil		
	Add: New Provision 4,280		
	4,280		
	Less: Old Provision 2,800	1,480	
			9,440

Krishna Ltd.
Balance Sheet, as on 31.12.2016 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	1,87,200
Reserves and Surplus	2	55,070
(ii) Non-current Liabilities		
Long-term Borrowings	3	NIL
(iii) Current Liabilities		
Short-term Borrowings	4	NIL
Trade Payables	5	26,400
Short-term Provisions	6	NIL
Other Current Liabilities	7	7,800
Total: (i) + (ii) + (iii)		**2,76,470**
II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	1,01,510
Intangible Assets	9	Nil
Non-current Investments	10	NIL
(ii) Current Assets		
Trade Receivables	11	83,720
Short-term Loans and Advances	12	240
Other Current Assets	13	NIL
Closing Stock	14	60,000
Cash in Hand and at Bank	15	31,000
Total: (i) + (ii)		**2,76,470**

Notes to Accounts on Balance Sheet

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Share Capital		
	Authorised Share Capital		
	1,00,000 Equity Shares of ₹10 each		10,00,000
	Issued, Subscribed, Called-Up and Paid-Up Capital:		
	20,000 Equity Shares of ₹10 each	2,00,000	
	Less: Calls-in-Arrears	12,800	1,87,200

(*Contd.*)

2.	Reserves and Surplus			
	Profit & Loss A/c		Nil	
	Balance at Beginning of year		–4930	
	Less: Profit for the Year		–4930	
	General Reserves		+48,000	
	Securities Premium		+12,000	55,070
3.	Long-term Borrowing			Nil
4.	Short-term Borrowings			Nil
5.	Trade Payables:			
	Creditors			26,400
6.	Short-term Provisions			Nil
7.	Other Current Liabilities:			
	Outstanding Wages		6,400	
	Outstanding Salaries		1,000	
	Outstanding Rates		400	7,800
8.	Tangible Assets			
	Land		20,000	
	Building less Depreciation (50,000 – 1,250)		48,750	
	Machinery less Depreciation (30,000 – 3,000)		27,000	
	Furniture less Depreciation (6,400 – 640)		5,760	1,01,510
9.	Intangible Assets			Nil
10.	Non-current Investments			Nil
11.	Trade Receivables:			
	Sundry Debtors	85,600		
	Less: Provision for Bad and Doubtful Debts	4,280	81,320	
	Bills Receivable		2,400	83,720
12.	Short-term Loans and Advances			
	Prepaid Fire Insurance			240
13.	Other Current Assets			Nil
14.	Closing Stock or Inventory:			
	Closing Stock			60,000
15.	Cash in Hand and at Bank:			
	Cash in Hand		5,000	
	Cash at Bank		26,000	31,000

Illustration 10

Rani Ltd. was registered with nominal capital of ₹12,00,000 equity shares of ₹10 each. The following is the list of balances extracted from its books on 31st December 2016.

Particulars	Amount (₹)	Particulars	Amount (₹)
Calls-in-Arrears	15,000	Freight and Carriage	26,230
Premises	6,00,000	Salaries	29,000
Plant and Machinery	6,60,000	Director's Fees	11,450
Interim Dividend Paid (on 01.08.2016)	75,000	Bad Debts	4,220
Stock (on 01.01.2016)	1,50,000	Debentures Interest Paid	18,000
Fixtures	14,400	Subscribed and Fully Called-up Capital	8,00,000
Sundry Debtors	1,74,000	6% Debentures	6,00,000
Goodwill	50,000	Profit & Loss A/c (Cr.)	29,000
Cash in Hand	1 500	Rills Payable	76000
Cash at Bank	79,800	Sundry Creditors	1,00,000
Purchases	3,70,000	Sales	8,30,000
Wages	1,69,730	General Reserves	50,000
Preliminary Expenses	10,000	Bad Debts Reserve (on 01.01.2016)	7,000
General Expenses	33,670		

Prepare statement of Profit & Loss A/c and balance sheet in proper format, after making the following adjustments.

(a) Depreciate plant and machinery by 10%;
(b) Write off the preliminary expenses;
(c) Provide half-year's debenture interest due
(d) Leave bad and doubtful debts reserves at 5% on sundry debtors;
(e) Closing stock ₹1,90,000.

Solution:

Rani Ltd.
Statement Showing Profit or Loss
for the Year Ended 31.12.2016 (As per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	8,30,000
Other Incomes	2	Nil
Total Revenues (A)		8,30,000

(*Contd.*)

Expenses:		
Cost of Goods Sold	3	3,56,230
Employee Benefit Expenses	4	1,98,730
Finance Costs	5	36,000
Depreciation and Amortisation Expenses	6	76,000
Other Expenses	7	51,040
Total Expenses (B)		7,18,000
Profits Before Tax (A – B)		1,12,000
Less: Current Tax (31,500 × 50%)		Nil
Profit for the Period		**1,12,000**

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales		8,30,000
2.	Other Incomes		Nil
3.	Cost of Goods Sold:		
	Opening Stock	1,50,000	
	Add: Purchases	3,70,000	
	Freight and Carriage	26,230	
		5,46,230	
	Less: Closing Stock	1,90,000	3,56,230
4.	Employee Benefit Expenses:		
	Wages	169,730	
	Salaries	29,000	1,98,730
5.	Finance Costs:		
	Interest on Debentures	18,000	
	Add: Interest Outstanding on Debentures (3,00,000 × 6% × ½)	18,000	36,000
6.	Depreciation and Amortisation Expenses:		
	Depreciation on Plant and Machinery (6,60,000 × 10%)	66,000	
	Preliminary Expenses written off	10,000	76,000
7.	Other Expenses:		
	General Expenses	33,670	
	Director's Fees	11,450	

(*Contd.*)

	Provision for Bad and Doubtful Debts:		
	New Bad Debts — Nil		
	Add: Old Bad Debts — 4,220		
	New Provision for Bad and Doubtful Debts — 8,700		
	12,920		
	Less: New Provision for Bad and Doubtful Debts — 7,000	5,920	51,040
	(Bad Debts Res. on 01.01.2015)		

Rani Ltd.
Balance Sheet, as on 31.12.2016 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	7,85,000
Reserves and Surplus	2	1,03,250
(ii) Non-current Liabilities		
Long-term Borrowings	3	6,00,000
(iii) Current Liabilities		
Short-term Borrowings	4	Nil
Trade Payables	5	1,76,000
Short-term Provisions	6	Nil
Other Current Liabilities	7	30,750
Total: (i) + (ii) + (iii)		**16,95,000**
II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	12,08,400
Intangible Assets	9	50,000
Non-current Investments	10	Nil
(ii) Current Assets		
Trade Receivables	11	1,65,300
Short-term Loans and Advances	12	Nil
Other Current Assets	13	Nil
Closing Stock	14	1,90,000
Cash in Hand and at Bank	15	81,300
Total: (i) + (ii)		**16,95,000**

Notes to Accounts on Balance Sheet

Note No.	Particulars		Amount (₹)	Amount (₹)
1.	Share Capital:			
	Authorised Share Capital			
	1,20,000 Equity Shares of ₹10 each			12,00,000
	Issued, Subscribed, Called-Up and Paid-Up Capital:			
	40,000 Equity Shares of ₹10 each		8,00,000	
	Less: Calls-in-Arrears		15,000	7,85,000
2.	Reserves and Surplus			
	Profit & Loss A/c		29,000	
	Balance at Beginning of year		29,000	
	Add: Profit for the Year		1,12,000	
			1,41,000	
	Less: Appropriations:			
	Interim Dividend Paid	75,000		
	Corporate Dividend Tax (75000 × 17%)	12,750	87,750	53,250
	General Reserves			50,000
				1,03,250
3.	Long-term Borrowing:			
	6% Debentures			6,00,000
4.	Short-term Borrowings			Nil
5.	Trade Payables:			
	Creditors		1,00,000	
	Bills Payable		76,000	1,76,000
6.	Short-term Provisions			Nil
7.	Other Current Liabilities:			
	Outstanding Interest on Debentures		18,000	
	Corporate Dividend Tax Payable		12,750	30,750
8.	Tangible Assets:			
	Premises		6,00,000	
	Plant and Machinery – Depreciation (6,60,000 – 66,000)		5,94,000	
	Fixtures		14,400	12,08,400
9.	Intangible Assets:			
	Goodwill			50,000
10.	Non-current Investments			Nil

(*Contd.*)

11.	Trade Receivables:		
	Sundry Debtors	1,74,000	
	Less: Provision for Bad and Doubtful Debts (1,94,000 × 5%)	8,700	1,65,300
12.	Short-term Loans and Advances		Nil
13.	Other Current Assets		Nil
14.	Closing Stock or Inventory:		
	Closing Stock		1,90,000
15.	Cash in Hand and at Bank:		
	Cash in Hand	1500	
	Cash at Bank	79,900	81,400

Illustration 11

Following is the trial balance of Johana Ltd., as on 31st March 2016.

Particulars	Debit (₹)	Credit (₹)
Stock (on 31.03.2015)	15,000	
Purchases and Sales	49,000	70,000
Wages	10,000	
Discounts	1,400	1,000
Salaries	1,500	
Rent	990	
Insurance	3,410	
Profit & Loss A/c (01.04.2016)		3,006
Dividend Paid	1,800	
Share Capital		20,000
Debtors and Creditors	7,500	3,500
Machinery	5,800	
Cash at Bank	3,240	
Reserves		3,100
Bad Debts	966	
Total	**1,00,606**	**1,00,606**

The following additional information is available:

(a) Stock on 31st March 2016 is ₹16,400
(b) Depreciate machinery at 10%
(c) Provide 5% discount on debtors
(d) Provide 2.5% discount on creditors
(e) 6 months' insurance was unexpired at ₹75 p.a.
(f) 1 month rent @ ₹1,080 p.a. was due on 31st March 2016

(g) Provide Managing Director's commission, 15% on the net profits before deducting his commission.

You are required to prepare statement of Profit & Loss A/c for the year ended 31st March 2016 and the balance sheet on that date.

Solution:

Johana Ltd.
Statement Showing Profit & Loss
for the Year Ended 31.03.2016 (As per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	70,000
Other Incomes	2	1,088
Total Revenues (A)		71,088
Expenses:		
Cost of Goods Sold	3	47,600
Employee Benefit Expenses	4	11,500
Finance Costs	5	Nil
Depreciation and Amortisation Expenses	6	580
Other Expenses	7	7,795
Total Expenses (B)		67,475
Profits Before Tax (A – B)		3,613
Less: Current Tax		Nil
Profit for the Period		**3,613**

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales		70,000
2.	Other Incomes:		Nil
	Discount Received	1000	
	Provision for Discount on Creditors	88	1,088
3.	Cost of Goods Sold:		
	Opening Stock	15,000	
	Add: Purchases	49,000	
		64,000	
	Less: Closing Stock	16,400	47,600
4.	Employee Benefit Expenses:		
	Wages	10,000	
	Salaries	1500	11,500

(*Contd.*)

5.	Finance Costs		Nil
6.	Depreciation and Amortisation Expenses:		
	Depreciation on Machinery (5,800 × 10%)		580
7.	Other Expenses:		
	Discount Allowed	1400	
	Rent and Outstanding Rent (990 + 90)	1080	
	Insurance less Prepaid Insurance (3,410 – 75)	3,335	
	General Expenses	Nil	
	Director's Fees	Nil	
	Provision for Bad and Doubtful Debts:		
	New Bad Debts Nil		
	Add: Old Bad Debts 966		
	Add: New Provision for Doubtful Debts 376		
	1,342		
	Less: Old Provision for Doubtful Debts Nil	1,342	7,157
	Managing Director's Remuneration = (Total Incomes) – (Total Expenditure) × 15% = (70,000 + 1088) – (47,600 + 11,500 + 580 + 7,156) × 15% = (71,088 – 66,836) × 15% = 4,252 × 15% = 638		638
	Total Other Expenses		7,795

Johana Ltd.
Balance Sheet, as on 31.03.2016 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	20,000
Reserves and Surplus	2	7,919
(ii) Non-current Liabilities		
Long-term Borrowings	3	Nil
(iii) Current Liabilities		
Short-term Borrowings	4	Nil
Trade Payables	5	3,412
Short-term Provisions	6	Nil
Other Current Liabilities	7	728
Total: (i) + (ii) + (iii)		**32,059**

(*Contd.*)

II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	5,220
Intangible Assets	9	Nil
Non-current Investments	10	Nil
(ii) Current Assets		
Trade Receivables	11	7,124
Short-term Loans and Advances	12	75
Other Current Assets	13	Nil
Closing Stock	14	16,400
Cash in Hand and at Bank	15	3,240
Total: (i) + (ii)		**32,059**

Notes to Accounts on Balance Sheet

Note No.	Particulars		Amount (₹)	Amount (₹)
1.	Share Capital:			
	Authorised Share Capital			
	Equity Shares Capital			20,000
	Issued, Subscribed, Called-Up and Paid-Up Capital:			
	Equity Share Capital			20,000
2.	Reserves and Surplus:			
	Profit & Loss A/c			
	Balance at Beginning of year	3,006		
	Add: Profit for the Year	3,613		
		6,619		
	Less: Appropriations:			
	Dividend Paid	1800	4,819	
	Reserves		3,100	7,919
3.	Long-term Borrowing			Nil
4.	Short-term Borrowings			Nil
5.	Trade Payables:			
	Creditors		3,500	
	Less: Provision for Discount on Creditors (3,500 × 2.5%)		88	3,412
6.	Short-term Provisions			Nil

(*Contd.*)

7.	Other Current Liabilities:		
	Rent Outstanding (₹1080/12 months × 1 month = 90)	90	
	Managing Director's Commission Payable	638	728
8.	Tangible Assets:		
	Machinery less Depreciation (5,800 – 580)		5,220
9.	Intangible Assets		Nil
10.	Non-current Investments		Nil
11.	Trade Receivables:		
	Sundry Debtors	7,500	
	Less: Provision for Bad and Doubtful Debts (7,500 × 5%)	376	7,124
12.	Short-term Loans and Advances:		
	Prepaid Insurances (150 × 6/12 = 75)		75
13.	Other Current Assets		Nil
14.	Closing Stock or Inventory:		
	Closing Stock		16,400
15.	Cash in Hand and at Bank:		
	Cash in Hand		3,240

Illustration 12

Rajesh Ltd. is a company with an authorised capital of ₹10,00,000, divided into 10,000 equity shares of ₹100 each. On 31st December 2016, 5,000 shares were fully called-up. The following balances were extracted from the ledger of the company as on 31st December 2016:

Particulars	Amount (₹)	Particulars	Amount (₹)
Stock	1,00,000	Advertisement	7,600
Sales	8,50,000	Bonus	21,000
Purchases	6,00,000	Debtors	77,400
Productive Wages	1,40,000	Creditors	70,400
Discount Allowed	8,400	Plant and Machinery	1,61,000
Discount Received	6,300	Furniture	34,200
Insurance (up to 31.3.2016)	13,440	Cash and Bank Balance	2,69,400
Salaries	37,000	Reserves	50,000
Rent	12,000	Loan from Managing Director	31,400
General Expenses	17,900	Bad Debts	6,400
Pro tit and Loss A/c	12,440	Calls-in-Arrears	10,000
Printing and Stationery	4,800		

You are required to prepare statement of Profit & Loss A/c for the year ended 31st December 2016 and the balance sheet on that date.

Additional information:

(a) Closing stock ₹1,83,000;
(b) Provide for depreciation at 15% on plant and machinery and 10% on furniture;
(c) Outstanding liabilities: Wages ₹10,400; Salary ₹2,440 and Rent ₹1,200;
(d) Provide 5% dividend of paid-up share capital;
(e) Provide for corporate dividend tax @17%.

Solution:

Rajesh Ltd.
Statement Showing Profit & Loss
for the Year Ended 31.12.2016 (As per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	8,50,000
Other Incomes	2	6,300
Total Revenues (A)		8,56,300
Expenses:		
Cost of Goods Sold	3	5,17,000
Employee Benefit Expenses	4	2,10,800
Finance Costs	5	Nil
Depreciation and Amortisation Expenses	6	27,570
Other Expenses	7	68,380
Total Expenses (B)		8,23,750
Profits Before Tax (A – B)		32,550
Less: Current Tax		Nil
Profit for the Period		**32,550**

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales		8,50,000
2.	Other Incomes:		
	Discount Received		6,300
3.	Cost of Goods Sold:		
	Opening Stock	1,00,000	6,300
	Add: Purchases	6,00,000	
		7,00,000	
	Less: Closing Stock	1,83,000	5,17,000

(*Contd.*)

4.	Employee Benefit Expenses:		
	Salaries add Outstanding Salaries (18,500 + 12,500)	39,400	
	Productive Wages add Outstanding (1,40,000 + 10,400)	1,50,400	
	Bonus	21,000	2,10,800
5.	Finance Costs		Nil
6.	Depreciation and Amortisation Expenses:		
	Depreciation on Plant and Machinery (1,61,000 × 15%)	24,150	
	Depreciation on Furniture (34,200 × 10%)	3,420	27,570
7.	Other Expenses:		
	Discount Allowed	8,400	
	Insurance 13,440		
	Less: Prepaid Insurance 3,360	10,080	
	(31.12.2009 – 31.03.2010		
	= 13,440 × 3/12 = 3,360)		
	Rent add Outstanding Rent (12,000 + 1200)	13,200	
	General Expenses	17,900	
	Printing and Stationery	4,800	
	Advertisement	7,600	
	Bad Debts	6,400	68,380

Rajesh Ltd.
Balance Sheet, as on 31.12.2016 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	4,90,000
Reserves and Surplus	2	66,324
(ii) Non-current Liabilities		
Long-term Borrowings	3	31,400
(iii) Current Liabilities		
Short-term Borrowings	4	Nil
Trade Payables	5	70,400
Short-term Provisions	6	Nil
Other Current Liabilities	7	42,666
Total: (i) + (ii) + (iii)		**7,00,790**

(*Contd.*)

II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	1,67,730
Intangible Assets	9	Nil
Non-current Investments	10	Nil
(ii) Current Assets		
Trade Receivables	11	77,400
Short-term Loans and Advances	12	3,360
Other Current Assets	13	Nil
Closing Stock	14	183,000
Cash in Hand and at Bank	15	2,69,400
Total: (i) + (ii)		**7,00,790**

Notes to Accounts on Balance Sheet

Note No.	Particulars			Amount (₹)	Amount (₹)
1.	Share Capital:				
	Authorised Share Capital				
	10,000 Equity Shares of ₹100 each				10,00,000
	Issued, Subscribed, Called-Up and Paid-Up Capital:				
	5,000 Equity Shares of ₹100 each			5,00,000	
	Less: Calls-in-Arrears			10,000	4,90,000
2.	Reserves and Surplus:				
	Profit & Loss A/c		12,440		
	Balance at the Beginning of the year		32,550		
	Add: Profit for the Year		44,990		
	Less: Appropriations:				
	Interim Dividend Paid	24,500			
	Corporate Dividend Tax (75000 × 17%)	4,166	28,666	16,324	
	Reserves			50,000	66,324
3.	Long-term Borrowing:				
	Loan from Managing Director				31,400
4.	Short-term Borrowings				Nil
5.	Trade Payables:				
	Creditors				70,400
6.	Short-term Provisions				Nil

(*Contd.*)

7.	Other Current Liabilities:			
	Wages Outstanding		10,400	
	Salary Outstanding		2,400	
	Rent Outstanding		1,200	
	Dividend Payable		24,500	
	Corporate Dividend Tax Payable		4,155	42,666
8.	Tangible Assets:			
	Plant and Machinery – Depreciation (1,61,000 – 24,150)		1,36,850	
	Furniture (34,200 – 3,420)		30,780	1,67,630
9.	Intangible Assets			Nil
10.	Non-current Investments			Nil
11.	Trade Receivables:			
	Sundry Debtors			77,400
12.	Short-term Loans and Advances			
	Prepaid Insurance			3,360
13.	Other Current Assets			Nil
14.	Closing Stock or Inventory:			
	Closing Stock			1,83,000
15.	Cash in Hand and at Bank:			
	Cash and Banlk Balance			2,69,400

Illustration 13

R.K. Ltd. has authorised capital of ₹100 lakh, divided into 10,00,000 equity shares of ₹10 each. The books show the following balances as on 31st December 2016:

Particulars	Debit Amount (₹)	Particulars	Credit Amount (₹)
Stock (on 01.01.2016)	13,30,000	Equity Share Capital	40,00,000
Discounts and Rebates	60,000	4% Debentures	10,00,000
Carriage Inwards	1,15,000	Bank Overdraft	13,70,000
Patents	7,50,000	Sundry Creditors	4,81,000
Rates, Taxes and Insurance	1,10,000	Sales	72,34,000
Furniture and Fixtures	3,00,000	Rent (Cr.)	60,000
Materials Purchases	24,65,000	Transfer Fees	13,000
Wages	26,10,000	Profit & Loss A/c	1,34,000

(*Contd.*)

Coal and Coke	1,26,000		
Freehold Land	25,00,000		
Plant and Machinery	15,00,000		
Engineering Tools	3,00,000		
Goodwill	7,50,000		
Sundry Debtors	5,32,000		
Bills Receivable	2,69,000		
Advertisement	30,000		
Commission and Brokerage	1,35,000		
Business Expenses	1,12,000		
Bank Current A/c	40,000		
Cash in Hand	16,000		
Debentures Interest (for ½ year)	20,000		
Bank Interest	1,82,000		
Preliminary Expenses	20,000		
Calls-in-Arrears	20,000		
	1,42,92,000		**1,42,92,000**

Adjustments:

(a) The stock valued at cost or market value whichever is lower as on 31st December 2016 was ₹14,16,000;
(b) Outstanding liabilities for wages ₹50, 000 and business expenses ₹50,000;
(c) Dividend declared 10% on paid-up shares capital;
(d) Charge depreciation on plant and machinery at 5%, engineering tools at 20%, patents at 10% and furniture and fittings at 10%;
(e) Provide 2% on debtors as doubtful debts after writing off ₹42,000 as bad debts;
(f) Write off preliminary expenses and create debenture redemption reserve ₹1,00,000;
(g) Provide ₹4,80,000 for income tax.

You are required to prepare a statement of Profit & Loss A/c for the year ended 31st December 2016 and balance sheet on that date.

Solution:

R.K. Ltd.
Statement Showing Profit & Loss
for the Year Ended on 31.12.2016 (As per Revised Schedule VI)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	72,34,000
Other Incomes	2	73,000
Total Revenues (A)		73,07,000

(*Contd.*)

Expenses:		
Cost of Goods Sold	3	24,94,000
Employee Benefit Expenses	4	26,60,000
Finance Costs	5	2,22,000
Depreciation and Amortisation Expenses	6	2,60,000
Other Expenses	7	6,75,780
Total Expenses (B)		63,11,780
Profits Before Tax (A – B)		9,95,220
Less: Current Tax Provision		4,80,000
Profit for the Period		**5,15,220**

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales		72,34,000
2.	Other Incomes:		
	Rent Received (Cr.)	60,000	
	Transfer Fees	13,000	73,000
3.	Cost of Goods Sold:		
	Openings Stock	13,30,000	
	Add: Materials Purchased	24,65,000	
	Carriage Inwards	1,15,000	
		39,10,000	
	Less: Closing Stock	14,16,000	24,94,000
4.	Employee Benefit Expenses:		
	Wages add Outstanding (26,10,000 + 50,000)		26,60,000
5.	Finance Costs:		
	Debenture Interest for Half-year 20,000		
	Add: Debenture Interest O/s for Half-year (10,00,000 × 4% × ½) 20,000	40,000	
	Bank Interest	1,82,000	2,22,000
6.	Depreciation and Amortisation Expenses:		
	Preliminary Expenses Written Off	20,000	
	Depreciation on Plant and Machinery (15,00,000 × 5%)	75,000	
	Depreciation on Engineering Tools (3,00,000 × 20%)	60,000	

(*Contd.*)

	Depreciation on Patents (7,50,000 × 10%)	75,000	
	Depreciation on Furniture and Fixtures (3,00,000 × 10%)	30,000	2,60,000
7.	Other Expenses:		
	Discount and Rebates	60,000	
	Rates, Taxes and Insurance	1,10,000	
	Coal and Coke	1,26,000	
	Advertisement	30,000	
	Commission and Brokerage	1,35,000	
	Business Expenses add Outstanding (1,12,000 + 50,000)	1,62,000	
	Provision for Bad and Doubtful Debts:		
	New Bad Debts 43,000		
	Add: Old Bad Debts Nil		
	Add: New Provision for Bad and Doubtful Debts 9,780		
	52,780	52,780	
	Less: Old Provision for Bad and Doubtful Debts Nil		6,75,780

R.K. Ltd.
Balance Sheet, as on 31.12.2016 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	39,80,000
Reserves and Surplus	2	183,560
(ii) Non-current Liabilities		
Long-term Borrowings	3	10,00,000
(iii) Current Liabilities		
Short-term Borrowings	4	13,70,000
Trade Payables	5	4,81,000
Short-term Provisions	6	4,80,000
Other Current Liabilities	7	5,85,660
Total: (i) + (ii) + (iii)		**80,80,220**
II. Assets:		
(i) Non-current Assets		
Tangible Assets	8	44,35,000
Intangible Assets	9	14,25,000
Non-current Investments	10	Nil

(*Contd.*)

(ii) Current Assets		
Trade Receivables	11	7,48,220
Short-term Loans and Advances	12	Nil
Other Current Assets	13	Nil
Closing Stock (or) Inventory	14	14,16,000
Cash in Hand at Bank	15	56,000
Total: (i) + (ii)		**80,80,220**

Notes to Accounts on Balance Sheet

Note No.	Particulars			Amount (₹)	Amount (₹)
1.	Share Capital:				
	Authorised Share Capital				
	10,00,000 Equity Shares of ₹10 each				1,00,00,000
	Issued, Subscribed, Called-Up and Paid-Up Capital				
	4,00,000 Equity Shares of ₹10 each			40,00,000	
	Less: Calls-in-Arrears			20,000	39,80,000
2.	Reserves and Surplus:				
	Profit & Loss A/c				
	Balance at the Beginning of the Year		134,000		
	Add: Profit for the Year		5,15,220		
	Less: Appropriations:		6,49,220		
	Dividend (39,80,000 × 10%)	3,98,000			
	Corporate Dividend Tax (3,98,000 × 17%)	67,660			
	Debenture Redemption Reserve	1,00,000	5,65,660	83,560	
	Debenture Redemption Reserves Transfer			1,00,000	183,560
3.	Long-term Borrowings:				
	4% Debentures				10,00,000
4.	Short-term Borrowings:				
	Bank Overdraft				13,70,000
5.	Trade Payables:				
	Sundry Creditors				4,81,000
6.	Short-term Provisions:				
	Provision for Income Tax				4,80,000

(*Contd.*)

7.	Other Current Liabilities:			
	Debenture Interest Outstanding of half-year		20,000	
	Wages Outstanding		50,000	
	Business Expenses Outstanding		50,000	
	Dividend Payable		3,98,000	
	Corporate Dividend Tax Payable		67,660	5,85,660
8.	Tangible Assets:			
	Furniture less Depreciation (3,00,000 – 30,000)		2,70,000	
	Freehold Land		25,00,000	
	Plant less Depreciation (15,00,000 – 75,000)		14,25,000	
	Engineering Tools (3,00,000 – 60,000)		2,40,000	44,35,000
9.	Intangible Assets:			
	Patents less Depreciation (7,50,000 – 75,000)		6,75,000	
	Goodwill		7,50,000	14,25,000
10.	Non-current Investments			Nil
11.	Trade Receivables:			
	Sundry Debtors	5,32,000		
	Less: New Bad Debts	43,000		
	Less: New Provision for Doubtful Debts	4,89,000		
	(4,89,000 × 2%)	9,780	4,79,220	
	Bills Receivable		2,69,000	7,48,220
12.	Short-term Loans and Advances			Nil
13.	Other Current Assets			Nil
14.	Closing Stock or Inventory:			
	Closing Stock			14,16,000
15.	Cash in Hand and at Bank:			
	Bank Current A/c		40,000	
	Cash in Hand		16,000	56,000

Illustration 14

Anand Co. Ltd. was registered with an authorised capital of ₹15,00,000, divided into 6,000 6% cumulative preference shares of ₹1,000 each and 4,500 equity shares of ₹100 each. The following is the balance taken as on 31st December 2008

Particulars	Amount (₹)	Particulars	Amount (₹)
Stock (on 01.01.2008)	4,83,000	Share Capital:	
Delivery Expenses	2,04,000	6,000 6% cumulative	
General Expenses	42,000	Preference Shares	
Bills Receivable	12,000	of ₹1000 each	6,00,000
Investment:		6,000 Equity Shares	
6,000 Shares of ₹10 each		(₹75 called-up)	4,50,000
in Sunrise Co. Ltd.	1,20,000	General Reserve	1,65,450
Preference Dividend		Profit & Loss A/c (Cr.)	1,17,000
half year (on 30.06.2008)	18,000	Sales	18,37,200
Bank Balance	1,95,000	5% Debentures	4,20,000
Goodwill	2,00,000	Trade Creditors	2,51,040
Trade Debtors	3,35,000	Provision for Taxation	17,600
Freehold Properties at Cost	7,80,000		
Salaries	2,07,000		
Rent & Rates	76,500		
Furniture at Cost	1,50,000		
Purchases	9,53,000		
Freight & Carriage Inwards	7,500		
Debentures Interest (half year)	10,500		
Final Dividend for 2007	40,500		
Cash in Hand	24,290		
	38,58,290		38,58,290

Prepare a statement of Profit & Loss for the year ended 31st December 2008 and balance sheet at that date, after taking the following into account:

(a) Closing stock ₹4,30,000;
(b) Deprecation 2.5 % on freehold property and 6% on furniture;
(c) Bills receivable for ₹5,000 maturing after 31st December 2008 has been discounted with bank;
(d) Directors proposed to pay second half-year's dividend on preference share;
(e) 10% dividend on equity shares is proposed;
(f) Provide 5% towards reserve for doubtful debts on trade debtors;
(g) Provide for corporate dividend tax.

Solution:

Anand Co. Ltd.
Statement of Profit & Loss
for the Year Ended 31.12.2008 (As per Revised Schedule)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	18,37,200
Other Incomes	2	Nil
Total Revenues (A)		18,37,200
Expenses:		
Cost of Goods Sold	3	10,13,500
Employee Benefit Expenses	4	2,07,000
Finance Costs	5	21,000
Depreciation and Amortisation Expenses	6	28,500
Other Expenses	7	3,39,250
Total Expenses (B)		16,09,250
Profits Before Tax (A – B)		2,27,950
Less: Current Tax Provision		Nil
Profit for the Period		**2,27,950**

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales		18,37,200
2.	Cost of Goods Sold:		
	Openings Stock		4,83,000
	Add: Purchases		9,53,000
	Add: Freight & Carriage Inwards		7,500
			14,43,500
	Less: Closing Stock		4,30,000
			10,13,500
3.	Employee Benefit Expenses:		
	Salaries		2,07,000
4.	Finance Costs:		
	Interest on Debentures	10,500	
	Add: Outstanding	10,500	21,000
5.	Depreciation and Amortisation Expenses:		
	Depreciation on Freehold Premises		19,500
	Depreciation on Furniture		9,000
			28,500

(*Contd.*)

6.	Other Expenses:		
	Delivery Expenses		2,04,000
	General Expenses		42,000
	Rent & Rates		76,500
	Provision for Bad Debts		16,750
			3,39,250

Anand Co. Ltd.
Balance Sheet, as on 31.3.1998 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	10,50,000
Reserves and Surplus	2	3,75,130
(ii) Non-current Liabilities		
Long-term Borrowings	3	4,20,000
(iii) Current Liabilities		
Trade Payables	4	2,51,040
Short-term Provisions	5	80,600
Other Current Liabilities	6	24,270
Total: (i) + (ii) + (iii)		**22,01,040**
II. Assets:		
(i) Non-current Assets		
Tangible Assets	7	9,01,500
Intangible Assets	8	2,00,000
Non-current Investments	9	1,20,000
(ii) Current Assets		
Trade Receivables	10	3,30,250
Closing Stock		4,30,000
Cash in Hand		24,290
Cash at Bank		1,95,000
Total: (i) + (ii)		**22,01,040**

Notes to Accounts on Balance Sheet

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Share Capital:		
	Issued, Subscribed and Called-up:		
	6,000 Equity Shares of ₹75 each		4,50,000
	6,000 6% Cumulative Preference Shares of ₹100 each		6,00,000
			10,50,000
2.	Reserves & Surplus:		
	General Reserve		1,65,450
	Surplus in Statement of Profit & Loss		
	Balance at the Beginning of the Year	1,17,000	
	Profit for the Year	2,27,950	
		3,44,950	
	Less: Appropriation:		
	Final Dividend	40,500	
	Preference Dividend Paid	18,000	
	Proposed Preference Dividend	18,000	
	Proposed Equity Dividend	45,000	
	Corporate Dividend Tax		
	(45,000 + 18,000 + 18,000 × 17%)	13,770	2,09,680
			3,75,130
3.	Long-term Borrowings:		
	5% Debentures		4,20,000
4.	Trade Payables:		
	Trade Creditors		2,51,040
5.	Short-term Provisions:		
	Proposed Preference Dividend		18,000
	Proposed Equity Dividend		45,000
	Provision for Taxation		17,600
			80,600
6.	Other Current Liabilities:		
	Dividend Tax Payable		13,770
	Outstanding Debenture Interest		10,500
			24,270

(*Contd.*)

7.	Tangible Assets:		
	Freehold Properties less Depreciation (3,90,000 – 9,750)		7,60,500
	Furniture less Depreciation (1,50,000 – 9,000)		1,41,000
			9,01,500
8.	Intangible Assets:		
	Goodwill		2,00,000
9.	Non-current Investments:		
	Shares in Sunrise Ltd.		1,20,000
10.	Trade Receivables		
	Trade Debtors less PBDD (3,35,000 – 16,750)		3,18,250
	Bills Receivable		12,000
			3,30,250

Illustration 15

Big Boss Ltd. has a nominal capital of ₹12,00,000, divided into shares of ₹10 each. The following trail balance was extracted from the books of the company, as on 31st December 2007.

Particulars	Amount (₹)	Particulars	Amount (₹)
Stock (on 01.01.2007)	150,000	Share Capital (Called-up)	9,20,000
Calls-in-Arrears	15,000	Bills Payable	76,000
General Expenses	33,800	General Reserve	50,000
Directors' Fees	11,480	Profit & Loss A/c (01.01.2007)	29,000
Bad Debts	4,220	Sales	8,30,000
4% Government Securities	1,20,000	6% Debentures	6,00,000
Preliminary Expenses	10,000	Creditors	1,00,000
Sundry Debtors	1,74,000	Provision for Bad Debts	7,000
Bank	79,800		
Goodwill	50,000		
Machinery	6,00,000		
Premises (₹60,000 added on 01.07.2007)	7,20,000		
Salaries	29,000		
Wages	169,600		
Furniture	14,400		
Purchases	370,000		

(*Contd.*)

Freight	26,200		
Debentures Interest	18,000		
Interim Dividend	15,000		
Cash	1,500		
	26,12,000		26,12,000

Prepare final accounts of the company for the year ended 31st December 2007 in the prescribed form, taking into account the following adjustment:

(a) Stock on 31st December 2007 was ₹2,02,000;
(b) Deprecation on Machinery 10 % and furniture 5%;
(c) Write off preliminary expenses;
(d) Wages included ₹20,000 paid for the construction of a compound wall to the premises and no adjustment was made;
(e) Transfer ₹20,000 to general reserve;
(f) Provide 5% for bad debts on sundry debtors;
(g) Provide for income tax ₹50,000.

Solution:

Big Boss Ltd.
Statement of Profit & Loss
for the Year Ended 31.12.2002 (As per Revised Schedule)

Particulars	Note No.	Amount (₹)
Revenue from Operations	1	8,30,000
Other Income	2	Nil
Total Revenue (A)		8,30,000
Expenses:		
Cost of Goods Sold	3	3,44,200
Employee Benefit Expenses	4	1,78,600
Finance Costs	5	36,000
Depreciation and Amortisation Expenses	6	70,720
Other Expenses	7	51,200
Total Expenses (B)		6,80,720
Profits Before Tax (A – B)		1,49,280
Less: Tax Expense: Current Tax		50,000
Profit for the Period		99,280

Notes to Accounts on Statement of Profit & Loss

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Revenue from Operations:		
	Sales		8,30,000

(*Contd.*)

2.	Cost of Goods Sold:		
	Opening Stock		1,50,000
	Add: Purchases		3,70,000
	Add: Freight		26,200
			5,46,200
			2,02,000
	Less: Closing Stock		3,44,200
3.	Employee Benefits Expenses:		
	Wages	1,69,600	
	Less: Wages for the Premises	20,000	
			1,49,600
	Salaries		29,000
			1,78,600
4.	Finance Costs:		
	Interest on Debentures	18,000	
	Add: Outstanding	18,000	36,000
5.	Depreciation and Amortisation Expenses:		
	Depreciation on Machinery		60,000
	Depreciation on Furniture		720
	Preliminary Expenses Written Off		10,000
			70,720
6.	Other Expenses:		
	Director's Fees		11,480
	Bad Debts	4,220	
	Add: New PBDD	8,700	
		12,920	
	Less: Old PBDD	7,000	5,920
	General Expenses		33,800
			51,200

Big Boss Ltd.
Balance Sheet, as on 31.12.2007 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	9,05,000
Reserves and Surplus	2	1,60,730

(*Contd.*)

(ii) Non-current Liabilities		
Long-term Borrowings	3	6,00,000
(iii) Current Liabilities		
Trade Payables	4	1,76,000
Short-term Provisions	5	50,000
Other Current Liabilities	6	20,550
Total: (i) + (ii) + (iii)		**19,12,280**
II. Assets:		
(i) Non-current Assets		
Tangible Assets	7	12,93,680
Intangible Assets	8	50,000
Non-current Investments	9	1,20,000
(ii) Current Assets		
Trade Receivables	10	1,65,300
Closing Stock		2,02,000
Cash		1,500
Bank		79,800
Total: (i) + (ii)		**19,12,280**

Notes to Accounts on Balance sheet

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Share Capital:		
	92,000 shares of ₹10 each	9,20,000	
	Less: Calls-in-Arrears	15,000	9,05,000
			9,05,000
2.	Reserves & Surplus:		
	General Reserve		50,000
	Add: Addition during the year		20,000
	Surplus in Statement of Profit & Loss:		
	Balance at the Beginning of the Year:	29,000	
	Profit for the Year	99,280	
		1,28,280	
	Less: Appropriation:		
	Interim Dividend	15,000	
	Corporate Dividend Tax (15,000 × 17%)	2,550	
	General Reserve	20,000	90,730
			1,60,730

(*Contd.*)

3.	Long-term Borrowings:		
	6% Debentures		6,00,000
4.	Trade Payables:		
	Creditors		1,00,000
	Bills Payable		76,000
			1,76,000
5.	Short-term Provisions:		
	Provision for Taxation		50,000
6.	Other Current Liabilities:		
	Dividend Tax Payable		2,550
	Outstanding Debenture Interest		18,000
			20,550
7.	Tangible Assets:		
	Premises	7,20,000	
	Add: Wrongly debited to Wages A/c	20,000	7,40,000
	Machinery	6,00,000	
	Less: 10% Depreciation	60,000	5,40,000
	Furniture	14,400	
	Less: 5% Depreciation	720	13,680
			12,93,680
8.	Intangible Assets:		
	Goodwill		50,000
9.	Non-current Investments:		
	4% Government Securities		1,20,000
10.	Trade Receivables		
	Trade Debtors less PBDD (1,74,000 – 8,700)		1,65,300

Illustration 16

The trial balance of Google Ltd., as on 30th September 2005 is as follows:

Particulars	(₹)	Particulars	(₹)
Preference Share Redemption	9,600	Share Capital	
Land (Cost)	40,000	(Authorised & Issued)	
Establishment Expenses	50,000	Equity Shares	
Directors' Fees	400	(30,000 Shares)	3,00,000
Building (Cost less Depreciation)	1,40,000	8% Redeemable Preference Shares (80 Shares)	8,000

(*Contd.*)

Investment in G.I notes	40,000	Securities Premium	5,000
Sundry Expenses	12,000	Trading A/c- G.P	1,60,000
Sundry Debtors	6,000	General Reserve	20,000
Cash at Bank in Current Account	39,000	Profit & Loss A/c (30.09.2004)	2,000
Motor Vehicle (Cost less Depreciation)	7,000	Discount Received	1,000
Rates, Taxes & Insurance	2,400	Interest on Investment (tax free)	1,600
Commission	800	Sundry Creditors	5,120
Depreciation	12,000	Unpaid Dividend	400
Payment to Auditors	800	Outstanding Expenses	1,200
Furniture (Cost less Depreciation)	4,000	Provision for Taxation (30.09.2004)	14,000
Stock at or Below Cost	70,600		
Income Tax Paid under Dispute (30.09.2004)	20,000		
Advance Payment of Income Tax	44,000		
Interim Dividend	15,320		
Cash in Hand	2,400		
Security Deposit	2,000		
	5,18,320		**5,18,320**

The following additional information is available:

(a) The preference shares were redeemed on 1st April 2005 at a premium of 20% but no entries were passed for giving effect thereto, except payment standing to the debit of preference share redemption account;

(b) Depreciation as per income tax rules provided up to 30st September 2005 is as follows:

(c) Building ₹42,000; Furniture ₹4,000; Motor Vehicle ₹12,000

(d) Payment to auditors includes ₹200 for taxation work in addition to audit fees;

(e) Market value of the investment as on 30th September 2005 was ₹36,000;

(f) Interim dividend includes dividend on equity shares ₹1,500 and dividend on preference shares ₹320;

(g) Sundry debtors include ₹4,000 due for period exceeding six months;

(h) All receivables and deposits are considered good;

(i) Income tax demand for the year ended 30th September 2005 for ₹20,000 has not been provided for in full, against which an appeal is pending;

(j) Income tax to be provided at 55%;

(k) Directors have recommended payment of further dividend on equity shares at ₹0.50 per share after appropriating ₹6,000 to general reserve;

(l) Ignore previous year's figures;
(m) Provide for corporate dividend tax @17%.

Prepare statement of Profit & Loss for the year ended 30th September 2005 and balance sheet as on date.

Solution:

Statement of Profit & Loss
for the Year Ended 30.09.2005 (As per Revised Schedule VI)

	Note No.	(₹)
Revenue from Operations	1	1,60,000
Other Income	2	2,600
Total Revenue (A)		1,62,600
Expenses:		
Depreciation and Amortisation Expenses	3	12,000
Other Expenses	6	66,400
Total Expenses (B)		78,400
Profit Before Tax (A – B)		84,200
Less: Tax Expense: Current Tax		46,310
Profit for the Period		**37,890**

Notes to Accounts on Statements of Profits and Loss

		(₹)
1.	Revenue from Operations:	
	Gross Profit	1,60,000
2.	Other Income:	
	Discount Received	1,000
	Interest on Investment	1,600
		2,600
3.	Depreciation and Amortisation Expenses:	
	Depreciation	12,000
4.	Other Expenses	
	Establishment Expenses	50,000
	Sundry Expenses	12,000
	Rates, Taxes & Insurance	2,400
	Commission	800
	Director's Fees	400
	Auditor's Fees	600
	Taxation Fees	200
		66,400

Balance Sheet, as on 30.09.2005 (As per Revised Schedule VI)

	Note No.	Amount (₹)
I. Equity and Liabilities:		
(i) Shareholders' Funds		
Share Capital	1	3,00,000
Reserves and Surplus	2	27,816
(ii) Non-current Liabilities		
(iii) Current Liabilities		
Trade Payables	3	5,120
Short-term Provisions	4	75,310
Other Current Liabilities	5	6,754
Total: (i) + (ii) + (iii)		**4,15,000**
II. Assets:		
(i) Non-current Assets		
Tangible Assets	6	1,91,000
Non-current Investments	7	40,000
(ii) Current Assets		
Trade Receivables	8	6,000
Short-term Loans and Advances	9	46,000
Other Current Assets	10	20,000
Closing Stock in Trade		70,600
Cash in Hand		2,400
Cash at Bank		39,000
Total: (i) + (ii)		**4,15,000**

Notes to Accounts on Balance Sheet

Note No.	Particulars	Amount (₹)	Amount (₹)
1.	Share Capital:		
	Authorised & Issued Capital:		
	30,000 equity shares of ₹10 each		3,00,000
2.	Reserves & Surplus:		
	Securities Premium		3,400
	General Reserve	12,000	
	Add: Addition during the year	6,000	18,000
	Capital Redemption reserve		8,000
	Surplus in Statement of Profit & Loss:		

(*Contd.*)

	Balance at the Beginning of the Year:	2,000	
	Profit for the Year	37,890	
		39,890	
	Less: Appropriation:		
	Interim Dividend on Preference Shares	320	
	Interim Dividend on Equity Shares	15,000	
	General Reserve	6,000	
	Proposed Equity Dividend	15,000	
	Corporate Dividend Tax (3,03,200 × 17%)	5,154	1,584
			27,816
3.	Trade Payables:		
	Creditors		5,120
4.	Short-term Provisions:		
	Provision for Taxation (14,000 + 46,310)		60,310
	Proposed Equity Dividend		15,000
			75,310
5.	Other Current Liabilities:		
	Dividend Tax Payable		5,154
	Unpaid Dividend		400
	Outstanding Expenses		1,200
			6,754
6.	Tangible assets:		
	Land at Cost		40,000
	Building less Depreciation		1,40,000
	Furniture less Depreciation		4,000
	Motor Vehicles less Depreciation		7,000
			1,91,000
7.	Non-current Investments:		
	G.P Notes (market value ₹18,000)		40,000
8.	Trade Receivables		
	Sundry Debtors (due for more than 6 months ₹4,000)		6,000
9.	Short-term Loans and Advances:		
	Advance Tax		44,000
	Security Deposit		2,000
			46,000
10.	Other Current Assets:		
	Income Tax Paid under Dispute		20,000

THEORY QUESTIONS

I. Short-Answer Questions

1. What is a Financial Statement?
2. What are the Objectives of a Financial Statement?
3. What do you mean by Revenue from Operations?
4. What do you mean by Employee Benefit Expenses?
5. State any two items appearing under other income.
6. What are Tangible Assets?
7. How do you deal with provision for tax in final accounts of companies?
8. Give the meaning of Cost of Materials Consumed.
9. Define the term Dividend.
10. What is the maximum rate of managerial remuneration in case of a public limited company?
11. What do you mean by Non-current Liabilities?
12. Briefly state the meaning of Shareholders Funds.
13. Give few examples of intangible assets.
14. State how preliminary expenses are to be treated in final accounts.
15. What do you mean by Trade Receivable?

II. Long-Answer Questions

1. What are the legal requirements for preparing company final accounts as per Companies (Amendment) Act, 1988?
2. Discuss about the managerial remuneration eligible for different managerial personnel.
3. Write the format of statement of Profit & Loss as per Revised Schedule VI.
4. Write the format of balance sheet as per Revised Schedule VI.
5. What is meant by Corporate Dividend Tax? Write its accounting treatment.
6. Give the rules regarding transfer of profits to reserves.
7. Explain the provisions relating to transfer to reserves.

OBJECTIVE-TYPE QUESTIONS

I. Multiple Choice Questions

1. Amount realised from sale of goods is regarded in the statement of Profit & Loss as:
   (a) Other income (b) Revenue from operations
   (c) Any of the above (d) None of the above
2. Gain on sale of fixed assets is shown in the statement of Profit & Loss as:
   (a) Other income (b) Revenue from operations
   (c) Any of the above (d) None of the above

3. Dividend received by a financial company is shown in the statement of Profit & Loss as:
   (a) Other income (b) Revenue from operations
   (c) Any of the above (d) None of the above
4. Raw materials purchased is considered in the statement of Profit & Loss as:
   (a) Cost of materials consumed (b) Purchase of stock in trade
   (c) Changes in inventories (d) None of these
5. Goods purchased for reselling is regarded in the statement of Profit & Loss as:
   (a) Cost of materials consumed (b) Purchase of stock in trade
   (c) Changes in inventories (d) None of these
6. Payment of wages and salaries is shown in the statement of Profit & Loss under:
   (a) Employees benefit expenses (b) Other expenses
   (c) Finance costs (d) None of these
7. Payment of interest on debentures and bank overdraft is shown in the statement of Profit & Loss under the head:
   (a) Employees benefit expenses (b) Other expenses
   (c) Finance costs (d) None of these
8. Preliminary expenses written off is shown in the statement of Profit & Loss as:
   (a) Employees benefit expenses
   (b) Other expenses
   (c) Finance costs
   (d) Depreciation and amortisation expenses
9. Carriage outwards is shown in the statement of Profit & Loss as:
   (a) Employees benefit expenses
   (b) Other expenses
   (c) Finance costs
   (d) Depreciation and amortisation expenses
10. Debentures redeemable after 10 years of issue are considered as:
    (a) Long-term borrowings (b) Short-term borrowings
    (c) Other current liabilities (d) None of these
11. Bank overdraft is shown in the balance sheet of a company as:
    (a) Long-term borrowings (b) Short-term borrowings
    (c) Other current liabilities (d) None of these
12. Dividend is paid on:
    (a) Authorised capital (b) Issued capital
    (c) Called-up capital (d) Paid-up capital
13. Securities premium is shown in the balance sheet of a company under:
    (a) Share capital (b) Reserves and surplus
    (c) Long-term borrowings (d) None of these

[*Ans:* 1. (b); 2. (a); 3. (b); 4.(a); 5. (b); 6. (a); 7. (c); 8.(d); 9. (b); 10.(a); 11. (b); 12.(d); 13. (b)**]**

II. True and False

1. Unclaimed dividend can be transferred to capital reserve after the expiry of six years.
2. Calls-in-Advance are shown as other current liability.
3. Bank charges levied by the bank are shown as finance costs.
4. Sale of scrap is treated as revenue from operations by a manufacturing company.
5. Shareholders can increase the rate of dividend as directed by the directors.
6. Share application money outstanding allotment is shown as a current liability.
7. Spares and stores, and also loose tools are treated as other current assets.
8. Dividend is not paid on Calls-in-Advance.
9. Provision for tax is regarded as a charge against profit and not as an appropriation of profit.
10. If rate of dividend is 20%, then the company has to transfer 7.5% of the current profit to reserve.

[*Ans:* 2, 4, 8, 9, 10 – True; and 1, 3, 5 ,6, 7 – False]

III. Fill in the Blanks

1. Expenses incurred for the employees are called as ____________.
2. Expenses incurred by the company on the borrowings are called as ____________.
3. ____________ is the distribution of cost of fixed cost over its useful life.
4. ____________ is writing off of intangible assets.
5. Share capital includes both ____________ and ____________.
6. Liabilities, which are not current liabilities, are termed as ____________.
7. Liabilities that are to be settled within 12 months are termed as ____________.
8. Trade payables include ____________ and ____________.
9. Trade receivables include ____________ and ____________.
10. Assets, which have physical existence, are called ____________.
11. Assets that are to be converted into cash within 12 months are known as ____________.
12. Statement of Profit & Loss shows ____________ performance.
13. Balance sheet is a statement of ____________ and ____________.

[*Ans:* 1. Employees benefit expenses; 2. Finance costs; 3. Depreciation; 4. Amortisation; 5. Equity capital, preference capital; 6. Non-current liabilities; 7. Current liabilities; 8. Creditors, bills payable; 9. Debtors, bills receivable; 10. Tangible assets; 11. Current assets; 12. Financial; 13. Assets, liabilities]

EXERCISE PROBLEMS

1. On 31st December 2016, the trial balance of ABC Ltd. shows provision for tax of ₹1,00,000, representing the provision of the previous year. The trial balance also shows income tax paid ₹90,000. It is estimated that a provision of ₹1,40,000 is required for the current year's income tax deducted at source while receiving

interest on investments amounted to ₹20,000. The gross amount of the interest was shown in the Profit & Loss A/c.

Write the provision for income tax account, incorporating the above details.

[*Ans:* Provision for tax balance on 01.01.2017: ₹1,20,000]

2. From the following items found in the trial balance of a company on 31st December 2016 and the adjustments given, show how the items would appear in the relevant accounts.

Particulars	Amount (₹)	Amount (₹)
Advance Tax Paid (2018)	30,000	-------
Provision for Taxation (2018)	-------	40,000
Tax Deducted at Source	5,000	--------

Adjustments:

(a) Income tax for 2018 has been assessed at ₹50,000, against which the advance payment of tax and tax deducted at source are to be adjusted.

(b) Provide ₹30,000 for taxation on current profits.

[*Ans:* Provision for tax balance on 01.01.2018: ₹30,000]

3. The following ledger balances were extracted from the books of Varun Ltd., as on 31st March 2016:

Land & Building ₹2,00,000; 12% Debentures ₹2,00,000; Share Capital ₹10,00,000 (equity shares of ₹10 each, fully paid-up; Plant & Machinery ₹8,00,000; Goodwill ₹2,00,000; Investment in shares of Raja Ltd. ₹2,00,000; General reserve ₹1,95,000; Stock in trade ₹1,00,000; Bills receivable ₹50,000; Debtors ₹1,50,000; Creditors ₹1,00,000; Bank loan (unsecured) ₹1,00,000; Provision for tax ₹50,000; Proposed dividend ₹55,000.

Prepare the balance sheet of the company as per revised Schedule VI, Part 1 of the Companies Act, 1956.

[*Ans:* Shareholders' funds: ₹11,95,000; Non-current liabilities: ₹2,00,000; Current liabilities: ₹3,05,000 ; Non-current assets: ₹14,00,000; Current assets: ₹3,00,000; Balance sheet total ₹17,00,000]

4. From the following balances, prepare the balance sheet of a company in the prescribed format. Goodwill ₹1,50,000; Investments ₹2,00,000; Share capital ₹5,00,000; Reserves ₹1,10,000; Securities premium ₹15,000; Preliminary expenses ₹10,000; Profit & Loss A/C (Cr.) ₹25,000; Debentures ₹2,50,000. Other fixed assets ₹4,70,000; Stock ₹80,000; Debtors ₹60,000; Bank balance ₹30,000. Unsecured loan ₹65,000; Sundry creditors ₹35,000.

[*Ans:* Shareholders' funds: ₹6,40,000; Non-current liabilities: ₹3,15,000; Current liabilities: ₹35,000; Non-current assets: ₹8,20,000; Current assets: Rs 1,70,000; Balance sheet total: ₹9,90,000]

Hint: 10% of current profit has to be transferred to general reserve as rate of proposed and interim dividend exceeds 20%.

5. From the following particular, determine the maximum remuneration available to a full-time director of a manufacturing company. The Profit & Loss A/c of the company showed a net profit of ₹40,00,000 after taking into account the following items:

(a) Depreciation (including special depreciation of ₹40,000) ₹1,00,000;
(b) Provision for income tax ₹2,00,000;
(c) Donation to political parties ₹50,000;
(d) Ex-gratia payment to a worker ₹10,000;
(e) Capital profit on sale of assets ₹15,000.

[*Ans:* Maximum Remuneration: ₹2,11,750]

6. Determine the maximum remuneration payable to the part-time director and manager of B Ltd. (a manufacturing company) under Sections 309 and 387 of the Companies Act from the following particulars:

   Before charging any such remuneration, the Profit & Loss A/c showed a credit balance of ₹23,10,000 for the year ended 31st March 2016 after taking into account the following information:

Particulars	Amount (₹)
Capital Expenditure	5,25,000
Subsidy Received from Government	4,20,000
Special Depreciation	70,000
Multiple Shift allowance	1,05,000
Bonus to Foreign Technicians	3,15,000
Provision for Taxation	28,00,000
Compensation paid to Injured Workman	70,000
Ex-gratia to an Employee	35,000
Loss on Sale of Fixed Assets	70,000
Profit on Sale of Investments	2,10,000

   Company is providing depreciation as per section 350 of the Companies Act.

[*Ans:* Net profit for managerial remuneration: ₹55,30,000;
Managerial remuneration payable: ₹3,31, 800]

7. Annamalai Ltd. is a company with an authorised capital of ₹5,00,000, divided in to 5,000 equity shares of ₹100 each on 31st March 2016; of which, 2,500 shares were fully called-up. The following are the balances from the ledger as on 31st March 2016.

Trial Balance of Annamalai Ltd.

Debit Balance	Amount (₹)	Credit Balance	Amount (₹)
Opening Stock	50,000	Sales	3,25,000
Purchases	2,00,000	Discount Received	3,150
Wages	70,000	Profit & Loss A/c	6,220
Discount Allowed	4,200	Creditors	35,200
Insurance (up to 30.06.2015)	6,720	Reserves	25,000
Salaries	18,500	Loan from M.D.	15,700
Rent	6,000	Share Capital	2,50,000

(*Contd.*)

General Expenses	8,950		
Printing & Stationery	2,400		
Advertisement	3,800		
Bonus	10,500		
Debtors	38,700		
Plant	1,80,500		
Furniture	17,100		
Bank	34,700		
Bad Debts	3,200		
Calls-in-Arrears	5,000		
	6,60,270		**6,60,270**

You are required to prepare statement of Profit & Loss for the year ended 31.03.2016 and the balance sheet as on that date. The following further information is given:

(a) Closing stock was valued at ₹1,91,500;

(b) Depreciation on plant at 15% and on furniture at 10% should be provided;

(c) A tax provision of ₹8,000 is considered necessary;

(d) The directors declared in interim dividend for six months, ending 30th September 2015 at 6%.

(e) Provide for corporate dividend tax at 17%.

[*Ans:* Profit & Loss balance: ₹1,00,275; Balance sheet: ₹4,35,395]

8. Suraj Ltd. was registered with an authorised capital of ₹6,00,000 in equity shares of ₹10 each. The following is its trial balance on 31st March 2016.

Debit Balance	**Amount (₹)**	**Credit Balance**	**Amount (₹)**
Goodwill	25,000	Share Capital	4,00,000
Cash	750	12% Debentures	3,00,000
Bank	39,900	Profit & Loss A/c	26,250
Purchases	1,85,000	Sales	4,15,000
Preliminary Expenses	5,000	Bills Payable	37,000
Calls-in-Arrears	7,500	Sundry Creditors	40,000
Premises	3 00,000	General Reserves	25,000
Plant & Machinery	3 30,000	Provision for Bad Debts	3,500
Interim Dividend	39,250		
Stock (on 01.04.2015)	75,000		
Furniture & Fixtures	7,200		

(*Contd.*)

Sundry Debtors	87,000		
Wages	84,865		
General Expenses	6,835		
Freight & Carriage	13,115		
Salaries	14,500		
Director's Fees	5,725		
Bad Debts	2,110		
Debenture Interest Paid	18,000		
	12,46,750		**12,46,750**

Prepare a statement of Profit & Loss and balance sheet in revised format, as per Schedule VI, after making the following adjustments:

(a) Depreciate plant and machinery by 15%;
(b) Write off preliminary expenses;
(c) Provide for six months' interest on debentures;
(d) Leave bad and doubtful debts provision at 5% on sundry debtors;
(e) Provide for income tax at 50%;
(f) Stock on 31st March 2016 was ₹95,000;
(g) Provide for corporate tax dividend tax @ 17%.

[*Ans:* Profit for the period: ₹15,750; Balance sheet: ₹8,31,000]

9. Shiva Ltd. was registered with an authorised capital of ₹30,00,000 in equity shares of ₹10 each. The following is the list of balances extracted from its books on 31st December 2016.

Particulars	Amount (₹)	Particulars	Amount (₹)
Purchases	9,25,000	Sundry Debtors	4,36,000
Wages	4,24,325	General Expenses	84,175
Manufacturing Expense	65,575	Stock (on 01.01.2015)	3,75,000
Salaries	70,000	Cash in Hand	1,00,000
Bad Debts	10,550	Goodwill	28,750
Director Fees	31,125	Cash at Bank	1,99,500
Debenture Interest Paid	45,000	Subscribed and Fully Called-up	
Capital	20,00,000	Profit & Loss A/c	72,500
Preliminary Expenses	25,000	6% Debentures	15,00,000
Calls-in-Arrears	37,500	Sundry Creditors	2,90,000
Plant & Machinery	15,00,000	Bills Payable	1,67,500
Premises	16,50,000	Sales	20,75,000
Interim Dividend Paid	1,87,500	General Reserves	1,25,000
Furniture & Fittings	35,000		

You are required to prepare statement of Profit & Loss for the year ended 31.12.2014 and the, Balance sheet on-that date, after making the following adjustments:

(a) Depreciate plant and machinery by 10%

(b) Provide half-year interest on debentures outstanding

(c) Also write off preliminary expenses

(d) Make provision for bad and doubtful debts of ₹4,250 on sundry debtors

(e) Stock on 31st December 2016, ₹4,55,000

(f) Provide for corporate dividend tax at 17%.

[*Ans:* Profit for the period: ₹2,75,000; Balance sheet: ₹42,50,000]

10. The following is the trial balance of Vishnu Ltd., as on 31st December 2016. The authorised capital is 50,000 equity shares of ₹10 each. Prepare statement of Profit & Loss A/c and balance sheet.

Debit Balance	Amount (₹)	Credit Balance	Amount (₹)
Calls-in-Arrears	6,400	Subscribed Capital: 10,000 shares of ₹10 each	1,00,000
Land	10,000	Bad Debts Reserve (01.01.2015)	1,400
Buildings	25,000	Sales	80,000
Machinery	15,000	Purchases Returns	3,400
Furniture	3,200	Sundry Creditors	13,200
Carriage Inwards	2,300	Securities Premium	6,000
Wages	21,400	General Reserves	24,000
Salary	4,600		
Sales Returns	1,700		
Bank Charges	100		
Coal	700		
Rates and Taxes	800		
Purchases	50,000		
Bills Receivable	1,200		
General Expenses	1,900		
Sundry debtors	42,800		
Stock (on 01.01.2015)	25,000		
Fire Insurance	400		
Cast at Bank	13,000		
Cash in Hand	2,500		
	2,28,000		**2,28,000**

Adjustments:

(a) Charge depreciation on buildings at 2 ½ %, on machinery at 10%, and on furniture at 10%

(b) Make a reserve of 5% on debtors for bad debtors
(c) Carry forward the following unexpired amount: fire insurance ₹120
(d) Provide for liabilities: Wages ₹3,200; salaries ₹500 and Rates ₹200
(e) The value of stock on 31st December 2015 ₹30,000

[*Ans:* Loss for the period: ₹ (–) 2,465; Balance sheet: ₹1,38,235]

11. Muruga Ltd. was registered with nominal capital of ₹6,00,000, equity shares of ₹10 each. The following is the list of balances extracted from its books on 31st December 2016.

Particulars	Amount (₹)	Particulars	Amount (₹)
Calls-in-Arrears	7,500	Freight & Carriage	13,115
Premises	3 00 000	Salaries	14,500
Plant & Machinery	3,30,000	Director Fees	5,725
Interim Dividend Paid (on 01.08.2015)	37,500	Bad Debts	2,110
Stock (on 01.01.2015)	75,000	Debentures Interest Paid	9,000
Fixtures	7,200	Subscribed and Fully Called-up Capital	4 00,000
Sundry Debtors	87,000	6% Debentures	3,00,000
Goodwill	25,000	Profit & Loss A/c (Cr.)	14,500
Cash in Hand	750	Bills Payable	38,000
Cash at Bank	39,900	Sundry Creditors	50,000
Purchases	1,85,000	Sales	4,15,000
Wages	84,865	General Reserves	25,000
Preliminary Expenses	5,000	Bad Debts Reserve (on 01.01.2015)	3,500
General Expenses	16,835		

Prepare the statement of Profit & Loss A/c and balance sheet in proper form after making the following adjustments:
(a) Depreciate plant and machinery by 10%
(b) Write off from preliminary expenses
(c) Provide half-year's debenture interest due
(d) Leave bad and doubtful debts reserves at 5% on sundry debtors
(e) Closing stock ₹95,000

[*Ans:* Profit for the period: ₹56,000; Balance sheet: ₹8,47,500]

12. The following is the trial balance of Anjali Ltd., as on 31st March 2016.

Particulars	Debit (₹)	Credit (₹)
Stock on 31.03.2015	7,500	
Purchases and Sales	24,500	35,000
Wages	5,000	

(*Contd.*)

Discounts	700	500
Salaries		750
Rent	495	
Insurance	1,705	
Profit & Loss A/c (01.04.2015)		1,503
Dividend Paid	900	
Share Capital		16,000
Debtors and Creditors	3,750	1,750
Machinery	2,900	
Cash at Bank	1,626	
Reserves		1,550
Bad Debts	483	
	50,303	**50,303**

Adjustments:

(a) Closing stock 28,200

(b) Depreciate machinery at 10%

(c) Provide 5% doubtful debts on debtors

(d) Provide 2 ½ % discount on creditors

(e) Six-months insurance was unexpired at ₹75 per annum

(f) One month's rent at ₹540 per annum was due on 31st March 2016

(g) Provide Managing director's commission of 15% on net profit before deducting his commission.

You are required to prepare the statement of Profit & Loss A/c for the year ended 31st March 2016 and the Balance Sheet on that date.

[*Ans:* Profit for the period: ₹1,807; Balance sheet: ₹16,030]

13. Sundar Raman Ltd. is a company with an authorised capital of ₹5,00,000, divided into 5,000 equity shares of ₹100 each. On 31st December 2016, 2,500 shares were fully called-up. The following balances were extracted from the ledger of the company, as on 31st December 2016.

Particulars	Amount (₹)	Particulars	Amount (₹)
Stock	50,000	Advertisement	3,800
Sales	4,25,000	Bonus	10,500
Purchases	3,00,000	Debtors	38,700
Productive Wages	70,000	Creditors	35,200
Discount Allowed	4,200	Plant & Machinery	80,500
Discount Received	3,150	Furniture	17,100
Insurance up to 31.03.2010	6,720	Cash and Bank Balance	1,34,700
Salaries	18,500	Reserves	25,000

(*Contd.*)

Rent	6,000	Loan from Managing Director	15,700
General Expenses	4,450	Bad Debts	3,200
Profit & Loss A/c	6,220	Calls-in-Arrears	5,000
Printing & stationery	2,400		

You are required to prepare the statement of Profit & Loss A/c for the year ended 31st December 2016 and the Balance Sheet on that date.

Additional information:

(a) Closing stock ₹91,500

(b) Provide for depreciation at 15% on Plant & Machinery and 10% on Furniture

(c) Outstanding liabilities: Wages ₹5,200; Salary ₹1,200 and Rent ₹600-

(d) Provide 5% dividend of paid-up share capital

(e) Provide for corporate dividend tax @ 17%

[*Ans:* Profit for the period: ₹16,275; Balance sheet: ₹3,50,395]

14. Lakshmi Ltd. has authorised capital of ₹50 lakh, divided into 5,00,000 equity shares of ₹10 each. The books show the following balances as on 31st December 2016.

Particulars	Debit (₹)	Particulars	Credit (₹)
Stock (on 01.01.2016)	6,65,000	Equity Share Capital	20,00,000
Discounts and Rebates	30,000	4% Debentures	5,00,000
Carriage Inwards	57,500	Bank Overdraft	6,85,000
Patents	3,75,000	Sundry Creditors	2,40,500
Rates, Taxes and Insurance	55,000	Sales	36,17,000
Furniture and Fixtures	1,50,000	Rent (Cr.)	30,000
Materials Purchased	12,32,500	Transfer Fees	6,500
Wages	13,05,000	Profit & Loss A/c	67.000
Coal and Coke	63,000		
Freehold Land	12,50,000		
Plant and Machinery	7,50,000		
Engineering Tools	1,50,000		
Goodwill	3,75,000		
Sundry Debtors	2,66,000		
Bills Receivable	1,34,500		
Advertisement	15,000		
Commission and Brokerage	67,500		
Business Expenses	56,000		

(*Contd.*)

Bank Current A/c	20,000		
Cash in Hand	8,000		
Debentures Interest (for half year)	10,000		
Bank Interest	91,000		
Preliminary Expenses	10,000		
Calls-in-Arrears	10,000		
	71,46,000		**71,46,000**

Additional information:

(a) The stock, valued at cost or market value, whichever is lower, as on 31st December 2016 was ₹7,08,000.

(b) Outstanding liabilities for wages ₹25,000 and business expenses ₹25,000

(c) Dividend declared 10% on paid-up shares capital

(d) Charge depreciation on Plant and Machinery at 5%, Engineering Tools at 20%, Patents at 10% and Furniture and Fittings at 10%

(e) Provide 2% on debtors are doubtful debts after writing off ₹21,500 as bad debts

(f) Write off preliminary expenses and create debenture redemption reserve ₹50,000.

(g) Provide ₹2,40,000 for income tax.

You are required to prepare a statement of Profit & Loss A/c for the year ended 31st December 2009 and balance sheet on that date.

[*Ans:* Profit for the period: ₹2,57,610; Balance sheet: ₹40,40,110]

15. The under-mentioned balances appeared in the books of Parameshwaran Ltd., as on 31st March 2016.

Particulars	(₹)	Particulars	(₹)
Authorised Capital:		Sales	
1,00,000 Equity Shares of ₹10 each	10,00,000	12% Debentures	8,50,000
Subscribed Capital:		Interest paid on Debentures Provision for Tax (01.04.2015)	3,000
50,000 Equity Shares of ₹10 each	5,00,000	Taxes Paid	40,000
Land & Buildings		Opening Inventories Investments in shares	36,000 32,000 60,000
Plant	4,60,000	Trade Expenses	7,200
Patents & Trade Marks	4,00,000	Carriage	6,400

(*Contd.*)

Trade Receivables	25,000	Salaries & Wages	32,800
Loose Tools	1,57,200	Rent	18,000
Cash	20,000	Capital Redemption Reserve	50,000
Underwriting Commission	47,900	Securities Premium A/c	50,000
Bad Debts Provision	5,000	Trade Payables	1,10,000
Bad Debts Written off	10,000	Dividend Received	4,800
Bad Debts Recovered	4,000	Expenses Owing	6,500
Purchases	1,200	Profit & Loss A/c (01.04.2015)	62,000
	4,20,000		

You are required to prepare the final accounts of the company after taking into consideration the following information:

(a) Goods worth ₹6,000 sent on sale or return basis to customers have been treated as actual sales at a price of ₹7,200.

(b) The book debts are all unsecured, ₹20,000 being doubtful.

(c) Provide 3% depreciation on Land and Building and 10% on Plant. Plant includes purchase of goods made during the year ₹1,00,000.

(d) Also provide ₹12,000 against bad and doubtful debts.

(e) Provision for taxation on current year's profit is to be made at 50% of the net profit. Directors have decided to recommend dividend at 12% and also to transfer minimum statutory amount to general reserve.

(f) Provide for corporate dividend tax at 17%.

(g) Closing inventories was valued at ₹50,000.

[*Ans:* Revenue from operations: ₹8,42,800: Other income: ₹4,800; Cost of goods sold: ₹5,02,400; Employee benefit expenses: ₹32,800; Finance cost: ₹6,000; Depreciation and amortised expenses: ₹43,800; Other expenses: ₹30,000; Profit after tax: ₹1,16,300; Shareholders' funds: ₹7,07,100; Non-current liabilities: ₹50,000; Current liabilities: ₹3,06,000; Non-current assets: ₹8,01,200; Current assets: ₹2,61,900; Balance sheet total: ₹10,63,100]

Hint: 2.5% of the current profit has to be transferred to general reserve, as rate of proposed dividend does not exceed 12.5%.

16. Easwari Ltd. has an authorised capital of ₹50 lakh, divided into 5,00,000 equity shares of ₹10 each. Their books show the following balances as on 31st December 2016.

Particulars	(₹)	Particulars	(₹)
Stock (on 01.01.2015)	6,65,000	Equity Share Capital (2,00,000 shares of ₹10 each)	20,00,000
Discounts & Rebates	30,000	4% Debentures (Repayable after 10 years)	5,00,000

(*Contd.*)

Carriage Inwards	57,500	Bank Overdraft	6,85,000
Patents	3,75,000	Sundry Creditors (for goods)	2,40,500
Rates, Taxes & Insurance	55,000	Sales	36,17,000
Furniture & Fixtures	1,50,000	Rent (Cr.)	30,000
Materials Purchased	12,32,500	Transfer Fees	6,500
Wages	13,05,000	Profit & Loss A/c (Cr.)	67,000
Coal and Coke	63,000		
Freehold Land	12,50,000		
Plant & Machinery	7,50,000		
Engineering Tools	1,50,000		
Goodwill	3,75,000		
Sundry Debtors	2,66,000		
Bills Receivable	1,34,500		
Advertisement	15,000		
Commission & Brokerage	67,500		
Business Expenses	56,000		
Bank Current A/c	20,000		
Cash in Hand	8,000		
Debenture Interest (for half-year 30.06.2015)	10,000		
Interest (banks)	91,000		
Preliminary Expenses	10,000		
Calls-in-Arrears	10,000		
	71,46,000		**71,46,000**

Additional information:

(a) The stock (valued at cost or market value, whichever is lower) as on 31st December 16 was ₹7,08,000.

(b) Outstanding liabilities for wages ₹25,000 and business expenses ₹25,000.

(c) Dividend declared 10% on paid-up capital.

(d) Charge depreciation: Plant & Machinery @ 5%; Engineering Tools @ 20%; Patents @ 10%; and Furniture & Fittings @ 10%.

(e) Provide 2% on debtors as doubtful debts after writing off ₹21,500 as bad debts.

(f) Write off preliminary expenses and create debenture redemption reserve ₹50,000;

(g) Provide ₹2,40,000 for income tax.

You are required to prepare the statement of Profit & Loss A/c for the year ended 31st December 2016 and the balance sheet as on that date.

[*Ans:* Revenue from operations: ₹36,17,000: Other income: ₹36,500; Cost of goods sold: ₹12,47,000; Employee benefit expenses: ₹13,30,000; Finance cost: ₹1,01,000; Depreciation and amortised expenses: ₹1,20,000; Other expenses: ₹3,37,890; Profit after tax: ₹2,77,610; Shareholders' funds: ₹20,91,780; Non-current liabilities: ₹5,00,000; Current liabilities: ₹14,48,330; Non-current assets: ₹29,30,000; Current assets: ₹11,10,110; Balance sheet total: ₹40,40,110]

Hint:

(i) The entire preliminary expenses have been written off, as they cannot be shown in the balance sheet, as per Para 56 of AS 26.

(ii) Provide for corporate dividend tax at 17%.

17. The following balances appeared in the books of Perumal Limited, as on 31st December 2016.

Particulars	(₹)
Cash and Bank	41,200
Stock of Wheat (on 01.01.2015)	9,500
Stock of Flour (on 01.01.2015)	16,000
Wheat Purchases	4,05,000
Manufacturing Expenses	90,000
Flour Sales	5,55,000
Salaries & Wages	13,000
Establishment	4,700
Interest (Cr.)	500
Rent Received	800
Profit & Loss A/c (Cr.) (on 01.01.2015)	15,000
Directors' Fees	1,200
Dividend for 2016	9,000
Creditors	1,24,000
Plant & Machinery	50,500
Land & Buildings	62,500
Furniture	5,100
Vehicles	5,100
Stores & Spares	18,300
Advances	24,500
Debtors	51,700
Investment	4,000
Share Capital	72,000
Pension Fund	23,000
Dividend Equalisation Fund	10,000
Taxation Provision	8,500
Unclaimed Dividends	900
Deposits (Cr.)	1,600

Prepare the company's Statement of Profit & Loss A/c for the year and balance sheet, as on 31 December 2016.

Adjustments:

(a) Stocks on 31st December 2016 were: Wheat at cost ₹14,900; Flour at market price ₹21,700.

(b) Outstanding expenses: Manufacturing expenses ₹23,500; Salaries and wages ₹1,200.

(c) Provide depreciation: Building 2%; Plant and Machinery at 10%; Furniture at 10% and Vehicles at 20%.

(d) Interest accrued on government securities ₹100.

(e) A tax provision of ₹8,000 is considered necessary.

(f) The directors proposed a dividend of 20%.

(g) Authorised capital is 12,000 equity shares of ₹10 each; of which, 7,200 shares were issued and fully paid up.

(h) Provide for corporate dividend tax at 17%. (Madras, B.Com, Sep. 1994)

[*Ans:* Revenue from operations: ₹5,55,000; Other income: ₹1,400; Cost of materials consumed: ₹3,93,900; Employee benefits expense: ₹14,200; Depreciation and amortisation expense: ₹7,830; Other expenses: ₹1,19,400; Shareholders' funds: ₹84,222; Non-current liabilities: ₹24,600; Current liabilities: ₹1,82,948; Non-current assets: ₹1,19,370; Current assets: ₹1,72,400; Profit before extraordinary items and tax: ₹21,070; Tax: ₹8,000 (given); Profit for the period: ₹13,070; Balance sheet total: ₹2,91,770]

18. Following is the trial balance of Babu Ltd. for the year ended 30th June 2016.

Credits	(₹)	Debits	(₹)
Sundry Creditors	40,000	Land	3,00,000
Bills Payable	20,000	Plant	4,50,000
General Reserve	2,00,000	Furniture	40,000
Profit & Loss A/c		Goodwill	60,000
Balance (on 01.07.2015)	90,000	Sundry Debtors	60,000
Sales	6,25,000	Bills Receivable	26,000
Purchase Returns	15,000	Investments at 5%	30,000
Equity Share Capital	5,00,000	Cash in Hand	2,000
8% Preference Share Capital	2,00,000	Cash in Bank	55,000
		Preliminary Expenses	29,000
		Purchases	4,00,000
		Sales Returns	10,000
		Stock (on 01.07.2015)	85,000
		Wages	47,000
		Salaries	55,000
		Rent	9,000

(*Contd.*)

		Carriage Inwards	6,500
		Law Charges	2,500
		Trade Expenses	23,000
	16,90,000		16,90,000

Prepare the statement of Profit & Loss A/c and the balance sheet of the company.

Additional particulars:

(a) Authorised capital is ₹10,00,000: ₹10, 50,000 equity shares and ₹100, 8% 50,000 preference shares.

(b) The original cost of Land ₹2,50,000; Plant ₹6,00,000 and Furniture ₹60,000. Additions during the year include Land ₹50,000 and Plant ₹20,000.

(c) Depreciation is to be charged on plant and furniture at 10% on original cost.

(d) Directors are entitled to a commission of 1% of the net profit before charging such commission.

(e) Stock on 30th June 2016 was ₹1,30,000. **(Madras, B.A., Sep 1996)**

[*Ans:* Revenue from operations: ₹6,15,000; Cost of goods sold: ₹3,46,500; Employee benefits expense: ₹1,02,000; Depreciation and amortisation expense: ₹66,000; Other expenses: ₹35,160; Shareholders' funds: ₹10,26,340; Current liabilities: ₹60,660; Non-current assets: ₹8,14,000; Current assets: ₹2,73,000; Profit for the period: ₹65,340; Balance sheet total: ₹10,87,000]

***Hint*:** As depreciation on plant was specifically asked to calculate on original cost, no depreciation on additional plant is provided.

19. The under-mentioned balances appeared in the books of the Dynamo Ltd., as on 31st December 2016.

Particulars	(₹)
Share Capital (authorised and issued 60,000 shares of ₹10 each) General Reserve	6,00,000
Unclaimed Dividends	2,50,000
Trade Creditors	6,526
Buildings	36,858
Purchases	1,00,000
Sales	5,00,903
Manufacturing Expenses	9,83,947
Establishment	3,59,000
General Charges	26,814
Machinery	31,078
Motor Vehicles	2,00,000
Furniture	15,000
Stocks	5,000
Book Debts	1,72,058
Investments	2,23,380

(*Contd.*)

Depreciation Reserve	2,88,950
Cash Balances	71,000
Directors' Fees	72,240
Interim Dividend	1,800
Interest (Cr.)	15,000
Profit & Loss A/c (on 01.01.2015) (credit balance)	8,544
Staff Provident Fund	16,848
	37,500

From these balances and the following information, prepare the company's balance sheet as on 31st December 2016, after preparing the statement of Profit & Loss A/c for the year ended on that date.

(a) The stocks of Wheat and Flour on 31st December 2016 were valued at ₹1,48,680.

(b) Provide ₹10,000 for depreciation of gross block and ₹1,500 for the company's contribution to the staff provident fund.

(c) Interest accrued on investment amounted to ₹2,750.

(d) A claim of ₹2,500 for workmen's compensation is being disputed by the company.

(e) Establishment includes ₹6,000 paid to the manager, who is entitled to remuneration at 5% of profit as per Companies Act, subject to a minimum of ₹10,000 per annum. You may make necessary adjustments.

[*Ans:* Revenue from operations: ₹9,83,947; Other income: ₹11,294; Cost of goods sold: ₹5,24,281; Depreciation and amortisation: ₹10,000; Other expenses: ₹4,24,192 Shareholders' funds: ₹8,88,616; Non-current liabilities: ₹39,000; Current liabilities: ₹47,384; Non-current assets: ₹5,27,950; Current assets: ₹4,47,050; Profit for the period: ₹36,768; Balance Sheet total: ₹9,75,000]

(***Hint:*** A claim for workmen's compensation is a contingent liability)

8

VALUATION OF GOODWILL AND SHARES

8.1 VALUATION OF GOODWILL

The word "Goodwill" means benevolence or well wishing, as per Oxford dictionary. It also refers to the disposition to mean and to do good. However, in the field of trade and commerce, it has a different meaning, which ultimately gives the very reason for the existence of a business in the market. Thus, in business world, the term goodwill indicates the reputation of the company and its competitive nature in the market. It refers to the name and fame of a company. The goodwill earned enables to attract and retain more customers, which in turn is reflected in terms of more sales and more income. Hence, goodwill facilitates earning more income, just as other assets do and so goodwill is regarded as an asset of a company.

❍ Goodwill

The Institute of Chartered Accountants of India defines goodwill as "an intangible asset arising from business connections or trade name or reputation of an enterprise".

Dr. Canning defines goodwill as "the present value of a firm's anticipated excess earnings".

Lord Eldon defines it as "Goodwill is nothing more than the probability that the old customers will resort to the old place".

Walton defines goodwill as "the element of an established business, which makes the business as a going concern worth more than its book value, that is, its net worth as shown by the books".

C.L. Woelfel defines goodwill as "Goodwill is the superior earning power of a business beyond the earning power that would be expected of a firm in a similar business and with a similar amount of other assets".

Therefore, it implies that goodwill refers to the reputation of a business, is regarded as a quantifiable asset, and is calculated as part of its value when it is sold. Further, goodwill also indicates the following:

- Goodwill is not visible but it enhances the worth of a business firm.
- Goodwill is an intangible asset, which gives it an edge over its competitors.
- Goodwill enables to retain the customers of a business and thereby, the income of a business can be sustained.

- Goodwill also enables to earn beyond the normal profit i.e., the super profit.
- Goodwill appears in the asset side of the Balance Sheet.
- Goodwill is relevant only for a going concern.
- Goodwill cannot be isolated from a business firm/company.

❍ Treatment of Goodwill as an Asset

From the financial accounting point of view, goodwill is shown in the asset side of the balance sheet and is treated as an intangible asset of a firm. Assets are acquired to facilitate the income-earning capacity of a business and similarly, goodwill is also acquired to facilitate the income-earning capacity of a business.

❍ Factors Influencing Goodwill

- The location of a firm/company
- The quality of the products and services
- The after-sale services provided by the firm
- The price of the products and services
- The behaviour of the sales personnel
- The trademark, trade name and the brand name
- The work culture of the organisation
- The acquisition of patent rights, copyrights, licenses, franchises, etc.

❍ Methods of Goodwill Valuation

- Arbitrary Method
- Average Profit Method or Year's Purchase of Past Profit Method
- Weighted Average Profit Method
- Capitalisation of Average Profit Method
- Capitalisation of Weighted Average Profit Method
- Super Profit Method
- Weighted Average Super Profit Method
- Sliding Scale Valuation of Super Profit Method
- Capitalisation of Super Profit Method
- Capitalisation of Weighted Average Super Profit Method
- Annuity Method
- Capitalisation Method using Capitalised Value of Business Less Net Assets

However, five important methods of Valuation of Goodwill shall be considered for extensive understanding, which are as follows:

1. Average Profit Method
2. Super Profit Method
3. Capitalisation of Super Profit Method
4. Annuity Method
5. Capitalisation Method using Capitalised Value of Business Less Net Assets

Average Profit Method or Adjusted Average Profit Method

Under this method, goodwill is calculated on the basis of the average profits of some agreed number of past years and then, multiplied by the agreed number of years.

$$Value\ of\ Goodwill = Adjusted\ Average\ Profits \times Number\ of\ Years\ of\ Purchase$$

Notes:

1. In the case of weighted average profits, the following formula is used to calculate the value of goodwill:

   $$Value\ of\ Goodwill = Weighted\ Average\ Profits \times Number\ of\ Years\ of\ Purchase$$

2. Format to calculate the adjusted average profits:

Particulars	Amount (₹)	Amount (₹)
Profits for the Year	xxx	
Less: Non-recurring Income or Profits	xxx	
	xxx	
Add: Non-recurring Expenses or Losses	xxx	xxx
Total Profits		xxx
Average Profits	Total Profits/ Number of Years	xxx
Less: Future Maintainable Expenses	xxx	
Insurance Premium on Stock	xxx	
Fair Remuneration to Proprietor	xxx	xxx
Adjusted Average Profits		xxx

Super Profit Method

The profits, which are earned above the normal profits, are called as Super Profits, i.e. the excess of actual profits over normal profits.

Goodwill is calculated by multiplying the super profits by the agreed number of year of purchase. The formula to calculate goodwill is as follows:

$$Value\ of\ Goodwill = Super\ Profits \times Number\ of\ Years\ of\ Purchase$$

Where, $Super\ Profit = Adjusted\ Average\ Profits - Normal\ Profits$ and

$$Normal\ Profit = Net\ Capital\ Employed \times Normal\ Rate\ of\ Return$$

Adjusted Average Profits are calculated as stated in the earlier method.

Capitalisation of Super Profits Method

Under this method, first, the super profits are calculated and then the capital needed for earning such super profits on the basis of normal rate of return is calculated.

$$Value\ of\ Goodwill = \frac{Super\ Profits}{Normal\ Profit}$$

Note: Super profits and normal profits are to be calculated as stated earlier.

Annuity Method

Under this method, super profits are calculated first and then multiplied with the annuity factor to calculate the value of goodwill. The formula to calculate goodwill is:

$$Value\ of\ Goodwill = Super\ Profits \times Annuity\ Factor$$

Capitalisation Method using Capitalised Value of Business Less Net Assets

Under this method, the total capitalised value of the firm is calculated based on the adjusted average profits and the normal rate of return. Then, the total capitalised value is deducted from the net assets of the firm. The net assets, in turn, refer to the difference between the total revalued assets and the total revalued liabilities. Hence, the formula to calculate the value of the goodwill is as given as:

$$Value\ of\ Goodwill = Total\ Capitalised\ Value\ of\ Business - Net\ Assets$$

where,

$$Total\ Capitalised\ Value\ of\ the\ Firm = \frac{Adjusted\ Average\ Profits}{Normal\ Rate\ of\ Return} \times 100$$

$$Adjusted\ Average\ Profits = Total\ Profits\ for\ all\ the\ Years/Number\ of\ Years$$

$$Net\ Assets\ of\ the\ Firm = Total\ Revalued\ Assets - Total\ Revalued\ Liabilities$$

Illustration 1

Average Profit Method

Calculate the amount of goodwill on the basis of three years' purchase of the last five years' average profits. The profits for the last five years are:

	(₹)
Year I	4,800
Year II	7,200
Year III	10,000
Year IV	3,000
Year V	5,000

[Madras University, B.Com. (G&AF), Apr 2012, 2011; B.Com. (CS) (BYA3A), Nov 2010; B.Com. (PZ3A), Nov 2008, Apr 2008; B.Com., (CS) Apr 2007, Nov 2006]

Solution:

Average Profit

	(₹)
Year I	4,800
Year II	7,200
Year III	10,000
Year IV	3,000
Year V	5,000
Total	30,000

$$\text{Average Profit} = \frac{₹30{,}000}{5} = ₹6{,}000$$

Goodwill = Average Profit × Number of Years of Purchase

= ₹6,000 × 3

= ₹18,000

Illustration 2

The following information is presented for five years, ending 31st December 1998:

Year	Profits (After Tax) (₹)	Taxation (₹)	Transfer to Reserve (₹)	Directors' Remuneration (₹)
1994	50,000	18,000	10,000	4,000
1995	55,000	20,000	12,000	4,500
1996	48,000	15,000	8,000	4,500
1997	65,000	25,000	15,000	5,000
1998	72,000	35,000	15,000	6,000

Fixed assets have been revalued and the same showed an appreciation of ₹5,00,000 (depreciation to be provided for @ 10%). The company has an 8% preference share capital of ₹1,00,000. The current rate of taxation may be taken at 50%.

Calculate the value of goodwill on the basis of four years' purchase of the last five years' average profits.

Solution:

Calculation of Average Maintainable Profit

Adjusted Profit	=	Profit (Given) +	Tax +	Director's Remuneration	(before tax and director's remuneration)
		(₹)	(₹)	(₹)	
1994	=	50,000	+18,000	+4,000	= 72,000
1995	=	55,000	+20,000	+4,500	= 79,500
1996	=	48,000	+15,000	+4,500	= 67,500
1997	=	65,000	+25,000	+5,000	= 95,000
1998	=	72,000	+35,000	+6,000	= 1,13,000
				Total	4,27,000

	₹	₹	
Average Profit	= 4,27,000/5 yrs		85,400
Less: Depreciation @ 10% on ₹5,00,000		50,000	
Director's Remuneration		6,000	56,000
			29,400
Less: Income Tax @ 50%		14,700	
Less: Preference Dividend		8,000	22,700
Average Maintainable Profit			6,700

Goodwill = *Average Maintainable Profit* × *Number of Years' Purchase*
= ₹6,700 × 4
= ₹26,800

Note:* Director's remuneration has been considered as ₹6,000, i.e. the amount prevailing on 31st December 1998 and not the average on since the same cannot be paid less than ₹6,000 in future.

Illustration 3

Following details are available about the business of Sagar Ltd.

(a) Profits in: 1994: ₹80,000; 1995: ₹1,00,000;1996: ₹1,20,000;
(b) Non-recurring income of ₹8,000 is included in the profit of 1995;
(c) Profits of 1994 have been reduced by ₹12,000 because goods were destroyed by fire;
(d) Goods have not been insured but it is thought prudent to insure them in future. The insurance premium is estimated at ₹800 per year;
(e) Reasonable remuneration of the proprietor of the business is ₹12,000 per year but it has not been taken into account for calculation of above-mentioned profits;
(f) Profits of 1996 include ₹10,000 income on investment. Calculate goodwill on the basis of three years' purchase of the average profit of last three years.

[Madras University, M.Com. (CAIA), Apr 2008; M.Com. (ICE) (PCMA), Oct 2006]

Solution:

Calculation of Average Profits

Year			(₹)	(₹)
1994		Profits	80,000	
	Add:	Unusual Loss: Stock Destroyed by Fire	12,000	92,000
1995		Profits	1,00,000	
	Less:	Non-recurring Income	8,000	92,000
1996		Profits	1,20,000	
	Less:	Income on Investment	10,000	1,10,000
		Total Profit	2,94,000	2,94,000
			3 (years)	
		Average Profits		98,000
	Less:	Insurance Premium	800	
		Proprietor's remuneration	12,000	12,800
		Average Maintainable Profit		85,200

Goodwill = *Average Maintainable Profits* × *Number of Years' Purchase*
= ₹85,200 × 3 years
= ₹2,55,600

Illustration 4

Vatsal, who has been carrying on a retail business for the past 20 years, intends to sell his business on 31st December 1998. It is agreed between Vatsal and the buyer that the latter pays ₹1,50,000 for goodwill. From the following particulars supplied by Vatsal, calculate the value of goodwill, if it were based on four years' purchase of the average profits of the last five years, including the profit of 1998.

Profits earned:

1994: ₹30,000; 1995: ₹40,000; 1996: ₹46,000; 1997: ₹55,000; 1998: ₹44,000.

At the time of acquiring Vatsal's business, the buyer was employed as the manager of a similar business on a salary of ₹1,000 per month. The profit of 1998 included income from investment ₹3,500 and profit of 1995 had been reduced by ₹4,000, being loss on speculation. Similarly, the profits of 1997 had been reduced by ₹6,000, owing to loss from betting.

[Madras University, M.Com. (CAIA), Apr 2009; Nov 2008]

Solution:

Calculation of Adjusted Profits

Year	Particulars	Profit (as given) (₹)	Adjusted Profits (₹)
1994		—	30,000
1995		40,000	
	Add: Speculation Loss	4,000	44,000
1996		—	46,000
1997		55,000	
	Add: Loss from Betting	6,000	61,000
1998		44,000	
	Less: Income from Investment	3,500	40,500
	Total Profits		2,21,500
	Average Profits: 2,21,500/5		44,300
	Less: Proprietor's Remuneration (₹1,000 × 12)		12,000
	Adjusted Average Profits		32,300

Goodwill = Adjusted Average Profits × Number of Years' Purchase

= ₹32,300 × 4

= ₹1,29,200

Illustration 5

Weighted Average Profit Method

The profits of Thilalga Ltd. for the last five years were as follows:

Year	(₹)
1994	15,000
1995	18,000

(*Contd.*)

1996	22,000
1997	25,000
1998	27,000

Compute the value of goodwill of Thilaga Ltd., on the basis of four years' purchase of weighted average profit after assigning weights 1, 2, 3, 4 and 5 serially to the profits.

[Madras University, B.Com. (AF), Apr 2008; BBA (IAC), May 2007]

Solution:

Calculation of Weighted Average Profit

Year (1)	Annual Profits (2) (₹)	Weights (3)	Product (2) × (3) (₹)
1994	15,000	1	15,000
1995	18,000	2	36,000
1996	22,000	3	66,000
1997	25,000	4	1,00,000
1998	27,000	5	1,35,000
		15	3,52,000

$$\text{Weighted Average Profits} = \frac{₹3,52,000}{15} = ₹23,467$$

Calculation of Value of Goodwill

Goodwill = Weighted Average Profit × Number of Years' Purchase

= ₹23,467 × 4

= ₹96,868

Note: Weighted average of profits may be taken if there is specific instruction in the problem or there is a clear increasing trend in profits from year to year.

Illustration 6

XY Co. Ltd. has agreed to purchase the business carried on by Thilak. For this purpose, goodwill is to be valued at four years' purchase of the weighted average profits of the past five years. The profits of the previous years were:

1994: ₹20,000; 1995: ₹22,000; 1996: ₹24,000; 1997: ₹28,000; and 1998: ₹30,000.

The appropriate weights to be used are

1994: 1; 1995: 2; 1996: 3; 1997: 4; 1998: 5

The accounts of the business revealed that:

(a) In the year 1994, a major repair was made in respect of Plant & Machinery and the amount involved was ₹5,000. It was agreed that the amount, which was charged to revenue, was to be capitalised for the purpose of valuing goodwill, subject to 10% depreciation on the diminishing balance method.

(b) The closing stock for the same year was overvalued by ₹2,000.
(c) ₹2,800 managerial remuneration should be provided for.

Calculate the value of goodwill of the business.

[Madras University, M.Com. (ICCAIA), Nov 2010]

Solution:

Calculation of Adjusted Profit

Year	Profit (+) (₹)	Capital Expenditure (–) (₹)	Depreciation (–) (₹)	Over-valuation of Closing Stock (+) (₹)	Over-valuation of Opening Stock (–) (₹)	Managerial Remu-naration (₹)	= Adjusted Profit (₹)
1994	20,000+	5000 –	500 –	2,000 +	0 –	2,800	= 19700
1995	22,000+	0 –	450 –	0 +	2000 –	2,800	= 20,750
1996	24,000+	0 –	405 –	0 +	0 –	2,800	= 20,795
1997	28,000+	0 –	365 –	0 +	0 –	2,800	= 24,835
1998	30,000+	0 –	328 –	0 +	0 –	2,800	= 26,872

Calculation of Weighted Average Profits

Year (i)	Adjusted Profit (ii) (₹)	Weights (iii)	Product (ii) × (iii) (₹)
1994	19,700	1	19,700
1995	20,750	2	41,500
1996	20,795	3	62,385
1997	24,835	4	99,340
1998	26,872	5	1,34,360
		15	3,57,285

(iii) Average Profit $= \dfrac{₹3,57,285}{15} = ₹23,819$

(iv) Value of Goodwill = ₹23,819 × 4 = ₹95,276

Working Note:

Calculation of Depreciation

Capital Expenditure	(₹)
	5,000
Less: Depreciation for 1994 (5,000 × 10%)	500
	4,500
Less: Depreciation for 1995 (4,500 × 10%)	450
	4,050
Less: Depreciation for 1996 (4,050 × 10%)	405
	3,645

(*Contd.*)

Less: Depreciation for 1997 (3,645 × 10%)	365
	3,280
Less: Depreciation for 1998 (3,280 × 10%)	328
	2,952

Illustration 7

Super Profit Method

From the following information, calculate the value of goodwill on the basis of three years' purchase of super profit.

(a) Average capital employed in the business is ₹20,00,000.
(b) Rate of interest expected from capital having regard to the risk involved is 10%.
(c) Net trading profits of the firm for the past three years were ₹3,50,400; ₹2,80,300 and ₹3,10,100.
(d) Fair remuneration to the partners for their services is ₹48,000 per annum.
(e) Sundry assets of the firm are the ₹23,50,400 and current liabilities are ₹95,110.

Solution:

Calculation of Adjusted Average Profit

	(₹)
Trading Profit for the Last Three Years	3,50,400
	2,80,300
	3,10,100
Total Profits	9,40,800
Average Profit = $\frac{₹9,40,800}{3}$ =	3,13,600
Less: Fair Remuneration to Partners	48,000
Average Profit	2,65,600

Calculation of Normal Profit

Normal Profit = Average Capital Employed × Normal Rate of Return

= ₹20,00,000 × 10%

= ₹2,00,000

Calculation of Super Profits

Super Profits = Adjusted Average Profit – Normal Profit

= ₹2,65,600 – ₹2,00,000

= ₹65,600

Calculation of Value of Goodwill

Goodwill = Super Profits × Number of Years' Purchase

= ₹65,600 × 3

= ₹1,96,800

Note: Information about sundry assets and current liabilities is irrelevant because average capital employed is given.

Illustration 8

Average capital employed in Kausik Ltd. is ₹35,00,000, whereas net trading profits before tax for the last three years have been ₹14,75,000; ₹14,55,000 and ₹15,25,000. In these three years, the managing director was paid a salary of ₹10,000 per month. But now, he would be paid a salary of ₹12,000 per month. Normal rate of return expected in the industry in which Kausik Ltd. is engaged is 18%. Rate of tax is 50%. Calculate goodwill on the basis of three years' purchase of the super profits.

[Madras University, B.Com. (G&AF), Nov 2010; B.Com. (CS)(BYA3A), Nov 2009; 1st M. Com (ICE), Oct 2005]

Solution:

Calculation of Average Annual Trading Profits

		(₹)
Total Trading for the Last Three Years		14,75,000
		14,55,000
		15,25,000
		44,55,000
Average Annual Trading Profits = $\frac{₹44,55,000}{3 \text{ (years)}}$ =		14,85,000
Less:	Additional Salary to Managing Director (₹12,000 – ₹10,000) × 12 =	24,000
		14,61,000
Less:	Income Tax @ 50%	7,30,500
	Adjusted Average Profits	7,30,500

Calculation of Normal Profits

Normal Profits = Average Capital Employed × Normal Rate of Return

= ₹35,00,000 × 18%

= ₹6,30,000

Calculation of Super Profits

Super Profits = Adjusted Average Profits – Normal Profits

= ₹7,30,500 – ₹6,30,000

= ₹1,00,500

Calculation of Value of Goodwill

Goodwill = Super Profits × Number of Years' Purchase

= ₹1,00,500 × 3 = 3,01,500

Illustration 9

The balance sheet of James Company Ltd., as on 31st December 1998, was as follows:

Liabilities	(₹)	Assets	(₹)
20,000 Shares of ₹10 each	2,00,000	Land & Buildings	1,68,000
Profit & Loss A/c	40,000	Plant & Machinery	1,20,000
Debentures	30,000	Furniture & Fittings	10,000
Trade Creditors	40,000	5% (Tax-free) Govt. Bonds	40,000
Provision for Taxation	18,000	Stock	4,000
Proposed Dividend	30,000	Book Debts	12,000
		Cash	4,000
	3,58,000		3,58,000

The net profits of the company after charging depreciation and taxes were as follows:

1994: ₹34,000; 1995: ₹38,000; 1996: ₹36,000; 1997: ₹40,000; 1998: ₹38,000.

On 31st December 1998, Land & Buildings were revalued at ₹1,90,000; Plant & Machinery at ₹1,42,000; and Furniture and Fittings at ₹8,000.

10% represents a fair commercial rate of return on investment in the company.

Calculate the value of goodwill, basing it at five years' purchase of the average super profits for the last five years.

[Madras University, B.Com. (CS) (BYA3A), Nov 2010; 1st M.Com (CAIA), Apr 2010; Apr 2007, Nov 2004]

Solution:

Calculation of Average Capital Employed

Assets	(₹)	(₹)
Fixed Assets:		
Land & Buildings		1,90,000
Plant & Machinery		1,42,000
Furniture & Fittings		8,000
Current Assets:		
Stock		4,000
Book Debts		12,000
Cash		4,000
Total Assets		3,60,000
Less: External Liabilities:		
Debentures	30,000	
Trade Creditors	40,000	
Provision for Taxation	18,000	
Proposed Dividend	30,000	1,18,000
Capital Employed		2,42,000

(*Contd.*)

Less: $\frac{1}{2}$ of Current Year's Profit (38,000 – 2,000) = (36,000 $\times \frac{1}{2}$)		18,000
Average Capital Employed		2,24,000

Note: Investment in Government bonds is taken as a non-business investment. Similarly, interest on Government bonds (i.e., ₹2,000) is excluded from the profit made by the business.

Calculation of Adjusted Average Profits

Year	Profits (₹)
1994	34,000
1995	38,000
1996	36,000
1997	40,000
1998	38,000
Total Profits	**1,86,000**

	Average Profits = $\frac{₹1,86,000}{5 \text{ years}}$	= 37,200
Less:	Interest on Investment (5% on ₹40,000)	2,000
	Adjusted Average Profit	35,200

Note: It is assumed that investments in govt. bonds were with the company for all the five years.

Calculation of Normal Profit

Normal Profit = Average Capital Employed × Normal Rate of Return

= ₹2,24,000 × 10% = ₹22,400

Calculation of Super Profits

Super Profits = Adjusted Average Profit – Normal Profit

= ₹35,200 – ₹22,400

= ₹12,800

Calculation of Value of Goodwill

Goodwill = Super Profits × Number of Years' Purchase

= ₹12,800 × 5 years

= ₹64,000

Illustration 10

The following is the balance sheet of Mr. Chauhan as on 30th September 1998.

Liabilities	(₹)	Assets	(₹)
Capital	1,64,000	Land & Buildings	36,000
General Reserve	40,000	Plant	54,000
Creditors	38,040	Investments	30,000
		Stock	26,850
		Bank	75,000
		Debtors	19,200
	2,42,040		2,42,040

The following were the net profits for the years ended

	(₹)
30th September 1996	32,280
30th September 1997	36,870
30th September 1998	43,350

The above amounts include income from investments ₹1,800 each year.

You are required to value the goodwill of the above business at two years' purchase of the average super profit for three years, taking into account the fact that the standard rate of return on capital employed in such type of business is 10%. Assume that each year's profit is immediately withdrawn in full by Mr. Chauhan.

[Madras University, 2nd M.Com. (ICE) (Old), Oct 2004]

Solution:

Calculation of Adjusted Profit

	(₹)	(₹)
Profit for the Year ending 30.09.1996	32,280	
Less: Interest on Investments	1,800	30,480
Profit for the Year ending 30.09.1997	36,870	
Less: Interest on Investments	1,800	35,070
Profit for the Year ending 30.09.1998	43,350	
Less: Interest on Investments	1,800	41,550

Calculation of Weighted Average Profit

Year	Profit (₹)	Weight	Product (₹)
30.09.1996	30,480	1	30,480
30.09.1997	35,070	2	70,140
30.09.1997	41,550	3	1,24,650
		6	2,25,270

Average Profits = ₹2,25,270/6 = 37,545

Calculation of Capital Employed

Assets	(₹)	(₹)
Fixed Assets:		
Land & Buildings		36,000
Plant		54,000
Current Assets:		
Stock	26,850	
Bank	75,990	
Debtors	19,200	2,12,040
		2,66,040
Less: External Liabilities:		
Creditors		38,040
Capital Employed		2,42,000

Calculation of Normal Profit

$$\begin{aligned} \textit{Normal Profit} &= \textit{Capital Employed} \times \textit{Normal Rate of Return} \\ &= ₹1,74,000 \times 10\% \\ &= ₹17,400 \end{aligned}$$

Calculation of Super Profits

$$\begin{aligned} \textit{Super Profits} &= \textit{Average Profit} - \textit{Normal Profit} \\ &= ₹37,545 - ₹17,400 \\ &= ₹20,145 \end{aligned}$$

Calculation of Value of Goodwill

$$\begin{aligned} \textit{Goodwill} &= \textit{Super Profits} \times \textit{Number of Years' Purchase} \\ &= ₹20,145 \times 2 \\ &= ₹40,290 \end{aligned}$$

Notes:

1. Average profits have been calculated on weighted average basis because profits show a rising trend.
2. Since the owner withdraws profit in full at the end of every year, half of current year's profit need not be reduced to find average capital employed

Illustration 11

Calculate the amount of goodwill on the basis of three years' purchase of the last five years' average profits. The profits for the last five years are:

Year	Amount (in ₹)
Year I	9,600
Year II	14,400
Year III	20,000
Year IV	6,000
Year V	10 ,000

Solution:

$$\textit{Value of Goodwill} = \textit{Average Profits} \times \textit{Number of Years' Purchase}$$
$$= ₹12{,}000 \times 3 \text{ years' purchase}$$
$$= ₹36{,}000$$

Calculation of Average Profits

Year	Amount (in ₹)
Year I	9,600
Year II	14,400
Year III	20,000
Year IV	6,000
Year V	10 ,000
Total Profits	60,000

$$\text{Average Profits} = \frac{\text{Total Profits}}{\text{Number of Years}} = \frac{₹60{,}000}{5 \text{ years}} = ₹12{,}000$$

Illustration 12

Calculate the amount of goodwill in the following case, on the basis of three years' purchase of the last four years' average profits. The profits and losses for the last four years are:

Year	Amount (in ₹)
1995	20,000
1996	32,000
1997	12,000 (Loss)
1998	24,000

Solution:

$$\textit{Value of Goodwill} = \textit{Average Profits} \times \textit{Number of Years' Purchase}$$
$$= ₹16{,}000 \times 3 \text{ years' purchase}$$
$$= ₹48{,}000$$

Calculation of Average Profits

Year	Amount (in ₹)
1995	20,000
1996	32,000
1997	12,000 (Loss)
1998	24,000
Total Profits	64,000

$$\textit{Average Profits} = \frac{\textit{Total Profits}}{\textit{Number of Years}} = \frac{₹\textit{64,000}}{\textit{4 years}}$$
$$= ₹16{,}000$$

Illustration 13

The profits of Swami Vivekananda Ltd. for the last five years are as follows:

Year	Amount (in ₹)
1994	30,000
1995	36,000
1996	44,000
1997	50,000
1998	54,000

Compute the value of goodwill of Swami Vivekananda Ltd. on the basis of 4 years' of purchase of weighted average profit after assigning weights 1, 2, 3, 4 and 5 serially to the profits.

Solution:

Year	Annual Profits (₹)	Weight	Product = Annual Profits × Weight (₹)
1994	30,000	1	30,000
1995	36,000	2	72,000
1996	44,000	3	132,000
1997	50,000	4	2,00,000
1998	54,000	5	2,70,000
Total		**15**	**7,04,000**

Weighted Average Profits = *Total Product/Total Weight*

= ₹7,04,000/15 = ₹46,933

Value of Goodwill = *Weighted Average Profits* × *Number of Years' Purchase*

= ₹46,933 × 4 years' purchase

= ₹1,87,732

Illustration 14

The following particular are available in respect of the business carried on by Valialar Ltd.

(a) Profit earned: 2006: ₹1,00,000; 2007: ₹96,000 and 2008: ₹1,04,000.
(b) Profit of 2007 is reduced by ₹10,000 due to stock destroyed by fire and profit of 2006 included a non-recurring income of ₹6,000.
(c) Profit of 2008 included ₹4,000 income on investment.
(d) The stock is not insured and it is thought prudent to insure the stock in future. The insurance premium is estimated at ₹1,000 per annum.
(e) Fair remuneration to the proprietor (not taken in the calculation of profits) is ₹20,000 per annum.

You are required to calculate the value of goodwill on the basis of 2 years' purchase of average profits of the last three years.

Solution:

Calculation of Adjusted Average Profits

Particulars		Amount (₹)	Amount (₹)
Profits for 2006		1,00,000	
Less: Non-recurring Income		6,000	94,000
Profits for 2007		96,000	
Add: Non-recurring Expenses (Stock Destroyed by fire)		10,000	1,06,000
Profits for 2008		104,000	
Less: Non-recurring Income (income on investment)		4,000	100,000
Total Profits			3,00,000
Average Profits			
Total Profits		3,00,000	1,00,000
Number of Years		3 years	
Less: Future Maintainable Expenses			
Insurance Premium on Stock	1,000		21,000
Fair Remuneration to Proprietor	20,000		
Adjusted Average Profits			79,000

Value of Goodwill = Adjusted Average Profits × Number of Years' Purchase

= ₹79,000 × 2 years' purchase

= ₹1,58,000

Illustration 15

Value of Goodwill under purchase of Super Profits

A firm earned net profits during the last three years as follows:
First year: ₹72,000; Second year: ₹80,000 and Third year: ₹88,000.

The capital investment of the firm is ₹2,00,000. A fair return on capital, having regard to the risk involved, is 10%.

Calculate the value of goodwill on the basis of three years' purchase of super profits.

Solution:

Value of Goodwill = Super Profits × Number of Years' Purchase

= ₹60,000 × 3 years' purchase

= ₹1,80,000

Calculation of Super Profits

Super Profits = Adjusted Average Profits – Normal Profits

= ₹80,000 – ₹20,000

= ₹60,000

Calculation of Adjusted Average Profit

Year	Amount (₹)
First Year	72,000
Second Year	80,000
Third Year	88,000
Total Profits	2,40,000

$$\textit{Adjusted Average Profits} = \frac{\textit{Total Profits}}{\textit{Number of years}}/$$

$$= \frac{₹2,40,000}{3 \text{ years}} = ₹80,000$$

Calculation of Normal Profits

$$\textit{Normal Profits} = \textit{Capital Employed} \times \textit{Normal Rate of Return}$$
$$= ₹2,00,000 \times 10\%$$
$$= ₹20,000$$

Illustration 16

The following particulars are available in respect of the business carried on by Mr. Kambam:

(a) Capital invested: ₹1,00,000;
(b) Trading results

Year	Profit/Loss	Amount (₹)
1990	Profits	24,400
1991	Profits	30,000
1992	Loss	4,000
1993	Profits	42,000

(c) Market rate of interest on investment: 8%;
(d) Rate of risk return on capital invested in business: 2%;
(e) Remuneration from alternative employment of the proprietor: ₹7,200 per annum.

Compute the value of goodwill of the business on the basis of three years' purchase of super profits, taking average of the last four years.

Solution:

$$\textit{Value of Goodwill} = \textit{Super Profits} \times \textit{Numbers of Years' Purchase}$$
$$= ₹5,900 \times 3 \text{ years' purchase}$$
$$= ₹17,700$$

Calculation of Super Profits

$$\textit{Super Profits} = \textit{Adjusted Average Profits} - \textit{Normal Profits}$$
$$= ₹15,900 - ₹10,000$$
$$= ₹\ 5,900$$

Calculation of Adjusted Average Profits

Year	Profit / Loss	Amount (₹)
1990	Profits	24,400
1991	Profits	30,000
1992	Loss	4,000
1993	Profits	42,000
Total Profits		92,400

$$\text{Average Profits} = \frac{\text{Total Profits}}{\text{Number of Years}} = \frac{₹92{,}400}{4} = ₹23{,}100$$

Less: Remuneration to the Proprietor = ₹7,200

Adjusted Average Profits = ₹15,900

Calculation of Normal Profits

Normal Profits = Capital Employed × Normal Rate of Return

= ₹1,00,000 × (8% + 2%)

= ₹1,00,000 × 10%

= ₹10,000

Illustration 17

Mr. Thiru has invested ₹8,00,000 in a business. His net profit before tax at 50% is ₹3,20,000; out of which, ₹24,000 of annual rent of own building used as business premises and ₹48,000 per annum as his salary were not deducted. For starting this business, he left a job fetching him a monthly salary of ₹4,000. Before starting this business, he had invested this amount on 10% securities. Fair compensation for the risk involved is 2%. Calculate the value of goodwill on the three years' purchase of the average super profits.

Solution:

Value of Goodwill = Super Profits × Number of Years' Purchase

= ₹40,000 × 3 years' purchase

= ₹1,20,000

Calculation of Super Profits

Super Profits = Adjusted Average Profits – Normal Profits

= ₹1,36,000 – ₹96,000

= ₹40,000

Calculation of Adjusted Average Profits

Average Annual Profits Before Tax	=	₹3,20,000
Less: Taxation at 5% (3,20,000 × 50%)	=	₹1,60,000
Average Profits After Tax	=	₹1,60,000
Less: Annual Rent for Own Buildings	=	₹24,000
Adjusted Average Profits	=	₹1,36,000

Calculation of Normal profits

Normal profits = *Capital Employed* × *Normal Rate of Return*
= ₹8,00,000 × (10% + 12%)
= ₹8,00,000 × 12%
= ₹96,000

Illustration 18

From the following information, calculate the value of goodwill on the basis of three years' purchase of the super profits:

(a) Average capital employed in the business: ₹14,00,000
(b) Net trading profit of the firm for the past three years: ₹2,15,200; ₹1,81,400; and ₹2,43,000.
(c) Rate of interest expected from capital having regard to the risk involved: 12%;
(d) Fair remuneration to the partner for their services: ₹24,000 per annum;
(e) Sundry assets of the firm: ₹15,09,524;
(f) Sundry liabilities of the firm: ₹62,658

Solution:

Value of Goodwill = *Super Profits* × *Number of Years' Purchase*
= ₹15,200 × 3 years
= ₹45,600

Calculation of Super Profits

Super Profits = *Adjusted Average Profits* – *Normal Profits*
= ₹183,200 – ₹1,68,000
= ₹15,200

Calculation of Adjusted Average Profits

Year	Amount (in ₹)
First Year	2,15,200
Second Year	1,81,400
Third Year	2,25,000
Total Profits	6,31,600

Average Profits = Total Profits/Number of Years = $\frac{6,21,600}{3}$ = ₹2,07,200
Less: Remuneration to the Proprietor = ₹24,000
Adjusted Average Profits = 1,83,200

Calculation of Normal Profits

Normal Profits = *Capital Employed* × *Normal Rate of Return*
= ₹14,00,000 × 12%
= ₹1,68,000

Hint: Sundry assets and Sundry Liabilities values should be ignored.

Illustration 19

The balance sheet of KN Ltd., as on 31st March 2015, is as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
10,000 8% Preference Shares of ₹10 each	1,00,000	Goodwill	20,000
20,000 Equity Shares of ₹10 each	2,00,000	Fixed Assets	3,60,000
Reserves (including provision for taxation ₹20,000)	2,00,000	Investments in 5% Govt. Loan	40,000
8% Debentures	1,00,000	Current Assets	2,00,000
Creditors	50,000	Preliminary Expenses	20,000
		Discount on Debentures	10,000
	6,50,000		6,50,000

The average profit of the company (after deducting interest on debentures and taxes) is ₹60,000. The market value of the machinery included in fixed assets is ₹10,000 less. Expected rate of return is 10%. Evaluate the goodwill of the company at five times of the super profits.

Solution:

(a) Calculation of super profits:

Super profits = Adjusted average profits – Normal profits

= ₹58,000 – ₹37,100 = ₹20,900

(b) Calculation of Adjusted average profits:

Average profits	=	₹60,000
Less: Interest on investment on Govt. loan (40,000 × 5%)	=	₹2,000
		₹58,000

(c) Calculation of Normal profits:

Normal profits = Net capital employed × Normal rate of return

= ₹3,71,000 × 10% = ₹37,100

(d) Calculation of Net Capital Employed:

Assets	Amount ₹	Amount ₹
Fixed Assets (3,60,000 + Machine value 10,000)	3,70,000	
Current assets	2,00,000	5,70,000
Less: Liabilities		
10% Debentures	1,00,000	
Creditors	50,000	
Provision for taxation	20,000	1,70,000
Capital employed		4,00,00
Less: 1/2 of net current year profits 58,000 × 1/2		29,000
(Net current year profits = Current year profits – Interest on Govt. loan = ₹60,000 – ₹2,000 = ₹58,000)		
Net Capital employed		3,71,000

Value of Goodwill = Super Profits × Number of Years' Purchase

= ₹20,900 × 5 years' purchase = ₹1,04,500

Illustration 20

Value of Goodwill under Capitalisation of Super Profits Method

The average net profits of a business, as adjusted for valuation of goodwill, amounted to ₹4,70,900. The net tangible assets employed were of the value of ₹29,00,000. But upon valuation, they amounted to ₹30,00,000. Assuming that 10% represented a fair commercial return, calculate the amount of goodwill by capitalising the super profits.

Solution:

$$\text{Value of Goodwill} = \frac{\text{Super Profits}}{\text{Normal Rate of Return}}$$

= ₹1,70,900/10%

$$= \frac{₹1{,}70{,}900}{10} \times 100$$

= ₹17,09,000

Calculation of Super Profits

Super Profits = Adjusted Average Profits – Normal Profits

= ₹4,70,900 – ₹3,00,000 = ₹1,70,900

Adjusted Average Profits (given in question itself): ₹4,70,900

Calculation of Normal Profits

Normal Profits = Net Capital Employed × Normal Rate of Return

= ₹30,00,000 × 10%

= ₹3,00,000

Note: Assume net tangible assets as a net capital employed

Illustration 21

The following information is given:

(a) Capital employed: ₹6,00,000;

(b) Net profits for five years were: 2001: ₹57,600; 2002: ₹61,600; 2003: ₹67,600; 2004: ₹69,600 and 2005: ₹71,600.

The above profits included non-recurring profits on an average basis of ₹4,000; out of which, it was deemed that even non-recurring profits had a tendency of appearing at the rate of ₹2,800 per annum

(c) Normal rate of profit is 10%;

You are required to calculate the value of goodwill as per capitalisation of super profits method.

Solution:

$$\text{Value of Goodwill} = \frac{\text{Super Profits}}{\text{Normal Rate of Return}}$$

$$= \frac{₹4{,}400}{10\%}$$

$$= \frac{₹4{,}400}{10} \times 100$$

$$= ₹44{,}000$$

Calculation of Super Profits

$$\text{Super Profits} = \text{Adjusted Average Profits} - \text{Normal Profits}$$

$$= ₹64{,}400 - ₹60{,}000$$

$$= ₹4{,}400$$

Adjusted Average Profits

Calculation of adjusted average profits

Year	Profits (₹)
2001	57,600
2002	61,600
2003	67,600
2004	69,600
2005	71,600
Total Profits	3,28,000

Average Profit = $\dfrac{\text{Total Profits}}{\text{Number of Years}} = \dfrac{₹3{,}28{,}000}{5 \text{ years}}$	=	₹65,600
Less: Non-recurring Profits (₹4,000 – ₹2,800)	=	₹1,200
Adjusted Average Profits	=	₹64,400

Calculation of Normal profits:

$$\text{Normal Profits} = \text{Net Capital Employed} \times \text{Normal Rate of Return}$$

$$= ₹6{,}00{,}000 \times 10\% = ₹60{,}000$$

Illustration 22

Value of Goodwill under Annuity Method of Super Profits

The net profits of a company, after providing for taxation, for the past five years were ₹80,000. ₹84,000; ₹90,000; ₹92,000; and ₹94,000. The capital employed in the business is ₹8,00,000; on which, a reasonable return of 10% is expected. It is expected that the company will be able to maintain its super profits for the next five years. Calculate the value of goodwill of the business on the basis of an annuity of super profits, taking the present value of annuity of one rupee of 5 years at 10% interest as ₹3.78.

Solution:

$$\textit{Value of Goodwill} = \textit{Super Profits} \times \textit{Annuity Factor}$$
$$= ₹8{,}000 \times 3.78$$
$$= ₹30{,}240$$

Calculation of Super Profits

$$\textit{Super Profits} = \textit{Adjusted Average Profits} - \textit{Normal Profits}$$
$$= ₹88{,}000 - ₹80{,}000$$
$$= ₹8{,}000$$

Adjusted Average Profits

Calculation of Adjusted average profits:

Year	Profits (₹)
First year	80,000
Second year	84,000
Third year	90,000
Fourth year	92,000
Fifth year	94,000
Total Profits	4,40,000

$$\text{Adjusted Average profits} = \frac{\text{Total profits}}{\text{Number of years}} = \frac{₹4{,}50{,}000}{5 \text{ years}} = ₹88{,}000$$

Calculation of Normal profits:

$$\textit{Normal profits} = \textit{Net capital employed} \times \textit{Normal rate of return}$$
$$= ₹8{,}00{,}000 \times 10\% = ₹80{,}000$$

Illustration 23

From the following particulars, find out the value of goodwill as per annuity method:

(a) Capital employed: ₹6,00,000;
(b) Normal rate of return is 10%;
(c) Present value of ₹1 and 5 years at 10% is 3.78;
(d) Normal profits for 5 years: first year: 60,000; second year: 64,000; third year: ₹68,000; fourth: year 72,000; fifth year: 76,000;
(e) Non-recurring income: ₹3,200;
(f) Non-recurring expenses: ₹2,000.

Solution:

$$\textit{Value of Goodwill} = \textit{Super Profits} \times \textit{Annuity Factor}$$
$$= ₹6{,}800 \times 3.78 = ₹25{,}704$$

Calculation of Super Profits

$$\begin{aligned}\textit{Super Profits} &= \textit{Adjusted Average Profits} - \textit{Normal Profits}\\ &= ₹66{,}800 - ₹60{,}000\\ &= ₹6{,}800\end{aligned}$$

Adjusted Average Profits

Calculation of Adjusted Average Profits

Year	Profits (₹)
First year	60,000
Second year	64,000
Third year	68,000
Fourth year	72,000
Fifth year	76,000
Total Profits	3,40,000

$$\text{Adjusted Average Profits} = \frac{\text{Total profits}}{\text{Number of years}} = \frac{₹3{,}40{,}000}{5 \text{ years}} = ₹68{,}000$$

Less: Non-recurring Incomes	=	₹3,200
	=	₹64,800
Add: Non-recurring Expenses	=	₹ 2,000
Adjusted Average Profits	=	₹66,800

Calculation of Normal Profits

$$\begin{aligned}\textit{Normal Profits} &= \textit{Net Capital Employed} \times \textit{Normal Rate of Return}\\ &= ₹6{,}00{,}000 \times 10\% = ₹60{,}000\end{aligned}$$

Illustration 24

Value of Goodwill under all the above four methods

From the following information, find out the value of goodwill as per annuity method.

(a) Capital employed: ₹3,00,000;
(b) Normal rate of profits at 10%
(c) Present value of annuity of ₹1 for 5 years at 10% is 3.78;
(d) Net profits for 5 years:

First year: ₹28,800; second year: ₹30,800; third year: ₹33,800; fourth year: ₹34,800; fifth year: ₹35,800.

Solution:

(i) *Value of Goodwill = Super Profits × Annuity Factor*

$$= ₹2{,}000 \times 3.78 = ₹7{,}560$$

(ii) *Value of Goodwill = Super Profits × Number of Years' Purchase*

= ₹2,000 × 5 years' purchase

= ₹2,000 × 5

= ₹10,000

(iii) $\textit{Value of Goodwill} = \dfrac{\textit{Super Profits}}{\textit{Normal Rate of Return}}$

$= \dfrac{₹2,000}{10\%}$

$= \dfrac{₹2,000}{10\%} \times 10$

= ₹20,000

(iv) *Value of Goodwill = Adjusted Average Profits × Number of Years' Purchased*

= ₹32,000 × 2 years

= ₹64,000

(a) Calculation of Super Profits

Super Profits = Adjusted Average Profits – Normal Profits

= ₹32,000 – ₹30,000

= ₹2,000

(b) Adjusted Average Profits

Calculation of Adjusted Average Profits

Year	Profits (₹)
First year	28,800
Second year	30,800
Third year	33,800
Fourth year	34,800
Fifth year	35,800
Total	1,64,000

$\text{Average Profits} = \dfrac{\text{Total Profits}}{\text{Number of Years}} = \dfrac{₹1,64,000}{5 \text{ years}}$

Average Profits	= ₹32,800
Less: Non-recurring profits (₹2,000 – 1,200)	₹800
Adjusted Average Profit	= ₹32,000

(c) Calculation of Normal Profits

Normal Profits = Net Capital Employed × Normal rate of Return

= ₹3,00,000 × 10%

= ₹30,000

Illustration 25

A firm earns ₹2,40,000 as its annual profits, the rate of normal profit being 10%. The assets of the firm amount to ₹28,80,000 and liabilities to ₹9,60,000. Find out the value of goodwill by capitalisation method.

Solution:

Goodwill = Total Capitalised Value of Business – Net Assets

= ₹24,00,000 – ₹19,20,000

= ₹4,80,000

(i) *Total Capitalised Value of the Firm* $= \dfrac{\text{Adjusted Average Profits}}{\text{Normal Rate of Return}} \times 100$

$= \dfrac{₹2,40,000}{10} \times 100$

Total Capitalised Value of Business = ₹24,00,000

(ii) *Net Assets of the Firm = Total Revalued Assets – Total Revalued Liabilities*

= ₹28,80,000 – ₹9,60,000

= ₹19,20,000

Illustration 26

Mr. Subash Chandra Bose runs a chemist shop. His net assets as on 31st March 2006 amounted to ₹40,00,000. After paying a rent of ₹90,000 a year and a salary of ₹60,000 to the chemist, he earns a profit of ₹4,20,000. His landlord, who happens to be an expert chemist, is interested in purchasing the shop. 8% is considered to be a reasonable return on capital employed. What can Mr. Subash Chandra Bose expect as a payment for goodwill under capitalisation method?

Solution:

Goodwill = Total Capitalised Value of Business – Net Assets

= ₹63,75,000 – ₹40,00,000

= ₹23,75,000

(i) *Total Capitalised Value of the Firm* $= \dfrac{\text{Adjusted Average Profits}}{\text{Normal Rate of Return}} \times 100$

= ₹5,10,000/8%

Total Capitalised Value of Business = ₹63,75,000

Adjusted Average Profits = Average Profits + Rent for the Shop

= ₹4,20,000 + ₹90,000

= ₹5,10,000

(ii) Net Assets of the Firm = ₹40,00,000

Illustration 27

From the data given below, calculate the goodwill of the company by the capitalisation method:

(a) Normal rate of return carried on by the company is 10%'
(b) Adjusted average profits of the preceding 5 years: ₹60,000;
(c) Net assets employed in the company: ₹4,00,000

Solution:

$$\begin{aligned}\textit{Goodwill} &= \textit{Total Capitalised Value of Business} - \textit{Net Assets}\\ &= ₹6,00,000 - ₹4,00,000\\ &= ₹2,00,000\end{aligned}$$

(i) $\textit{Total Capitalised Value of the Firm} = \dfrac{\textit{Adjusted Average Profits}}{\textit{Normal Rate of Return}} = \dfrac{₹60,000}{10\%}$

Total Capitalised Value of Business = ₹6,00,000

(ii) Net Assets of the Firm = ₹4,00,000

Illustration 28

The net profits of a company, after providing for taxation for the past five years, are ₹80,000; ₹84,000; ₹92,000 and ₹94,000. The capital employed in the business is ₹8,00,000, on which a reasonable rate of return of 10% is expected. Calculate the value of goodwill under capitalisation method.

Solution:

$$\begin{aligned}\textit{Goodwill} &= \textit{Total Capitalised Value of Business} - \textit{Net Assets}\\ &= ₹8,80,000 - ₹8,00,000\\ &= ₹80,000\end{aligned}$$

(i) $\textit{Total Capitalised Value of the Firm} = \dfrac{\textit{Adjusted Average Profits}}{\textit{Normal Rate of Return}} = \dfrac{₹88,000}{10\%}$

Total Capitalised Value of Business = ₹8,80,000

$$\begin{aligned}\text{Adjusted Average Profits} &= \frac{80,000 + 84,000 + 90,000 + 92,000 + 94,000}{5 \text{ years}}\\ &= \frac{4,40,000}{5 \text{ years}}\\ &= ₹88,000\end{aligned}$$

(ii) Net Assets of the Firm = ₹8,00,000

Illustration 29

From the following information, calculate the value of goodwill under capitalisation method:

(a) Average capital employed: ₹24,00,000;
(b) Company declares 15% dividend on the shares of ₹20 fully paid, which is quoted in the market at ₹25.

(c) Sundry assets of the firm ₹31,70,000 and sundry liabilities ₹1,25,308;
(d) Net trading profits of the firm for the past three years: ₹4,30,400; ₹3,62,800 and ₹4,50,000.

Solution:

$$\textit{Goodwill} = \textit{Total Capitalised Value of Business} - \textit{Net Assets}$$
$$= ₹34{,}53{,}334 - ₹30{,}44{,}692$$
$$= ₹4{,}08{,}642$$

$$\textit{Total Capitalised Value of the Firm} = \frac{\textit{Adjusted Average Profits}}{\textit{Normal Rate of Return}} = \frac{₹4{,}14{,}400}{12\%}$$

Total Capitalised Value of Business = ₹34,53,334

(i) Adjusted Average Profits $= \dfrac{4{,}30{,}400 + 3{,}62{,}800 + 4{,}50{,}000}{3 \text{ years}} = \dfrac{12{,}53{,}200}{3 \text{ years}}$

$= ₹4{,}17{,}733$

(ii) Normal Rate of Return $= \dfrac{20}{25} \times 15\% = 12\%$

(iii) *Net Assets of the Firm* = *Sundry Assets – Sundry Liabilities*
= ₹31,70,000 – ₹1,25,308
= ₹30,44,692

8.2 VALUATION OF SHARES

Valuation of shares is the most complex one in accounting problems. The financial and accounting data has been used in valuation of shares. It depends mostly on the valuer's judgement, experience and knowledge. The valuation, which is done on quantitative data, may not show the actual value of share in the market. Thus, valuation of share is an intricate exercise. It involves accounting and non-accounting data, objective and subjective considerations and people from different areas. Moreover, valuation differs according to the purpose for which it has been valued.

The Articles of Association of the Company states the value of shares. The balance sheet of the companies also reveals the value of shares. The value, which is stated in the Articles of Association or Balance Sheet is called 'book-value' of a share. The value at which it could be purchased or sold from the capital market is 'market value'. The market value may be more or less than the book value. The money value attached to the share is known as value of a share. It may be the book value or the price at which it can be sold or purchased.

❍ Importance of Valuation of Shares

- The actual value of shares may differ from the quoted price of shares in Stock Exchanges. The value quoted for shares are helpful to the investors when shares purchased or sold are few. The quoted price may not be helpful while more number of shares/controlling shares are purchased or sold. Moreover, all shares are not quoted on stock exchanges. Hence, valuation of unquoted shares is necessary for transferring shares from one person to another person.

- There is a need to value the shares for calculating the purchase consideration in amalgamation of companies.
- The terms of issue of preference shares and debentures give an option to convert it into equity shares. Under such circumstances, the company has to determine the value of its equity shares based on share exchange ratio.
- The shares and debentures can be offered as security to obtain loans from financial institutions and banks. It is easy for the company to receive loans from these institutions if its shares valued.
- The valuation of shares is essential while a Public Sector Undertaking is converted into a limited company by making a public issue. Besides, when the government acquires the shares of a limited company under a scheme of nationalisation, the concerned company has to value its shares automatically so as to compensate the shareholders.

❍ Factors Influencing the Value of Shares

The internal and external factors, which influence the value of shares are**:**

Internal Factors

1. Net worth of assets (Realisable value of assets minus all liabilities)
2. Return on investments
3. Profit after tax
4. Profit available to equity shareholders
5. Earnings per share
6. Dividend per share or rate of dividend

External Factors

1. General economic condition of the country
2. Political and social environment globally and within the nation.
3. Demand for shares
4. Industries prospective growth
5. Transparency in the flow of information
6. Insider trading
7. General instinct in capital and securities market
8. Investor's education and their awareness towards capital market

❍ Methods of Valuation of Shares

The following are the different methods of valuation of shares:

1. Net Assets Method (or) Intrinsic Value Method
2. Yield Method
3. Fair value Method

Net Assets Method or Intrinsic Value Method

Net assets method is also known as Intrinsic Value Method, Asset Backing Method, Equity Method, Asset Balancing Method or Assets Valuation Method.

$$\text{Value of one equity share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

The net assets value has been estimated by deducting the liabilities from the total realisable assets. The value of each share is obtained by dividing the worth of the net assets by the number of outstanding shares.

Points to be considered while using the Net Assets Method

The following points are to be considered while calculating the value of each equity share under net asset method:

1. When market value or realisable value is not given, the assets should be considered at book value.
2. Maintain adequate provision for depreciation.
3. Apply current market price for investments made outside the firm (e.g., investment in shares, debentures of other companies, etc.) and on inventory.
4. Create adequate provision for bad and doubtful debts for bills receivable and trade debtors.
5. Do not take into account fictitious assets like preliminary expenses, debit balance of profit and loss account, or any unamortised expenditure and deferred revenue expenditure.
6. The realisable value of unrecorded assets should be considered and in the same way, all unrecorded liabilities are taken into consideration.
7. Deduct from the total value of all realisable assets, the value of liabilities, including contingent liabilities and liabilities relating to the employees.
8. The value of net assets available for equity shareholders is obtained by deducting from the above calculated figure, the paid-up amount of preference share capital, if any, and the unpaid amount of preference dividend if not deducted as liabilities.
9. The value of net assets available for equity shareholders is divided by the number of equity shares (issued and subscribed) to ascertain the value of each equity share.

$$\text{Value of each Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

Proforma for Net Assets Method of Valuation of Shares

	₹	₹
Assets as Market Value:		
Goodwill		xxx
Fixed Assets		xxx

(*Contd.*)

Investment		xxx
Current Assets		xxx
Total Assets		xxx
Less: Current Liabilities		
Debentures	xxx	
Preference Share Capital	xxx	xxx
Net Assets Available for Equity Shareholders		xxx

$$Intrinsic\ Value\ per\ Share = \frac{Net\ Assets\ Available\ for\ Equity\ Shareholders}{Number\ of\ Equity\ Shares}$$

Alternative Method of Calculation of Net Shares

Equity Share Capital		xxx
Reserves	xxx	
Other Surplus	xxx	
Profit on Revaluation of Assets	xxx	
Gross Equity		xxx
Less: Loss on Revaluation of Assets	xxx	
Miscellaneous Expenditure and Losses	xxx	xxx
Net Equity		xxx

$$Intrinsic\ Value\ per\ Share = \frac{Net\ Equity}{Number\ of\ Equity\ Shares}$$

Yield Method

Yield value of a share is also known as capitalised value of earning capacity. Normal rate of return in the industry and actual or expected rate of return of the firm are taken into consideration to find out yield value of a share. Yield refers to the earnings or productivity of a firm in relation to its investments, such yield may be Earnings Yield or Dividend Yield.

The value of equity share is calculated as follows under this method:

$$\begin{array}{l} Value\ of\ shares\ under \\ yield\ value\ method \end{array} = \frac{Expected\ Rate\ of\ Return}{Normal\ Rate\ of\ Return} \times Paid\text{-}up\ Value\ per\ Share$$

Calculation of Expected Rate of Return

$$ERR = \frac{Profits\ available\ to\ equity\ shareholders}{Total\ paid\text{-}up\ equity\ shares\ capital\ amount} \times 100$$

Calculation of Profits Available to Equity Shareholders

Particulars	Amount (₹)
$\text{Average Profit} = \dfrac{\text{Total Profits}}{\text{Number of Years}}$	xxxx
Less: Provision for Taxation Paid	xxxx
Average Profit after Tax	xxxx
Less: Transfer to General Reserves	xxxx
Average Profits After Tax and Reserves	xxxx
Less: Dividend on Preference Shares Paid	xxxx
Profits Available to Equity Shareholders	xxxx

Total paid-up equity share capital amount = Number of Equity Shares × Paid-up Value per share

Fair Value Method

The average of net assets value and yield value is known as Fair Value of Shares. It provides a better indication about the value of shares than the earlier two methods.

Under this method, value of one equity share is calculated as under:

$$Value\ of\ Shares = \frac{Net\ Assets\ Value + Yield\ Value}{2}$$

Illustration 30

Net Asset Method (or) Intrinsic Value Method (or) Break Up Value Method (or) Asset Backing Method

The following is the balance sheet of LMN Ltd., as on 31st December 2008.

Liabilities	(₹)	Assets	(₹)
2,000 10% Pref. Shares of ₹100 each	2,00,000	Sundry Assets at Book Value	6,00,000
30,000 Equity Shares of ₹10 each	3,00,000		
Bills Payable	25,000		
Creditors	75,000		
	6,00,000		6,00,000

The market value of 70% of the assets is estimated to be 20% more than the book value and that of the remaining 30% at 10% less than the book value. There is an unrecorded liability of ₹5,000.

Find the value of each equity share (it is to be assumed that preference shares have no prior claim as to payment of dividend or to repayment of capital).

Solution:

Calculation of Net Assets

		(₹)
Sundry Assets:		
$6,00,000 \times 70\% \times 120\%$		5,04,000
$6,00,000 \times 30\% \times 90\%$		1,62,000
		6,62,000
Less: Current Liabilities:		
Bills Payable	25,000	
Creditors	75,000	
Unrecorded Liability	5,000	1,05,000
		5,57,000
Less: Preference Share Capital		2,00,000
Net Assets Available for Equity Shareholders		3,57,000

$$\text{Intrinsic Value per Share} = \frac{\text{Net Assets for Equity Shareholders}}{\text{Number of Equity Shares}}$$

$$= \frac{₹3,57,000}{30,000} = ₹11.90$$

Illustration 31

Net Asset Method with Goodwill Valuation

The balance sheet of Sachu Ltd. disclosed the following position on 31st December 2008.

Liabilities	(₹)	Assets	(₹)
Share Capital:			
3,000 Equity Shares of ₹100 each	3,00,000	Goodwill	82,500
Profit & Loss A/c	37,500	Investments	2,62,500
General Reserve	1,12,500	Stock	3,30,000
6% Debentures	2,25,000	Sundry Debtors	1,95,000
Sundry Creditors	75,000	Cash at Bank	30,000
Workmen's Savings Bank A/c	1,50,000		
	9,00,000		9,00,000

(a) The profits for the past five years were:
2004: ₹15,000; 2005: ₹35,000; 2006: ₹25,000; 2007: ₹27,500 and 2008: ₹47,500.

(b) The market value of investments was ₹1,65,000.

(c) Goodwill is to be valued at three years' purchase of the average annual profits for the last five years.
Find the intrinsic value of each share.

Solution:

Calculation of Value of Goodwill:

Total Profits for five years = ₹15,000 + 35,000 + 25,000 + 27,500 + 47,500
= ₹1,50,000

$$\text{Average Profits per Year} = \frac{₹1,50,000}{5} = ₹30,000$$

Goodwill = Average Profits × Number of Years of Purchase
= ₹30,000 × 3 years = ₹90,000

Calculation of Intrinsic Value of Shares

	(₹)	(₹)
Calculation of Net Assets:		
Assets at Market Value:		
Goodwill		90,000
Investments		1,65,000
Stock		3,30,000
Sundry Debtors		1,95,000
Cash at Bank		30,000
		8,10,000
Less: Liabilities:		
6% Debentures	2,25,000	
Sundry Creditors	75,000	
Workmen's Savings Bank A/c	1,50,000	4,50,000
		3,60,000

$$\text{Intrinsic value of each share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{₹3,60,000}{6,000 \text{ shares}}$$

$$= ₹60$$

Illustration 32

Revaluation of Assets and Valuation of Goodwill—Net Asset Method

The balance sheet of Gowtham Ltd., as on 31st December 2010 was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:			
7,500 Equity Shares of ₹100 each	7,50,000	Land & Buildings	3,30,000
Profit & Loss A/c	1,54,500	Plant & Machinery	1,42,500
Sundry Creditors	1,15,500	Stock	5,25,000
Bank Overdraft	30,000	Sundry Debtors	2,32,500
Provision for Taxation	67,500		
Dividend Equalisation Fund	1,12,500		
	12,30,000		12,30,000

The net profit of the company, after deducting all working charges and providing for depreciation and taxation, were as under:

2006: ₹2,55,000; 2007: ₹2,88,000; 2008: ₹2,70,000; 2009: ₹3,00,000 and 2010: ₹2,85,000.

On 31st December 2010, Land & Buildings were valued at ₹3,75,000 and Plant & Machinery at ₹2,25,000.

In view of the nature of the business, it is considered that 10% is a reasonable return on capital.

Calculate the value of the company's share after taking into account the revised values on fixed assets and goodwill valued on the basis of four years' purchase of the annual super profits.

Solution:

Computation of Goodwill

Calculation of Average Capital Employed

Total Net Assets	(₹)	(₹)
Land & Buildings		3,75,000
Plant & Machinery		2,25,000
Stock		5,25,000
Sundry Debtors		2,32,500
		13,57,500
Less: Liabilities:		
Sundry Creditors	1,15,500	
Bank Overdraft	30,000	
Provision for Taxation	67,500	2,13,000
		11,44,500
Less: ½ of Net Profit of 2010 (2,85,000 × ½)		1,42,500
		10,02,000

Normal Profit = *Average Capital Employed* × *Normal Rate of Return*

= 10,02,000 × 10/100

= ₹1,00,200

Average Profit

Total Profits = ₹2,55,000 + 2,88,000 + 2,70,000 + 3,00,000 + 2,85,000

= ₹13,98,000

$$\text{Average Profit} = \frac{₹13,98,000}{5} = ₹2,79,600$$

Super Profit = *Average Profit* – *Normal Profit*

= ₹2,79,600 – 1,00,200

= ₹1,79,400

Goodwill = *Super Profit* × *Number of Years of Purchase*

= ₹1,79,400 × 4 years

= ₹7,17,600

Valuation of Shares

Net Assets (as above)	=	13,57,500
Goodwill	=	7,17,600
Net Assets Available for Equity Shareholders		20,75,100

$$\text{Intrinsic Value of Share} = \frac{₹20,75,100}{7,500 \text{ shares}} = ₹276.68$$

Illustration 33

Revaluation of Assets, Valuation of Goodwill and Non Trading Income—Net Asset Method

The balance sheet of Ramya Ltd., as on 31st March 2008 was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:			
10% Preference Shares of ₹100 each, fully paid	1,00,000	Goodwill	50,000
2,000 Equity Shares of ₹100 each, fully paid	2,00,000		
General Reserve	80,000	Land & Buildings	1,10,000
Capital Reserve	10,000	Machinery	1,50,000
Profit & Loss A/c	60,000	Furniture	20,000

(*Contd.*)

5% Debentures	60,000	Investments in 5% Govt. Securities at Cost (face value ₹40,000)	50,000
Sundry Creditors	90,000	Stock	1,50.000
Provision for Taxation	20,000	Book Debts	60,000
		Cash at Bank	30,000
	6,20,000		6,20,000

The assets were revalued as follows:

	(₹)
Land & Buildings	1,50,000
Machinery	1,25,000
Furniture	25,000

The normal return on capital employed for valuation of goodwill is 12%, the basis of valuation being four years' purchase of super profits. 60% of investments in building are treated as non-trading assets because a sum of ₹9,000 is collected annually as rent from the building. Calculate the value of each equity share, assuming that the average annual profit after tax at 50% is ₹70,000.

Solution:

Computation of Value of Goodwill

Calculation of Capital Employed

	(₹)	(₹)
Fixed Assets (as revalued):		
Land & Buildings	1,50,000	
Machinery	1,25,000	
Furniture	25,000	3,00,000
Less: Non-trading Buildings (i.e. ₹1,50,000 × 60%)		90,000
		2,10,000
Add: Current Assets:		
Stock	1,50,000	
Book Debts	60,000	
Cash at Bank	30,000	2,40,000
		4,50,000

(*Contd.*)

Less: External Liabilities:		
5% Debentures	60,000	
Sundry Creditors	90,000	
Provision for Taxation	20,000	1,70,000
Capital Employed		2,80,000

Calculation of Average Trading Profit

Average Annual Profit after Tax		70,000
Less: Non-trading Income (less 50% tax)		
Rent – 60% of ₹9,000	4,500	
Interest on Investments – 50% of 2000 (40,000 × 5%)	1,000	5,500
		64,500

Calculation of Super Profit

	(₹)
Average Trading Profit	64,500
Less: Normal Profit 2, 80,000 × 12%	33,600
Super Profit	30,900

Calculation of Value of Goodwill

$$\textit{Goodwill} = \textit{Super Profit} \times \textit{Number of Years of Purchase}$$

$$= ₹30{,}900 \times 4 \text{ years} = ₹1{,}23{,}600$$

(i) Computation of Value of Each Equity Share

(a) Calculation of Net Assets

	(₹)	(₹)
Goodwill		1,23,600
Land & Buildings		1,50,000
Machinery		1,25,000
Furniture		25,000
Investments		50,000
Stocks		1,50,000
Book Debts		60,000
Cash at Bank		30,000
Less: External Liabilities		7,13,600
Less: 5% Debentures	60,000	
Sundry Creditors	90,000	
Provision for Taxation	20,000	
10% Preference Share Capital	1,00,000	2,70,000
Net Assets		4,43,600

(b) $$\textit{Intrinsic value of each share} = \frac{\textit{Net Assets}}{\textit{Number of Equity Shares}}$$

$$= \frac{₹4,43,600}{2,000 \text{ shares}} = ₹221.80$$

Illustration 34

Non-Trading Income and Tax Ignored on Average Profits—Net Asset Method

From the following information, compute the intrinsic value of an equity share of Sunny Ltd.

Liabilities	(₹)	Assets	(₹)
4,000 Equity Shares of ₹200 each, fully paid	4,00,000	Land & Buildings	1,60,000
4,000 6% Preference Shares of ₹10 each	40,000	Plant & Machinery	1,60,000
General Reserve	1,00,000	Book Debts	20,000
5% Debentures of ₹200 each	40,000	Stock-in-trade	80,000
Sundry Creditors	40,000	Cash & Bank Balance	1,40,000
		Investment in 5% Govt. Securities	40,000
		Preliminary Expenses	20,000
	6,20,000		6,20,000

(a) Fair return on capital employed in this type of business is 10% p.a.
(b) Goodwill is to be taken at four years' purchase value of super profits.
(c) Average of the profits (after deduction of preliminary expenses) for the last seven years is ₹76,000. Preliminary expenses to the extent of ₹4,000 have been written off every year for the last seven years. Profit is more or less stable over years and the same trend is expected to be maintained in the near future. Ignore taxation.

Solution:

Computation of Goodwill

Calculation of Capital Employed

	(₹)	(₹)
Land & Buildings		1,60,000
Plant & Machinery		1,60,000
Book Debts		20,000
Cash & Bank Balance		80,000
		5,60,000

(*Contd.*)

Less: External Liabilities:		
Sundry Creditors	40,000	
5% Debentures	40,000	80,000
Capital Employed		4,80,000

Normal Profit = ₹4, 80,000 × 10% = ₹48,000

Average Profit

Average Profit	76,000
Less: Interest on Investments (40,000 × 5%)	2,000
	74,000

Super Profit = *Average Profit – Normal profit*

= ₹74, 000 – 48,000

= ₹26, 000

Goodwill = *Super Profit* × *Number of Years of Purchase*

= ₹26, 000 × 4 years

= ₹1, 04,000

Computation of Value of Each Equity Shares

Calculation of Net Assets

	(₹)	(₹)
Investments		40,000
Goodwill		1,04,000
Land & Buildings		1,60,000
Plant & Machinery		1,60,000
Book Debts		20,000
Stock-in-trade		80,000
Cash & Bank Balance		1,40,000
		7,04,000
Less: External Liabilities		
Sundry Creditors	40,000	
5% debentures	40,000	
Preference Share Capital	40,000	1,20,000
Net Assets available for Equity Shareholders		5,84,000

$$\textit{Intrinsic value of each share} = \frac{\textit{Net Assets}}{\textit{Number of Equity Shares}}$$

$$= \frac{₹5,84{,}000}{4{,}000 \text{ shares}} = ₹146$$

Illustration 35

Revaluation of Assets and Interest on Debentures Outstanding—Net Asset Method

The following is the balance sheet of X Co. Ltd., as on 31st December 2006.

Liabilities	(₹)	Assets	(₹)
Share Capital:			
1,000 6% Pref. Shares of ₹10 each	10,000	Fixed Assets	30,000
3,000 Equity Shares of ₹10 each	30,000		
7% Debentures	10,000	Current Assets	25,000
Debenture Redemption Fund	5,000	Discount on Issue of Debentures	3,000
Depreciation Fund	10,000	Preliminary Expenses	2,000
Creditors	7,000	Profit & Loss A/c	12,000
	72,000		72,000

The following information is supplied to you:

(a) Debenture interest is owed for one year.

(b) Book debts included in current assets are doubtful to the extent of ₹2,000, for which no provision has been made.

(c) The market value of investments included in current assets is ₹10,000, while the asset has been shown at its cost of ₹15,000.

Ascertain the value of each equity share by the asset backing method.

Solution:

Calculation of Net Assets

Assets at Market Value

	(₹)	(₹)
Fixed Assets	30,000	
Less: Depreciation Fund	10,000	20,000
Current Assets:		
Investments		10,000
Other Assets	10,000	
Less: Provision for Doubtful Debts	2,000	8,000
		38,000
Less: External liabilities:		
7% Debentures	10,000	
Interest on Debentures Outstanding (10,000 × 7%)	700	
Creditors	7,000	
6% Preference Share Capital	10,000	27,700
Net Assets		10,300

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{10{,}300}{3{,}000} = ₹3.43$$

Illustration 36

Valuation of fully paid and partly paid shares of different denominations—Net Asset Method

From the balance sheet of AB Co. Ltd., as on 31st March 2000, the following figures have been extracted:

	(₹)
Share Capital:	
9% Preference Shares of ₹100 each	12,00,000
40,000 Equity Shares of ₹10 each, ₹5 paid-up	2,00,000
40,000 Equity Shares of ₹10 each, ₹2.50 paid-up	1,00,000
40,000 Equity Shares of ₹10 each, fully paid-up	4,00,000
	19,00,000
Reserves & Surplus:	
General Reserve	8,00,000
Profit & Loss A/c	2,00,000
	29,00,000

On a revaluation of assets on 31st March 2000, it was found that they had appreciated by ₹3,00,000 over their value in the aggregate.

The Articles of Association of the company provide that in case of liquidation, preference shareholders would have a further claim of 10% of the surplus assets if any.

Determine the value of each equity share, assuming that liquidation of the company has to take place on 31st March 2000 and that the expenses of winding up are nil.

Solution:

Computation of Surplus Assets Available to Equity Shareholders

	(₹)
Preference Share Capital	12,00,000
Equity Share Capital	7,00,000
General Reserve	8,00,000
Profit & Loss A/c	2,00,000
Profit on Appreciation of Assets	3,00,000

(*Contd.*)

Net Assets	32,00,000
Less: Preference Share Capital	12,00,000
	10,00,000
Less: Equity Share Capital	7,00,000
Surplus Assets Available to Shareholders	13,00,000
Less: Surplus to Preference Shareholders (10% of surplus assets)	1,30,000
Surplus Assets available to Equity Shareholders	11,70,000

Computation of total amount available to Equity Shareholders

	(₹)
Equity Share Capital	7,00,000
Equity Shareholders' Share of Surplus	11,70,000
Total Amount Available	18,70,000

Computation of Value per Equity Share of Different Paid-up Values

$$\textit{Value of ₹1 of paid-up Capital} = \frac{\textit{Total Amount Available}}{\textit{Paid-up Capital}}$$

$$= \frac{18{,}70{,}000}{7{,}00{,}000} = ₹2.67$$

Therefore, the value of each ₹2.50 share: 2.67 × 2.50 = ₹6.68

The value of each ₹5 share: 2.67 × 5 = ₹13.35

The value of each ₹10 share: 2.67 × 10 = ₹26.70

Illustration 37

With Contingent Liability

The summarised balance sheet of BK Ltd., as at 31st March 2007, is as follows:

Balance Sheet

Liabilities	(₹)	Assets	(₹)
30,000 Equity Shares of ₹10, each fully paid	3,00,000	Goodwill	70,000
10,000 Equity Shares of ₹10 each, ₹8 paid-up	80,000	Fixed Assets	4,50,000
Reserves	1,80,000	Current Assets	2,20,000
11% Debentures	1,00,000	Preliminary Expenses	10,000
Current Liabilities	90,000		
	7,50,000		7,50,000

(a) The goodwill is independently valued at ₹50,000 and fixed assets at ₹4,20,000.

(b) There was a contingent liability of ₹20,000, which has become payable.

Determine the value of both the categories of shares under net assets method.

Solution:

Calculation of Net Assets

Assets at Market Value

	(₹)	(₹)
Goodwill		50,000
Fixed Assets		4,20,000
Current Assets		2,20,000
		6,90,000
Less: External Liabilities		
11% Debentures	1,00,000	
Current Liabilities	90,000	
Contingent Liability	20,000	2,10,000
Net Assets		4,80,000

Computation of Value per Equity Share of Different Paid-up Values

$$\text{Value of ₹ 1 of Paid-up Capital} = \frac{\text{Total Amount Available}}{\text{Paid-up Capital}}$$

$$= \frac{4,80,000}{3,80,000} = ₹1.263$$

The value of each ₹8.00 per share = 1.263 × 8 = ₹10.10
The value of each ₹10.00 per share = 1.263 × 10 = ₹12.63

Illustration 38

Arrears of Preference Dividend, Contingent Liability and Unrecorded Liability

From the following balance sheet of Y Co. Ltd., as on 31st December 1998, calculate the value per equity share under the asset backing method.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Goodwill	6,00,000
18,000 6% Preference Shares of ₹100 each	18,00,000	Land & Buildings	3,00,000
3,00,000 Equity Shares of ₹1 each	3,00,000	Plant & Machinery	7,50,000
Capital Reserve	60,000	Furniture	2,40,000
General Reserve	1,50,000	Investment in Govt. Securities	3,00,000

(*Contd.*)

Profit & Loss A/c	1,50,000	Stock	3,00,000
5% Debentures	3,00,000	Debtors	2,70,000
Sundry Creditors	1,20,000	Cash at Bank	1,20,000
Provision for Taxation	60,000	Preliminary Expenses	60,000
	29,40,000		29,40,000

Preference dividends are in arrears for three years. There is a disputed liability of ₹30,000 not shown in the above balance sheet and ₹24,000 is likely to materialise. There is also liability of ₹6,000, which remains unrecorded. Goodwill is worth the same figure and 5% of debtors are considered doubtful.

Solution:

Calculation of Net Assets

	(₹)	(₹)
Assets:		
Goodwill		6,00,000
Land & Building		3,00,000
Plant & Machinery		7,50,000
Furniture		2,40,000
Investments in Government Securities		3,00,000
Stock		3,00,000
Debtors	2,70,000	
Less: Provision for Doubtful Debt @ 5%	13,500	2,56,500
Cash at Bank		1,20,000
		28,66,500
Less: External Liabilities		
5% Debentures	3,00,000	
Sundry Creditors	1,20,000	
Provision for Taxation	60,000	
6% Preference Share Capital	18,00,000	
Arrears of Preference Dividend (18,00,000 × 6% × 3 years)	3,24,000	
Contingent Liability	24,000	
Unrecorded Liability	6,000	26,34,000
Net Assets		2,32,500

$$\text{Value per Share} = \frac{2,32,500}{3,00,000} = ₹0.775$$

Illustration 39

Yield Method

From the following information, calculate the value per equity share:

	(₹)
5,000 8% Preference Shares of ₹100 each	5,00,000
75,000 Equity Shares of ₹10 each, ₹8 per share paid-up	6,00,000
Expected Profits per Year Before Tax	2,80,000
Rate of Tax	50%
Transfer to General Reserve Every Year	20% of the Profit
Normal Rate of Earnings	10%

(Madras, B.Com. (G & AF), Nov 2010)

Solution:

Calculation of Profilt Available for Equity Dividend

		₹
Expected Profit	2,80,000	
Less: Tax at 50%	1,40,000	1,40,000
Less: Transfer to General Reserve at 20%		28,000
Profit after General Reserve & Tax		1,12,000
Less: 8% Preference Dividend on ₹5,00,000		
(5,00,000 × 8/100)		40,000
Profit Available for Equity Dividend		72,000

Calculation of Expected Rate of Return

$$\textit{Expected Rate of Return} = \frac{\textit{Profit Available for Equity Dividend}}{\textit{Paid-up Equity Capital}} \times 100$$

$$= \frac{72{,}000}{6{,}00{,}000} \times 100 = 12\%$$

Calculation of Value of the Equity Share

$$\textit{Yield Value per Share} = \frac{\textit{Expected Rate of Return}}{\textit{Normal Rate of Return}} \times \textit{Paid-up Value per Equity Share}$$

$$= \frac{12\%}{10\%} \times ₹8 = ₹9.60$$

Illustration 40

The issued share capital of a company was ₹10,00,000, consisting of 10,000 equity shares of ₹100 each. The net profits for the last five years were: ₹1,00,000; ₹80,000, ₹1,20,000 , ₹1,60,000 and ₹1,40,000; of which, 20% was placed to reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 12%.

Compute the value of the company's share by the yield value method.

[Madras University, B.Com. (CS), Apr 2007]

Solution:

Calculation of Profit Available for Equity Shareholders

₹

$$\text{Average Profit} = \frac{1,00,000 + 80,000 + 1,20,000 + 1,60,000 + 1,40,000}{5}$$

Average Profit	1,20,000
Less: Transfer to Reserve at 20% on 1,20,000	24,000
Profit Available for Equity Dividend	96,000

Calculation of Expected Rate of Return

$$\textit{Expected Rate of Return} = \frac{\textit{Profit Available for Equity Dividend}}{\textit{Paid-up Equity Capital}} \times 100$$

$$= \frac{96,000}{10,00,000} \times 100 = 9.6\%$$

Calculation of Value of the Equity Share

$$\textit{Yield Value per Share} = \frac{\textit{Expected Rate of Return}}{\textit{Normal Rate of Return}} \times \textit{Paid-up Value per Equity Share}$$

$$= \frac{9.6\%}{12\%} \times ₹100 = ₹80$$

Illustration 41

When only few shares are sold and when majority shares are sold

From the following particulars relating to AB Ltd., calculate the value of shares if (i) only a few shares are to be sold and if (ii) majority shares are to be sold.

(a) Share Capital: 20,000 shares of ₹100 each, fully paid.
(b) Profit (after deduction of tax and dividend) for the last three years: ₹4,50,000; ₹7,00,000; and ₹5,50,000;
(c) Dividend paid for the last three years: 12%, 15%,18%
(d) Normal rate of return: 10%.

Solution:

(i) Only Few Shares are to be Sold

$$\text{Average Rate of Dividend} = \frac{12 + 15 + 18}{3} = 15\%$$

$$\textit{Yield Value per Share} = \frac{\textit{Expected Rate of Return}}{\textit{Normal Rate of Return}} \times \textit{Paid-up Value per Equity Share}$$

$$= \frac{15\%}{10\%} \times ₹100 = ₹150$$

(ii) When Majority of Shares are to be Sold

(a) Average Profit of Last Three Years

$$\text{Average Profit} = \frac{4{,}60{,}000 + 7{,}00{,}000 + 5{,}50{,}000}{3} = ₹5{,}70{,}000$$

(b) Calculation of Expected Rate of Return

$$\textit{Expected Rate of Return} = \frac{\textit{Profit Available for Equity Dividend}}{\textit{Paid-up Equity Capital}} \times 100$$

$$= \frac{5{,}70{,}000}{20{,}00{,}000} \times 100 = 28.5\%$$

(c) Yield Value per Share

$$\textit{Yield Value per Share} = \frac{\textit{Expected Rate of Return}}{\textit{Normal Rate of Return}} \times \textit{Paid-up Value per Equity Share}$$

$$= \frac{28.5\%}{10\%} \times ₹100 = ₹285$$

Illustration 42

The paid-up share capital of Soundaraya Ltd. consists of 4,000 8% preference shares of ₹100 each and 20,000 equity shares of ₹50 each. According to Articles of Association, the preference shares are entitled to participate in the surplus profit, to the extent of 1/10 of profits remaining after payment of 8% dividend on preference shares and 12% dividend on equity shares. The balance of profit is available to equity shareholders.

The average annual profits of the company are ₹3,92,000 after providing for depreciation and taxation. It is considered necessary to transfer ₹40,000 per annum to reserve fund. The normal rate of return expected on preference shares and equity share in the company.

Solution:

(i) Calculation of Profits Available to Equity Shareholders

	(₹)
Average Profit	3,92,000
Less: Transfer to Reserve Fund	40,000
	3,52,000
Less: Preference Dividend @ 8% on ₹4,00,000	32,000
	3,20,000
Less: Equity Dividend @ 12% on ₹10,00,000	1,20,000
	2,00,000
Less: Surplus for Preference Shareholders $\frac{1}{10}$ on ₹2,00,000	20,000
Surplus Profit Available for Equity Shareholders	1,80,000

$$\text{Total Profit of Preference Shareholders} = ₹32{,}000 + 20{,}000 = ₹52{,}000$$

$$\text{Rate of Dividend} = \frac{₹52{,}000}{4{,}00{,}000} \times 100 = 13\%$$

$$\text{Value of Preference Shares} = \frac{13\%}{10\%} \times ₹100 = ₹130$$

$$\text{Total Profit Available for Equity Shareholders} = ₹1{,}20{,}000 + 1{,}80{,}000 = ₹3{,}00{,}000$$

$$\text{Rate of Dividend} = \frac{₹3{,}00{,}000}{1{,}00{,}000} \times 100 = 30\%$$

$$\text{Value of Equity Share} = \frac{30\%}{12\%} \times ₹50 = ₹125$$

Illustration 43

Majority and Minority Shareholdings

From the following particulars, calculate the value of equity shares from the point of view of (i) Majority holdings and (ii) Minority holdings

(a) Share Capital: 40,000 equity shares of ₹10 each, fully paid
(b) Profits (after deduction of tax) for the last three years: ₹90,000; 1,20,000; and 1,14,000
(c) Dividend paid for the last three years: 12%,17% and 16%
(d) Normal rate of return: 12%

Solution:

I. $$\begin{array}{c}\textit{Value of each Equity Share}\\ \textit{– Majority Holdings}\end{array} = \frac{\textit{Expected Rate of Return}}{\textit{Normal Rate of Return}} \times \textit{Paid-up Value}$$

(i) $$\text{Average Profit for the Last Three Years} = \frac{90{,}000 + 1{,}20{,}000 + 1{,}14{,}000}{3} = ₹1{,}08{,}000$$

(ii) $$\textit{Expected Rate of Return} = \frac{\textit{Profit Available for Equity Dividend}}{\textit{Paid-up Equity Capital}} \times \textit{100}$$

$$= \frac{1{,}08{,}000}{4{,}00{,}000} \times 100 = 27\%$$

$$= \frac{27\%}{12\%} \times ₹10 = ₹22.5$$

II. *Value of Each Equity Share – Minority Holdings*

$$\text{Average Rate of Dividend} = \frac{12\% + 17\% + 16\%}{3} = 15\%$$

$$\frac{\textit{Yield Value}}{\textit{per Share}} = \frac{\textit{Expected Rate of Return}}{\textit{Normal Rate of Return}} \times \textit{Paid-up Value per Equity Share}$$

$$= \frac{15\%}{12\%} \times ₹10 = ₹12.5$$

Illustration 44

The directors of a private company, on the death of a principal shareholder, consult you as to the real value of the share. You find the dividends for the last three years have been 20%, 30%, and 25%. You came to the conclusion that on the basis of an average dividend of 12½% over the last three years, the shares (which are of ₹100 each) should be deemed to be worth par and that for every half-percent (1/2%) paid more or less than the 12½ over the last three years basis, the shares should be worth ₹3.50 more or less than par. On this basis, what would be the value of the deceased shareholder's share?

Solution:

Calculation of Average Dividend

Dividend for the Last Three Years = 20% + 30% + 25%

$$\text{Average Dividend} = \frac{20\% + 30\% + 25\%}{3} = 25\%$$

Value per Share at 12½ % Dividend = ₹100

It is stated in the problem that for every ½ % increase in dividend above 12 ½ %, the shares are worth ₹3.50 more.

Therefore, for 12½ % increases in dividend, its worth should be

½ % – 3.50

12 ½ – ?

= 25/2 × 2/1 × 3.50 = ₹87.50

Value of the Deceased Shareholders' Share

= ₹100 + ₹87.50

= ₹187.50

Illustration 45

Net Assets Method and Yield Method

On 31st December 1998, the balance sheet of a limited company disclosed the following position:

Liabilities	(₹)	Assets	(₹)
Issue Capital in ₹10 Shares	8,00,000	Fixed Assets	10,00,000
Profit and Loss A/c	40,000	Current Assets	4,00,000
Reserves	1,80,000	Goodwill	80,000
5% Debentures	2,00,000		
Current Liabilities	2,60,000		
	14,80,000		14,80,000

On 31st December 1998, the fixed assets were independently valued at ₹7,00,000 and the goodwill at ₹1,00,000. The net profit for the year were 1996: ₹1,03,200; 1997: ₹1,04,000 and 1998: ₹1,03,300; of which, 20% was placed to reserve. This proportion being considered reasonable in the industry in which the company is engaged and where a fair return on investment may be taken at 10%. Compute the value of the company shares by (a) the net asset method and (b) the yield method.

[Madras University, B.Com. (CS) (old), Nov 2009]

Solution:

I. Net Assets Method

Calculation of Intrinsic Value of Shares

	(₹)	(₹)
Assets at Market Value		
Fixed Assets at Market Value		7,00,000
Current Assets as per Balance Sheet		4,00,000
Goodwill (as per valuation)		1,00,000
		12,00,000
Less: Liabilities		
5% Debentures	2,00,000	
Current Liabilities	2,60,000	
	4,60,000	
Net Assets		7,40,000

$$Intrinsic\ Value\ per\ Share = \frac{Net\ Assets}{Number\ of\ Equity\ Shares}$$

$$= \frac{₹7{,}40{,}000}{80{,}000 \text{ shares}} = ₹9.25$$

II. Yield Value Method

(i) Calculation of Average Expected Future Profits

	₹
Net Profit for Three Years before Transfer to Reserve (₹1,03,200 + 1,04,000 + 1,03,300)	3,10,500
Average Profits before Transfer to Reserve = 3,10,500/3	1,03,500
Less: Transfer to Reserve @ 20%	20,700
Average Profits after Transfer to Reserve	82,800

(ii) Calculation of Expected Return on Equity Share Capital

$$Expected\ Rate\ of\ Return = \frac{Expected\ Profits}{Equity\ Paid\text{-}up\ Capital} \times 100$$

$$= \frac{82{,}800}{8{,}00{,}000} \times 100 = 10.35\%$$

(iii) Calculation of Yield Value of Share

$$Yield\ Value\ per\ Share = \frac{Expected\ Rate\ of\ Return}{Normal\ Rate\ of\ Return} \times Paid\text{-}up\ Value\ per\ Share$$

$$= \frac{10.35\%}{10\%} \times ₹10 = ₹10.35$$

Illustration 46

The following is the balance sheet of Robert Lee Ltd., as on 31st December 1998:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Land and Building	1,10,000
20,000 Shares of ₹10 each	2,00,000	Plant and Machinery at Cost (less Depreciation)	1,30,000
General Reserve	40,000	Trademarks	20,000
Taxation Reserve	60,000	Stock	48,000
Workmen Savings Account	30,000	Debtors	88,000
Profit and Loss A/C	32,000	Cash	52,000
Sundry Creditors	98,000	Preliminary Expenses	12,000
	4,60,000		4,60,000

The plant and machinery are worth ₹1,20, 000 and land and buildings have been valued at ₹2,40,000 by an independent valuer. ₹8,000 of the debts is bad. The profits of the company have been as follows:

1996: ₹80,000; 1997: ₹90,000 and 1998: ₹1,60,000. It is the company's practice to transfer 25% of the profits to reserve. Ignoring taxation, find out the value of shares. Similar companies give a yield of 10% on the market value of their shares. Goodwill may be taken to be worth ₹1,60,000.

[Bharathiar, B.Com., Apr 2005]

Solution:

(i) Net Asset Method

Particulars	(₹)	(₹)
Assets at Market Value:		
Goodwill		1,60,000
Land and Building		2,40,000

(*Contd.*)

Plant and Machinery		1,20,000
Trademarks		20,000
Stock		48,000
Debtors (less Bad Debts)		80,000
Cash		52,000
Total Assets		7,20,000
Less: Liabilities:		
Taxation Reserve	60,000	
Workmen Saving A/c	30,000	
Sundry Creditors	98,000	1,88,000
Net Assets		5,32,000

$$\textit{Intrinsic Value per Share} = \frac{\textit{Net Asset}}{\textit{Number of Equity Shares}}$$

$$= \frac{₹5,32,000}{20,000 \text{ shares}} = ₹26.60$$

(ii) Yield Value Method

1. Profits Available for Dividend

Particulars	(₹)
Total Profits for Three Years (₹80,000 + 90,000 + 1,60,000)	2,76,000
(–) Bad Debts	8,000
Total Profit	2,68,000
Average Profits $= \dfrac{₹2,68,000}{3 \text{ years}}$	89,333
Less: 25% of the Average Profit transferred to General Reserve (89,333 × 25%)	22,333
Profit Available for Dividend	67,000

2. Expected Rate of Return

$$\text{Expected Rate of Return} = \frac{\text{Profit Available for Return}}{\text{Paid-up Capital}} \times 100$$

$$= \frac{67,000}{200,000} \times 100 = 33.5\%$$

3. Yield Value per Share

$$\text{Yield Value per Share} = \frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}} = 33.5\%$$

$$= \frac{33.5\%}{10\%} \times ₹10 = ₹33.5$$

Illustration 47

Valuation of fully paid and partly paid shares of different denominations—Net Assets Method and Yield Method

The following is the summarised balance sheet of Harini Co. Ltd., as on 31st December 1998.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets (including goodwill)	2,20,000
30,000 Equity Shares of ₹10 each, fully paid	3,00,000	Current Assets:	
20,000 Equity Shares of ₹7.5 each, fully paid	1,50,000	Stock	2,00,000
10,000 Equity Shares of ₹5 each, fully paid	50,000	Book Debts	1,40,000
General Reserve	1,20,000	Cash at Bank	1,40,000
Sundry Creditors	80,000		
	7,00,000		7,00,000

(a) The average profit for the last four years, after charging income tax is ₹1,00,000.
(b) Fair return on investment: 10%
(c) It is the practice of the company to transfer 20% of profit to reserve.

You are required to calculate the break-up value and yield value of each kind of equity shares.

Solution:

Calculation of Break-up Value

Particulars	(₹)
Asset as taken at Market Value:	
Fixed Assets	2,20,000
Stock	2,00,000
Book Debts	1,40,000
Cash at Bank	1,40,000
	7,00,000
Less: External Liabilities	80,000
Net Assets	6,20,000

$$\text{Value of ₹1 of Paid-up Capital} = \frac{₹6,20,000}{₹6,00,000}$$

$$= ₹1.24$$

Value of each ₹10 Share = ₹1.24 × 10 = ₹12.40
Value of each ₹7.50 Share = ₹1.24 × 7.50 = ₹9.30
Value of each ₹5 Share = ₹1.24 × 5 = ₹6.20

Calculation of Yield Value

Profit Available for Dividend

Particulars	(₹)
Average Profit	1,00,000
Less: Transfer to Reserve @ 20%	20,000
Profit Available for Dividend	80,000

Expected Rate of Return

$$\frac{₹80,000}{6,00,000} \times 100 = 16\%$$

Value of each ₹10 Share = $\frac{16\%}{10\%} \times ₹10 = ₹16$

Value of each ₹7.50 Share = $\frac{16\%}{10\%} \times ₹7.50 = ₹12$

Value of each ₹5 Share = $\frac{16\%}{10\%} \times ₹5 = ₹8$

Illustration 48

Determine, from the information given below, the value of each class of equity shares, both under asset backing method and earning capacity method:

(a) Paidup Capital (on 31.12.1998)

	(₹)
30,000 Equity Shares of ₹10 each, fully paid-up	3,00,000
25,000 Equity Shares of ₹10 each, ₹6 per share called and paid-up	1,50,000
500, 12% Preference Shares of ₹100 each, fully paid-up	50,000
General Reserve	1,19,500
Profit & Loss A/c	80,000

(b) The preference shares are preferential as to the return of capital but do not participate in any surplus assets in case the company is winding up.

(c) The average annual profits of the company are ₹59,200.

(d) All assets are worth their book value.

(e) 10% return is considered fair in this type of company

[C.U.B.Com., (Hons) New]

Solution:

Value of Shares Under Assets Backing Method

Net Assets:	(₹)
Paid-up Equity Share Capital	
30,000 Equity Shares of ₹10 each, fully paid-up	3,00,000
25,000 Equity Shares of ₹10 each, ₹6 paid-up	1,50,000
General Reserves	1,19,500
Profit & Loss A/c	80,000
	6,49,500
Add: Notional call at ₹4 on 25,000 shares	1,00,000
Net assets	7,49,500

$$\text{Intrinsic Value per Equity Share} = \frac{7,49,500}{55,000} = ₹13.63$$

Therefore, value of each type of equity share is:
Fully Paid-up Share of ₹10 = ₹13.63
Partly Paid-up Share of ₹6 = ₹9.63 (₹13.63 – 4.00)

Value of Shares Under Earning Capacity Method

Average Annual Profit	59,200
Less: Preference Dividend @ 12 % on ₹50,000	6,000
Maintainable Profit	53,200

$$\text{Paid-up Equity Share Capital} = 3,00,000 + 1,50,000$$
$$= ₹4,50,000$$

Therefore,

$$\textit{Rate of Dividend} = \frac{\textit{Profit}}{\textit{Paid-up Capital}} \times 100$$
$$= \frac{53,200}{4,50,000} \times 100 = 11.82\%$$

$$\text{Value of each Fully Paid Equity Share} = \frac{11.82\%}{10\%} \times ₹10 = ₹11.82$$

$$\text{Value of ₹6 Paid-up Equity Share} = \frac{11.82\%}{10\%} \times ₹6 = ₹7.10$$

Illustration 49

Under the articles of a private limited company dealing in wines and tobacco, you, as an auditor, have to annually fix the fair value of the shares. On 31st December 2008, the company's position was as follows:

Liabilities		(₹)	Assets		(₹)
1,000,8% Preference Shares of ₹100 each, fully paid-up		1,00,000	Building at Cost		80,000
4,000 Equity Shares of ₹100 each, fully paid		4,00,000	Furniture at Cost		3,000
Reserve Fund		1,50,000	Stock-in-trade (market value)		4,50,000
Profit and Loss A/c:			4% Govt. Securities at Cost (face value ₹400,000)		3,80,000
Balance on 01.01.2008	80,000		Book Debts	300,000	
Profit for 2008	4,30,000	5,10,000	(–) Provision	20,000	2,80,000
			Cash and Bank		
			Balances		60,000
			Preliminary Expenses		10,000
Provision against:					
Building	10,000				
Investments	45,000	55,000			
Creditors		48,000			
		12,63,000			12,63,000

You are given the following information:

(a) The company's prospects for 2009 are equally good.
(b) The buildings are now worth ₹3,50,000.
(c) Public companies doing similar business show a profit-earning capacity of 15%.
(d) Profits for the past three years have shown an increase of ₹50,000 annually.
(e) Provide for income tax at 50% and goodwill is to be valued at three years' purchase of super profits. Calculate the fair value of shares, as on 31st December 2008.

Solution:

For calculation of intrinsic value, it is necessary to calculate the value of goodwill:

Calculation of Average Capital Employed

Particulars	(₹)
Buildings	3,50,000
Furniture	3,000
Stock-in-trade	4,50,000
Book Debts	2,80,000
Cash and Bank Balance	60,000

(*Contd.*)

	11,43,000
Less: Creditors	48,000
	10,95,000
Less: ½ of the Profits (excluding income on investment after taxes)	1,03,500
Average Capital Employed	9,91,500

Calculation of Adjusted Annual Profit

Particulars	(₹)
Profit for the Year	4,30,000
Less: Income on Investment (4,00,000 × 4%)	16,000
	4,14,000
Less: Income Tax (50% on 4,14,000)	2,07,000
	2,07,000

Calculation of Average Profit for Three Years

Particulars	(₹)
Profit for 1998 (given)	4,30,000
Profit for 1997	3,80,000
Profit for 1996	3,30,000
	11,40,000

Profit for 1997 = 1998 Profit; ₹4,30,000 – ₹50,000 = ₹3,80,000
Profit for 1996 = 1997 Profit; ₹3,80,000 – ₹50,000 = ₹3,30,000

$$\text{Average Profit} = \frac{₹11,40,000}{3} = ₹3,80,000$$

Calculation of Actual Average Profits

Particulars	(₹)
Average Profits, as calculated above	3,80,000
Less: Income from Investment (i.e. non-trading asset)	16,000
	3,64,000
Less: 50% Income Tax	1,82,000
Actual Average Profit	1,82,000

Calculation of Normal Profit

Normal Profits = Average Capital Employed × Normal Rate of Return

= 9,91,500 × 15%

= ₹1,48,725

Calculation of Super Profits

Super Profits = Actual (average) Profits – Normal Profits

= ₹1,82,000 – ₹1,48,725

= ₹33,275

Calculation of Value of Goodwill

$$Goodwill = Super\ Profits \times Number\ of\ Years'\ Purchase$$
$$= ₹33{,}275 \times 3 \text{ years}$$
$$= ₹99{,}825$$

Valuation of Shares:

Calculation of Intrinsic Value

Particulars	(₹)	(₹)
Asset at Market Value		
Goodwill		99,825
Buildings		3,50,000
Furniture		3,000
Stock-in-trade		4,50,000
Investment (less Provision)		3,35,000
Book Debts		2,80,000
Cash and Bank Balance		60,000
Less: Liabilities		15,77,825
Creditors	48,000	
Preference Share Capital	1,00,000	1,48,000
Net Assets for Equity Shareholders		14,29,825

$$Net\ Assets\ for\ Equity\ Shareholders = \frac{Intrinsic\ Value\ per\ Share}{Number\ of\ Equity\ Shares}$$
$$= \frac{₹14{,}29{,}825}{4{,}000 \text{ shares}} = 357.46$$

Calculation of Yield Value

Particulars		(₹)
Average Profits		3,80,000
Less: Taxation (50%)		1,90,000
		1,90,000
Less: Preference Divided		8,000
Profit Available for Equity Dividend		1,82,000

Expected Rate of Return

$$Expected\ Rate\ of\ Return = \frac{Profit\ Available\ for\ Equity\ Dividend}{Paid\text{-}up\ Capital} \times 100$$
$$= \frac{1{,}82{,}000}{400{,}000} \times\ = 45.5\%$$

Yield Value per Share

$$\text{Yield Value per Share} = \frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{45.5\%}{15\%} \times ₹10 = ₹303$$

Calculation of Fair Value

$$\text{Fair Value} = \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

$$= \frac{357.46 + 303}{2} = ₹303.23$$

THEORY QUESTIONS

I. Short-Answer Questions

1. Give the definition of Goodwill.
2. Why is Valuation of Goodwill needed?
3. What are the important factors that affect goodwill?
4. How do we determine the Normal Rate of Return?
5. What is Capital Employed?
6. While evaluating goodwill, why do we consider average capital employed?
7. What do you understand by Number of Year's Purchase?
8. What are the methods of calculating goodwill based on super profit?
9. Explain Annuity Factor.
10. What do you mean by Normal Rate of Return?
11. Give the factors that affect the Value of Shares.
12. State the method to calculate the intrinsic value of shares.
13. While determining the value of shares, what are the factors to be considered in valuing the assets?

II. Long-Answer Questions

1. Discuss the various methods of calculating Goodwill.
2. Explain the factors affecting the value of goodwill of a company.
3. Explain the treatment of Partly Paid-up Shares.
4. What are the different classes of equity shares?
5. "Valuation of shares is not an exact science- it is a sophisticated form of approximation." Comment.

OBJECTIVE-TYPE QUESTIONS

I. Multiple choice questions:

1. State which one of the following is not a main source for generating goodwill.
   (a) Providing easy credit facilities to customers
   (b) Location of the firm
   (c) Quality of the products
   (d) Name and fame of the management
2. State which one of the following is not the main factor that would affect the value of goodwill.
   (a) Profitability (b) Size of the business
   (c) Normal rate of return (d) Capital employed
3. Which one of the following items is to be excluded while computing capital employed?
   (a) All fixed assets (b) All current assets
   (c) Fictitious assets (d) Trade investments
4. Which one of the following has to be included while calculating capital employed?
   (a) Patents, trademarks and copyrights
   (b) Discount in issue of shares and debentures
   (c) Provision for bad debts
   (d) Bills receivable
5. State which of the following methods is not a recognised method for goodwill valuation.
   (a) Average profit method (b) Annuity method
   (c) Capitalisation method (d) None of these
6. "Capital employed" represents the funds provided by:
   (a) Creditors (b) Debenture holders
   (c) Shareholders (d) All of these
7. The average rate of return of similar firms in the similar industry is to be taken as:
   (a) Normal rate of return (b) Expected rate of return
   (c) Average rate of return (d) None of these
8. State the following factor, which will not affect the value of shares.
   (a) Demand and supply of shares
   (b) Nature of company's business
   (c) Profit-earning capacity of the company
   (d) Labour force
9. Under the Yield Method, the value of equity shares is calculated under the presumption that the company would be:
   (a) A going concern (b) Liquidated
   (c) Either (a) or (b) (d) None of these

[*Ans:* 1. (a) ; 2. (b) ; 3. (c) ; 4. (d) ; 5. (d) ; 6. (c) ; 7. (a) ; 8. (d) ; 9. (a)]

II. True and False

1. Goodwill is an intangible asset.
2. Generally, goodwill is not recorded in the books of accounts.
3. Goodwill means the capacity of a business to earn profit at the current accounting period.
4. Income from non-trading assets should be excluded while evaluating goodwill.
5. Profit of the past years earned by the firm is a major factor that affects the value of goodwill.
6. All current liabilities should be excluded while computing capital employed.
7. While computing capital employed, fictitious assets should be included.
8. While computing average capital employed, provision for taxation should be treated as a part of profit.
9. The amount of capital employed is directly proportional to the value of goodwill.
10. If the trend is increase in profit every year, then, weighted average method can be used to calculate the future maintainable profit.
11. Normal rate of return refers to the rate of profit normally earned by other similar firms in a particular industry.
12. The value of goodwill will be maximum by the use of capitalisation of super profit method.
13. The proportion of liabilities and the capital affects the value of shares.
14. Investment should be valued at their book value while valuing the intrinsic value of shares.
15. While valuing the intrinsic value of shares by considering the assets value, the provision for bad and doubtful debts should not be taken into consideration.
16. The claim for surplus should not be deducted from the value of the assets in the case where the preference shares are participating preference shares.
17. It is imperative to convert partly paid-up shares into fully paid-up shares by making a notional call, in the case of partly paid-up and fully paid-up shares.
18. The intrinsic value of shares and the yield value of shares are not connected with the fair value of shares.
19. The expected rate of return is computed when only a few shares are to be sold
20. Asset backing method is another name of intrinsic value method.

[*Ans:* 2, 4, 8, 10, 11, 12, 13, 17, 20 – True; and
1, 3, 5 ,6, 7, 9, 14, 15, 16, 18, 19 – False]

III. Fill in the Blanks

1. Goodwill is an ____________ asset.
2. Goodwill is the ____________ value of a firm's anticipated excess earnings.
3. While evaluating goodwill, the purchaser is keen with regard to future _________.
4. The rate of earnings, which the investors in general expect on their investment, refers to ____________.

5. Capital employed is a combination of fixed assets and net ____________.
6. The average capital employed may be determined by either _______ or _______ approach or way.
7. Goodwill is equal to average profit multiplied by ____________.
8. ____________ is referred to as the excess of expected average profit over normal profit.
9. Normal profit is equal to average capital employed multiplied by ____________.
10. The average super profit is capitalised at a certain ____________, under capitalisation of super profit method.
11. Goodwill is equal to ____________ multiplied by annuity rate.
12. Goodwill is equal to ____________ net tangible assets.
13. It is essential to determine the value of the ____________ of the company, to ascertain the intrinsic value of shares.
14. Goodwill should be valued at ____________, while determining the value of shares.
15. The finished goods may be valued at ____________, while calculating the value of inventories.
16. Liabilities are valued at ____________.
17. Intrinsic value per share is equal to ____________ divided by the number of equity shares.
18. Yield value per share is equal to expected rate of return divided by normal rate of return and multiplied by ____________.
19. Fair value of shares is the ____________ of the net assets value and yield value of shares.
20. Market value method is also known as ____________.

[*Ans:* 1. Intangible; 2. Present; 3. Maintainable profits; 4. Normal rate of return; 5. Working capital; 6. Assets side or liabilities side; 7. Number of years' purchase; 8. Super profits; 9. Normal rate of return; 10. Rate of return; 11. Average annual super profit; 12. Capitalised value of business; 13. Net assets; 14. Current cost or cost price; 15. Cost price; 16. Book value; 17. Net equity; 18. Paid-up value per equity share; 19. Average; 20. Yield method]

EXERCISE PROBLEMS

1. Goodwill is to be valued at three years' purchase of five years' average profits. The profits for the last five years were:

   1994: ₹2,400; 1995: ₹3,000; 1996: ₹3,400; 1997: ₹3,200; 1998: ₹4,000.

   Calculate the amount of goodwill.

   [Madras, B.Com (G & A.F.); Nov 2010; B.Com (CS) (ICE); Oct 2009]

   [*Ans:* Average profit: ₹3,200; Goodwill: ₹9,000]

2. Calculate the amount of goodwill in the following case, on the basis of three years' purchase of the last four years' average profits. The profits and losses for the last four years are:

Year	(₹)
1995	10,000
1996	16,000
1997	(–) 6,000
1998	12,000

[Madras, B.Com (CS) Apr 2008; Apr 2007]

[*Ans:* Goodwill: ₹24,000]

3. Total assets of a firm are ₹8,40,000. The liabilities of the firm are ₹4,40,000. Normal rate of return in this class of business is 12 ½%. The firm earned a profit of ₹64,000. Calculate goodwill, if it is to be valued at two years' purchase of super profit. **[Madras, B.Com (G & A.F) Nov 2011]**

[*Ans:* Goodwill: ₹28,000, i.e. 64,000 – 50,000 = 14,000 × 2]

4. Goodwill is to be valued at three years' purchase of five years' average profits. The profits for the last five years of the firm were:

   1994: ₹4,800; 1995: ₹6,000; 1996: ₹6,400; 1998: ₹8,000. Calculate the amount of goodwill.

   [*Ans:* Average profit: ₹6,400; and Value of goodwill = ₹19,200]

5. Vidhya & Co. decided to purchase a business for ₹7,20,000. Its profits for the last four years were:

   2006: ₹2,00,000; 2007: ₹1,28,000; 2008: ₹2,20,000; 2009: ₹2,80,000. The owner of the business was personally managing this. A manager to replace him has to be paid ₹27,000 per annum.

   You are required to calculate the value of goodwill, which is valued on the basis of three years of purchase of the average net profit for the last four years.

   [*Ans:* Goodwill: ₹5,40,000]

6. P Ltd. proposed to purchase the business carried on by M/s K. Goodwill for this purpose is agreed to be valued at three years' purchase of the average profit of the past four years. The appropriate weights to be used are as follows:

   2006: 1; 2007: 2; 2008: 3; 2009: 4.

   Profits for these years were:

   2006: ₹50,000; 2007: ₹55,000;

   2008: ₹60,000; 2009: ₹75,000.

   Compute the value of the goodwill of the firm.

   [*Ans:* Goodwill: ₹1,92,000]

7. From the following information, calculate the value of goodwill on the basis of three years' purchase of the super profit:

   (a) Average capital employed in the business: ₹35,00,000

   (b) Net trading profit of the firm for the past three years: ₹5,38,000; ₹4,53,500; ₹5,62,000

   (c) Rate of interest expected from capital has regard to the risk involved: 12%

   (d) Fair remuneration to the partners for their services: ₹60,000 p.a.

(e) Sundry assets of the firm: ₹37,73,810

(f) Sundry liabilities of the firm: ₹1,56,645

[*Ans:* Super Profit: ₹38,000; Goodwill: ₹1,14,0000]

8. Calculate the amount of goodwill in the following case, on the basis of two years' purchase of the last four years average profits. The profits and losses for the last four years are:

Year	Amount (₹)
1995	60,000
1996	96,000
1997	36,000 (Loss)
1998	72,000

[*Ans:* Average profit: ₹48,000 and Value of goodwill: ₹96,000]

9. The following is the balance sheet of Sun Ltd., as on 31st December 2008.

Liabilities	(₹)	Assets	(₹)
50,000 Equity Shares of ₹10 each, fully paid	5,00,000	Goodwill	40,000
Profit & Loss A/c	1,10,000	Machinery	2,00,000
Sundry Creditors	40,000	Land	1,50,000
Bills Payable	10,000	Investment	60,000
		Stock	1,00,000
		Debtors	80,000
		Cash at Bank	20,000
		Preliminary Expenses	10,000
	6,60,000		6,60,000

From the above information, you are asked to ascertain the value of each equity share of the company by net asset method.

[*Ans:* Value of equity share: ₹12]

Hint: Goodwill is assumed to be worth the amount given.

10. The balance sheet of Z Ltd., as on 31st December 2007.

Liabilities	(₹)	Assets	(₹)
20,000 Equity Shares	2,00,000	Goodwill	30,000
1000, 9% Pref. Shares (₹100 each)	1,00,000	Fixed Assets	3,50,000
Provision for Taxation	2,00,000	Investment 6% Govt. Loan	45,000
10% Debentures	90,000	Current Assets	2,00,000
Creditors	60,000	Selling Commission on Shares	10,000
		Discount on Issue of Debentures	15,000
	6,50,000		6,50,000

Find the value of an equity share by net worth method.

[*Ans:* Value of equity share: ₹8.75;
Goodwill is assumed to be worth the given figure]

11. From the following particulars, compute the value per equity share under net assets method:

    Total assets at market value: ₹49,80,000

    Total outside liabilities: ₹19,00,000

    2,00,000 equity shares of ₹10 each: ₹20,00,000

    [*Ans:* Value per equity share: ₹15.40 (i.e. 30,80,000/ 2,00,000]

12. Compute the value of an equity share under break-up value method with the help of following data, assuming preference shares have no priority as to capital and dividend.

    6% preference shares of ₹10 each, fully paid: ₹2,00,000

    Equity shares of ₹120 each, fully paid: ₹3,00,000

    Net assets available to shareholders: ₹4,89,500

    [*Ans:* Value per equity share = ₹117.48]
    (i.e. 4,89,500 × 3/5 × 1/2,500)

    Hint: As the preference shareholders have no priority, they are treated like equity shares.

13. Ascertain the value of an equity share under net worth method from the following data, assuming preference shares have priority as to the payment of capital only:

    10% preference shares of ₹10 each, fully paid: ₹6,00,000

    Equity shares of ₹10 each, fully paid: ₹8,00,000

    Net assets available to shareholders: ₹28,00,000

    [*Ans:* Value per equity share: ₹27.50]
    (22,00,000/80,000 shares)

14. XYZ Co. Ltd. has equity share capital as given below:

    30,000 equity shares of ₹10 each, fully paid-up: ₹3,00,000

    10,000 equity shares of ₹10 each, ₹8 paid-up: ₹80,000

    Net assets available to Equity shareholders: ₹4,80,000

    Determine the value of both the shares under net assets method

    [*Ans:* Value per share: Fully paid: ₹12.50 (i.e. 5,00,000/40,000);
    Partly paid: ₹10.50 (i.e. 12.50 – 2)]

    Hint: Add notional calls (i.e. uncalled capital of ₹20,000 (10,000 × 2) to net assets available to equity shareholders.

15. Ascertain the expected rate of return from the particulars given below:

    80,000 equity shares of ₹10 each, fully paid: ₹8,00,000

    Expected profit per year before tax: ₹5,20,000

    Rate of tax: 50%

    Transfer to general reserve every year: 20% of profit

    Preference share dividend: ₹40,000

    [*Ans:* E.R.R: 21% Profit available for equity shareholders: ₹1,68,000
    (i.e. 5,20,000 – 2,60,000 – 52,000 – 40,000)]

16. Compute the yield value of the equity shares on the basis of dividend yield from the information given below:

    Average profit after tax: ₹17,000

    Preference share dividend: ₹5,400

    Transfer to general reserve: 10%

    9,000 equity shares of ₹10 each, fully paid: ₹90,000

    Normal rate of dividend: 9%

    [*Ans:* Expected rate of dividend: 11% (i.e. 9,900/90,000 × 100); Yield value per share: ₹12.22 (i.e. 11/9x10)]

17. Calculate the yield value per share from the information given below:

    40,000 equity shares of ₹10 each, fully paid

    Normal rate of return: 8%

    Expected rate of return: 12% [*Ans:* Market value per share: ₹15]

18. X Ltd. has earnings per share of ₹60 and is quoted at ₹480. Y Ltd., which is a similar firm, has earnings per share of ₹48. What should be the value of the share of Y Ltd.?

    [*Ans:* PE ratio of X Ltd.: 480/60 = 8; Value of shares of Y Ltd.: 48 × 8 = ₹384]

19. From the following, you are required to ascertain the fair value of each share:

    1,00,000 equity shares of ₹10 each, fully paid: ₹10,00,000

    Net assets available to equity shareholders: ₹25,10,000

    Expected rate of return: 90%

    Normal rate of return: 10%

    [*Ans:* Intrinsic value: ₹25.10; Yield value: ₹90; Fair value: ₹57.55]

OTHER EXERCISES

1. Param Ltd. proposed to purchase the business carried on by Mr. Mohan. Goodwill for this purpose is agreed to be valued at three years' purchase of the average profit of the past four years. The appropriate weight to be used as:

    1994: 1; 1995: 2; 1996: 3; 1997: 4.

    Profits for these years were:

    1994: ₹20,000; 1995: ₹22,000; 1996: ₹24,000; 1997: ₹30,000.

    Compute the value of the goodwill of the firm.

    [*Ans:* Weighted average profits: ₹25,600; Value of goodwill: ₹76,800]

2. The following particular are available in respect of the business carried on by M R Ltd:

    (a) Profit earned:

    2004: ₹1,60,000; 2005: ₹2,00,000 and 2006: ₹2,40,000.

    (b) Profit of 2004 is reduced by ₹24,000, due to stock destroyed by fire and profit of 2005 included a non-recurring income of ₹16,000.

    (c) Profit of 2006 included ₹20,000 income on investment.

    (d) The stock is not insured and it is thought prudent to insure the stock in future. The insurance premium is estimated at ₹1,600 per annum.

(e) Fair remuneration to the proprietor (not taken in the calculation of profits) is ₹24,000 per annum.

You are required to calculate the value of goodwill on the basis of two years' purchase of average profit of the last three years.

[*Ans:* Adjusted average profits = ₹1,70,400; Value of goodwill = ₹3,40,800]

3. The following information is given:
   (a) Capital employed: ₹3,00,000
   (b) Normal rate of return on profit is 10%;
   (c) Net profits for five years were:

   First year: ₹28,800; second year: ₹30,800; third year: ₹33,800; fourth year: ₹34,800; fifth year: ₹35,800.

   Calculate the value of goodwill as per five years' purchase of super profits.

   [*Ans:* Super profits: ₹2,800; Value of goodwill: ₹14,000]

4. The following particulars are available in the business carried on by Mr. Kanan:
   (a) Capital invested: ₹2,40,000
   (b) Trading results:

Year	Profit/Loss	Amount (₹)
1995	Profits	1,20,000
1996	Profits	1,44,000
1997	Loss	16,000
1998	Profits	1,76,000

   (c) Market rate of interest on investment: 12%
   (d) Rate of risk return on capital invested in business: 3%
   (e) Remuneration from alternative employment of the proprietor: ₹60,000 per annum;

   Compute the value of goodwill of the business on the basis of three years' purchase of super profits, taking average of the last four years.

   [*Ans:* Super profits: ₹10,000; Value of goodwill: ₹30,000]

5. Mrs Vasuda invested ₹16,00,000 in a business. Her net profit before tax at 50% is ₹6,40,000; out of which, ₹48,000 was annual rent of own building used as business premises and ₹96,000 per annum as her salary were not deducted. For starting this business, she left a job fetching a monthly salary of ₹8,000. Before starting this business, she had invested this amount on 10% securities. Fair compensation for the risk involved is 2%. Calculate the value of goodwill on the three years' purchase of the average annual super profits.

   [*Ans:* Goodwill: ₹2,40,000; Super profits: ₹80,000;
   Adjusted average profits: ₹2,72,000; Normal profits: ₹1,92,000]

6. From the following information, calculate the value of goodwill on the basis of three years' purchase of the super profits:
   (a) Average capital employed in the business: ₹28,00,000;
   (b) Net trading profits of the firm for the past three years were ₹4,30,000; ₹3,62,800; and ₹4,50,000
   (c) Rate of interest expected from capital having regard to the risk involved: 12%

(d) Fair remuneration to the partner for their services: ₹48,000 per annum
(e) Sundry assets of the firm ₹10,54,762
(f) Sundry liabilities of the firm ₹1,11,329

[*Ans:* Goodwill: ₹91,200; Super profits: ₹30,000; Adjusted average profits: ₹3,66,400; Normal profits: ₹3,36,000]

7. The balance sheet of Chiti Ltd., as on 31st December 2008, was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
80,000 Shares of ₹10 each	8,00,000	Land and buildings	6,72,000
Profit & Loss A/c	1,60,000	Plant and machinery	4,80,000
Debentures	1,20,000	Furniture and fittings	40,000
Trade Creditors	1,60,000	5% tax free Govt. bonds	1,60,000
Provision for Taxation	72,000	Stock	16,000
Proposed Dividend	1,20,000	Book debts (Debtors)	48,000
		Cash	16,000
	14,32,000		**14,32,000**

The net profits of the company after charging depreciation and taxes were as follows:

2004: ₹1,36,000; 2005: ₹1,52,000; 2006: ₹144,000; 2007: ₹1,60,000; and 2008: ₹1,52,000.

On 23 December 2008, land and buildings were revalued at ₹7,60,000; plant and machinery at ₹5,68,000; and furniture and fittings at ₹32,000.

10% represents a fair commercial rate of returns on investment in the company.

Calculate the value of goodwill basing it at five years' purchase of the average super profits for the last five years.

[*Ans:* Goodwill: ₹2,56,000; Super profits: ₹51,200; Adjusted average profit: ₹140,800; Normal profits: ₹89,600; Net capital employed: ₹8,96,000]

8. The average net profits of a business as adjusted for valuation of goodwill amounted to ₹14,12,700. The net tangible assets employed were of the value of ₹87,00,000. But upon valuation, they amounted to ₹90,00,000. Assuming that 10% represented a fair commercial return, calculate the amount of goodwill by capitalising the super profits.

[*Ans:* Goodwill: ₹51,27,000; Super profits: ₹5,12,700; Normal profits: ₹9,00,000]

Note: Assume net tangible assets as a net capital employed.

9. The following information is given:

(a) Capital employed: ₹60,00,000
(b) Net profits for five years were:

2001: ₹5,76,000; 2002: ₹6,16,000; 2003: ₹6,76,000; 2004: ₹6,96,000 and 2005: ₹7,16,000;

The above profits, which included non-recurring profits on an average basis of ₹40,000 out of which it was deemed that even non-recurring profits had a tendency of appearing at the rate of ₹28,000 per annum.

(c) Normal rate of profit is 10%

You are required to calculate the value of goodwill as per capitalisation of super profits method.

[*Ans:* Goodwill: ₹4,40,000; Super profits: ₹44,000; Adjusted average profits: ₹6,44,000; Normal profits: ₹6,00,000]

10. The net profits of a company, after providing for taxation, for the past five years are ₹1,60,000; ₹1,68,000; ₹1,80,000; ₹1,84,000; and ₹1,88,000. The capital employed in the business is ₹16,00,000; on which, a reasonable return of 10% is expected. It is expected that the company will be able to maintain its super profits for the next five years. Calculate the value of goodwill of the business on the basis of an annuity of super profits, taking the present value of annuity of one rupee for five years at 10% interest as ₹3.78.

[*Ans:* Goodwill: ₹60,480; Super profits: ₹16,000; Adjusted average profits: ₹1,76,000; Normal profits: ₹1,60,000]

11. From the following particulars, find out the value of goodwill as per annuity method:
    (a) Capital employed: ₹12,00,000
    (b) Normal rate of return is 10%;
    (c) Present value of ₹1 for 5 years at 10% is ₹3.78;
    (d) Normal profits for five years:
    first year: ₹1,20,000; second year: ₹1,28,000; third year: ₹1,36,000; fourth year: ₹1,44,000; fifth year: ₹1,52,000;
    (e) Non-recurring income: ₹6,400
    (f) Non-recurring expenses: ₹4,000

[*Ans:* Goodwill: ₹51,408; Super profits: ₹13,600; Adjusted average profits: ₹1,33,600; Normal profits: ₹1,20,000]

12. The following particulars are available in respect of the business carried on by a trader:
    (a) Profit earned in 2007: ₹2,00,000; 2008: ₹2,40,000; 2009: ₹2,20,000;
    (b) Normal rate of profit :10%;
    (c) Capital employed: ₹12,00,000;
    (d) Present value of an annuity of one rupee for five years at 10% is ₹3.78;
    (e) The profit included non-recurring profits on an average basis of ₹16,000; out of which, it was deemed that even non-recurring profits had a tendency of appearing at the rate of ₹4,000;

    You are required to calculate goodwill:
    (i) as per annuity method;
    (ii) as per five years' purchase of super profits;
    (iii) as per capitalisation method of super profits;
    (iv) as per three years' purchase of adjusted average profits.

[*Ans:* Goodwill: (i) ₹3,32,640; (ii) ₹4,40,000; (iii) ₹8,80,000 and (iv) ₹6,24,000; Super profits: ₹88,000; Adjusted average profits: ₹2,08,000; Normal profits: ₹1,20,000]

13. A firm earns ₹4,80,000 as its annual profits, the rate of normal profit being 10%. The assets of the firm amount to ₹57,60,000 and liabilities to ₹19,20,000. Find out the value of goodwill by capitalisation method.

[*Ans:* Value of goodwill = ₹9,60,000]

14. Mr. Gandhi runs a chemist shop. His net assets as on 31st March 1996 amounted to ₹80,00,000. After paying a rent of ₹1,80,000 a year and a salary of ₹120,000 to the chemist, he earns a profit of ₹8,40,000. His landlord, who happens to be an expert chemist, is interested in purchasing the shop. 8% is considered to be a reasonable return on capital employed. What can Mr. Gandhi expect as payment for goodwill under capitalisation method?

[*Ans:* Goodwill ₹47,50,000; Capitalised value of business: ₹127,50,000; Net assets of the firm = ₹80,00,000

15. From the data given below, calculate the goodwill of the company by the capitalisation method:
   (a) Normal rate of return carried on by the company is 10%
   (b) Adjusted average profits of the preceding 5 years ₹1,20,000;
   (c) Net asset employed in the company ₹8,00,000

[*Ans:* Goodwill: ₹4,00,000; Total capitalised value of the firm: ₹12,00,000]

16. The net profits of a company, after providing for taxation for the past five years, are ₹1,60,000; ₹1,68,000; ₹1,80,000; ₹1,84,000 and ₹1,88,000. The capital employed in the business is ₹16,00,000; on which, a reasonable rate of return of 10% is expected. Calculate the value of goodwill under capitalisation method.

[*Ans:* Goodwill = ₹1,60,000; Total capitalised value of the firm ₹17,60,000.

17. From the following information, calculate the value of goodwill under capitalisation method:
   (a) Average capital employed: ₹48,00,000
   (b) Company declares 15% dividend on the shares of ₹40 fully paid, which is quoted in the market at ₹50;
   (c) Sundry assets of the firm: ₹63,40,000 and sundry liabilities: ₹2,50,616;
   (d) Net trading profits of the firm for the past three years were: ₹8,60,000; ₹7,25,600 and ₹9,00,000.

[*Ans:* Goodwill = ₹8,17,284; Total capitalised value of the firm: ₹69,06,668; and Net assets: ₹60,89,384]

18. Following is the balance sheet of M Co. Ltd., as on 31st March 1998.

Liabilities	(₹)	Assets	(₹)
60,000 Equity Shares of ₹100 each, fully paid	60,00,000	Goodwill at Cost	5,00,000
Capital Reserve	2,00,000	Plant & Machinery	17,00,000
General Reserve	13,90,000	less Depreciation	6,00,000
Profit & Loss A/c	30,000	Furniture & Fixtures	32,00,000
Sundry Creditors	25,70,000	less Depreciation	20,00,000
Provision for Taxation	15,00,000	Stock	49,10,000
Proposed Dividend	13,20,000	Sundry Debtors	1,00,000
		Cash	
		Preliminary Expenses	
	1,30,10,000		1,30,10,000

The following additional information is provided to you:
   (a) The reasonable return on capital employed in the industry in which M Co. Ltd. is engaged is 18%.

(b) The rate of tax is 50%. The balance in provision for taxation account is in respect of profit for the year ended 31st March 1998.

(c) The year 1997–98 was a normal year and the prospects for 1998–99 are equally good.

Calculate value of goodwill at four years' purchase of super profits of the company.

[**Madras, 1st M.Com (CAIA), Nov 2006**]

[*Ans:* Goodwill: ₹5,35,200; Super profits: ₹1,33,800; Average profits: ₹75,90,000; Normal profits: ₹13,66,200]

19. From the following balance sheet, you are required to value the equity shares:

Liabilities	(₹)	Assets	(₹)
2000 6% Pref. Shares of ₹100 each	2,00,000	Assets at Book Value	
30,000 equity shares of ₹10 each	3,00,000		
Current Liabilities	1,00,000		
	6,00,000		6,00,000

The market value of 50% of the assets is considered as 10% more than the book value and that the remaining 50% at 5% less than the book value. There was a liability of ₹5,000, which remained unrecorded. Assume preference shares have no priority as to the repayment of capital or dividend.

[*Ans:* Net assets: ₹5,10,000; Value of each preference shares of ₹100 and that of equity share ₹10.33: (3,10,000 /30,000)]

Hint: when net asset are adequate, preference capital is repaid and balance goes to equity shareholders whether preference shareholders have preference or not.

20. The following is the balance sheet of 'S' Company Limited, as on 31st December 2008.

Liabilities	(₹)	Assets	(₹)
3000 equity shares of ₹100 each	3,00,000	Cash in Hand	2,000
1500 8% preference shares of ₹100 each.	1,50,000	Cash at Bank	20,000
General Reserve	40,000	Sundry Debtors	80,000
Profit & Loss A/c	10,000	Stock-in-trade	1,40,000
Bank Loan	50,000	Land and Buildings	2,05,000
Sundry Creditors	15,000	Furniture	30,000
		Goodwill	70,000
		Discount on Shares	18,000
	5,65,000		5,65,000

The value of assets is assessed as follows:

(a) Furniture to be depreciated at 10% .

(b) Value of stock-in-trade, land and buildings and goodwill is estimated at ₹1,20,000; ₹80,000 respectively.

(c) Debtors are expected to realise 80% of book value. Find out the value of equity shares.

[*Ans:* Value per equity share:: ₹116; Net assets ₹3,48,000).
Goodwill revalued and contingent liability]

21. The summarised balance sheet of BK Ltd., as on 31st March 1997 is as follows:

Liabilities	(₹)	Assets	(₹)
30,000 Equity Shares of ₹10 each, fully paid	3,00,000	Goodwill	70,000
10,000 Equity Shares of ₹10 each, ₹8 paid-up	80,000	Fixed Assets	4,50,000
Reserves	1,80,000	Current Assets	2,20,000
11% Debentures	1,00,000	Preliminary Expenses	10,000
Current Liabilities	90,000		
	7,50,000		7,50,000

The goodwill is independently valued at ₹50,000 and fixed assets at ₹4,20,000. There was a contingent liability of ₹20,000, which has become payable.

Determine the value of both the categories of shares under the net assets method.

[*Ans:* Value of full- paid equity share: ₹12.63;
Value per partly-paid equity share: ₹10.10]

22. From the following information, find out the value of each share:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets:	
20,000 Equity Shares of ₹10 each	2,00,000	Goodwill	1,90,000
Reserves and Surplus:		Investment	3,00,000
Reserves	2,50,000	Current Assets:	
Profit & Loss A/c	30,000	Loans and Advances:	
Unsecured Loans	80,000	Current Assets	50,000
Current Liabilities	20,000	Loans and Advances	30,000
		Miscellaneous Expenditure	10,000
	5,80,000		5,80,000

For the purpose of valuation of shares, goodwill shall be taken at two years' purchase of the average profit of the last five years. The profits for the last five years are ₹60,000; ₹70,000; ₹40,000; ₹50,000 and ₹50,000.

[*Ans:* Goodwill: ₹1,08,000; Net assets available for equity shareholders:
₹3,88,0000; Value per share: ₹19.40]

23. Following is the balance sheet of Abdul Hakeem Company Ltd., as on 31st March 2008.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets	9,67,960
6,160 Shares of ₹100 each	6,16,000	Stock	7,28,000
Reserve Fund	1,06,260	Investments (at market value)	5,69,800
Employees Savings A/c	63,560	Cash and Bank Balance	8,63,520
Employees Security Deposit	15,120	Preliminary Expenses	7,000
Workmen's Compensation Fund	73,130		
Depreciation Fund	1,29,640		
Income Tax	33,130		
Creditors	10,88,080		
Profit & Loss A/c	10,11,360		
	31,36,280		31,36,280

Depreciation fund is more by ₹15,120 than actual depreciation. Find out the intrinsic value of the shares.

[*Ans:* Net assets ₹18,14,870; Intrinsic value per share: ₹294.62]

24. On 31st December 2008, the balance sheet of a company was as follows:

Liabilities	(₹)	Assets	(₹)
10,000 Equity Shares of ₹100 each, fully paid	10,00,000	Land & Buildings	4,40,000
Profit & Loss A/c	2,00,000	Plant & Machinery	1,90,000
Creditors	1,80,000	Stock	7,00,000
Provision for Tax	1,00,000	Debtors	3,00,000
Proposed Dividend	1,50,000		
	16,30,000		16,30,000

The net profit of the company after providing for taxation were: 2004: ₹1,70,000; 2005: ₹1,92,000; 2006: ₹1,80,000; 2007: ₹2,00,000 and 2008: ₹1,90,000.

On 31st December 2008, Land & Buildings were revalued at ₹5,00,000, Plant & Machinery at ₹3,00,000 and Debtors at 10% less. In view of the nature of the business, it is considered that 10% is a reasonable return on investment.

Calculate the value of company's shares, valuing goodwill at five years' purchase of the annual super profits.

[*Ans:* Super profit: ₹52,400; Goodwill: ₹2,62,000;
Net assets: ₹16,02,000; Value of each share: ₹160.20]

25. From the following details, calculate the value of each equity share and preference share:

Balance Sheet, as on 31.03.1998

Liabilities	(₹)	Assets	(₹)
Share Capital: 80,000 Equity Shares of ₹10 each	8,00,000	Land & Buildings at Cost	3,00,000
4,000 7% Pref. Shares of ₹100 each	4,00,000	Plant & Machinery at Cost	5,00,000
General Reserve	1,00,000	Stock at Market Value	5,00,000
Profit & Loss A/c	80,000	Book Debts	2,40,000
Workmen's Savings A/c	40,000	Cash at Bank	1,50,000
Provident Fund	50,000	Prepaid Expenses	30,000
Depreciation Fund	1,60,000		
Creditors	90,000		
	17,20,000		17,20,000

Additional information:

(a) Goodwill is valued at ₹1,60,000.

(b) Depreciation fund is excess to the extent of ₹60,000.

(c) Debtors of ₹20,000 are likely to prove bad.

(d) There is a disputed liability of ₹30,000 (not provided in the accounts); out of which, ₹20,000 is likely to materialise.

(e) On liquidation, preference shareholders have a right to participate in surplus.

[*Ans:* Net assets available to both shareholders: ₹15,60,000;
Surplus: ₹3,60,000; Equity shareholders' share of surplus: ₹2,40,000;
Preference shareholders' share of surplus: ₹1,20,000;
Value per equity share: ₹13; Value per preference share: ₹130]

26. Raman holds 5,000 equity shares in Raghavan Ltd. The paid-up capital, of which is 30,000 equity shares of ₹1 each, it is ascertained that:

(a) The normal net profit of such company is ₹5,000 and

(b) The normal return for the type of business carried out by the company is 8%. Raman requests you to value his shares based upon the above figures.

[**Ans:** Yield value per equity share: ₹2.08; Raman's holding amounts to ₹10,400]

27. Mr. Share Wallah holds 12,000 equity shares in Bharath Ltd. The nominal and paid-up capital of which consists of:

(a) 40,000 equity shares of ₹1 each.

(b) 10,000 preference shares of ₹1 each, rate of dividend at 8%.

(c) Preference shares do not further participate in profits.

(d) Usual transfer to reserve: 10% of the profits

It is ascertained that:

- Normal annual profit is ₹12,000.
- Normal rate of return is 15%.

Mr. Share Wallah requests you to value his holdings, based upon the above figures.

[*Ans:* Yield value per share: ₹1.80; Share Wallah's holdings amount to ₹21,600]

Hint: When shares of a principal shareholder are valued, transfer to reserve should be ignored.

28. X Ltd. has 10,000 equity shares of ₹10 each, ₹8 paid and 1,00,000 6% preference shares of ₹10 each, fully paid. The company has a practice of transferring 20% of the profit to general reserve every year. If the expected profit (based on past years' performance) before tax is ₹2,00,000 and the rate of tax is 50%, you are required to calculate the value of equity share. It may be assumed the normal rate of dividend is 20%.

[*Ans:* Profit available for equity dividend: ₹20,000;
Expected rate of return: 25%; Value of each equity share: ₹10]

29. From the following information, calculate the value of an equity share:
    (a) The subscribed share capital of a company consists of 10,000, 14% preferences shares of ₹100 each and 2,00,000 equity shares of ₹10 each. All the shares are fully paid-up.
    (b) The average annual profits of the company after providing deprecation but before taxation are ₹25,00,000. It is considered necessary to transfer ₹1,25,000 to general reserve before declaring any dividend. Rate of taxation is 50%.
    (c) The normal return expected by investors on equity shares from the type of business carried on by the company is 20%.

[*Ans:* Profit available for equity dividend ₹9,85,000;
Value of an equity share: ₹24.63]

30. A company has ₹1,00,000 as its capital — 'A' equity shares of ₹1 each, fully paid, 1,00,000 'B' equity shares of ₹1 each, 75 paisa paid-up and 1,00,000 'C' equity shared of ₹1 each, 50 paisa paid-up. The normal average net profit less tax, of the company is estimated to be ₹36,000 and the estimated rate of capitalisation is 8%. Calculate the value of each class of share.

[*Ans:* Expected rate of return: 16%; Value of each 'A' equity share: ₹2;
Value of each 'B' equity share: ₹1.50; Value of each 'C' equity share: ₹1]

31. The authorised and paid-up capital of a company consists of 1,000, 5% preference shares of ₹100 each and 20,000 equity shares of ₹15 each, all fully called-up and paid-up. A person holds 300 preference and 2,000 equity shares. Find out the value of equity shares held by the person, assuming that the normal annual profit of the company is ₹40,000 and the normal annual return on similar equity shares is 8% per annum. Assume that the company transfers 25% of the profit to general reserve and the profit above is profit after tax.

[*Ans:* Value of an equity share: ₹15.625]

32. The profits of a company, limited by shares, for the year ended 31st March 1999 were ₹6,00,000. After setting apart an amount for interest on borrowings, taxation and other provisions, the net surplus available to shareholders is estimated at ₹1,50,000. The company's capital consisted of:

    (a) 10,000 equity shares of ₹100 each, ₹50 per share paid-up; and

    (b) 2,500 12% redeemable preference shares of ₹100 each, fully paid-up.

    Enquiries in the stock market reveal that shares of companies engaged in similar business and declaring a dividend of 15% on equity shares are quoted at a premium of 10%.

    On the basis of yield method, compute the value of the equity share.

    [*Ans:* Equity share value: ₹88; Expected Rate: 24%; Normal rate: ₹13.63]

33. The following is the balance sheet of Jaya Co. Ltd., as on 31 December 1998.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Land & Buildings	10,00,000
9,000 Equity Shares of ₹100 each.	9,00,000	Plant & Machinery	14,00,000
21,000 8% Preference Shares of ₹100 each	21,00,000	Stock-in-trade	6,00,000
Profit & Loss A/c	3,00,000	Sundry Debtors	6,00,000
Sundry Creditors	4,50,000	Cash at Bank	1,50,000
	37,50,000		37,50,000

The net profits of the company for the past five years, before providing for taxation, were:

1994: ₹5,40,000; 1995: ₹6,00,000; 1996: ₹5,40,000; 1997: 4,50,000 and 1998: 3,00,000.

Another company, engaged in the same type of business, pays a dividend of 10% and its shares are quoted on the stock exchange at ₹100. Assuming taxation at 50% and appropriation of 10% of the balance to reserves, calculate the value of each equity share.

[*Ans:* Value of each equity share: ₹56.33]

34. On 31st December 1995, the balance sheet of a limited company disclosed the following positions:

Liabilities	(₹)	Assets	(₹)
Issued Capital in ₹10 Shares	4,00,000	Fixed Assets	5,00,000
Reserves	90,000	Current Assets	2,00,000
Profit & Loss A/c	20,000	Goodwill	40,000
5% Debentures	1,00,000		
Current Liabilities	1,30,000		
	7,40,000		7,40,000

On 31st December 1995, the fixed assets were independently valued at ₹3,50,000 and the goodwill at ₹50,000. The net profits for the three years were:

1993: ₹51,600; 1994: ₹52,000 and 1995: ₹51,650; of which, 20% was placed to reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%.

Compute the value of the company's share by (a) net assets method and (b) yield method.

[*Ans:* (a) ₹9.25; (b) ₹10.35]

35. The balance sheet of Ganesh Ltd. as on 31st March 1995, was as under:

Liabilities	(₹)	Assets	(₹)
2,000 Equity Shares of ₹100 each	2,00,000	Land & Buildings	1,25,000
General Reserve	50,000	Machinery	75,000
Profit & Loss A/c	25,000	Investment at Cost (market value ₹37,500)	45,000
Creditors	45,000	Debtors	50,000
Provision for Taxation	20,000	Stock	37,500
Provident Fund	17,500	Cash at Bank	25,000
	3,57,500		3,57,500

Additional information:

(a) Land & Buildings and machinery were valued at ₹1,37,500 and ₹55,000 respectively.

(b) Of the total debtors, ₹2,500 were bad.

(c) Goodwill is to be taken at ₹25,000.

(d) The normal rate of dividend declared by such type of companies is 15% on the paid-up capital.

(e) The average rate of dividend, declared and paid by this company is 18% on its paid-up capital. Calculate the fair value of the equity share of the company.

[*Ans:* Intrinsic value per share: ₹141.25; Yield value per share: ₹120;
Fair value per share: ₹130.63]

36. The following is the summarised balance sheet of ABC Ltd. as at 31st December 2010.

Liabilities	(₹)	Assets	(₹)
1,00,000 Equity Shares of ₹10 each	10,00,000	Plant & Machinery	4,80,000
Share Premium	2,00,000	Furniture	2,00,000
General Reserve	4,78,800	Stock	12,40,000
Profit & Loss A/c	3,15,200	Debtors	4,12,000
Sundry Creditors	8,18,800	Cash at Bank	8,74,800
Provision for Taxation	3,94,000		25,000
	32,06,800		32,06,800

The company transfers 20% of its profits (after tax) to general reserve. Net profits before taxation of the last three years have been as follows:

2008: ₹6,70,000; 2009: ₹7,32,000; and 2010: ₹7,88,000.

Machinery is valued at ₹6,40,000.

Average yield in this type of business is 20%.

The rate of tax is 50%.

Find out the value of each equity share on the basis of (a) net assets method (b) yield method.

[*Ans:* Net assets available to equity shareholders: ₹21,54,000; Intrinsic value per share: ₹21.54; Expected rate of return: 29.2%; Yield value per share: ₹14.60]

37. The following is the balance sheet of Murali Co. Ltd., as on 31st March 2008.

Liabilities	(₹)	Assets		(₹)
3000 8% Preference Shares of ₹100 each, fully paid	3,00,000	Buildings less Depreciation		3,90,000
6,000 Equity Shares of ₹100 each, fully paid	6,00,000	Machinery less Depreciation		3,60,000
General Reserve	3,30,000	Furniture less Depreciation		60,000
Profit & loss A/c	1,20,000	Investment in 6% Govt. Securities (face value ₹3,00,000)		2,70,000
Sundry Creditors	3,00,000	Stock		3,00,000
		Debtors	1,95,000	
		Less: Provision for Bad Debts	15,000	1,80,000
		Cash at Bank		60,000
		Preliminary Expenses		30,000
	16,50,000			16,50,000

Additional information:

(a) Companies doing similar business show profit-earning capacity of 10% on market value of their shares.

(b) The present value of buildings is ₹5,40,000 and that of machinery in ₹2,40,000.

(c) The average annual profit after 50% tax of last three years is ₹1,44,000.

(d) The company has held 6% govt. securities for last three years and the interest on the government securities is liable to tax.

(e) Goodwill of the company is to be valued at five years' purchase of super profit.

(f) It is considered necessary to transfer ₹30,000 to general reserve before declaring any dividend. Calculate the fair value of the share of the company.

[*Ans:* Goodwill: ₹1,35,000; Intrinsic value of shares: ₹197.50; Yield value per share: ₹150; Fair value: ₹173. 75]

38. The following particulars are available in relation to a company.
    - (a) Capital: 450 6% preference shares of ₹100 each, fully paid; 4,500 equity shares of ₹10 each, fully paid.
    - (b) External liabilities: ₹7,500
    - (c) Reserves & surplus: ₹3,500
    - (d) The average profit (after taxation) earned every year by the company: ₹8,500.
    - (e) The normal profit earned on the market value of equity shares fully paid of the same type of companies: 9%
    - (f) 10% of the profits after tax each year is transferred to reserves.

    Calculate the fair value of share, assuming that out of the total, assets worth ₹350 are fictitious.

    [*Ans:* Net assets available to equity shareholders: ₹48,150; Intrinsic value without goodwill: ₹10.70; Yield value: ₹12.22; Fair value: ₹11.46; Expected rate of return: 11%]

39. The following is the balance sheet of the Bright & Co. Ltd., as on 31 December 2008.

Particulars	(₹)	Assets	(₹)
Share Capital:		Buildings at Cost	1,60,000
Authorised & paid-up:		Furniture at Cost	6,000
10,000 shares of ₹100 each, fully paid	10,00,000	Investments in 5% Govt. Securities at Cost	7,60,000
Reserve Fund	3,00,000	Stock-in-trade (at market value)	8,50,000
Provisions:		Sundry Debtors (all considered good)	6,50,000
Building 20,000		Cash at Bank	1,40,000
Investments 90,000	1,10,000		
Sundry Creditors	96,000		
Provision for Bad Debts	40,000		
Profit & Loss A/c:			
Balance on 31.12.97 8,60,000			
Profit for the Year 1,60,000	10,20,000		
	25,66,000		25,66,000

It is now ascertained that:
- (a) The company's prospects for 2009 are equally good.
- (b) Profits for the past three years have shown an increase of ₹40,000 annually.
- (c) The buildings are now worth ₹1,96,000 and furniture ₹10,000.
- (d) Companies of similar nature are showing a profit-earning capacity of 10% on the market value of the shares.

You are required to ascertain the fair value of each share, showing your calculation in detail. Ignore income tax.

[*Ans:* Intrinsic value of each equity share: ₹242; Yield value: ₹120; Fair value: ₹181]

9

ALTERATION OF SHARE CAPITAL AND INTERNAL RECONSTRUCTION

9.1 ALTERATION OF SHARE CAPITAL

A company can alter its share capital in two ways. They are:

1. Alterations, which do not require the approval of a court of law.
2. Alterations, which require prior approval of a court of law.

The second type of alterations is more complicated, needing fulfilment of several legal formalities. They are separately discussed under the heading, "Internal Reconstruction".

❍ Alteration of Share Capital, which does not Require Court Approval

The provisions of Sections 94 to 97 of the Companies Act deal with this type of alteration.

Section 94 of the Companies Act permits a limited company to alter the capital clause in Memorandum of Association in five different ways, which are as follows:

1. Increase the share capital by issue of new shares.
2. Consolidated all or part of its existing shares of smaller denomination into shares of larger denominations.
3. Sub-divide all or part of its existing shares of higher denomination into shares of lesser amounts.
4. Convert all or any part of its fully paid-up shares into stock and vice-versa.
5. Cancel the unissued share capital.

A company can make any of the above five alterations by fulfilling the following conditions:

1. If it is authorised by its Articles of Association to carry out such alteration;
2. An ordinary resolution is passed in the general body meeting.

Section 95 of the Companies Act stipulates that any such alteration must be notified to the Registrar of Companies and a copy of the resolution should be filed with him within 30 days of the date of passing of such resolution.

❍ Kinds of Alteration of Share Capital and the Necessary Accounting Entries

1. ***Increase of share capital:*** This is the same as a new issue of shares. Accounting entries are the same as those for 'issues of shares'.
2. ***Consolidation of shares:*** The shares of lower denomination are consolidated into shares of higher denomination. Thus, the paid-up capital remains the same and total number of shares get reduced.

   Example: A company having ₹7,00,000 9% preference shares of ₹10 each decides to consolidate the shares into shares of ₹100 each. The journal entry will be:

Journal Entry

Particulars	Debit (₹)	Credit (₹)
9% Preference Share Capital (₹10) A/c Dr. To 9% Preference Share Capital (Rs. 100) A/c *(Being consolidation of 7,00,000 preference shares of ₹10 each into 70,000 preference shares of ₹100 each as per resolution No ______ dated ______)*	70,00,000	 70,00,000

3. ***Sub-division of shares:*** The shares of higher face value are divided into several shares of lower face value. Hence, the paid-up capital does not change but the total number of shares thus increases.

   Example: A company, which has 4,000 equity shares of ₹100 each, decides to sub-divide them into shares of ₹10 each. The required journal entry is as follows:

Journal Entry

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital (₹100) A/c Dr. To Equity Share Capital (₹10) A/c *(Being sub-division of 4,000 equity shares of ₹100 each into 40,000 shares of ₹10 each, as per resolution No ______ Dated ______)*	4,00,000	 4,00,000

4. ***Conversion of shares into stock and vice versa:*** A company can decide to convert its fully paid-up shares into stock or convert existing stock into fully-paid shares.

   Example: A company decides to convert its ₹10 equity share capital of ₹6,00,000 into stock. The journal entry to be passed is as follows:

Journal Entry

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital Dr. To Equity Capital Stock A/c *(Being conversion of 60,000 equity shares of ₹10 each fully paid into ₹6,00,000 equity stock as per resolution No ______ dated ______)*	6,00,000	 6,00,000

For converting stock into fully paid shares, reverse entry to the above can be passed.

5. ***Cancellation of unissued shares:***The shares, which are not yet issued by the company, are cancelled. Thus, it is the reduction of unissued capital, without any reduction in the paid-up capital.

   The authorised capital stands reduced, to the extent of unissued shares cancelled. No journal entry is required.

9.2 INTERNAL RECONSTRUCTION OR CAPITAL REDUCTION

The reorganisation of the capital structure of a company is called reconstruction. It may result in the reduction of claims of both the shareholders and creditors against the company. The companies whose financial position is bad may opt for reconstruction. Such reconstruction can be 'External' or 'Internal'.

An existing company will be liquidated and a new company will be formed in external reconstruction.

The capital of a company is reorganised in internal reconstruction to enable the company a fresh beginning after eliminating all accumulated losses.

The companies prefer internal reconstruction to the external reconstruction due to the following reasons:

1. Legal formalities are more in liquidation of an existing company and in formation of new company and are quite expensive.
2. Though the shareholders remain the same, accumulated losses of the liquidating company cannot be set off against the profits of the newly formed company. Thus, an important tax advantage is lost.
3. The quantum of time needed for external reconstruction is more when compared to internal reconstruction.

❍ Reduction of Share Capital

The provisions of Sections 100 to 105 of the Companies Act, 1956, deals with reduction of share capital by a company. Reduction of capital can take any of the following three forms.

1. Reducing or completely extinguishing shareholders' liability for uncalled capital.
2. Refunding surplus paid up capital, which is found to be in excess of the needs of the company.
3. Cancelling or writing off paid up capital which is lost and not represented by assets.

❍ Procedure for Reducing Share Capital

1. The Articles of Association of the company must permit reduction of share capital. If articles are silent, it may be ' Altered ' through a special resolution to enable the company to reduce its share capital.

2. A special resolution must be passed for reduction of share capital in the general body meeting.
3. Confirmation of the court for capital reduction must be obtained.
   The company has to prepare a specific scheme of capital reduction. Then, it has to apply to the Court for an order of confirmation submitting the scheme. The Court may make an order confirming the capital reduction on such terms and conditions as it thinks proper. It is ensured by the court that the interests of creditors and minority shareholders are protected. If any of them objects to the scheme proposed by the company, the court ensures that their claims against the company are satisfied. The company may be asked to add the words, 'And Reduced' to its name for a period of time, thought to be appropriate by the Court.
4. A copy of the resolution for reducing the share capital and the confirmation order from the court should be filed with the Registrar of Joint Stock Companies.

❍ Accounting Entries for Reduction of Capital

1. Reducing or completely extinguishing liability of the shareholders for uncalled capital:

   Example: A company, whose capital consists of 6,000 shares of ₹100 each, ₹75 called and paid, decides to reduce the shares into 6,000 shares of ₹75 each fully paid.

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Share Capital (₹75) A/c	Dr.	4,50,000	
To Share Capital (₹75) A/c			4,50,000
(*Being conversion of 6,000 shares of ₹100 each, ₹75 paid up into 6,000 shares of ₹75 each, fully paid up*)			

2. Refunding surplus capital, which is found to be in excess of the needs of the company:

   Example: A company,whose paid-up capital includes 20,000 equity shares of ₹100 each, fully paid, decides to return ₹20 per share to the members, thus reducing each share to ₹80 each, fully paid.

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Equity Share Capital A/c	Dr.	20,00,000	
To Equity Share Capital (₹80) A/c			16,00,000
To Sundry Shareholders A/c			4,00,000
(*Being conversion of 20,000 shares of ₹100 each into shares of ₹80 each and the balance to be returned transferred to the members*)			
Sundry Shareholders A/c	Dr.	4,00,000	
To Bank A/c			4,00,000
(*Being return of capital to shareholders as per the scheme*)			

3. Cancelling or writing off lost capital, not represented by assets: When face value of share is changed or the rate of preference dividend is changed, thus changing the category of the share:

   Example: 10,000 equity shares of ₹10 each are reduced to fully paid shares of ₹6 each

Journal Entry

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital (₹10) A/c Dr. To Equity Share Capital (₹6) A/c To Capital Reduction A/c (*Being conversion of 10,000 shares of ₹10 each into shares of ₹6 each fully paid, balance transferred to capital reduction A/c*) *Example:* 20,000 -9% preference shares of ₹10 each are converted into 8% preference shares of ₹8 each fully paid.	1,00,000	 60,000 40,000

Example: 10,000 -9% preference shares of ₹10 each are converted into 8% preference shares of ₹8 each fully paid.

Journal Entry

Particulars	Debit (₹)	Credit (₹)
9% Preference Share Capital A/c Dr. To 8% Preference Share Capital A/c To Capital Reduction A/c (*Being conversion of 10,000 9% preference shares of ₹10 each into 8% pref. shares of ₹8 each fully paid, balance transferred to capital reduction A/c*)	1,00,000	 80,000 20,000

4. When there is no change in the face value of the share or rate of preference dividend, thus resulting in no change in the category of the share:

   Example: A company decides to reduce ₹2 per share on its 70,000 equity shares of ₹10 each, fully paid.

Journal Entry

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital A/c Dr. To Capital Reduction A/c (*Being reduction of ₹2 per share on 70,000 shares of ₹10 each as per capital reduction scheme*)	1,40,000	 1,40,000

5. When debenture holders or creditors make some sacrifice as a part of capital reduction scheme:

   Example: The capital reduction of the company states that 4,000 6% debentures of ₹100 each are to be reduced to ₹80 each and the trade creditors have agreed to reduce their claims by ₹60,000.

Journal Entry

Particulars		Debit (₹)	Credit (₹)
6% Debentures A/c	Dr.	80,000	
Creditors A/c	Dr.	60,000	
To Capital Reduction A/c			1,40,000
(*Being reduction of ₹20 per debenture on 4,000 debentures and reduction of creditors as per capital reduction scheme*)			

6. When there is appreciation in the value of any of the assets

   Example: A company finds that its buildings have appreciated by ₹50,000 and the value of stock has gone up by ₹40,000 on the date of capital reduction.

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Buildings A/c	Dr.	50,000	
Stock A/c	Dr.	40,000	
To Capital Reduction A/c			90,000
(*Being appreciation in the value of assets credited to capital reduction*)			

7. When any contingent liability or expenses as proposed in the capital reduction scheme have to be paid:

   Example: At the time of implementing a capital reduction scheme, it was found that the sales tax under disputes so far for ₹30,000 has to be paid immediately and the expenses of implementing the scheme are ₹15,000.

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Sales Tax Payable A/c	Dr.	30,000	
Scheme Expenses A/c	Dr.	15,000	
To Bank A/c			45,000
(*Being liability for sales tax paid and scheme expenses met*)			
Capital Reduction A/c	Dr.	45,000	
To Sales Tax Payable A/c			30,000
To Scheme Expenses A/c			15,000
(*Being sales tax under dispute paid and scheme expenses written off through capital reduction A/c*)			

8. When capital reduction account is used to write off losses, reduce assets, etc. as per the approved scheme

Journal Entries

Particulars	Debit (₹)	Credit (₹)
Capital Reduction A/c Dr.	xxx	
To Profit & Loss A/c (Dr balance)		xxx
To Preliminary Expenses A/c		xxx
To Discount on Issue of Shares or Debentures A/c		xxx
To Goodwill A/c		xxx
To Assets A/c (amount to be reduced)		xxx
To Capital Reserve A/c (balance of any)	xxx	
(*Being losses written off and assets reduced as per capital reduction scheme*)		

9.3 SOME POINTS TO BE NOTED

1. Deficit or surplus in capital reduction account: The balance in the capital reduction is sufficient to write off the losses accumulated and reduce the values of assets usually. The scheme drafted to submit to the court of law must take care of this aspect.

Sometimes, a small deficit in capital reduction amount may have to be made up by utilising some provisions like workmen's compensation fund or provision for taxation. In such cases, the accounts concerned are debited and capital reduction account is credited. Any surplus in capital reduction account is automatically transferred to capital reserve account.

2. Capital reduction account or reconstruction account: Some accounting experts are of the opinion that sacrifice made by creditors and debenture holders should not be treated as capital reduction and credited to that account. In such cases, the account must be termed as 'Reconstruction Account ' or ' Reorganisation Account'.

However, the modern meaning of the term 'Capital' has widened considerably and 'Capital Structure' is now agreed to be all the own and borrowed sources of funds. So, usage of the term ' Capital Reduction' is acceptable even when creditors make sacrifices.

3. Arrears of preference dividend: Cumulative preference shareholders are eligible for accumulation of dividends, if not paid in any particular year. Unless otherwise mentioned, all preference shares must be assumed as cumulative. Without clearing preference dividend arrears, equity dividend cannot be paid.

If preference dividend is declared, it becomes a liability and appears under current liabilities in the balance sheet liabilities side.

If preference shareholders agree to forego the arrears, which are already declared, it is transferred to capital reduction account, just like other sacrifices.

If preference dividend is not declared, then it is only a contingent liability shown as a footnote to the balance sheet or shown in the inner column on the liabilities sides of the balance sheet.

If preference shareholders agree to sacrifice the undeclared preference dividend, no separate entry is necessary to record such sacrifice because the dividend was not taken into account. A note may be written to that effect.

If preference dividend, not previously declared, is agreed to be paid in cash at the time of implementing a capital reduction scheme, it is to be treated as additional loss. Dividend is debited and the bank is credited for the payment of cash. Then the dividend is written off through capital reduction account, along with other losses.

4. Surrender of shares: As a part of capital reduction scheme, shareholders may be required to 'surrender' a part of their shares to the company. The surrendered shares may be cancelled immediately by transferring their values to capital reduction account. It is also possible that some of the surrendered shares may be re-issued by the company to the creditors or debenture holders as a part of the capital reduction scheme. In such cases, they usually agree to forego a portion of their claim in return for the issue of surrendered shares. The reduction in their claim is fully transferred to capital reduction account. The following journal entries are usually passed.

Journal Entries

Particulars		Debit (₹)	Credit (₹)
(1) When shares are surrendered:			
Share Capital A/c	Dr.	xxx	
To Surrendered Shares A/c			xxx
(2) When surrendered shares are re-issued			
Surrendered Shares A/c	Dr.	xxxx	
To Share Capital A/c			xxxx
(3) When unissued surrendered shares are cancelled			
Surrendered Shares A/c		xxxx	
To Capital Reduction A/c			xxxx

9.4 ALTERATION OF SHARE CAPITAL

Illustration 1

Sub-division of Shares

Rathu Ltd., having a share capital of ₹4,00,000 divided into 4,000 shares of ₹100 each, resolves to sub-divide the shares into 40,000 shares of ₹10 each. Pass the necessary journal entry.

Solution:

Journal Entry

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c (₹100) Dr. To Share Capital A/c (₹10) (*Being 4000 shares of ₹100 each sub-divided into 40,000 shares of ₹10 each as per Board's resolution dated ……*)		4,00,000	4,00,000

Illustration 2

Sub-division of shares and conversion of shares into stock

Madhu Ltd. has share capital of ₹6,00,000 divided into 6,000 shares of ₹100 each, fully paid. Show the entries under each of the following conditions:

(a) When Madhu Ltd. resolves to sub-divide the shares into 60,000 shares of ₹10 each fully paid.

(b) When Madhu Ltd. resolves to convert its 6,000 shares of ₹100 each into ₹6,00,000 worth of stock.

Solution:

Journal Entry

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c (₹100) Dr. To Share Capital A/c(₹10) (*Being sub-division of 6000 shares of ₹100 each fully paid as per Board's resolution dated.....*)		6,00,000	6,00,000
	Equity Share Capital A/c Dr. To Equity Capital Stock A/c (*Being the conversion of 6,000 equity shares of ₹100 each into ₹6,00,000 stock as per board's resolution dated.....*)		6,00,000	6,00,000

Illustration 3

Sub-division of Shares, Consolidation of Shares and Conversion of partly paid shares into fully paid up shares

Aarthi Ltd. has the following shares as a part of its share capital.

20,000 7% preference shares of ₹100 each fully paid.

30,000 equity shares of ₹5 each fully paid

10,000 equity shares of ₹10 each, ₹9 called up and paid up.

The company has decided to alter the share capital as follows:

(a) To sub-divide the preference shares into shares of ₹10 each.
(b) To consolidate the equity shares of ₹5 each into shares of ₹10 each.
(c) To convert the partly paid-up equity shares into fully paid-up shares of ₹9 each, with necessary legal sanctions.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	7% Preference Share Capital A/c (₹100) Dr. To 7% Preference Share Capital A/c (₹10) (*Being sub-division of 20,000 preference shares of ₹100 each into 2,00,000 preference shares of ₹10 each*)		20,00,000	20,00,000
	Equity Share Capital A/c (₹5) Dr. To Equity Share Capital A/c (₹10) (*Being consolidation of 30,000 equity shares of ₹5 each into ₹15,000 equity shares of ₹10 each*)		1,50,000	1,50,000
	Equity Share Capital A/c(partly paid) Dr. To Equity Share Capital A/c (fully paid) (*Being conversion of partly paid shares into fully paid shares*)		90,000	90,000

Illustration 4

Cancellation of unpaid amount on shares

Kalyani Ltd. has an issued capital of ₹5,00,000 into 50,000 shares of ₹10 each, on which ₹9 per share has been called up. The company now decides to reduce the share capital to share of ₹9 each, fully paid by cancelling the unpaid amount of ₹1 per share. Pass the journal entry.

Solution:

Journal Entry

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c (₹100) Dr. To Share Capital A/c(₹9) (*Being reduction of 50,000 shares of ₹10 each to ₹9 each, by the cancellation of unpaid amount of ₹1 per share, as per special resolution dated .... as confirmed by court.*)		4,50,000	4,50,000

9.5 CAPITAL REDUCTION

Illustration 5

Return of Share Capital

Badri Ltd. has 80,000 equity shares of ₹100 each, ₹80 per share called up. The company decides to pay off ₹20 per share of the paid-up capital now and at the same time to reduce ₹100 per share to ₹70 per share fully paid up by cancelling the unpaid amount. Pass journal entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c (₹100) Dr.		64,00,000	
	To Share Capital A/c (₹70)			56,00,000
	To Shareholders A/c			8,00,000
	(*Being reduction of 80,000 equity shares of ₹100 each, ₹80 per share paid to 80,000 shares of ₹70 each fully paid and refund of ₹10 per share by cancelling the unpaid amount*)			
	ShareholdersA/c Dr.		8,00,000	
	To Bank A/c			8,00,000
	(*Being the amount paid to shareholders A/c*)			

Illustration 6

Surplus in Capital Reduction Account

Alpha Ltd., passed resolution and got court permission for the reduction of its share capital by ₹5,00,000 for the purposes mentioned as under:

(a) To write off the debit balances of profit and loss account of ₹2,50,000.

(b) To reduce the value of plant and machinery by ₹80,000 and goodwill by ₹50,000.

(c) To reduce the value of investments by ₹90,000.

The reduction was made by converting 50,000 preference shares of ₹20 each fully paid to the same number of preference shares of ₹15 each fully paid and by converting 50,000 equity shares of ₹20 each on which ₹15 is paid up into 50,000 equity shares of ₹10 each fully paid up. Pass journal entries to record the share capital reduction.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Preference Share Capital A/c (₹20) Dr.		10,00,000	
	To Preference Share Capital A/c (₹15)			7,50,000
	To Capital Reduction A/c			2,50,000
	(*Being conversion of 50,000 shares of ₹20 each fully paid into shares of ₹15 each fully paid and the balance transferred to capital reduction A/c*)			
	Equity Share Capital A/c (partly paid) Dr.		7,50,000	
	To Equity Share Capital A/c (fully paid)			5,00,000
	To Capital Reduction A/c			2,50,000
	(*Being conversion of partly-paid shares into fully paid shares and balance transferred to capital reduction A/c*)			
	Capital Reduction A/c Dr.		5,00,000	
	To Profit & Loss A/c			2,50,000
	To Plant & Machinery A/c			80,000
	To Goodwill A/c			50,000
	To Investments A/c			90,000
	To Capital Reserve A/c (Bal. Fig.)			30,000
	(*Being losses written off, assets written down and balance of capital reduction transferred to capital reserve A/c*)			

Illustration 7

Capital Reduction Account and Issue of Shares for Arrears of Preference Dividend and Balance in Capital Reduction transferred to Capital Reserve Account

A scheme of capital reduction (approved) on 31st March 1990 of A Co., Ltd. is as follows:

Share Capital:
10,000 shares of ₹100 each, ₹90 per share paid up (amount uncalled on these shares is to be cancelled now and the paid-up value is to be reduced by ₹20 per share).

5,000 8% cumulative preference shares of ₹100 each, fully paid-up. (These shares are now to be converted into non-cumulative, and in exchange for one share of ₹100, nine shares of ₹10 are to be given. Against their accrued but not declared dividend of ₹80,000 at the rate of one share per every dividend of ₹100 8% non-cumulative preference shares of ₹10 each are to be given).

Included in the assets are:
Buildings ₹2,00,000(original cost ₹2,50,000 less depreciation fund ₹50,000), debit balance of profit and loss account ₹70,000, goodwill ₹30,000 and

preliminary expenses ₹15,000(The value of the building is to be reduced by ₹50,000 and its depreciation fund is to be increased by ₹10,000. Intangible and fictitious assets are to be written off completely). Give necessary journal entries to give effect to the above scheme.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity Share Capital A/c (₹90) Dr. To Equity Share Capital A/c(₹70) To Capital Reduction A/c (*Being reduction of 10,000 shares of ₹90 each by ₹20 per share*)		9,00,000	 7,00,000 2,00,000
	8% Cumulative Preference Share Capital A/c (₹100) Dr. To 8% Non-cumulative Preference Share Capital A/c (₹10) To Capital Reduction A/c (Being 5,000, 8% cumulative pref.shares converted into non-cumulative preference shares of ₹10 each)		5,00,000	 4,50,000 50,000
	Preference Dividend A/c Dr. To 8% Non-cumulative Pref.Share Capital A/c (*Being issue of one non- cumulative preference shares for every dividend of ₹100 in arrear) (80,000/100 × 1 = 800 × 10*)		8,000	 8,000
	Capital Reduction A/c Dr. To Profit & Loss A/c To Buildings A/c To Depreciation fund A/c To Goodwill A/c To Preliminary Expenses A/c To Preference Dividend A/c To Capital Reserve A/c (*Being various losses written off and assets written down as per scheme of capital reduction and balance in capital reduction A/c transferred to capital reserve A/c*)		2,50,000	 70,000 50,000 10,000 30,000 15,000 8,000 67,000

Illustration 8

Elimination of Securities Premium Account

Following a series of losses, ABC Co. Ltd., resolved to reduce its capital to 50,000 fully paid ₹5 shares and to eliminate securities premium account. The company's balance sheet prior to implementation of the scheme was:

Liabilities	(₹)	Assets	(₹)
Share Capital:			
50,000 Fully-paid Shares of ₹10 each	5,00,000	Goodwill	1,00,000
Securities Premium A/c	50,000	Land & Buildings	1,62,000
Creditors	62,000	Plant & Machinery	2,07,000
Bank Overdraft	73,000	Stock	92,000
		Debtors	74,000
		Profit & Loss A/c	50,000
	6,85,000		6,85,000

It was resolved to apply the sum available under the scheme:

(a) To write off the goodwill account.
(b) To write off the debit balance of the profit and loss account.
(c) To reduce the book values of the assets by the following amounts:

Particulars	(₹)
Land & Buildings	42,000
Plant & Machinery	67,000
Stock	33,600

(d) To provide a bad debts reserve of 10% of the book value of debtors.

Pass journal entries to give effect to the scheme and prepare the revised balance sheet after its implementation.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c (₹10) Dr. To Share Capital A/c (₹5) To Capital Reduction A/c *(Being reduction of 50,000 shares of ₹10 each into ₹5 each)*		5,00,000	 2,50,000 2,50,000
	Securities Premium A/c Dr. To Capital Reduction A/c *(Being amount in the share premium A/c transferred to capital reduction A/c)*		50,000	 50,000
	Capital Reduction A/c Dr. To Goodwill A/c To Profit & Loss A/c To Land & Buildings A/c To Plant & Machinery A/c To Stock A/c To Provision for Bad Debts A/c *(Being losses written off and assets written down with the help of capital reduction A/c)*		3,00,000	 1,00,000 50,000 42,000 67,000 33,000 7,400

Notes to Accounts:

	(₹)
1. Share Capital:	
Issued and Paid-up Capital 50,000 Equity Shares of ₹5 each	2,50,000
2. Trade Payables:	
Creditors	62,000
3. Short-term Borrowings:	
Bank Overdraft	73,000
4. Tangible Assets:	
Land & Buildings	1,20,000
Plant & Machinery	1,40,000
	2,60,000

Balance Sheet of ABC Co. Ltd. as on …. (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	2,50,000
Reserves and Surplus	—	—
(ii) Non-current Liabilities	—	—
(iii) Current Liabilities:		
Trade Payables	2	62,000
Short-term Borrowings	3	73,000
Total: (i) + (ii) + (iii)		3,85,000
II. Assets:		
(i) Non-current Assets:		
Tangible Assets	4	2,60,000
Intangible Assets	—	—
(ii) Current Assets:		
Stock		58,400
Trade Receivables (debtors) (74,000 – 7,400)		66,600
Total: (i) + (ii)		3,85,000

Illustration 9

Appreciation in Value of Assets and Expenses of Reconstruction

The following is the balance sheet of Manu Industries Ltd. on 31st December 2008.

Liabilities	(₹)	Assets	(₹)
Share Capital:			
12,000 7% Preference Shares of ₹100 each	12,00,000	Goodwill	90,000
24,000 Equity Shares of ₹100 each	24,00,000		
8% Debentures	6,00,000	Land & Building	12,00,000
Bank Overdraft	6,00,000	Plant & Machinery	18,00,000
Sundry Creditors	3,00,000	Stock	2,60,000
		Debtors	2,80,000
		Cash	30,000
		Profit & Loss A/c	14,00,000
		Preliminary Expenses	40,000
	51,00,000		51,00,000

On the above date, the company adopted the following scheme of reconstruction:

(a) The equity shares are to be reduced to shares of ₹40 each, fully paid and the preference shares to be reduced to fully paid shares of ₹75 each.
(b) The debenture holders took overstock and debtors in full satisfaction of their claims.
(c) The land and buildings are to be appreciated by 30% and plant and machinery to be depreciated by 30%.
(d) The fictitious and intangible assets are to be eliminated.
(e) Expenses of reconstruction amounted to ₹10,000.

Pass journal entries incorporating the above scheme of reconstruction and prepare the reconstructed balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	7% Preference Share Capital A/c (₹100) Dr. To 7% Preference Share Capital A/c (₹25) To Capital Reduction A/c (*Being 12,000 preference shares of ₹100 each reduced to ₹25 each*)		12,00,000	 9,00,000 3,00,000

(*Contd.*)

	Equity Share capital A/c (₹100) Dr. To Equity Share capital A/c To Capital Reduction A/c (*Being 24,000 equity shares of ₹100 each reduced by ₹60 each*)		24,00.000	 9,60,000 14,40,000
	8% Debentures A/c Dr. To Stock A/c To Debtors A/c To Capital Reduction A/c (*Being debenture holders given stock and debtors in full satisfaction of their claim*)		6,00,000	 2,60,000 2 80,000 60,000
	Land & Buildings A/c Dr. To Capital Reduction A/c (*Being Land & Buildings appreciated by 30%*)		3,60,000	 3,60,000
	Reconstruction expenses A/c Dr. To Bank A/c (*Being reconstruction expense paid*)		10,000	 10,000
	Capital Reduction A/c Dr. To Goodwill A/c To Profit & Loss A/c To Preliminary Expenses A/c To Plant & Machinery A/c To Reconstruction Expenses A/c To Capital Reserve A/c (Bal.Fig.) (*Being losses written off and assets written down and balance in capital reduction A/c transferred to capital reserve A/c*)		21,60,000	 90,000 14,00,000 40,000 5,40,000 10,000 80,000

Notes to Accounts:

	(₹)
1. Share Capital:	
Issued and Paid-up Capital	
24,000 Equity Shares of ₹40 each	9,60,000
12,000, 7% Pref. Shares of ₹75 each	9,00,000
	18,60,000
2. Reserves and Surplus:	
Capital Reserve	80,000
3. Trade Payables:	
Sundry Creditors	3,00,000
4. Short-term Borrowings:	
Bank Overdraft	6,00,000
5. Tangible Assets:	
Land & Buildings	15,60,000
Plant & Machinery	12,60,000
	28,20,000

Balance Sheet of Manu Industries Ltd. as on … (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	18,60,000
Reserves and Surplus	2	80,000
(ii) Non-current Liabilities		
(iii) Current Liabilities:		
Trade Payables	3	3,00,000
Short-term Borrowings	4	6,00,000
Total: (i) + (ii) + (iii)		28,40,000
II. Assets:		
(i) Non-current Assets:		
Tangible Assets	5	28,20,000
Intangible Assets		
(ii) Current Assets:		
Cash (30,000 – 10,000)		20,000
Total: (i) + (ii)		28,40,000

Illustration 10

Issue of Shares for Arrears of Preference Dividend

The summarised Balance Sheet of Yathish Co., Ltd., as on 31st December 2008 was as follows:

Liabilities	(₹)	Assets	(₹)
Authorised & Issued Capital:			
1,00,000 Equity Shares of ₹10 each, fully paid	10,00,000	Land & Buildings	7,50,000
5,000 6% Cumulative Preference Shares of ₹100 each, fully paid	5,00,000		
Bank Overdraft	3,50,000	Plant & Machinery	5,00,000
Sundry Creditors	2,50,000	Goodwill	1,00,000
(Note: The cumulative preference dividend is in arrear for three years)		Patents & Trademark	50,000
		Stock	2,00,000
		Sundry Debtors	1,50,000
		Preliminary Expenses	50,000
		Profit & Loss A/c	3,00,000
	21,00,000		21,00,000

A scheme of capital reduction was approved on the following terms:

(a) The preference shareholders agree that their shares are to be reduced to fully paid shares of ₹50 each and to accept equity shares of ₹5 each, fully paid in lieu of the dividend arrears.

(b) The equity shareholders agree that their shares are to be reduced to a fully paid value of ₹5 each.

(c) The authorised capital of the company is to remain at ₹15,00,000, divided into 2,00,000 equity shares of ₹5 each and 10,000 6% cumulative preference shares of ₹50 each.

(d) All the intangible and fictitious assets are to be eliminated and bad debts of ₹25,000 and obsolete stock of ₹40,000 are to be written off.

Give the necessary journal entries to record the capital reduction and draw up the revised balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	6%Cumulative Preference Share Capital A/c (₹100) Dr. To 6%Cumulative Preference Share Capital A/c (₹50) To Capital Reduction A/c *(Being 5,000 preference shares of ₹100 each reduced to ₹50 each)*		5,00,000	 2,50,000 2,50,000
	Equity Share Capital A/c (₹100) Dr. To Equity Share Capital A/c To Capital Reduction A/c *(Being 1,00,000 equity shares of ₹10 each reduced by ₹5 each)*		10,00.000	 5,00,000 5,00,000
	Preference Dividend A/c Dr. To Equity Share Capital A/c *(Being 18,000 equity shares @ ₹5 each issued for the preference dividend arrears)*		90,000	 90,000
	Capital Reduction A/c Dr. To Goodwill A/c To Patents & Trademarks A/c To Preliminary expenses A/c To Profit & LossA/c To Sundry DebtorsA/c To Stock A/c To Preference Dividend A/c To Capital Reserve A/c (balancing figure) *(Being losses and fictitious assets written off, assets written down and balance in capital reduction A/c transferred to capital reserve A/c)*		7,50,000	 1,00,000 50,000 50,000 3,00,000 25,000 40,000 90,000 95,000

Notes to Accounts:

	(₹)
1. Share Capital:	
Authorised Capital:	
2,00,000 Equity Shares of ₹5 each	10,00,000
10,000, 6% Cum. Pref. Shares of ₹50 each	5,00,000
	15,00,000
Issued and Paid-up Capital	
1,18,000 Equity Shares of ₹5 each	5,90,000
5,000, 6% Cum. Pref. shares of ₹50 each	2,50,000
	8,40,000
2. Reserves and Surplus:	
Capital Reserve	95,000
3. Trade Payables:	
Sundry Creditors	2,50,000
4. Short-term Borrowings:	
Bank Overdraft	3,50,000
5. Tangible Assets:	
Land & Buildings	7,50,000
Plant & Machinery	5,00,000
	12,50,000

Balance Sheet of Yathish Co. Ltd., as on 31.12.2008 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	8,40,000
Reserves and Surplus	2	95,000
(ii) Non-current Liabilities	—	—
(iii) Current Liabilities:		
Trade Payables	3	2,50,000
Short-term Borrowings	4	3,50,000
Total: (i) + (ii) + (iii)		15,35,000
II. Assets:		
(i) Non-current Assets:		
Tangible Assets	5	12,50,000
Intangible Assets	—	—
(ii) Current Assets:		
Stock		1,60,000
Trade Receivables		1,25,000
Total: (i) + (ii)		15,35,000

Illustration 11

Pro-rata Write Off of Assets

M/s Aditya & Co., promoted a joint stock company in 2003. The working of the company was not successful. On 31st December 2006, its balance sheet stood as follows:

Liabilities	(₹)	Assets	(₹)
Nominal Capital:			
30,000 Shares of ₹100 each	30,00,000	Goodwill	1,00,000
Subscribed Capital:		Land & Buildings	3,00,000
25,000 Shares of ₹100 each fully paid	25,00,000	Machinery	6,50,000
Creditors	1,75,000	Furniture	40,000
Aditya & Co. Loan	2,00,000	Stock	4,75,000
		Debtors	2,50,000
		Profit and Loss A/c	10,60,000
	28,75,000		28,75,000

The company is to be reconstructed on the basis of the following scheme:

(a) The 25,000 shares of ₹100 each are to be reduced to an equal number of fully-paid shares of ₹45 each.

(b) The debt of ₹2,00,000 due to Aditya & Co. is also to be reduced. They have agreed to accept 2,500 shares of ₹45 each, fully paid, in full settlement of the amount due to them.

(c) The amount thus rendered available by the reduction of capital and by the above arrangement with Aditya & Co. is to be utilised in wiping off the goodwill and profit and loss account and in writing down the value of machinery, and land and buildings in proportion to their book values.

Give journal entries in the books of the company, necessitated by the above reconstruction and show the new balance sheet of the company.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity Share Capital A/c (₹100) Dr. To Equity Share Capital A/c(₹45) To Capital Reduction A/c (*Being reduction of equity shares of ₹100 each into ₹45 each*)		2,50,000	 11,25,000 13,75,000

(*Contd.*)

	Aditya & Co. Loan A/c Dr. To Equity Share Capital A/c (₹2,500 x 45) To Capital Reduction A/c (*Being 2,500 shares of ₹45 each accepted by Aditya & Co. for the amount which is due to them*)		2,00,000	 1,12,500 87,500
	Capital Reduction A/c Dr. To Goodwill A/c To Profit & Loss A/c To Machinery A/c To Land & Buildings A/c (*Being losses written off and the balance in capital reduction A/c utilised to write off the value of machinery, land and buildings proportionately*)		14,62,500	 1,00,000 10,60,000 2,06,974 95,526

Notes to Accounts:

	(₹)
1. Share Capital:	
Issued and Paid-up Capital	
27,500 Shares of ₹45 each	12,37,500
2. Trade Payables:	
Creditors	1,75,000
3. Tangible Assets:	
Land & Buildings (3,00,000 – 95,526)	2,04,474
Machinery (6,50,000 – 2,06,974)	4,43,026
Furniture	40,000
	6,87,500

Balance Sheet of Aditya &Co., as on 31.12.2006 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	12,37,500
Reserves and Surplus	—	—
(ii) Non-current Liabilities	—	—
(iii) Current Liabilities:		
Trade Payables	2	1,75,000
Total: (i) + (ii) + (iii)		14,12,500
II. Assets:		
(i) Non-current Assets:		
Tangible Assets	3	6,87,500
Intangible Assets	—	—

(*Contd.*)

(ii) Current Assets:		
Stock		4,75,000
Debtors		2,50,000
Total: (i) + (ii)		14,12,500

Illustration 12

Consolidation of Shares

The following is the balances sheet of Downhill Ltd., as on 31st March 2010.

Liabilities	(₹)	Assets	(₹)
20,000 Equity Shares of ₹100 each	20,00,000	Goodwill	25,000
12% Debentures	5,00,000	Land & Buildings	1,50,000
Outstanding Debenture Interest	1,20,000	Plant & Machinery	3,00,000
Creditors	3,00,000	Furniture	80,000
		Stock	2,70,000
		Debtors	60,000
		Cash at Bank	35,000
		Preliminary Expenses	20,000
		Profit & Loss A/c	19,80,000
	29,20,000		29,20,000

The following scheme of reconstruction is executed:

(a) Equity shares are reduced by ₹95 per share. They are, then, consolidated into 10,000 equity shares of ₹10 each.

(b) Debentures holders agree to forego outstanding debentures interest. As a compensation, 12% debentures are converted into 14% debentures, the amount remaining ₹5,00,000.

(c) Creditors are given the option to either accept 50% of their claim in cash in full settlement or to convert their claim into equity shares of ₹10 each. Creditors for ₹2,00,000 opt for shares in satisfaction of their claims.

(d) To make payment to creditors opting for cash payment and to augment working capital, the company issues 50,000 equity shares of ₹10 each at par, the entire amount being payable along with application. The issue was fully subscribed.

(e) Land & Buildings are revalued at ₹2,00,000 whereas Plant & Machinery is to be written down to ₹2,10,000. A provision amounting to ₹5,000 is to be made for doubtful debts.

Pass journal entries and draft the company's balance sheet immediately after the reconstruction.

Solution:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity Share Capital A/c (₹100) Dr. To Equity Share Capital A/c (₹5) To Capital Reduction A/c (*Being conversation of old equity shares into new shares of ₹5 each and balance transferred to capital reduction A/c*)		20,00,000	 1,00,000 19,00,000
	Equity Share Capital A/c (₹5) Dr. To Equity Share Capital A/c (₹10) (*Being consolidation of equity shares of ₹5 each into equity shares of ₹10 each*)		1,00,000	 1,00,000
	12% Debentures A/c Dr. To 14% Debentures A/c (*Being 12% debentures converted into 14% debentures*)		5,00,000	 5,00,000
	Outstanding Debenture Interest A/c Dr. To Capital Reduction A/c (*Being interest on debenture foregone by debenture holders and transferred to capital reduction A/c*)		1,20,000	 1,20,000
	Creditors A/c Dr. To Cash A/c To Capital Reduction A/c To Equity Share Capital A/c (*Being cash paid to creditors for ₹1,00,000 in full settlement and equity shares allotted to them for ₹2,00,000*)		3,00,000	 50,000 50,000 2,00,000
	Bank A/c Dr. To Equity Share Capital A/c (*Being 50,000 equity shares issued*)		5,00,000	 5,00,000
	Land & Building A/c Dr. To Capital Reduction A/c (*Being increase in value land and building transferred to capital reduction A/c*)		50,000	 50,000
	Capital Reduction A/c Dr. To Plant & Machinery A/c (3,00,000 – 2,10,000) To Provision for Doubtful Debts A/c To Profit & Loss A/c To Preliminary Expenses A/c To Goodwill A/c (*Being losses written off and assets reduced as per capital reduction scheme*)		21,20,000	 90,000 5,000 19,80,000 20,000 25,000

Notes to Accounts:

	(₹)
1. Share Capital: Issued and Paid-up Capital 80,000 Equity Shares of ₹10 each	8,00,000
2. Long-term Borrowings:	
14% Debentures	5,00,000
3. Tangible Assets:	
Land & Buildings	2,00.000
Plant &Machinery	2,10,000
Furniture	80,000
	4,90,000

Balance Sheet of Downhill Ltd. as on 31.03.2010 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	8,00,000
Reserves and Surplus	—	—
(ii) Non-current Liabilities		
Long-term Borrowings	2	5,00,000
(iii) Current Liabilities:		
Total: (i) + (ii) + (iii)		13,00,000
II. Assets:		
(i) Non-current Assets:		
Tangible Assets	3	4,90,000
Intangible Assets	—	—
(ii) Current Assets:		
Stock		2,70,000
Debtors (60,000 – 5,000)		55,000
Cash at Bank (35,000 + 5,00,000 – 50,000)		4,85,000
Total: (i) + (ii)		13,00,000

Illustration 13

Sub-division of Shares

Sumathi Ltd. decided upon a scheme of reconstruction as on 31st March 2011 approved by the Court and agreed to by the concerned parties. Give the journal entries and prepare the balance sheet after reconstruction. The summarised balance sheet of the company as on that date was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets:	
2,000 6% Preference Shares of ₹100 each	2,00,000	Land & Buildings	50,000
3,000 Equity Shares of ₹100 each	3,00,000	Plant & Machinery	1,00,000
Creditors	1,00,000	Current Assets:	
		Stock	1,00,000
		Debtors	1,40,000
		Cash at Bank	10,000
		Miscellaneous Expenditure:	
		Profit & Loss A/c	2,00,000
	6,00,000		6,00,000

The main features of the reconstruction scheme were as under:

(a) Each existing 6% preference share would be written down from ₹100 to ₹80 of which ₹50 will be represented by 7½% preference shares and ₹30 by equity shares.
(b) Each existing equity share would be written down from ₹100 to ₹20.
(c) Both classes of shares will then be sub-divided into shares of ₹10 each.

Reduction of capital would be used to writing down plant and machinery by ₹20,000; Stock by ₹20,000; and Debtors by ₹40,000.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	6%Pref. Share Capital A/c (₹100) Dr.		2,00,000	
	To 7 ½ % Preference Share Capital (₹50)			1,00,000
	To Equity Share Capital A/c (₹30)			60,000
	To Capital Reduction A/c			40,000
	(*Being 6% preference share capital converted into equity share capital of ₹30 each, 7½% preference share capital of ₹50 each and balance transferred to capital reduction*)			
	Equity Share Capital A/c (₹100) Dr.		3,00,000	
	To Equity Share Capital A/c (₹20)			60,000
	To Capital Reduction A/c			2,40,000
	(*Being equity share reduced to ₹20 per share on account of reconstruction scheme*)			
	7 ½ % Preference Share Capital A/c (₹50) Dr.		1,00,000	
	To 7 ½ Preference Share Capital A/c (₹10)			1,00,000
	(*Being sub-division of 7½ preference share of ₹50 each into ₹10,000, 7½ preference share of ₹10 each per share*)			

(*Contd.*)

	Equity Share Capital A/c (₹30) Dr. To Equity Share Capital A/c (₹10) (*Being sub-division of equity share capital of ₹30 each into equity share of ₹10 each – 6,000 shares*)		60,000	60,000
	Equity Share Capital A/c (₹20) Dr. To Equity Share Capital A/c (₹10) (*Being sub-division of 3,000 equity shares of ₹20 each into 6,000 equity shares of ₹10 each*)		60,000	60,000
	Capital Reduction A/c Dr. To Plant &Machinery To Stock A/c To Debtors A/c To Profit &Loss A/c (*Being losses written off and assets value reduced through reconstruction scheme*)		2,80,000	20,000 20,000 40,000 2,00,000

Notes to Accounts:

	Amount (₹)	Amount (₹)
1. Share Capital:		
Issued and Paid-up:	1,00,000	
71/2% Preference Shares of ₹10 each	1,20,000	2,20,000
12,000 Equity Shares of ₹10 each		
2. Trade Payables:		
Creditors		1,00,000
3. Tangible Assets:		
Land & Buildings	50,000	
Plant & Machinery (1,00,000 – 20,000)	80,000	1,30,000
4. Current Assets:		
Stock (1,00,000 – 20,000)	80,000	
Debtors (1,40,000 – 40,000)	1,00,000	
Cash at Bank	10,000	1,90,000

Balance Sheet of Sumathi Ltd., as on 31.03.2011 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	2,20,000
Reserves and Surplus		—
(ii) Non-current Liabilities		—
(iii) Current Liabilities:		
Trade Payables	2	1,00,000
Total: (i) + (ii) + (iii)		3,20,000

(*Contd.*)

II. Assets:		
(i) Non-current Assets:		
Tangible Assets	3	1,30,000
Intangible Assets		—
(ii) Current Assets:	4	1,90,000
Total: (i) + (ii)		3,20,000

Illustration 14

Shares issued for arrears of preference dividend partly and cancelled partly

The balance sheet of Revathi Limited as on 31st December 2011 was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital		Goodwill	20,000
10,000 9% Cumulative Preference Shares of ₹10 each	1,00,000	Patents &Trademarks	15,000
20,000 Equity Shares of ₹10 each	2,00,000	Land & Buildings	88,000
6% Debentures (secured on land and buildings)	50,000	Plant & Machinery	86,000
Interest due on the above	3,000	Shares in Companies	30,000
Bank Overdraft	59,000	Stock	70,000
Creditors	85,000	Debtors	1,01,000
Advance by Directors	23,000	Profit &Loss A/c	1,10,000
	5,20,000		5,20,000

Dividend on preference shares is in arrear for 3 years and there is a contingent liability to the extent of ₹10,000.

A scheme of capital reduction contained the following terms.

(a) The preference shares are to be reduced to ₹8 and the equity shares to ₹2.50 each. The preference shareholders waive two-third of the dividend arrears and receive equity shares of ₹2.50 for the balance.

(b) All intangible assets are to be eliminated and bad debts of ₹7,000 and obsolete stock of ₹10,500 are to be written off.

(c) The investments in shares of companies are sold for ₹40,000.

(d) The debenture holders agreed to take over one of the company's properties (book value ₹17,500) at a price ₹25,000 in part satisfaction of the debentures and to provide further cash of ₹15,000 on the floating charge of assets. The interest due to them is paid.

(e) The contingent liability materialised at ₹5,000 and was paid.

(f) The directors agreed to take equity shares in satisfaction of their advances.

Pass the necessary journal entries and set out the reduced balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	9%Cumulative Preference Share Capital A/c (₹10) Dr. To 9% Cumulative Preference Share Capital (₹8) To Capital Reduction A/c (*Being conversion of preference shares of ₹10 each into share of ₹8 each and balance transferred to capital reduction*)		1,00,000	 80,000 20,000
	Equity Share Capital A/c(₹10) Dr. To Equity Share Capital A/c (₹2.50) To Capital Reduction A/c (*Being equity shares of ₹10 each converted into equity shares of ₹2. 50 each and balance transferred to capital reduction*)		2,00,000	 50,000 1,50,000
	Preference Dividend A/c Dr. To Equity Share Capital A/c (*Being equity shares allotted to preference shares for 1/3rd of arrears of preference dividend*)		9,000	 9,000
	6% Debentures A/c Dr. To Debentures Holders A/c (*Being amount to be settled to debenture holders*)		50,000	 50,000
	Debentures Holders A/c Dr. To Land & Building A/c To Bank A/c To Capital Reduction A/c (*Being amount due to debenture holders settled in the form of land and buildings, cash and balance to capital reduction*)		50,000	 17,500 15,000 17,500
	Interest on Debentures A/c Dr. To Bank A/c (*Being interest on debentures paid to debenture holders*)		3,000	 3,000
	Contingent Liability A/c Dr. To Bank A/c (*Being amount paid to contingent liabilities*)		5,000	 5,000
	Bank A/c Dr. To Shares in Companies A/c To Profit & Loss A/c (*Being profit on sale of investments in shares*)		40,000	 30,000 10,000

(*Contd.*)

	Advances by Directors A/c Dr.		23,000	
	To Equity Share Capital A/c			23,000
	(*Being equity shares allotted to directors for the advances made by directors*)			
	Capital Reduction A/c Dr.		1,87,500	
	To Goodwill A/c			20,000
	To Patents &Trademarks A/c			15,000
	To Profit & Loss A/c			1,10,000
	To Bad Debts A/c			7,000
	To Stock A/c			10,500
	To Preference Dividend A/c			9,000
	To Contingent Liabilities A/c			5,000
	To Capital Reserve A/c (Bal. Fig.)			11,000
	(*Being losses written off, amount reduced from assets and balance transferred to capital reserve A/c*)			

Bank Account

Particulars	(₹)	Particulars	(₹)
To Investments in Shares in Companies A/c	40,000	By Balance b/d	59,000
To Balance c/d	42,000	By Debenture Holders A/c	15,000
		By Interest on Debentures A/c	3,000
		By Contingent Liability A/c	5,000
	82,000		82,000

Notes to Accounts:

	Amount (₹)	Amount (₹)
1. Share Capital:		
Issued and Paid-up:		
32,800 Equity Sharesof Rs 2.50 each	82,000	
10000 9% Cumulative Preference Shares of ₹8 each	80,000	1,62,000
2. Reserves & Surplus:		
Profit &Loss A/c	10,000	
Capital Reserve	11,000	21,000
3. Long-term Borrowings:		
Bank Overdraft		42,000
4. Trade Payables		
Creditors		85,000
5. Tangible Assets:		
Land & Buildings (88,000 – 17,500)	70,500	
Plant & Machinery	86,000	1,56,500

Balance Sheet of Revathi Ltd. as on 31.12.2011 (and reduced)

		Note No.	(₹)
I. Equity and Liabilities:			
(i) Shareholder's Funds			
Share Capital		1	1,62,000
Reserves and Surplus		2	21,000
(ii) Non-current Liabilities			
Long-term Borrowings		3	42,000
(iii) Current Liabilities:			
Trade Payables		4	85,000
Total: (i) + (ii) + (iii)			3,10,000
II. Assets:			
(i) Non-current Assets:			
Tangible Assets		5	1,56,500
Intangible Assets			—
(ii) Current Assets:			
Stock (70,000 – 10,500)			59,500
Debtors	1,01,000		
Less: Bad Debts	7,000		94,000
Total: (i) + (ii)			3,10,000

Illustration 15

Sale of Property at loss to debenture holders

The following is the balance sheet of Gamma Ltd. as on 31st March 2008.

Liabilities	(₹)	Assets	(₹)
Share Capital		Sundry Assets	3,00,000
40,000 Equity Shares of ₹10 each, fully paid	4,00,000	Workmen's Compensation Fund Investments	60,000
36000 8% Preference Shares of ₹10 each, fully paid	3,60,000	Property: Hyderabad 3,20,000 Vishakhapatnam 2,40,000	5,60,000
6% First Debentures (secured on Hyderabad property)	60,000	Profit &Loss A/c	80,000
6% Second Debentures (secured on Vishakhapatnam property)	70,000		
Workmen's Compensation Fund Hyderabad 40,000 Vishakhapatnam 20,000	60,000		
Creditors	50,000		
	10,00,000		10,00,000

The following scheme was duly prepared and sanctioned:

(a) Equity shares were to be reduced to ₹1 each.

(b) Preference share were to be reduced to ₹1 each.

(c) Debenture holders to forego their interest ₹10,400, which is included among sundry creditors.

(d) Second debenture holder agreed to take over Vishakhapatnam property at ₹1,00,000 accept an allotment of 6,000 ₹1 equity shares at par and upon their forming, a company called Vani Ltd. to take over the Vishakhapatnam property, they allotted Gamma Ltd. 3,600 shares of ₹10 each, fully paid at par.

(e) The Vishakhapatnam workmen's compensation disclosed the fact that there were liabilities to the extent of ₹4,000. The investments pertaining to it were sold at a profit of 10% on book value and the liability was paid.

(f) Sundry assets were to be written down by ₹1,60,000.

Show the journal entries to give effect to the above and prepare the reconstructed balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity Share Capital A/c (₹10) Dr. To Equity Share Capital A/c (₹1) To Capital Reduction A/c (*Being 40,000 equity shares of ₹10 each reduced by ₹9 each*)		4,00,000	 40,000 3,60,000
	8% Preference Share Capital A/c (₹10) Dr. To 8% Preference Share Capital A/c (₹8) To Capital Reduction A/c (*Being 36,000 8% preference shares of ₹10 each reduced by ₹2 per share*)		3,60,000	 2,88,000 72,000
	Sundry Creditors A/c Dr. To Capital Reduction A/c (*Being debenture interest included in creditors A/c waived*)		10,400	 10,400
	6% Second debenture A/c Dr. Shares in Vani Ltd. A/c Dr. Loss on Sale of Vishakhapatnam Property A/c Dr. To Vishakhapatnam Property A/c To Equity Share Capital A/c (*Being second debenture holder's claim satisfied by issuing 6,000 equity shares of ₹1 each and Vishakhapatnam property and 3,600 shares of ₹10 each being received from Vani Ltd.*)		70,000 36,000 1,40,000	 2,40,000 6,000

(*Contd.*)

	Bank A/c Dr. To Workmen Compensation Fund Investment A/c To Workmen Compensation Fund A/c (*Being investment realised at a profit of 10%*)		22,000	 20,000 2,000
	Workmen Compensation Fund A/c Dr. To Bank A/c To Capital Reduction A/c (*Being liability on account of workmen's compensation being paid*)		22,000	 4,000 18,000
	Capital Reduction A/c Dr. To Loss on Sale of Vishakhapatnam Property A/c To Profit & Loss A/c To Sundry Assets A/c To Capital Reserve A/c (*Being Profit & Loss A/c and sundry assets written off and balance transferred to capital reserve A/c*)		4,60,000	 1,40,000 80,000 1,60,000 80,400

Notes to Accounts:

	Amount (₹)
1. Share Capital: Authorised, Issued and Subscribed Capital 46,000 Equity Shares of ₹1 each 20,000 8% Preference Shares of ₹8 each	 46,000 2,88,000
	3,34,000
2. Reserves and Surplus: Capital Reserve Workmen Compensation Fund – Hyderabad	 80,400 40,000
	1,20,400
3. Long-term Liabilities: 6% First Debentures (secured on Hyderabad property) 4. Trade Payables Creditors 5. Tangible Asset: Sundry Assets Property – Hyderabad	 60,000 39,600 1,40,000 3,20,000
	4,60,000
6. Non-current Investments: Workmen Compensation Fund Investment 3,600 shares of Vani Ltd. of ₹10 each	 40,000 36,000
	76,000

Balance Sheet of Gamma Ltd. as on 31.03.2008 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	3,34,000
Reserves and Surplus	2	1,20,400
(ii) Non-current Liabilities		
Long-term Borrowings	3	60,000
(iii) Current Liabilities:		
Trade Payable	4	39,600
Total: (i) + (ii) + (iii)		5,54,000
II. Assets:		
(i) Non-current Assets:		
Tangible Assets	5	4,60,000
Non-current Investment	6	76,000
(ii) Current Assets:		
Bank (22,000 – 4,000)		18,000
Total: (i) + (ii)		5,54,000

Illustration 16

Settlement Options to Creditors

The balance sheet of Shanmathi Co. Ltd. as on 31st December 2008, was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital		Premises	4,80,000
40,000 Preference Shares of ₹10 each	4,00,000	Plant	3,50,000
1,20,000 Equity Shares of ₹5 each	6,00,000	Loose Tools	1,00,000
Reserves	2,000	Stock	80,000
9% Debentures	2,40,000	Debtors	1,20,000
Creditors	4,00,000	Bills Receivable	40,000
		Bank	12,000
		Goodwill	2,80,000
		Profit & Loss A/c	1,80,000
	16,42,000		16,42,000

Upon revaluation of assets, it was considered that the entire goodwill was worthless and assets were overvalued as follows:

Premises ₹80,000; Plant ₹50,000; Loose tools ₹60,000; and Debtors ₹10,000.

Scheme of rearrangement and reduction of capital was agreed to by the court and the creditors on the following lines:

(a) That the creditors should accept 9% debentures to the extent of half of their debts the balance to be settled by payment of cash at 90%.
(b) That the preference shares be reduced to shares of ₹5 each fully paid.
(c) That the equity shares be reduced to ₹1 each.
(d) That the assets should be reduced to the revalued figures.

Pass journal entries and prepare the balance sheet after rearrangement.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Preference Share Capital A/c (₹10) Dr.		4,00,000	
	To Pref. Share Capital A/c (₹5)			2,00,000
	To Capital Reduction A/c			2,00,000
	(*Being reduction of preference shares of ₹10 each into ₹5 each*)			
	Equity Share Capital A/c (₹5) Dr.		6,00,000	
	To Equity Share Capital A/c (₹1)			1,20,000
	To Capital Reduction A/c			4,80,000
	(*Being equity shares reduced from ₹5 to ₹1 each*)			
	Creditors A/c Dr.		4,00,000	
	To 9% Debentures A/c			2,00,000
	To Bank A/c (90% of ₹2,00,000)			1,80,000
	To Capital Reduction A/c			20,000
	(*Being 9% debentures issued, paid cash for the balance amount at 90%*)			
	Capital Reduction A/c Dr.		7,00,000	
	To Goodwill A/c			2,80,000
	To Profit & Loss A/c			1,80,000
	To Premises A/c			80,000
	To Plant A/c			50,000
	To Loose Tools A/c			60,000
	To Debtors A/c			10,000
	To Capital Reserve A/c (Bal. Fig.)			40,000
	(*Being losses written off, amount reduced from assets, which are overvalued and balance transferred to capital reserve A/c*)			

Bank Account

Particulars	(₹)	Particulars	(₹)
To Balance b/d	12,000	By Creditors A/c	1,80,000
To Balance c/d	1,68,000		
	1,80,000		1,80,000

Notes to Accounts:

	Amount (₹)
1. Share Capital:	
Issued and Paid-up Capital	
40,000 Preference Shares of ₹5 each	2,00,000
1,20,000 Equity Shares of ₹1 each	1,20,000
	3,20,000
2. Reserves and Surplus:	
Reserves	2,000
Capital Reserve	40,000
	42,000
3. Long-term Borrowings:	
9% Debentures (2,40,000 + 2,00,000)	4,40,000
4. Other Current Liabilities:	
Bank Overdraft	1,68,000
5. Tangible Assets:	
Premises (4,80,000 – 80,000)	4,00,000
Plant (3,50,000 – 50,000)	3,00,000
Loose Tools (1,00,000 – 60,000)	40,000
	7,40,000

Balance Sheet of Shanmathi Co. Ltd. as on 31.12.2008 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	3,20,000
Reserves and Surplus	2	42,000
(ii) Non-current Liabilities		
Long-term Borrowings	3	4,40,000
(iii) Current Liabilities:		
Other Current Liabilities	4	1,68,000
Total: (i) + (ii) + (iii)		9,70,000
II. Assets:		
(i) Non-current Assets:		
Tangible Assets	5	7,40,000
Intangible Assets		
(ii) Current Assets:		
Stock		80,000
Debtors (1,20,000 – 10,000)		1,10,000
Bill Receivable		40,000
Total: (i) + (ii)		9,70,000

Illustration 17

Comprehensive Problem

Given below is the balance sheet of Slow Success Ltd., as on 31st December 2006.

Liabilities	(₹)	Assets	(₹)
Share Capital		Land &Buildings	1,00,000
4,000 Equity Shares of ₹100 each, fully paid	4,00,000	Machinery	4,00,000
1000 'A'Equity Shares of ₹100 each, ₹50 paid	50,000	Motor Vans	40,000
Development Rebate Reserve	1,50,000	Furniture	10,000
Loan (unsecured)	6,40,000	Investments (market value ₹40,000)	50,000
Creditors (including ₹10,000 holding lien on some assets)	2,60,000	Stock	1,00,000
		Debtors	1,90,000
		Bank Balance	10,000
		Profit & Loss A/c	6,00,000
	15,00,000		15,00,000

The company having turned corner, a scheme of reconstruction was prepared and approved as under:

(a) To revalue land and buildings to its present market value of ₹1,50,000.
(b) Equity shares to be reduced to ₹10 per share but the face value to remain at ₹100.
(c) A call of ₹50 to be made on equity shareholders to provide funds for working capital.
(d) Unsecured loans to be paid immediately to the extent of ₹1,00,000.
(e) Unsecured creditors to be paid immediately to the extent of 10% of their claims and they accept a remission of 20% of their claims.
(f) Development rebate reserve being no longer required, to be transferred to profit and loss account.
(g) Investments to be brought to their market value and
(h) The amount available as a result of the scheme to be used to write off the debit balance on profit and loss account.

Pass the necessary journal entries to give effect to the above scheme and prepare the reconstructed balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity Share Capital A/c (₹100) Dr. To Equity Share Capital A/c (₹10) To Capital Reduction A/c (*Being equity shares reduced to ₹10 per share and the balance transferred to capital reduction A/c*)		4,00,000	 40,000 3,60,000
	Equity Share Capital A/c (₹100) Dr. To Equity Share Capital A/c (₹10) To Capital Reduction A/c (*Being equity shares reduced to ₹10 per share, which is ₹50 paid up and the balance transferred to capital reduction A/c*)		50,000	 10,000 40,000
	Bank A/c (4,000 + 1,000 shares × 50) Dr. To Equity Share Capital A/c To A Equity Share Capital A/c (*Being a call of ₹50 per share made from both the classes of equity shares*)		2,50,000	 2,00,000 50,000
	Unsecured Loan A/c Dr. To Bank A/c (*Being amount paid to unsecured loan to the extent of ₹1,00,000*)		1,00,000	 1,00,000
	Unsecured Creditors A/c Dr. To Bank A/c To Capital Reduction A/c (*Being amount paid to unsecured creditors @10% and 20% of the amount transferred to capital reduction A/c*)		75,000	 25,000 50,000
	Development Rebate Reserve A/c Dr. To Profit & Loss A/c (*Being development rebate reserve adjusted to Profit & Loss A/c*)		1,50,000	 1,50,000
	Land & Building A/c Dr. To Capital Reduction A/c (*Being land and buildings revalued and amount transferred to capital reduction A/c*)		1,50,000	 1,50,000
	Capital Reduction A/c Dr. To Investments A/c To Profit & Loss A/c To Capital Reserve A/c (*Being loss written off, value of investments brought down to market value and balance transferred to capital reserve*)		6,00,000	 10,000 4,50,000 1,40,000

Bank Account

Particulars	(₹)	Particulars	(₹)
To Balance b/d	10,000	By Unsecured Loan A/c	1,00,000
To Equity Share Capital A/c	2,00,000	By unsecured Creditors	25,000
To A Equity Share Capital A/c	50,000	By Balance c/d	1,35,000
	2,60,000		2,60,000

Notes to Accounts:

	Amount (₹)	Amount (₹)
1. Share Capital:		
Issued and Paid-up		
4,000 Equity Shares of ₹100 each, ₹60 Paid-up	2,40,000	
1,000 A Equity Shares of ₹100 each, ₹60 Paid-up	60,000	3,00,000
2. Reserves and Surplus:		
Capital Reserve	40,000	40,000
3. Long-term Borrowings:		
Loans (Unsecured)		5,40,000
4. Other Current Liabilities:		
Creditors (including ₹10,000 holding lien on some assets - 2,60,000 – 75,000)		1,85,000
5. Tangible Assets:		
Land & Buildings (1,00,000 + 1,50,000)	2,50,000	
Machinery	4,00,000	
Motor Vans	40,000	
Furniture	10,000	7,00,000
6. Other Current Assets:		
Investments		40,000

Balance Sheet of Success Ltd. as on 31.12.2006 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	3,00,000
Reserves and Surplus	2	1,40,000
(ii) Non-current Liabilities		
Long-term Borrowings	3	5,40,000
(iii) Current Liabilities:		
Other Current Liabilities	4	1,85,000
Total: (i) + (ii) + (iii)		11,65,000

(*Contd.*)

II. Assets:		
(i) Non-current Assets:		
Tangible Assets	5	7,00,000
Intangible Assets		
(ii) Current Assets:		
Stock	6	1,00,000
Debtors		1,90,000
Bank		1,35,000
Other Current Assets		40,000
Total: (i) + (ii)		11,65,000

Illustration 18

Reorganisation through surrender of shares

In order to reconstruct the balance sheet, Rohit Ltd. passed the following resolution:

(a) The share capital of the company consisting of 2,000 ordinary shares of ₹100 each to be converted into 20, 000 shares of ₹10 each.
(b) The shareholders to surrender 60% of their shares after such conversion.
(c) The amount available should be utilised to write off machinery of ₹20,000, stock of ₹10,000 and the balance available to write off the debit balance in profit and loss account.

You are required to pass the necessary journal entries.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity Share Capital A/c (₹100) Dr.		2,00,000	
	To Equity Share Capital A/c (₹10)			2,00,000
	(*Being 2,000 ordinary shares of ₹100 each, subdivided into 20,000 shares of ₹10 each*)			
	Equity Share Capital A/c (₹10) Dr.		1,20,000	
	To Surrendered Shares A/c			1,20,000
	(*Being surrender of 60% of shares by the shareholders*)			
	Surrendered Shares A/c Dr.		1,20,000	
	To Capital Reduction A/c			1,20,000
	(*Being cancellation of surrendered shares by transferring to capital reduction A/c*)			
	Capital Reduction A/c Dr.		1,20,000	
	To Machinery A/c			20,000
	To Stock A/c			10,000
	To Profit &Loss (Dr.) A/c			90,000
	(*Being the utilisation of capital reduction A/c to write off machinery, stock and accumulated losses*)			

Illustration 19

A company's position on 30th June 2003 was as follows:

	(₹)
20,000 equity shares of ₹100 each	20,00,000
1,000 6% Debentures of ₹1,000 each	10,00,000
Interest on the above	1,20,000

The assets on that date amounted to ₹9,60,000 (valued according to their present worth). The following steps were taken with the approval of all concerned.

(a) The shares were subdivided into shares of ₹5 each and 90% of the shares were surrendered.

(b) The total claims of the debenture holders were reduced to ₹4,90,000 and in consideration of this, they were allotted shares (out of the surrendered shares) amounting to ₹2,50,000.

(c) The shares surrendered but not re-issued were cancelled.

Pass journal entries and give the balance sheet of the company after reconstruction.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity Share Capital A/c (₹100) Dr. To Equity Share Capital A/c (₹5) (*Being sub-division of 20,000 equity shares of ₹100 each into 4,00,000 shares of ₹5 each*)		20,00,000	20,00,000
	Equity Share Capital A/c (₹5) Dr. To Surrendered Shares A/c (*Being surrender of 90% of equity shares by the shareholders as per capital reduction scheme*)		18,00,000	18,00,000
	6% Debentures A/c Dr. Interest on Debentures A/c Dr. To Capital Reduction A/c (*Being debentures holders claim reduced to ₹4,90,000*)		5,10,000 1,20,000	6,30,000
	Surrendered Shares A/c Dr. To Equity Share Capital A/c (*Being issue of 50,000 equity shares of ₹5 each to debenture holders out of surrendered shares, as per capital reduction scheme*)		2,50,000	2,50,000
	Surrendered Shares A/c Dr. To Capital Reduction A/c (*Being unissued surrendered shares cancelled and transferred to capital reduction A/c*)		15,50,000	15,50,000

(*Contd.*)

	Capital Reduction A/c Dr. To Profit &Loss A/c To Capital Reserve A/c (Bal. Fig.) (*Being loss written off and balance transferred to capital reserve A/c*)		21,80,000	 21,60,000 20,000

Working Note 1

Balance Sheet of … Company as on 30.06.2003

Liabilities	Amount (₹)	Assets	Amount (₹)
20,000 Equity Shares of ₹100 each	20,00,000	Fixed Assets	9,60,000
1,000 6% Debentures of ₹1,000 each	10,00,000	Profit & Loss A/c (Bal. Fig.)	21,60,000
Interest on Debentures Outstanding	1,20,000		
	31,20,000		31,20,000

Notes to Accounts:

	Amount (₹)	Amount (₹)
1. Share Capital:		
Issued and Paid-up:		
90,000 Equity Shares of ₹5 each		4,50,000
2. Reserves and Surplus:		
Capital Reserve		20,000
3. Long-term Borrowings:		
6% Debentures		4,90,000
4. Tangible Assets:		
Fixed Assets		9,60,000

Balance Sheet of … Company as on 30.06.2003 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	4,50,000
Reserves and Surplus	2	20,000
(ii) Non-current Liabilities		
Long-term Borrowings	3	4,90,000
(iii) Current Liabilities:		
Total: (i) + (ii) + (iii)		9,60,000

(*Contd.*)

II. Assets:		
(i) Non-current Assets:		
Tangible Assets	4	9,60,000
Intangible Assets		
(ii) Current Assets		
Total: (i) + (ii)		9,60,000

Illustration 20

The balance sheet of Prospective Ltd., as on 31st December 2011, was as follows:

Liabilities	(₹)	Assets	(₹)
Authorised & Subscribed Capital:		Patents &Copyrights (at cost)	1,00,000
8,000 Equity Shares of ₹100 each, fully paid	8,00,000	Other Sundry Assets (Net)	6,00,000
8% Debentures 2,00,000		Profit &Loss A/c	4,16,000
Add: Interest Accrued 16,000	2,16,000		
Sundry Creditors	72,000		
Provision for Income Tax	28,000		
	11,16,000		11,16,000

It was decided to reconstruct the company for which necessary resolutions were passed and necessary sanctions were obtained from appropriate authorities:

Accordingly, it was decided that:

(a) Each share be sub-divided into one hundred fully paid equity shares of ₹1 each.
(b) After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and creditors as necessary.
(c) Out of shares surrendered, 54,000 shares of ₹1 each shall be converted into preference shares of ₹10 each, fully paid up.
(d) The claims of the debenture holders shall be reduced by 75% in consideration thereof, the debentureholders shall receive preference shares to the value of 25% of their claims against the company as at 31st December 2011.
(e) Creditors' claim shall be reduced to 50% to be settled by the issue of equity shares of ₹1 each out of the shares surrendered.
(f) Patents and copyrights, having no realisable value, be completely written off, along with the debit balance of profit andloss account.
(g) The shares surrendered and not re-issued shall be cancelled.

You are required to show the journal entries giving effect to the above and the resultant balance sheet.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity Share Capital A/c (₹100) Dr. To Equity Share Capital A/c (₹1) (*Being sub-division of 8,000 equity shares of ₹100 each, into 8,00,000 equity shares of ₹1 each*)		8,00,000	 8,00,000
	Equity Share Capital A/c (₹1) Dr. To Surrendered Shares A/c (*Being surrender of 50% of equity shares by the shareholders as per capital reduction scheme*)		4,00,000	 4,00,000
	Shares Surrendered A/c Dr. To Preference Share Capital A/c (*Being issues of 5,400 preference shares @ ₹10 each to the surrendered shareholders, who have surrendered the shares*)		54,000	 54,000
	8% Debentures A/c Dr. Interest on Debentures A/c Dr. To Capital Reduction A/c To Preference Share Capital A/c (*Being debentures holders received preference shares for their claim @ 25% and 75%of their amount transferred to capital reduction A/c*)		2,00,000 16,000	 1,62,000 54,000
	Sundry Creditors A/c Dr. To Capital Reduction A/c (*Being reduction of creditors claim to ₹36,000*)		72,000	 72,000
	Surrender Shares A/c Dr. To Equity Share Capital A/c (*Being issue of 36,000 equity shares of ₹1 each to creditors out of the surrendered shares*)		36,000	 36,000
	Surrendered Shares A/c Dr. To Capital Reduction A/c (*Being unissued surrendered shares cancelled and transferred to capital reduction A/c*)		3,10,000	 3,10,000
	Capital Reduction A/c Dr. To Profit & Loss A/c To Patents & Copyrights A/c To Capital Reserve A/c (Bal. Fig.) (*Being loss written off and balance transferred to capital reserve A/c*)		5,44,000	 4,16,000 1,00,000 28,000

Notes to Accounts:

	Amount (₹)	Amount (₹)
1. Share Capital:		
Issued and Paid-up:		
4,36,000 equity shares of ₹1 each, fully paid	4,36,000	
10,800 preference shares of ₹10 each, fully paid	1,08,000	5,44,000
2. Reserves and Surplus:		
Capital Reserve		28,000
3. Other Current Liabilities		
Provision for Income Tax		28,000
4. Tangible Assets:		
Other Sundry Assets		6,00,000

Balance Sheet of Prospective Ltd. as on 31.12.2011 (and reduced)

	Note No.	(₹)
I. Equity and Liabilities:		
(i) Shareholder's Funds		
Share Capital	1	5,44,000
Reserves and Surplus	2	28,000
(ii) Non-current Liabilities		
Long-term Borrowings		
(iii) Current Liabilities:		28,000
Other Current Liabilities	3	
Total: (i) + (ii) + (iii)		6,00,000
II. Assets:		
(i) Non-current Assets:		
Tangible Assets	4	6,00,000
Intangible Assets		
(ii) Current Assets		
Total: (i) + (ii)		6,00,000

THEORY QUESTIONS

I. Short-Answer Questions

1. What is Capital Reduction?
2. What is Internal Reconstruction?
3. What do you mean by Alteration of Share Capital'?
4. Enumerate alterations of share capital, which do not require court approval.
5. State the differences between Internal and External reconstruction.
6. Explain the terms Consolidation and Sub-division of Shares?

7. How will you treat the increase and decrease in the value of assets in internal reconstruction?
8. Write short notes on:
   (a) Scheme of Capital Reduction
   (b) Surrendered Shares
   (c) Capital Reduction Account

II. Long-Answer Questions

1. Explain the different kinds of Alteration of Share Capital, which do not require approval of a court of law.
2. What is Capital Reduction? State the provisions of the Companies Act in regard to the reduction of share capital.
3. Explain the procedure to be followed for reducing share capital?

OBJECTIVE-TYPE QUESTIONS

I. Multiple Choice Questions

1. Alteration of share capital is affected by a company if it is authorised by the:
   (a) Register of Members (b) Articles of Association
   (c) Minutes Book (d) Board of Directors
2. The Capital Reduction Scheme can be implemented only after getting permission from:
   (a) SEBI Board (b) Controller of Capital Issues
   (c) Shareholders (d) CompetentCourt
3. In case of sub-division of share capital, the total number of shares:
   (a) Do not change (b) Decreases
   (c) Increases (d) Increases disproportionately
4. When a company converts its equity shares into the capital stock, then the account to be credited is:
   (a) Preference Share Capital A/c (b) Equity Share Capital A/c
   (c) Equity Capital Stock A/c (d) No entry is required
5. After writing off of all accumulated losses and fictitious assets, the balance in capital reduction accountshould be transferred to:
   (a) Share Capital A/c (b) Capital Reserve A/c
   (c) General Reserve A/c (d) Goodwill A/c
6. Any gain on revaluation of the assets at the time of internal reconstruction will be credited to:
   (a) Capital Reserve A/c (b) General Reserve A/c
   (c) Surrendered Shares A/c (d) Capital Reduction A/c
7. In the scheme of reorganisation, amount of shares surrendered by shareholders is transferred to:
   (a) Capital Reserve A/c (b) General Reserve
   (c) Surrendered Shares A/c (d) Capital Reduction A/c

8. Any decrease in the value of assets, at the time of internal reconstruction, will be charged to:
   (a) Capital ReserveA/c (b) Capital Reduction A/c
   (c) Revaluation A/c (d) Shares SurrenderedA/c
9. A company has issued capital of 60,000 equity shares of ₹10 each, fully paid. It decides to convert its capital into 1,20,000 equity shares of ₹5 each. It is a case of:
   (a) Decrease in Unissued Share Capital
   (b) Sub-division of Share Capital
   (c) Consolidation of Share Capital
   (d) None of the Above

[*Ans:* 1. (b); 2. (d); 3. (c); 4. (c); 5. (b); 6. (b); 7. (c); 8. (b); 9. (b)]

II. True or False

1. Internal reconstruction refers to the reorganisation of capital structure of a company with the liquidation of the company.
2. In case the unissued share capital is to be decreased, the share capital account need not be cancelled.
3. A company is free to reduce or extinguish the uncalled liability of its members.
4. A company is not allowed to convert its fully-paid shares into stock.
5. Reconstruction Account is an alternative term for Capital Reduction Account.
6. The balance in securities premium account can be transferred to capital reduction account.
7. Cancellation of unissued capital is also a case of capital reduction.
8. If the balance in capital reduction account is not adequate enough to write off accumulated losses, any reserve in the liabilities side can be used to the extent required.
9. Claim foregone by debenture holders should not be transferred to capital reduction account.

[*Ans:* True: 2, 5,6, 7, 8;False: 1, 3,4, 9]

III. Fill in the Blanks

1. Sub division of shares does not affect the amount of ________.
2. A company can convert fully paid ________ into stock and also reconvert ________ back into shares.
3. Cancellation of shares not taken up does not amount to ________ of capital.
4. A company can carry out ________ only after a court approves a scheme.
5. Any debit balance in profit and loss account represents ________ and such losses will be written off as part of a capital organisation.
6. Alteration of shares of smaller amount into shares of larger amount is called _______ of share capital.
7. Consent of ________ is not required if capital reduction involves the writing off of paid-up capital not represented by available assets.
8. In a scheme of capital reduction, any new liability to be provided for, such as arrears of preference dividend, must be met out of _______ account.

9. Reserves of the company can be utilised in meeting the accumulated _______ at the time of internal reconstruction.
10. After giving permission for capital reduction, the Court may order the use of the words _______ after the name of the company, for a specified period.

[*Ans:* 1. Share capital; 2. Shares, stock; 3. Reduction;4. Capital reduction; 5. Accumulated losses; 6. Consolidation; 7.Creditors; 8. Capital reduction; 9. Losses; 10. and reduced]

EXERCISE PROBLEMS

1. On the capital reduction, a company finds that its buildings have appreciated by ₹40,000 and the value of stock is ₹30,000.
   Record these events in journal. [*Ans:* Capital reduction: ₹70,000]
2. Find out the amount of capital reserve when the capital reduction is ₹5,00,000. Accumulated loss ₹3,00,000, preliminary expenses ₹1,00,000 and the plant to be written down by ₹40,000. [*Ans:* Capital reserve: ₹60,000]
3. Calculate the provision for tax used for the purpose of capital reduction from the following information:

Capital Reduction	₹3,00,000	
Income Tax Provisions	₹10,000	
Stock to be written down by	₹6,000	
Goodwill is reduced by	₹2,00,000	
Profit and Loss (Dr.)	₹1,00,000	[*Ans:* ₹60,000]

4. In order to provide fund for capital reduction scheme, the preference shareholders of ₹10,00,000 have agreed to take over the building for ₹8,00,000 in full settlement. Pass journal entry for the above transactions.
   [*Ans:* Amount foregone by preference shareholders ₹2,00,000]
5. Rani Company Ltd., with a share capital of ₹20,000, equity shares of ₹10 each fully-paid, carries out by proper resolution, a sub-division into shares of ₹1 each. Pass journal entry to give the effect to the above information.
   [*Ans:* 2,00,000 equity shares of ₹1 each]
6. On 31st March 2008, Rahim Ltd. passed resolution to sub-divide 50,000 equity shares of ₹100 each into shares of ₹50 each. Show the necessary journal entries to give effect to the above resolution.
   [*Ans:* 1,00,000 equity shares of ₹50 each]
7. On 31st December 2008, Parry Ltd. passed a resolution consolidating 1,00,000 fully-paid equity shares of ₹100 each into shares of ₹100 each. On 31st March 2009, the company passed another resolution converting the shares into stock. Pass necessary journal entries.
   [*Ans:* 10,000 equity shares of ₹100 each]
8. LMK Ltd. has an issued capital of ₹5,00,000 in shares of ₹100 each, on which ₹80 per share has been called up. The company now decided to reduce the share capital to share of ₹80 each fully paid by cancelling the uncalled amount of ₹20 per share. Show journal entry.
9. ABC Ltd. has a paid-up share capital of ₹11,20,000 divided into 1,60,000 equity shares of ₹10 each, ₹7 per share paid-up. The company decided to reduce the

paid-up capital to ₹6 per share, capital to ₹6 per share paidup paying off the necessary amount. Give the necessary journal entries.

[*Ans:* Payment ₹1,60,000]

10. Lawrence Ltd. has 20,000 equity shares of ₹100 each, ₹80 per share called up and paid up. The company decided to pay off ₹30 per share of the paid-up capital and to reduce the ₹100 shares to ₹50 shares fully paidup by cancelling the unpaid amount. Pass journal entries for the above transaction.

[*Ans:* Amount paid: ₹6,00,000]

11. The 9% ₹20,00,000 debenture holders of Mac Ltd. have accepted to contribute towards the capital reduction scheme by reducing their claims to debentures and half by the issue of 10% preference share of ₹100 each. Pass journal entry in the books of the company.

[*Ans:* Amount foregone by debenture holders: ₹10,00,000;
₹5,00,000 12% debentures; and 5,000 10% preference shares of ₹100 each]

12. Kali Ltd. has been suffering heavy losses in the past. So it has decided to go for reconstruction scheme by reducing 50,000 equity shares of ₹100 each into ₹60 each, so as to write off accumulated losses of ₹19,50,000. Give journal entry to record the above transactions.

[*Ans:* Balance in capital reduction transferred to capital reserve: ₹50,000]

13. In order to write off the accumulated losses of ₹90,000 from the balance sheet, P. Ltd. has decided to convert its 30,000 9% preference shares of ₹10 each into 8% preference shares of ₹10 each, ₹6 per share paid. Show the journal entries in the books of the company.

[*Ans:* Balance of capital reduction transferred to capital revenue**:**₹30,000]

14. As a contribution towards capital reduction scheme, the 5% debenture holders, who were to receive ₹13,80,000 from the company, have agreed to reduce their claims to 50%, which is to be satisfied half by the issue of 7% mortgage debentures and half by the issue of 8% preference shares of ₹100 each. Pass necessary journal entry in the books of company.

[*Ans:* Amount foregone by debenture holders: ₹6,90,000;
Balance of debentures in the company's books: Nil]

15. Give journal entries for the following transactions in connection with internal reconstruction:
    (a) 30,000 equity shares of ₹10 each, fully paid, reduced to shares of ₹5 each, fully paid.
    (b) 300 9% debentures of ₹1,000 each converted into 1,500 12% debentures of ₹100 each.
    (c) The debit balance of profit and loss account ₹1,50,000 and the preliminary expenses ₹30,000 were written off.
    (d) The value of plant and machinery and stock were written down by ₹60,000 and ₹30,000 respectively.

[*Ans:* Total capital reduction: ₹3,00,000;
Balance of capital reduction A/c transferred to capital reserve: ₹30,000]

16. The shares capital of Zea Ltd. consisted of the following:
    (a) 10,000 6% preference shares of ₹100 each and
    (b) 50,000 equity shares of ₹10 each

The shares were fully paid. The company had accumulated losses totalling ₹3,50,000 besides preliminary expenses ₹20,000. It was also ascertained that fixed assets, which stood in the books at ₹14,00,000 were overvalued to the extent of ₹4,00,000. The following scheme was adopted to write off the losses and reduce the assets:

(a) 6% preference shares were to be converted into 7% preference shares of ₹60 each.

(b) Equity shares were to reduce to ₹2 each.

Journalise.

[*Ans:* Total capital reduction ₹8,00,000;
Balance of capital reduction A/c transferred to capital reserve ₹30,000]

17. The following scheme of reconstruction has been approved for B Ltd.

(a) The shareholders to receive in lieu of their present of 50,000 shares of ₹10 each, the following.

(i) Fully-paid equity shares equal to $\frac{2}{5}$ of their holding.

(ii) 10% preference shares, fully paid, to the extent of $\frac{1}{5}$ of the above new equity shares: and

(iii) ₹60,000 14% second debentures.

(b) An issue of ₹50,000 12% first debentures was made and allotted, payment for the same being received in cash forthwith.

(c) Goodwill, which stood at ₹1,50,000 was completely written off.

(d) Plant and machinery, which stood at ₹1,00,000, was written down to ₹75,000.

(e) Freehold and leasehold premises, which stood at ₹1,75,000 were written down to ₹1,50,000.

Give journal entries in the books of the company, necessitated by the above reconstruction.

[*Ans:* Total capital reduction: ₹2,00,000]

OTHER EXERCISES

1. The share capital of Zea Ltd. consisted of the following:

(a) 10,000 6% preference shares of ₹100 each and

(b) 50,000 equity shares of ₹10 each.

The shares were fully paid. The company had accumulated losses totalling ₹3,50,000, besides preliminary expenses of ₹20,000. It was also ascertained that fixed assets, which stood in the books at ₹14,00,000, were overvalued to the extent of ₹4,00,000. The following scheme was adopted to write off the losses and reduce the assets.

(a) 6% preference shares were to be converted into 7% preference shares of ₹60 each.

(b) Equity shares were to be reduced to ₹2 each.

[*Ans:* Total capital reduction: ₹8,00,000;
Balance of capital reduction A/c transferred to capital reserve: ₹30,000]

2. The following scheme of reconstruction has been approved by B Ltd.
   (a) The shareholders to receive in lieu of their present holding of 50,000 shares of ₹10 each, the following:
      (i) Fully-paid shares equal to $\frac{2}{5}$ of their holding.
      (ii) 10% preference shares, fully paid, to the extent of $\frac{1}{5}$ of the above new equity shares; and
      (iii) ₹60,000 14% second debentures.
   (b) An issue of ₹50,000 12% first debentures was made and allotted, payment for the same being received in cash forthwith.
   (c) Goodwill, which stood at ₹1,50,000, was completely written off.
   (d) Plant and Machinery, which stood at ₹1,00,000, were written down to ₹75,000.
   (e) Freehold and leasehold premises, which stood at ₹1,75,000, were written down to ₹1,50,000.

   Give journal entries in the books of the company, necessitated by the above reconstruction.

   [*Ans:* Total capital reduction: ₹2,00,000]

3. Balance sheet of S Ltd. is given as follows:

Liabilities	(₹)	Assets	(₹)
Authorised Capital:		Fixed Assets	1,00,000
30,000 Equity Shares of ₹10 each	3,00,000	Stock	60,000
Paid-up Capital:		Sundry Debtors	90,000
20,000 Equity Shares of ₹10 each	2,00,000	Bank Balance	2,70,000
Profit & Loss A/c	1,40,000		
6% Debentures	1,20,000		
Creditors	60,000		
	6,20,000		6,20,000

   It was resolved in the Annual General Meeting:
   (a) To pay dividend of 10%.
   (b) To issue one bonus share for every four shares held, on the date of balance sheet given above.
   (c) To give the existing shareholders the option to buy ₹10 per share at ₹14 each, for every four shares held prior to the issue of bonus shares.
   (d) The debentures are to be redeemed at a premium of 4%.

   All the shareholders accepted the proposal (c) and exercised it.

   Pass journal entries and prepare the balance sheet after giving effect to the above resolutions.

   [*Ans:* Bonus shares: ₹50,000; Balance sheet total: ₹4,45,200]

4. Given below is the balance sheet of a company as on 31st March 2002.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Goodwill	1,20,000
2,000 Preference Shares of ₹ 100 each.	2,00,000	Fixed Assets	2,50,000
3,000 Ordinary Shares of ₹100 each	3,00,000	Current Assets	1,80,000
Securities Premium	50,000	Preliminary Expenses	15,000
Other Liabilities	1,50,000	Profit & Loss A/c	1,35,000
	7,00,000		7,00,000

During 2002–03, the following resolutions were implemented:

(a) To reduce the face value of the preference and equity shares to ₹50 each.

(b) To write off other assets (except real assets) by utilising securities premium to the required extent.

Prepare the balance sheet after the reconstruction and also the journal entries thereon.

[*Ans:* Securities premium used: ₹20,000; Balance sheettotal: ₹4,30,000]

5. Vijaya Lakshmi Co. Ltd was floated with a capital of ₹20,00,000 in 1,00,000 equity shares of ₹10 each and 1,00,000 preferences shares of ₹10 each and the capital was fully subscribed and paid. The preference shares carried cumulative preference rights as to dividend but not as to capital repayment. The company was unsuccessful and sustained trading losses amounting to ₹3,00,000. In addition, the majority of the patents acquired by the company proved to be worthless.

It was resolved to write off ₹10,00,000 of the subscribed capital by reducing each class of shares by ₹5 per share and to reduce the assets correspondingly by

(a) Wiping out the debt balance of the profit and loss account of ₹3,00,000.

(b) Writing down goodwill to the extent of ₹3,00,000;

(c) Writing off patents by entries to give effect to the above transactions.

[*Ans:* Total capital reduction: ₹10,00,000]

6. The following is the summarised balance sheet of Reckless Co. Ltd., as on 31st March 1996.

Liabilities	(₹)	Assets	(₹)
5,000 Equity Shares of ₹100 each	5,00,000	Sundry Assets	2,02,800
		Profit & LossA/c	2,97,200
	5,00,000		5,00,000

The company has decided that the worst is over and hence it adopts a scheme of reconstruction, reducing all its equity shares into an equal number of fully-paid equity shares of ₹10 each.

Pass journal entries and prepare the balance sheet immediately after the reconstruction.

[*Ans:* Total capital reduction: ₹4,50,000; Balance sheet total: ₹2,02,800; Capital reserve: ₹1,52,800]

7. The following is the summarised balance sheet of Kanmani Ltd., as on 31st December 2000.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Land &Building	3,00,000
5,000 Equity Shares of ₹1,000 each	5,00,000	Plant	2,60,000
1000 Pref. Shares of ₹50 each	50,000	Goodwill	90,000
6 % Debentures	1,50,000	Sundry Debtors	1,40,000
Loans	2,00,000	Preliminary Expenses	60,000
Sundry Creditors	1,00,000	Profit&LossA/c	1,50,000
	10,00,000		10,00,000

Following reconstruction scheme is approved:

(a) Equity shares are to be reduced to ₹75; Preference shares to ₹25.

(b) Land and building, and plant and machinery are appreciated by ₹1,00,000 and ₹40,000 respectively.

(c) The 6%debentures holders have taken the debtors in full satisfaction of all amounts due to them.

(d) The amount so available is to be applied for writing off goodwill, preliminary expenses and profit and loss account.

Prepare capital reduction account and revised balance sheet.

[*Ans:* Capital reduction: ₹3,00,000; Balance sheet total: ₹7,00,000]

8. The balance sheet of Gloomy Ltd. was as follows on 30th June 1978.

Liabilities	(₹)	Assets	(₹)
4000 Shares of ₹100 each, fully paid	4,00,000	Goodwill	60,000
6% Debentures	2,00,000	Land & Buildings	1,00,000
Sundry Creditors	2,50,000	Plant &Machinery	4,00,000
		Stock	90,000
		Sundry Debtors	60,000
		Preliminary Expenses	10,000
		Profit & Loss A/c	1,30,000
	8,50,000		8,50,000

In order to reconstruct the company, wiping off fictitious and intangible assets and writing down plant and machinery to its purpose figure of ₹3,00,000, the shares were reduced to ₹20 each. Court's approval was obtained. Draft the necessary journal entries and show the balance sheet after the scheme is put through.

[*Ans:* Total capital reduction: ₹3,20,000; Amount of capital reduction transferred to capital reserve: ₹20,000; Balance sheet total: ₹5,50,000]

9. The following is the balance sheet of Weak Ltd. on 31st March 2003.

Liabilities	(₹)	Assets	(₹)
20,000 Equity Shares of ₹10 each.	2,00,000	Patents	40,000
500 10% Pref. Shares of ₹100 each.	50,000	Buildings	2,00,000
8% Debentures	1,00,000	Machinery	1,30,000
Creditors	3,30,000	Stock	80,000
Outstanding Expenses	20,000	Debtors	55,000
Sundry Creditors	1,00,000	Profit& Loss A/c	1,95,000
	7,00,000		7,00,000

With a view to reconstruct the company, it is proposed:

(a) To reduce equity share paid up amount by ₹9 each.

(b) To reduce 10% preference shares by ₹40 each.

(c) To reduce 8% debentures by 10%.

(d) To reduce trade creditors' claim by one-third.

(e) To reduce machinery by ₹60,000.

(f) To reduce inventory by ₹10,000.

(g) To provide ₹15,000 for bad debts.

(h) To write off all the intangible assets.

Pass journal entries to give effect to the above scheme and show the company's balance sheet after reconstruction.

[*Ans:* Capital reduction: ₹3,20,000; Balance sheettotal: ₹3,80,000]

10. The following is the balance sheet of Reckless Co. Ltd., as on 31st March 2006.

Liabilities	(₹)	Assets	(₹)
Subscribed Share Capital:		Leasehold Premises	1,30,000
7,500 Preference Shares of ₹100 each, fully paid	7,50,000	Plant	42,200
5,000 Equity Shares of ₹100 each, fully paid	5,00,000	Patents	8,50,000
Sundry Creditors	30,000	Stock	55,000
Bank Overdraft	20,000	Debtors	76,500
		Cash	500
		Preliminary Expenses	12,000
		Discount on Issue of Shares	18,000
	1,00,000	Profit &LossA/c	1,15,000
	13,00,000		13,00,000

As the company was not doing well, the following scheme of reconstruction was adopted.

(a) The preference shares to be reduced to an equal number of fully paid shares of ₹50 each.

(b) The equity shares to be reduced to an equal number of shares of ₹25 each.

(c) The amount available to be used to write off the fictitious assets fully, ₹30,800 off the leasehold premises, ₹15,000 off stock, 20% off plant and debtors and the balance available off patents.

Journalise and prepare the balance sheet after the reconstruction has been carried out.

[*Ans:* Total capital reduction: ₹7,50,000; Patents written off ₹5,35,400; Balance sheet total: ₹5,50,000]

11. Sick Ltd. had the following balance sheet as on 31st March 2007.

Liabilities	(₹)	Assets	(₹)
6% Preference Shares of ₹100 each	2,00,000	Goodwill	60,000
Equity Shares of ₹100 each	4,00,000	Fixed Assets	3,00,000
Debentures	1,00,000	Stock	1,50,000
Sundry Creditors	1,50,000	Debtors	60,000
		Discount on Debentures	10,000
		Bank	1,000
		Profit &LossA/c	2,69,000
	8,50,000		8,50,000

The following reconstruction scheme was approved:

(a) Preference shares to be reduced to 8% preference shares of ₹60 each.

(b) Equity shares to be reduced by ₹80 each.

(c) The amount thus made available to be utilised to write off fictitious assets, including goodwill and ₹50,000 from fixed assets.

Give entries for the reconstruction and the final balance sheet.

[*Ans:* Total capital reduction: ₹4,00,000; Balance of capital reduction A/c transferred to capital reserve: ₹11,000; Balance sheet total: ₹4,61,000]

12. The balance sheet of Kavitha Industries Ltd., as at 31st December 2008, was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Goodwill	15,000
2,000 Preference Shares of ₹100 each	2,00,000	Freehold Properties	2,00,000
4,000 Equity Shares of ₹100 each	4,00,000	Plant &Machinery	3,00,000
5% Mortgage Debentures	1,00,000	Stock	50,000
Bank Overdraft	50,000	Debtors	40,000
Creditors	1,00,000	Profit& Loss A/c	2,45,000
	8,50,000		8,50,000

The company got the following scheme of capital reduction by the court:

(a) The preference shares to be reduced to ₹75 per share, fully paid up and the equity shares to ₹37.50

(b) The debentures holders took over the stock-book debts in full satisfaction of the amount due to them.

(c) The goodwill account is to be eliminated.

(d) The freehold properties to be depreciated by 50%.

(e) The value of the plant and machinery to be increased by ₹50,000.

Give journal entries for the above and prepare the revised balance sheet.

[*Ans:* Total capital reduction A/c: ₹3,60,000; Balance sheet total: ₹4,50,000]

13. The following was the balance sheet of ABC Limited, as on 31st December 2002.

Liabilities		(₹)	Assets		(₹)
Issued and Paid-up Capital:			Goodwill		10,000
12,000 Shares of ₹10 each	1,20,000		Land &Buildings		20,500
Less: Call-in-Arrear: ₹3 per 3,000 shares	9,000	1,11,000	Machinery		50,850
Creditors		15,425	Preliminary Expenses		1,500
Provision for Tax		4,000	Stock		10,275
			Debtors		15,000
			Bank		1,500
			Profit& LossA/c	22,000	
			Less: Net Profit of this Year	1,200	20,800
		1,30,425			1,30,425

Machinery value was ₹10,000 in excess. It is proposed to write down this asset and to extinguish the profit and loss account debit balance and to write off goodwill and preliminary expenses by the adoption of the following scheme.

(a) Forfeit the shares on which the calls are outstanding.

(b) Reduce the paid-up capital by ₹3 per share.

(c) Re-issue the forfeited shares at ₹5 per share.

(d) Utilise the provision for tax, if necessary.

You are required to draft the journal entries necessary and the balance sheet after carrying out the scheme.

[*Ans:* Total capital reduction: ₹42,300; Balance sheet total: ₹1,03,125;
Provision for tax to be used:₹300]

14. The position of X Ltd. on 31st December 1970 was follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Land & Buildings	30,000
12,000 Shares of ₹10 each	1,20,000	Machines	20,000
Creditors	12,000	Stock	32,000
		Debtors	10,000
		Cash	2,000
		Profit &Loss A/c	38,000
	1,32,000		1,32,000

The following scheme of reconstruction was submitted to and approved by the court.

(a) That the capital be reduced to 12,000 shares of ₹5 each fully paid, each shareholder on the register on 31st December 1970 receiving one ₹5 share, fully paid, in exchange for each ₹10 share.

(b) That the debit balance on profit andloss accountto be written off.

(c) Machines to be reduced to ₹14,000 and stock to ₹16,000.

Show the journal entries necessary to give effect to the above scheme and the balance sheet as it would appear after reconstruction.

[*Ans:* Total capital reduction: ₹60,000; Balance sheet total: ₹72,000]

15. The following is the balance sheet of Sujatha Co. Ltd. as on 31st March.

Liabilities	(₹)	Assets	(₹)
Authorised Capital		Land & Building	3,00,000
And Paid-up Capital	3,00,000	Machinery	2,50,000
30,000 5% Cumulative Preference Shares of ₹10 each.	5,00,000	Goodwill	70,000
50,000 Equity Shares of ₹10 each	8,00,000	Furniture	2,000
9% Debentures	2,50,000	Stock	30,000
Loans	50,000	Sundry Debtors	1,20,000
Sundry Creditors	1,93,000	Bills Receivable	95,000
		Cash at Bank	6,000
		Profit & Loss A/c	4,20,000
	12,93,000		12,93,000

Preference dividend is in arrears for 2 years.

Depreciation on machinery has not been provided to the extent of ₹20,000. Preference shares have priority to repayment of capital in the event of winding up. In view of the heavy losses suffered by the company in the past, it is decided that

(a) Arrears of dividends are to be cancelled.

(b) Preference shares to be reduced to ₹8 per share, fully paid, but the rate of dividend be increased by 2.5%.

(c) Equity shares be reduced to ₹2 each, ₹1 paid up and the unpaid amount of ₹1 be called to provide additional capital, and

(d) Debit balance of profit and loss account to be written off. Depreciation of ₹20,000 be provided for machinery and goodwill be written off. Pass necessary journal entries to give effect to the above agreement and prepare the received balance sheet.

[*Ans:* Total capital reduction: ₹5,10,000; Balance sheet total: ₹8,33,000]

16. The following was the balance sheet of Y Ltd. as on 31st March 1987.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Goodwill	60,000
3,000 7% Preference Shares of ₹100 each	3,00,000	Land & Building	1,50,000
4,000 Equity Shares of ₹100 each	4,00,000	Plant & Machinery	3,00,000
Profit Prior to Incorporation	10,000	Patents	20,000
6% Debentures	3,00,000	Stock	2,20,000
Sundry Creditors	2,00,000	Sundry Debtors	1,50,000
		Cash at Bank	5,000
		Preliminary Expenses	25,000
		Profit & Loss A/c	2,70,000
	12,10,000		12,10,000

The following scheme of reconstruction was duly approved:

(a) 7% preference shares to be converted into 9% preference shares, the amount being reduced by 30%.

(b) Equity shares to be reduced to fully-paid shares of ₹50 each.

(c) Land and buildings to be appreciated by 20%.

(d) Debentures to be reduced by 20%.

(e) All intangible assets, fictitious assets including patents and accumulated losses to be written off. Utilise profit prior to incorporation, if necessary.

(f) Equity shareholders to subscribe equity shares of ₹1,00,000, the amount to be utilised for acquiring new plant and machinery.

Assuming the whole scheme to have been put through, give journal entries and prepare the resultant balance sheet.

[*Ans:* Total capital reduction: ₹3,80,000; Profit prior to incorporation to be utilised: ₹5,000; Balance sheet total: ₹9,55,000]

17. The following is the balance sheet of Unibex Ltd. as on 31st December 2011.

Liabilities	(₹)	Assets	(₹)
Paid-up Capital:		Goodwill	1,40,000
7,000 Equity Shares of ₹10 each	7,00,000	Land & buildings	4,00,000
10% Debentures	4,00,000	Plant & machinery	4,40,000
Creditors	2,00,000	Stock	1,30,000
Bank Overdraft	2,50,000	Debtors	80,000
Bills Payable	50,000	Bills Receivable	1,70,000
		Preliminary Expenses	40,000
		Profit & Loss A/c	2,00,000
	16,00,000		16,00,000

The directors decided to reduce the equity share capital to ₹2,80,000 and all the fictitious and intangible assets were to be wiped off. It was decided to write down plant and machinery by ₹40,000. Give journal entries to record the effect of the above scheme of reductions of share capital and prepare the balance sheet after the reconstruction has been carried out.

[*Ans:* Total capital reduction: ₹4,20,000; Balance sheet total: ₹11,80,000]

18. The following is the balance sheet of PP Ltd. as on 31st March 2012.

Liabilities	(₹)	Assets	(₹)
Share Capital		Goodwill	2,00,000
1,00,000 Equity Shares of ₹10 each, fully paid	10,00,000	Machinery	10,00,000
2,000 10% Cumulative Preference Shares of ₹100 each, fully paid	2,00,000	Stock	2,50,000
Sundry Liabilities	10,00,000	Debtors	2,00,000
		Bank	50,000
		Profit &Loss A/c	5,00,000
	22,00,000		22,00,000

Preference share dividends are in arrears for the last four years and the following scheme of reconstruction is passed by the shareholders and approved by the court.

(a) The 1,00,000 equity shares of ₹10 each are to be reduced to an equal number of equity shares of ₹1 each.

(b) 50% of the preference dividends in arrears are to be paid in cash immediately and preference shareholders have agreed to forego the balance.

(c) Plant and machinery are to be depreciated by 5% and a provision for doubtful debts is to be created at 10% on debtors.

(d) All intangible assets and fictitious assets are to be written off.

[*Ans:* Total capital reduction: ₹9,00,000; Balance of capital reduction A/c transferred to capital reserve A/c: ₹90,000; Balance sheet total: ₹13,90,000]

(**Hint:** No sacrifice by unsecured creditors.)

19. The following is the balance sheet of Skylekha Ltd. as on 31st March 2012.

Liabilities		(₹)	Assets		(₹)
Share Capital			Bombay Works		20,00,000
Authorised, Issued & Paid-up:			Calcutta Works		10,00,000
4,00,000 Ordinary Shares of ₹5 each, fully paid		20,00,000	Workmen's Compensation Fund Investments		35,000
3,00,000 6% Preference Shares of ₹5 each, fully paid		15,00,000			
'A' 6% Debentures secured on Bombay works		1,00,000	Stock		1,15,000
'B' 6% Debentures secured on Calcutta works		2,50,000	Debtors		50,000
Workmen's Compensation Fund:			Discount on Debentures:		
Bombay:	25,000		'A'	2,500	
Calcutta:	10,000	35,000	'B'	10,000	12,500
Bank Overdraft		7,50,000	Profit & Loss A/c		16,22,500
Creditors		2,00,000	Profit &Loss A/c		5,00,000
		48,35,000			48,35,000

On 1st April 2012, a scheme to reduce the capital implemented the following:

(a) The ordinary shares were reduced to ₹0.25 each.

(b) The preference shares were reduced to ₹3.75 each and the rate of dividend on them to 5%.

(c) The 'A' and 'B' debenture holders waived payment of ₹42,000 interest (which was included in 'creditors' ₹2,00,000).

(d) The directors were to refund ₹50,000 fees they had received.

(e) The 'B' debenture holders formed a new company to take over the Calcutta works for ₹5,00,000 and this price was satisfied on the same date, by the surrender of the 'B' debentures and the allotment of 50,000 fully paid shares of ₹5 each in the new company.

The investments were valued at ₹25,000. Stock at ₹50,000 and the debtors at ₹40,000. There was no actual liability to workmen at Calcutta. The fund was to be written down accordingly. Any fictitious assets were to be eliminated. Only necessary reserves were to be retained and the balance available was to be written off the book value of the Bombay works.

Journalise these transactions and prepare the balance sheet after this scheme is carried out.

[*Ans:* Total capital reduction: ₹23,77,000; Balance sheet total: ₹22,58,000; Bombay works written off: ₹1,57,000]

20. The following is the balance sheet of Kamyab Ltd. as on 31st March 2007.

Liabilities	(₹)	Assets	(₹)
13% Cumulative Preference Shares of ₹100 each	1,00,000	Fixed Assets	15,00,000
Equity Shares of ₹10 each	7,00,000	Current Assets	35,00,000
8% Debentures	3,00,000	Profit & Loss A/c	3,00,000
Current Liabilities	39,00,000		
Provision for Taxation	3,00,000		
	53,00,000		53,00,000

The following scheme of reorganisation is sanctioned:

(a) Fixed assets are to be written down by 33 1/3%.

(b) Current assets are to be revalued at ₹27,00,000.

(c) Preference shareholders decide to forego their right of arrears of dividend, which are in arrears for three years.

(d) The taxation liability of the company is settled at ₹4,00,000.

(e) One of the creditors of the company, to whom the company owes ₹25,00,000, decides of forego 50% of his claim. He is allotted 1,00,000 equity shares of ₹5 each, in part satisfaction of the balance of his claim.

(f) The rate of interest on debentures is increased to 11%.

(g) The debenture holders surrender their existing debentures of ₹100 each and exchange the same for fresh debentures of ₹75 each.

(h) All existing equity shares are reduced to ₹5 each.

(i) All preferences shares are reduced to ₹75 each.

Pass journal entries and show the balance sheet of the company after giving effect to the above.

[*Ans:* Total capital reduction: ₹17,00,000; Balance sheet total: ₹33,00,000]

(**Hints:**

1. No effect for preference dividend foregone, since it is not a part of balance sheet.
2. Current assets are assumed to include sufficient cash to pay tax liability of ₹4,00,000.)

21. The balances sheet of Hospital Ltd.,as at 31st March 2012 is as follows:

Liabilities		(₹)	Assets	(₹)
Issued &Subscribed Capital:			Sundry Assets	1,54,000
8,000 Shares of ₹10 each, fully paid		80,000	Investments	3,000
Debentures	1,34,000		Profit & Loss A/c	1,07,000
Add: Interest Due	4,000	1,38,000		
Creditors:				
Income Tax	1,000			
Others	45,000	46,000		
		2,64,000		2,64,000

The following reconstruction scheme is passed and duly sanctioned.

(a) Each share is to be sub-divided into ten, fully-paid equity shares of ₹1 each.

(b) After such sub-division, each shareholder shall surrender to the company, 95% of his holding. For the purpose of re-issues to debenture holders and creditors as far as necessary and the balance cancelled.

(c) Of these surrendered, 23,000 shares of ₹1 each shall be converted into preference shares of ₹1 each, fully paid.

(d) The claims of debenture holders shall be reduced by five-sixth and in consideration there for the debenture holders shall receive preference shares to the value of one-sixth of their claim as at 31st March 1998.

(e) The income tax liability is to be paid in full, and claims of other creditors to be reduced to one-fifth of their claims to be satisfied by the issue of equity shares of ₹1 each from the shares surrendered.

(f) The shares surrendered and not re-issued to be cancelled. Set out journal entries and the resultant balance sheet assuming that the income tax liability is still outstanding and the amounts of the assets and unaltered.

[*Ans:* Total capital reduction: ₹2,04,000; Balance of shares surrendered transferred to capital reduction A/c: ₹44,000; Balance of capital reduction A/c transferred to capital reserve: ₹97,000; Balance sheet total: ₹1,57,000]

SOLVED QUESTION PAPER I 2016

B. Com (General) November 2016

Semester III

Time: Three hours **Maximum: 75 marks**

Part A (10 × 2 = 20 marks)

Answer any TEN questions

All questions carry equal marks

1. What is meant by allotment of shares?

Sol. **Allotment of Shares:** After the subscription list is closed, the application is forwarded to the company by the Bank. The Board of Directors have then to proceed with the allotment of shares. The allotment of shares will be subject to certain legal provision. They are

Legal Provision relating to Allotment of Shares:

The Companies Act lays down certain provisions regarding the allotment of shares as follows:

1. The amount of minimum subscription as stated in the prospectus should be received before allotment of shares.
2. The prospectus (or) statement in lieu of prospectus is filed before the first allotment of shares in due time with the Registrar of Companies.
3. Application money should not be less than 5% of the nominal value of share [25% for public issue.]
4. All the application money shall be deposited and kept in a scheduled bank until the certificate of commencement of business is obtained.
5. Return of application money to those applicants to whom shares could not be allotted.
6. Share allotment must be communicated to applicants.

2. What is firm underwriting?

Sol. Firm Underwriting is an assured agreement by the Underwriters to take up a certain number of shares or debentures of a company irrespective of number of shares or debenture subscribed by the public. Even if the issue of share (or) debenture is over subscribed, the underwriters are liable to take up the agreed number of shares or debentures.

3. What is meant by forfeiture?

Sol. **Forfeiture of Shares:** In case a member fails to pay any call money on the day fixed for payment, the Directors may either by adopting Table A (or) by an express provision in its articles proceed to forfeit the shares held by a defaulting shareholders. The necessary notice should be given to defaulting shareholders for forfeiture of shares.

Journal Entry

Share Capital A/c	Dr.	xxx	
To Share Forfeiture A/c			xxx
To Calls-in-Arrear A/c			xxx

4. What do you mean by collateral securities?

Sol. Collateral security is the security given in addition to main security against the Bank Loan (or) Mortgage Loan. Debenture may be issued as secondary security in addition to main security. Such issue is called "Issue of Debenture as Collateral Security".

5. Explain the meaning of profits prior to incorporation of a company.

Sol. Profit prior to incorporation means the profit earned upto the date of incorporation from the date of Purchase of Company. These profits are capital profits and these are not available for dividends to shareholders. Therefore, the profit before incorporation is to be credited to Capital Reserve A/c. If there is any loss prior to Incorporation, it is treated as 'Capital Loss' and to be debited to 'Goodwill A/c'.

6. How is purchase consideration calculated under the net payment method?

Sol. Under net payment method, purchase consideration is made by partly issuing shares, partly issuing debentures and partly in cash. Thus, to calculate purchase consideration add all the payments together. Further add any other payments made to the vendor company.

7. Define goodwill.

Sol. "Goodwill may be said to be that element arising from the reputation, connection, or other advantages possessed by a business which enables it to earn greater profits than the return normally to be expected on the capital represented by the net tangible assets employed in the business".

8. Explain the meaning of external reconstruction.

Sol. A new company formed with a similar name but with a new capital structure in order to take over the business of an existing company is called External Reconstruction. The assets and liabilities of the liquidated company are revalued and transferred to the new company.

9. What is amalgamation?

Sol. The term amalgamation is used when two or more existing companies go for liquidation and a new company is formed to take over their business.

10. What do you mean by 'Interim dividend'?

Sol. It is a dividend paid in between two annual general meetings, i.e., in the middle of the year, before ascertainment of the profit for the year.

11. What is the need for capital reduction?

Sol. Capital Reduction (or) Internal Reconstruction is the process by which the affairs of the existing company are reorganised. The existing company will not be liquidated. The capital structure is reorganized without forming new company by getting the approval of the court. This is also called Re-organisation. It may also include a scheme of capital reduction by writing off the accumulated losses and fictitious assets. It is resorted to in the following cases: (a) Accumulated losses, (b) Shortage of working capital, (c) Large amount of fictitious assets, (d) Overvaluation of assets, etc.

12. From the following particulars calculate the value of equity share.

75,000 equity shares of ₹10 each

₹8 per share paid up: ₹6,00,000

Profit available for equity dividend (after tax): ₹72,000

Normal rate of earnings: 10%

Sol. **Calculation of Value of Equity Share [Yield Method]:**

$$\textit{Value per share} = \frac{\textit{Expected Rate}}{\textit{Normal Rate}} \times \left(\begin{array}{c}\textit{Paid up Value}\\ \textit{per Share}\end{array} \right)$$

$$\textit{Expected Rate} = \frac{\textit{Profit available}}{\textit{Total paid-up Equity Capital}} \times 100$$

$$= \frac{72{,}000}{6{,}00{,}000} \times 100 = 12\%$$

$$\text{Normal rate given} = 10\%$$

$$\therefore \qquad \text{Value per Share} = \frac{12\%}{10\%} \times ₹8$$

$$= ₹9.60 \text{ per share}$$

Part B (5 × 5 = 25 marks)

13. X Company Ltd. issued 50,000 equity shares of ₹10 each to the public on the condition that full amount of shares will be paid in a lumpsum. All these shares were taken up and paid by the public. All these shares were taken up and paid by the public. Pass journal entries for the following:

(a) Shares are issued at par
(b) At a premium of 10%
(c) At a discount of 10%

Sol. **Journal Entries in the Books of X Co. Ltd.**

Particulars		Debit ₹	Credit ₹
Bank A/c	Dr.	5,00,000	
To Equity Share Capital A/c			5,00,000
(*Being 50,000 shares issued at ₹10 each*)			
Bank A/c	Dr.	5,50,000	
[50,000 × 11]			
To Equity Share Capital A/c			5,00,000
[50,000 × 10]			
To Share Premium A/c			50,000
(*Being 50,000 shares of ₹10 each issued at premium of ₹1 per share*)			
Bank A/c	Dr.	4,50,000	
[50,000 × 9]			
Discount on Issue of Shares	Dr.	50,000	5,00,000
[50,000 × 1]			
To Equity Share Capital A/c			5,00,000
[50,000 × 10]			
(*Being 50,000 shares of ₹10 each issued at discount of ₹1 per share*)			

14. A company has 9,000 redeemable preference shares of ₹100 each ₹80 paid the company propose to redeem the shares on 31.10.1997 at a premium of 30%. It has P & L A/c on that date ₹20,00 (Dr.) and equity premium ₹3,00,000 required number of equity shares of ₹10 each should be issued. Give journal entries.

Sol. **Journal Entry for Redemption**

1.	9,000 redeemable preference shares of ₹100 each, ₹80 paid up. It is partly paid up shares. Fully paid up shares to be redeemed. Therefore, ₹20 per share is called up.	
2.	(a) Therefore, total preference share for redemption purpose [9,000 × ₹100]	9,00,000
	(b) Premium on Redemption @30% [9,00,000 × 30/100]	2,70,000
3.	₹9,00,000 is redeemable out of fresh issue of equity shares @ ₹10 each. [P & L A/c ₹20,000 is given as "Dr.". Therefore, it is loss. It will not be utilised for redemption.]	
4.	₹2,70,000 premium on redemption is taken out of Equity Premium ₹3,00,000 available.	

Journal Entries

Sl. No.	Particulars	Debit ₹	Credit ₹
1.	*Partly paid, then making fully paid*		
	(a) Redemption Preference Share Final Call A/c Dr.	1,80,000	
	To Redemption Preference Share Capital		1,80,000
	(*Being the final call money due for 9,000 redeemable Preference Shares @ ₹20*)		
	(b) Bank A/c Dr.	1,80,000	
	To Red. Pref. Share Final Call A/c		1,80,000
	(*Being the final call money received for 9,000 Redeemable Pref. Shares @ ₹20 each*)		
2.	*For fresh issue of new Equity Shares for redemption*		
	Bank A/c Dr.	9,00,000	
	To Share Capital A/c		9,00,000
	(*Being the fresh issue of Equity Shares @ ₹10 each*)		
3.	*Adjustment of Premium on Redemption*		
	Equity Share Premium A/c Dr.	2,70,000	
	To Premium on Redemption A/c		2,70,000
	(*Being the Premium on Redemption is taken out of old Equity Share Premium A/c (it is given)*)		
4.	*Transfer of Preference Share Capital with Premium on Reemption to Preference Shareholder:*		
	Red. Pref. Share Capital A/c Dr.	9,00,000	
	Premium on Redemption [30%] A/c Dr.	2,70,000	
	To Redemption Preference Shareholder A/c		11,70,000
	(*Being the redemption Preference Share Capital transferred to Shareholder with Premium on Redemption*)		
5.	*Redemption to Preference Shareholder:*		
	Redemption Preference Shareholder A/c Dr.	11,70,000	
	To Bank A/c		11,70,000
	(*Being the repayment of amount to Redemption Preference Shareholder*)		

15. A company incorporated on 01.07.2010 to take over the business of Mr. Akilan as a going concern with effect from 01.04.2010. Accounts are closed on 31.03.2011. Total sales for the year 31.03.2011 was ₹3,00,000 dividend into ₹1,00,000 for the period upto 01.07.2010 and the balance for the remaining period. Calculate the time ratio and sales ratio.

Sol. (a) Calculation of Time Ratio:

Business started	01.04.2010	3 months
Incorporation date	01.07.2010	
Year end date	31.03.2011	9 months

Time ratio = 3 months:9 months

1:3

(b) Calculation of Sales Ratio:

	₹
Sales upto 01.07.2010 [From 01.04.2010 to 01.07.2010]	1,00,000
Sales from 01.07.2010 to 31.03.2011 [3,00,000 – 1,00,000]	2,00,000
Total	3,00,000

∴ Sales Ratio = 1,00,000:2,00,000 (or) 1:2

16. From the following particulars, determine the maximum remuneration available to a full time director of manufacturing company:

Particulars	₹
Net profit shown by P & L A/c after taking into account the following items	40,00,000
(a) Depreciation [including special depreciation of ₹40,000]	1,00,000
(b) Provision for Income tax	2,00,000
(c) Donation to political parties	50,000
(d) Ex-gratia payment to a worker	10,000
(e) Capital profit on sale of assets	15,000

Sol. Calculation of Profit for Managerial Remuneration

Particulars	₹	₹
Net Profit		40,00,000
Add:		
Special Depreciation	40,000	
Provision for Income Tax	2,00,000	
Ex-gratia Payment to Workers	10,000	2,50,000
		42,50,000
Less:		
Capital Profit on Sale of Assets		15,000
Profit for Managerial Remuneration		42,35,000

∴ Remuneration payable to full-time Director as per law = 5%

∴ $42{,}35{,}000 \times \frac{5}{100}$ = ₹2,11,750

17. VGP runs a chemist shop. His net assets on 31st March 2008 amount to ₹20,00,000. After paying rent of ₹15,000 a year to the landlord for premises valued at ₹1,00,000, salary of ₹20,000 to the chemist, he earns a profit of ₹2.50 lakhs. His landlord, who incidentally is the chemist of the shop, is keen to purchase the shop. 12% is considered to be a reasonable return on capital employed for this type of business. What should be the value of goodwill?

Sol. Valuation of Goodwill after Purchase of Business by Landlord:

(a) Calculation of Future Expected Profit:

	₹
Profit after Paying Rent & Salary	2,50,000
Add:	
Rent not to be paid by landlord	15,000
[after taking over of business]	
Future expected Profit	2,65,000

Note: The landlord is chemist, but takes salary for his work at chemist shop. (New shop is alternative employment).

(b) Calculation of Normal Profit:

Capital Employed × Normal Rate of return

Capital Employed:

Net asset given	20,00,000
After taking over of business	
by landlord, his building value	1,00,000
Total Capital Employed	21,00,000
Normal Rate of Return	12%
Normal Profit = $21{,}00{,}000 \times \frac{12}{100}$	2,52,000

(c) Calculation of Super Profit:

= Future Expected Profit – Normal Profit

= 2,65,000 – 2,52,000

Super Profit = 13,000

(d) Calculation of Goodwill under Capitalisation Method:

$$= \frac{\text{Super Prifit}}{\text{Normal Rate}} \times 100$$

$$= \frac{13,000}{12\%} \times 100$$

Goodwill = ₹1,08,333

18. The market price of a share of ₹150. The company declared a dividend of 30%. On its paid up value of ₹100. Find the normal rate of return.

Sol. Calculation of Normal Rate of Return:

$$\textit{Normal Rate of Return} = \frac{\textit{Earning on Shares}}{\textit{Market Price}} \times 100$$

Earning on Shares = Dividend = 30%

∴ Paidup value = ₹100

Earning on Shares $= 100 \times \frac{30}{100}$

= ₹30

∴ Normal Rate of Return $= \frac{₹30}{₹150} \times 100$

= 20%

19. The following scheme of reconstruction was approved by ABC Ltd.

(a) The shareholders to receive in lieu of their present holding of 50,000 shares of ₹10 each, the following:

(i) Fully paid ordinary share capital equal to $\frac{2}{5}$ of their holdings.

(ii) 5% preference shares to the extent at $\frac{1}{5}$ of the above ordinary shares.

(iii) ₹60,000, 6% debentures.

(b) The goodwill which stood at ₹3,00,000 was written down to ₹1,50,000.

(c) Plant and buildings were written down by ₹20,000 and ₹30,000 respectively.

Pass journal entries.

Sol. **Journal entries**

1.	Share Capital A/c Dr.	5,00,000	
	[50,000 × ₹10]		
	To Ordinary (or)		
	Equity Share Capital A/c		2,00,000
	$\left[5{,}00{,}000 \times \frac{2}{5}\right]$		
	To 5% Preference Share Capital A/c		40,000
	$\left[2{,}00{,}000 \times \frac{1}{5}\right]$		
	$\left[\frac{1}{5}^{\text{th}}\text{ of above ordinary capital }2{,}00{,}000\right]$		
	To 6% Debenture A/c		60,000
	To Capital Reduction		2,00,000
	[Balancing Figure]		
	(*Being the present shareholders of 50,000 @ ₹10 each (50,000 × 10 = ₹5,00,000) is exchanged as above and balance utilized for capital reduction*)		
2.	Capital Reduction A/c Dr.	2,00,000	
	To Goodwill A/c		1,50,000
	To Plant A/c		20,000
	To Building A/c		30,000
	(*Being the assets written off*)		

Part C (3 × 10 = 30 marks)

Answer any THREE questions

20. A company with an authorised capital of ₹25 lakhs issued a prospective inviting applications for 1 lakh shares at ₹10 each and the terms of payment

On application	₹5
On allotment	₹2.50
First and final call	₹2.50

The capital offered was oversubscribed by 10,000 shares. The amount due on allotment was received in full. Excess share application money was returned. There was Calls-in-Arrears to the tune of ₹50,000 for first call. Sundry assets were purchased for ₹1,50,000 by issue of shares to vendors.

Pass journal entries for the above transactions.

Sol. **Journal Entries**

Sl. No.	Particulars		Debit ₹	Credit ₹
1.	Bank A/c	Dr.	5,50,000	
	To Share Application A/c			5,50,000
	(*Being the Share application money received @₹5 per share for 1,00,000 + 10,000* (*over subscribed*) *= 1,10,000 shares × ₹5*)			
2.	Share Application A/c	Dr.	5,00,000	
	[1,00,000 × ₹5]			
	To Share Capital A/c			5,00,000
	(*Being the Share Application money transferred to Share Capital A/c for offered 1,00,000 shares @₹5*)			
3.	Share Application A/c	Dr.	50,000	
	To Bank A/c			50,000
	[10,000 × 5]			
	(*Being the 10,000 excess application @ ₹5 is rejected and refunded*)			
4.	Share Allotment A/c	Dr.	2,50,000	
	To Share Capital A/c			2,50,000
	[1,00,000 × ₹2.50]			
	(*Being the Share Allotment money @ ₹2.50 per share is due for 1,00,000 shares*)			
5.	Bank A/c	Dr.	2,50,000	
	To Share Allotment A/c			2,50,000
	(*Being the Share Allotment money received for 1,00,000 share*)			
6.	Share First & Final Call A/c	Dr.	2,50,000	
	To Share Capital A/c			2,50,000
	[1,00,000 × ₹2.50]			
	(*Being the Share First & Final call money due for 1,00,000 shares @ ₹2.50 per share*)			
7.	Bank A/c	Dr.	2,00,000	
	Calls-in-Arrears	Dr.	50,000	
	[20,000 × ₹2.50]			
	To Share First & Final Call A/c			2,50,000
	(*Being the Share First & Final call money received except for ₹50,000, i.e.,* $\frac{50,000}{2.50}$ *= 20,000 shares*)			
	Purchase of Sundry Assets for shares			
	Sundry Assets A/c	Dr.	1,50,000	
	To Share Capital A/c			1,50,000
	(*Being the Sundry Assets purchased and in return 15,000 shares @ ₹10 each allotted to the vendor*)			

21. X Company Limited purchased a business on 1st April 2011. The company obtained certificate to commence business on 31st July 2011. From the following particulars for the year ending 31st March 2012, ascertain profit prior to incorporation and divisible profits.

(a) Total sales upto 31st March 2012 ₹10,00,000. Sales from 1st April 2011 to 31st July 2011 ₹2,50,000.

(b) Gross profit for the year ₹2,12,000.

(c) Expenses debited to profit and loss account.

Particulars	₹
Rent	6,000
Insurance	1,500
Salaries	27,000
Selling expenses	9,000
Advertisement	8,000
Interest on debentures	4,000
Audit fees	1,200
Printing and stationery	4,200
Depreciation on machinery	30,000
Commission on sales	12,600
Bad debts [₹850 related prior to incorporation]	2,400
General expenses	4,800
Directors' fees	2,600
Preliminary expenses	7,200
Interest paid to vendors upto 1st September 2011	5,000

Sol. **1. Calculation of Time Ratio:**

Business acquired on	01.04.2011	} 4 months
Incorporation date	31.07.2011	
Date of year ending	31.03.2012	} 8 months

∴ Time Ratio 4 : 8 or 1 : 2

2. Calculation of Sales Ratio:

Sales upto Incorporation [01.04.2011 to 31.07.2011]	₹2,50,000
Sales after Incorporation [10,00,000 – 2,50,000]	₹7,50,000
Total Sales	₹10,00,0000

∴ Sales ratio 2,50,000:7,50,000 or 1:3

3. Interest on Debentures, Director Fees, Preliminary expenses are considerd only after Incorporation.

4. Interest paid to Vendor upto 1st September 2011 for ₹5,000 is considered on actual basis:

From 01.04.2011 to 01.09.2011 5 months

Prior Incorporation

$$[01.04.2011 \text{ to } 31.07.2011] = \frac{5{,}000}{5 \text{ months}} \times 4 \text{ months} = ₹40{,}000$$

After Incorporation

$$[01.08.2011 \text{ to } 01.09.2011] = \frac{5{,}000}{5 \text{ months}} \times 1 \text{ months} = ₹1{,}000$$

$$₹5{,}000$$

New Format—Profit & Loss A/c

Statement of Profit Prior and Post to Incorporation

Particulars	Total	Basis	Prior Incorpo-ration	After Incorpo-ration
Revenue from Operation				
Gross Profit	2,12,000	Sales [1 : 3]	53,000	1,59,000
Total (A)			53,000	1,59,000
Expenses:				
Employee Cost				
Salaries	27,000	Time [1:2]	9,000	18,000
Finance Cost				
Interest on Debenture	4,000	After	—	4,000
Interest on Vendor (See: Note 4)	5,000	Actual	4,000	1,000
Depreciation & Amortisation				
Depreciation on Machine	30,000	Time	10,000	20,000
Preliminary Expenses	7,200	After	—	7,200
Other Expenses				
Rent	6,000	Time [1:2]	2,000	4,000
Insurance	1,500	Time	500	1,000
Advertisement	8,000	Sales	2,000	6,000
Audit Fees	1,200	Time	400	800
Printing & Stationery	4,200	Time	1,400	2,800
Commission on Sales	12,600	Sale	3,150	9,450
Bad Debts	2,400	Actual given	850	1,550
General Expenses	4,800	Time	1,600	3,200
Directors' Fees	2,600	After	—	2,600
Selling Expenses	9,000	Sales	2,250	6,750
Total (B)			37,150	88,350
Net Profit (A – B)		15,850	70,650	

Profit Prior to Incorporation = ₹15,850

22. Moon and Star Ltd. is a company as authorised capita of ₹5,00,000 is divided into 5,000 equity shares at ₹100 each on 31.12.1995 of which 2,500 shares were fully called up. The following is the total balance as at 31.12.1995.

Debit balance	₹	Credit balance	₹
Opening stock	50,000	Sales	3,25,000
Purchases	2,00,000	Discount received	3,150
Wages	70,000	Profit and Loss A/c	6,220
Discount allowed	4,200	Creditors	35,200
Insurance (upto 31.03.1996)	6,720	Reserves	25,000
Salaries	18,500	Loan from MID	15,700
Rent	6,000	Share capital	2,50,000
General expenses	8,950		
Printing	2,400		
Advertisements	3,800		
Bonus	10,500		
Debtors	38,700		
Plant	1,80,500		
Furniture	17,100		
Bank	34,700		
Bad debts	3,200		
Calls-in-Arrears	5,000		
	6,60,270		6,60,270

You are required to prepare profit and loss account and balance sheet as on 31.12.1995 after taking into account the following adjustments:

(a) Closing stock was valued at ₹1,91,500.

(b) Depreciate plant by 15% and furniture by 10%.

(c) Provide for income tax ₹8,000.

(d) The directors declared an interim dividend on 15.08.1995 at 6%.

Sol. **Statement of Profit and Loss for the year end 31.12.2009**

Particulars	Note No.	Amount ₹
Revenue for Operation	1	3,25,000
Other Income	2	3,150
Total Revenue (A)		3,28,150
Cost of Goods Sold	3	58,500
Employee Benefit Expenses	4	99,000
Finance Cost	—	—
Depreciation & Amortization Expenses	5	28,785
Other Expenses	6	33,590
Total Expenses (B)		2,19,875

(*Contd.*)

Profit Before Tax		1,08,275
Less: Tax Expenses: Current Tax Provision		8,000
Profit for the Current Period		1,00,275

Notes to Accounts on Statement of Profit & Loss Account

1.	*Revenue from Operation*		
	Sales		3,25,000
2.	*Other Income*		
	Discount Received		3,150
3.	*Cost of Goods Sold*		
	Opening Stock		50,000
	Add: Purchases		2,00,000
			2,50,000
	Less: Closing Stock		1,91,500
			58,500
4.	*Employee Benefit Expenses*		
	Wages		70,000
	Salaries		18,500
	Bonus		10,500
			99,000
5.	*Depreciation and Amortisation Expenses*		
	On Plant = $1,80,500 \times \frac{15}{100}$		27,075
	On Furniture = $17,100 \times \frac{10}{100}$		1,710
			28,785
6.	*Other Expenses*		
	Discount allowed		4,200
	Insurance	6,720	
	Less: Prepaid [3 months]	1,680	
	$6,720 \times \frac{3}{12}$		5,040
	Rent		6,000
	General Expenses		8,950
	Printing		2,400
	Advertisement		3,800
	Bad debts		3,200
			33,590

Balance Sheet as on 31.12.2009

I.	*Equity and Liabilities*		
	(i) *Shareholder Funds*		
	Share Capital	1	2,45,000
	Reserve & Surplus	2	1,16,795

(*Contd.*)

	(ii) *Non-Current Liabilities*		
	Long-term Borrowings	3	15,700
	(iii) *Current Liabilities*		
	Trade Payable	4	35,200
	Short-term Provision	5	22,700
	Total		4,35,395
II.	*Assets*		
	(i) *Non-Current Assets*		
	(a) Fixed Assets:		
	Tangible Assets	6	1,68,815
	(ii) *Current Assets*		
	Trade Receivables	7	38,700
	Closing Stock	—	1,91,500
	Bank Balance	—	34,700
	Other Current Assets	8	1,680
	Total		4,35,395

Notes to Accounts on Balance Sheet

1.	*Share Capital*			
	Authorised Capital			
	500 Equity Shares @ ₹100 each			5,00,000
	Subscribed and Paidup Capital			
	2,500 Shares @ ₹100		2,50,000	
	Less: Calls-in-Arrears		5,000	2,45,000
2.	*Reserve & Surplus*			
	(i) General Reserve [Opening Balance]			25,000
	(ii) Surplus i.e., Opening Balance P & L		6,220	
	Add: Current Year Profit		1,00,275	
	[refer: Statement of Profit]			
			1,06,495	
	Less: Appropriation			
	Proposed Interium			
	Dividend declared @ 6%			
	Paid-up Capital	2,50,000		
	(–) Calls in Arrear	5,000		
		2,45,000		
	∴ 2,45.000 × 6/100		14,700	91,795
				1,16,795
3.	*Long-term Borrowings*			
	Loan from Managing Director			15,700

4.	*Trade Payable*		
	Creditors		35,200
5.	*Short-term Provision*		
	Provision for taxation		8,000
	[Refer: Revenue Statement]		
	Proposed Interim Dividend		14,700
	[Not yet paid — Refer: Reserve & Surplus]		
			22,700
6.	*Tangible Assets*		
	Plant	1,80,500	
	Less: Depreciation @ 15%	27,075	1,53,425
	Furniture	17,100	
	Less: Depreciation @ 10%	1,710	15,390
			1,68,815
7.	*Trade Receivable*		
	Debtors		38,700
8.	*Other Current Assets*		
	Prepaid Insurance		1,680

23. From the following information, calculate goodwill on the basis of:

(a) super profit method

(b) capitalisation method

(c) annuity method

You take ₹1 at 12% interest in 8 years will be ₹4,961.8.

(i) Capital employed ₹6,00,000.

(ii) Net profit for the last three years were ₹1,07,600; ₹90,700 and ₹1,12,500.

(iii) Expected rate of return 12%.

(iv) Proprietor's salary per year ₹12,000.

(v) Assets ₹7,54,762 and current liabilities ₹31,329.

Sol. Valuation of Goodwill:

A. Super Profit Method:

1. Calculation of Average Profit:

I year	1,07,600
II year	90,700
III year	1,12,500
Total Profit	3,10,800

Average Profit = $\frac{3,10,800}{3 \text{ years}}$	1,03,600
Less: Proprtietor's Salary	12,000
Average Profit	91,600

2. Calculation of Normal Profit on Capital employed:

$$\text{Normal Profit} = \text{Capital Employed} \times \text{Rate of Return}$$

$$= 6,00,000 \times \frac{12}{100}$$

$$= \underline{₹72,000}$$

3. Super Profit:

$$\text{Super Profit} = \text{Average Profit} - \text{Normal Profit}$$

$$= 91,600 - 72,000$$

$$= \underline{₹19,600}$$

4. Valuation of Goodwill based on Super Profit

$$\text{Goodwill} = \text{Super Profit} \times \text{Number of years}$$

$$= 19,600 \times 8 \text{ years}$$

$$= \underline{₹1,56,800}$$

B. Capitalisation Method:

$$\text{Goodwill} = \frac{100}{\text{Normal Rate}} \times \text{Super Profit}$$

$$= \frac{100}{12} \times 19,600$$

$$= \underline{₹1,63,333}$$

C. Annuity Method:

Present Value @ 12% for 8 years for ₹1

$$= 4.9618$$

$$\text{Goodwill} = \text{Super Profit} \times \text{Annuity}$$

$$= 19,600 \text{ ₹ } 4.9618$$

$$= \underline{₹97,251}$$

Note: Capital Employed ₹6,00,000 is given. Therefore Assets ₹7,54,762 and Liability ₹31,329 are not considered.

24. The balance sheet of X Ltd., is as follows:

Liabilities	₹	Assets	₹
10,000 equity shares at ₹10 each	1,00,000	Goodwill	10,000
10,000 at 7% preference shares at ₹10 each	1,00,000	Fixed assets	90,000
		Stock	25,000
		Debtors	30,000
		P & L A/c	45,000
	2,00,000		2,00,000

It was resolved that equity shares of ₹10 each be reduced to fully paid shares at ₹6 each and 7% preference shares at ₹10 each, be reduced to 8% preference shares at ₹7 each. Number of shares in each case remained the same. The amount available will be used to write off P & L A/c, goodwill and the balance if any on fixed assets. You are required to make journal entries and prepare revised balance sheet.

Sol. **Journal Entries**

1.	Equity Share Capital A/c (₹10)	Dr.	1,00,000	
	To Equity Share Capital A/c (₹6)			60,000
	To Capital reduction A/c (₹4)			40,000
	(*Being capital reduced for reconstruction*)			
2.	7% Preference Share Capital A/c (₹10)	Dr.	1,00,000	
	To 8% Preference Share Capital A/c (₹7)			70,000
	To Capital Reduction A/c (₹3)			30,000
	(*Being capital reduced for reconstruction*)			
3.	Capital Reduction A/c (40,000 + 30,000)	Dr.	70,000	
	To Profit and Loss A/c			45,000
	To Goodwill A/c			10,000
	To Fixed Assets A/c			15,000
	(*Being the Assets written off*)			

New Format—Balance Sheet Balance Sheet as on ...

	Particulars	Notes	Amount ₹
I.	*Equity & Liabilities*		
	(i) *Shareholder Funds*		
	Share Capital;	1	1,30,000
	Reserve & Surplus	2	Nil
	(ii) Non-Current Liability	—	—
	(iii) Current Liability	—	—
	Total		

(*Contd.*)

II.	*Assets*		
	(i) *Non-Current Assets*		
	(a) *Fixed Assets*		
	Tangible	3	75,000
	Intangible	4	Nil
	(ii) *Current Assets*		
	Trade Receivable	5	30,000
	Closing Stock	—	25,000
	Total		1,30,000

Notes to Accounts on Balance Sheet

1.	*Share Capital*	
	Authorised Capital	xxx
	Subscribed and Paid-up Capital:	
	10,000 Equity Shares of ₹6 each	60,000
	7% Preference Shares of ₹7 each	70,000
		1,30,000
2.	*Reserve & Surplus*	
	P & L A/c [Opening] – Loss	(–) 45,000
	Less: Written Off	(+) 45,000
		Nil
3.	*Tangible Assets*	
	Fixed Assets	90,000
	Less: Written off	15,000
		75,000
4.	*Intangible Assets*	
	Goodwill	10,000
	Less: Written off	10,000
		Nil
5.	*Trade Receivable*	
	Debtors	30,000

SOLVED QUESTION PAPER II 2016

B. Com (CS) November 2016

Semester III

Time: Three hours **Maximum: 75 marks**

Section A ($10 \times 2 = 20$ marks)

Answer any TEN questions

All questions carry equal marks

1. What is equity shares?

Sol. Equity shares are those which carry no preferential rights in respect of (i) payment of dividend at the fixed rate, and (ii) return of capital on winding up of the company. Dividend on equity shares is paid out of the balance profit left after paying dividend on preference shares. The equity shareholders are paid back at the time of winding up only after all creditors and preferential shareholders have been paid in full.

2. Define underwriting.

Sol. Underwriting may be defined as, "a contract entered into by the company with persons or institutions called Underwriters, who undertake to take up the whole or a portion of such of the offered shares or debentures as may not be subscribed for, by the public in consideration of remuneration called Underwriting Commission".

3. What do you mean by capital redemption reserve account?

Sol. When preference shares are to be redeemed out of divisible profits, an amount equal to the face value of shares so redeemed is transferred to 'Capital Redemption Reserve'.

Capital redemption Reserve account is to be treated as 'Capital reserve' like paid-up capital.

Capital Redemption Reserve is used to issue fully paid Bonus shares to its shareholders.

4. What is profit prior to incorporation?

Sol. Profit prior to incorporation refers to the profit earned upto the date of incorporation from the date of Purchase of Company. These profits are capital profits and these are not available for dividends to shareholders. Therefore, the profit before incorporation is to be credited to Capital Reserve account. If there is any loss prior to incorporation, it is treated as 'Capital Loss' and to be debited to 'Goodwill A/c'.

5. What is Dividend?

Sol. Dividend has following meanings:

(a) Dividend is a part of the profits of a company which is divided to the shareholders of company.

(b) In case of winding up, division of realised assets among creditors and shareholders (i.e., contributories).

6. What is managerial remuneration?

Sol. The term Managerial Remuneration includes remuneration payable to the (a) Managing Director, (b) Wholetime Director, (c) Part-time Director and (d) Manager. The total managerial remuneration payable does not exceed 11% of the net profit of company for each financial year.

7. What is meant by tax deducted at source?

Sol. Tax Deducted at Source is one method of collection of tax. Under this method, persons responsible for making payment of income covered by the scheme are responsible to deduct tax at the time of payment and deposit the same to the Government account within specified time. This is called 'Tax Deducted at Source'.

8. Define goodwill.

Sol. "Goodwill may be said to be that element arising from the reputation, connection or other advantages possessed by a business which enables it to earn greater profits than the return normally to be expected on the capital represented by the net tangible assets employed in the business".

9. What is average profit?

Sol. Average Profit is calculated by taking certain years profits divided by number of years.

$$\textit{Average Profit} = \frac{\textit{Total Profits for certain years}}{\textit{Number of years}}$$

10. How do you determine 'Fair value' of shares?

Sol. Under this method, the valuation share may be average of the net asset method and yield income method.

$$\text{Value per share} = \frac{\begin{pmatrix}\text{Intrinsic Value}\\ \text{per Share}\end{pmatrix} + \begin{pmatrix}\text{Yield Income Value}\\ \text{per Share}\end{pmatrix}}{2}$$

11. What is reconstruction?

Sol. Reconstruction is a method by which the affairs of the company are restructured. It has two methods:

(i) ***External Reconstruction:*** A new company is formed with the similar name but with the new capital structure in order to take over the business of an existing company is called external reconstruction. The assets and liabilities of the liquidated company are revalued and transferred to the new company.

(ii) ***Internal Reconstruction:*** Internal reconstruction is the process by which the affairs of the existing company are reorganised. The existing company will not be liquidated. The capital structure is reorganised without forming new company by getting the approval of the court. This is also called Re-organisation.

12. What is capital reduction?

Sol. Capital Reduction (or) Internal Reconstruction is the process by which the affairs of the existing company are reorganised. The existing company will not be liquidated. The capital structure is reorganised without forming new company by getting the approval of the court. This is also called Reorganisation. It may also include a scheme of capital reduction by writing off the accumulated losses and fictitious assets. It is resorted to in the following case: (a) Accumulated losses, (b) Shortage of working capital, (c) Large amount of fictitious assets, (d) Overvaluation of assets etc.

Section B (5 × 5 = 25 marks)

Answer any FIVE questions

13. ABC Ltd. invited applications for 20,000 shares of ₹100 each payable.

₹25 on application

₹35 on allotment

₹40 on call

25,000 shares were applied for. The directors accepted applications for 20,000 shares and rejected the remaining applications. All moneys due were fully received. Give journal entries and show the balance sheet of the company.

Sol. **Journal Entries**

Sl. No.	Particulars		Debit ₹	Credit ₹
(a)	Bank A/c	Dr.	6,25,000	
	To Share Application A/c			6,25,000
	(*Being application money received on 25,000 shares @ ₹25 per share*)			
(b)	Share Application A/c	Dr.	5,00,000	
	To Share Capital A/c			5,00,000
	(*Being allotment of 20,000 shares and application money transferred to share capital account*)			
(c)	Share Application A/c	Dr.	1,25,000	
	To Bank A/c			1,25,000
	(*Being excess application money on 5,000 shares were refunded*)			
(d)	Share Allotment A/c	Dr.	7,00,000	
	To Share Capital A/c			7,00,000
	(*Being share allotment due on 20,000 shares @ ₹35 per share*)			
(e)	Bank A/c	Dr.	7,00,000	
	To Share Allotment A/c			7,00,000
	(*Being allotment amount received*)			
(f)	Share Final Call A/c	Dr.	8,00,000	
	To Share Capital A/c			8,00,000
	(*Being final call money due on 2,00,000 shares @ ₹40 per share*)			
(g)	Bank A/c	Dr.	8,00,000	
	To Share Call A/c			8,00,000
	(*Being final call money received*)			

Balance Sheet

	Particulars	Note No.	Amount ₹
I.	*Equity and Liabilities*		
	(i) *Shareholders' Funds:*		
	Share Capital	1	20,00,000
	(ii) Non-Current Liabilities		—
	(iii) Current Liabilities		—
	Total (i) + (ii) + (iii)		20,00,000
II.	*Assets*		
	(i) Non-Current Assets		—
	(ii) *Current Assets:*		
	Cash at Bank		20,00,000
	Total (i) + (ii)		20,00,000

Notes to Accounts on Balance Sheet

1.	*Share Capital* Issued and paid up capital 20,000 shares of ₹100 each	20,00,000

14. Ragul Ltd. issued 60,000, 6% debentures of ₹100 each. 80% of the issue was underwritten by Balu Brothers. Applications for 45,000 shares were received in all out of which applications for 30,000 were marked. Determine the liability of Balu Brothers.

Sol. **Statement of Underwriter Liability**

Particulars		Total	Balu Bros. [Underwriter] 80%	Ragul Ltd. [Company] Balance 20%
Gross liability		60,000	48,000	12,000
			$\left[60,000 \times \frac{80}{100}\right]$	$\left[60,000 \times \frac{20}{100}\right]$
Less: Marked Application		—	30,000	—
			18,000	12,000
Less: Unmarked Application to Company				
Total Application	45,000			
Marked	30,000			
Unmarked	15,000	—	—	15,000
			18,000	–3,000
Excess in Company account is credited to Underwriter		—	–3,000	+3,000
Net Liability		—	15,000	—

15. Modern Ltd. has part of its share capital as 5,000 redeemable preference shares of ₹100 each. When the shares became due for redemption, the company decided that the whole amount will be redeemed out of a fresh issue at equal amount of equity shares of ₹10 each.

Show the journal entries in the books of the company.

Sol. *Required Amount for Redemption of Preference Shares*

5,000 Redeemable Preference Shares × ₹100 = ₹5,00,000

Amount out of fresh issue Equity Share of ₹10 each:

$$\therefore \frac{5,00,000}{₹10/\text{- each}} = 50,000 \text{ Equity Shares of ₹10 each}$$

Journal Entries for Redemption

Sl. No.	Particulars	Debit ₹	Credit ₹
(a)	Bank A/c Dr.	5,00,000	
	To Equity Share Capital A/c		5,00,000
	(*Being the fresh issue of 50,000 equity shares of ₹10 each*)		
(b)	Redeemable Preference Share Capital A/c Dr.	5,00,000	
	To Redeemable Preference Shareholder A/c		5,00,000
	(*Being the Redeemable Preference Share Capital amount transferred to its shareholder a/c for repayment*)		
(c)	Redeemable Preference Shareholder A/c Dr.	5,00,000	
	To Bank A/c		1,25,000
	(*Being the repayment of Redeemable Preference Share Capital to its shareholders*)		

16. A company was incorporated on 01.06.2014 in order to purchase a running business from 01.01.2014. The following particulars are available from its records.

	₹
Total sales for 2014	80,000
Sales from 01.01.2014 to 31.05.2014	20,000
Gross profit for the whole year	30,000
Total expenses of 2014 (including director's fees ₹1,000)	25,000
Company's share capital	75,000

Find out profit prior to incorporation and after incorporation by preparing profit and loss account.

Sol. **Statement of Profit Prior to Incorporation**

Particulars	Total	Basis	Prior Incorporation ₹	After Incorporation ₹
Revenue from Operation				
Gross Profit	30,000	Sales Ratio	7,500	22,500
Expenses:				
Other Expenses	24,000	Time	10,000	14,000
Director Fees	1,000	After	—	1,000
		Total Expenses	10,000	15,000
		Net Loss/Net Profit	(–)2,500	(+)7,500

Loss Prior to Incorporation	(–)₹2,500
Profit After Incorporation	(+)₹7,500

Workings:

1. **Sales Ratio:**

Total Sales		₹80,000
Sales from 01.01.1994 to 31.05.1994		₹20,000
After Incorporation		₹60,000
∴ Sales Ratio	20,000 : 60,000	or 1 : 3

2. **Time Ratio:**

Year Beginning	01.01.1994	5 months
Date of Incorporation	01.06.1994	
Date of year ending	31.12.1994	7 months
∴ Time Ratio		5 : 7

3. Director fee is only after incorporation.

17. A firm earned net profits during the last three years as follows:

	₹
I Year	36,000
II Year	40,000
III Year	44,000

The capital investment of the firm is ₹1,00,000.

A fair return on the capital, having regard to the risk involved is 10%.

Calculate the value of goodwill on the basis of 3 years purchase of super profit.

Sol. Valuation of Goodwill:

Goodwill = Super Profit × Number of years purchase

Super Profit = Average Profit (or) Actual Profit – Normal Profit

Average Profit

I year	36,000
II year	40,000
III year	44,000
Total Profit	1,20,000

$$\text{Average Profit} = \frac{1,20,000}{3 \text{ years}} = ₹40,000$$

Normal Profit = 10% on Capital employed

Capital Investment given = ₹1,00,000

$$\therefore \quad 1,00,000 \times \frac{10}{100} = ₹10,000$$

$$\therefore \quad \text{Super Profit} = 40,000 - 10,000 = ₹30,000$$

Goodwill = Super Profit × Number of years Purchase

= 30,000 × 3 years given

Goodwill = ₹90,000

18. Ram Ltd. has 60,000 equity shares of ₹100 each. ₹80 per share called up. Now the company decides to pay off ₹20 per share of the paid up capital and at the same time to reduce the ₹100 share to ₹60 share fully paid up by canceling the unpaid amount. Give journal entries.

Sol. **Journal Entries**

Sl. No.	Particulars	L. F.	Amount ₹ Debit	Amount ₹ Credit
(i)	Share Capital A/c Dr.		48,00,000	
	[₹100 each]			
	[60,000 shares × ₹80 paid up]			
	To Equity Share Capital A/c			36,00,000
	[₹60 each]			
	[60,000 shares × ₹60 each conversion]			
	To Equity Share Holder A/c			12,00,000
	[60,000 shares × ₹20 each payoff]			
	(*Being the reduction of 60,000 equity shares of ₹100 each, ₹80 per share paidup to 60,000 shares of ₹60 each fully paid and refund of ₹20 per share by canceling unpaid amount*)			
(ii)	Equity Share Capital A/c Dr.		12,00,000	
	[₹100 each]			
	To Bank A/c			12,00,000
	(*Being the amount paid to Equity Shareholders*)			

19. From the following particulars, determine the maximum remuneration payable to a full time director of a manufacturing company.

The profit and loss account of the company showed a net profit of ₹40,00,000 after taking into account the following items.

	₹
Depreciation [including special depreciation of ₹40,000]	1,00,000
Provision for Income tax	2,00,000
Donation to political parties	50,000
Ex-gratia payment to a worker	10,000
Capital profit on sale of assets	15,000

Sol. Calculation of Profit for Managerial Remuneration

	₹	₹
Net Profit		40,00,000
Add:		
Special Depreciation	40,000	
Provision for Income Tax	2,00,000	
Ex-gratia Payment to Workers	10,000	2,50,000
		42,50,000
Less:		
Capital Profit on Sale of Assets		15,000
Profit for Managerial Remuneration		42,35,000

∴ Remuneration payable to full-time Director as per law = 5%

∴ $$42{,}35{,}000 \times \frac{5}{100} = ₹2{,}11{,}750$$

Section C (3 × 10 = 30 marks)

Answer any THREE questions

20. X Company Ltd. issued 60,000 equity shares of ₹10 each at a premium of 10% and 3,000 6% debentures of ₹100 each at a discount of 5%. 75% of the issue is underwritten by M/s Ram & Co., at the maximum rate of commission allowed by law, on the issue price. Applications were received for 50,000 equity shares and 2,000 debentures which were accepted and payment for these was received in full. Journalise the above transactions.

Sol. Statement of Underwriter Liability

	Shares	Debentures
Total Issues	60,000	3,000
Issue undertaken by Ram & Co.	60,000 × 75% = 45,000	3,000 × 75% = 2,250
Less: Marked Application	= 37,500 [50,00 × 75%]	= 1,500 [2,000 × 75%]
[In the above of actual number marked, the net liability ratio is applied for finding marked application. Therefore as against actual applied 75% is taken]		
Net Liability	7,500	500

Journal Entries in the Books of X Ltd.

Sl. No.	Particulars	Debit ₹	Credit ₹
(a)	Bank A/c Dr.	5,50,000	
	To Equity Share Capital A/c		5,00,000
	To Share Premium A/c [10%]		50,000
	(Being allotment of 50,000 shares of ₹10 each)		
(b)	Bank A/c Dr.	1,90,000	
	Discount on Issue of Debentures A/c Dr.	10,000	
	To 6% Debentures A/c		2,00,000
	(Being allotment of 2,000 debentures of ₹100 each @ ₹95 each)		
(c)	M/s Ram & Co. A/c Dr.	82,500	
	To Equity Share Capital A/c		75,000
	To Share Premium A/c		7,500
	(Being allotment of 7,500 shares of ₹10 each at a premium of 10% to underwriters)		
(d)	M/s. Ram & Co. A/c Dr.	71,250	
	Discount on Issue of Debentures A/c Dr.	3,750	
	To 6% Debentures A/c		75,000
	(Being allotment of 750 debentures of ₹10 each at a discount of 5% to underwriters)		
(e)	Underwriting Commission on Issue of Shares A/c Dr.	12,375	
	Underwriting Commission on Issue of Debentures A/c Dr.	5,344	
	To M/s. Ram & Co. A/c		17,719
	(Being commission payable to the underwriters:		
	(i) 5% on Shares		
	45,000 × 11 = 4,95,000 × 5% = 12,375		
	(ii) 2,250 × 95 = 2,13,750 × 2.5% = 5,344		
(f)	Bank A/c Dr.	1,36,031	
	To M/s. Ram & Co. A/c		1,36,031
	(Being allotment of 50,000 shares of ₹10 each)		

Notes: 1. Commission on shares normally @ 5% on Net Liability.

2. Commission on Debentures normally @ 2.5% on Net Liability.

21. The summarised balance sheet of ABC Ltd. on 31.12.2014 was as follows:

Liabilities	₹	Assets	₹
Share capital:		Sundry assets	9,80,000
2,000 9% redeemable preference shares of ₹100 each fully paid	2,00,000	Cash at bank	4,20,000
80,000 equity shares of ₹10 each, fully paid	8,00,000		
Profit and Loss A/c	2,60,000		
Creditors	1,40,000		
	14,00,000		14,00,000

On the above date, the preference shares were redeemed at a premium of 10%. You are required to pass journal entries and give the balance sheet.

Sol.

ABC Ltd.
Journal Entries

Sl. No.	Particulars	L.F.	Amount ₹ Debit	Amount ₹ Credit
31.12.2007				
1.	P & L A/c Dr.		4,40,000	
	To Capital Redemption Reserve A/c			4,00,000
	To Premium on Redemption A/c			40,000
	(*Being the Preference Share Capital and Premium on Redemption provided out of P & L A/c*)			
2.	Preference Share Capital A/c Dr.		4,00,000	
	Premium on Redemption A/c Dr.		40,000	
	To Preference Shareholder A/c			4,40,000
	(*Being Redemption due transfer to Red. Pref. Share Holder A/c alongwith premium on redemption*)			
3.	Redeemable Preference Shareholder A/c Dr.		4,40,000	
	To Bank A/c			4,40,000
	(*Being payment made to Preference Shareholder*)			

Balance Sheet [After Redemption]

I.	*Equity and Liabilities*		
	(i) *Shareholder Funds:*		
	Share Capital	1	8,00,000
	Reserve & Surplus	2	2,40,000
	(ii) Non-Current Liabilities	—	—
	(iii) *Current Liabilities*		
	Trade Payable	3	1,40,000
	Total		11,80,000
II.	*Assets*		
	(i) *Non-Current Assets*		
	(a) *Fixed Assets:*		
	Tangible	4	9,80,000
	(ii) *Current Assets*		
	Cash at Bank	5	2,00,000
	Total		11,80,000

Notes to accounts on Balance Sheet

1.	*Share Capital*		
	Redeemable Preference Shares [Redeemed]	Nil	
	Equity Shares		
	80,000 Equity Shares @ ₹10 each	8,00,000	
		8,00,000	
2.	*Reserve & Surplus*		
	Profit & Loss A/c Opening	2,60,000	
	Less: Appropriation		
	(i) Transfer to Capital Redemption Reserve	2,00,000	
		60,000	
	(ii) Transfer to Premium Redemption	20,000	40,000
	Capital Redemption Reserve A/s		2,00,000
			2,40,000
3.	*Trade Payable*		
	Creditors		1,40,000
4.	*Tangible Assets*		
	Sundry Assets		9,80,000
5.	Cash at Bank	4,20,000	
	Less: Repayment to Preference Share Capital	2,20,000	2,00,000

22. From the following trial balance prepare final accounts for the year ended 31st December 2014.

Debit Balance	₹	Credit Balance	₹
Opening stock	30,00	Equity share capital	
Rent and taxes	6,000	1000 shares of	
Purchases	60,900	₹100 each	1,00,000
Wages	55,200	5% debentures	25,000
Discount	1,500	Sales	1,75,000
Fuel	2,570	Creditors	8,000
Building	70,000	Bank overdraft	12,000
Carriage inwards	1,175	Discount	2,200
Debtors	20,000	Transfer fee	100
Goodwill	28,000	Returns outwards	100
Plant and machinery	25,000		
Loose tools	6,000		
Advertisement	3,000		
General expenses	4,400		
Bad debts	1,030		
Debenture interest [for half year]	625		
Miscellaneous expenses	3,000		
Insurance	1,000		
Cash	3,000		
	3,22,400		3,22,400

(a) The authorised capital of the company is ₹2,00,000.

(b) Stock on 31st December 2014 is ₹20,000.

(c) Depreciate plant and machinery at 9% and revalue tools at ₹4,100.

(d) Allow 2.5% discount on debtors and 2% as bad debts reserve.

Sol. **Statement of Profit and Loss for the year end 31.12.2014**

Particulars	Note No.	Amount ₹
Revenue from Operations	1	1,75,000
Other Income	2	2,300
Total (A)		1,77,300
Expenses		
Cost of Goods Sold	3	71,975
Employee Benefit Expenses	4	55,200
Finance Cost	5	1,250
Depreciation & Amortization Expenses	6	4,150
Other Expenses	7	23,390
Total (B)		1,55,965

(*Contd.*)

Profit Before Tax		21,335
Less: Tax Expenses: Current Tax		—
Profit for the Period		21,335

Notes to Accounts on Statement of Profit & Loss Account

1.	*Revenue from Operation*		
	Sales		1,75,000
2.	*Other Income*		
	Discount [Credit—Received]		2,200
	Transfer Fees		100
			2,300
3.	*Cost of Goods Sold*		
	Opening Stock		30,000
	Add: Purchases	60,900	
	Less: Purchase Return [Return outward]	100	
		60,800	
	Add: Carriage inward	1,175	61,975
			91,975
	Less: Closing Stock		20,000
			71,975
4.	*Employee Benefit Expenses*		
	Wages		55,200
5.	*Finance Cost*		
	Debenture Interest		625
	Add: Outstanding		
	One year interest	1,250	
	$\left[25{,}000 \times \frac{5}{100}\right]$		
	Less: Already Paid [T.B.]	625	625
			1,250
6.	*Depreciation and Amortisation Expenses*		
	Depreciation on Plant & Machinery	2,250	
	$\left[25{,}000 \times \frac{9}{100}\right]$		
	Loss on Revaluation of Loose Tools:		
	Loose Tools	6,000	
	Revaluation of Tools	4,100	1,900
			4,150

(*Contd.*)

7.	*Other Expenses*		
	Rent and Taxes		6,000
	Discount Allowed [Dr.]		1,500
	Fuel		2,570
	Advertisement		3,000
	General Expenses		4,400
	Bad Debts		1,030
	Discount on Debtors $\left[20{,}000 \times \frac{2.5}{100}\right]$		500
	Reserve for Bad debts @ 2%:		
	Debtors	20,000	
	Less: Discount on debtors @ 2.5%	500	
		19,500	
	2% on 19,500		390
	Miscellaneous Expenses		3,000
	Insurance Expenses		1,000
			23,390

Balance Sheet as on …

	Particulars	Note No.	Amount ₹
I.	*Equity and Liabilities*		
	(i) *Shareholders Funds:*		
	Share Capital	1	1,00,000
	Reserve & Surplus	2	21,335
	(ii) *Non-Current Liability*		
	Long-term Borrowings	3	25,000
	(iii) *Current Liability*		
	Trade Payable	4	8,000
	Short-term Borrowing	5	12,000
	Other Current Liability	6	625
	Total (i) + (ii) + (iii)		1,66,960
II.	*Assets*		
	(i) *Non-Current Assets*		
	(a) *Fixed Assets*		
	Tangible	7	92,750
	Intangible	8	28,000
	(ii) *Current Assets*		
	Trade Receivable	9	19,110
	Closing Stock	10	24,100
	Cash	—	3,000
	Total (i) + (ii)		1,66,690

Notes to Accounts on Balance Sheet

1.	*Share Capital*		
	Authorised Capital		2,00,000
	Subscribed and Paid-up Capital:		
	1,000 Equity Shares @ ₹10 each		1,00,000
2.	*Reserve & Surplus*		
	P & L A/c [Profit for the year]		21,335
3.	*Long-term Borrowing*		
	5% Debenture		25,000
4.	*Trade Payable*		
	Creditors		8,000
5.	*Short-term Borrowing*		
	Bank Overdraft		12,000
6.	*Other Current Liability*		
	Outstanding Debenture Interest		625
	[6 months] $\left[25,000 \times \frac{5}{100} \times \frac{6}{12}\right]$		
7.	*Tangible Assets*		
	Buildings		70,000
	Plant & Machinery	25,000	
	Less: Depreciation @ 9%	2,250	22,750
			92,750
8.	*Intangible Assets*		
	Goodwill		28,000
9.	*Trade Receivables*		
	Debtors		20,000
	Less: Discount on Debtors @ 2.5%		500
	$\left[25,000 \times \frac{2.5}{100}\right]$		
			19,500
	Less: Provision for Bad Debts @ 2%		390
	$\left[19,500 \times \frac{2}{100}\right]$		
			19,110
10.	*Closing Stock/Inventories*		
	Closing Stock		20,000
	Loose Tools [Valued]		4,100
			24,100

23. From the following balance sheet, you are required to value the equity shares:

Liabilities	₹	Assets	₹
2,000 6% pref. shares of ₹10 each	2,00,000	Assets at book value	6,00,000
30,000 equity shares of ₹10 each	3,00,000		
Current liabilities	1,00,000		
	6,00,000		6,00,000

The market value of 50% of the assets is considered as 10% more than the book values and that remaining 50% at 5% less than the book values. There was a liability of ₹5,000 which remained unrecorded. Assume preference shares have no priority as to the repayment of capital or dividend.

Sol. **Valuation of Shares – Intrinsic Value Method**

	₹	₹
Assets [Revised Value]		
1/2 of assets $\left[6{,}00{,}000 \times \frac{1}{2}\right]$	3,00,000	
Add: 10% more than Book Value		
$\left[3{,}00{,}000 \times \frac{10}{100}\right]$	30,000	3,30,000
1/2 of Assets $\left[6{,}00{,}000 \times \frac{1}{2}\right]$	3,00,000	
Add: 5% of Book Value		
$\left[3{,}00{,}000 \times \frac{5}{100}\right]$	15,000	2,85,000
		6,15,000
Less: External Liabilities		
Liabilities		1,00,000
Unrecorded Liability	5,000	1,05,000
Net Asset		5,10,000
Less: Preference Share Capital		2,00,000
Amount available for Equity		3,10,000

$$\text{Value per Equity Share} = \frac{\textit{Amount Available}}{\textit{Number of Equity Shares}}$$

$$\text{Value per Equity Share} = \frac{₹3{,}10{,}000}{30{,}000 \textit{ Equity Shares}}$$

$$= ₹10.33 \text{ per share}$$

$$= ₹10.33$$

24. Rainbow Ltd. has the following balance sheet as on 31.12.2014.

Liabilities	₹	Assets	₹
6% preference share of ₹100 each	2,00,000	Goodwill	60,000
Equity shares of ₹100 each	4,00,000	Fixed assets	3,00,000
Debentures	1,00,000	Stock	1,50,000
Sundry creditors	1,50,000	Debtors	60,000
		Discount on debentures	10,000
		Bank	1,000
		P and L A/c	2,69,000
	8,50,000		8,50,000

The following reconstruction scheme was approved:

(a) Preference shares be reduced to 8%
Preference shares of ₹60 each.

(b) Equity shares to be reduced by ₹80 each.

(c) The amount thus made available to be utilized to write off fictitious assets and goodwill.

Give entries for the reconstruction and the final balance sheet.

Sol. **Internal Reconstruction – Journal Entry**

Sl. No.	Particulars	Debit ₹	Credit ₹
1.	6% Preference Share Capital A/s Dr.	2,00,000	
	[₹100 each][2,000 × 100]		
	To 8% Preference Share Capital A/c [₹60 each][2,000 × 60]		1,20,000
	To Capital reduction A/c [2,000 × 40]		80,000
	(*Being the 6% preference share @ ₹100 each reduced to 8% preference share of* ₹60 each. *Balance capital reduction*)		
2.	Equity Share Capital A/c Dr. [₹100 each][4,000 ₹ 100]	4,00,000	
	To Equity Share Capital A/c Dr. [₹20 each][4,000 ₹ 20]		80,000
	To Capital Reduction A/c [4,000 × 80]		3,20,000
	(*Being the existing Equity shares of ₹100 each reduced by ₹80*)		
3.	Capital reduction A/c Dr.	3,39,000	
	To Profit & Loss A/c		2,69,000
	To Discount on Debenture A/c		10,000
	To Goodwill A/c		60,000
	(*Being the fictitious asset and goodwill written off*)		

(*Contd.*)

4.	Capital Reduction A/c Dr.	61,000	
	To Capital Reserve A/c		61,000
	(*Being the balance in capital reduction transfer to Capital Reserve A/c*)		
	Capital Reduction A/c		
	Cr. 80,000		
	Cr. 3,20,000		
	Cr. 4,00,000		
	Dr. 3,39,000		
	Balance 61,000		

Balance Sheet of Rainbow Ltd.

	Particulars	Note No.	Amount ₹
I.	*Equity and Liabilities*		
	(i) *Shareholders Funds:*		
	Share Capital	1	2,00,000
	Reserve & Surplus	2	61,000
	(ii) *Non-Current Liabilities*		
	Long-term Borrowings		
	Debenture	—	1,00,000
	(iii) *Current Liability*		
	Trade Payable		
	Creditors		1,50,000
	Total (i) + (ii) + (iii)		5,11,000
II.	*Assets*		
	(i) *Non-Current Assets*		
	Fixed Assets		
	Tangible	—	3,00,000
	(ii) *Current Assets*		
	Trade Receivable:		
	Debtors	—	60,000
	Stock	—	1,50,000
	Bank	—	1,000
	Total (i) + (ii)		5,11,000

Notes to Accounts on Balance Sheet

1.	*Share Capital*	
	2,000, 8% Preference Share Capital of ₹60/- each	1,20,000
	4,000, Equity Sahres of ₹20/- each	80,000
		2,00,000
2.	*Reserve & Surplus*	
	Capital Reserve a/c balance	61,000

SOLVED QUESTION PAPER I 2017

B. Com (General) November 2017

62419/CPZ3A/CPG3A/CPW3A/CPM3A/CPC3A

Time: Three hours **Maximum: 75 marks**

Section A (10 × 2 = 20 marks)

Answer any TEN questions.

1. When shares are forfeited?

Sol. In case a member fails to pay allotment and/or call money on the day appointed for payment, the directors may either by the adoption of Tally A or by an express provision in its Articles, proceed to forfeit the shares held by such a defaulting shareholder.

2. State the meaning of share premium.

Sol. When a company issue shares at a price higher than their face value, the excess amount is called share premium which should be credited to 'Securities Premium A/c'?

3. Mention the status of debenture in a company.

Sol. Debentures are 'creditorship securities' issued by a company, usually for a fixed period, at a specified rate of interest payable periodically. They are categorised as long-term borrowings and include debenture stock, bonds and any other securities of a company, whether constituting a change on the assets of a company or not.

4. What is a Preference Share?

Sol. A preference share is one which enjoys preferential rights first, on preference shares a fixed dividend is guaranteed before any payment of dividend is made in respect of equity shares. The second preference is in respect of return of capital in the event of winding up of the company.

5. In which side the own debentures account will appear in the balance sheet?

Sol. Whenever surplus funds are available and market price of debentures is favourable, the company can buy its own debentures as an investment.

Thus, the own debenture account will appear in the asset side of the balance sheet.

6. What are the components of final accounts?

Sol. The final accounts of a company consist of two basic financial statements such as statement of profit and loss which indicates the financial performance of a company by showing profit earned or loss incorrect during a period and balance sheet that summarises company's equity, liabilities and asset.

7. State the different methods of valuation of goodwill.

Sol. The following methods are followed for valuation of goodwill:
1. Average profits method
2. Super profit method
3. Capitalisation method

8. Give the meaning of Super Profit.

Sol. Super profit is the excess of profit which can be expected in future years over and above what is necessary for paying a fair return on capital employed, having regard to the risk involved in that class of business and fair managerial remuneration.

9. Define Goodwill.

Sol. According to J.O. Magee, "The capacity of a business to earn profits in future" is basically what is meant by the term goodwill.

10. Mention two forms of reconstruction.

Sol. Reconstruction refers to reorganisation of the capital structure of a company. It can be of two types: external reconstruction—a new company formed to take over the business of existing company which will be liquidated and internal reconstruction—the capital of a company reorganised after eliminating accumulated losses.

11. What is Balance Sheet?

Sol. Balance sheet is a financial statement that summarises company's equity (shareholder's fund), liabilities and assets. These three Balance Sheet segments show what the company owns and what it owes.

12. How do you calculate sales ratio?

Sol. The sales ratio is the ratio of sales or turnover of the company before and after incorporation. For example, when sales before and after incorporation were ₹2,00,000 and ₹6,00,000 respectively, the sales ratio is 1:3.

Section B (5 × 5 = 25 marks)

13. Y Limited forfeited 1,000 equity shares of ₹10 each, issued at a discount of 10% for non-payment of the first call of ₹2 and the final call of ₹3 per share. Show the necessary Journal entries.

Sol.

Share capital A/c	Dr.	10,000	
To share first call A/c			2,000
To share final call A/c			3,000
To discount an issue of shares A/c			1,000
To forfeited shares A/c			4,000
(*Being the forfeiture of 1000 shares for non payment of first call and final call*)			

14. What are the sources of redemption of debentures?

Sol. I. Redemption without Provision

(a) *Redemption on specified due date*

(i) *If the redemption is out of profits:* Profits equivalent to the debentures redeemed are transferred from profit and loss account to debenture redemption account.

(ii) *If the redemption is out of capital:* Usually new issue of shares on debenture might have been made for this specific purpose.

(b) *Redemption in instalment*

(i) *Drawings by lot:* A company agrees to repay every year a predetermined amount of debentures by conducting a lot, using the distinctive numbers of the debenture.

(ii) *Open market buying:* The terms of issue of debentures may prevent a company to buy its own debentures in the open market and cancel or retain or re-issue them.

(c) *Redemption by conversion*

(i) *Conversion on the date of redemption:* When the debentures were issued, a specified redemption date is fixed and on that date the conversion takes place.

(ii) *Conversion before redemption due date:* Sometimes option may be given to the debentureholders to convert their debentures into shares earlier than the due date for redemption

II. Redemption of Debentures out of Provision

(a) *Sinking fund method*

A sinking fund may be created for redemption of debentures. It is also called 'debenture redemption fund' to distinguish it from any other sinking funds. In this method, the amount repayable on debentures, including any premium on redemption is ascertained. Reference to sinking fund tables can provide the amount to be set aside every year from the profits as annual contribution to sinking fund.

(b) *Insurance policy method*

A sinking fund insurance policy is taken to make provision for redemption of debenture. A fixed amount of premium is paid every year. The insurance company receives the premium year after year and pays the agreed amount on the specified future date which is used to repay the debenture.

15. From the following particulars of Balu Limited for the year ended 31.03.2002, calculate the net profit for managerial remuneration:

(a) Net profit as per Profit & Loss account is ₹16,00,000

(b) Remuneration and perquisites paid to

Managing director: ₹75,000

Whole time director: ₹60,000

(c) Provision for doubtful debts made during the year: ₹30,000

(d) Provision for income tax: ₹8,00,000

Sol. Calculation of Net Profit for Managerial Remuneration

Particulars		₹
Net profit as per Profit & Loss A/c		16,00,000
Add: Managing director's remuneration	75,000	
Whole time director's remuneration	60,000	
Provision for doubtful debt	30,000	
Provision for income tax	8,00,000	9,65,000
Profit available for managerial remuneration		**25,65,000**

16. From the following data relating to Pandian & Co., calculate the goodwill on the basis of three years purchase of the average profits.

(a) Profits for the years ending 2000, 2001 and 2002 were ₹80,000, ₹90,000 and ₹1,00,000.

(b) A non recurring income of ₹15,000 is included in the profits of 2000

(c) The closing stock for the year 2001 was over valued by ₹30,000.

Sol. Calculation of Goodwill:

Average Profit

Year	Amount (₹)	
2000	65,000	Profit – Non recurring income 80,000 15,000
2001	90,000	Profit – Overvaluation of closing stock 1,00,000 70,000
2002	70,000	
Total profit	**2,25,000**	

$$\text{Average profit} = \frac{₹2,25,000}{3} = ₹75,000$$

$$\text{Goodwill} = \text{Average profit} \times \text{No of year of purchase}$$
$$= ₹75,000 \times 3$$
$$= ₹2,25,000$$

17. The share capital of ABC Ltd. consisted of the following:

(a) 10,000 6% preference shares of ₹100 each and

(b) 50,000 equity shares of ₹10 each

The shares were fully paid. The company had accumulated losses totalling ₹3,50,000 besides preliminary expenses of ₹20,000. It was also ascertained that fixed assets which stood in the books at ₹14,00,000 were overvalued to the extent of ₹4,00,000. The following scheme was adopted to write off the losses and reduce the assets.

(i) 6% preference shares were to be converted into 7% preference shares of ₹60 each.

(ii) Equity shares were to be reduced to ₹2 each. Journalize and prepare balance sheet.

Sol. **Journal Entries**

Particulars	₹	₹
6% preference share capital A/c (₹100)	10,00,000	
To 7% preference share capital A/c (₹60)		6,00,000
To capital reduction A/c		4,00,000
(*Being 6% preference shares reduced to ₹60 each*)		
Equity share capital A/c (₹10)	5,00,000	
To equity share capital A/c (₹2)		1,00,000
To capital reduction A/c		4,00,000
(*Being equity shares reduced to ₹2 each*)		
Capital Reduction A/c Dr.	8,00,000	
To accumulated losses		3,50,000
To preliminary expenses		20,000
To fixed assets		4,00,000
To capital reserve A/c (B/s)		30,000
(*Being losses written off, fixed assets reduced and balance transferred to Capital Reserve A/c*)		

Notes to Accounts

1. Share capital	
50,000 equity shares of ₹2 each fully paid	1,00,000
10,000 7% preference shares of ₹60 each fully paid	6,00,000
	7,00,000
2. Reserves and Surplus	
Capital Reserve	30,000
3. Tangible assets	
Fixed assets ₹(14,00,000 – 4,00,000)	10,000

Balance Sheet of ABC Ltd. as on …

Particulars	Note No.	₹
I. Equity and Liabilities		
(i) Shareholder's Funds		
Share Capital	1	7,00,000
Reserves and Surplus	2	30,000
(ii) Non-current Liabilities		—
(iii) Current Liabilities		—
Total (i) + (ii) + (iii)		**7,30,000**
II. Assets		
(i) Non current assets		
Tangible assets	3	10,00,000
Intangible assets		—
(ii) Current assets		—
Total (i) + (ii)		**10,00,000**

Note: The hidden informations have not been stated in the given problem and this results in variation in the Balance Sheet Total.

18. Raja Ltd., was incorporated on 1st July 2004, which took over a running concern with effect from 1st January, 2004. The sales for the period up to 1st July, 2004 was ₹2,70,000 and the sales for 1st July, 2004 to 31st December, 2004 amounted to ₹3,30,000. Find out sales ratio and time ratio.

Sol. Calculation of Time Ratio

Pre incorporation period from 01.01.2004 to 01.07.2004	6 months
Post incorporation period from 01.07.2004 to 31.12.2004	6 months
Time ratio	1:1

Calculation of Sales Ratio

Pre Incorporation sales	:	Post Incorporation sale
2,70,000	:	3,30,000
9	:	11

19. Distinguish between internal and external reconstruction.

Sol.

Basis of Comparison	Internal Reconstruction	External Reconstruction
Meaning	Internal reconstruction refers to the method of corporate restructuring wherein existing company is not liquidated to form a new one	External reconstruction is one in which the company undergoing reconstruction is liquidated to take over the business of existing company
New Company	No new company is formed	New company is formed
Use of specific terms in balance sheet	Balance sheet of the company contains "And reduced"	No specific terms are used in the balance sheet
Capital reduction	Capital is reduced and the external liability holders waive their claims	No reduction in the capital
Approval of court	Approval of court is must	No approval of court is required
Transfer of assets and liabilities	No such transfer takes place	Asset and liabilities of existing company is transferred to new company

Section C ($3 \times 10 = 30$ marks)

Answer any THREE questions.

20. A Ltd. issued 10,000 equity shares of ₹10 each payable as under ₹2 on application, ₹5 on allotment, and ₹3 on first and final call.

The public applied for 8,000 shares which are allotted. All the money due on shares was received except the first and final call on 100 shares. These shares were forfeited and reissued at ₹8 per share. Show the journal entries in the book of the company.

Sol. **Journal Entries in the Books of the Company**

Particulars		₹	₹
Bank A/c	Dr.	16,000	
To share application A/c			16,000
(Being application money received on 8,000 shares)			
Share application A/c	Dr.	16,000	
To share capital A/c			16,000
(Being application money transferred to share capital A/c)			
Share allotment A/c	Dr.	40,000	
To share capital A/c			40,000
(Being amount due on allotment)			
Bank A/c	Dr.	40,000	
To share allotment A/c			40,000
(Being amount received on allotment)			
Share first and final call A/c	Dr.	24,000	
To share capital A/c			24,000
(Being amount due on first & final call)			
Bank A/c	Dr.	23,700	
To share first & final call A/c			23,700
(Being amount received on first & final call on 7,900 shares)			
Share capital A/c	Dr.	1000	
To share first & final call A/c			300
To forfeited share A/c			700
(Being forfeiture of 100 shares for non-payment of first & final call)			
Bank A/c	Dr.	800	
Forfeited Share A/c	Dr.	200	
To share capital A/c			1000
(Being reissue of forfeited shares @₹8 per share)			
Forfeited shares A/c	Dr.	500	
To Capital Reserve A/c			500
(Being transfer of balance amount from shares forfeited A/c to capital reserve A/c)			

21. Time Limited, issued 1,000 8% debentures of ₹100 each. Give appropriate journal entries in the books of the company, if the debenture were issued as follows:

(a) Issued at par, redeemable at par.

(b) Issued at a discount of 5%, repayable at par

(c) Issued at a premium of 10%, repayable at par
(d) Issued at par, redeemable at a premium of 10%
(e) Issued at a discount of 5%, repayable at a premium of 10%.

Sol. Journal Entries in the Books of the Company

Particulars		₹	₹
(a) Issued at par, redeemable at par			
Bank A/c	Dr.	1,00,000	
To 8% Debentures A/c			1,00,000
(*Being issue of 1,000 8% debentures at par and redemption at par*)			
(b) Issued at a discount of 5% and repayable at par			
Bank A/c	Dr.	95,000	
Discount an issue of debentures A/c	Dr.	5,000	
To 8% Debentures A/c			1,00,000
(*Being issue of 1,000 8% Debentures at 5% discount and redemption at par*)			
(c) Issued at a premium of 10%, repayable at par			
Bank A/c	Dr.	1,10,000	
To 8% Debentures A/c			1,00,000
To securities premium A/c			10,000
(*Being issue of 1,000 8% Debentures at 10% premium and redemption at par*)			
(d) Issued at par, redeemable at a premium of 10%			
Bank A/c	Dr.	1,00,000	
Loss on issue of debenture A/c	Dr.	10,000	
To 8% Debenture A/c			1,00,000
To premium is redemption of debenture A/c			10,000
(*Being issue of 1,000 8% Debentures at par and redemption at a premium of 10%*)			
(e) Issued at a discount 5%, repayable at a premium of 10%			
Bank A/c	Dr.	95,000	
Discount on issue of debenture A/c	Dr.	5,000	
Loss on issue of debenture A/c	Dr.	10,000	
To 8% Debenture A/c			1,00,000
To premium on redemption of debenture A/c			10,000
(*Being issue of 1,000 8% debenture, at a discount of 5% and redemption at 10% premium*)			

22. A Limited was registered with an authorised capital of ₹6,00,000 in equity shares of 10 each. The following is its trial balance on 31st March 2008.

	Debit ₹	Credit ₹
Goodwill	25,000	
Cash	750	
Bank	39,900	
Purchase	1,85,000	
Preliminary expenses	5,000	
Share capital		4,00,000
12% Debentures		3,00,000
P & L account		26,250
Calls-in-Arrears	7,500	
Premises	3,00,000	
Plant and machinery	3,30,000	
Interim dividend	39,250	
Sales		4,15,000
Opening stock	75,000	
Furniture	7,200	
Sundry debtors	87,000	
Wages	84,865	
General expenses	6,835	
Freight and carriage	13,115	
Salaries	14,500	
Director's fees	5,725	
Bad debts	2,110	
Debenture interest paid	18,000	
Bills payable		37,000
Sundry creditors		40,000
General reserve		25,000
Provision for bad debts		3,500
Total	**12,46,750**	**12,46,750**

Prepare profit and loss account, profit and loss appropriation account and balance sheet in proper form after making the following adjustments:

(a) Depreciate plant and machinery by 15%

(b) Write off ₹500 from preliminary expenses

(c) Provide for 6 months interest on debentures.

Sol. **Notes to Accounts on Statement of Profit and Loss**

	₹
1. Revenue from Operations	
Sales	4,15,000
2. Cost of Goods Sold	
Opening stock	75,000
Add: Purchase	1,85,000
Add: Freight & carriage	13,115
	2,73,115
Less: Closing stock	—
	2,73,115
3. Employee Benefit Expenses	
Wages	84,865
Salaries	14,500
	99,365
4. Finance Costs	
Interest on debenture	18,000
Add: Outstanding $\left(3,00,000 \times 12\% \times \frac{6}{12}\right)$	18,000
	36,000
4. Depreciation and Amortisation Expenses	
Depreciation on plant and machinery	49,500
Preliminary expense written off	500
	50,000
5. Other Expenses	
General expenses	6,835
Director's fees	5,725
Bad debt 2,110	
Add: New provision for bad debts —	
2,110	12,560
Less: Old provision for bad debts 3,500	
	(1,390)
	14,170

Statement of Profit and Loss A/c for the year ended 31/03/08

Particulars	Note No	₹
Revenue from operations	1	4,15,000
Other income		—
Total revenue(A)		**4,15,000**
Expenses		
Cost of goods sold	2	2,73,115
Employee benefit expense	3	99,365

(*Contd.*)

Finance costs	4	36,000
Depreciation and amortisation expenses	5	50,000
Other expenses	6	11,170
Total expense (B)		**4,69,650**
Profit before tax/Loss (A – B) *Less: tax*		(54,650)
Profit/Loss for the period		(54,650)

Notes to Account on Balance Sheet

1. Share capital		
Authorised capital		6,00,000
Issued, subscribed and called up 40,000 shares of ₹10 each	4,00,000	
Less: Calls-in-Arrear	7,500	3,92,500
2. Reserve & Surplus		
General Reserve		25,000
Deficit in statement of Profit & Loss A/c	54,650	
Balance at the beginning of the year	26,250	
Profit for the year	28,400	
Less: Appropriation-Intern dividend corporate dividend tax (39250 × 17%)	39,250	(10,850)
		14,150
3. Long-term borrowings		
12% Debentures		3,00,000
		3,00,000
4. Trade payables		
Creditor		40,000
Bills payable		37,000
		77,000
5. Other current liabilities		
O/s Interest on debenture		18,000
		18,000
6. Tangible assets		
Plant & machinery (3,30,000 – 49,500)		2,80,500
Premises		3,00,000
Fixture		7,200
		5,87,700
7. Intangible assets		
Goodwill		25,000
		25,000

(*Contd.*)

8. Trade receivable Debtor		87,000
		87,000
9. Other current assets Preliminary expense		4,500
		4,500

Balance Sheet as on 31/03/2008

Particulars	Note No.	₹
I. Equity and Liabilities		
(i) Shareholders funds		
Share capital	1	3,92,500
Reserve & Surplus	2	14,150
(ii) Non current liabilities		
Long-term borrowing	3	3,00,000
(iii) Current Liabilities		
Trade payable	4	77,000
Other current liabilities	5	18,000
Total (i) + (ii) + (iii)		**8,01,650**
II. Asset		
(i) Non current assets		
Tangible assets	6	5,87,700
Intangible assets	7	25,000
(ii) Current assets		
Trade receivable	8	87,000
Cash in bank		39,900
Cash in hand		750
Other CA	9	4,500
Total (i) + (ii)		**7,44,850**

Note: The hidden informations have not been stated in the given problem and this results in variation in the Balance Sheet Total.

23. The following is the balance sheet of S Company Limited as on 31st December 2008:

Liabilities	₹	Assets	₹
Equity share ₹100 each	3,00,000	Cash in hand	2,000
8% preference shares ₹100 each	1,50,000	Cash at bank	20,000
General reserve	40,000	Sundry debtors	80,000

(*Contd.*)

Profit and loss account	10,000	Stock	1,40,000
Bank loan	50,000	Land and buildings	2,05,000
Sundry creditors	15,000	Furniture	30,000
		Goodwill	70,000
		Discount on shares	18,000
	5,65,000		**5,65,000**

The value of assets is assessed as follows:

(a) Furniture to be depreciated at 10%

(b) Value of stock, Land and Buildings and Goodwill is estimated at ₹1,20,000; ₹2,50,000 and ₹80,000 respectively.

(c) Debtors are expected to realize 80% of book value. Find out the value of equity shares.

Sol. **Calculation of Net Assets**

Cash in hand		2000
Cash at bank		20,000
Debtors (80% of 80,000)		64,000
Stock		1,20,000
Land & Buildings		2,50,000
Furniture (30,000 – 3,000)		27,000
Goodwill		80,000
		5,63,000
Less: Bank loan	50,000	
Creditor	15,000	65,000
Net assets for equity and preference shareholders		4,98,000
Less: Preference shareholders		1,50,000
Net assets for equity shareholders		**3,48,000**

$$\text{Intrinsic value per share} = \frac{\text{Net asset for equity shareholders}}{\text{Number of equity shares}}$$

$$= \frac{3,48,000}{3,000}$$

$$= ₹116$$

24. S Limited had the following balance sheet as on 31.03.2000:

Liabilities	₹	Assets	₹
8% preference shares ₹100 each	2,00,000	Goodwill	60,000
Equity shares ₹100 each	4,00,000	Fixed assets	3,00,000
Debentures	1,00,000	Stock	1,50,000
Creditors	1,50,000	Debtors	60,000
		Discount on debentures	10,000
		Bank	1,000
		P & L account	2,69,000
	8,50,000		**8,50,000**

The following reconstruction scheme was approved:

(a) Preference shares be reduced to ₹60 each

(b) Equity shares to be reduced by ₹80 each

(c) The amount thus made available to be utilized to write off fictitious assets including goodwill and ₹50,000 from fixed assets.

Give entries for the reconstruction and the final balances sheet.

Sol. **Journal Entries**

Particulars		₹	₹
8% Preference share capital A/c	Dr. (₹100)	2,00,000	
To 8% preference share capital A/c	(₹60)		1,20,000
To capital reduction A/c			80,000
(*Being 8% preference shares reduced to ₹60 each*)			
Equity share capital A/c	Dr. (₹100)	4,00,000	
To equity share capital A/c	(₹20)		80,000
To capital reduction A/c			3,20,000
(*Being equity shares reduced to ₹20 each*)			
Capital Reduction A/c	Dr.	4,00,000	
To Goodwill A/c			60,000
To Discount on Debentures A/c			10,000
To Profit & Loss A/c			2,69,000
To fixed assets A/c			50,000
To capital reserve A/c			11,000
(*Being losses written off, fixed assets reduced and balance transferred to capital reserve A/c*)			

Notes to Accounts

1. Share capital	
Issued and paid up capital	
4,000 equity share of ₹20 each	80,000
2,000 8% paid up shares of ₹60 each	1,20,000
	2,00,000
2. Reserve & surplus	
Capital Reserve	11,000
	11,000
3. Long-term borrowings	
Debenture	1,00,000
	1,00,000
4. Trade payables	
Creditor	1,50,000
	1,50,000
5. Tangible assets	
Fixed assets (3,00,000 – 50,000)	**2,50,000**

Balance Sheet of S Ltd. as on 31.03.2000

Particulars	Note No	₹
I. Equity and Liabilities		
(i) Shareholders fund		
Share capital	1	2,00,000
Reserve & surplus	2	11,000
(ii) Non current liabilities		
Long-term borrowings	3	1,00,000
(iii) Current liabilities		
Trade payable	4	1,50,000
Total (i) + (ii) + (iii)		**4,61,000**
II. Asset		
(i) Non current assets		
Tangible assets	5	2,50,000
(ii) Current assets		
Trade receivables		60,000
Stock		1,50,000
Bank		1,000
Total (i) + (ii)		**4,61,000**

SOLVED QUESTION PAPER II 2017

B. Com (CS) November 2017

60552/CYA3A

Time: Three hours **Maximum: 75 marks**

Section A (10 × 2 = 20 marks)

Answer any TEN questions.

1. What is meant by 'allotment' of shares?

Sol. While the application is an offer to buy shares, allotment of shares by the company constitutes an acceptance of such offer. Shares are allotted on receipt of minimum subscription within 120 days. If the minimum subscription is not received the money shall be returned to subscribers within 10 days.

2. Write a note on underwriting.

Sol. Underwriting is a contact entered into by the company with persons or institutions called underwriters who undertake to take up the whole or a portion of such offered shares or debentures as may not be subscribed by the public, in consideration of remuneration called underwriting commission.

3. What is a debenture?

Sol. Debentures are 'creditorship securities' issued by a company, usually for a fixed period, at a specified rate of interest payable periodically. It includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of a company or not.

4. What is meant by acquisition of business?

Sol. Sometimes a limited company already in operation acquires or takes over the business of some other concern trading more or less on the same fines. Many a times, sole proprietorship or partnership businesses are converted into limited liquidity companies. These newly formed companies take over the business of sole trader or firm. The acquiring company is called the purchaser, the selling concern is called the vendor and purchase price is called purchase consideration.

5. Give a short note on shareholder's funds.

Sol. Shareholders funds consists of share capital in which shares are issued by the company for subscription reserves and surplus wherein reserve amount is set aside out of profits and other surpluses to meet future uncertainties and many received against share warrants.

6. What do you understand by current liabilities?

Sol. Liabilities that are to he repaid within 12 months from the date of balance sheet are categorised as current liabilities. Such liabilities are divided into short term borrowings, trade payables, other current liabilities and short term provisions.

7. Define 'goodwill'.

Sol. According to J. O. Magee, "The capacity of a business to earn profits in future is basically what is meant by the term goodwill."

8. How do you calculate 'average capital employed'?

Sol. Average capital employed means the average of the capital employed at the end of the year and that employed in the beginning of the year.

9. What do you understand by 'alteration of share capital'?

Sol. Section 94 of the Companies Act permits a limited company to alter the capital clause of its Memorandum of Association in five different ways namely increase of share capital, consolidation of shares, subdivision, conversion of shares into stock and vice versa, and cancellation of unissued shares.

10. What are Calls-in-Advance?

Sol. When a company accepts money from the shareholder in advance towards calls not yet made by the company such amounts are termed as 'Calls-in-Advance'.

11. Mention any two situations which call for internal reconstruction.

Sol.
1. When there are huge accumulated losses and it is required to write off these losses for the benefit of the company.
2. When a part of the capital is not represented by available tangible assets.

12. What do you mean by profit prior to incorporation?

Sol. Profit prior to incorporation is the profit earned or loss suffered during the period before incorporation. It is a capital profit and is not legally available for dividend.

Section B (5 × 5 = 25 marks)

Answer any FIVE questions.

13. A company forfeits 100 shares of ₹10 each, originally issued at a premium of ₹2 per share. The shareholder paid ₹4 per share on application but did not pay the allotment money of ₹4 per share (including premium) and call of ₹4 per share. The shares are subsequently re-issued at ₹11 per share as fully paid up. Pass journal entries for forfeiture and reissue of forfeited shares.

Sol.

Share capital A/c	Dr.	1,000	
Securities premium A/c	Dr.	200	
To share allotment A/c			400
To share call A/c			400
To forfeited shares A/c			400
Bank A/c	Dr.	1,100	
To share capital A/c			1,000
To securities premium A/c			100
Forfeited shares A/c	Dr.	400	
To Capital Reserve A/c			400

14. Arun Ltd., issued 1,00,000 equity shares. The whole of the issue was underwritten as follows:

X-40%; Y-40%; Z-20%

Applications for 80,000 shares were received in all out of which applications for 20,000 shares had stamp of X, those for 10,000 shares that of Y and 20,000 shares that of Z.

The remaining applications did not bear any stamp.

Show the liability of the underwriters.

Sol. **Statement Showing Liability of the Underwriters**

Particulars	X	Y	Z	Total
Gross liability	40,000	40,000	20,000	1,00,000
Less: Marked applications	20,000	10,000	20,000	50,000
	20,000	30,000	—	50,000
Less: Unmarked applications (in the ratio of gross liability 2:2:1)	12,000	12,000	6,000	30,000
	8,000	18,000	(6,000)	20,000
Less: Surplus of Z transferred to X & Y (in their gross liability)	3,000	3,000	6,000	—
Net liability	5,000	15,000	Nil	20,000

15. You are required to calculate the time ratio for the pre and post incorporation period from the following particulars:

(a) Date of incorporation: 1st June 1999.

(b) Period of financial accounts: April 1999 to March 2000.

(c) Total wages ₹4,800.

(d) Number of workers: Pre incorporation period: 5
Post incorporation period: 25

Also divide the total wages between pre and post incorporation periods.

Sol. Time Ratio

Pre Incorporation Period : Post Incorporation Period

April to June 1st : June 1st to March 31st 2000)

2 months : 10 month

or

1 : 5

Weighted Time Ratio

Pre Incorporation Period × Number of workers : Post Incorporation Period × Number of Workers

$$1 \times 5 : 5 \times 25$$

$$5 : 125 \text{ i.e. } 1{:}25$$

Total wages ₹4,800

$$\text{Pre Incorporation Period} = 4{,}800 \times \frac{1}{26} = ₹185$$

$$\text{Post Incorporation Period} = 4{,}800 \times \frac{25}{26} = ₹4{,}615$$

16. Give the format of balance sheet as per revised schedule VI.

Sol. Format of Balance Sheet as per Revised Schedule VI

Particulars	Note No	₹
I. Equity and Liabilities		
(i) Shareholders funds		
Share Capital	1	xxx
Reserves and Surplus	2	xxx
Money received against share warrants	3	xxx
(ii) Non Current Liabilities		
Long-term borrowings	4	xxx
Deferred tax liabilities	5	xxx
Other long-term liabilities	6	xxx
Long-term provisions	7	xxx

(*Contd.*)

(iii) Current Liabilities		
Short term borrowings	8	xxx
Trade payable	9	xxx
Other current liabilities	10	xxx
Short term provisions	11	xxx
Total		**xxx**
II. Assets		
(i) Non Current Assets:		
(a) Fixed assets		
Tangible assets	12	xxx
Intangible assets	13	xxx
Capital work in progress	14	xxx
Intangible assets under development	15	xxx
(b) Non current investment	16	xxx
(c) Deferred tax assets (net)	17	xxx
(d) Long-term loans and advances	18	xxx
(e) Other non current asset	19	xxx
(ii) Current Assets		
Current investments	20	xxx
Inventories	21	xxx
Trade receivables	22	xxx
Cash and cash equivalents	23	xxx
Short term loans and advances	24	xxx
Other current assets	25	xxx
Total		**xxx**

17. Ascertain the expected Rate of Return from the particulars given below:

Particulars	₹
80,000 Equity shares of ₹10 each fully paid	8,00,000
Expected profit per year before tax	5,20,000
Rate of tax	50%
Transfer to general reserve every year	20% of profit
Preference share dividend	40,000

Sol. Expected Rate of Return $= \dfrac{\text{Profit available for equity dividend}}{\text{Paid up equity capital}} \times 100$

$$= \frac{1,68,000}{8,00,000} \times 100$$

$$= 21\%$$

Expected Profit	5,20,000
Less: tax (50%)	2,60,000
	2,60,000
Less: Transfer to general reserve 20%	52,000
	2,08,000
Less: Preference dividend	40,000
Profit available for equity dividend	1,68,000

18. Suguna Co. has been suffering heavy losses in the past. So, it has decided to go for reconstruction scheme by reducing 22,000 equity shares of ₹100 each into ₹50 each so as to write off accumulated losses of ₹10,70,000. Give journal entries to record the above transaction.

Sol.

Share Capital A/c	Dr.	22,00,000	
To share capital A/c			11,00,000
To capital reduction A/c			11,00,000
(*Being amount reduced from share capital @₹50 and transferred to capital reduction A/c*)			
Capital Reduction A/c	Dr.	11,00,000	
To Accumulated losses A/c			10,70,000
To Capital Reserve A/c			30,000
(*Being accumulated losses written off and balance transferred to Capital Reserve A/c*)			

19. Redeemable preference shares to be redeemed: ₹4,00,000.

Premium on redemption: 10%

Divisible profit available: ₹80,000

Fresh issue of equity shares of ₹10 each is to be made at 25% premium.

From the given information, you are required to find out:

(a) The minimum fresh issue of shares

(b) The necessity of applying formula and

(c) The amount of issue.

Sol. (a) Computation of Minimum Fresh Issue

Minimum Fresh Issue = Redeemable preference shares to be redeemed – Divisible profit available

= 4,00,000 – 80,000

$$= ₹3{,}20{,}000 \left(\frac{3{,}20{,}000}{10} = 32{,}000 \text{ shares}\right)$$

(b) Is it necessary to apply the equation

Premium on Minimum Issue (3,20,000 × 25%)	₹80,000
Add: Existing premium	Nil
Total premium	₹80,000

As this premium is sufficient to pay off ₹40,000 premium on redemption of preference shares, it is not necessary to apply the equation.

(c) Minimum fresh issue of shares to be made for redemption of preference shares: ₹3,20,000

Section C (3 × 10 = 30 marks)

Answer any THREE questions.

20. AB Ltd. issued 10,000 equity shares of ₹10 each at a discount of 10% payable as follows:

₹2 per share on application

₹2 per share on allotment

₹2 per share on first call

₹3 per share on final call

Application were received for 12,000 shares and the directors allotted 10,000 shares and refunded the application money for 2,000 shares.

The allotment money was duly received on all the shares. One shareholder holding 1,000 shares did not pay the first and final calls. Another shareholder holding 200 shares paid the final call money along with the first call itself.

Pass necessary journal entries in the books of AB Ltd.

Sol. **Journal Entries in the Books of AB Ltd.**

Particulars		₹	₹
Bank A/c	Dr.	24,000	
To share application A/c			24,000
(*Being application money received*)			
Share application A/c	Dr.	24,000	
To share capital A/c			20,000
To Bank A/c			4,000
(*Being transfer of application money to share capital A/c and refund of excess application money*)			
Share allotment A/c	Dr.	20,000	
Discount on issue of shares A/c	Dr.	10,000	
To share capital A/c			30,000
(*Being amount due on allotment*)			

(*Contd.*)

Bank A/c	Dr.	20,000	
To share allotment A/c			20,000
(*Being allotments money received*)			
Share first call A/c	Dr.	20,000	
To share capital A/c			20,000
(*Being amount due on first call*)			
Bank A/c	Dr.	18,600	
Calls-in-Arrears A/c	Dr.	2,000	
To share first call A/c			20,000
To Calls-in-Advance A/c			600
(*Being amount received on 9,000 shares for first call and Calls-in-Advance for 200 shares*)			
Share final call A/c	Dr.	30,000	
To share capital A/c			30,000
(*Being amount due on share final call*)			
Bank A/c	Dr.	26,400	
Calls-in-Arrears A/c	Dr.	3,000	
Calls-in-Advance A/c	Dr.	600	
To share final call A/c			30,000
(*Being amount received on share final call on 9,000 shares*)			

21. On 1st January, X Ltd. has ₹1,00,000 6% debentures. In accordance with the power under the deed the directors acquire the debentures as follows in the open market for immediate cancellation.

March 1, ₹20,000 at ₹98 cum-interest

April 1, ₹40,000 at ₹100.25 cum-interest

December 15, ₹10,000 at ₹98.5 ex-interest

Debenture interest is payable half yearly on 30th June and 31st December every year.

Show journal entries for purchase and cancellation of debentures.

Sol.

01.03	6% Debentures A/c	Dr.	20,000	
	Debenture Interest A/c	Dr.	200	
	(20,000 × 6% × 2/12)			
	To Bank A/c			19,600
	To profit on cancellation of debenture			600
	(*Being purchase and cancellation of ₹20,000 debentures at ₹98 cum interest inclusive of profit*)			

(*Contd.*)

01.04	6% Debenture A/c Dr. Debenture Interest A/c Dr. (40,000 × 6% × 3/12) To Bank A/c To profit on cancellation debentures A/c *(Being purchase and cancellation of ₹40,000 debentures at ₹100.25 cum interest which includes profit)*	40,000 600	 40,100 500
15.12	6% Debentures A/c Dr. Debenture Interest A/c Dr. $\left(₹10,000 \times 6\% \times \frac{5½}{12}\right)$ To Bank A/c $₹10,000 \times \frac{98.5}{100} + 275$ To profit on cancellation of debenture A/c *(Being purchase and cancellation of ₹10,000 at ex-interest of ₹98.5 which includes profit)*	10,000 275	 10,125 150

22. Prepare a balance sheet as on 31st March 2010 from the following information ABC Ltd. as required under the companies act:

Particulars	₹	Particulars	₹
Term loan	10,00,000	Loss for the year	3,00,000
Creditors	11,45,000	Sundry debtors	12,25,000
Advances	3,72,000	Miscellaneous expenses	58,000
Cash and bank balances	2,75,000	Loans from directors	2,00,000
Staff advances	55,000	Provisions for doubtful debts	20,200
Provision for tax	1,70,000	Stock	4,00,000
Securities premium	4,75,000	Fixed assets (W.D.V)	51,50,000
Loss tools	50,000	Finished goods	7,50,000
Investments	2,25,200		
General reserve	20,50,000		
Capital work in progress	2,00,000		

Additional information:

(a) Share capital consists of:
   (i) 30,000 equity shares of ₹100 each fully paid up
   (ii) 10,000 –10% preference share of ₹100 each fully paid up
(b) Term loan is secured
(c) Depreciation on assets: ₹5,00,000.

Sol. Notes to Accounts

	₹
1. Share capital	
Equity share capital	30,00,000
10% preference share capital	10,00,000
	40,00,000
2. Reserves and Surplus	
Securities premium	4,75,000
General reserve	20,50,000
	25,25,000
Less: Loss for the year and miscellaneous expenses (3,00,000 + 58,000)	3,58,000
	21,67,000
3. Long-term Borrowing	
Term loan	10,00,000
4. Short term borrowings	
Loans from directors	2,00,000
5. Trade payables	
Creditors	11,45,000
6. Short term provisions	
Provision for tax	1,70,000
7. Tangible assets	
Fixed assets	51,50,000
8. Capital W&P	2,00,000
9. Non current Investments	2,25,200
10. Trade receivables	
Sundry debtors	12,25,000
Less: PBDD	20,200
	12,04,800
11. Inventories	
Finished goods	7,50,000
Stock	4,00,000
Loose tools	50,000
	12,00,000
12. Short term loans	
Advances	3,72,000
Staff Advance	55,000
	4,27,000

Balance Sheet

I. Equity and Liability		
1. Shareholders fund		
Share capital	1	40,00,000
Reserve & surplus	2	21,67,000
2. Non Current Liabilities		
Long-term borrowing	3	10,00,000
3. Current liabilities		
Short term borrowing	4	2,00,000
Trade payable	5	11,45,000
Other current liabilities	—	—
Short term provision	6	1,70,000
Total		**86,82,000**
II. Assets		
1. Non current assets		
Tangible assets	7	51,50,000
Capital W&P	8	2,00,000
Non current investment	9	2,25,200
2. Current assets		
Trade receivable	10	12,04,800
Inventories	11	12,00,000
Short term loans & Advances	12	4,27,000
Cash		2,75,000
Other current assets	—	—
Total		**86,82,000**

23. Compute the yield value of the equity share on the basis of dividend yield from the information given below:

Particulars	₹
Average profit after tax	17,000
Preference share dividend	5,400
Transfer to general reserve	10%
9,000 equity shares of ₹10 each fully paid	90,000
Normal rate of dividend	9%

Sol. (i) Calculation of profit available for equity shareholders

Average profit after tax	17,000
Less: Transfer to General Reserve	1,700
	15,300
Less: Preference dividend	5,400
Profit available for equity dividend	9,900

(ii) Calculation of expected rate of return

$$\text{Expected rate of return} = \frac{\text{Profit available for equity dividend}}{\text{Paid up equity capital}} \times 100$$

$$= \frac{₹9,900}{90,000} \times 100 = 11\%$$

(iii) Calculation of yield value

$$\text{Yield value per share} = \frac{\text{Expected rate of return}}{\text{Normal rate of return}}$$

$$\times \text{Paid up value equity share}$$

$$= \frac{11\%}{9\%} \times 10$$

$$= ₹12.22$$

24. Sick Ltd. had the following balance sheet as on 31.03.2007.

Liabilities	₹	Assets	₹
6% preference share of ₹100 each	2,00,000	Goodwill	60,000
Equity share of ₹100 each	4,00,000	Fixed assets	3,00,000
Debentures	1,00,000	Stock	1,50,000
Sundry creditors	1,50,000	Debtors	60,000
		Discount on debentures	10,000
		Bank	1,000
		Profit & Loss A/c	2,69,000
	8,50,000		**8,50,000**

The following reconstruction scheme was approved:

(a) Preference shares are reduced to 8% preference shares of ₹60 each.

(b) Equity shares to be reduced by ₹80 each.

(c) The amount thus made available to be utilised to write of fictitious assets including goodwill and ₹50,000 from fixed assets.

Give entries for the reconstruction and the final balance sheet.

Sol. **Journal Entries in the Books of Sick Ltd.**

Particulars		₹	₹
Equity share capital A/c	Dr. (₹100)	4,00,000	
To equity share capital A/c (₹20)			80,000
To Capital Reduction A/c			3,20,000
(*Being amount reduced from equity shares @₹80 each*)			
Preference share capital A/c	Dr. (₹100)	2,00,000	
To pressure share capital A/c (₹60)			1,20,000
To capital reduction A/c			80,000
(*Being amount reduced from preference shares @ ₹40 each*)			
Capital Reduction A/c	Dr.	4,00,000	
To Profit & Loss A/c			2,69,000
To discount on debenture A/c			10,000
Goodwill A/c			60,000
To fixed assets A/c			50,000
To capital reserve A/c (B/f)			11,000
(*Being losses written off, amount reduced from fixed assets and balance transferred to capital reserve A/c*)			

Notes to Account

1. Share capital	
4,000 Equity shares of ₹20 each	80,000
2,000, 6% Preference shares of ₹60 each	1,20,000
	2,00,000
2. Reserves and Surplus	
Capital Reserve	11,000
	11,000
3. Long-term Borrowings	
Debenture	1,00,000
	1,00,000
4. Trade payables	
Sundry creditors	1,50,000
	1,50,000
5. Tangible assets	
Fixed Assets (3,00,000 – 50,000)	2,50,000
	2,50,000

Balance Sheet of Sick Ltd. as on 31.03.2007 (and reduced)

Particulars	Note No.	₹
I. Equity and Liabilities		
(i) Share holders funds		
Share capital	1	2,00,000
Reserves and surplus	2	11,000
(ii) Non current liabilities		
Long-term borrowings	3	1,00,000
(iii) Current Liabilities		
Trade payables	4	1,50,000
Total (i) + (ii) + (iii)		**4,61,000**
II. Assets		
(i) Non current asset		
Tangible asset	5	2,50,000
(ii) Current assets		
Trade receivable (Debtors)		60,000
Bank		1,000
Stock		1,50,000
Total (i) + (ii)		**4,61,000**