Corporate Accounting

for Bangalore University

(As per CBCS Syllabus 2014-15 as Revised in March 2017)

B.COM III SEMESTER

About the Author

Ruqsana Anjum is currently working as an Assistant Professor at St. Joseph's College of Commerce (Autonomous), Bangalore and is a visiting faculty at ICAI (works) and various other management institutes.

CMA Ruqsana Anjum has completed her M.Phil in Commerce from Madurai Kamraj University; M.Com from Mount Carmel College, Bangalore University and B.Com from AK College, Bangalore. She is currently pursuing Ph.D in the field of Finance from Aligarh Muslim University (AMU), Uttar Pradesh. She has secured All India 46th rank in ICWA (Final) examination (2010) and cleared NET examination conducted by UGC. She is a member of Institute of Cost Accountants of India and a fellow member of Chartered Institute of Management Accounting London (U.K.).

Professor Ruqsana has been actively involved in the field of academics and has a teaching experience of over fifteen years. She has authored several research articles in professional journals in the field of Finance, Accounting, Management and one minor research project in the field of Humanities. Professor Ruqsana has participated in various seminars, workshops, national and international conferences. Her acumen in research is highly appreciated and the papers presented by her at various conferences have been acclaimed in respective domains.

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Assistant Professor
St. Joseph's College of Commerce
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Dedicated to

Almighty God

and

My Sister
Late Farzana Anjum

Preface

This book is written in a systematic manner where every module provides deeper insight into the concept, theory, illustrations, and exercises. The book caters to the requirements of the students of B.Com III Semester (CBCS syllabus), Bangalore University, as well as other B.Com students of various universities, and the foundation and inter-level examinations conducted by various professional bodies. With a view to meet the manifold requirements at different levels, the discussion flows logically from one chapter to another. Many developments have taken place in the accounting philosophy, and in international and Indian accounting standards. An effort has been made to incorporate all such developments in this book. The final chapter of this book has been worked on the basis of the revised format as per 2011.

The problems vary from simple to complex, and intricacies of the advanced problems have been explained and solved in a lucid manner, along with explanatory notes and alternative solutions with a view to widen the reader's horizon. The book consists of various illustrations based on own creation and previous years' question papers of B.Com, Bangalore University (December 2003 to 2017), and also, foundation and inter-level questions of professional examinations. Latest three years' solved question papers (2015–2017) are provided at the end of the book, helping the reader to practise after understanding all the five modules.

The content of the book is duly supported by graded illustrations and unsolved problems, with a view to encourage exploratory attitude. Problems are arranged under suitable sub-headings. Detailed answers are given along with hints and assumptions provided at the end of the tricky problems. Asterisks are marked in the working, guiding the students to observe, at the end of the question, points that need additional working and to facilitate smooth understanding of solutions. Chapter summary, including answers to the most expected and appeared theory questions, at the end of each chapter is also provided to facilitate the students to make quick reference before the exams.

All care has been taken to make the book free of conceptual errors; however, in spite of best efforts, some typographical, numerical and other human errors might have escaped our attention. These should cause no discerning effect to the reader's understanding of subject. Constructive criticism, comments and suggestions are most welcome and will be incorporated in the forth-coming editions.

RUQSANA ANJUM

Acknowledgements

I am thankful to the Almighty God for the grace bestowed upon me to complete the book. This book would not have been possible without the sincere and sustained support of my family. All my love goes to my son, Mohammed Hamdaan, who, just at the age of five, has been so very understanding and accommodating, otherwise, this book would have been a distant reality.

I owe my gratitude to a host of colleagues and friends. In this connection, the contributions made by Ms. Shoba N.S. deserve a special mention.

I gratefully acknowledge the moral support and encouragement received in my personal as well as professional endeavours from our Principal, Rev. Dr. Daniel Fernandes, St. Joseph's College of Commerce.

My sincere thanks are due to Mr. Suman Sen for providing me this opportunity and being an excellent mentor. My special appreciation to Mr. Amit Chatterjee for his commendable cooperation and guidance at every stage of book writing, Ms. Laxmi Singh, for her support and guidance, and the entire production and marketing team of McGraw Hill Education (India) for their untiring efforts in bringing this book out in time and in a fine get-up.

I owe a special note of thanks to a host of reviewers for their valuable suggestions and knowledge sharing in the course of writing the manuscript.

I will consider myself amply rewarded, if this book is found useful by the readers.

Ruqsana Anjum

Syllabus

Corporate Accounting

Bangalore University

B.COM III Semester

(As per CBCS Syllabus 2014-15 and Revised Syllabus 2017-18)

3.3. CORPORATE ACCOUNTING (III Semester) (IA- 30 M + Written-70M)	Chapter in the Book
UNIT 1: UNDERWRITING OF SHARES Meaning – Underwriting Commission – Underwriter – Functions - Advantages of Underwriting, Types of Underwriting – Marked and Unmarked Applications – Problems (Excluding Journal entries)	**Chapter 1**
UNIT 2: PROFIT PRIOR TO INCORPORATION Meaning – Calculation of Sales Ratio – Time Ratio – Weighted Ratio – Treatment of Capital and Revenue Expenditure – Ascertainment of Pre-incorporation and Post-incorporation Profits by Preparing Profit and Loss Account and Balance Sheet	**Chapter 2**
UNIT 3: VALUATION OF GOODWILL Meaning – Circumstances of Valuation of Goodwill – Factors Influencing the Value of Goodwill – Methods of Valuation of Goodwill: Average Profit Method, Super Profit Method, Capitalization of Average Profit Method, Capitalization of Super Profit Method, and Annuity Method - Problems	**Chapter 3**
UNIT 4: VALUATION OF SHARES Meaning – Need for Valuation – Factors Affecting Valuation – Methods of Valuation: Intrinsic Value Method, Yield Method, Earning Capacity Method, Fair Value of Shares. Rights Issue and Valuation of Rights Issue – Problems	**Chapter 4**
UNIT 5: COMPANY FINAL ACCOUNTS Statutory Provisions regarding Preparation of Company Final Accounts –Treatment of Special Items – Tax Deducted at Source – Advance Payment of Tax – Provision for Tax – Depreciation – Interest on Debentures – Dividends – Rules regarding Payment of Dividends – Transfer to Reserves – Preparation of Profit and Loss Account and Balance Sheet in Vertical Form (As per 2011 revised format)	**Chapter 5**

Skill Development

- Collect and fill the share application form of a limited company.
- Collect prospectus of a company and identify its salient features.
- Collect annual report of a company and list out its assets and liabilities.
- Collect latest final accounts of a company and find out the intrinsic value of shares.
- Collect the annual reports of company and calculate the value of goodwill under different methods.

Question Paper Pattern

Corporate Accounting (III Semester)

(With effect from 2017-18)

Maximum Marks: 70 **Duration: 03 Hours**

Note:

1. Question paper consists of ***three*** sections: Section A, B and C
2. Question 1 carries *10 marks*
3. Questions 2 to 6 each carries *6 marks*
4. Questions 7 to 11 each carries *14 marks*

<table>
<tr><th>Particulars</th><th>Marks</th><th>Nature of Question</th></tr>
<tr><td>SECTION-A (Conceptual Questions)
Q-1: Answer any five sub questions out of seven
(a) (b) (c) (d) (e) (f) (g)
(5Q × 2 marks)</td><td>10 marks</td><td>Theory</td></tr>
<tr><td>SECTION-B (Analytical Questions)
Answer any three questions out of five
Q-2
Q-3
Q-4 (3Q × 6 marks)
Q-5
Q-6</td><td>18 marks</td><td>Practical</td></tr>
<tr><td>SECTION-C (Essay Type Questions)
Answer any three questions out of five
Q-7
Q-8
Q-9 (3Q × 14 marks)
Q-10
Q-11</td><td>42 marks</td><td>Practical</td></tr>
<tr><td>Gross Total</td><td>70 Marks</td><td rowspan="2"></td></tr>
<tr><td></td><td></td></tr>
</table>

Contents

1

Underwriting of Shares

CHAPTER OUTLINE

1.1 INTRODUCTION

As per Companies Act, a public company is not authorised to make the first allotment of its shares and also obtain the Business Commencement Certificate, unless and until it gets the minimum subscription from the investing public. For this reason, promoters of the companies often resort to 'Underwriting' of their shares. In case of debentures, although there is no legal stipulation, promoters resort to underwriting to ensure most of their issued debentures are subscribed for. Thus, underwriting is an agreement/undertaking or guarantee between the promoters of the company and the underwriters (individuals or institutions), to ensure that in case the public does not subscribe to the shares and debentures issued by the company, the unsubscribed shares and debentures will be taken up by the underwriters, as per the terms of the agreement, for specified commission.

1.2 UNDERWRITING OF SHARES AND DEBENTURES

Underwriting of shares and debentures is an agreement between the company and the underwriters, where, underwriters guarantee the subscription of whole or a certain portion of the issued shares, in case the public, as per the pre-determined terms and conditions of the agreement and for an agreed remuneration, does not subscribe the shares and debentures. In other words, underwriting is an undertaking by the underwriters to the company that the shares or debentures offered to the public will be subscribed in full and this is done for a certain remuneration called 'Underwriting Commission'.

1.3 UNDERWRITERS

The individuals or institutions willing to underwrite the issue of shares or debentures, either in part or full, for an agreed consideration are called 'Underwriters'. An underwriter could be an individual, a partnership firm, a joint stock company, a bank, or a specialized financial institution led by the government such as, Life Insurance Corporation of India, Industrial Credit and Investment Corporation of India, Industrial Development Bank of India, etc. In this regard, even the brokers obtain the subscription to the shares and debentures from the investing public on behalf of the company for an agreed Brokerage Commission. The only difference here is that the broker undertakes only the subscription and not the obligation to compulsorily subscribe to the shares or debentures of the company, in the event that public subscription falls short of minimum subscription.

If an underwriter enters into a 'sub-agreement' with other underwriters for subscription of shares or debentures that the public fails to apply for, the other underwriters in this case are termed as 'Sub-underwriters'. This kind of arrangement is often taken up to minimise risk. As no agreement is entered into by the Company and the Sub-underwriter, they are not eligible to either receive commission or are liable to the company for non-fulfilment of subscription. They can claim consideration only from the main underwriter, for shares or debentures underwritten by them. The main underwriter receives additional commission over and above the regular commission; this is for the subscriptions obtained by the sub-underwriters and this commission is generally termed as 'Overriding Commission'.

1.4 DIFFERENCE BETWEEN UNDERWRITER AND BROKER

The difference between an underwriter and a broker are listed as follows:

1. An underwriter receives commission as per the agreement for shares and debentures subscribed by him. Whereas, the broker receives brokerage fee for procuring subscription to the shares or debentures from the public, on behalf of the company.
2. The shares or debentures not applied for by the public have to be compulsorily subscribed by the underwriter. As per the agreement, it is his obligation or responsibility. Whereas, a broker has no such obligation to compulsorily subscribe, in the event that the public fails to take up the shares or debentures offered by the company.
3. As an underwriter is a person agreeing to subscribe shares and debentures in the event of the public not subscribing for them, they are guided by the agreement's terms and conditions and are also eligible to receive fixed amount of commission, prescribed by the regulatory bodies and Companies Act. Whereas, a broker is a person, whose role is of a middlemen, facilitating the subscription of shares between the company and the investing public, for some agreed fee.

1.5 FUNCTIONS OF AN UNDERWRITER

The functions of an underwriter are as follows:

1. Purchase of Securities

The primary function of an underwriter is to purchase/subscribe the shares issued by the company, which may not be subscribed by the public. A compulsory stipulation of Companies Act states that when the company fails to receive minimum subscription of its issued shares, it will not be allowed to make first allotment of shares; in order to fulfil this, companies usually engage underwriters. Underwriters take it as an obligation to purchase securities, either in part or full, in the event of public not subscribing the same.

2. Distribution of Securities

The role of an underwriter also extends to being a mediator between the company and the investing public and ensuring distribution of securities on behalf of the company. The companies reach to the investing public through the underwriters, as they assure wide reach due to their network. This happens through the contacts they have with the public having interest in investing or they do it through the other underwriters. They also market the company's shares on the company's behalf. The companies may otherwise not be able to reach out to so many people without the services of an underwriter.

3. Providing Information

As underwriters are well connected with the market, companies use their services to draw the information from the market with regard to the expectations of the investing public, flow of money in the market, demand and supply, other IPOs lined up for allotment, types of securities to be issued, timing of issue, pricing of issue, regulatory bodies' rules and restrictions, government initiatives, etc. All this information may come very handy to the company to take crucial calls with regard to the timing and pricing of its issues.

1.6 ADVANTAGES OF UNDERWRITING

The advantages of underwriting are as follows:

- Underwriting comes in handy to newly formed companies that are yet to make a mark in the industry and those who do not have previous performance record. The investing public looks back on the past performance before investing. In the absence of a past record, public may be sceptical to invest. Therefore, the underwriters act as middlemen and give assurance, both to the company as well as the investing public.
- As mentioned earlier, the underwriters' expertise and long-standing in the market comes in handy to the company to gather information about the market and procure expert opinion on the types of securities trending in the market, their pricing and timing of the issue and also the expectations of the investing public.
- Underwriting ensures protection against the risk of under-subscription due to poor public response.
- Investing public may otherwise not trust the company. They subscribe to companies shares, trusting the underwriters, as they are believed to be people of strong financial integrity and established reputation.
- Due to high credibility and established reputation of the underwriters in the market, the public find it safe and less risky to invest in the shares or debentures that are underwritten.
- Underwriting Agreement sometimes saves the company's reputation if there is under-subscription or no subscription to the companies' shares or debentures.
- If the company has opted for the underwriters' services, it can be rest assured of getting the required amount of capital within a definite period of time. It may not have to even wait for the actual sale of securities.
- The company need not worry about the tighter market condition, recession period or poor public response at the time of issue after engaging an underwriter.
- Due to widespread network of the underwriters, wider geographical dispersion of securities is assured to the company. This may otherwise not be possible.

1.7 UNDERWRITING AGREEMENT

As discussed earlier, underwriting agreement is an undertaking or guarantee against the under-subscription of company's shares and debentures. It comprises of all the terms, conditions, stipulations and circumstances relating to underwriting. It also includes the remuneration likely to be received by the underwriters. It indicates the liabilities, obligations or the responsibilities of an underwriter. The agreement may also mention whether an underwriter is authorised to engage services of sub-underwriters or brokers. Sometimes, the Underwriting Agreement gives out the details about the role, duties or functions of an underwriter to avoid any kind of overlapping, misunderstanding or dispute in the future. For the underwriter, there is high level of contingency in the agreement, which means that if the public response is good, they will be eligible to receive the agreed remuneration without being liable to take up any shares. Otherwise, if there is poor public response, they may be liable to take up the agreed upon unsubscribed shares and also receive the pre-fixed commission.

1.8 PROVISIONS CONCERNING UNDERWRITING AGREEMENT AS PER COMPANIES ACT

The important provisions relating to Underwriting Agreement are as follows:

1. The directors are expected to express their opinion regarding the fact that the underwriter is capable of discharging his obligations with the resources he possesses.
2. The prospectus should disclose the number of shares and debentures that the underwriter has agreed to subscribe. This is to provide clarity and avoid any kind of risk in the future.
3. The details about the non-compliance by the underwriter and the causes for the same have to be disclosed in the statutory report.
4. The company board should make a declaration regarding the fact that no commission is to be paid on the shares or debentures not subscribed by underwriter.
5. Any amount of sum payable by way of commission has to be disclosed in the balance sheet, under the heading 'Miscellaneous Expenditures'.

1.9 PROVISIONS REGARDING PAYMENT OF COMMISSION (SECTION 76 OF COMPANIES ACT 1956)

Payment of Commission

A company is required to pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions:

1. The payment of such commission shall be authorized in the company's articles of association.
2. The commission may be paid out of the proceeds of the issue or the profit of the company or both.

3. The rate of commission paid or agreed to be paid shall not exceed, in case of shares, *five per cent* of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed *two and a half per cent* of the price at which the debentures are issued, or as specified in the company's articles, whichever is less.
4. The prospectus of the company shall disclose:
   i. The names of the underwriters.
   ii. The rate and amount of the commission payable to the underwriters.
   iii. The number of securities, which are to be underwritten or subscribed by the underwriter, absolutely or conditionally.
5. No commission shall be paid to any underwriter on securities, which are not offered to the public for subscription.
6. A copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus, for registration.

1

1.10 PROVISIONS OF THE COMPANIES ACT 1956, REGARDING DISCLOSURE OF UNDERWRITING AGREEMENT

The provisions of the Companies Act 1956, regarding disclosure of Underwriting Agreement are as follows:

1. **Disclosure in the Prospectus:** As per the provisions of the Companies Act 1956, if the company has opted for an underwriting arrangement and has engaged underwriters, the names of the underwriters and the opinion of the directors regarding the resources of the underwriters, stating that their resources are sufficient to discharge all their obligations, should be clearly stated in the prospectus. The prospectus should also disclose the number of shares or debentures, which the underwriters have agreed to subscribe, along with the amount or rate of commission payable to them.
2. **Disclosure in Statutory Report:** As per the provisions of the Companies Act 1956, the companies are required to clearly set out the extent to which the Underwriting Contract has not been carried out and the reasons for the same.
3. **Disclosure of Amount Payable:** As per the provisions of Schedule VI of the Companies Act, any amount payable by way of commission and brokerage, etc., must be disclosed clearly in the balance sheet, under 'Miscellaneous Expenditure'.

1.11 SEBI GUIDELINES FOR UNDERWRITING

Following are the SEBI guidelines for underwriting:

1. As per the original guidelines issued by SEBI on 11 June 1992, underwriting was mandatory for full issue and a minimum requirement of 90% subscription was also mandatory for every

issue of capital to public. However, as per the revised guidelines issued by SEBI on 10 October 1994, underwriting is not mandatory and the issuers have the option of deciding whether the issue is to be underwritten or not. The issuers would also decide the number of underwriters they wish to engage.

2. If the issue is not underwritten and if the minimum subscription of 90% of the offer to the public is not received, the entire amount received, as subscription, would have to be returned in full.
3. If the issue is underwritten and if the company does not receive 90% of the issued amount from public subscription, plus accepted development from underwriters, within 60 days of the opening of the issue, the company should refund the amount of subscription. In case of disputed devolvement, the company should refund the subscription if the aforementioned conditions are not met.
4. The lead manager(s) must satisfy themselves about the net worth of the underwriters and the outstanding commitment and disclose the same to SEBI. A statement to this effect should be incorporated in the prospectus.
5. The Underwriting Agreement may be filed to SEBI.

1.12 TYPES OF UNDERWRITING

Various types of underwriting are as follows:

1. **Complete Underwriting:** When the entire issue of shares or debentures are underwritten, either by a single or by two or more underwriters is termed as 'Complete Underwriting'.
2. **Partial Underwriting:** When only part of the issue of shares or debentures is underwritten by the underwriter it is known as 'Partial Underwriting'. Under this type, the risk and obligation of the underwriter is comparatively lesser than Complete Underwriting.
3. **Pure or Open Underwriting:** It is an arrangement under which the underwriter agrees to take up the shares or debentures of the company only when the whole or a certain portion of the issue is not fully subscribed by the public. Under this type of arrangement, generally, the risk, liability and obligation of the underwriter is not known and moreover, it is conditional. The liability of an underwriter under this type arises only when the public does not subscribe the whole or a part of the issue underwritten by them.
4. **Firm Underwriting:** An arrangement under which an underwriter makes a commitment to take up a specified number of shares or debentures of a company, irrespective of whether they are subscribed by the public or not. Furthermore, the liability, obligation or risk of the underwriter is known right at the time of entering into an agreement. In other words, an underwriter agrees to take up a definite number of shares or debentures in addition to the shares or debentures they are required to take up under the Open Underwriting Agreement.

1.13 UNDERWRITING COMMISSION

The underwriters are entitled to some commission, for the risk undertaken by them. The amount of money paid to the underwriters for underwriting the shares or debentures is called as 'Underwriting Commission'. In other words, it is a specified rate calculated on the issue price of the shares or debentures underwritten by the underwriters.

In the event of the subscription of shares by the public in full with no liability on the part of the underwriter to subscribe shares, the commission will still be payable because of the risk that the underwriters assumed at the time of entering into an agreement. The amount of commission is generally adjusted against the amount due from them on the shares or debentures taken up by them. If there is no due or if the due amount is less than the amount they are supposed to receive, the balance amount of commission will be paid to them either in cash or in shares.

Following are the rates of commission applicable and payable to the underwriter:

Details	For the amount of shares subscribed by them (%)	For the amount of shares subscribed by the public (%)
(A) Equity Shares	2.5	2.5
(B) Convertible or Non-Convertible Debentures/ Preference Shares		
i. For an amount up to ₹ 5 lakh	2.5	1.5
ii. In excess of ₹ 5 lakh	2	1

1.14 MARKED AND UNMARKED APPLICATIONS

1. **Marked Applications:** When the issue of shares and debentures of a company is underwritten by more than one underwriter, in order to determine the liability of one or more underwriters, the applications are stamped, bearing the name(s) of the underwriter(s) for the purpose of easy identification and to distinguish the applications received by one underwriter from that of the another. The applications, bearing the official stamp of the respective underwriters, are termed as 'Marked Applications'.
2. **Unmarked Applications:** The applications are received by a company directly from the public, not bearing any stamp of the underwriter, are called 'Unmarked Applications'.

1.15 ACCOUNTING ENTRIES CONCERNING UNDERWRITING OF SHARES OR DEBENTURES

In the Books of Company

S. No.	Circumstances	Journal Entry
1	For Direct Applications from public (Applications subscribed by public)	Bank A/c .... Dr. Discount on issue of shares/debentures A/c .... Dr. (If issued at discount) To Share Capital A/c To Debentures A/c To Securities Premium A/c (If issued at premium)
2	For Shares/Debentures taken up by Underwriters (Applications not subscribed by public)	Underwriter's A/c .... Dr. Discount on issue of shares/debentures A/c .... Dr. (If issued at discount) To Share Capital A/c To Debentures A/c To Securities Premium A/c (If issued at premium)
3	For Underwriting Commission payable to Underwriter	Underwriting Commission A/c .... Dr. To Underwriter's A/c
4	For amount received from Underwriter in final settlement	Bank A/c .... Dr. To Underwriter's A/c
5	For amount paid to Underwriter in final settlement	Underwriter's A/c .... Dr. To Bank A/c

In the Books of Underwriter

S. No.	Circumstances	Journal Entry
1	For Shares/Debentures taken by Underwriters (Applications not subscribed by public)	Investment in Shares/Debentures of the company A/c .... Dr. To Company's A/c ***Note:*** Premium/Discount on issue of shares, if any, will be netted off, i.e., net amount will be shown as an investment made in the company by the Underwriter.
2	For Underwriting Commission	Company's A/c .... Dr. To Underwriting Commission A/c
3	For amount received from Company in final settlement	Bank A/c .... Dr. To Company's A/c
4	For amount paid to Company in final settlement	Company's A/c .... Dr. To Bank A/c

1.16 SPECIMEN PROFORMA SHOWING CALCULATION OF NET LIABILITY OF UNDERWRITER

Particulars	UW1	UW2	UW3	Total
Gross Liability of the Underwriter	xxx	xxx	xxx	xxx
Less: Marked Applications (Including Firm Underwriting Shares, if they are treated as Marked Shares)	(xxx)	(xxx)	(xxx)	(xxx)
	xxx	**xxx**	**xxx**	**xxx**
Less: Unmarked Applications (In the Gross Liability Ratio)	(xxx)	(xxx)	(xxx)	(xxx)
	xxx	**xxx**	**xxx**	**xxx**
Less: Surplus of Underwriter, if any, to be adjusted from the liability of the remaining Underwriters (In the Gross Liability Ratio)	(xxx)	(xxx)	(xxx)	(xxx)
	xxx	**xxx**	**xxx**	**xxx**
Add: Firm Underwriting Applications	xxx	xxx	xxx	xxx
Net Liability of the Underwriter	**xxx**	**xxx**	**xxx**	**xxx**

*UW = Underwriter

1.17 DETERMINING THE LIABILITY OF AN UNDERWRITER(S) UNDER DIFFERENT CIRCUMSTANCES

1. When the entire issue of shares or debentures is underwritten by one or more Underwriters (Complete Underwriting)

In this case, he will be liable to take up all those shares offered but not have been subscribed for by the public. It is immaterial to take note of whether the applications are received directly by the company or through the underwriter. The liability of the underwriter in this case will be equal to the number of shares underwritten minus the number of shares offered to the public for subscription. However, if the issue is over-subscribed, the underwriter is free from the liability, but eligible to receive his commission on the total issue price of shares or debentures.

Illustration 1 **(Complete Underwriting – One Underwriter)**

A company issued 2,00,000 shares of ₹10 each. The entire issue was underwritten by Mr Adam. Applications for 1,60,000 shares were received in total. Determine Mr Adam's liability.

SOLUTION

Statement Showing the Net Liability of the Underwriter

Particulars	Shares
Gross Liability as per the Underwriting Agreement	2,00,000
Less: Total Application received and credited to Mr Adam (irrespective of whether received directly by the company or through Mr Adam)	1,60,000
Net Liability of the Underwriter	**40,000**

Illustration 2 **(Complete Underwriting – One Underwriter)**

MN Ltd. issued 1, 00,000 shares of ₹10 each at par. Neil & Co. has underwritten the entire issue for a commission of 6%. The company received applications only for 96,000 shares. Draft Journal Entries to reflect the given transactions.

SOLUTION

Journal Entries

S. No.	Particulars	(₹)	(₹)
1. 2.	Bank A/c . . . . Dr. To Equity Share Capital A/c (Being issue of 96,000 shares of ₹10 Each.)	9,60,000	 9,60,000
3.	Neil & Co. A/c . . . . Dr. To Equity Share Capital A/c (Being the allotment of 4,000 shares of ₹10 each not subscribed for by the public) (1,00,000 – 96,000)	40,000	 40,000
4.	Commission on issue of shares A/c . . . . Dr. To Neil & Co. A/c (Being commission due to Neil & Co. @ 6% on ₹10,00,000)	60,000	 60,000
5.	Neil & Co. A/c . . . . Dr. To Bank A/c (Being balance due to Neil & Co. paid)	20,000	 20,000

Illustration 3 **(More than one underwriter)**

Synergy Ltd. issued 40,000 shares. The entire issue was underwritten as follows:
X: 40%; Y: 35% and Z: 25%. Applications for only 32,000 shares were received in all; out of which, applications bore the stamp for 9,000, 6,000 and 5,000 shares respectively, for X, Y and Z. Determine the liability of the underwriters X, Y and Z.

SOLUTION

Statement Showing the Liability of Each of the Underwriters

Particulars	X = 40% (Shares)	Y = 35% (Shares)	Z = 25% (Shares)	Total
Gross Liability* of each of the Underwriters	16,000	14,000	10,000	40,000
Less: Credit allotted to each of the underwriters with regard to the Unmarked Applications (Unmarked Applications 12000** in the ratio of 40:35:25)	4,800	4,200	3,000	12,000
Balance	11,200	9,800	7,000	28,000
Less: Marked Applications of each of the Underwriters (Given)	9,000	6,000	5,000	20,000
Net Liability of each of the Underwriters	**2,200**	**3,800**	**2,000**	**8,000**

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* Gross Liability = 40,000 in the ratio of 40:35:25 (i.e., X = 16,000, Y = 14,000 and Z = 10,000)
**Unmarked Applications = Total Applications received – Marked Applications
12,000 shares = 32,000 shares – 20,000 shares (X = 9,000 + Y = 6,000 + Z = 5,000 shares)

Note: If the entire issue of shares or debentures is underwritten by more than one underwriter in an agreed ratio, liability of the underwriters can be ascertained in either of the following ways:

1. The Gross Liability of each underwriter, as per the agreed ratio, should be reduced first with Unmarked Applications in the ratio of their Gross Liability for applications, and Marked Applications must be deducted from the balance remaining.
2. The Gross Liability of each underwriter, as per the agreed ratio, should be reduced first with Marked Applications and the credit may be given with regard to Unmarked Applications in the ratio of Gross Liability as reduced by Marked Applications.

Illustration 4 **(More than one underwriter)**

A company issued 5,00,000 shares of ₹10 each. The entire issue was underwritten by four underwriters as follows:

K: 2,00,000; L: 1,50,000; M: 50,000 and N: 1,00,000.

The company received applications for 4,50,000 shares; of which, Marked Applications were given as follows:

K: 2,20,000; L: 1,10,000; M: 10,000 and N: 90,000.

Determine the Liability of each Underwriter.

SOLUTION

Statement Showing the Liability of Underwriters

Particulars	Number of Shares				Total
	K	L	M	N	
Gross Liability (given)	2,00,000	1,50,000	50,000	1,00,000	5,00,000
Less: Unmarked Application 20,000 in the ratio of 4:3:1:2	8,000	6,000	2,000	4,000	20,000
Balance	1,92,000	1,44,000	48,000	96,000	4,80,000
Less: Marked Applications (given)	2,20,000	1,10,000	10,000	90,000	4,30,000
Balance	–28,000	34,000	38,000	6,000	50,000
Less: Credit given to L, M and N in respect of surplus of K in the ratio of 3:1:2	+28,000	14,000	4667	9333	-
Balance	-	20,000	33,333	–3333	50,000
Less: Credit given to L and M in respect of surplus of N in the ratio of (3:1)	-	2,500	833	+3333	-
Net Liability of Underwriters	**-**	**17,500**	**32,500**	**-**	**50,000**

Working Notes:

(i) *Calculation of Agreed Ratio/ Gross Liability Ratio*

K = 2,00,000 ÷ 5,00,000 × 100 = 40% or 40 or 4

L = 1,50,000 ÷ 5,00,000 × 100 = 30% or 30 or 3

M = 50,000 ÷ 5,00,000 × 100 = 10% or 10 or 1

N = 1,00,000 ÷ 5,00,000 × 100 = 20% or 20 or 2

Therefore, the agreed ratio is 4:3:1:2

(ii) *Calculation of Unmarked Applications*

Total Applications received – Marked Applications = Unmarked Applications

4,50,000 – 4,30,000 = 20,000 Shares

(iii) *Calculation of Marked Applications*

= 2,20,000 + 1,10,000 + 10,000 + 90,000 = 4,30,000

Illustration 5 **(More than one underwriter)**

A company with 50,000 shares of ₹10 each, has engaged six underwriters, who agreed to take up the whole issue, which is given as follows:

Ram: 15,000 shares; Shyam: 17,500 shares; Peter: 5,000 shares; Xavier: 7,500 shares; Seeta: 1,000 shares and Geeta: 4,000 shares.

1

Company received 10,000 Unmarked Applications, and Marked Applications are as follows:

Ram: 12,500 shares; Shyam: 11,750 shares; Peter: 3,250 shares; Xavier: 500 shares; Seeta:1,000 shares and Geeta: 3,500 shares. Determine the Underwriter's Liabilities.

Solution

Statement Showing the Liability of Underwriters

Particulars	Number of Shares						Total
	Ram	Shyam	Peter	Xavier	Seeta	Geeta	
Gross Liability (Given)	15,000	17,500	5,000	7,500	1,000	4,000	50,000
Less: Marked Applications (Given)	12,500	11,750	3,250	500	1,000	3,500	32,500
Balance	2,500	5,750	1,750	7,000	-	500	17,500
Unmarked Applications (*in the ratio of Gross Liabilities as reduced by Marked Applications)	1,429	3,286	1,000	4,000	-	285	10,000
Net Liability of Underwriters	**1,071**	**2,464**	**750**	**3,000**	**-**	**215**	**7,500**

Notes:

Calculation of ratio of gross liabilities as reduced by Marked Applications:

* The ratio of Gross Liabilities, as reduced by Marked Applications is 2500:5750:1750:7000:500

Unmarked application of

Ram $\dfrac{2{,}500 \times 10{,}000}{17{,}500} = 1{,}429$ Shares

Shyam $\dfrac{5{,}750 \times 10{,}000}{17{,}500} = 3{,}286$ Shares

Peter $\dfrac{1{,}750 \times 10{,}000}{17{,}500} = 1{,}000$ Shares

Xavier $\dfrac{7{,}000 \times 10{,}000}{17{,}500} = 4{,}000$ Shares

Seeta –

Geeta $\dfrac{500 \times 10{,}000}{17{,}500} = 285$ Shares

Unmarked Applications = 10,000 Shares

2. If a part of the issue of shares or debentures is underwritten by one or more underwriters (Partial Underwriting)

In case only a part of the issue of shares or debentures is underwritten by one underwriter and the balance of the issue, the company itself is said to have underwritten the same. In line with the calculations done previously, Marked Applications are deducted from Gross Liability to arrive at Net Liability. If Marked Applications are equal to or exceed the number of shares or debentures underwritten, the underwriter is not liable to take up any shares or debentures. Likewise, if the public subscribes in full, the underwriter is free from this liability even if the Marked Applications are less than the number of shares or debentures underwritten. As calculations done earlier, from the Gross Liability, credit if any towards surplus arising to the company for Unmarked Applications should be deducted.

Illustration 6 **(Partial Underwriting – More than one Underwriter)**

Manasa Ltd. issued 20,000 equity shares of ₹100 each. The issue was underwritten as follows:

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

The company received applications for 15,000 shares in total.

Determine the liability of the underwriters.

[Bangalore University, Nov/Dec 2008, Section B]

Solution

Statement Showing the Liability of Underwriter

Particulars	A (30%) (Shares)	B (30%) (Shares)	C (20%) (Shares)	Manasa Ltd. (Shares)
Gross Liability of 20,000 shares in the ratio of 3:3:2:2	6,000	6,000	4,000	4,000
Less: Applications received, distributed in the ratio of Gross Liability (3:3:2:2) (15,000 shares)	4,500	4,500	3,000	3,000
Net Liability	**1,500**	**1,500**	**1,000**	**1,000**

Illustration 7 **(Partial Underwriting – More than one Underwriter)**

Rajesh Ltd. issued 20,000 shares of ₹10 each. These shares were underwritten as follows:

X: 10,000 shares; Y: 6,000 shares

The public applied for 16,000 shares, which included Marked Applications, as follows:

X: 2,400 shares; Y: 600 shares

Prepare a Statement of Underwriters' Liability.

[Bangalore University, Nov/Dec 2009, Section B]

Solution

Statement Showing the Liability of Underwriter

Particulars	X (Shares)	Y (Shares)	Rajesh Ltd. (Shares)
Gross Liability	10,000	6,000	4,000
Less: Unmarked Applications (16,000 – 3,000 Marked Applications)	-	-	13,000
Balance	10,000	6,000	–9,000
Less: Credit of surplus of company given to X and Y in the ratio of 5:3 (9,000 × 5 ÷ 8 and 9,000 × 3 ÷ 8) (Gross Liability Ratio)	5,625	3,375	+9,000

(*Contd.*)

Particulars	X (Shares)	Y (Shares)	Rajesh Ltd. (Shares)
Balance	4,375	2,625	-
Less: Marked Applications	2,400	600	-
Net Liability	**1,975**	**2,025**	**NIL**

Illustration 8 **(Partial Underwriting – One Underwriter)**

Star Ltd. issued 40,000 shares of ₹10 each. Moon Ltd. underwrote only 75% of these shares. Of the 35,000 shares received, 20,000 applications were marked. Determine the liability of Moon Ltd. as an underwriter.

SOLUTION

Statement Showing the Liability of the Underwriters

Particulars	Number of Shares		Total (100%)
	Moon Ltd. (75%)	Star Ltd. Company (25%)	
Gross Liability	30,000	10,000	40,000
Less: Unmarked Applications credited to the company (35,000 – 20,000)	-	15,000	15,000
Balance	30,000	–5,000	25,000
Less: Credit given to Moon Ltd. with regard to surplus accruing to the company	–5,000	+5,000	-
Balance	25,000	-	25,000
Less: Marked Applications	20,000	-	20,000
Net Liability of the Underwriter	**5,000**	**-**	**5,000**

Illustration 9 **(Partial Underwriting – More than One Underwriter)**

A company issues 50,000 equity shares of ₹10 each. X, Y and Z underwrote 80% of the issue in the ratio of 3:2:1. Applications for 40,000 were received in total; of which, the Marked Applications were given as follows:

X: 20,000 shares; Y: 10,000 shares and Z: 5,000 shares.

Determine the liability of underwriters.

Solution

Statement Showing the Liability of the Underwriters

Particulars	Number of Shares				Total
	X	Y	Z	Company	
Gross Liability	20,000	13,333	6,667	10,000	50,000
Less: Unmarked Applications credited to the company Total received applications – Marked = Unmarked (40,000 – 35,000) = 5000 shares	-	-	-	5,000	5,000
Balance	20,000	13,333	6,667	5,000	45,000
Less: Marked Applications	20,000	10,000	5,000	-	35,000
Net Liability	**-**	**3,333**	**1,667**	**5,000**	**10,000**

Notes:

1. *Calculation of Gross Liability:*

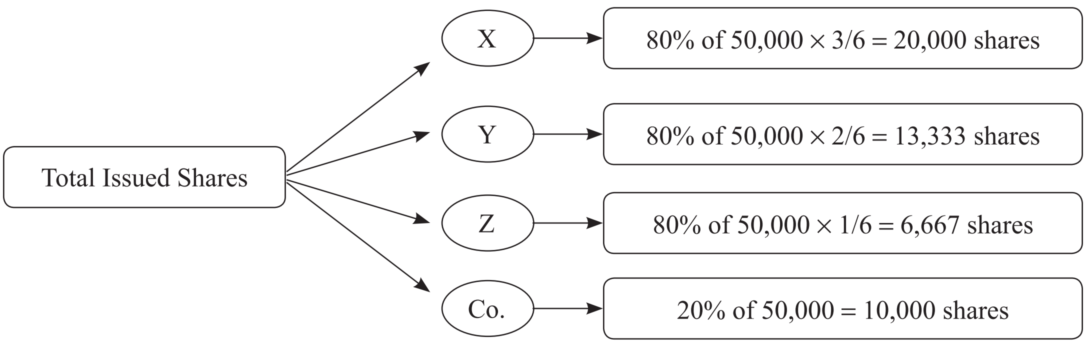


Illustration 10 **(Open Underwriting – One Underwriter)**

Mr Ashok underwrites the issue of 1,000 shares of ₹100 each of Metro Company Ltd., with an agreed commission of 2.5% with an option of receiving 60% in cash and the balance in fully paid shares. The public subscribed 400 shares and the underwriter took up the balance. Subsequently, the shares were quoted in the market at 10% discount. Pass entries in the books of company and the underwriter.

SOLUTION

In the Books of Company
Journal Entries

Particulars	(₹)	(₹)
Bank A/c Dr. To Share Capital A/c (Being 400 shares subscribed by the Public)	40,000	40,000
Ashok A/c Dr. To Share Capital A/c (Being 600 shares issued to Mr Ashok, the underwriter)	60,000	60,000
Underwriting Commission A/c Dr. To Ashok A/c (Being credit of 2.5% of ₹1,00,000 commission to Mr Ashok)	2,500	2,500
Ashok A/c Dr. To Share Capital (Being 40% of commission paid by issuing fully paid shares)	1,000	1,000
Bank A/c Dr. To Ashok A/c (Being 60% of the commission paid in cash)	1,500	1,500

In the Books of Mr Ashok
Journal Entries

Particulars	(₹)	(₹)
Shares in Metro Co. A/c Dr. To Metro Co. A/c (Being shares not taken over by the public)	60,000	60,000
Metro Co. A/c Dr. To Underwriting Commission A/c (Being commission earned on underwriting share, issued by Metro Co.)	2,500	2,500
Shares in Metro Co. A/c Dr. To Metro Co. A/c (Being shares received in Metro Co. for 40% Commission)	1,000	1,000
Metro Co. A/c Dr. To Bank A/c (Being balance due to Metro Co. paid)	58,500	58,500
Underwriting Commission A/c Dr. Profit and Loss A/c Dr. To Shares in Metro Co. A/c	2,500 3,600	 6,100

Shares in Metro Co.

Particulars	(₹)	Particulars	(₹)
To Metro Co. A/c	60,000	By Underwriting Commission	2,500
To Metro Co. A/c	1,000	By Profit and Loss A/c (Bal. Fig)	3,600
		By Balance c/d (61,000 × 90 ÷ 100)	54,900
	61,000		**61,000**

Working Note:

Calculation of the amount to be written off on shares in Profit and Loss Account

Particulars	No. of Shares
No. of shares taken up by Mr Ashok, as per Underwriting Agreement: 60% of 1000 shares	600
Add: No. of shares received by Mr Ashok in settlement of Underwriting Commission 40% of Underwriting Commission was received in shares (1, 00,000 × 2.5%) = ₹2,500 × 40% received in shares and the balance in cash ₹1,000 in shares. Therefore, no. of shares received towards Underwriting Commission = ₹1,000 ÷ 100	10
Total Number of Shares held	610
Particulars	**(₹)**
Face value of shares: 610 × ₹100 (600 + 10 shares)	61,000
Less: Drop in the value of shares i.e., 10% discount (61,000 × 10 ÷ 100). The amount to be written off	**6,100**

Illustration 11 **(Partial Underwriting)**

Raman Ltd. issued 50,000 shares of ₹10 each. The company received applications for 40,000 shares. Calculate the Net Liability of all the underwriters engaged by the company.

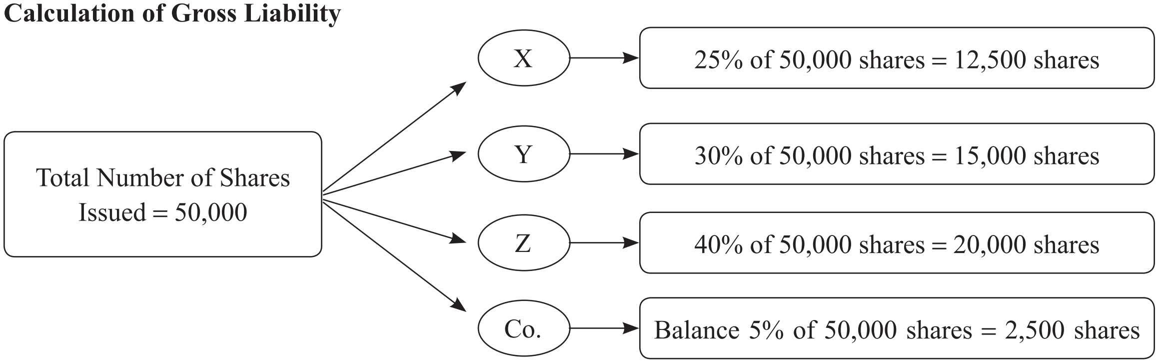
Underwriter	% of shares underwritten	Marked Applications
X	25	5,000
Y	30	8,000
Z	40	7,000

Solution

Statement Showing the Liability of the Underwriters

Particulars	X (Shares)	Y (Shares)	Z (Shares)	Raman Ltd. (Shares)
Gross Liability	12,500	15,000	20,000	2,500
Less: Unmarked Applications*	–	–	–	20,000
Balance	12,500	15,000	20,000	–17,500
Less: Credit of surplus accruing to Raman Ltd. given to the underwriters in the ratio of 5:6:8**	4,606	5,526	7,368	+17,500
Balance	7,896	9,474	12,632	–
Less: Marked Applications	5,000	8,000	7,000	–
Net Liability of the Underwriters	2,896	1,474	5,632	–

Calculation of Gross Liability



Particulars	Shares
Number of applications received	40,000
Less: Marked Applications	20,000
Unmarked Applications	**20,000**

Note: As the company is underwritten for 2,500 shares and yet has received 20,000 shares, the excess applications received by it, i.e., 17,500 (20,000 – 2,500) shares, are credited to the underwriters in the ratio of underwriting, i.e., 12500:15000:20000 shares or 5:6:8 ratio.

17500 shares in the ratio of 5:6:8

$X = 17500 \times 5 \div 19$ = 4606 Shares

$X = 17500 \times 6 \div 19$ = 5526 Shares

$X = 17500 \times 8 \div 19$ = 7368 Shares

Illustration 12

Akash Co. Ltd issued 40,000 shares of ₹10 each. These shares were underwritten as follows:

P: 20,000 shares and Q: 12,000 shares. The public subscribed for 32,000 shares; this included Marked Applications as follows:

P: 4,800 and Q: 1,200 shares.

Show the Underwriter Liability with all the necessary workings.

Solution

Statement Showing the Liability of the Underwriters

Particulars	P (Shares)	Q (Shares)	Akash Co. Ltd. (Shares)
Gross Liability	20,000	12,000	8,000
Less: Unmarked applications	–	–	26,000
Balance	20,000	12,000	–18,000
Less: Credit of surplus accruing to Akash Co. Ltd. given to the underwriters in the ratio of 5:3	11,250	6,750	+18,000
Balance	8,750	5,250	–
Less: Marked applications	4,800	1,200	–
Net Liability of the Underwriters	3,950	4,050	–

Particulars	Shares
Number of shares in the company	40,000
Less: Number of shares underwritten	32,000
Company is the underwriter for these shares	**8,000**
Particulars	**Shares**
Number of applications received	32,000
Less: Marked Applications	6,000
Unmarked Applications	**26,000**

Note: As the company is underwritten for 8,000 shares and yet has received 26,000 shares, the excess applications received by it, i.e., 18,000 (26,000 – 8,000) shares, are credited to the underwriters in the ratio of underwriting, i.e., 20000:12000 or 5:3.

18000 shares in the ratio of 5:3

P = 18000 × 5 ÷ 8
= 11250 shares

Q = 18000 × 3 ÷ 8
= 6,750 shares

3. When the entire issue or part of the issue is underwritten by one or more than one underwriter, coupled with Firm Underwriting

Firm Underwriting is where an underwriter commits to buy a definite number of shares or debentures issued by the company, in addition to the shares or debentures he has agreed to take up, as per the Underwriting Agreement. If the shares or debentures are oversubscribed, the underwriter gets priority over general public, under Firm Underwriting.

Illustration 13 **(Complete and Firm Underwriting with more than one underwriter)**

A company has issued 60,000 shares of ₹10 each. These shares were underwritten as follows:

A: 36,000 shares; B: 15,000 shares; and C: 9,000 shares

In addition to this, there was Firm Underwriting as follows:

A: 6,000 shares; B: 1,000 shares and C: 2,000 shares

Applications subscribed by the public (excluding Firm Underwriting and Marked Applications) were 6,000 shares.

Marked Applications were A: 6,000 shares; B: 8,000 shares and C: 4,000 shares.

Determine the liability of underwriters.

Solution

Statement Showing the Liability of the Underwriters

Particulars	A (Shares)	B (Shares)	C (Shares)
Gross Liability (12:5:3) ratio	36,000	15,000	9,000
Less: Credit given to each of the underwriter in respect of Unmarked Applications directly received by the company (12:5:3)	9,000	3,750	2,250
Balance	27,000	11,250	6,750
Less: Marked Applications	6,000	8,000	4,000
Net liability of the underwriters	21,000	3,250	2,750
Add: Firm underwriting	6,000	1,000	2,000
Total Liability of the underwriters	**27,000**	**4,250**	**4,750**

Working Notes

1. *Unmarked Application*

Total shares subscribed by the public (Excluding Firm and Marked Applications)	6,000 Shares
Add: Firm Underwriting of all the underwriters	9,000 Shares
Unmarked Applications	**15,000 Shares**

2. *Distribution of Unmarked Applications in the ratio of 12:5:3 (36,000:15,000:9,000 shares)*

15 000 shares in the ratio of 12:5:3

A = 15000 × 12 ÷ 20 = 9000 shares

B = 15000 × 5 ÷ 20 = 3750 shares

C = 15000 × 3 ÷ 20 = 2250 shares

Illustration 14 **(Complete and Firm Underwriting with more than one underwriter)**

A company has issued 1,00,000 equity shares of ₹50 each. The entire issue was underwritten as follows:

L: 30,000 shares (Firm Underwriting: 5,000 shares)
M:15,000 shares (Firm Underwriting: 2,000 shares)
N: 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 Applications:
L: 16000 shares; M: 10000 shares; and N: 4000 shares.
Ascertain the Total Liability of all the underwriters.

SOLUTION

Statement Showing the Liability of the Underwriters

Particulars	L	M	N	Total
Gross Liability	30,000	15,000	5,000	50,000
Less: Credit given to each of the underwriter in respect of Unmarked Applications received directly from the public 15,000 shares (45,000 shares (total application received) – 30000 shares (marked forms) in the ratio of Gross Liability 30:15:5 or 6:3:1	9,000	4,500	1,500	15,000
Balance	21,000	10,500	3,500	35,000
Less: Marked Applications	16,000	10,000	4,000	30,000
Balance	5,000	500	–500	5,000
Less: Credit given to L and M in respect of the surplus accruing to N in the ratio of 6:3 or 2:1	333	167	+500	-

(*Contd.*)

Particulars	L	M	N	Total
Net Liability of the Underwriters	4,667	333	-	5,000
Add: Liability for Firm Underwriting	5,000	2,000	1,000	8,000
Total Liability of the Underwriters	**9,667**	**2,333**	**1,000**	**13,000**

Note: With regard to the treatment of Firm Applications, it should be noted that Firm Applications are always considered as Unmarked Applications, unless it is mentioned in the problem to treat the same as Marked Applications.

Illustration 15 **(Partial and Firm Underwriting with one underwriter)**

Suguna Ltd. has issued 10,000 shares of ₹10 each. 75% of the issue is underwritten by Mr Shyam, along with Firm Underwriting of 2,000 shares. Company received 9,000 applications; of which, Marked Applications were 6,000 shares. Find the liability of Mr Shyam in the capacity of an underwriter.

SOLUTION

Statement Showing the Liability of the Underwriter

Particulars	Mr Shyam Shares	Suguna Ltd. Shares	Total Shares
Gross Liability 75:25 or 3:1	7,500	2,500	10,000
Less: Credit given to the company in respect of Unmarked Application received directly from the public (9000 – 6000)	-	3,000	3,000
Balance	7,500	–500	7,000
Less: Credit given to Mr Shyam in respect of surplus 500 shares accruing to the company	500	+500	-
Balance	7,000	-	7,000
Less: Marked Applications	6,000	-	6,000
Net Liability of Mr. Shyam	1,000	-	1,000
Add: Liability under Firm Underwriting	2,000	-	2,000
Total Liability of Mr Shyam	**3,000**		**3,000**

Illustration 16

Magnum Ltd. issued 5,00,000 equity shares of ₹10 each. Aman, Akash and Amar committed to underwrite the issue in an agreed ratio of 3:2:1. The commission was payable at 4% of the issue price. The Firm Underwriting was agreed at 35,000, 25,000 and 15,000 respectively by the underwriters. Marked Applications received were 75,000, 60,000 and 45,000 respectively by Aman, Akash and Amar. The Unmarked Applications directly received by the company were 60,000. 25% of the issue was reserved for promoters and the balance was offered to the public for subscription. The application money to be payable was fixed at ₹2.50 per share.

Calculate:

(i) Total liability of all the underwriters.

(ii) Pass journal entries in the books of Magnum Ltd. showing liability of underwriters, amount of cash payable to or received by the underwriters.

(iii) Calculate the commission payable to underwriters.

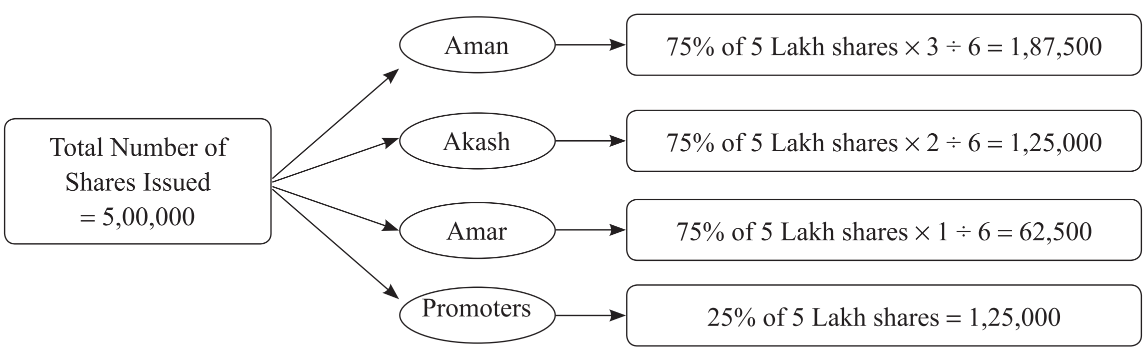
SOLUTION

Statement Showing the Liability of the Underwriters

Particulars	Aman (Shares)	Akash (Shares)	Amar (Shares)
Gross Liability	1,87,500	1,25,000	62,500
Less: Credit of Unmarked Applications of 60,000 shares (given) in the ratio of 3:2:1 given to all the underwriters directly received by the company	30,000	20,000	10,000
Balance	1,57,500	1,05,000	52,500
Less: Marked Applications	75,000	60,000	45,000
Balance	82,500	45,000	7,500
Less: Firm Underwriting	35,000	25,000	15,000
Balance	47,500	20,000	–7,500
Less: Credit given to Aman and Akash in respect of the surplus accruing to Amar in the ratio of 3:2	4,500	3,000	+7,500
Net Liability of the Underwriters	43,000	17,000	-
Add: Firm Underwriting	35,000	25,000	15,000
Total Liability	**78,000**	**42,000**	**15,000**

Note: It is evident from the information given in the problem that Unmarked Applications exclude Firm Underwriting and Unmarked Applications are less than Firm Underwriting in total.

Calculation of Gross Liability



In the books of Magnum Ltd.
Journal Entries

S. No.	Particulars		Debit (₹)	Credit (₹)
1.	Aman A/c (43000 Shares × 2.50)	Dr.	1,07,500	
	Akash A/c (17000 Shares × 2.50)	Dr.	42,500	
	To Equity Share Capital A/c			1,50,000
	(Being the shares allotted to underwriters, 43,000 shares to Aman and 17,000 shares to Akash and application money receivable on the same at the rate of ₹2.50)			
2.	Underwriting Commission A/c	Dr.	1,50,000	
	To Aman A/c (187500 shares at ₹10 × 4 ÷ 100)			75,000
	To Akash A/c (125000 at ₹10 × 4 ÷ 100)			50,000
	To Amar A/c (62500 at ₹10 × 4 ÷ 100)			25,000
	(Being the Underwriting Commission payable on the amount of shares underwritten)			
3.	Akash A/c (50000 – 42500)	Dr.	7,500	
	Amar A/c	Dr.	25,000	
	To Bank A/c			32,500
	(Being payment made to Akash and Amar in full settlement of their account)			
4.	Bank A/c (107500 – 75000)	Dr.	32,500	
	To Aman A/c			32,500
	Being receipt of payment from Aman (shares allotted minus Underwriting Commission)			

1

Illustration 17

Ajanta Ltd. issued 2,00,000 equity shares of ₹10 each. An amount of ₹5 is payable along with the application and balance payable at the time of allotment of shares by the company. X, Y and Z underwrote the issue in the ratio of 2:1:1, along with an agreed rate of commission of 5%. Applications in all were received for 1,60,000 shares. Of which, Unmarked Applications were 10,000; Firm Underwritings were, 6,000, 6,000 and 5,000 respectively for X, Y and Z. The applications bearing official stamp in favour of underwriter X were 46,000, Y were 51,000 and that of Z were 36,000. Determine the Net Liability of all the underwriters and journalise the aforementioned transactions in the books of Ajanta Ltd.

Note: It is evident from the information given in the problem that Unmarked Applications exclude Firm Underwriting and Unmarked Applications are less than Firm Underwriting in total.

SOLUTION

Statement Showing the Liability of the Underwriters

Particulars	X (Shares)	Y (Shares)	Z (Shares)	Total (Shares)
Gross Liability in the ratio of 2:1:1	1,00,000	50,000	50,000	2,00,000
Less: Credit of unmarked applications directly received by the company of 10,000 shares (given) in the ratio of 2:1:1 given to all the underwriters.	5,000	2,500	2,500	10,000
Balance	95,000	47,500	47,500	1,90,000
Less: Marked Applications	46,000	51,000	36,000	1,33,000
Balance	49,000	–3,500	11,500	57,000
Less: Firm Underwriting	6,000	6,000	5,000	17,000
Balance	43,000	–9,500	6,500	40,000
Less: Credit given to X and Z in respect of the surplus accruing to Y in the ratio of 2:1	6,333	+9,500	3,167	-
Balance	36,667	-	3,333	40,000
Add: Firm Underwriting	6,000	6,000	5,000	17,000
Total Liability	**42,667**	**6,000**	**8,333**	**57,000**

Journal Entries

S. No.	Particulars	Debit (₹)	Credit (₹)
1.	Bank A/c Dr. To Equity Share Application A/c (Being the application money at ₹5 per share on 1,60,000 shares received from the public and Firm Underwriting)	8,00,000	 8,00,000
2.	Equity Share Application A/c Dr. To Equity Share Capital A/c (Being the application money transferred to share capital account)	8,00,000	 8,00,000
3.	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Being the allotment due on 1,60,000 shares subscribed by the public and the Firm Underwriting)	8,00,000	 8,00,000
4.	Bank A/c Dr. To Equity Share Allotment A/c (Being the allotment money received)	8,00,000	 8,00,000
5.	A's A/c Dr. (36667 × 10) C's A/c Dr. (3333 × 10) To Equity Share Capital A/c (Being allotted shares taken up by the underwriters)	3,66,670 33,330	 4,00,000

(*Contd.*)

S. No.	Particulars	Debit (₹)	Credit (₹)
6.	Underwriting Commission A/c Dr.	1,00,000	
	To A's A/c (100000 × ₹10 at 5%)		50,000
	To B's A/c (50000 × ₹10 at 5%)		25,000
	To C's A/c (50000 × ₹10 at 5%)		25,000
	(Being the Underwriting Commission payable on the amount of shares underwritten)		
7.	Bank A/c Dr.	3,25,000	
	To A's A/c (366670 – 50000)		3,16,670
	To C's A/c (33330 – 25000)		8,330
	Being receipt of payment from A and C (shares allotted minus Underwriting Commission)		
8.	B's A/c Dr.	25,000	
	To Bank A/c		25,000
	(Being payment made to B in full settlement of their account)		

Illustration 18

Phantom Ltd. issued 50,000 shares of ₹10 each. Sagar, an underwriter, agreed to underwrite the new issue at an agreed commission of 2.5%. He further agreed to receive the commission amount due by way of fully paid shares and cash (i.e., 60% in shares and 40% in cash). In addition to this, Firm Underwriting was agreed at 2,000 shares. 50% of the issue was underwritten by Sagar, which he was able to sell in the stock market at a profit of 15%.

Prepare journal entries in the books of Phantom Ltd. and Sagar and also prepare the shares account showing the profit earned on sale of shares.

Solution

Journal Entries
In the books of Phantom Ltd.

S. No.	Particulars	Debit (₹)	Credit (₹)
1.	Bank A/c Dr.	2,50,000	
	To Equity Share Capital A/c		2,50,000
	(Being issue of 25,000 shares to the public at ₹10 each)		
2.	Sagar's A/c Dr.	2,50,000	
	To Equity Share Capital A/c		2,50,000
	(Being 50% of the total issue subscribed by the underwriter)		
3.	Sagar's A/c Dr.	20,000	
	To Equity Share Capital A/c		20,000
	(Being 2,000 shares firm underwritten taken up by the underwriter) (2000 × ₹10)		

(*Contd.*)

S. No.	Particulars	Debit (₹)	Credit (₹)
4.	Underwriting Commission A/c Dr.	6,250	
	To Sagar's A/c		6,250
	(Being Underwriting Commission on shares underwritten)		
5.	Sagar's A/c Dr.	3,750	
	To Share Capital A/c		3,750
	(Being 60% of the commission due to Sagar converted into share capital 6250 × 60 ÷ 100)		
6.	Bank A/c Dr.	2,67,500	
	To Sagar's A/c		2,67,500
	(Being the amount due from Sagar received)		

1

Amount due from Sagar

Amount due for purchase of shares (2,50,000 + 20,000)	=	2,70,000
Less: Commission payable to him in cash	=	(2,500)
		₹2,67,500

In the Books of Sagar

S. No.	Particulars	Debit (₹)	Credit (₹)
1.	Equity Shares A/c Dr.	2,50,000	
	To Phantom Co. A/c		2,50,000
	(Being 50% shares of Phantom Co. taken up for underwriting)		
2.	Equity Shares A/c Dr.	20,000	
	To Phantom Co. A/c		20,000
	(Being shares received on account on Firm Underwriting)		
3.	Phantom Co. A/c Dr.	6,250	
	To Underwriting Commission A/c		6,250
	(Being commission due on shares underwritten on the issue price)		
4.	Equity Shares A/c Dr.	3,750	
	To Phantom Co. A/c		3,750
	(Being 60% of Underwriting Commission due received in the form of equity shares)		
5.	Phantom Co. A/c Dr.	2,67,500	
	To Bank A/c		2,67,500
	(Being amount due to Phantom Co. paid in cash)		

Shares Account

Particulars	(₹)	Particulars	(₹)
To Phantom Co.	2,50,000	By Underwriting Commission	6,250
To Phantom Co. (2,000 × ₹10)	20,000	By Balance c/d	3,08,562.50
To Phantom Co. (6250 × 60%)	3,750		
To Profit and Loss A/c	41,062.50		
	3,14,812.50		**3,14,812.50**

Profit on sale of shares = 2,73,750* × 15 ÷ 100 = ₹41,062.50

(***2,73,750** = 2,50,000 + 20,000 + 3,750)

Illustration 19 **(Pure Underwriting)**

Ashwin underwrites the new issue of 10,000 shares of ₹10 each of Symphony Ltd. The commission was agreed at 2.5%, to be payable 60% in fully paid shares and 40% in cash. The public subscribed 5,500 shares and the balance were taken up by the underwriter. Subsequently, the shares were quoted at the exchange for a discount of 10%. Pass the necessary journal entries in the books of Symphony Ltd. and Mr Ashwin and also prepare a Shares Account, reflecting the profit and loss from the underwriting transaction.

1

Solution

Journal Entries
In the books of Symphony Ltd.

S. No.	Particulars	Debit (₹)	Credit (₹)
1.	Bank A/c Dr. To Equity Share Capital A/c (Being issue of 5,500 shares to the public at ₹10 each)	55,000	55,000
2.	Ashwin's A/c Dr. To Equity Share Capital A/c (Being 4,500 shares subscribed by the underwriter) (10000 – 5500)	45,000	45,000
3.	Underwriting Commission A/c Dr. (100000 × 2.5%) To Ashwin's A/c (Being Underwriting Commission on shares underwritten)	2,500	2,500
4.	Ashwin's A/c Dr. To Share Capital A/c (Being 60% of the commission due to Ashwin converted into share capital 2500 × 60 ÷ 100)	1,500	1,500
5.	Bank A/c Dr. To Ashwin's A/c (Being the amount due from Ashwin received) (₹45,000 – ₹1,000 commission payable in cash)	44,000	44,000

In the Books of Ashwin

S. No.	Particulars	Debit (₹)	Credit (₹)
1.	Equity Shares A/c Dr. To Symphony Ltd. A/c (Being 4,500 shares at ₹10 of Symphony Ltd. taken up for underwriting)	45,000	45,000
2.	Symphony Ltd. A/c Dr. To Underwriting Commission A/c (Being commission due on shares underwritten on the issue price)	2,500	2,500
3.	Equity Shares A/c Dr. To Symphony Ltd. A/c (Being 60% of Underwriting Commission due received in the form of equity shares)	1,500	1,500
4.	Symphony Ltd. A/c Dr. To Bank A/c (Being amount due to Symphony Ltd., paid in cash)	44,000	44,000

Shares Account

Particulars	(₹)	Particulars	(₹)
To Symphony Ltd. (4500 × 10)	45,000	By Underwriting Commission A/c	2,500
To Symphony Ltd. (150 × 10)	1,500	By Profit and Loss A/c (Bal. Fig.)	2,150
		By Balance c/d (4500 shares + 150 shares × 9) (after discount of 10%)	41,850
	46,500		**46,500**

Illustration 20

A company issued 1,00,000 shares of ₹10 each. The whole issue was fully underwritten by A, B, C and D as follows:

A: 40,000; B: 30,000; C: 10,000 and D: 20,000

The company received applications for 90,000 shares; of which, Marked Applications were as follows:

A: 44,000; B: 22,000; C: 2,000 and D: 18,000

Determine the liability of each underwriter.

[Bangalore University, Nov/Dec 2005/2015, Section B]

Solution

Particulars	A (Shares)	B (Shares)	C (Shares)	D (Shares)	Total (Shares)
Gross Liability	40,000	30,000	10,000	20,000	1,00,000
Less: Marked Applications	44,000	22,000	2,000	18,000	86,000
Balance	–4,000	8,000	8,000	2,000	14,000
Less: Unmarked Applications (4,000 × 4:3:1:2)	–1,600	1,200	400	800	4,000
Balance	–5,600	6,800	7,600	1,200	10,000
Less: Surplus of A transferred to B, C and D in the ratio of 3:1:2	+5,600	2,800	933	1,867	-
Balance	-	4,000	6,667	-667	10,000
Less: Surplus of D transferred to B and C in the ratio of 3:1	-	500	167	+667	-
Net Liability	**-**	**3,500**	**6,500**	**-**	**10,000**

Unmarked Applications = Total Applications – Marked Applications

= 90,000 – 86,000 (44,000 + 22,000 + 2,000 + 18,000)

= 4,000

Illustration 21

Nischal Ltd. issued 2,50,000 shares of ₹10 each, which were underwritten as follows:

Mr A: 75,000 shares (Firm Underwriting: 8,000 shares)
Mr B: 62,500 shares (Firm Underwriting: 12,000 shares)
Mr C: 62,500 shares (Firm Underwriting: NIL)
Mr D: 50,000 shares (Firm Underwriting: 30,000 shares)

The total applications, excluding Firm Underwriting but including Marked Applications were for 1,80,000 shares. The Marked Applications were given as follows:

Mr A: 40,000 shares; Mr B: 36,000 shares; Mr C: 24,000 shares and Mr D: 48,000 shares. Calculate the Net Liability of each underwriter, treating:

(a) Firm Underwriting as Marked Applications
(b) Firm Underwriting as Unmarked Applications

[Bangalore University, Nov/Dec 2006/2009, Section C]

Solution

Gross Liability Ratio = 75,000: 62,500: 62,500: 50,000

= 6:5:5:4

Statement Showing the Liability of Underwriter

When Firm Underwritten shares are treated as Marked Applications

Particulars	A (Shares)	B (Shares)	C (Shares)	D (Shares)	Total (Shares)
Gross Liability	75,000	62,500	62,500	50,000	2,50,000
Less: Marked Applications (including FUW)	48,000	48,000	24,000	78,000	1,98,000
Balance	27,000	14,500	38,500	–28000	52,000
Less: Unmarked Applications (32,000* × 6:5:5:4)	9,600	8,000	8,000	6,400	32,000
Balance	17,400	6,500	30,500	–34,400	20,000
Less: Surplus of D transferred to A, B and C in the ratio of 6:5:5	12,900	10,750	10,750	+34,400	-
Balance	4,500	–4,250	19,750	-	20,000
Less: Surplus of B transferred to A and C in the ratio of 6:5	2,318	4250	1,932	-	-
Net Liability	2,182	-	17,818	-	20,000
Add: Firm Underwriting	8,000	12,000	-	30,000	50,000
Total Liability	**10,182**	**12,000**	**17,818**	**30,000**	**70,000**

Total Applications = 1,80,000 + 50,000 (Firm Underwriting) = 2,30,000

Marked Application = 40,000 + 36,000 + 24,000 + 48,000 + 50,000 (Firm Underwriting)
= 1,98,000

*Unmarked Applications = Total Applications – Marked Applications
= 2,30,000 – 1,98,000
= **32,000**

Statement Showing the Liability of Underwriters

When Firm Underwritten shares are treated as Unmarked Applications

Particulars	A (Shares)	B (Shares)	C (Shares)	D (Shares)	Total (Shares)
Gross Liability	75,000	62,500	62,500	50,000	2,50,000
Less: Marked Applications (excluding FUW)	40,000	36,000	24,000	48,000	1,48,000
Balance	35,000	26,500	38,500	2,000	1,02,000
Less: Unmarked Applications (82,000*×6:5:5:4)	24,600	20,500	20,500	16,400	82,000
Balance	10,400	6,000	18,000	–14,400	20,000
Less: Surplus of D transferred to A, B and C in the ratio of 6:5:5	5,400	4,500	4,500	14,400	-
Net Liability	5,000	1,500	13,500	-	20,000
Add: Firm Underwriting	8,000	12,000	-	30,000	50,000
Total Liability	**13,000**	**13,500**	**13,500**	**30,000**	**70,000**

Total Applications = 1,80,000 + 50,000 (Firm Underwriting) = 2,30,000

Marked Applications = 40,000 + 36,000 + 24,000 + 48,000 = 1,48,000

*Unmarked Applications (including Firm Underwriting)

= Total Applications – Marked Applications

= 2,30,000 – 1,48,000

= **82,000**

Illustration 22

Raj Ltd. invited applications from the public for ₹2,50,000 shares of ₹10 each, at a premium of ₹5 per share.

The entire issue was underwritten by Underwriters A, B, C and D, to the extent of 30%, 20%, 30% and 20% with the provision of Firm Underwriting of 7,500 shares, 2,500 shares, 5,000 shares and 2,500 shares respectively. The company received applications for ₹1,75,000 shares, excluding Firm Underwriting; out of which, Marked Applications were A: 47,500 shares; B: 52,500 shares; C: 25,000 shares and D; 20,000 shares respectively.

Prepare a statement showing Net Liability of Underwriters, treating:

(a) Firm Underwriting as Marked Applications

(b) Firm Underwriting as Unmarked Applications

[Bangalore University, Nov/Dec 2015, Section C]

Solution

Statement Showing the Liability of Underwriter

When Firm Underwritten shares are treated as Marked Applications

Particulars	A (Shares)	B (Shares)	C (Shares)	D (Shares)	Total (Shares)
Gross Liability	75,000	50,000	75,000	50,000	2,50,000
Less: Marked Applications (including FUW)	55,000	55,000	30,000	22,500	1,62,500
Balance	20,000	–5,000	45,000	27,500	87,500
Less: Unmarked Applications (30,000×3:2:3:2)	9,000	6,000	9,000	6,000	30,000
Balance	11,000	–11,000	36,000	21,500	57,500
Less: Surplus of B transferred to A, C and D in the ratio of 3:3:2	4,125	+11,000	4,125	2,750	-
Net Liability	6,875	-	31,875	18,750	57,500
Add: Firm Underwriting	7,500	2,500	5,000	2,500	17,500
Total Liability	**14,375**	**2,500**	**36,875**	**21,250**	**75,000**

Total Applications = 1,75,000 + 17,500 (Firm Underwriting) = 1,92,500

Marked Applications = 47,500 + 52,500 + 25,000 + 20,000 + 17,500 (Firm Underwriting)
= 1,62,500

Unmarked Applications = Total Applications – Marked Applications
= 1,92,500 – 1,62,500
= **30,000**

Statement Showing the Liability of Underwriter

When Firm Underwritten shares are treated as Unmarked Applications

Particulars	A (Shares)	B (Shares)	C (Shares)	D (Shares)	Total (Shares)
Gross Liability	75,000	50,000	75,000	50,000	2,50,000
Less: Marked Applications (excluding FUW)	47,500	52,500	25,000	20,000	1,45,000
Balance	27,500	–2,500	50,000	30,000	1,05,000
Less: Unmarked Applications (47,500 × 3:2:3:2)	14,250	9,500	14,250	9,500	47,500
Balance	13,250	–12,000	35,750	20,500	57,500
Less: Surplus of B transferred to A, C and D in the ratio of 3:3:2	4,500	+12,000	4,500	3,000	-
Net Liability	8,750	-	31,250	17,500	57,500
Add: Firm Underwriting	7,500	2,500	5,000	2,500	17,500
Total Liability	**16,250**	**2,500**	**36,250**	**20,000**	**75,000**

Total Applications = 1,75,000 + 17,500 (Firm Underwriting) = 1,92,500
Marked Applications = 47,500 + 52,500 + 25,000 + 20,000 = 1,45,000
Unmarked Applications (including Firm Underwriting)
= Total Applications – Marked Applications
= 1,92,500 – 1,45,000
= **47,500**

Illustration 23

Apoorva Ltd. issued 5, 00,000 equity shares of ₹10 each, at a premium of 20%. The sale of the issue is underwritten by Apoorva, Bhoomika and Chaitra, as follows:

Apoorva: 2,50,000 shares (Firm Underwriting: 25,000 shares)
Bhoomika: 1,50,000 shares (Firm Underwriting: 15,000 shares)
Chaitra: 1,00,000 shares (Firm Underwriting: 10,000 shares)

The Underwriting Commission is 5% on the issue price and the company agreed to treat Firm Underwriting Applications as marked forms.

The company received applications for 4,00,000 equity shares (excluding Firm Underwriting); of which, marked forms were as under:

Apoorva: 1,15,000 shares
Bhoomika: 1,25,000 shares
Chaitra: 1,30,000 shares

You are required to show:

(a) Net Liability to underwriters in terms of number of shares

(b) Commission due to each underwriter and

(c) Net amount due from each underwriter to the company

[Bangalore University, Nov/Dec 2007, Section C]

SOLUTION

Particulars	A (Shares)	B (Shares)	C (Shares)	Total (Shares)
Gross Liability	2,50,000	1,50,000	1,00,000	5,00,000
Less: Marked Applications	1,15,000	1,25,000	1,30,000	3,70,000
Balance	1,35,000	25,000	–30,000	1,30,000
Less: Firm Underwriting	25,000	15,000	10,000	50,000
	1,10,000	10,000	–40,000	80,000
Less: Unmarked Applications (30,000* × 5:3:2)	15,000	9,000	6,000	30,000
Balance	95,000	1,000	–46,000	50,000
Less: Surplus of C transferred to A and B in the ratio of 5:3	28,750	17,250	+46,000	-
Balance	66,250	–16,250	-	50,000
Less: Surplus of B transferred to A	16,250	+16,250	-	-
Balance	50,000	-	-	50,000
Add: Firm Underwriting	25,000	15,000	10,000	50,000
Net Liability	**75,000**	**15,000**	**10,000**	**1,00,000**

Underwriting Commission:

A = 2,50,000 × (10 + 2 premium) × 5% = 1,50,000

B = 1,50,000 × (10 + 2 premium) × 5% = 90,000

C = 1,00,000 × (10 + 2 premium) × 5% = 60,000

Net Amount due:

A = 75,000 × 10 + 2 = 9,00,000 – 1,50,000 = 7,50,000

B = 15,000 × 10 + 2 = 1,80,000 – 90,000 = 90,000

C = 10,000 × 10 + 2 = 1,20,000 – 60,000 = 60,000

Gross Liability Ratio = 2,50,000: 1,50,000: 1,00,000 or 5:3:2

*Unmarked Applications = Total Applications – Marked Applications

= 4,00,000 – 3,70,000 (1,15,000 + 1,25,000 + 1,30,000)

= 30,000

Illustration 24

Arunodhaya Ltd. issued 2,00,000 shares of ₹10 each.

The entire issue was underwritten as follows:

Arun: 1,00,000 shares (Firm Underwriting: 20,000 shares)

Bharat: 60,000 shares (Firm Underwriting: 10,000 shares)

Udhay: 40,000 shares (Firm Underwriting: 10,000 shares)

Shares applied for were 1,80,000 being the marked forms, including Firm Underwriting, which is also regarded as marked forms.

Arun: 70,000 shares; Bharat: 28,000 shares; Udhay: 32,000 shares

Calculate the liability of underwriters.

[Bangalore University, Oct 2000, Section C]

SOLUTION

Statement Showing the Liability of Underwriter

Particulars	Arun (Shares)	Bharat (Shares)	Udhay (Shares)	Total (Shares)
Gross Liability	1,00,000	60,000	40,000	2,00,000
Less: Marked Applications (includes Firm Underwriting)	70,000	28,000	32,000	1,30,000
Balance	30,000	32,000	8,000	70,000
Less: Unmarked Applications (50,000 × 5:3:2)	25,000	15,000	10,000	50,000
Balance	5,000	17,000	-2,000	20,000
Less: Surplus of Udhay transferred to Arun and Bharath in the ratio of 5:3	1,250	750	+2,000	-
Balance	3,750	16,250	-	20,000
Add: Firm Underwriting	20,000	10,000	10,000	40,000
Net Liability	**23,750**	**26,250**	**10,000**	**60,000**

Gross Liability Ratio = 1,00,000: 60,000: 40,000 or 5:3:2

Unmarked Applications = Total Applications – Marked Applications

= 1,80,000 – 1,30,000 (70,000 + 28,000 + 32,000)

= 50,000

Illustration 25

Airlinks Ltd. made a public issue of 2, 50,000 equity shares of ₹10 each, with the entire amount payable on application.

The entire issue was underwritten as follows:

Red: 30%, Yellow: 25%, Green: 25% and White: 20% respectively. Red, Yellow, Green and White had also agreed on Firm Underwriting of 8,000, 12,000, NIL and 30,000 shares respectively.

The Underwriting Contract provides that underwriters be given credit for firm applications.

The total subscription, excluding Firm Underwriting and including Marked Applications, were 1,80,000 shares. The Marked Applications received were as follows:

Red: 48,000; Yellow: 40,000; Green: 24,000 and White: 48,000

Ascertain the Net Liability of each underwriter, treating:

(a) Firm Underwriting as Marked Applications

(b) Firm Underwriting as Unmarked Applications

[Bangalore University, Nov/Dec 2013, Section C]

SOLUTION

Total Shares issued	2,50,000
Less: Total Shares subscribed (1,80,000 + 50,000) (FUW)	2,30,000
Shares not subscribed	**20,000**

Statement Showing the Liability of Underwriter

When Firm Underwritten shares are treated as Marked Applications

Particulars	Red (30%) (Shares)	Yellow (25%) (Shares)	Green (25%) (Shares)	White (20%) (Shares)	Total (100%) (Shares)
Gross Liability	75,000	62,500	62,500	50,000	2,50,000
Less: Marked Applications (including FUW)	56,000	52,000	24,000	78,000	2,10,000
Balance	19,000	10,500	38,500	–28,000	40,000
Less: Unmarked Applications (20,000 × 6:5:5:4)	6,000	5,000	5,000	4,000	20,000
Balance	13,000	5,500	33,500	–32,000	20,000
Less: Surplus of White transferred to Red, Yellow and Green in the ratio of 6:5:5	12,000	10,000	10,000	+32,000	-
Balance	1,000	–4,500	23,500	-	20,000
Less: Surplus of Yellow transferred to Red and Green in the ratio of 6:5	2,455	+4,500	2,045	-	-
Balance	–1,455	-	21,455	-	20,000
Less: Surplus of Red transferred to Green	+1,455	-	1,455		-
Net Liability	-	-	20,000	-	20,000
Add: Firm Underwriting	8,000	12,000	-	30,000	50,000
Total Liability	**8,000**	**12,000**	**20,000**	**30,000**	**70,000**

Total Applications received including FUW (1,80,000 + 50,000)	2,30,000
Less: Marked Applications (48,000 + 40,000 + 24,000 + 48,000)	(1,60,000)
Less: Firm Underwriting (8,000 + 12,000 + NIL + 30,000)	(50,000)
Unmarked Applications	**20,000**

Statement Showing the Liability of Underwriter

When Firm Underwritten shares are treated as Unmarked Applications

Particulars	Red (30%) (Shares)	Yellow (25%) (Shares)	Green (25%) (Shares)	White (20%) (Shares)	Total (100%) (Shares)
Gross Liability	75,000	62,500	62,500	50,000	2,50,000
Less: Marked Applications (Excluding FUW)	48,000	40,000	24,000	48,000	1,60,000
Balance	27,000	22,500	38,500	2,000	90,000
Less: UnmarkedApplications(70,000*×6:5:5:4)	21,000	17,500	17,500	14,000	70,000
Balance	6,000	5,000	21,000	–12,000	20,000
Less: Surplus of White transferred to Red, Yellow and Green in the ratio of 6:5:5	4,500	3,750	3,750	+12,000	-
Net Liability	1,500	1,250	17,250	-	20,000
Add: Firm Underwriting	8,000	12,000	-	30,000	50,000
Total Liability	**9,500**	**13,250**	**17,250**	**30,000**	**70,000**

Total Applications received including FUW (1,80,000 + 50,000)	2,30,000
Less: Marked Applications (48,000 + 40,000 + 24,000 + 48,000)	(1,60,000)
***Unmarked Applications**	**70,000**

Illustration 26 **(Partial Underwriting)**

A company issued 50,000 shares. These shares were underwritten as follows:

X: 10,000 shares; Y: 15,000 shares and Z: 5,000 shares. In addition, there was a Firm Underwriting as follows: X: 5000 shares; Y: 2000 shares and Z: 1000 shares. The total subscription was 40,000 shares and the firms included the following marked forms: X: 10000 shares; Y: 10000 shares and Z: 5000 shares. Determine the total liability of underwriters and the company.

[Bangalore University, Nov/Dec 2016, Section B]

SOLUTION

Statement Showing the Liability of Underwriter

Particulars	X (Shares)	Y (Shares)	Z (Shares)	Company (Shares)	Total (Shares)
Gross Liability	10,000	15,000	5,000	20,000	50,000
Less: Marked Applications	10,000	10,000	5,000	-	25,000
Balance	-	5,000	-	20,000	25,000
Less: *Unmarked Applications and Firm Underwriting (15,000 + 8,000)	-	-		23,000	23,000
Balance	-	5,000	-	–3,000	2,000
Less: Surplus of Company transferred to Y	-	3,000	-	+3,000	-
Balance	-	2,000	-	-	2,000
Add: Firm Underwriting	5,000	2,000	1,000	-	8,000
Net Liability	**5,000**	**4,000**	**1,000**	**-**	**10,000**

Note: Firm underwritten shares are treated as unmarked applications.

Gross Liability Ratio = 10,000:15,000:5,000 or 2:3:1

*Unmarked Applications = Total Applications – Marked Applications

= 40,000 – 25,000 (10,000 + 10,000 + 5,000)

= 15,000

Illustration 27

A limited company issued 1,00,000 equity shares of ₹100 each. M, N, O and P underwrite the entire issue in the proportion of 30%, 30%, 20% and 20% respectively, in consideration of commission in cash at 4%.

They also apply for firm share application as follows:

M: 3,000 shares
N: 2,000 shares
O: 2,000 shares and
P: 3,000 shares

Besides, the firm applications the public apply for 60,000 shares; of which, Marked Applications are follows:

M: 10,000 shares
N: 6,000 shares
O: 8,000 shares
P: 16,000 shares

Show the number of shares to be taken up by each of the underwriters, assuming Firm Applications as Marked and Unmarked, and commission payable to underwriters under each case.

[Bangalore University, Nov/Dec 2016, Section C]

SOLUTION

Statement Showing the Liability of Underwriter

When Firm Underwritten shares are treated as Marked Applications

Particulars	M (30%) (Shares)	N (30%) (Shares)	O (20%) (Shares)	P (20%) (Shares)	Total (100%) (Shares)
Gross Liability	30,000	30,000	20,000	20,000	1,00,000
Less: Marked Applications (including FUW)	13,000	8,000	10,000	19,000	50,000
Balance	17,000	22,000	10,000	1,000	50,000
Less: Unmarked Applications (20,000 × 3:3:2:2)	6,000	6,000	4,000	4,000	20,000
Balance	11,000	16,000	6,000	–3,000	30,000
Less: Surplus of P transferred to M, N and O in the ratio of 3:3:2	1,125	1,125	750	+3000	-
Net Liability	9,875	14,875	5,250	-	30,000
Add: Firm Underwriting	3,000	2,000	2,000	3,000	10,000
Total Liability	**12,875**	**16,875**	**7,250**	**3,000**	**40,000**

Marked Applications plus Firm Underwriting:

M = 10,000 + 3,000 =13,000

N = 6,000 + 2,000 = 8,000

O = 8,000 + 2,000 =10,000

P = 16,000 + 3,000 =19,000

Unmarked Applications = Total Applications – Marked Applications

= 70,000 – 50,000 (13,000 + 8,000 + 10,000 + 19,000)

= **20,000**

Statement Showing the Liability of Underwriter

When Firm Underwritten shares are treated as Unmarked Applications

Particulars	M (Shares)	N (Shares)	O (Shares)	P (Shares)	Total (Shares)
Gross Liability	30,000	30,000	20,000	20,000	1,00,000
Less: Marked Applications (excluding FUW)	10,000	6,000	8,000	16,000	40,000
Balance	20,000	24,000	12,000	4,000	60,000
Less: Unmarked Applications (30,000 × 3:3:2:2)	9,000	9,000	6,000	6,000	30,000
Balance	11,000	15,000	6,000	-2,000	30,000
Less: Surplus of P transferred to M, N and O in the ratio of 3:3:2	750	750	500	+2,000	-
Net Liability	10,250	14,250	5,500	-	30,000
Add: Firm Underwriting	3,000	2,000	2,000	3,000	10,000
Total Liability	**13,250**	**16,250**	**7,500**	**3,000**	**40,000**

Total Applications = 60,000 + 10,000 (Firm Underwriting) = 70,000

Marked Application = 10,000 + 6,000 + 8,000 + 16,000 = 40,000

Unmarked Applications (including Firm Underwriting)

= Total Applications – Marked Applications

= 70,000 – 40,000

= **30,000**

Calculation of commission payable to the underwriters:

M = 30,000 × 4 ÷ 100 × ₹100 = 1,20,000

N = 30,000 × 4 ÷ 100 × ₹100 = 1,20,000

O = 20,000 × 4 ÷ 100 × ₹100 = 80,000

P = 20,000 × 4 ÷ 100 × ₹100 = 80,000

Illustration 28 **(Partial Underwriting – One Underwriter)**

Akshara Ltd. issued 80,000 shares of ₹10 each at a premium of 20%. Mr A underwrites 80% of the issue. The company receives applications for 75% of the issue; of which, 40,000 applications bear the rubber stamp of Mr A. Underwriting Commission is 4% of the issue price. Determine the liability of Mr A and also calculate the Underwriting Commission.

[Bangalore University, Nov/Dec 2006, Section B]

SOLUTION

Statement Showing the Liability of Underwriter

Particulars	A (Shares) 80%	Akshara Ltd. (Shares) 20%
Gross Liability	64,000	16,000
Less: Credit of unmarked application directly received by the company of 20,000 (80,000 × 75% – 40,000)	-	20,000
Balance	64,000	(4,000)
Less: Credit of surplus given by Company to Mr A	4,000	4,000
Balance	60,000	-
Less: Marked Application	40,000	-
Net Liability	**20,000**	**-**

Underwriting Commission = 64,000 shares × ₹10 × 4% = **₹25,600**

SUMMARY

- **Underwriting of shares and debentures** is an agreement between the company and the underwriters, where, underwriters guarantee to subscribe the whole or a certain portion of issued shares, if in case shares and debentures are not subscribed by the public, as per the predetermined terms and conditions of the agreement and for an agreed remuneration.
- The individuals or institutions willing to underwrite the public issue of shares or debentures, either in part or full, for an agreed consideration are called **Underwriters**.
- If an underwriter enters into a sub-agreement with other underwriters for subscription of shares or debentures, if the public fails to apply for, the other underwriters in this case are termed as **Sub-underwriters.**
- An underwriter receives commission as per the agreement for shares and debentures subscribed by him. Whereas, a broker receive brokerage fee for procuring subscription to the shares or debentures from the public, on behalf of the company.
- The functions of an underwriter are to facilitate subscription, distribution of securities and providing of timely and relevant information.

- Underwriting comes in handy to newly formed companies, which are yet to make a mark in the industry and those that do not have previous performance record. The investing public looks back on the past performance before investing. In the absence of a past record, public may be sceptical to invest. Therefore, an underwriter acts as middleman and gives assurance both to the company and the public.
- An **Underwriting Agreement** comprises of all the terms, conditions, stipulations and circumstances relating to underwriting. It also includes the remuneration likely to be received by the underwriters. It indicates the liabilities, obligations or the responsibilities of an underwriter.
- Types of underwriting are: complete, partial, open/pure and firm underwriting. Complete underwriting is where the entire issue is underwritten; partial underwriting is where only a part of the issue is underwritten; open or pure underwriting is where the underwriters take-up subscription of shares only when they are not underwritten; and firm underwriting is where underwriters subscribe to shares whether it is taken up by the public or not.
- **Underwriting Commission** is a specified rate calculated on the issue price of the shares or debentures underwritten by the underwriters.
- **Marked Applications** are when the issue of shares and debentures of a company is wholly or partly underwritten by more than one underwriter.
- Applications received by a company directly from the public, not bearing any stamp of the underwriter, are called **Unmarked Applications**.

THEORY QUESTIONS

Section A

1. Define Underwriting. **[Nov/Dec 2005, 2006]**
2. What is meant by underwriting of shares and debentures?
3. Who is an Underwriter? **[Nov/Dec 2013/2008]**
4. Give examples of an Underwriter.
5. Distinguish between Gross Liability and Net Liability of Underwriters. **[Nov/Dec 2006]**
6. Write any two advantages of an Underwriter.
7. Give the meaning of Sub-Underwriter.
8. Write any two differences between a Sub-Underwriter and a Broker.
9. List out the functions of an Underwriter.
10. What is Underwriting Commission? **[Nov/Dec 2006/2008]**
11. How is Underwriting Commission calculated?
12. Write the provisions relating to Underwriting Commission.
13. What is the maximum rate of Underwriting Commission payable to Underwriters?

14. What is an Underwriting Agreement?
15. Mention the types of Underwriting. **[Nov/Dec 2007]**
16. What do you mean by Firm Underwriting? **[Nov/Dec 2009/2013/2016]**
17. Define Open/Pure Underwriting. **[Nov/Dec 2008]**
18. Explain the term Complete Underwriting. **[Nov/Dec 2006]**
19. Give the meaning of Partial Underwriting. **[Nov/Dec 2005/2006]**
20. Write any two differences between Complete and Partial Underwriting.
21. Differentiate between Pure Underwriting and Firm Underwriting. **[Nov/Dec 2007]**
22. How is Net Liability for an Underwriter calculated?
23. What do mean by Marked Applications?
24. Explain the term Unmarked Applications. **[Nov/Dec 2009]**
25. Write the differences between Marked and Unmarked Applications.
26. In what ratio are the Unmarked Applications divided among the various Underwriters?

Section B

1. Briefly explain the different types of Underwriting with examples. **[Nov/Dec 2009]**
2. Explain the advantages and functions of underwriting of shares and debentures. **[Nov/Dec 2007/2015]**
3. Explain the provisions of Companies Act relating to underwriting shares. **[Nov/Dec 2006]**
4. Write about the SEBI guidelines for underwriting of shares and debentures.
5. Explain the relevant provisions relating to Underwriting Commission as per Companies Act and SEBI guidelines.
6. Write the accounting entries relating to underwriting of shares and debentures in the books of the company and the underwriter.
7. Show the Specimen Proforma for calculating Net Liability of an Underwriter.
8. State restrictions and conditions placed under Companies Act on payment of Underwriting Commission.

PRACTICAL QUESTIONS

Section B and C

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

   X: 30%; Y: 30%; Z: 20%. The company received applications for 8,000 shares only. Ascertain the liability of each underwriter with all the necessary workings.

   (The Net Liability of X: 600 shares; Y: 600 shares and Z: 400 shares)
2. Siti. Co. Ltd. was with a capital of ₹1, 00,000 at the rate of ₹10 per share, the entire amount being issued to the public for subscription. The underwriting was as follows:

   P: 100 shares; Q: 30 Shares; R: 200 shares; S: 350 shares; T: 20 shares and U: 300 shares.

Marked Applications were as follows:

P: 75 shares; Q: 50 shares; R: 200 shares; S: NIL; T: NIL and U: 225 shares.

Applications for 130 shares were received as unmarked. Calculate the Net Liability of all the underwriters.

(P: 6 shares; Q: NIL; R: NIL; S: 62 shares; T: 16 shares and U: 16 shares)

3. R Ltd. issues 25,000 shares of ₹20 each at par. Malik has underwritten the whole issue, at a commission of 4%. The company received applications for 23,500 shares. All the applications were accepted. Give journal entries in the books of R Ltd.

(Net Liability of Mr Malik: 1500 Shares; and the amount payable by Mr Malik to R Ltd. is ₹10,000)

4. A & B Co. Ltd. issued 10,000 shares of ₹10 each. The following underwriters agreed to underwrite the shares issued to the public as follows:

Raj: 3,500 shares; Ravi: 3,000 shares; Rohan: 2,000 shares; Rakesh: 1,000 shares; Rajesh: 300 shares and Ramesh: 200 shares;

The company received Marked Applications from the public as follows:

Raj: 1,000 shares; Ravi: 2,250 shares; Rohan: 2,000 shares; Rakesh: 750 shares; Rajesh: 500 shares and Ramesh: NIL.

A & B Co. received 2000 applications on unmarked forms. Draw up the statement to show the Net Liability of each of the underwriter, making suitable assumptions and show all the necessary workings.

(The Net Liability is Raj: 1,365 shares; Ravi: NIL; Rohan: NIL; Rakesh: NIL; Rajesh: NIL and Ramesh: 135 shares)

5. Shankar Ltd. issued 5 lakh shares of ₹10 each, at a premium of 10%. The entire issue was underwritten by A, B, C and D. Out of 4.5 lakh applications received by Shankar Ltd., the Market Applications were as follow:

A: 2.2 lakh shares

B: 0.90 lakh shares

C: 1.10 lakh shares

D: 0.10 lakh shares

It was agreed that underwriters will be paid a commission at 5% on the issue price. You are required to find out the liabilities of each underwriter with all the necessary workings.

(A: NIL; B: 22,500 shares; C: NIL and D: 27,500 shares)

6. XYZ Co. Ltd. was formed with a capital of 1,00,000 shares of ₹10 each. The shares were underwritten as follows:

Ram: 35,000; Laxman: 30,000; Duryodhan: 20,000; Arjun: 10,000; Karan: 3,000; and Sharan: 2,000.

The Marked Applications received were as follows:

Ram: 10,000; Laxman: 22,500; Duryodhan: 20,000; Arjun: 7,500; Karan: 5,000; and Sharan: NIL.

The Unmarked forms received were 20,000.

Compute the statement showing Net Liability of Underwriters.

(Ram: 13,647 shares; Laxman: NIL; Duryodhan: NIL; Arjun: NIL; Karan: NIL; and Sharan: 1,353 shares)

7. Ghanshayam Inc. issued a prospectus inviting applications for 5 lakh equity shares of ₹10 each.

   The entire issue was underwritten by Shiv: 2 lakh shares; Bhim: 1.5 lakh shares; Ganesh: 1 lakh shares; and Narayan: 0.5 lakh shares. Applications of 4.5 lakh shares include Marked Applications of Shiv: 2.2 lakh shares; Bhim: 1.1 lakh shares; Ganesh: 0.9 lakh shares; and Narayan: 0.1 lakh shares.

   Ascertain the Net Liability of all the Underwriters.

   (Shiv: NIL; Bhim: 22,500 shares; Ganesh: NIL; and Narayan: 27,500 shares)

8. Sugam Ltd. issued share capital of 10 lakh equity shares of ₹10 each, at a premium of 5%. ₹2.5 payable on application and ₹3.00 payable on allotment including premium.

   The issue was underwritten by 2 underwriters Peter and John in an agreed ratio of 1:1; commission was agreed at 5% of the issue price. Underwriters agreed to firm underwrite 20,000 shares each. Public subscribed in total 9.6 lakh shares, of which, applications bearing rubber stamp of Peter were 5.2 lakh and that of John, 3.6 lakh shares. Unmarked forms were 0.8 lakh shares.

   One of the failed to pay allotment money on 2,000 shares and his applications bore the rubber stamp of Peter. The shares are subsequently forfeited and re-allotted on payment of cash ₹4 per share.

   Pass the journal entries to record the aforementioned events and transactions.

   (Net Liability: Peter; 20,000 shares and John; 60,000 shares)

9. Saturn Ltd. issued 10,000 shares of ₹10 each. The entire issue was underwritten as follows:

   Venus: 5000 shares; Earth: 3000 shares and Mars: 2000 shares and the Firm Underwriting by the underwriters was agreed at 1000, 500 and 500 shares respectively by Venus, Earth and Mars. Public applied for 9,000 shares; of which, marked forms including Firm Underwriting were: 3,500, 1,400 and 1,600 shares respectively for Venus, Earth and Mars. Calculate the liability of each underwriter.

   (Net Liability of Venus: 1187 shares; Earth: 1,313 shares and Mars: 500 shares)

10. Star Ltd. issued 50,000 shares of ₹50 each. The entire issue was underwritten as follows:

    A: 30,000 shares

    B: 15,000 shares

    C: 5,000 shares

    Out of the total issue, 45,000 shares including Firm Underwriting were subscribed.

    Firm Underwritten shares were:

    A: 5,000 shares

    B: 2,000 shares

    C: 1,000 shares

    The Marked Applications received by Star Ltd. are given as follows:

    A: 16,000 shares

    B: 10,000 shares

    C: 4,000 shares

    Calculate the liability of each of the underwriter.

    (A: 16,000 shares; B: 10,000 shares and C: 4,000 shares)

11. Vibrant Ltd. issued 4 lakh equity shares, which were underwritten by three underwriters, as follows:

    Amar: 2.4 lakh shares

    Akbar: 1 lakh shares

    Anthony: 0.6 lakh shares

The Firm Underwriting was as under:

Amar: 32,000 shares

Akbar: 12,000 shares

Anthony: 40000 shares

The total subscription excluding Firm Underwriting but including Marked Applications were for 2 lakh shares.

Compute the respective liabilities of each underwriter as follows:

(i) When Firm Underwriting shares were treated at par with Marked Applications

(ii) When Firm Underwriting shares were treated at par with Unmarked Applications.

((a) Amar: 1.48 lakh shares; Akbar: 0.12 lakh shares and Anthony: 0.40 lakh shares

(b) Amar: 1.328 lakh shares; Akbar: 0.12 lakh shares and Anthony: 0.552 lakh shares)

12. X Ltd. issued 40,000 equity shares of ₹10 each, at par. The entire issue was underwritten as follows;

Sam: 24,000 shares

David: 10,000 shares

Vincent: 6,000 shares

The Firm Underwriting were given as follows:

Sam: 3,200 shares

David: 4,000 shares

Vincent: 1,200 shares

The total applications including Firm Underwriting were for 28,400 shares. The Marked Applications were given as follows:

Sam: 7,200 shares

David: 9,000 shares

Vincent: 3,200 shares

The Underwriting Agreement provided that credit for Unmarked Applications be given to the underwriters in the proportion to the shares underwritten. Determine the liability of each of the underwriters and the amount of commission payable to them as per the SEBI guidelines.

(Net Liability of underwriters: Sam: 13,600 shares; David: 4,000 shares and Vincent: 2,400 shares

(Commission payable to Sam: ₹12,000; David: ₹5,000 and Vincent: ₹3,000)

13. Vibgyor Ltd. made a public issue of 1, 25,000 equity shares of ₹100 each; ₹50 is payable on application. The entire issue was underwritten by four underwriters – Red, Blue, Green and Yellow – in the agreed ratio of 6:5:5:4, respectively. As per the terms of the Underwriting Agreement, a commission of 2% was payable on the amounts underwritten.

The Firm Underwriting, agreed by Red, Blue, Green and Yellow were, 4000, 6000, NIL and 15000 shares respectively. The total subscription, excluding Firm Underwriting and including Marked Applications, is for 90,000 shares. Marked Applications received were given as follows:

Red: 24000 shares

Blue: 20000 shares

Green:12000 shares

Yellow: 24,000 shares

Ascertain the Net Liability of all the underwriters and also show the journal entries drafted in the books of the company. Show all the relevant workings, making necessary assumptions.

(The Net Liability of Red: 12,000 shares; Blue: 7,500 shares; Green: 16,000 shares and Yellow: 9,000 shares)

14. Lion Inc. issued 50,000 equity shares of ₹10 each at par. The entire issue was underwritten as follows:

    Deer: 30,000 shares (Firm Underwriting: 4,000 shares)

    Stag: 15,000 shares (Firm Underwriting: 5,000 shares)

    Zebra: 5,000 shares (Firm Underwriting: 1,000 shares)

    The total application, including Firm Underwriting, were for 40,000 shares. The Marked Applications were as follows:

    Deer: 10,000 shares

    Stag: 7,000 shares

    Zebra: 3,000 shares

    The agreement of Underwriting Contract provides for Marked Applications be given to the underwriters in proportion to the shares underwritten.

    Compute the Net Liability of the underwriters and also the commission payable to them.

    (The total liabilities of Deer: 12,000 shares; Stag: 7,000 shares and Zebra: 1,000 shares. The commission payable for Deer: ₹15,000; Stag: ₹7,500 and Zebra: ₹2,500)

15. Applications were invited by Gangotri Ltd. from public for 1,00,000 equity shares of ₹10 each, at a premium of ₹5 per share. The entire issue was underwritten by underwriters – P, Q, R and S – to the extent of 3:3:2:2 ratio respectively, along with the provision of Firm Underwriting of 3,000, 2,000, 1,000 and 1,000 shares respectively.

    The underwriters were allowed maximum commission permissible as per law and regulations of SEBI. The company received applications for 70,000 shares from public; out of which, applications for 19,000, 10,000, 21,000 and 8,000 shares were marked in the favour of P, Q, R and S respectively.

    Calculate the liability of each of the underwriters and also ascertain the Underwriting Commission payable to the different underwriters.

    (P: 5,750 shares; Q: 14,750 shares; R: 1,000 shares and S: 8,500 shares)

2 Profit Prior to Incorporation

CHAPTER OUTLINE

2.1 INTRODUCTION

In common parlance, a company comes into existence only after its incorporation or registration. Sometimes, a company that is newly formed, although not incorporated, may acquire an existing business at a date prior to the Date of Incorporation of the company. The amount of Profit or Loss of such a business for the period to the date the newly formed company came into existence is termed as Prior Period Profit or Loss. Such Profit or Loss, although belonging to the company, are capital in nature and are required to be disclosed separately from the Trading Profits and Losses. For example, a company incorporated on 1 July 2017 may acquire a seller's business on 31 March 2017. This is the date on which the seller's accounts are usually compiled. If the company has earned any Profit or incurred any Losses from the Date of Purchase to the Date of its Incorporation, such Profits or Losses are termed as Pre-incorporation Profits or Losses. Profits up to the Date of Incorporation of the company have to be treated as Capital Profits, which are meant to be transferred to Capital Reserve Account. Otherwise, if there is a Loss, Prior to Incorporation, it has to be treated as Capital Loss and debited to Goodwill Account. In calculating all these, one of the important considerations is the Date of Incorporation and not the Date of Business Commencement.

2.2 MEANING OF PROFIT OR LOSS PRIOR TO INCORPORATION OR PRE-INCORPORATION PROFITS OR LOSSES

Profits or Losses of a company for the period prior to the date the company came into existence are termed as Prior Period Profits or Losses or Pre-incorporation Profits or Losses. In other words, a company yet to be incorporated may acquire an already existing business on a particular date. Hence, it is entitled to receive all the Profits after its purchase. The Profits earned by the company that was purchased, even before the company was incorporated, are known as Pre-incorporation Profits and are capital in nature. Such Profits or Losses must be transferred to a Capital Reserve Account or a Goodwill Account, as the case may be.

2.3 NATURE AND USE OF PROFIT OR LOSS PRIOR TO INCORPORATION

Any public company cannot commence its business until it procures a Business Commencement Certificate nor can it earn Profits or incur Losses prior to its existence as a legal entity. Any such Profits or Losses earned by the company prior to its incorporation are to be treated as Capital Profits. As the Profits or Losses earned prior to incorporation may alter the Net Assets acquired by the company upon its formation, it is advisable to treat the same as Capital Profits or Losses.

Pre-incorporation Profits are not available for distribution of Dividend and are supposed to be used for Capital purposes only. For example, any amount in Capital Reserve Account can be used to writing off of any Capital Losses or reduction in the value of Goodwill. They are meant to be transferred to a Special Reserve Account (Capital Reserve Account) if it is a Profit or Goodwill Account if it is a loss. Any profits earned post-incorporation are revenue in nature and hence available for Dividend Distribution.

It is noteworthy that in order to calculate Pre-incorporation Profits or Losses, it is the Date of Incorporation that is considered and not the Date of Business Commencement. Generally, there are two methods observed for computing Pre-incorporation Profits. One method is to close the old books and open new books with the Assets and Liabilities, as they existed on the Date of Incorporation. By doing this, the results to that date will be automatically adjusted. The other method is to split the profits between Pre- and Post-incorporation Periods. This is either done on time basis or turnover basis or a combination of both.

2.4 PRE-INCORPORATION PERIOD AND POST-INCORPORATION PERIOD

1. **Pre-incorporation Period:** It is the period from the Date of Purchase or Acquisition of business to the Date of Incorporation.

2. **Post-incorporation Period:** It is the period from the Date of Incorporation to the last date on which the accounts are compiled.

2.5 ASCERTAINMENT OF PROFIT OR LOSS PRIOR TO INCORPORATION

For the proper ascertainment and allocation of Profits, Stocks have to the considered and accounts may have to be balanced. This may involve a great deal of inconvenience to the company. In order to avoid the same, the following steps can be observed:

Step 1*:* Preparation of Trading Account for the entire period, i.e., from the date on which the running business was purchased to the last date of accounts closing of the newly incorporated company. This is required to calculate Gross Profit for the period.

Step 2*:* Calculate different ratios, namely: Time Ratio, Weighted Time Ratio and Turnover Ratio. *Time Ratio* is calculated for the period falling between the last date of the balance sheet of the vendor company and the Date of Incorporation and the period between the Date of Incorporation and the date on which accounts are compiled. *Sales Ratio* is the ratio of sales of Pre-incorporation and Post-incorporation Periods. *Weighted Time Ratio* and Time Ratio are same, but Time Ratio is used if expenses remain the same through the year and Weighted Time Ratio is used if expenses do not remain the same throughout the year.

Step 3: Preparation of Profit or Loss Account for Pre-incorporation Period and Post-incorporation Period separately, on different bases that are discussed later; and apportionment of all the items appearing on the debit side and credit side of the Profit and Loss Account, on the basis of their characteristics.

Ascertainment of Profit or Loss Prior to Incorporation

Ascertaining Gross Profit by preparing Trading Account

↓

Calculating different ratios for Allocation and Apportionment

↓

Calculating Pre-incorporation and Post-incorporation Profits by preparing Profit and Loss Account

↓

Allocating all items of Profit and Loss Account on suitable bases

2.6 BASIS OF APPORTIONMENT

1. **Time Ratio:** The fixed charges or the expenses, which are periodical, are required to be apportioned on time basis, such as rents, rates and taxes, etc. Hence, Time Ratio is the ratio of Pre-incorporation Period and Post-incorporation Period.
2. **Sales Ratio:** The expenses, which are directly related to sales, need to be apportioned on the basis of sales, such as Bad Debts, Brokerage or Commission or advertisement, etc. Hence, Sales Ratio is the ratio of Pre-incorporation Sales and Post-incorporation Sales.
3. **Weighted Ratio:** If the expenses are uniform through the year, then they can be apportioned on the basis of time factor; but, if the expenses are not uniform throughout the year due to major changes in the company, then they need to be apportioned on the basis of Weighted Ratio or Weighted Time Ratio.
4. **Revised Time Ratio:** This ratio is calculated in case the vendor is not allowed to take Pre-incorporation Profits. In that scenario, vendors are usually paid interest on purchase consideration. This interest payable is allocated on the basis of Revised Time Ratio. The interest payable is usually calculated from the Date of Acquisition to the Date of Discharge of Purchase Consideration.
5. **Actual Basis:** The expenses incurred for a specific period should be charged for that respective period only. Expenses incurred in the Pre-incorporation Period are charged as expenses of Pre-incorporation Period only and expenses incurred in the Post-incorporation Period are charged as expenses of Post-incorporation period only.

Basis of Apportionment of Expenses and Incomes

Item	Basis of Apportionment between Pre- and Post-incorporation Periods
Gross Profit or Gross Loss	- On the basis of *Turnover Ratio* in the respective periods. - On the basis of *Cost of Goods Sold* in the respective periods in the absence of any information regarding Turnover. - On the basis of *Time Ratio* in the respective periods in the absence of information regarding Turnover and Cost of Goods Sold.
Variable Expenses or Incomes linked to Turnover. (Example: Carriage/Cartage Outward, Rates, Bad Debts, Brokerage, Commission, Discount Allowed, Selling and Distribution Expenses, Advertisement Expenses, Sales Promotion Expenses, etc.)	- On the basis of *Turnover Ratio/Sales Ratio*

(*Contd.*)

2

Item	Basis of Apportionment between Pre- and Post-incorporation Periods
Fixed Expenses or Incomes or rent. (Example: Salaries, Taxes, Depreciation, General Expenses, Printing and Stationery, Postage, Administrative Expenses, Trade Expenses, Interest, Bank Charges, Repairs, Miscellaneous Expenses, etc.)	- On the basis of *Time Ratio*
Expenses exclusively relating to Pre-incorporation Period only. (Example: Interest on Vendor's Capital, Loss or Gain on Sale of Investment, Vendor's Salary, etc.)	- *Actual Basis* – by charging to Pre-incorporation Period only
Expenses relating exclusively to Post-incorporation Period (Example: Formation Expenses, Director's Fees, Audit Fees, Interest on Debentures, Preliminary Expenses, Underwriting Commission, Director's Remuneration, Discount on Issue of Shares or Debentures, etc.)	- *Actual Basis* – by charging to Post-incorporation Period only
Interest on Purchase Consideration to Vendor	- *Revised Time Ratio*
Expenses and Incomes relating to purchases	- *Net Purchases Ratio*

Illustration 1 **(Time Ratio)**

Singh & Co. purchased Luminous Inc. on 01 April 2016 and the Date of Incorporation was on 01 August 2016. The accounts of Singh & Co. were complied on 31 March 2017. Mention the Pre- and Post-incorporation Profits and calculate the Time Ratio.

Solution

Pre-incorporation Period is 4 months (April 2016 to July 2016)

Post-incorporation Period is 8 months (August 2016 to March 2017)

Time Ratio is **4:8 or 1:2**

Illustration 2 **(Time and Sales Ratio)**

Sam Ltd. purchased BB Co. on 31 March 2016. While the Date of Incorporation is 01 July 2016, the accounts of Sam Ltd. were closed for compilation on 31 March 2017. Sales for the period from March to June 2016 were ₹3,00,000 and for the period from July to March 2017, the Sales were reported as ₹9,00,000. Compute Time Ratio and Sales Ratio for Pre and Post-incorporation Periods.

Solution

Pre-incorporation Period is 3 months (April 2016 to June 2016)

Post-incorporation Period is 9 months (July 2016 to March 2017)

Time Ratio is **3:9 or 1:3**

Sales Ratio is ₹3,00,000: ₹9,00,000 or **1:3**

Illustration 3 (Sales Ratio)

All-well Industries was incorporated on 01 April 2017. Prior to this, the company had acquired Well-being Company on 01 January 2017. Sales for the period of 01 January 2017 to 31 December 2017 were ₹12,00,000. Sales for the first two months of the calendar year were 1½ times the Average Monthly Sales. Sales from March to July 2017 are equal to half of the Average Monthly Sales. Sales from August and September are a quarter of the Average Monthly Sales and the Sales from October to December 2017 are equal to twice the Average Monthly Sales. Compute the Sales Ratio.

Solution

Average Monthly Sales = ₹12, 00,000 ÷ 12 months = ₹1,00,000

Sales for each month

	Month	Working	(₹)	
Pre-incorporation Period	January	1,00,000 × 1½	1,50,000	**3,50,000**
	February	1,00,000 × 1½	1,50,000	
	March	1,00,000 × ½	50,000	
Post-incorporation Period	April	1,00,000 × ½	50,000	**8,50,000**
	May	1,00,000 × ½	50,000	
	June	1,00,000 × ½	50,000	
	July	1,00,000 × ½	50,000	
	August	1,00,000 × ¼	25,000	
	September	1,00,000 × ¼	25,000	
	October	1,00,000 × 2	2,00,000	
	November	1,00,000 × 2	2,00,000	
	December	1,00,000 × 2	2,00,000	

Pre-incorporation Sales (January to March 2017) = ₹3,50,000

Post-incorporation Sales (April to December 2017) = ₹8,50,000

Therefore, the Sales Ratio = 3,50,000: 8,50,000 = **7:17**

Illustration 4

A Co. took over B Co. as on 01 January 2017 and was incorporated on 01 June 2017. The sales for the calendar year were ₹4,80,000. Sales for the month of January, March and September were 1 ½ times the Average Monthly Sale. The sales for February were half of the Average Monthly Sales and for the month of December, they were twice the Average Sales. Calculate the Pre-incorporation and Post-incorporation Sales.

SOLUTION

Average Monthly Sales = ₹4, 80,000 ÷ 12 months = ₹40,000

January (1 ½ times of 40,000) = ₹60,000

February (½ times of 40,000) = ₹20,000

March (1 ½ times of 40,000) = ₹60,000

September (1 ½ times of 40,000) = ₹60,000

December (2 times of 40,000) = ₹80,000

Total sales for five months = 2,80,000

Therefore, the sales for remaining seven months are ₹2,00,000 (i.e., 4,80,000 – 2,80,000).

The Average Sales for seven months = 2,00,000 ÷ 7 = ₹28,571

Pre-incorporation Sales (January to May 2017) = 5 months

(60,000 + 20,000 + 60,000 + 28,571 + 28,571) = ₹1,97,142

Post-incorporation Sales (June 2017 to December 2017) = 7 months

(28,571 + 28,571 + 28,571 + 60,000 + 28,571 + 28,571 + 80,000) = ₹2,82,855

Illustration 5

Nanda Ltd. had purchased a business on 01 April 2015. The company received its Certificate of Incorporation on 01 September 2015. The Average Monthly Sale for the period before incorporation was 25% more than the Average Monthly Sales for the period after incorporation. The Total Sales during the year were ₹13,25,000.

Ascertain:

(i) Time Ratio

(ii) Sales Ratio

(iii) Pre- and Post-incorporation Sales

[Bangalore University, Nov/Dec 2015, Section B]

SOLUTION

Calculation of Time Ratio

Pre-incorporation period is 5 months (April 2015 to August 2015)

Post-incorporation period is 7 months (September 2015 to March 2016)

Time Ratio = **5:7**

Calculation of Sales Ratio

Let Post-incorporation Sale be assumed as 100

Pre-incorporation Sales be 100 + 25 = 125

Total sales before incorporation = 125 × 5 months = 625

Total sales after incorporation = 100 × 7 months = 700

Therefore, Sales Ratio = 625:700 = **25:28**

Calculation of Pre- and Post-incorporation Sales

Pre-incorporation Sales = 13,25,000 × 25 ÷ 53 = ₹6,25,000

Post-incorporation Sales = 13,25,000 × 28 ÷ 53 = ₹7,00,000

Illustration 6

Sunder Ltd. acquired a business on 01 January 2017 and was incorporated on 01 April 2017. The Total Sales for the calendar year (Jan. to Dec. 2017) was ₹8,25,000. The Average Monthly Sale for the period before incorporation was 30% less than the monthly average for the period after incorporation. There were 15 Factory Staff before incorporation and were paid Wages at ₹75 per month. Later, there were 50 Factory Staff, who were paid at ₹150 per month, per member. The number of Office Staff prior to incorporation was 7. Post incorporation, the number of Office Staff were 30 and the Salary paid to them also increased from ₹175 to ₹450 per month, per member. Compute the Sales Ratio and the Total Amount of Wages and Salaries before and after incorporation.

Solution

Calculation of Sales Ratio

Pre-incorporation Period (January to March 2017) = 3 months

Post-incorporation Period (April to December 2017) = 9 months

Note: Accounts compiling is assumed to be on 31 December 2017

Assume the Post-incorporation Sales to be 100

Hence, the Pre-incorporation Sales will be (100 – 30) = 70

Sales Prior to Incorporation = 70 × 3 months = 210

Sales Post Incorporation = 100 × 9 months = 900

Sales Ratio = 210: 900 or 7: 30

Therefore, Pre-incorporation Sales = 7 ÷ 37 × 8,25,000 = ₹1, 56,081

Post-incorporation Sales = 30 ÷37 × 8, 25,000 = ₹6, 68,918

Wages of Factory Staff

Wages before incorporation:

Pre-incorporation Period × Number of Factory Staff × Rate

3 months × 15 staff × ₹75 = ₹3,375

Wages after incorporation:

Post-incorporation Period × Number of Factory Staff × Rate

$9 \times 50 \times 150 =$ ₹67,500

Salaries of Office Staff

Salaries before incorporation:

Pre-incorporation Period × Number of Office Staff × Rate

3 months × 7 staff × ₹175 = **₹3,675**

Salaries after incorporation:

Post-incorporation Period × Number of Office Staff × Rate

9 months × 30 staff × ₹450 = **₹1,21,500**

Illustration 7 **(Weighted Ratio)**

Zed Ltd. acquired Why Ltd. on 01 January 2017 and received Certificate of Incorporation on 01 May 2017. There were 16 employees prior to incorporation and 48 employees Post-incorporation. The Total Wages paid were ₹4,80,000. Compute Weighted Time Ratio.

SOLUTION

Pre-incorporation Period (January to April 2017) = 4 months

Post-incorporation Period (May to December 2017) = 8 months

Time Ratio = **4:8** or **1:2**

Weighted Time Ratio = $(1 \times 16):(2 \times 48)$ = **16:96** or **1:6**

(Ratio × Number of employees)

Calculation of Wages

Pre Incorporation = 4, 80,000 × 1 ÷ 7 = ₹68,571

Post Incorporation = 4, 80,000 × 6 ÷ 7 = ₹4,11,429

Illustration 8

Date of Acquisition: 01 January 2017
Date of Incorporation: 01 July 2017
Discharge of Purchase Consideration to Vendors: 01 September 2017
Date of Closure of Books of Accounts: 31 March 2018
Calculate Revised Time Ratio.

SOLUTION

Revised Time Ratio = Date of Acquisition to Date of Incorporation: Date of Incorporation to Date of Discharge of Purchase Consideration

Revised Time Ratio = 01 January 2017 to 30 June 2017: 01 July 2017 to 1 September 2017
= **6:2 or 3:1**

2

Illustration 9

Violet Inc. was incorporated on 01 March 2017 and procured its Business Commencement Certificate on 01 April 2017. Violet Inc. bought Indigo Inc. on 01 November 2016. From the following figures relating to the year ending 31 October 2017, find out the Pre- and Post-incorporation Profits:

(i) Sales were ₹20,00,000; out of which, Sales up to 01 March 2017 were ₹8,00,000 and up to 01 April 2017 were ₹9,00,000.

(ii) Gross Profit for the year: ₹6,50,000.

(iii) The expenses debited to Profit and Loss Account are given as follows:

Particulars	(₹)
Rent	20,000
Salaries	26,000
Director's Fees	8,000
Interest on Debentures	12,000
Audit Fees	9,000
Discount on Sales	9,600
Depreciation	66,000
General Expenses	11,400
Advertising	44,000
Stationery	12,300
Sales Commission	15,800
Bad Debts (3,000 relates to pre-incorporation period)	6,000
Interest to Vendor on purchase consideration up to 01 May 2017	6,000

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
Gross Profit	Sales (2:3)	2,60,000	3,90,000
Less: Expenses			
Rent	Time (1:2)	6,667	13,333
Salaries	Time (1:2)	8,667	17,333
Director's Fees	-	-	8,000
Interest on Debentures	-	-	12,000
Audit Fees	Time (1:2)	3,000	6,000
Discount on Sales	Sales (2:3)	3,840	5,760
Depreciation	Time (1:2)	22,000	44,000

(*Contd.*)

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
General Expenses	Time (1:2)	3,800	7,600
Advertising	Sales (2:3)	17,600	26,400
Stationery	Time (1:2)	4,100	8,200
Sales Commission	Sales (2:3)	6,320	9,480
Bad Debts	Actual Basis	3,000	6,000
Interest to Vendor	Revised Time Ratio (1:2)	2,000	4,000

Working Notes

(1) Pre-incorporation Period: (November 2016 to February 2017) = 4 months

(2) Post-incorporation Period: (March 2017 to October 2017) = 8 months

(3) Time Ratio: **4:8 or 1:2**

(4) Sales Ratio: 8,00,000: 12,00,000 or **2:3**

(5) Revised Time Ratio:

Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Closing of Books of Accounts

= 01 November 2016 to 28 February 2017: 01 March 2017 to 31 October 2017

= **4:8 or 1:2**

(6) As audit arises only after the company is formed, the Audit Fees may also be allocated wholly to period after incorporation.

(7) Director's Fees and Interest on Debentures are paid after the incorporation and hence relate to Post-incorporation Period.

2

Illustration 10

Sun Ltd. was incorporated on 01 January 2017. On 01 October 2016, the company acquired Moon Ltd. The accounts of the company for the period ended 30 September 2017 revealed a Profit of ₹85,400, after providing for the following expenses:

Salary:	₹18,000 (there were 3 Office Staff in the Pre-incorporation Period and 9 Office Staff Post-incorporation Period)
Wages:	₹21,240 (there were 6 Factory Staff in the Pre-incorporation Period at ₹100 per month per staff and 12 Factory Staff in the Post-incorporation Period at ₹180 per month per staff)
Director's Fees:	₹6,000
Sales:	₹5,50,000 (of which, ₹2,50,000 related to Pre-incorporation Period)

You are required to calculate Profits for Pre- and Post-incorporation Periods.

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
Revenue from Operations (Gross Profit – WN 4)	Sales (5:6)	53,490	64,190
Other Income	-	-	-
Total Revenue (A)		**53,490**	**64,190**
Expenses:			
Employee Benefit Expenses:			
Salaries (WN 3)	Weighted time ratio	1,800	16,200
Wages (WN 2)	Weighted time ratio	1,800	19,440
Other Expenses: Director's Fees	Post-Inc.		6,000
Total Expenses (B)		**3,600**	**41,640**
Net Profit (A – B)		**-**	**22,550**
Capital Profits (A – B)		**49,890**	-

2

Working Notes

(1) *Calculation of Sales Ratio*

Time Ratio:

$\left.\begin{array}{l}\text{Pre-incorporation Period (October to December 2016)} = 3 \text{ months} \\ \text{Post-incorporation period (January to September 2017)} = 9 \text{ months}\end{array}\right\}$ **3:9 or 1:3**

Sales Prior to Incorporation = ₹2,50,000

Sales Post Incorporation = ₹3,00,000

Sales Ratio = **5:6**

(2) *Wages of Factory Staff*

Wages before incorporation:

Pre-incorporation Period × Number of Factory Staff × Rate

$3 \times 6 \times 100 =$ **₹1,800**

Wages after incorporation:

Post-incorporation Period × Number of Factory Staff × Rate

$9 \times 12 \times 180 =$ **₹19,440**

(3) *Salaries of Office Staff*

Simple Time Ratio = 1: 3

Weighted Time Ratio = (1 × 3 Office Staff): (3 × 9 Office Staff)
= **3:27 or 1:9**

Salaries before incorporation: ₹18,000 × 1 ÷ 10 = **₹1,800**

Salaries after incorporation: ₹18,000 × 9 ÷ 10 = **₹16,200**

(4) *Calculation of Gross Profit*

Profit after Charging Expenses	85,400
Add: Salary	18,000
Wages	8,280
Director's Fees	6,000
Gross Profit	**1,17,680**

Illustration 11

2

Amaze Ltd. was incorporated on 01 June 2017 and took over an existing business of Delight Ltd. on 01 April 2017. Following are the details for the year ended 31 March 2018:

Particulars	(₹)
Sales: 1 April 2017 to 31 May 2017	12,000
1 June 2017 to 31 March 2018	38,000
Director's Fees	200
Debentures Interest	640
Depreciation	888
Distribution Expenses (60% variable)	2,500
Sales Commission	1,750
Office Expenses	3,536
Cost of Sales	32,000
Preliminary Expenses written off	400
Goodwill written off	660
Interest Paid to Vendors (Loan repaid up to 01 September 2017)	746
Net Profit	**6,680**

The company witnessed a dip of 10% in Unit Cost of Sale, post incorporation. Compute the Net Profit between both the periods with the bases of apportionment.

SOLUTION

Profit Before and After Incorporation

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
Revenue from Operations (Sales)	Actual	12,000	38,000
Other Income	-	-	-
Total Revenue (A)		**12,000**	**38,000**
Expenses:			
Cost of Sales	60: 171 (WN 4)	8312	23688
Employee Benefit Expenses: Office Expenses	 Time (1:5)	 589	 2947
Finance Cost: Interest to Vendors Debenture Interest	 Revised Time (2:3) Post-Inc.	 298 -	 448 640
Depreciation and Amortisation Expenses: Depreciation Preliminary Expenses written off Goodwill written off	 Time (1:5) Post-Inc. Post-Inc.	 148 - -	 740 400 660
Other Expenses: Selling Commission	 Sales (6:19)	 420	 1330
Distribution Expenses: Fixed (40%) Variable (60%) Director's Fees	 Time (1:5) Sales (6:19) Post-Inc.	 167 360 -	 833 1140 200
Total Expenses (B)		**10,294**	**33,026**
Net Profit (A – B)		**-**	**4,974**
Capital Profits (A – B)		**1,706**	**-**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (April to May 2017) = 2 months

Post-incorporation Period (June to March 2018) = 10 months

Time Ratio = **2:10 or 1:5**

(2) *Sales Ratio*

Pre-incorporation Sales = 12,000

Post-incorporation Sales = 38,000

Sales ratio = 12,000: 38,000 or **6:19**

(3) *Revised Time Ratio*

= Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Repayment of Loan

= 01 April 2017 to 31 May 2017: 01 June 2017 to 31 August 2017

= **2:3**

(4) The ratio for Cost of Sales is calculated as follows: (Decrease in sales of 10% Post-incorporation)

12,000: 38,000 × 90% = 12,000:34200 or **60:171**

Illustration 12

Phoenix Ltd. acquired a business with effect from 01 January 2017. It received its Business Commencement Certificate on 01 May 2017. The Books of Accounts for the year were closed on 30 September 2017. Manager of the firm discontinued work post incorporation. With the following data, ascertain the profits prior to and after incorporation:

Particulars	(₹)
Rent - up to 30 June 2017 (₹50 per month)	300
- July onwards	375
Manager's Salary up to April 2017	1,000
Director's Fees	2,500
Miscellaneous Expenses	7,200
Incorporation Expenses	750
Gross Profit	28,000
Sales (Average Monthly Sales for the first four months of 2017 being half of the remaining period)	4,20,000

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Pre (₹) Incorporation	Post (₹) Incorporation
Revenue from Operations (Gross Profit)	Sales (2:5)	8,000	20,000
Other Income		-	-
Total Revenue (A)		**8,000**	**20,000**
Expenses:			
Employee Benefit Expenses: Manager's Salary (Pre-Inc.)	Actual	1,000	-

(*Contd.*)

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
Other Expenses:			
Miscellaneous Expenses	Time (4:5)	3,200	4,000
Rent	Time (WN 3)	200	475
Director's Fees	Actual		2,500
Incorporation Expenses (Post)	Actual		750
Total Expenses (B)		**4,400**	**7,725**
Net Profit (A – B)		**-**	**12,275**
Capital Profit (A – B)		**3,600**	**-**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (January to April 2017) = 4 months

Post-incorporation Period (May to September 2017) = 5 months

Time Ratio = 4:5

(2) *Sales Ratio*

Interpretation: Average Pre-incorporation Sales is half of the Post-incorporation Sales

Pre-incorporation Sales = $\frac{1}{2} \times 4 = 2$

Post-incorporation Sales = $1 \times 5 = 5$

Sales Ratio = 2:5

(3) *Rent*

Pre-incorporation Rent = ₹50 × 4 months = ₹200

Post-incorporation Rent (May to June 2017) = ₹50 × 2 months = ₹100

(July to September 2017) = ₹375 (given)

Illustration 13

G Ltd. took over H Ltd. on 01 January 2017 and was incorporated on 01 June 2017. The Profit and Loss Account for the year ended 31 December 2017 was as follows:

Particulars	(₹)
Sales:	
Up to 31 May 2017: 1,00,000	
After 01 June 2017: 1,50,000	2,50,000
Purchases	1,00,000
Opening Stock	20,000

(*Contd.*)

Particulars	(₹)
Closing Stock	35,000
Office Expenses	15,000
Selling and Distribution Expenses	30,000
Director's Fees	5,000
Audit Fees	3,000
Preliminary Expenses written off	3,000
Net Profit	74,000

Compute a statement showing Pre and Post-incorporation Profits.

SOLUTION

Profit Before and After Incorporation

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
Revenue from Operations (Sales)	Actual	1,00,000	1,50,000
Other Income	-	-	-
Total Revenue (A)		**1,00,000**	**1,50,000**
Expenses:			
Cost of Goods Sold	Sales (2:3)	34,000	51,000
Depreciation and Amortisation Expenses: Preliminary Expenses written off	Post-Inc.	-	3,000
Other Expenses: Office Expense Selling and Distribution Expenses Director's Fees Audit Fees	 Time (5:7) Sales (2:3) Post-Inc. Post-Inc.	 6,250 12,000 - -	 8,750 18,000 5,000 3,000
Total Expenses (B)		**52,250**	**88,750**
Net Profit (A – B)		**47,750**	**-**
Capital Profit (A – B)		**-**	**61,250**

Working Notes

(1) *Calculation of Cost of Goods Sold*

Cost of Goods Sold = Opening Stock + Purchases – Closing Stock

₹85,000 = 20,000 + 1,00,000 – 35,000

(2) *Calculation of Gross Profit (Gross Profit can also be considered as Revenue from operations)*

Gross Profit = Sales – Cost of Goods Sold

₹1,65,000 = 2,50,000 – 85,000

2

(3) *Time Ratio*

Pre-incorporation Period (January to May 2017) = 5 months

Post-incorporation Period (June to December 2017) = 7 months

Time Ratio = **5:7**

(4) *Sales Ratio*

Pre-incorporation Sales = 1,00,000

Post-incorporation Sales = 1,50,000

Sales Ratio = 1,00,000 : 1,50,000 or **2:3**

Illustration 14

Sai Krishna Ltd., incorporated on 1 July 2017, had acquired an on-going business on 01 April 2017. The consideration to be paid for the purchase of the on-going business was agreed at ₹20,00,000, but it was paid only on 30 September 2017, with an interest of 12% per annum. The Books of Accounts were closed on 31 March 2018. Prepare the Profit and Loss Account to show profit earned before and after incorporation, with the help of the information given as follows:

2

Particulars	(₹)
Salaries	8,50,000
Managing Director's Remuneration	65,000
Advertisements	5,00,000
Discounts	6,00,000
Office Expenses	2,00,000
Rent	12,43,000
Interest	8,00,000
Depreciation	1,65,000
Cost of Goods Sold	38,00,000
Sales	86,00,000
Profit	10,55,000

The sales of the newly incorporated company were twice the Average Monthly Sales post incorporation. While the Salaries were three times more than what was paid prior to incorporation, due to expansion in the activities, the office space also had to be expanded. This resulted in an additional rental of ₹85,000 from 01 September 2017.

SOLUTION

Profit Before and After Incorporation

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
Revenue from Operations (Sales)	Sales	18,86,250	67,13,750
Other Income	-	-	-
Total Revenue (A)		**18,86,250**	**67,13,750**
Expenses:			
Cost of Goods Sold	Sales	5,42,857	32,57,143
Employee Benefit Expenses:			
Salaries	Time (WN 4)	85,000	7,65,000
Managing Director's Remuneration	Post	-	65,000
Finance Cost: Interest	Revised time (WN 3)	4,00,000	4,00,000
Depreciation and Amortisation Expenses:			
Depreciation	Time	41,250	1,23,750
Other Expenses:			
Advertisements	Sales	71,429	4,28,571
Discounts	Sales	85,714	5,14,286
Office Expenses	Time	50,000	1,50,000
Rent	Time (WN 5)	1,62,000	10,81,000
Total Expenses (B)		**14,38,250**	**67,84,750**
Net Loss (A – B)		**-**	**71,000**
Capital Profits (A – B)		**4,48,000**	**-**

Working Notes

(1) *Calculation of Sales Ratio*

Pre-incorporation Period (April to June 2017) = 3 months

Post-incorporation Period (July to March 2018) = 9 months

Pre-incorporation Sales = 86, 00,000 × 3/12 = ₹18, 86,250

Post-incorporation Sales = 86, 00,000 × 9/12
= ₹67, 13,750 × 2 (two times increase in sales post incorporation)

Alternatively, (3 × 1): (9 × 2) = 3:18 or 1:6

(2) *Time Ratio* = 3: 9 or 1:3

(3) *Revised Time Ratio to Calculate Interest to Vendors*

= Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Repayment of Loan

= 01 April 2017 to 1 July 2017: 1 July 2017 to 30 September 2017
= **3:3 = 1:1**

(4) *Ratio of Office Salaries*

Pre-incorporation Period (April to June 2017) = 3 × 1

Post-incorporation Period (July to March 2018) = 9 × 3 (3 times increase in salaries post incorporation)

Ratio = **3:27 or 1:9**

(5) *Apportionment of Rent*

Total Rent (given) = ₹12,43,000

Less: Additional rent post incorporation for 7 months (01/09/2017– 31/03/2018)

(85,000 × 7) = ₹5,95,000

Office Rent of Old Premises = ₹6,48,000

Monthly Rent = 6,48,000 ÷ 12 months = ₹54,000

2

	Pre-incorporation (3 months) (₹)	Post-incorporation (9 months) (₹)
Rent of Old Office Premises at the rate of ₹54,000 per month	1,62,000	4,86,000
Rent of Additional Office Premises at the rate of ₹85,000 per month	-	5,95,000
Total Rent	**1,62,000**	**10,81,000**

Illustration 15

Ravi Ltd. took over the going concern, Chandra Ltd., on 01 April 2017, and was incorporated on 01 August 2017. From the following information for the year ended 31 March 2018, show the Statement for Pre- and Post-incorporation Periods:

Particulars	(₹)	Particulars	(₹)
To Rent	19,200	By Gross Profit b/d	1,60,000
To Salaries	42,000	By Miscellaneous Income	2,000
To Director's Fees	2,000		
To Auditor's Fees	1,200		
To Partner's Salary	12,000		
To Bad Debts	2,400		
To Sales Commission	8,000		
To Preliminary Expenses	1,400		
To Debenture Interest	3,200		
To Interest of Capital	3,600		

(*Contd.*)

Particulars	(₹)	Particulars	(₹)
To Depreciation	4,200		
To Electricity Charges	1,800		
To Travelling Expenses	8,000		
To Advertisement	8,800		
To Printing and Stationery	3,000		

Additional Information

(i) Total Sales for the year were ₹16,00,000.

(ii) Gross Profit was at 10% of Sales. Commission was paid at 0.5% of Sales.

(iii) Rent up to 30 September 2017 was ₹16,800 per annum. The increase from 01 October 2017 was ₹21,600 per annum.

(iv) Expenses incurred on travelling were to promote Sales during the third quarter.

(v) Depreciation Charge amounting to ₹1,200 was towards the Assets acquired post incorporation.

(vi) Bad Debts written off:

(a) Debt for Goods Sold in September 2017: ₹1,600

(b) Debt taken over from the vendor: ₹800

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
Revenue from Operations (Gross Profit)	Sales (1:2)	53,333	1,06,667
Other Income	Actual	-	2,000
Total Revenue (A)		**53,333**	**1,08,667**
Expenses:			
Employee Benefit Expenses:			
Salaries	Time	14,000	28,000
Finance Cost:			
Interest on Capital	Actual	3,600	-
Interest on Debenture	Actual	-	3,200
Depreciation and Amortisation Expenses:			
Depreciation	Time (WN 4)	1,000	3,200
Preliminary Expenses	Actual	-	1,400
Other Expenses:			
Rent	Time (WN 3)	5,600	13,600
Advertisements	Sales (1:2)	2,933	5,867

(*Contd.*)

Particulars	Basis of Allocation	Pre (₹)	Post (₹)
		Incorporation	
Printing and Stationery	Time	1,000	2,000
Travelling Expenses	Actual	Nil	8,000
Electricity Charges	Time	600	1,200
Director's Fees	Actual	-	2,000
Auditor's Fees	Time	400	800
Bad Debts	Actual	800	1,600
Sales Commission	Sales (1:2)	2,667	5,333
Partner's Salary	Actual	12,000	-
Total Expenses (B)		**44,600**	**76,200**
Net Profit (A – B)		**-**	**32,467**
Capital Loss (A – B)		**8,733**	**-**

Note: Sales during the third quarter relates to Post-incorporation period therefore travelling expenses are assigned to Post-incorporation period.

2

Working Notes

(1) *Sales Ratio*

Pre-incorporation Period (April to July 2017) = 4 months

Post-incorporation Period (August 2017 to March 2018) = 8 months

Therefore, Sales Ratio = **4:8 or 1:2**

(2) *Time Ratio*

Pre-incorporation Period (April to July 2017) = 4 months

Post-incorporation Period (August 2017 to March 2018) = 8 months

Time Ratio = 4:8 or 1:2

(3) *Office Rent*

Pre-incorporation: April to July = 16,800 × 4 ÷ 12 = ₹5,600

Post-incorporation:
$$\left\{\begin{array}{l}\text{August to September} = 16{,}800 \times 2 \div 12 = ₹2{,}800 \\ \text{October to March} = 21{,}600 \times 6 \div 12 = ₹10{,}800\end{array}\right\} \mathbf{13{,}600}$$

(4) *Depreciation*

	Pre-Inc. (₹)	Post-Inc. (₹)
On Post-incorporation Assets	-	1,200
Balance ₹3,000 on the basis of Time Ratio (1:2)	1,000	2,000
(4,200 – 1,200)	**1,000**	**3,200**

Illustration 16

Sundrop Ltd. was incorporated on 01 April 2017. Prior to this, Sundrop Ltd. had purchased the business of Moonlight Ltd. on 01 January 2017. The Books of Accounts of the firm were closed on 31 December 2017.

	(₹)		(₹)
To Carriage Outward	1,100	By Gross Profit	1,90,000
To Rent	15,600	By Share Transfer Fees	6,000
To Salaries	30,000	By Discount received on purchases	5,000
To Director's Fees	10,800	By Interest Income received on deposits made in the bank after April 2017	1,000
To Sales Commission	6,000		
To Discount	1,750		
To Sales Expenses	2,750		
To Advertisement	7,600		
To Bank Charges	1,400		
To Repairs	4,900		
To Insurance	800		
To Depreciation	18,000		
To Bad Debts	3,600		
To Interest on Debentures	7,400		
To Interest to Vendor (Loan repaid on 31 August 2017)	8,000		
To Discount on Issue of Debentures	3,750		
To Preliminary Expenses	5,800		
To Postage	700		
To Packing	4,500		
To Printing	3,800		

Additional Information

(i) The Commission received by the agent is a fixed percentage of the sales target achieved by the agent. The agent received a Commission of ₹2,000 before and ₹4,000 after incorporation, respectively. However, the Rate of Commission doubled after 01 April 2017.

(ii) The information on Sales is not known; however, it is presumed that entire Sales are made through an agent on a fixed percentage of the Commission.

(iii) The numbers of employees were 4 up to June 2017, and increased to 8 in July 2017.

(iv) Purchases for the first six months of the calendar year were ₹36,000 per month and the next six months were ₹44,000 per month.

(v) Rent up to 31 May 2017 remained the same, after which it was two times more than the amount paid earlier.

2

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Pre (₹)	Post (₹)
			Incorporation	
Revenue from operations (Gross Profit)	Sales (WN3)	1:4	47,500	1,42,500
Other Income:				
Share Transfer Fees	Actual	(Post-Inc.)	-	6,000
Interest on Deposits	Actual	(Post-Inc.)	-	1,000
Discount on Purchases	Purchases (WN6)	9:31	1,125	3,875
Total Revenue (A)			**48,625**	**1,53,375**
Expenses:				
Employee Benefit Expenses:				
Salaries	(WN 4)	1:5	5,000	25,000
Finance Cost:				
Interest on Debenture	Actual	(Post-Inc.)	-	7,400
Interest on Vendor	(WN2)	3:5	3,000	5,000
Bank Charges	Time	1:3	350	1,050
Depreciation and Amortisation Expenses:				
Depreciation	Time	1:3	4,500	13,500
Preliminary Expenses	Actual	(Post-Inc.)	-	5,800
Discount on Issue of Shares and Debenture	Actual	(Post-Inc.)	-	3,750
Other Expenses:				
Rent	(WN5)	3:16	2,463	13,137
Repairs	Time	1:3	1,225	3,675
Insurance	Time	1:3	200	600
Packing	Sales	1:2	1,500	3,000
Printing	Time	1:3	950	2,850
Advertisement	Sales	1:2	2,533	5,067
Discount	Sales	1:2	583	1,167
Director's Fees	Actual	(Post-Inc.)	-	10,800
Bad Debts	Sales	1:2	1,200	2,400
Selling Expenses	Sales	1:2	917	1,833
Postage	Time	1:3	175	525
Commission	Given	-	2,000	4,000
Carriage Outward	Sales	1:2	367	733
Total Expenses (B)			**26,963**	**1,06,762**
Net Profit (A – B)			**-**	**46,613**
Capital Profit (A – B)			**21,662**	**-**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (January to March 2017) = 3 months

Post-incorporation Period (April 2017 to December 2017) = 9 months

Time Ratio = 3:9 or 1:3

(2) *Revised Time Ratio to calculate Interest to Vendors*

= Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Repayment of Loan

= 01 January 2017 to 31 March 2017: 01 April 2017 to 31 August 2017

= 3:5

(3) *Sales Ratio (on the basis of commission to agents)*

Pre-incorporation Commission = 2000

Post-incorporation Commission = 4000 (Commission doubled after 01 April 2017)

Sales Ratio = 2000: 4000 or 1:2

(4) *Salary*

Pre-incorporation period (January to March 2017) = 3 months × 4 employees = 12

$$\left.\begin{array}{r}\text{Post-incorporation period (April to June 2017)} = 3 \text{ months} \times 4 \text{ employees} = 12\\ \text{(July to December 2017)} = 6 \text{ months} \times 8 \text{ employees} = 48\end{array}\right\} = 60$$

Salary Ratio = 12: 60 or 1:5

(5) *Rent*

Pre-incorporation Period (January to March 2017) = 3 months × 1

$$\left.\begin{array}{r}\text{Post-incorporation Period (April to May 2017)} = 2 \text{ months} \times 1\\ \text{(June to December 2017)} = 7 \text{ months} \times 2\end{array}\right\}\text{(Rent doubled from June)}$$

Rent Ratio = 3:16

(6) *Discount Received on Purchases*

Pre-incorporation Period (January to March 2017) = 3 months × 36,000 = 1,08,000

$$\left.\begin{array}{r}\text{Post-incorporation Period (April to June 2017)} = 3 \text{ months} \times 36,000 = 1,08,000\\ \text{(July to December 2017)} = 6 \text{ months} \times 44,000 = 2,64,000\end{array}\right\}$$

Discount of Purchases = 1,08,000: 3,72,000 or 27: 93 or 9:31

Illustration 17

Pradhan Ltd. was incorporated on 01 January 2017 and took over an on-going concern, Pawan Ltd., for a Purchase Price of ₹40,000 as on 01 October 2016, for interest at 10% per annum by fully paid shares for ₹17,500 and the balance by cheque. The Purchase Price was settled on 31 March 2017. As on its Date of Incorporation, Pradhan Ltd. had a capital of 50,000 shares of ₹10 each.

The company's Trial Balance as on 30 September 2017 is given as follows:

	(₹)	(₹)
Cash and Bank Balances (Cash ₹360)	9,720	-
Share Capital (₹10 per share)	-	45,000
Land and Building	16,000	-
Furniture	1,500	-
Loose Tools	2,000	-
Salaries	2,400	-
Purchases	97,000	-
Sales	-	90,000
Debtors & Creditors	9,000	6,000
Rent from Tenants	-	1,200
Rent, Rates and Taxes	600	-
Office Expenses	300	-
Director's Fees	1,440	-
Sundry Charges	240	-
Interest to Vendor	2,000	-
	1,42,200	**1,42,200**

Draft the final accounts for the year ending 30 September 2017, by taking the following information into account:

(i) Closing Stock: ₹28,000

(ii) Bad Debts to be written off:
   (a) Debt on Goods Sold: ₹400
   (b) Debt taken over from the vendor: ₹100

(iii) Sales of Pre-incorporation Period = ₹15,000

(iv) Depreciation on Building is 5% and on Loose Tools is 20%.

(v) Provision for Doubtful Debt: ₹500.

SOLUTION

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Pre (₹)	Post (₹)
			Incorporation	
Revenue from Operations (Gross Profit) (WN4)	Sales (WN3)	1:5	3,500	17,500
Other Income: Rent from Tenants	Time	1: 3	300	900
Total Revenue (A)			**3,800**	**18,400**
Expenses: Employee Benefit Expenses: Salaries	Time	1:3	600	1,800
Finance Cost: Interest on Vendor	Revised time	1:1	1,000	1,000
Depreciation and Amortisation Expenses: Depreciation Building at the rate of 5% Loose Tools at the rate of 20%	 Time Time	 1:3 1:3	 200 100	 600 300
Other Expenses: Rent Office Expenses Director's Fees Sundry Charges Bad Debts Provision for Doubtful Debt	 Time Time Actual Time Sales Actual	 1:3 1:3 Post-Inc. 1:3 1:5 Post-Inc.	 150 75 - 60 83 -	 450 225 1,440 180 417 500
Total Expenses (B)			**2,268**	**6,912**
Net Profit (A – B)			**-**	**11,488**
Capital Profit (A – B)			**1,532**	**-**

BALANCE SHEET OF PRADHAN LTD.
As on 30 September 2017

Particulars	(₹)	(₹)
Equity and Liabilities		
(1) Shareholders Funds		
(i) Share Capital		45,000
Authorised, Subscribed, Issued and Paid-up Capital 4,500 equity shares of ₹10 each. (out of the above 1,750 shares were allotted as fully paid to vendors for purchase of business)		
(ii) Reserves and Surplus:		
Capital Reserve (Profit before Incorporation)	1,532	
Surplus A/c (Profit after Incorporation)	11,488	13020

(*Contd.*)

Particulars	(₹)	(₹)
(2) Non-Current Liabilities	-	-
(3) Current Liabilities		
Creditors		6,000
Total Equities and Liabilities (1+2+3)		**64,020**
Assets		
(1) Fixed Assets		
Building	16,000	
Less: Depreciation	800	15,200
Loose Tools	2,000	
Less: Depreciation	400	1,600
Furniture	1,500	1,500
(2) Current Assets		
Stock		28,000
Debtors (9000 – 500 Bad Debt)	8,500	
Less: Provision for Doubtful Debt	500	8,000
Cash at Bank (9,720 – 360)		9,360
Cash in hand		360
Total Assets (1+2)		**64,020**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (October to December 2016) = 3 months

Post-incorporation Period (January 2017 to September 2017) = 9 months

Time Ratio = 3:9 or 1:3

(2) *Revised Time Ratio to Calculate Interest to Vendors*

= Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Repayment of Loan

= 01 October 2016 to 31 December 2016: 01 January 2017 to 31 March 2017

= 3:3 or 1: 1

(3) *Sales Ratio*

Pre-incorporation Sales = ₹15,000

Post-incorporation Sales = ₹75,000 (90,000 – 15,000)

Sales Ratio = 15,000:75,000 or 1:5

(4) *Calculation of Gross Profit*

Opening Stock + Purchases – Closing Stock = Cost of Goods Sold

Nil + 97,000 – 28,000 = 69,000

Sales – Cost of Goods Sold = Gross Profit

90,000 – 69,000 = 21,000

Illustration 18

Singhania Co. Ltd. took over the business of Shubham Ltd. on 01 April 2017. As per the terms of the agreement, all Profits made by the company after 01 April 2017 belong to Singhania Co. Ltd. and the amount of consideration was agreed at ₹3,50,000. The vendors were to receive half of it in cash on 01 October 2017, along with interest at the rate of 10% per annum and the other half was through allotment of 1,750 shares priced at ₹100 each. Draft the accounts of company with the help of the following information, assuming that Singhania Co. Ltd. received its Business Commencement Certificate on 01 July 2017 and Books of Accounts are closed on 31 March 2018:

Particulars	(₹)	Particulars	(₹)
Purchases	3,85,000	Bank Overdraft	82,500
Sales	4,55,000	Debtors	47,500
Share Capital (2,250 shares of ₹100 each)	2,25,000	Creditors	32,500
Goodwill	1,450	Cash in Hand	6,000
Opening Stock	2,10,000	Interest of Vendors	8,750
Building	65,000	Directors Fees	1,200
Furniture	7,500	Miscellaneous Expenses	11,000
Plant and Machinery	17,500	Rent Received	6,500
Land	25,000	Taxes and Insurance	3,500
Unsecured Loans	17,500	Repairs to Building	1,500
Preliminary Expenses to be written off	4,000	Salaries	24,000

Additional Information

(i) Closing Stock: ₹2,40,000

(ii) Bad Debts: ₹500 (₹250 relates to the Shubham Ltd.)

(iii) Provision for Doubtful Debts: ₹2500

(iv) Depreciation has to be written off:

(a) Building: 5%

(b) Furniture: 10%

(c) Plant and Machinery: 20%

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Pre (₹)	Post (₹)
			Incorporation	
Revenue from Operations (Gross Profit)(WN3)	Time	1:3	25,000	75,000
Other Income: Rent	Time	1:3	1,625	4,875
Total Revenue (A)			**26,625**	**79,875**
Expenses: Employee Benefit Expenses: Salaries	Time	1:3	6,000	18,000
Finance Cost: Interest to Vendor	Revised Time	1:1	4,375	4,375
Depreciation and Amortisation Expenses: Depreciation Building at the rate of 5% Furniture at the rate of 10% Plant and Machinery at the rate of 20%	 Time Time Time	 1:3 1:3 1:3	 812.50 187.50 875	 2,437.50 562.50 2,625
Other Expenses: Preliminary Expenses written off Taxes and Insurance Repairs to Building Bad Debts Provision for Doubtful Debts Director's Fees Miscellaneous Expenses	 Actual Time Time Actual Actual Actual Time	 Post-Inc. 1:3 1:3 (given) Post-Inc. Post-Inc. 1:3	 - 875 375 250 - - 2,750	 4,000 2,625 1,225 250 2,500 1,200 8,250
Total Expenses (B)			**16,500**	**48,050**
Net Profit (A – B)			**-**	**31,825**
Capital Profit (A – B)			**10,125**	**-**

BALANCE SHEET OF PRADHAN LTD.
As on 30 September 2017

Particulars	(₹)	(₹)
Equity and Liabilities: (1) Shareholders Funds (i) Share Capital Authorised, Subscribed, Issued and Paid-up Capital 2,250 equity shares of ₹100 each (out of the above 1,750 shares were allotted as fully paid to vendors for purchase of business) (ii) Reserves and Surplus: Capital Reserve (Profit before Incorporation) Surplus A/c (Profit after Incorporation)	 10,125 31,825	 2,25,000 41,950

(*Contd.*)

Particulars	(₹)	(₹)
(2) Non-Current Liabilities		
Bank Overdraft	82,500	
Unsecured Loan	17,500	
(3) Current Liabilities:		1,00,000
Creditors		32,500
Total Equities and Liabilities (1+2+3)		**3,99,450**
Assets:		
(1) Fixed Assets		
Land		25,000
Building	65,000	
Less: Depreciation	3,250	61,750
Furniture	7,500	
Less: Depreciation	750	6,750
Plant and Machinery	17,500	
Less: Depreciation	3,500	14,000
(2) Intangible Assets: Goodwill		1,450
(3) Current Assets		
Stock		2,40,000
Debtors (47,500 – 500 Bad Debt)	47,000	
Less: Provision for Doubtful Debt	2,500	44,500
Cash in hand		6,000
Total Assets (1+2)		**3,99,450**

2

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (April to June 2017) = 3 months

Post-incorporation Period (July 2017 to March 2018) = 9 months

Time Ratio = 3:9 or 1:3

(2) *Revised Time Ratio to calculate Interest to Vendors*

= Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Repayment of Loan

= 01 April 2017 to 30 June 2017: 01 July 2017 to 01 October 2017

= 3:3 or 1: 1

(3) *Calculation of Gross Profit*

Opening Stock + Purchases – Closing Stock = Cost of Goods Sold

2,10,000 + 3,85,000 – 2,40,000 = ₹3,55,000

Sales – Cost of Goods Sold = Gross Profit

4,55,000 – 3, 55,000 = ₹1,00,000

Illustration 19

SS Ltd. was incorporated on 01 July 2012 to take over the running business of M/s SK and Co., with effect from 01 April 2012. The company closes its Books of Accounts on 31 March 2013.

There were 50 employees during the Pre-incorporation Period and it was increased to 70 employees during the Post-incorporation Period.

Average Monthly Sales during the Pre-incorporation Period were ₹1, 00,000 and the Average Monthly Sales of Post-incorporation Period was ₹2,50,000. Prepare a statement showing how the following expenses are allocated between Pre- and Post-incorporation Periods.

Rent: ₹96,000; Salary: ₹3,12,000; Salesman Commission: ₹1,02,000 and Director's Fees: ₹25,000.

[Bangalore University, Nov/Dec 2013, Section C]

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Total (₹)	Pre (₹) Incorporation	Post (₹) Incorporation
Rent	Time	1:3	96,000	24,000	72,000
Salary	Time or number of employees (50:70)	5:7	3,12,000	1,30,000	1,82,000
Salesman's Commission	Sales	6:45	1,02,000	12,000	90,000
Director's Fees	Actual	Post	25,000	-	25,000
Total	-	-	**5,35,000**	**1,66,000**	**3,69,000**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (April to June 2012) = 3 months

Post-incorporation Period (July 2012 to March 2013) = 9 months

Time Ratio = 3:9 or 1:3

(2) *Sales Ratio*

Average Monthly Pre-incorporation Sales = 1,00,000 × 3 months = ₹3,00,000

Average Monthly Post-incorporation Sales = 2,50,000 × 9 months = ₹22,50,000

Sales Ratio = 3,00,000: 22,50,000 or 6:45

Illustration 20

RKS Ltd. was incorporated on 01 September 2012 to take over the running business of M/s SK & Co., with effect from 01 April 2012. The company closed its Books of Accounts on 31 March 2013. Following are the incomes and expenses of RKS Ltd., for the year ending 31 March 2013.

Particulars	(₹)	Particulars	(₹)
Gross Profit	24,00,000	Interest to Vendors (31.1.2013)	60,000
Discount Earned	1,14,000	Rent Paid	96,000
Interest on Investments	1,20,000	Selling Expenses	54,000
Salary and Wages	3,60,000	Director's Fees	30,000
Discount Allowed	2,16,000	Auditor's Fees	24,000
Preliminary Expenses written off	10,000	Depreciation	1,44,000
General Expenses	24,000	Insurance	12,000
Carriage Outward	5,400	Carriage Inward	2,280
Bad Debts	3,600	Interest on Debentures	24,000

Additional Information

(i) Average Monthly Purchases during the Pre-incorporation Period was ₹1,50,000 and the Average Monthly Purchases of Post-incorporation Period was ₹3,00,000.

(ii) Average Monthly Sales during the Pre-incorporation Period was ₹2,00,000 and the Average Monthly Sales of Post-incorporation Period was ₹5,00,000.

Prepare a statement showing the allocation of aforementioned items between Pre and Post-incorporation Periods and state how the Pre- and Post-incorporation Profits are dealt within the Books of Accounts.

[Bangalore University, Nov/Dec 2013, Section C]

SOLUTION

Statement Showing Allocation of Expenses

Particulars	Basis of Allocation	Ratio	(₹) Total	Pre (₹)	Post (₹)
				Incorporation	
Revenue from Operation (Gross Profit)	Sales	2:7	24,00,000	5,33,333	18,66,667
Other Income:					
Discount Earned	Purchase	5:14	1,14,000	30,000	84,000
Interest on Investments	Time	5:7	1,20,000	50,000	70,000
Total Revenue (A)			**26,34,000**	**6,13,333**	**20,20,667**
Expenses:					
Employee Benefit Expenses:					
Salaries	Time	5:7	3,60,000	1,50,000	2,10,000
Finance Cost:					
Interest to Vendor	Revised Time	1:1	60,000	30,000	30,000
Interest on Debenture	Actual Ratio	–	24,000	–	24,000
Depreciation and Amortisation Expenses:					
Depreciation	Time	5:7	1,44,000	60,000	84,000
Preliminary Expenses Written off	Post-Inc.		10,000	–	10,000

(*Contd.*)

Particulars	Basis of Allocation	Ratio	(₹) Total	Pre (₹)	Post (₹)
				Incorporation	
Other Expenses:					
Discount Allowed	Sales	2:7	2,16,000	48,000	1,68,000
General Expenses	Time	5:7	24,000	10,000	14,000
Carriage Outwards	Sales	2:7	5,400	1,200	4,200
Bad Debts	Sales	2:7	3,600	800	2,800
Rent Paid	Time	5:7	96,000	40,000	56,000
Selling Expenses	Sales	2:7	54,000	12,000	42,000
Director Fee	Post-Inc.	Actual	30,000	–	30,000
Auditors Fee	Time	5:7	24,000	10,000	14,000
Insurance	Time	5:7	12,000	5,000	7,000
Total Expenses (B)				**3,67,000**	**6,96,000**
Net Profit (A – B)			**1,06,300**		**13,24,667**
Capital Profit (A – B)				**2,46,333**	

2

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (April to August 2012) = 5 months

Post-incorporation Period (September 2012 to March 2013) = 7 months

Time Ratio = 5:7

(2) *Revised Time Ratio to Calculate Interest to Vendors*

= Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Repayment of Loan

= 01 April 2012 to 30 August 2012: 01 September 2012 to 31 January 2013

= 5:5 or 1: 1

(3) *Sales Ratio*

Pre-incorporation Sales = 2, 00,000 × 5 = ₹10, 00,000

Post-incorporation Sales = 5,00,000 × 7 = ₹35,00,000

Sales Ratio = 10:35 or 2:7

(3) *Purchases Ratio*

Pre-incorporation Purchase = 1, 50,000 × 5 = ₹7, 50,000

Post-incorporation Purchase = 3,00,000 × 7 = ₹21,00,000

Purchases Ratio = 75:210 or 5:14

Illustration 21

Swetha Ltd. was incorporated on 01 August 2013 to take over the running business of Soumya Ltd. from 01 April 2013. Figures of the company for the year ending 31 March 2014 were as follows:

Particulars	(₹)	Particulars	(₹)
To Salaries and Allowances	60,000	By Gross Profit	2,00,000
To Rent and Taxes	23,000		
To General Expenses	7,200		
To Director's Fees	3,000		
To Selling Expenses	4,000		
To Discount on Sales	1,000		
To Advertisement	7,500		
To Preliminary Expenses written off	3,300		
To Interest on Debentures	1,400		
To Interest on Vendors (Up to 30 September 2013)	6,000		
To Repairs to Buildings	1,200		
To Depreciation	2,400		
To Net Profit	80,000		
Total	**2,00,000**	**Total**	**2,00,000**

Additional Information

(i) Rent was paid at ₹1,000 per month up to 01 August 2013 and thereafter, it was increased to ₹2,000 per month.

(ii) The Average Monthly Sales during the Pre-incorporation Period was ₹60,000 and the Average Monthly Sales of Post-incorporation Period was ₹70,000.

Prepare a Statement of Profit and Loss showing Profit prior to and after incorporation of the company.

[Bangalore University, Nov/Dec 2014, Section C]

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Total (₹)	Pre (₹) Incorporation	Post (₹) Incorporation
Revenue from Operations (Gross Profit)	Sales	3:7	2,00,000	60,000	1,40,000
Other Income:	-	-	-	-	-
Total Revenue (A)	**-**	**-**	**2,00,000**	**60,000**	**1,40,000**
Expenses: Employee Benefit Expenses: Salaries and Allowances	Time	1:2	60,000	20,000	40,000

(*Contd.*)

Finance Cost:					
Interest on Debentures	Post-Inc.	-	1,400	-	1,400
Interest to Vendors	Revised Time	2:1	6,000	4,000	2,000
Depreciation and Amortisation Expenses:					
Depreciation	Time	1:2	2,400	800	1,600
Preliminary Expenses written off	Actual	Post-Inc.	3,300	-	3,300
Other Expenses:					
Rent	Time	WN	20,000	4,000	16,000
Taxes (23,000 – 20,000)	Time	1:2	3,000	1,000	2,000
Director's Fees	Post-Inc.	Actual	3,000	-	3,000
Selling Expenses	Sales	3:7	4,000	1,200	2,800
Discount on Sales	Sales	3:7	1,000	300	700
Advertisement	Sales	3:7	7,500	2,250	5,250
Repairs to Building	Time	1:2	1,200	400	800
General Expenses	Time	1:2	7,200	2,400	4,800
Total Expenses (B)			**1,20,000**	**36,350**	**83,650**
Net Profit (A – B)			**80,000**	**-**	**56,350**
Capital Profit (A – B)				**23,650**	**-**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (April to July 2013) = 4 months

Post-incorporation Period (August 2013 to March 2014) = 8 months

Time Ratio = 4:8 or 1:2

(2) *Revised Time Ratio to Calculate Interest to Vendors*

= Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Repayment of Loan
(Interest is paid up to 30 September 2013)

= 01 April 2013 to 1 August 2013: 01 August 2013 to 30 September 2013

= 4:2 or 2:1

(3) *Sales Ratio*

Pre-incorporation Sales = ₹60,000 × 4 = 2,40,000

Post-incorporation Sales = ₹70,000 × 8 = 5,60,000

Sales Ratio = 2,40,000:5,60,000 or 24:56 or **3:7**

(4) *Rent Paid*

Pre-incorporation Period = 1,000 × 4 = 4,000

Post-incorporation Period = 2,000 × 8 = 16,000

Illustration 22

Anirudha Ltd. took over the business of Shankar on 01 April 2014 and it was incorporated on 01 July 2014.

The Profit and Loss Account of Anirudha Ltd. on 31 March 2014 was as follows:

Particulars	(₹)	Particulars	(₹)
To Commission (Sales)	2,625	By Gross Profit	98,000
To Advertising	5250	By Bad Debts Recovered	500
To Managing Director's Remuneration	9,000		
To Depreciation	2,800		
To Salaries	18,000		
To Insurance	600		
To Preliminary Expenses written off	700		
To Rent and Taxes	3,000		
To Discount	350		
To Bad Debts	1,250		
To Net Profit	54,925		
	98,500		**98,500**

Additional Information

(i) The Average Monthly Sales after incorporation were twice the earlier Average Monthly Sales.

(ii) Rent was paid for the first three months at ₹200 per month, and was increased by ₹50 per month for the balance of the period.

(iii) Bad Debts of ₹350 related only to the period after 01 September 2014 and the balance related to the sales made up to 01 September 2014.

(iv) The Bad Debts realised belong to the Debts, which were written off during 2013–14.

Find out the Profits before and after incorporation.

[Bangalore University, Nov/Dec 2015, Section C]

SOLUTION

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Total (₹)	Pre (₹) Incorporation	Post (₹) Incorporation
Revenue from Operations (Gross Profit)	Sales	1:6	98,000	14,000	84,000
Other Income: Bad Debts Recovered	Pre-Inc.		500	500	-
Total Revenue (A)	-	-	**98,500**	**14,500**	**84,000**

(*Contd.*)

Particulars	Basis of Allocation	Ratio	Total	Pre (₹)	Post (₹)
			(₹)	Incorporation	
Expenses:					
Employee Benefit Expenses:					
Salaries and Allowances	Time	1:3	18,000	4,500	13,500
Finance Cost:	-	-	-	-	-
Depreciation and Amortisation Expenses:					
Depreciation	Time	1:3	2,800	700	2,100
Preliminary expenses written off	Actual	Post-Inc.	700	-	700
Other Expenses:					
Commission	Sales		2,625	375	2,250
Advertising	Sales	1:6	5,250	750	4,500
MD's Remuneration	Post	1:6	9,000	-	9,000
Rent	Actual	-	2,850	600	2,250
Taxes	Time	1:3	150	38	112
Discount	Sales	1:3	350	50	300
Bad Debts	Actual		1,250	540	710
Total Expenses (B)			**42,975**	**7,553**	**35,422**
Net Profit (A – B)			**55,525**	**-**	**48,578**
Capital Profit (A – B)				**6,947**	**-**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (April to June 2014) = 3 months

Post-incorporation Period (July 2014 to March 2015) = 9 months

Time Ratio = 3:9 or 1:3

(2) *Sales Ratio*

Pre-incorporation Sales is assumed to be 1: 1 × 3 months = 3

Post-incorporation Sales is assumed to be 2: 2 × 9 months = 18 (The sales are two times of the Pre-incorporation Sales)

Sales Ratio = 3:18 or 1:6

(3) *Calculation of Distribution of Bad Debts*

Total Bad Debts = ₹1,250

₹350 relates to Post-incorporation Period

The balance Bad Debt of ₹900 has to be distributed between Pre- and Post-incorporation Periods (01 April 2014 to 31 August 2014 = 5 months).

Pre-incorporation Period = 01 April 2014 to 31 June 2014 = 3 months

Post-incorporation Period = 01 July 2014 to 31 August 2014 = 2 months

Ratio = 3:2

Pre-incorporation Period = 900 × 3/5 = ₹540

Post-incorporation Period = 900 × 2/5 = ₹360 +350 = ₹710

(4) *Calculation of Distribution of Rent and Taxes*

Total Rent and Taxes (given) = ₹3,000

Pre-incorporation Rent = 200 × 3 months = 600

Post-incorporation Rent = 250 × 9 months = 2,250

Total Rent = 2,850

Therefore, Taxes = 3,000 – 2,850 = ₹150

Pre-incorporation Taxes = 150 × 3/12 = ₹38

Post-incorporation Taxes = 150 × 9/12 = ₹112

Illustration 23

G Ltd. took over the business of H Ltd. on 01 April 2015 and it was incorporated on 01 July 2015. The Profit and Loss Account of G Ltd. on 31 March 2016 was as follows:

(i) The Average Monthly Sales after incorporation were twice the earlier Average Monthly Sales.

(ii) Rent, paid for the first three months at the rate of ₹2,000 per month, was increased by ₹500 per month, for the balance of the period.

(iii) Bad Debts of ₹3,500 related to the period after 01 September 2015 and the balance related to the Sales made up to 01 September 2015.

(iv) The Bad Debts recovered belonged to the Debts, which were written off in 2014.

Find out the Profits before and after the incorporation of the company.

Profit and Loss Account for the year ended 31 March 2016

Particulars	(₹)	Particulars	(₹)
To Commission on Sales	26,250	By Gross Profit (Operating Profit)	9,80,000
To Advertising	52,500	By Bad Debts Recovered	5,000
To MD's Remuneration	90,000		
To Depreciation	28,000		
To Salaries	1,80,000		
To Insurance	6,000		
To Preliminary Expenses	7,000		
To Rent and Taxes	30,000		
To Discount	3,500		
To Bad Debts	12,500		
To Net Profit	5,49,250		
	9,85,000		**9,85,000**

[Bangalore University, Nov/Dec 2016, Section C]

SOLUTION

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Total	Pre (₹)	Post (₹)
			(₹)	Incorporation	
Revenue from Operations (Gross Profit)	Sales	1:6	9,80,000	1,40,000	8,40,000
Other Income: Bad Debts Recovered	 Pre-Inc.		 5,000	 5,000	 -
Total Revenue (A)	**-**	**-**	**9,85,000**	**1,45,000**	**8,40,000**
Expenses: Employee Benefit Expenses: Salaries and Allowances	 Time	 1:3	 1,80,000	 45,000	 1,35,000
Finance Cost:	-	-	-	-	-
Depreciation and Amortisation Expenses: Depreciation Preliminary Expenses written off	 Time Actual	 1:3 Post-Inc.	 28,000 7,000	 7,000 -	 21,000 7,000
Other Expenses: Commission Advertising MD's Remuneration Rent Taxes Discount Bad Debts	 Sales Sales Post Actual Time Sales Actual	 1:6 1:6 - - 1:3 1:6 	 26,250 52,500 90,000 28,500 1,500 3,500 12,500	 3,750 7,500 - 6,000 375 500 5,400	 22,500 45,000 90,000 22,500 1,125 3,000 7,100
Total Expenses (B)			**4,29,750**	**75,525**	**3,54,225**
Net Profit (A – B)				**-**	**4,85,775**
Capital Profit (A – B)			**5,55,250**	**69,475**	**-**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (April to June 2015) = 3 months

Post-incorporation Period (July 2015 to March 2016) = 9 months

Time Ratio = 3:9 or 1:3

(2) *Sales Ratio*

Pre-incorporation Sales is assumed to be 1: 1×3 months = 3

Post-incorporation Sales is assumed to be 2: 2×9 months = 18

Sales Ratio= 3:18 or 1:6

(3) *Calculation of Distribution of Bad Debts*

Total Bad Debts = ₹12,500

₹3,500 relates to Post-incorporation Period

The balance Bad Debt of ₹9,000 has to be distributed between Pre- and Post-incorporation periods (01 April 2015 to 31 August 2015 = 5 months).

Pre-incorporation Period = 01 April 2015 to 31 June 2015 = 3 months

Post-incorporation Period = 01 July 2015 to 31 August 2015 = 2 months

Ratio = 3:2

Pre-incorporation Period = 9,000 × 3/5 = ₹5,400

Post-incorporation Period = 9,000 × 2/5 = ₹3600 + 3500 = ₹7,100

(4) *Calculation of Distribution of Rent and Taxes*

Total Rent and Taxes (given) = ₹30,000

Pre-incorporation Rent = 2,000 × 3 months = 6,000

Post-incorporation Rent = 2,500 × 9 months = 21,500

Total Rent = 28,500

Therefore, Taxes = 30,000 – 28,500 = ₹1,500

Pre-incorporation Taxes = 1,500 × 3/12 = ₹375

Post-incorporation Taxes = 1,500 × 9/12 = ₹1,125

2

Illustration 24

A company incorporated on 01 April 2016 to take over the business of a firm as from 01 January 2016. All profits made from this earlier period were to the benefit of the company but interest on the purchase price of ₹5,00,000 were to be paid at 6% interest p.a. to the vendor up to 01 June 2016. The following was the profit and loss account for the year ended 31 December 2016.

Profit and loss account for the year ended 31.12.2016

Particulars	(₹)	Particulars	(₹)
To management expenses	30,000	By Gross Profit (Operating Profit)	2,00,000
To Bad debts	2,500		
To Directors fees	10,000		
To Interest to vendor	12,500		
To Preliminary expenses	5,000		
To Depreciation	10,000		
To Net profit	1,30,000		
	2,00,000		**2,00,000**

Out of bad debts written off ₹1,000 related to the period prior to incorporation and the balance relating to the Post-incorporation Period. Prepare profit and loss account and apportion the profit between prior and Post-incorporation Period assuming that the sales was spread evenly over the entire period.

[Bangalore University, Nov/Dec 2016, Section B]

Solution

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Total (₹)	Pre (₹)	Post (₹)
				Incorporation	
Revenue from operations (Gross Profit)	Sales	1:3	2,00,000	50,000	1,50,000
Other Income					
Total revenue (A)	**-**	-	2,00,000	50,000	1,50,000
Expenses: Employee benefit expenses					
Finance Cost: Interest to vendors	Revised Time ratio	- 3:2	12,500	7,500	5,000
Depreciation and Amortisation expenses: Depreciation Preliminary expenses written off	 Time Actual	 1:3 Post-Inc	 10,000 5,000	 2,500 -	 7,500 5,000
Other Expenses: Director's fees Bad debts Management expenses	 Actual Actual Time	 Post-Inc Given 1:3	 10,000 10,000 30,000	 - 2,500 7,500	 10,000 7,500 22,500
Total expenses (B)			**77,500**	**20,000**	**57,500**
Net Profit (A – B)				**-**	**92,500**
Capital Profit (A – B)			**-**	**30,000**	**-**

Working Notes:

(1) *Time Ratio*

Pre-incorporation Period (January to 1.4.2016) = 3 Months

Post-incorporation Period (April 201 to December 2016) = 9 Months

Time Ratio = 3:9 or 1:3

(2) *Sales Ratio*

Pre-incorporation Sales = 3

Post-incorporation Sales = 9

Sales Ratio = **3:9 or 1:3**

(3) *Revised Time Ratio*

Revised time ratio = Date of Acquisition to Date of Incorporation**:** Date of Incorporation to Date of Discharge of Purchase Consideration

Revised time ratio = 1.1.2016 to 31.3.2016: 1.4.2016 to 1.6.2016

Revised time ratio = **3:2**

SUMMARY

- Profit or loss of a company for the period prior to the date the company came into existence is termed as **Prior Period Profits or Losses or Pre-incorporation Profits or Losses.**
- **Pre-incorporation Period** is the period from the date of purchase or acquisition of business to the date of incorporation.
- **Post-incorporation Period** is the period from the date of incorporation to the last date on which the accounts are compiled.
- Steps in Ascertainment of Profit or Loss Prior to Incorporation:

  Step 1: Ascertaining Gross Profit by preparing trading account

  Step 2: Calculating different ratios for allocation and apportionment

  Step 3: Calculating pre-incorporation and post-incorporation profits by preparing Profit and Loss Account

  Step 4: Allocating all items of profit and loss account on suitable bases
- The fixed charges or the expenses, which are periodical in nature, such as rent rates and taxes, etc., need to be apportioned on time-basis. Hence, **Time Ratio** is the ratio of pre-incorporation period and post-incorporation period.
- The expenses, which are directly related to sales, such as bad debts, brokerage or commission or advertisement, etc., need to be apportioned on the basis of sales. Hence, **Sales Ratio** is the ratio of pre-incorporation sales and post-incorporation sales.
- If the expenses are uniform through the year, then it can be apportioned on the basis of time factor, but if the expenses are not uniform throughout the year due to major changes in the company, then it needs to be apportioned on Weighted Ratio or Weighted Time Ratio basis.
- This ratio is calculated in the event when the vendor is not allowed to take pre-incorporation profits and is usually paid interest on purchase consideration. This interest payable is allocated on the basis of Revised Time Ratio. The interest payable is usually calculated from the date of acquisition to the date of discharge of purchase consideration.
- The expenses incurred for the specific period should be charged for the respective period only. Expenses incurred in the pre-incorporation period are charged as expenses of pre-incorporation period only.

2

THEORY QUESTIONS

Section A

1. Explain the term Profit Prior to Incorporation. **[Nov/Dec 2013/2016]**
2. How do you treat Pre- and Post-incorporation Profits?
3. What do you mean by Pre-incorporation Period?
4. What do you mean by Post-incorporation Period?
5. How is Loss Prior to Incorporation treated?
6. How is Value of Shares determined under Yield Value Method? **[Nov/Dec 2013]**
7. Mention any two expenses charged only to Post-incorporation Period. **[Nov/Dec 2014]**
8. Mention the different bases of apportionment.
9. How is Time Ratio calculated? Give one example. **[Nov/Dec 2014]**
10. Mention any four items apportioned on the basis of Time Ratio.
11. What is Revised Time Ratio?
12. How do you treat Loss Prior to Incorporation in the Books of Accounts? **[Nov/Dec 2015]**
13. What is the difference between Time Ratio and Revised Time Ratio?
14. What is Sales Ratio?
15. What ratios are normally used to apportion Pre- and Post-incorporation Incomes and Expenses? **[Nov/Dec 2015]**
16. Mention any four items apportioned on Sales Ratio.
17. What is Weighted Ratio? When do you use it?
18. How do you apportion Gross Profit?
19. Write a note on Apportionment of Interest to Vendors on purchase consideration.

Section B

1. Distinguish between:
   (i) Pre and Post-incorporation Profits
   (ii) Pre and Post-incorporation Periods
2. Explain the nature and use of Profit or Loss Prior to Incorporation.
3. Briefly explain the apportionment of interest to vendors on purchase consideration, if settlement of purchase consideration is made prior to the closure of accounts.
4. Explain the different ratios used to apportion expenses and also mention the differences between the different ratios.
5. Write down the steps involved in Ascertainment of Profit or Loss Prior to Incorporation.
6. Explain the different basis of Apportionment of Expenses and Incomes.

PRACTICAL QUESTIONS

Section C

1. There were 25 workers prior to incorporation and were paid wages at ₹1,000 each per month. After incorporation, there were 35 workers and they were paid ₹1,250 each per month. Ascertain the Pre- and Post-incorporation Wages.

   (Pre-incorporation Wages: ₹25,000 per month; Post-incorporation Wages: ₹43,750 per month)

2. Darshan Inc. acquired Shruti Co. Ltd. on 01 January 2017. After incorporation on 01 May 2017, the Books of Account of Darshan Inc. were closed for the first time on 30 September 2017. Prepare a Statement showing Pre- and Post-incorporation Profits, assuming Sales to be ₹12,30,000 and the Average Monthly Sales for the first four months of calendar year 2017 were half that of the remaining period. Other information is given as follows:

   Gross Profit: ₹84,000; Incorporation Expenses: ₹21,330; Director's Fees: ₹750 per month; Preliminary Expenses to be written off: ₹2,250; Rent up to June 2017 was ₹150 per month, but thereafter increased to ₹375 per month; Manager was appointed post incorporation and his salary was ₹750 per month.

   (Pre-incorporation Profit: ₹10,920; Post-incorporation Profit: ₹36,975)

3. S Ltd. was incorporated on 01 September 2017 to take over a business of T Ltd., which was working since 01 April 2017. The Total Sales of S Ltd. were ₹80,000 (Pre-incorporation Sales = ₹20,000). Other information is given as follows:

   Gross Profit: ₹30,000; Total Expenses: ₹24,000; Director's Fees: ₹1,000; Shares Capital: ₹75,000. Calculate the rate of dividend payable by S Ltd.

   (Loss Prior to Incorporation: ₹2,500; Profit after Incorporation: ₹7,500; Rate of Dividend: 10% on Share Capital)

4. Pioneer Ltd. was incorporated on 1 November 2016 and it had acquired Shogun Ltd. prior to its incorporation on 01 July 2016. The first accounts were drawn up to 31 March 2017. Prepare a Statement showing Profit or Loss, assuming that the Net Sales were ₹8,20,000. The monthly average for the first four months, starting from 01 July 2016, is half of that of the remaining period. The Profit was earned uniformly on Sales. Other information is given as follows:

   Gross Profit: ₹56,000; Director's Fees: ₹6,000 per annum; General Expenses: ₹14,220; Establishment Expenses: ₹1,500; Rent up to 31 December 2016 was ₹1,200 per annum, after which it was increased to ₹3,000 per annum; Manager's Salary: ₹6,000 per annum (appointed after incorporation).

   (Pre-incorporation Profit: ₹7,280; Post-incorporation Profit: ₹24,650)

5. P and Q, working in partnership, registered a Joint Stock Company, under the name of PQ Ltd. on 01 September 2016 to take over the existing business with effect from 01 April 2016. Sales of the year totalled to ₹2,25,000, out of which, ₹1,50,000 relates to the period from 01 September 2016 to 31 March 2017. Prepare a Statement apportioning the Profits between Pre- and Post-incorporation Periods, with the help of the following Profit and Loss Account Statement:

Particulars	(₹)	Particulars	(₹)
Dividend on Equity Share @ 5%	6,000	Gross Profit	84,000
Provision for Taxes	5,000		
Depreciation	2,000		
Director's Fees	800		
Salaries and Wages	41,400		
Debenture Interest	5,000		
Interest to Vendors (up to 30 September 2016)	10,800		
To Preliminary Expenses written off	1,000		
Selling Commission	12,000		
Total	**84,000**		**84,000**

(Pre-incorporation Profit: ₹10,000; Post-incorporation Profit: ₹21,400)

6. Kishen Ltd. was incorporated on 1 July 2017 and it acquired Ram Ltd. on 01 April 2017. For this, the purchase consideration was agreed at ₹2,00,000 with interest at 9% per annum, payable on 01 October 2017. by the allotment of 17,500 fully paid equity shares to the vendors and the balance in cash. Prepare a Statement of Profit and Loss Account for the year ended 31 March 2017 and a Balance Sheet as on that date from the following information:

   Closing Stock: ₹1,40,000

   Bad Debts: ₹500 (₹200 belongs to the Debts relating to Ram Ltd.) to be written off

   Provision for Doubtful Debt: ₹2,500

   Depreciation on building and furniture at the rate of 5 and 10%, respectively

	Dr. (₹)	Cr. (₹)
Share Capital		2,25,000
Land	25,000	
Building	65,000	
Furniture	7,500	
Salaries	12,000	
Purchases (including stock taken over)	4,85,000	
Sales (Sales of Pre-incorporation Period was ₹75,000)		4,50,000
Sundry Debtors	45,000	
Sundry Creditors		30,000
Rent Received		6,000
Rent and Taxes	3,000	
Repairs	1,500	
Director's Fees	1,200	
Miscellaneous Expenses	7,200	
Interest to Vendors	8,750	

(*Contd.*)

	Dr. (₹)	Cr. (₹)
Cash in hand	1,800	
Cash at Bank	48,050	
Total	**7,11,000**	**7,11,000**

(Gross Profit: ₹1,05,000; Pre-incorporation Profit: ₹7,500; Post-incorporation Profit: ₹62,850; Balance sheet total ₹3,25,350)

7. Gangotri Ltd. was incorporated on 01 August 2017. It had acquired an on-going concern on 01 April 2017. With the help of the following information, ascertain the Profit Prior to Incorporation, assuming Sales up to 01 August 2017 were ₹2,00,000 and after August 2017, Sales were ₹8,00,000:

Particulars	(₹)	Particulars	(₹)
Director's Fees	4,000	Gross Profit	2,00,000
Salaries	40,000		
General Expenses	10,000		
Carriage	15,000		
Advertising	20,000		
Debenture Interest	6,000		
Audit Fees	5,000		
Depreciation	20,000		
Interest to Vendor (30 September 2017)	10,000		
Net Profit	70,000		
	2,00,000		**2,00,000**

(Pre-incorporation Profit: ₹1,333; Post-incorporation Profit: ₹68,667)

8. MNO Ltd. took over the business with effect from 01 April 2017. It was incorporated on 01 August 2017. Prepare a Profit and Loss Account, showing allocation of Pre- and Post-incorporation Profits from the following information, for the year ended 31 March 2018.

Particulars	(₹)	Particulars	(₹)
Depreciation on Fixed Assets	4,800	Gross Profit	1,60,000
Selling Expenses	12,600		
Interest paid to Vendors	2,100		
Debenture Interest	1,500		
Audit Fees	3,000		
Commission to Selling Agents	8,000		
Bad Debts	1,600		
Electricity Charges	2,100		
Director's Fees	5,600		
Rent	13,200		
Miscellaneous Expenses	18,900		

(*Contd.*)

Particulars	(₹)	Particulars	(₹)
Advertisement	8,000		
Travelling Expenses	8,400		
Printing and Stationery	2,400		
Salaries	24,000		
Net Profit	43,800		
	1,60,000		**1,60,000**

Other information:

(i) Total Sales amounted to ₹9, 60,000, this increased by 2/3 times, post incorporation.

(ii) Rent was ₹1,000 per month up to September 2017, and thereafter, it was increased by ₹200 per month.

(iii) Travelling Expenses include ₹2,400 towards Sales Promotion.

(iv) Depreciation includes ₹300 for assets acquired in the Post-Acquisition Period.

(v) The final amount of purchase consideration was discharged on 30 September 2017, by issuing equity shares of ₹10 each.

(Pre-incorporation Profit: ₹6,150; Post-incorporation Profit: ₹37,650)

9. Star Ltd. was incorporated on 01 May 2017 to take over the business of Moon Ltd. on 01 January 2017. The Profit and Loss Account for the year ending 31 December 2017 is given as follows. Ascertain the Profits earned prior to and Post-incorporation Period.

Profit and Loss Account of Star Ltd.

Particulars	(₹)	Particulars	(₹)
Advertisement	8,000	Gross Profit	1,90,000
Commission	12,000		
Auditor's Fees	3,200		
Director's Fees	6,000		
Salaries	72,000		
Electricity Charges	4,800		
Insurance	6,000		
Rent and Taxes	24,000		
Discount	7,000		
Interest on Loan	6,000		
Bad Debts	4,000		
Preliminary Expenses	13,000		
Bank Charges	3,000		
Carriage	6,000		
Office Expenses	15,000		
	1,90,000		**1,90,000**

Additional Information

(i) Sales for the year ending 31 December 2017 were ₹10,00,000 (₹3,00,000 is for the period up to 01 May 2017).

(ii) The Average Monthly Sales after incorporation was twice the Average Monthly Sales before incorporation.

(iii) Rent, which was paid for the first three months at ₹200 per month, increased by ₹50 per month, for the balance of the period.

(iv) Bad Debts of ₹350 related only to the period after 01 September 2017 and the balance related to the Sales up to 01 September 17.

(v) The Bad Debts realised belonged to the Debts, which were written off in 2017.

(Pre-incorporation Profit: ₹13,457; Post-incorporation Profit: ₹46,453)

10. Brilliant Pvt. Ltd. took over the business of Excel Inc. on 01 April 2017 and it was incorporated on 01 August 2017.

Profit and Loss Account on 31 March 2017

Particulars	(₹)	Particulars	(₹)
Commission on Sales	2,625	Gross Profit	98,000
Advertising	5,250	Bad Debts Realised	500
MD's Remuneration	9,000		
Depreciation	280		
Salaries	18,000		
Insurance	600		
Preliminary Expenses written off	700		
Rent and Taxes	3,000		
Discount	350		
Bad Debts	1,250		
Net Profit	57,445		
	98,500		**98,500**

(Pre-incorporation Profit: ₹4,583; Post-incorporation Profit: ₹26,325)

11. Violet Ltd. was incorporated on 01 May 2017 to purchase a business from the preceding 01 January 2017. The accounts were made up to 31 December 2017 and the Trading and Profit and Loss Account gave the following results:

Particulars	(₹)	Particulars	(₹)
Opening Stock	14,000	Sales	1,20,000
Purchases	91,000	Closing Stock	15,000
Gross Profit	30,000		
	1,35,000		**1,35,000**
Rent and rates	1,800	Gross Profit	30,000
Director's Fees	2,000		
Salaries	5,000		

(*Contd.*)

Particulars	(₹)	Particulars	(₹)
Office Expenses	5,000		
Traveller's Commission	1,100		
Discounts	1,500		
Bad Debts	200		
Audit Fees	250		
Depreciation	600		
Debenture Interest	450		
Interest on Purchase Consideration (up to 31 August 2017)	1,600		
Net Profit	10,500		
	30,000		**30,000**

It is ascertained that Sales from January 2017 to April 2017 were ₹30,000. You are required to apportion to year's profit, between Pre-incorporation Period and Post-incorporation Period.

(Pre-incorporation Profit: ₹1,866; Post-incorporation Profit: ₹8,634)

12. XYZ Ltd. was incorporated on 01 May 2017 to take over the business of ABC & Co. from 01 January 2017. Figures, as given by XYZ Ltd., for the year ending 31 December 2017 are as follows:

Particulars	(₹)	Particulars	(₹)
Rent and Taxes	90,000	Gross Profit	10,64,000
Salaries including Manager's Salary of ₹85,000	3,31,000	Interest on Investments	36,000
Carriage Outward	14,000		
Printing and Stationery	18,000		
Interest on Debentures	25,000		
Sales Commission	30,800		
Bad Debts (related to Sales)	91,000		
Underwriting Commission	26,000		
Preliminary Expenses	28,000		
Audit Fees	45,000		
Loss on Sale on Investments	11,200		
Net Profit	3,90,000		
	11,00,000		**11,00,000**

Prepare a Statement of Profit and Loss Account showing allocation of Pre-incorporation and Post-incorporation Profits after considering the following information:

(i) All investments were sold in April 2017.
(ii) Manager's salary increased by ₹2,000 from 01 May 2017.
(iii) Bad Debts are shown after adjusting a recovery of ₹7,000 of Bad Debt for a sale made in July 2015.

(iv) Sales for January and October were 1½ times the Average Monthly Sales, while Sales for December were twice the Average Monthly Sales.

(v) Gross Profit Ratio was constant throughout the year.

(Pre-incorporation Profit: ₹1,71,900; Post-incorporation Profit: ₹2,18,100)

13. A Co. Ltd. was incorporated on 01 August 2017 to take over the business of B Co. Ltd., as from 01 April 2017. The Books of Accounts were closed on 31 March 2018. Prepare a Statement of Profit and Loss Account, showing Profit prior to and after incorporation, with the help of the following details:

Particulars	(₹)	Particulars	(₹)
Salaries and Allowances	60,000	Gross Profit	2,00,000
Rent and Taxes	23,000		
General Expenses	7,200		
Director's Fees	3,000		
Selling Expenses	4,000		
Discount on Sales	1,000		
Advertisement	3,000		
Audit Fees	4,500		
Formation Expenses	1,800		
Miscellaneous Expenses	1,500		
Interest on Debentures	1,400		
Interest to Vendors (up to 30 September 2017)	6,000		
Repairs to building	1,200		
Depreciation	2,400		
Net Profit	80,000		
	2,00,000		**2,00,000**

Other information

(i) Rent was paid at 1,000 per month up to 01 August 2017 and thereafter, it was increased to ₹2,000 per month.

(ii) The Average Monthly Sales for the first four months during the year were ₹60,000; whereas, the Average Monthly Sales for the subsequent period was ₹70,000.

(Pre-incorporation Profit: ₹23,000; Post-incorporation Profit: ₹57,000)

14. Bhavesh Enterprises purchased Mr. Kumar's business on 01 January 2017; subsequently, it was incorporated on 01 April 2017. Ascertain the Profits earned prior to and post incorporation:

(i) From January 2017 to December 2017, the Sales were ₹2,40,000. The trend of Sales was given as follows:
January to February = Half of Average Sales each month
May, June, July and October = Average Sales each month
September, November and December = Half the Average Sales each month

(ii) Cost of Goods Sold: ₹60,000

(iii) Salary and other Expenses: ₹6,000
(iv) Bad Debts: ₹2,400
(v) Interest for purchase consideration, which was paid to Navin's old business on 01 August 2017: ₹2,100
(vi) Expenses exclusively related to the company: ₹8,900

(Pre-incorporation Profit: ₹1,333; Post-incorporation Profit: ₹68,667)

15. Bharath Ltd., incorporated on 01 April 2017, took over a running business on 01 January 2017. The Books of Accounts were closed on 31 December 2017. From the following particulars, calculate the Sales Ratio of Pre and Post-incorporation Periods.
    (i) The Gross Profit was ₹2,40,000.
    (ii) The sales for the year amounted to ₹12,00,000, of which, ₹5,40,000 were for the first six months.
    (iii) The expenses debited to the Profit and Loss Account included Director's Fees of ₹15,000, Bad Debts of ₹3,600, and an Advertising Expense of ₹12,000 (under a contract amounting to ₹1,000 per month). Salaries and General Expenses amounted to ₹64,000. Preliminary Expenses written off were ₹5,000; Donation to political party given by the company was ₹5,000.

(Pre-incorporation Profit: ₹1,526; Post-incorporation Profit: ₹29,444)

3 Valuation of Goodwill

CHAPTER OUTLINE

3.1 INTRODUCTION TO GOODWILL

When any business organisation is in a position to earn its profits at an exceptionally higher rate when compared to their competitors, then such business organisation is said to have Goodwill. In commercial sense, Goodwill is treated as an intangible asset. Intangible assets are those assets that cannot be touched or seen but can be only felt. There will be depreciation on goodwill like other real assets, but its value fluctuates. It is unseen; it also does not become obsolete or gets used up in the lifetime of the firm. It can be only valued, if it is capable of being transferred from one person (unit) to the other person (unit). Goodwill may be explained as the edge that a business has in connection with its stakeholders (namely: consumers, workforce, borrowers and lenders and investors, etc.). Goodwill accrues to a firm due to efficient and competent managers, customers' confidence and trust in the products offered or services rendered by the firm; it could also be due to location advantage, advanced technology used, quality products or services offered, motivated and dedicated employees, experience in the market, contribution made by the company to the society, subsidies and tax benefits accruing to the company from the government. To sum up, Goodwill may be explained as the value of reputation or good name earned by the firm on the same capital employed as compared to the other firms in the same business.

Goodwill of a business conveys trustworthiness, approval or the image of the business in the market. Goodwill is the additional worth associated with a business organisation, which is exceptionally higher when compared to other similar businesses and it is over and above the intrinsic value of its own net assets. In other words, it is that value, which benefits a firm in earning Super Profits, as a result of its established brand, reputation, large network, amicable relationship with its workforce, and quality products or services offered.

3.2 DEFINITION OF GOODWILL

In the words of Morisse, 'Goodwill may be defined as the present value of the firm's excess future earnings'.

As per *Kohler's Dictionary of Accountants,* Goodwill has been delineated as the present value of anticipated future income, which is in excess of the regular return on investment in tangible assets. This amount of goodwill will not be recorded, except for those circumstances in which it is paid for. In other words, it is the excess of the price paid for a business as a whole, over and above the book value of all the tangible assets possessed or purchased by the firm.

Hendrickson has defined goodwill as, 'The expected future earnings, if more than the normal return on investment, the capitalisation of this surplus is generally termed as Goodwill'.

From the given definitions, it can be inferred that Goodwill is the value of the fame of a business in terms of profits earned and expected to be earned in the future, which is generally over and above the regular profits earned by the other businesses in the same industry.

3.3 NATURE OF GOODWILL

In commercial parlance, Goodwill has generally been classified or valued either on the basis of location or its customers. This has further led to classifying Goodwill zoologically by Justice Rich. In his famous judgement in case of *Whiteman Smith Motor Company Ltd. versus Chaplin (1934),* the judiciary has interpreted the nature of customers to be mainly of four types: Dog, Cat, Rat and Rabbit.

- **Dog's Nature of Goodwill**: A dog remains faithful to his master and not the place; similarly, customers are more attached to the owner of the business and not the business. In short, the Goodwill no longer exists if the owner of the business is changed or vice-versa.
- **Cat's Nature of Goodwill:** A cat remains faithful to the location or the place but not the person. In the case of customers under this category, they prefer the business and not the owner. Change of ownership will hardly affect the value of the goodwill.
- **Rat's Nature of Goodwill:** The characteristic of a rat is casual in nature, such that a change in place or person does not make much of a difference. Likewise, the customers under this category are neither attached to the owner nor to the business. Goodwill under this category is subject to fluctuations.
- **Rabbit's Nature of Goodwill:** One of the main characteristics of a rabbit is affinity, which means the connection or the solidarity. Due to this reason, it is difficult for a rabbit to go

elsewhere and it prefers being attracted to either the place or the owner only for the reason of nearness or proximity and not for any other reason. Likewise, a customer under this category remains connected to either the owner or the business merely because of propinquity (nearness) and not for any other reason.

In recent times, the nature of goodwill has been classified into personal goodwill, inherent goodwill and free goodwill.

- **Personal Goodwill**: Personal goodwill depicts the proficiency or the charisma of the owner. For example, a painter or a photographer; here, the attachment of the customer is pertinent to the skill or personality of the owner but not necessarily the business. Small businesses exhibit goodwill of this type.
- **Inherent Goodwill:** Goodwill under this category is due to the customer's attachment to the place or location. Examples: restaurants, malls or saloon. The location or the place attracts the customer more than the owner and the customer prefers to visit the place often due to comfort, convenience or preference.
- **Free Goodwill:** The goodwill under this category is not for any particular reason. Goodwill is created due to random buying and casual attitude of the customer not due to the attachment either to the place or the person.
- **No Goodwill:** There are few businesses that do not have goodwill at all. Example: farming business.

3.4 TYPES OF GOODWILL

Different types of goodwill are as follows:

1. Purchased Goodwill

This type of goodwill accrues to a firm in the event when a business concern is bought by another business and purchase consideration is in excess of the net assets of the acquired business. Such goodwill is recognised as per the Indian Accounting Standards (Ind-AS) and reflects in the financial statements of the firms.

2. Non-Purchased/Inherent/Raised Goodwill

This type of goodwill is generated by the firm on its own over a period of time, as a result of managerial efficiency, dedicated employees, quality of products and services, brand name, business strategies, advanced technology used in the production, coupled with effective sales and promotional policies. Such type of goodwill is generally not recognised by the accounting profession and does not reflect in the financial statements of the firm. The valuation of such type of goodwill is generally on the basis of the subjectivity of the assessor.

3.5 CONCEPT OF GOODWILL

As per the Legal concept, Goodwill need not necessarily be measured in terms of the extraordinary profits; it could also be in terms of its customers, namely: the number of customers, frequency of their visits and the assurance they have with regard to the quality, service and price of the products offered to them. It could also include the trustworthiness, image and the reputation that the business house enjoys with its customers.

As per the Economic concept, there are certain unreported assets in the business in addition to the reported assets; these unreported assets help the businesses to earn Super Profits. This additional profit of the firm is termed as goodwill in economic sense.

As per the Accounting concept, if a business earns profit over and above the regular profits, such business is said to have goodwill and the same thing gets recorded in the books but will be valued only if it is transferrable from one person to another.

3.6 COMPONENTS OF GOODWILL

As previously mentioned, the extra earning capacity of the firm, over and above its regular profits, is termed as goodwill. This is due to a combination of the following factors:

1. The technological edge that the business enjoys.
2. The number of patents, licenses, trademarks, copyrights and franchises that the firm has to its credit.
3. Any competitive advantage, namely, long-term contracts at low or remunerative prices.
4. Availability of resources at reasonable prices
5. Locational advantage
6. Managerial efficiency
7. Employee morale
8. Loyal customers
9. Prompt suppliers
10. Expeditious lenders
11. Government backing in terms of grant-in-aid, subsidies, tax holidays, tax concessions, etc.

3.7 FEATURES OF GOODWILL

The different features of goodwill are listed as follows:

1. Goodwill is an intangible asset.
2. It is a real asset and not a fictitious one, as its existence can be felt through the extra earning capacity of the business. As it is a real asset, it can be realised by its possible sale.

3. It is the extra value in non-physical form over and above the physical value of the physical assets.
4. It can be valued only if it can be transferred from one business to another. There is no value of goodwill, if it cannot be transferred from one business to another.
5. If goodwill has to be transferred from one business to another, it can be sold only with the entire business. It cannot be sold in parts or remoteness; it can only be sold along with the business it relates to except in the case of admission and retirement of a partner.
6. Goodwill is always associated with the business and has no existence by itself.
7. Goodwill of a business can be positive or negative in value (if the expected future earnings are more than the normal earnings, the capitalisation of this surplus is termed as Positive Goodwill and if the expected future earnings are less than the normal earnings, the capitalisation of this deficiency is termed as Negative Goodwill).
8. It has no specific/exact cost, as it is subject to fluctuations due to internal and external factors influencing the firm.
9. Goodwill is not depreciated nor does it become obsolete.
10. There is no affinity (association) between value of goodwill and the amount expended to constitute the same.
11. The assessor, on the basis of his subjective judgement or assessment, arrives at the value of goodwill.
12. Goodwill being a real asset is generally realised at the time of liquidation of the firm.

3.8 NEED FOR VALUATION OF GOODWILL

In case of sole-proprietorship kind of business, goodwill is valued only at the time of sale, as goodwill cannot be bought if the old business still continues with the same name, brand image and other advantages associated with the business. Whereas, in case of a joint-stock company or a partnership firm, valuation of goodwill may be required even if the business is running.

In case of a sole-proprietorship form of business, valuation of goodwill is required in the following cases:

1. At the time of sale
2. In the event of death of the proprietor, when estate duty has to collected
3. When the sole-proprietor firm is either converted into a partnership or a joint-stock firm
4. When the sole-proprietor firm is amalgamated with another sole-proprietor firm
5. For tax purposes

In case of a partnership form of business, valuation of goodwill is required in the following cases:

1. When the existing partners have decided to change their profit-sharing ratio
2. In the event of admission of a new partner
3. In the event of retirement of an old partner
4. In the event of death of a partner
5. At the time of sale of a partnership firm to a limited company
6. In the event of amalgamation of one or more partnership firms
7. In the event of dissolution of partnership firm

In case of a joint-stock company form of business, valuation of goodwill is required in the following cases:

1. In the event of amalgamation of two or more companies
2. In the event of absorption of a company by another company
3. At the time of external reconstruction of a company
4. In the event of conversion of a private-limited company into a public-limited company
5. When one company buys controlling interest in another company or in the event of acquisition of majority share by a parent (holding) company
6. When one class of shares is transformed into another
7. In the event of a government take-over
8. For the purpose of valuation of shares for taxation purpose, in the event of non-availability of stock market quotations

3.9 DETERMINANT FACTORS INFLUENCING THE VALUATION OF GOODWILL

Several factors influence the value of the firm directly or indirectly. Any firm intending to value its goodwill may have to be aware of the following influencing factors that determine the value of goodwill.

1. **Firm's Earning Capacity:** If a firm is extremely competitive in nature and is able to fare better than its counterparts with reasonable earning capacity, this may strengthen the goodwill of the firm.
2. **Nature of Industry:** If the firm is engaged in the industry, which is profitable, less riskier, requiring optimum cost, then all these factors may enhance goodwill of the firm. Hence, the nature of the industry can be an influencing factor that can determine the value of goodwill.
3. **Nature of Business:** If the business is dealing in goods, which are necessities in life, it experiences an enhanced goodwill, as the profits are likely to be constant than the one dealing in goods affected by changes in trend.

4. **Size of the Business:** Larger organisations are able to manufacture their goods for lesser cost due to economies of scale; this proves to be an advantage over the smaller organisations manufacturing goods at higher costs, as they cannot achieve economies of scale in their operations. Furthermore, large organisations can afford to reduce their selling price, giving greater benefit to the consumers due to their low cost of production. This brings them goodwill in the long run, which is otherwise not possible if the size of the business is small.
5. **Nature or Quality of Products and Services:** Goodwill accrues to those concerns that pay extra attention in enhancing the quality of the product or service offered. This might result in extra burden in terms of cost but the firm can gain good name in the market in the long run. If the concerns are compromising the quality, it might bring them good revenue but only in the short run. Such concerns may end up losing goodwill due to poor quality of products and services offered.
6. **Stable Nature of the Business:** A consistent or stable business enjoys more goodwill when compared to an unstable one.
7. **Number of Years of Firm's Existence in the Industry:** A well-established concern with long standing in the industry is certain to enjoy more goodwill when compared to a newly established undertaking, on account of the experience it has in conducting the business under different scenarios or circumstances.
8. **Future Growth Prospects of the Business:** If a firm is engaged in the business that has future growth prospects, the value of goodwill may also improve over a period of time due to this factor, when compared to those businesses that are stagnated or saturated.
9. **Firms' Location Advantage:** Locational advantage can bring in greater benefit to the firms, in terms of easy access to raw material, labour, customers, suppliers of materials and lenders of capital. It could also result in savings in freight if the business is centrally located. All these factors can enhance the value of the goodwill of the firm.
10. **Monopolistic Stand Enjoyed by the Firm in the Market:** If a firm is enjoying a monopolistic situation in the market, either due to no competition or very few competitors, this may augment the firm's earning capacity, in turn boosting up the value of the firm.
11. **Managerial Efficiency:** The managerial skills play a pivotal role in augmenting the value of the goodwill. Success of any business organisation depends largely on the skills and strategies adopted by the managers in conducting the business extraordinarily.
12. **Motivated and Dedicated Work Force:** Involvement of workforce in business processes can bring in greater returns to the firm, if the workforce engaged is highly motivated. Employees with high morale contribute and aid business houses in achieving their goals. Dedicated and motivated employees can be a boon to the firm, as they are one of the crucial elements facilitating firms in executing the plans and strategies formulated.
13. **Level of Advertising and Sales Promotion:** Goodwill of the firm also depends on the level of awareness among the customers with regard to the products or services offered by the firm. This, in turn, depends on the amount of expenditure made by the firm on advertisement and sales promotion of the products and services. If the firm makes huge investments in creating

awareness among its customers, this may bring in more customers, ultimately resulting in heightened value of goodwill.

14. **Level of Competition**: If there are a large number of competitors in the market for the goods and services offered by the firm, then the firm's market share may reduce due to immense competition. This may further decrease the firm's profitability, thereby further abbreviating the value of the goodwill.
15. **Large Number of Contracts:** If a firm has a large number of profitable contracts to its credit, this may inflate the profits of the firm in the long run, hence augmenting the value of the goodwill.
16. **Risk Appetite:** Risky ventures bring in more returns but the consistency in returns is not guaranteed. Because of this, the value of goodwill may not increase due to the uncertain nature of business. If the business is stable and consistent, earning steady returns, this may result in enhanced amount of goodwill to the firm.
17. **Government Assistance and Support:** if the policies framed by the government favour any particular industry, this may boost the profitability, in turn resulting in increased value of goodwill. Therefore, government's interference in terms of assistance and support acts as a decisive factor in building up the value of goodwill.
18. **Market Conditions**: If a firm operates in a favourable environment, this may aid the firm to conduct business with ease and earn good returns. The favourable market conditions denote a stable demand for and supply of goods and services, stationary interest rates, steady inflation and invariable foreign exchange. Such an environment may contribute to firm's growth prospects, further adding value to the goodwill.
19. **Political Conditions:** Firms can perform better if they are assured with a stable political environment. If there is political instability, there may be frequent changes in industrial and economic policies, further resulting in extra burden on the firm in terms of compliance and adherence to new reforms. Such instability may challenge the future growth prospects, leading to abridged value of goodwill.
20. **Economic Situation:** The value of the goodwill and the firm's profitability may be relatively low if there is economic backwardness in the country. Therefore, economic prosperity or favourable economic situation in the country plays a critical role in businesses being viable and profitable.

3.10 COMPUTATION OF GOODWILL

There are four methods of valuing goodwill. They are:

1. Average Profits or Simple Profits Method
2. Super Profits Method

3. Capitalisation method
4. Annuity method

3.10.1 Average Profits Method

Under this method, the value of goodwill is arrived at by multiplying the Adjusted Average Profits or the Average Future Maintainable Profits of the last few years with a certain number of years (generally termed as number of years of purchase). The fundamental assumption under this method is that a newly established enterprise earns little or nil amount of profits in the initial years of its operation. Therefore, in this scenario, the amount of goodwill paid at the time of acquiring an on-going business should be the average profits multiplied by the number of years of purchase.

Value of Goodwill under Average Profits Method
= Adjusted Average Annual Profits or Average Future Maintainable Profits
× Number of years of purchase

Steps in Valuation of Goodwill under Average Profits Method

The following steps have to be taken into consideration at the time of valuing goodwill under Average Profit Method:

Step 1: *Calculation of Adjusted Average Profits or Adjusted Future Maintainable Profits*

The reason for calculating the average profits is to ensure that the profits reflect the future profits, which are likely to be earned in the coming years. In other words, profits used to calculate average profit should be adjusted in light of the future possibilities. The years selected to calculate average profits should be Normal Years. If there are any abnormal losses on account of strike, theft, flood, damage, accident or fire, etc., in any given year, that year should be ignored for calculation of Normal Years.

The following points needs to be borne in mind while calculating the adjusted profits:

i. All actual expenses and losses that are not likely to occur in the future have to be added to the profit at the time of calculating Adjusted Profits.

ii. All incomes and gains that are likely to occur in the future have to be added to the profit at the time of calculating Adjusted Profits.

iii. All actual expenses and losses that are likely to occur in the future have to be deducted from the profit at the time of calculating Adjusted Profits.

iv. All incomes and gains that are not likely to occur in the future have to be deducted from the profit at the time of calculating Adjusted Profits.

v. Profits of the previous four or five years are to be taken into account while calculating the average profits (As profit of one year alone may not be sufficient to determine the value of goodwill).

vi. If the profits are steady and gradual over the period of four or five years, Simple Average Method of calculating average profits can be adopted.

vii. If the profits are continuously rising or falling over the period of four or five years, then Weighted Average Method can be used to calculate the average profits. Under this method, more weights can be assigned to the latest years (recent year) and fewer weights can be allotted to the remotest year. (First year).

viii. If the information regarding the number of years of purchase is not given in the question, then the number of years for which profit or loss information are given should be taken into account for calculating the number years of purchase.

Proforma for Calculating Adjusted Future Profits

Particulars	₹
Profits	xxx
Add: All actual expenses and losses not likely to occur or incur in the future	xxx
Add: All incomes and gains likely to be earned in the future	xxx
Less: All actual expenses and losses likely to occur or incur in the future	xxx
Less: All incomes and gains not likely to be earned in the future	xxx
Adjusted (Future) Profits	**xxx**

3

Step 2: *Calculation of Adjusted Average Profits*

In Step 1, Adjusted Profits were calculated but the valuation of goodwill under this method should be on the basis of Adjusted Average Profits. This can be done as discussed, on the basis of Simple Average or the Weighted Average Method.

i. When there are variations in the profits, Simple Average Profit Method must be adopted. This is calculated by using the following formula:

Adjusted Average Profits (using Simple Average Method)

$$= \frac{\textbf{Overall Adjusted Profits for all the given years}}{\textbf{Number of Years}}$$

ii. If the profits are markedly increasing or decreasing, Weighted Average Profit Method must be adopted. If weights are not mentioned in the question, then they can be calculated by assigning more weights to the latest years (recent year) and fewer weights to the remotest year (initial year). The following formula can be used to calculate Weighted Adjusted Average Profits.

Weighted Adjusted Average Profits (using Weighted Average Method)

$$= \frac{\textbf{Overall Adjusted Profits multiplied with the respective weights}}{\textbf{Total of Weights}}$$

Step 3: *Calculation of Goodwill*

Goodwill under this method can be arrived at by multiplying the Adjusted Average Profits (Step 2) with the Number of years of purchase.

Value of Goodwill = Adjusted Average Profits × Number of Years of Purchase

Illustration 1 **(Adjusted Average Profits Method)**

Mr Suresh has furnished the following information, asking you to calculate Future Maintainable Profits for the purpose of valuation of goodwill:

(i) Profits:

2014: ₹3,00,000; 2015: ₹2,80,000; 2016: ₹3,20,000; 2017: ₹4,50,000.

(ii) The profit for the year 2014 has been decreased by ₹35,000, due to loss by theft by one of the employees of the firm.

(iii) The profits of 2015 include an amount of ₹20,000, meant to be the non-recurring income.

(iv) Due to the recent theft that took place, the proprietor has decided to opt for insurance in future and the premium is expected to be ₹1,500 per annum.

(v) The profit of 2016 includes ₹6,000, received on account of investments made outside the business (non-trading investments).

(vi) Profit of 2017 consists of ₹40,000 towards a claim lodged in the year 2000; for which, no entry has been made in the books of accounts.

(vii) The amount of remuneration payable to the proprietor of the business, Mr Suresh, is ₹30,000 per annum. This has not been incorporated while ascertaining the profits for the previous years.

Ascertain the Adjusted Average Profits.

Solution

Particulars	(₹)	(₹)
Profits for the year 2014	3,00,000	
Add: Loss on account of theft (Non-recurring Loss)	35,000	2,65,000
Profit for the year 2015	2,80,000	
Less: Non-recurring Income	20,000	2,60,000
Profit for the year 2016	3,20,000	
Less: Income from Non-trading Investments	6,000	3,14,000
Profit for the year 2017	4,50,000	
Less: Income relating to the year 2000 (claim lodged)	40,000	4,10,000
Total Profits for four years		**12,49,000**

3

Average Profits = 12, 49,000 ÷ 4 = ₹3,12,250

Future Maintainable Profits/Adjusted Average Profits

Average Profit	₹3,12,250
Less: Expected Expenses	
Insurance Premium	₹1,500
Proprietor's Remuneration	₹30,000
Future Maintainable Profits/Adjusted Average Profits	**₹2,80,750**

Illustration 2 **(Simple Average Profits Method)**

Sam & Co. is contemplating to acquire a business for ₹1, 60,000. Profits for the last five years from 2013 to 2017 are given as follows:

2013: ₹10,000
2014: ₹12,000
2015: ₹14,000
2016: ₹9,000
2017: ₹11,000

The business was taken care of by the management. Remuneration from the alternative employment, if not engaged in the business, for the management comes to ₹4,500 per annum.

Ascertain the Amount of Goodwill, if it is valued on the basis of three years' purchase of the Average Net Profit for the last five years.

Solution

Step 1: *Calculation of Adjusted Average Profits*

Particulars	(₹)
Profit in 2013	10,000
Profit in 2014	12,000
Profit in 2015	14,000
Profit in 2016	9,000
Profit in 2017	11,000
Total Profit of Sam & Co. for the last five years	**56,000**

Average Profits = 56,000 ÷ 5 = **₹11,200**

Future Maintainable Profits/Adjusted Average Profits

Average Profit	₹11,200
Less: Expected Expenses	
Remuneration for Management per year	₹4,500
Future Maintainable Profits/Adjusted Average profits	**₹6,700**

Step 2: *Calculation of the Value of Goodwill*

Value of Goodwill = Adjusted Average Annual Profits × Number of years of purchase
= 6,700 × 3
= **₹20,100**

Illustration 3 **(Simple Average Profits Method)**

Mr Shankar intends to sell his business on 01 June 2017. From the following details given, ascertain the amount of goodwill based on four years' purchase of Average Profits of the last five years. The profits during these five years are given as follows:

2013: ₹1,50,000
2014: ₹2,00,000
2015: ₹2,80,000
2016: ₹3,20,000
2017: ₹3,00,000

The profit of 2016 includes ₹45,000; this is the interest earned on the investments made. The profits of 2013 were decreased by ₹50,000, being speculation loss. Furthermore, the profits of 2015 were reduced by ₹70000 on account of betting loss. At the time of acquisition of business, the buyer was employed as a manager of similar business on a salary of ₹5,000 per month.

Solution

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2013 (₹)	2014 (₹)	2015 (₹)	2016 (₹)	2017 (₹)
Profits	1,50,000	2,00,000	2,80,000	3,20,000	3,00,000
Add: Expenses or Losses not likely to recur in future					
Loss from speculation	50,000	-	-	-	-
Loss from betting	-	-	70,000	-	-
Add: Income or Gains likely to be earned in the future	-	-	-	-	-
Less: Expenses or Losses likely to recur in future					
Manager's Salary (₹5,000 × 12)	(60,000)	(60,000)	(60,000)	(60,000)	(60,000)
Less: Income or Gains not likely to be earned in the future					
Income from Investment				(45,000)	
Adjusted Annual Profits for the period of five years	**1,40,000**	**1,40,000**	**2,90,000**	**2,15,000**	**2,40,000**

Simple Average Profits = 1,40,000 + 1,40,000 + 2,90,000 + 2,15,000 + 2,40,000 ÷ 5
= 10,25,000 ÷ 5
= **₹2,05,000**

Step 2: *Calculation of the Value of Goodwill*

Value of Goodwill = Adjusted Average Annual Profits × Number of years of purchase

= 2,05,000 × 4

= **₹8,20,000**

Illustration 4 **(Weighted Average Profits Method)**

Sunshine Enterprises has proposed to purchase Moonlight Incorporation. Goodwill for this purpose will be valued at three years' purchases of the Weighted Average Profit of the last four years. The profits and the weights assigned are given as follows:

Year	Profits (₹)	Weights
2014	1,00,000	1
2015	2,15,000	2
2016	1,85,000	3
2017	2,60,000	4

Further analysis revealed the following information:

(i) On 30 June 2015, a major overhaul repair was undertaken with regard to a particular machinery, amounting to ₹35,000 and the same was charged to revenue. The same amount will now be capitalised for the purpose of goodwill valuation, along with the depreciation at the rate of 15%, on Written Down Value Method.

(ii) There was overvaluation of closing stock by ₹7,000 in the year 2015.

(iii) A year-end charge of ₹10,000 needs to be made for the purpose of goodwill valuation to cover the management cost.

Solution

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2014 (₹)	2015 (₹)	2016 (₹)	2017 (₹)
Profits	1,00,000	2,15,000	1,85,000	2,60,000
Add: Capital Expenditure treated as Revenue Expenditure (Major Overhaul Repair)		35,000		
Less: Depreciation on major repair to be considered as Capital Expenditure (35,000 × 10/100)		(3,500)	(3,150)	(2,835)
Less: Overvaluation of Closing Stock (2015)		(7,000)		
Add: Overvaluation of Opening Stock (2016) (if Closing Stock is overvalued, then certainly the Opening Stock also reflects the Overvalued Value)			7,000	
Less: Annual Charge towards Management Cost	(10,000)	(10,000)	(10,000)	(10,000)
Adjusted Annual Profits for the period of four years	**90,000**	**2,29,500**	**1,78,850**	**2,47,165**

***Depreciation Calculation**

Year	Capital Expenditure	Depreciation Rate @ 10%	Amount of Depreciation
2015	35,000	35,000 × 10%	3,500
2016	31,500 (35,000 – 3,500)	31,500 × 10%	3,150
2017	28,350 (31,500 – 3,150)	28,350 × 10%	2,835

Step 2: *Calculation of Weighted Average Profits*

Year	Adjusted Profits (₹)	Weights	Product (₹)
2014	90,000	1	90,000
2015	2,29,500	2	4,59,000
2016	1,78,850	3	5,36,550
2017	2,47,165	4	9,88,660
		10	**20,74,210**

Weighted Average Profits = 20,74,210 ÷ 10 = ₹2,07,421

Step 3: *Calculation of the Value of Goodwill*

Value of Goodwill = Weighted Average Profits × Number of years of purchase

= 2,07,421 × 3

= **₹6,22,263**

Illustration 5 **(Weighted Average Profits Method)**

Rose Ltd. intends to acquire the business of Lily Ltd. Ascertain the value of goodwill on the basis of four years' purchase of weighted average for five years.

The profits and the weights assigned are given as follows:

Year	Profits (₹)	Weights
2013	70,000	1.1
2014	1,00,000	2.2
2015	1,15,000	3.3
2016	1,90,000	4.4
2017	1,60,000	5.5

Further analysis revealed the following information:

(i) Management is expecting an extra remuneration commitment of ₹20,000.

(ii) The opening stock was undervalued by ₹6,000 in the year 2015.

(iii) Company had purchased loose tools for ₹10,000 on 6 June 2016 and the same was recorded in the Profit and Loss Account as an expense. Rectify the same for the purpose of Goodwill Valuation, by charging depreciation of 15% on Reducing Balance Method.

SOLUTION

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2013 (₹)	2014 (₹)	2015 (₹)	2016 (₹)	2017 (₹)
Profits	70,000	1,00,000	1,15,000	1,90,000	1,60,000
Add: Capital Expenditure treated as Revenue Expenditure (Loose tools recorded in P/L A/c)				10,000	
Less: Depreciation on major repair to be considered as Capital Expenditure (10,000 × 15/100)				(1,500)	(1,275)
Less: Undervaluation of Opening Stock (2015)			(6,000)		
Add: Undervaluation of Closing Stock (2014) (if Opening Stock is undervalued, then, certainly Closing Stock also reflects the undervalued value)		6,000			
Less: Management Remuneration	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)
Adjusted Annual Profits for the period of five years	**50,000**	**86,000**	**89,000**	**1,78,500**	**1,38,725**

***Depreciation Calculation**

Year	Capital Expenditure	Depreciation Rate @ 10%	Amount of Depreciation
2016	10,000	10,000 × 15%	1,500
2017	8,500 (10,000 – 1,500)	8,500 × 15 %	1,275

Step 2: *Calculation of Weighted Average Profits*

Year	Adjusted Profits (₹)	Weights	Product (₹)
2013	50,000	1.1	55,000
2014	86,000	2.2	1,89,200
2015	89,000	3.3	2,93,700
2016	1,78,500	4.4	7,85,400
2017	1,38,725	5.5	7,62,987.50
		16.5	**20,86,287.50**

Weighted Average Profits = 20,86,287.50 ÷ 16.5 = ₹1,26,442 (rounded off)

Step 3: *Calculation of the Value of Goodwill*

Value of Goodwill = Weighted Average Profits × Number of years of purchase

= 1, 26,442 × 4

= ₹5, 05,768

3.10.2 Super Profit Method

As previously discussed, Goodwill can be identified with any particular business on the basis of its extra earning capacity over and above its normal profits, based on the normal rate or return. Super Profits indicate excess of average profits over normal profit. Under this method, goodwill is assessed by multiplying the Super Profits with the number of years of purchase.

In order to arrive at the value of goodwill on the basis of Super Profit Method, the following details are required:

1. Average (future) Profits
2. Normal Rate of Return
3. Capital Employed

Average (future) Profits: The Adjusted Average Profits or the Future Maintainable Profits can be calculated in the same manner, as explained in Average Profit Method.

Normal Rate of Return: It is that rate which signifies the expectations of the investors. In other words, it is that rate of earnings that convince the investors. This rate differs from industry to industry and from time to time. This rate is often influenced by the prevailing bank rate, duration of investment made, risk associated with the investment, alternative investment opportunities, macro-economic, political and general economic conditions.

Capital Employed: The amount used up by the business is the capital employed. This could be calculated on the basis of two approaches, namely, *Asset-based Approach* and *Liability-based Approach*.

Calculation of Average Capital Employed as per the Asset-based Approach

The total of all assets, except intangible assets such as goodwill, irrelevant trademarks, patents, copyrights, investment that are non-trading in nature and fictitious assets such as preliminary expenses and discount on issue of shares and debentures, etc., are termed as *Gross Capital Employed*. If current liabilities are deducted from the gross capital employed, the resulting amount is termed as *Net Capital Employed*. The fixed assets for the purpose of calculating gross capital employed should be taken at their *Replacement Cost* and the current liabilities should be taken at their *Current Price*. The following statement relates to calculation of capital employed as per the Asset-based Approach.

Proforma for Calculating Average Capital Employed as per Asset-based Approach

Particulars	(₹)
All Tangible Assets (except for Goodwill, Irrelevant Trademarks, Patents, Copyrights, Investments that are non-trading in nature and Fictitious Assets like Preliminary Expenses and Discount on Issue of Shares and Debentures) at Replacement Cost	xxx
Less: All External Liabilities at current price or revised value	(xxx)
Less: Non-Participating Preference Share Capital	(xxx)

(*Contd.*)

Particulars	(₹)
Capital Employed at the end of the year	xxx
Less: Half of the profit earned during the year (in the current year)	(xxx)
Average Capital Employed for the year	**xxx**

Calculation of Average Capital Employed as per the Liability-based Approach

As per this approach, Capital Employed can be arrived at by taking into account the liability side of balance sheet, namely Equity Share Capital and Preference Share Capital (all paid up), reserves and profits, profit on account of revaluation of assets and liabilities. They are all summed up and from this, Total Debit Balance of Profit or Loss Account, Fictitious Assets, Non-trading Assets, and Loss on account of Revaluation of Assets and Liabilities should be deducted. Another important aspect to be noted under this approach is that debentures and loans are to be excluded, as the profits are considered after interest on debentures or loans.

Proforma for Calculating Average Capital Employed as per Liability-based Approach

Particulars	(₹)	(₹)
Paid-up Equity Share Capital		xxx
Preference Share Capital		xxx
Reserves		xxx
Credit Balance of Profit or Loss Account		xxx
Profit on Revaluation of Assets and Liabilities		xxx
		xxx
Less: Debit Balance of Profit or Loss Account	xxx	
Loss on Revaluation of Assets and Liabilities	xxx	
Goodwill (Book Value)	xxx	
Non-Trading Assets	xxx	
Fictitious Assets	xxx	**(xxx)**
Capital Employed at the end of the year		**xxx**
Less: Half of the profit earned during the year		**(xxx)**
Average Capital Employed for the year		**xxx**

Note: The Average Capital Employed is also calculated by taking into account, the capital at the beginning of the year and capital at the end of the year and dividing the sum total by 2. Alternatively, half of the current year's profit after tax can be added to the capital at the beginning of the year or half of the current year's profit after tax can be deducted from the capital at the end of the year to arrive at Average Capital Employed.

Therefore, steps for arriving at the value of goodwill under Super Profit method are summarised as follows:

Step 1: *Calculation of Adjusted Average Profit* (discussed earlier)

Step 2: *Calculation of Average Capital Employed* (either Assets or Liability-based Approach)

Step 3: *Calculation of Normal Profits*

Normal Profits: These are the profits earned in the normal course of the business. In the absence of information, the same can be calculated with the help of the following formula.

Normal Profits = Average Capital Employed × Normal Rate of Return

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	xxx
Less: Normal Profit (Step 3)	(xxx)
Super Profit	**xxx**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase

Illustration 6 **(Super Profit Method)**

XYZ Ltd.'s profit and loss for the last five years are as follows:

2013: ₹1,20,000
2014: ₹80,000
2015: ₹(-) 95,000
2016: ₹1,70,000
2017: ₹1,65,000

The average capital employed in the business was ₹5,00,000. The expected rate of return on the capital invested is 8%. The managerial remuneration is expected to be at ₹30,000 per annum. Ascertain the amount of goodwill on the basis of three years' purchase of Super Profit, based on the average of five years.

SOLUTION

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2013 (₹)	2014 (₹)	2015 (₹)	2016 (₹)	2017 (₹)
Profits	1,20,000	80,000	(–)95,000	1,70,000	1,65,000
Less: Management Remuneration	(30,000)	(30,000)	(30,000)	(30,000)	(30,000)
Adjusted Annual Profits for the period of five years	**90,000**	**50,000**	**(–)1,25,000**	**1,40,000**	**1,35,000**

Adjusted Average Profits = 90,000 + 50,000 – 1,25,000 + 1,40,000 + 1,35,000 ÷ 5
= 2,90,000 ÷ 5
= **₹58,000**

Step 2: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return

= 5,00,000 × 8%

= **₹40,000**

Step 3: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	58,000
Less: Normal Profit (Step 2)	40,000
Super Profit	**18,000**

Step 4: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase

= 18,000 × 3

= **₹54,000**

Illustration 7 **(Super Profit Method)**

Given below is the balance sheet of Chirag Ltd. as on 31 March 2017.

Liabilities	(₹)	Assets	(₹)
Share Capital	10,00,000	Fixed Assets	18,00,000
Reserves and Surplus	8,00,000	Current Assets	4,00,000
Creditors	6,00,000	Investments	2,00,000
	24,00,000		**24,00,000**

The profit of the company for the last five years were ₹5,00,000; ₹5,85,000; ₹6,25,000; ₹7,15,000 and ₹7,65,000 respectively. Normal rate of return on Average Capital Employed is 18%. The investments are 8% government treasury bills. Calculate goodwill at four years' purchase of Super Profits.

Note: As the profits are showing an increasing trend, Weighted Average Method can be used for calculating step 1.

Solution

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Calculation of Weighted Average Profits

Year	Adjusted profits (₹)	Weights	Product (₹)
I	5,00,000	1	5,00,000
II	5,85,000	2	11,70,000
III	6,25,000	3	18,75,000
IV	7,15,000	4	28,60,000
V	7,65,000	5	38,25,000
		15	**1,02,30,000**

Weighted Average Profits = 1,02,30,000 ÷ 15 = **₹6,82,000**

Calculation of Adjusted Average (weighted) Profits

Adjusted Average (weighted) Profits = Average profit – Interest on Investment
= 6,82,000 – 16,000 (2,00,000 × 8%)
= **₹6,66,000**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	(₹)
Fixed Assets	18,00,000
Current Assets	4,00,000
Less: Current Liabilities	(6,00,000)
Capital Employed	**16,00,000**

Average Capital Employed = Closing Capital Employed – Half of current-year profit
= 16,00,000 – (1/2 of 7,49,000 (7,65,000 – 16,000))
= 16,00,000 – 3,74,500
= **₹12, 25,500**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return
= 12,25,500 × 18% = **2,20,590**

3

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	6,66,000
Less: Normal Profit (Step 3)	2,20,590
Super Profit	**4,45,410**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 4,45,410 × 4
= **₹17,81,640**

Illustration 8 **(Goodwill as per Super Profits method and Capital employed calculated on the basis of Asset-based approach)**

From the following balance sheet of Prashanth Ltd. as on 31 December 2017, find out the value of goodwill according to Super Profit Method, assuming three years' purchase.

Liabilities	(₹)	Assets	(₹)
10,000 Equity Shares of ₹10 each fully paid up	1,00,000	Building at cost	37,500
2,000 8% Preference Shares of ₹10 each fully paid up	20,000	Furniture	1,000
Reserves	7,000	Stock	1,11,500

(*Contd.*)

Liabilities		(₹)	Assets		(₹)
Profit and Loss A/c			Investment (5%)		75,000
Balance as on 1 January 2017	10,000		Book Debts	25,000	
Profit 2017	1,05,000	1,15,000	*Less:* Reserve	1250	23,750
Depreciation Fund:			Cash and Bank Balances		27,750
Buildings	4,000		Preliminary Expenses		3,500
Investments	10,000	14,000			
Creditors		24,000			
		2,80,000			**2,80,000**

The following additional information is supplied to you:

1. Current value of building is ₹1,00,000.
2. The normal rate of return is 10%.
3. There is an annual increase of ₹20,000 in the profit for the past three years.
4. The taxation needs to be taken at 60%.
5. The investments comprises 750, 5% treasury bonds of ₹100 each.

3

SOLUTION

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2015 (₹)	2016 (₹)	2017 (₹)
Profits	65,000 (₹20,000 less than the profit of 2016)	85,000 (₹20,000 less than the profit of 2017)	1,05,000
Less: Income from Non-trading Investments (75,000 × 5%)	3,750	3,750	3,750
Balance	61,250	81,250	1,01,250
Less: Income Tax @ 60%	36,750	48,750	60,750
Balance	24,500	32,500	40,500
Less: Preference Dividend @ 8% of 20,000	1,600	1,600	1,600
Adjusted Profits/Future Maintainable Profits	**22,900**	**30,900**	**38,900**

Adjusted Average Profits = 22,900 + 30,900 + 38,900 ÷ 3
= 92,700 ÷ 3
= **₹30,900**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	(₹)
Building at Replacement Cost	1,00,000
Furniture	1,000
Stock	1,11,500
Book Debts less Reserve	23,750
Cash and Bank Balances	27,750
	2,64,000
Less: Sundry Liabilities	
Creditors	(24,000)
Preference Capital	(20,000)
Capital Employed at the end of the year	2,20,000
Less: Half of the current-year profit before tax	
Half of (1,05,000 – 3,750 (Income on Investment))	(50,625)
Average Capital Employed	**1,69,375**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return

= 1,69,375 × 10%

= **₹16,937.50**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	30,900.00
Less: Normal Profit (Step 3)	16,937.50
Super Profit	**13,962.50**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase

= 13962.50 × 3

= **₹41.887.50**

Illustration 9 **(Goodwill as per Super Profits Method and Capital Employed calculated on the basis of Asset-based Approach)**

Balance Sheet of Standard Ltd. as on 31 March 2006 is as follows:

Liabilities	(₹)	Assets	(₹)
10,000 Equity Shares of ₹100 each	10,00,000	Fixed Assets	10,00,000
6,000, 15% Preference Shares of ₹100 each	6,00,000	Stock	3,50,000
General Reserve	80,000	Debtors	4,50,000
Profit and Loss A/c	1,60,000	Cash and Bank	2,00,000
Sundry Creditors	1,60,000		
	20,00,000		**20,00,000**

The profits of the company (before providing taxation at 38.5%) and declared with respect to the past five financial years are as follows:

Financial Year	Profit (₹)	Rate of Dividend
2001–02	2,70,000	8%
2002–03	3,10,000	10%
2003–04	3,40,000	12%
2004–05	3,30,000	15%
2005–06	3,60,000	15%

You are required to find out the value of goodwill at five years' purchase of the Super Profits of the company.

[Bangalore University, B.Com Nov/Dec 2006, 2010, 2011 and 2012]

Solution

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2001–02 (₹)	2002–03 (₹)	2003–04 (₹)	2004–05 (₹)	2005–06 (₹)
Profits	2,70,000	3,10,000	3,40,000	3,30,000	3,60,000
Less: Income Tax @ 38.5%	1,03,950	1,19,350	1,30,900	1,27,050	1,38,600
Balance	1,66,050	1,90,650	2,09,100	2,02,950	2,21,400

3

Adjusted Average Profits = 1,66,050 + 1,90,650 + 2,09,100 + 2,02,950 + 2,21,400 ÷ 5
= 9, 90,150 ÷ 5 = **₹1,98,030**

Alternatively

Particulars	(₹)
Profits (2001–02 to 2005–06)	16,10,000 ÷ 5
Average Profits	3,22,000
Less: Income Tax @ 38.5%	1,23,970
Adjusted Average Profits	**1,98,030**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	(₹)
Fixed Assets	10,00,000
Stock	3,50,000
Debtors	4,50,000
Cash and Bank	2,00,000
	20,00,000
Less: Sundry Liabilities	
Creditors	(1,60,000)
Capital Employed at the end of the year	18,40,000
Less: Half of the current-year profit before tax	
Half of 3,60,000 (current-year profit)	(1,80,000)
Average Capital Employed	**16,60,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*

= 16,60,000 × 12% = **₹1,99,200**

(*Normal rate of return is arrived at by taking the average of rate of dividend)

Normal Rate of Return = 8 + 10 + 12 + 15 + 15 = 60 ÷ 5 = 12

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	1,98,030
Less: Normal Profit (Step 3)	1,99,200
Super Profit	**(-1,170)**

Step 5: *Calculation of Goodwill*

Goodwill = NIL*

(*Goodwill value will be NIL as Super Profits are negative.)

3.10.3 Capitalisation Method

This method calculates goodwill by capitalising the average (future) profits by applying the normal rate of return. This method estimates the amount of capital required for earning a certain amount of profit at the normal rate of return. There are two ways to find out the value of goodwill under this method:

1. Capitalisation of Average Profit Method
2. Capitalisation of Super Profit Method

3

Capitalisation of Average (Future) Profit Method

Step 1: *Calculation of Adjusted Average Profits*

The Adjusted Average Profit or the Future Maintainable Profits can be calculated in the same manner as explained earlier in Average Profit Method.

Step 2: *Calculation of the Capitalised (Total) value* of the aforementioned Adjusted Average Profits by using the following formula:

$$\textbf{Capitalised Value of the Business} = \frac{\textbf{Adjusted Average Profits}}{\textbf{Normal Rate of Return}} \times \textbf{100}$$

Step 3: *Compute the Actual Capital Employed in the business (Net Assets of the business)* according to the procedure explained in the Super Profit Method previously.

Step 4: *Compute the Value of Goodwill*

Capitalised (Total) Value of the business	xxx
Less: Capital Employed in the business	xxx
Value of Goodwill as per Capitalisation of Average Profits	**xxx**

Capitalisation of Super Profit Method

This method aims at estimating the capital required to earn the amount of Super Profit. In order to ascertain Goodwill under this method, Super Profit of the business and the Normal Rate of Return are required. The following formula is used to ascertain goodwill as per the Capitalisation of Super Profit Method.

$$\textbf{Goodwill as per the capitalisation of Super Profit Method} = \frac{\textbf{Super Profit}}{\textbf{Normal Rate of Return}} \times \mathbf{100}$$

Illustration 10 **(Capitalisation of Adjusted Average Profits)**

The Balance Sheet of Suman Enterprises as on 31 December 2017 was as follows:

Liabilities	(₹)	Assets	(₹)
Capital	1,00,000	Building	50,000
Creditors	20,000	Machinery	25,000
Bills Payable	5,000	Furniture	25,000
		Stock	20,000
		Cash	5,000
	1,25,000		**1,25,000**

3

The business profits for the past five years ending 31 December 2017 were given as follows:
2013: ₹12,000
2014: ₹14,000
2015: ₹18,000
2016: ₹20,000
2017: ₹18,000.
Building was re-valued at ₹65,000, Machinery at ₹29,000 and Furniture at ₹27,000.
Ascertain the value of goodwill as per capitalisation, assuming the normal rate of return as 10%.

SOLUTION

Step 1: *Calculation of Adjusted Average Profits*

Adjusted Average Profits = 12,000 + 14,000 + 18,000 + 20,000 + 18,000 ÷ 5
= 82,000 ÷ 5 = **₹16,400**

Step 2: *Calculation of the Capitalised (Total) Value*

$$\text{Capitalised Value of the Business} = \frac{\text{Adjusted Average Profits}}{\text{Normal Rate of Return}} \times 100$$

= 16,400 ÷ 10 × 100
= **₹1,64,000**

Step 3: *Calculation of the Capital Employed*

Particulars	(₹)
Building (Re-valued value)	65,000
Machinery (Re-valued value)	29,000
Furniture (Re-valued value)	27,000
Stock	20,000
Cash	5,000
	1,46,000
Less: Creditors	(20,000)
Bills Payable	(5,000)
Capital Employed at the end of the year	**1,21,000**

Step 4: *Compute the Value of Goodwill*

Capitalised (Total) Value of the business	1,64,000
Less: Capital Employed in the business	(–) 1,21,000
Value of Goodwill as per Capitalisation of Average Profits	**43,000**

Illustration 11 **(Capitalisation of Super Profits)**

The Balance Sheet of Akshay Ltd. as on 31 December 2017 is as follows:

Liabilities	(₹)	Assets	(₹)
10,000 Equity Shares of ₹100 each	10,00,000	Goodwill	3,00,000
Profit and Loss A/c	3,00,000	Building	9,00,000
Loans	5,50,000	Plant	4,50,000
Creditors	4,25,000	Stock	6,00,000
Provision for Taxation	3,25,000	Debtors	3,00,000
		Cash	50,000
	26,00,000		**26,00,000**

The business profits for the past five years ending 31 December 2017 were:
2013: ₹2,20,000
2014: ₹2,80,000
2015: ₹4,00,000
2016: ₹3,40,000
2017: ₹4,60,000

The company has paid dividend at 10% in 2013, 2014 and 2015; while in 2016 and 2017, the dividend rate was increased to 15%. The value of the plant was ₹6, 00,000 and the building was re-valued at ₹10,00,000. Ascertain the amount of goodwill, assuming the tax rate as 35%, using Capitalisation Method based on Super Profits.

Solution

Step 1: *Calculation of Adjusted Average Profits*

Particulars	**(₹)**
Total Profits (2,20,000 + 2,80,000 + 4,00,000 + 3,40,000 + 4,60,000)	17,00,000
Average Profits (17,00,000 ÷ 5)	3,40,000
Less: Income Tax @ 35%	1,19,000
Adjusted Average Profits	**2,21,000**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	**(₹)**
Building	10,00,000
Plant	6,00,000
Stock	6,00,000
Debtors	3,00,000
Cash	50,000
	25,50,000
Less: Sundry Liabilities	
Loans	(5,50,000)
Creditors	(4,25,000)
Provision for Taxation	(3,25,000)
Capital Employed at the end of the year	12,50,000
Less: Half of the current-year profit before tax	
Half of 4,60,000 (current-year profit)	(2,30,000)
Average Capital Employed	**10,20,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*

= 10,20,000 × 12% = **₹1,22,400**

(*Normal rate of return is arrived at by taking the average of rate of dividend)

Normal Rate of Return = 10 + 10 + 10 + 15 + 15 = 60 ÷ 5 = 12

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	2,21,000
Less: Normal Profit (Step 3)	(1,22,400)
Super Profit	**98,600**

Step 5: *Calculation of Goodwill*

$$\text{Goodwill as per the Capitalisation of Super Profit Method} = \frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$$

= 98,600 ÷ 12 × 100

= ₹8,21,667

3.10.4 Annuity Method

The valuation of goodwill under this method is determined with the help of the present value of an annuity for a certain number of years at a certain rate of interest. The annuity represents the Super Profits of the business, and the Super Profit (annuity) is multiplied by the present value of ₹1 from the annuity tables.

Goodwill as per Annuity Method = Super Profit × Annuity Value

Illustration 12

Ascertain the value of goodwill of Sunrise Ltd. on the basis of Annuity Method:

The profits of the firm were given as follows:

2013: ₹1,18,000
2014: ₹99,000
2015: ₹1,15,000
2016: ₹1,24,000
2017: ₹1,09,000

It is also expected that Super Profit can be maintained for the next five years. A managerial remuneration of ₹10,000 per annum is considered acceptable. Earlier in 2014, an amount of ₹2,000, that was written off as bad several years ago, was received and was included in the profits of 2014. The expected normal rate of return is 10%. The Average Capital Employed was ₹9, 00,000. Present value of an annuity of ₹1 for five years at 10% is ₹3.78.

3

SOLUTION

Step 1: *Calculation of Adjusted Average Profits*

Particulars	**(₹)**
Total Profits 2013: 1,18,000 2014: 97,000 – 2,000 (Bad Debt recovered) 2015: 1,15,000 2016: 1,24,000 2017: 1,08,000	5,60,000
Average Profits = 5,60,000 ÷ 5	1,12,000
Less: Managerial Remuneration	10,000
Adjusted Average Profits	**1,02,000**

Step 2: *Calculation of Average Capital Employed*

Average Capital Employed (given) = **₹9,00,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 9,00,000 × 10% = **₹90,000**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	1,02,000
Less: Normal Profit (Step 3)	90,000
Super Profit	**12,000**

Step 5: *Calculation of Goodwill*

Goodwill as per Annuity Method = Super Profit × Annuity Value
= 12,000 × 3.78
= **₹45,360**

Comprehensive Illustrations

Illustration 13

From the following information calculate the value of goodwill under:

(i) Three years' purchase of Super Profits Method
(ii) Capitalisation of Super Profits Method

(a) Average Capital Employed: ₹8,70,000
(b) Net Profits of the firm for the past three years were ₹1,22,000, ₹98,500 and ₹1,75,500.
(c) Managerial Remuneration is employed elsewhere at ₹18,000 per annum.
(d) Normal rate of return is 8%.

[Bangalore University, B.Com Nov/Dec 2005 and 2014, Section B]

SOLUTION

Step 1: *Calculation of Adjusted Average Profits*

Particulars	(₹)
Total Profits (1,22,000 + 98,500 + 1,75,500)	3,96,000
Average Profits = 3,96,000 ÷ 3	1,32,000
Less: Managerial Remuneration	18,000
Adjusted Average Profits	**1,14,000**

Step 2: *Calculation of Average Capital Employed*

Average Capital Employed (given) = ₹8,70,000

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 8, 70,000 × 8%
= ₹69,600

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	1,14,000
Less: Normal Profit (Step 3)	69,600
Super Profit	**44,400**

Step 5: ***Calculation of Goodwill (Super Profits Method)***

Goodwill = Super Profit × Number of years of purchase

= 44,400 × 3

= ₹1,33,200

Calculation of Goodwill (Capitalisation of Super Profits Method)

$$\text{Goodwill} = \frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{44{,}400}{8\%} \times 100$$

= 5,55,000

Illustration 14

Following is the Balance Sheet of X Ltd., as on 31 December 2001.

Liabilities	(₹)	Assets	(₹)
Equity Share Capital of ₹10 each	5,00,000	Buildings	1,65,000
General Reserve	2,00,000	Machinery	85,000
Profit and Loss A/c	1,00,000	Furniture	50,000
Sundry Creditors	60,000	Motor Vans	1,00,000
Bills Payable	20,000	Investments (Market Price ₹1,20,000)	1,00,000
Provision for Tax	20,000	Stock	1,50,000
		Debtors	80,000
		Bank	1,70,000
	9,00,000		**9,00,000**

Net Profit before Tax:
1999: ₹2,10,000
2000: ₹2,20,000
2001: ₹2,50,000
Rate of taxation: 40%

Income from Investments may be taken at 6%. Normal rate of return on average capital employed is 15%. Building is valued at ₹1,80,000 and Machinery at ₹90,000. Taking Weighted Average Profits after tax as basis. Calculate the value of goodwill based on:

(i) Five years' purchase of Super Profits

(ii) Capitalisation of Super Profits

(iii) Annuity of Super Profits taking annuity rate at 2.97 (Ignore additional depreciation on Buildings and Machinery)

[Bangalore University, B.Com Nov/Dec 2005, Section C]

SOLUTION

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Calculation of Weighted Average Profits

Year	Profits (₹)	Weights	Product (₹)
1999	2,10,000	1	2,10,000
2000	2,20,000	2	4,40,000
2001	2,50,000	3	7,50,000
		6	**14,00,000**

*Income on Investments = ₹6,000 (1,00,000 × 6%)
Weighted Average Profits = 14,00,000 ÷ 6 = ₹2,33,333

Calculation of Adjusted Average (weighted) Profits

Adjusted Average (weighted) Profits = Average Profit – Interest on Investment – Tax@40%
= 2, 33,333 – 6,000 (1,00,000 × 6%) – 90,933
= **₹1,36,400**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars		(₹)
Buildings		1,80,000
Machinery		90,000
Furniture		50,000
Motor Vans		1,00,000
Stock		1,50,000
Debtors		80,000
Bank		1,70,000
		8,20,000
Less: Sundry Liabilities		
Sundry Creditors	(60,000)	
Bills Payable	(20,000)	
Provision for Tax	(20,000)	1,00,000
Capital Employed at the end of the year		7,20,000
Less: Half of the current-year profit before tax Half of 2,44,000 (2,50,000 – 6,000)		(1,22,000)
Average Capital Employed		**5,98,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*

= 5,98,000 × 15% = **₹89,700**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	1,36,400
Less: Normal Profit (Step 3)	(89,700)
Super Profit	**46,700**

Step 5: *Calculation of Goodwill (Super Profits Method)*

Goodwill = Super Profit × Number of years of purchase

= 46,700 × 5

= **₹2,33,500**

II. Capitalisation of Super Profits

Goodwill as per the Capitalisation of Super Profit Method = $\frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$

= 46,700 ÷ 15 × 100

= **₹3,11,333**

III. Annuity Method

Goodwill as per Annuity Method = Super Profit × Annuity Value

= 46,700 × 2.97

= **₹1,38,699**

Illustration 15

Following is the Balance Sheet of Chandana Ltd. as on 31 March 2006.

Liabilities	(₹)	Assets	(₹)
Share Capital	30,00,000	Fixed Assets	20,00,000
Reserves and Surplus	7,50,000	Current Assets	25,00,000
Creditors	12,50,000	Investments	5,00,000
	50,00,000		**50,00,000**

The investments are 8% government bonds. The Net Profits after taxation for the past four years were ₹7,85,000, ₹8,45,000, ₹8,50,000 and ₹8,60,000, respectively. Normal rate of return on average capital employed is 20%. Calculate goodwill at three years' purchase of Super Profits.

[Bangalore University, B.Com Nov/Dec 2006, Section B]

Solution

Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Calculation of Weighted Average Profits

Year	Profits (₹)	Weights	Product (₹)
1	7,85,000	1	7,85,000
2	8,45,000	2	16,90,000
3	8,50,000	3	25,50,000
4	8,60,000	4	34,40,000
		10	**84,65,000**

Weighted Average Profits = 84,65,000 ÷ 10 = ₹8, 46,500

Note: As the profits show increasing trend weighted Average Profit is used.

Calculation of Adjusted Average (weighted) Profits

Adjusted Average (weighted) Profits = Average Profit – Interest on Investment
= 8,46,500 – 40,000 (5,00,000 × 8%)
= 8,06,500

3

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	(₹)
Fixed Assets	20,00,000
Current Assets	25,00,000
	45,00,000
Less: Sundry Liabilities	
Creditors	(12,50,000)
Capital Employed at the end of the year	32,50,000
Less: Half of the current-year profit before tax Half of 8,20,000 (8,60,000 – 40,000)	(4,10,000)
Average Capital Employed	**28,40,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 28,40,000 × 20%
= **₹5,68,000**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	8,06,500
Less: Normal Profit (Step 3)	(5,68,000)
Super Profit	**2,38,500**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase

= 2,38,500 × 3

= **₹7,15,500**

Illustration 16

The profits disclosed by Chaitra Ltd. for the past five years were as follows:

2002: ₹40,000 (including abnormal profit of ₹5,000)
2003: ₹50,000 (after charging abnormal loss of ₹10,000)
2004: ₹45,000 (excluding ₹5,000 of insurance premium)
2005: ₹60,000
2006: ₹80,000 (including profit on sale of building: ₹20,000)

You are required to calculate the value of goodwill at two years purchase of Average Profits.

[Bangalore University, B.Com Nov/Dec 2007 and 2011, Section B]

Solution

Average Profits Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	(₹)	(₹)
Profits 2002	40,000	
Less: Abnormal Profit	(5,000)	35,000
Profits 2003	50,000	
Add: Abnormal Loss	10,000	60,000
Profits 2004	45,000	
Less: Insurance Premium (Recurring in nature)	(5,000)	40,000
Profits 2005	-	60,000
Profits 2006	80,000	
Less: Profit on sale of Building	(20,000)	60,000
Adjusted Annual Profits for the period of five years		**2,55,000**

Simple Average Profits = 2,55,000 ÷ 5

= **₹51,000**

Step 2: *Calculation of the Value of Goodwill*

Value of Goodwill = Adjusted Average Annual Profits × Number of years of purchase

= 51,000 × 2

= **₹1,02,000**

Illustration 17

The following particulars are available in respect of the business carried on by Indira Ltd.:

(i) Profits earned for the years:
2004–05: ₹50,000
2005–06: ₹60,000
2006–07: ₹55,000

(ii) Profit of 2004–05 included a non-recurring income of ₹5,000

(iii) During the year 2005–06, closing stock was undervalued by ₹10,000

(iv) Normal rate of return is 10%

(v) Average capital employed is ₹3,00,000

(vi) Present value of an annuity of ₹1 for five years at 10% is ₹3.78

You are required to calculate the Value of Goodwill:

(a) As per five years' purchase of Super Profits

(b) As per Capitalisation of Super Profits

(c) As per Annuity Method

[Bangalore University, B.Com Nov/Dec 2007, Section C]

3

SOLUTION

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2004–05 (₹)	2005–06 (₹)	2006–07 (₹)
Profits	50,000	60,000	55,000
Less: Non-Recurring Income	(5,000)	-	-
Add: Undervaluation of Closing Stock	-	10,000	-
Less: Undervaluation of Opening Stock (Undervaluation of Closing Stock in 2005–06 means undervaluation of Opening Stock in 2006–07. Hence, shown separately)			(10,000)
Adjusted Annual Profits for the period of three years	**45,000**	**70,000**	**45,000**

Simple Average Profits = 45,000 + 70,000 + 45,000 ÷ 3
= 1,60,000 ÷ 3
= **₹53,333**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Average Capital Employed (given) = **₹3,00,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 3,00,000 × 10%
= **₹30,000**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	53,333
Less: Normal Profit (Step 3)	(30,000)
Super Profit	**23,333**

Step 5: *Calculation of Goodwill (Super Profits Methods)*

Goodwill = Super Profit × Number of years of purchase
= 23,333 × 5
= **₹1,16,665**

II. Capitalisation of Super Profits

Goodwill as per the Capitalisation of Super Profit Method = $\frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$
= 23,333 ÷ 10 × 100
= **₹2,33,330**

III. Annuity Method

Goodwill as per Annuity Method = Super Profit × Annuity Value
= 23,333 × 3.78
= ₹88,199

Illustration 18

The net profits of Karthik Ltd., after providing for taxation for the past five years were ₹80,000, ₹85,000, ₹92,000, ₹1,13,000 and ₹1,10,000. The capital employed in the business is ₹8,00,000. The normal rate of return expected in this type of business is 10%.

Calculate the value of goodwill on the basis of:

(i) Five years' purchase of Super Profits Method, and

(ii) Annuity Method, taking the present value of annuity of ₹1 for five years at 10% as ₹3.78.

[Bangalore University, B.Com Nov/Dec 2008, Section B]

SOLUTION

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Simple Average Profits = 80,000 + 85,000 + 92,000 + 1,13,000 + 1,10,000 ÷ 5
= 4,80,000 ÷ 5
= **₹96,000**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*
Average Capital Employed (given) = **₹8,00,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 8,00,000 × 10%
= **₹80,000**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	96,000
Less: Normal Profit (Step 3)	(80,000)
Super Profit	**16,000**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 16,000 × 5
= **₹80,000**

III. Annuity Method

Goodwill as per Annuity Method = Super Profit × Annuity Value
= 16,000 × 3.78
= **₹60,480**

3

Illustration 19

The following particulars are available with respect to the business carried on by Nischal Ltd.

(i) Profits earned:

2006: ₹1,00,000

2007: ₹96,000

2008: ₹1,04,000

(ii) Profit of 2007 is reduced by ₹10,000 due to stock being destroyed by fire and profit of 2006 included a non-recurring income of ₹6,000.

(iii) Profit of 2008 include ₹4,000 income from investment

(iv) 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.

(v) Normal rate of return is 10%

(vi) Average capital employed is ₹8,00,000

(vii) Present value of an annuity of ₹1 for 5 years at 10% is ₹3.78

You are required to calculate the value of Goodwill:

(a) As per five years' purchase of Super Profits

(b) As per Capitalisation of Super Profits

(c) As per Annuity Method

[Bangalore University, B.Com Nov/Dec 2008, Section C]

Solution

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2006 (₹)	2007 (₹)	2008 (₹)
Profits	1,00,000	96,000	1,04,000
Add: Stock destroyed by fire (Abnormal loss: Non-recurring in nature)	-	10,000	
Less: Abnormal Gain (Non-Recurring Income)	(6,000)	-	-
Less: Income from Investment	-	-	(4,000)
Less: Insurance (Recurring Expense)	(1,000)	(1,000)	(1,000)
Adjusted Annual Profits for the period of three years	**93,000**	**1,05,000**	**99,000**

Simple Average Profits = 93,000 + 1,05,000 + 99,000 ÷ 3
= 2,97,000 ÷ 3
= **₹99,000**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Average Capital Employed (given) = **₹8,00,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 8,00,000 × 10%
= **₹80,000**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	₹99,000
Less: Normal Profit (Step 3)	₹(80,000)
Super Profit	**₹19,000**

Step 5: *Calculation of Goodwill (Super Profits Method)*

Goodwill = Super Profit × Number of years of purchase
= 19,000 × 5
= **₹95,000**

II. Capitalisation of Super Profits

Goodwill as per the Capitalisation of Super Profit Method = $\frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$

= 19,000 ÷ 10 × 100

= **₹1,90,000**

III. Annuity Method

Goodwill as per Annuity Method = Super Profit × Annuity Value

= 19,000 × 3.78

= **₹71,820**

Illustration 20

Sri Ram has invested a sum of ₹3,00,000 in his own business, which is very profitable. The annual profit earned from his business is 60,000, which included a sum of ₹10,000 received as compensation for acquisition of part of his business.

The money could have been invested in deposits for a period of five years at 10% interest and he could earn ₹7,200 per annum in alternative employment, considering 2% as fair compensation for the risk involved in the business.

Calculate the value of goodwill of his business on capitalisation of super profits at a normal rate of return of 12%.

[Bangalore University, B.Com Nov/Dec 2009 and 2015, Section B]

3

SOLUTION

I. Capitalisation of Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	(₹)
Profits	60,000
Less: Compensation received (Non-Business Income/Non-recurring nature)	(7,200)
Less: Interest on Investment (Non-Business Income)	(10,000)
Adjusted Annual Profits for the year	**42,800**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Average Capital Employed (given) = ₹3,00,000

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*

= 3,00,000 × 12%

= ₹36,000

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	42,800
Less: Normal Profit (Step 3)	(36,000)
Super Profit	**6,800**

Step 5: *Calculation of Goodwill*

Goodwill as per the Capitalisation of Super Profit Method = $\frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$

$= 6{,}800 \div 12 \times 100$

$= ₹56{,}667$

Illustration 21

The Balance Sheet of Venu is as follows on 31 December 2002:

Liabilities	(₹)	Assets	(₹)
Share Capital: Equity Shares of ₹10 each	5,00,000	Fixed Assets	4,00,000
General Reserves	2,00,000	Investment (6% Govt. Bonds)	1,00,000
Profit and Loss A/c	1,00,000	Current Assets	4,00,000
Current Liabilities	1,00,000		
	9,00,000		**9,00,000**

Net Profit after Taxation:
2000: 1,30,000
2001: 1,25,000
2002: 1,50,000
The normal rate of return is 15%
The current assets are to be taken as ₹4, 20,000.
Ascertain the goodwill under:

(i) Four years' purchase of Super Profits
(ii) Capitalisation of Super Profits
(iii) Annuity of Super Profits taking the present value of an annuity of ₹1 for five years at 10% interest as ₹3.78.

[Bangalore University, B.Com Nov/Dec 2009, 2014, 2016, Section C]

SOLUTION

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Simple Average Profits = 1,30,000 + 1,25,000 + 1,50,000 ÷ 3
= 4,05,000 ÷ 3
= ₹1,35,000

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	**(₹)**
Fixed Assets	4,00,000
Current Assets	4,20,000
	8,20,000
Less: Sundry Liabilities	
Creditors	(1,00,000)
Capital Employed at the end of the year	7,20,000
Less: Half of the current-year profit before tax Half of ₹1,50,000	(75,000)
Average Capital Employed	**6,45,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 6,45,000 × 15%
= **₹96,750**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	1,35,000
Less: Normal Profit (Step 3)	(96,750)
Super Profit	**38,250**

Step 5: *Calculation of Goodwill (Super Profits Method)*

Goodwill = Super Profit × Number of years of purchase
= 38,250 × 4
= **₹1,53,000**

II. Capitalisation of Super Profits

Goodwill as per the Capitalisation of Super Profit Method = $\frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$
= 38,250 ÷ 10 × 100
= **₹3,82,500**

III. Annuity Method

Goodwill as per Annuity Method = Super Profit × Annuity Value
= 38,250 × 3.78
= **₹1,44,585**

Illustration 22

The net profits of a business, after providing for taxation, for the past five years were ₹40,000, ₹42,000, ₹45,000, ₹46,000 and ₹47,000, respectively. The capital employed in the business is ₹4,00,000; on which, a reasonable rate of 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 in the basis of:

(i) Five years' purchase of Super Profits

(ii) Annuity of Super Profits, taking the present value of an annuity of ₹1 for five years at 10% interest is ₹3.78.

[Bangalore University, B.Com Nov/Dec 2010, Section B]

Solution

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Note: As the profits are showing an increasing trend, Weighted Average Profits Method can be followed:

Calculation of Adjusted Average (weighted) Profits

Year	Profits (₹)	Weights	Product (₹)
1	40,000	1	40,000
2	42,000	2	84,000
3	45,000	3	1,35,000
4	46,000	4	1,84,000
5	47,000	5	2,35,000
		15	**6,78,000**

Weighted Average Profits = 6,78,000 ÷ 15 = **₹45,200**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Average Capital Employed (given) = **₹4,00,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 4,00,000 × 10%
= **₹40,000**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	45,200
Less: Normal Profit (Step 3)	(40,000)
Super Profit	**5,200**

3

Step 5: *Calculation of Goodwill (Super Profits Method)*

Goodwill = Super Profit × Number of years of purchase
= 5,200 × 5
= **₹26,000**

II. Annuity Method

Goodwill as per Annuity Method = Super Profit × Annuity Value
= 5,200 × 3.78
= **₹19,656**

Illustration 23

The Balance Sheet of ABC Ltd. as on 31 March 2012 was as follows:

Liabilities	(₹)	Assets	(₹)
20,000 Equity Shares of ₹10 each	2,00,000	Fixed Assets	3,80,000
10% Preference Share Capital	1,00,000	Investments (5% Govt. Bonds)	40,000
Profit and Loss A/c	2,00,000	Current Assets	2,00,000
9% Debentures	1,00,000	Preliminary Expenses	15,000
Creditors	35,000		
	6,35,000		**6,35,000**

The average profit of the company is ₹62,000. Normal rate of return is 10%.
You are required to calculate goodwill as four times of the Super Profits.

[Bangalore University, B.Com Oct/Nov 2012, Section B]

Solution

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Average Profits (given) = ₹62,000 (given)

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	(₹)
Fixed Assets	3,80,000
Current Assets	2,00,000
	5,80,000
Less: Sundry Liabilities	
9% Debentures	(1,00,000)
Creditors	(35,000)
Average Capital Employed (refer note)	**4,45,000**

Note: In the absence of the information on current year's profit, capital at the end of the year can be presumed as Average Capital Employed.

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 4,45,000 × 10%
= **₹44,500**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	62,000
Less: Normal Profit (Step 3)	(44,500)
Super Profit	**17,500**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 17,500 × 4
= **₹70,000**

Illustration 24

Nischal Ltd. proposed to purchase the business of Nishanth Ltd. For this purpose, Goodwill is agreed to be valued at two years' purchase of the weighted average profits of the past three years.

The weights to be used are as follows:
2010: 1
2011: 2
2012: 3

The profits were given as follows:
2010: ₹46,000
2011: ₹56,000
2012: ₹45,000

It is ascertained that the closing stock of 2011 was overvalued by ₹7,000.

You are required to calculate the value of goodwill assuming that ₹10,000 should be provided to cover management expenses.

[Bangalore University, B.Com Nov/Dec 2013, Section B]

Solution

Step 1: *Calculation of Adjusted (weighted) Average Profits/Future Maintainable Profits*

Particulars	2010 (₹)	2011 (₹)	2012 (₹)
Profits	46,000	56,000	45,000
Less: Overvaluation of Closing Stock	-	(7,000)	-
Add: Overvaluation of Opening Stock	-	-	7,000
Less: Management Cost	(10,000)	(10,000)	(10,000)
Adjusted Annual Profits for the period of three years	**36,000**	**39,000**	**42,000**

Year	Adjusted Profits (₹)	Weights	Weighted Adjusted Profits (₹)
2010	36,000	1	36,000
2011	39,000	2	78,000
2012	42,000	3	1,26,000
		6	**2,40,000**

Weighted Adjusted Average Profits = 2,40,000 ÷ 6 = **₹40,000**

Step 2: *Calculation of the Value of Goodwill*

Value of Goodwill = Adjusted (weighted) Average Annual Profits × Number of years of purchase
= 40,000 × 2
= **₹80,000**

Illustration 25

The net profits of SN Ltd., before providing for taxation at 30%, are as follows:

Financial Year	Profits (₹)	Weights
2008–09	1,60,000	1
2009–10	1,68,000	2
2010–11	1,80,000	3
2011–12	1,84,000	4
2012–13	1,88,000	5

The present value of assets and liabilities of the company are as follows:
Buildings: ₹12,00,000
Machinery: ₹6,00,000
Furniture: ₹2,00,000
Stock: ₹3,00,000
Debtors: ₹1,00,000
Cash and Bank: ₹50,000
Debentures: ₹5,00,000
Creditors: ₹3,00,000
Bills Payables: ₹80,000
Bank Loan: ₹7,70,000

Normal rate of return on net capital employed is 10%

You are required to find out the value of goodwill under the following methods:

(i) Two years' purchase of the Simple Average Profits
(ii) Two years' purchase of the Weighted Average Profits
(iii) Five years' purchase of Super Profits of the past five years

[Bangalore University, B.Com Nov/Dec 2013, Section C]

3

Solution

I. Simple Average Profits Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Simple Average Profits = 1,60,000 + 1,68,000 + 1,80,000 + 1,84,000 + 1,88,000 ÷ 5
= 8,80,000 ÷ 5
= ₹1,76,000 – Tax @30%
= ₹1,76,000 – 52,800
= **₹1,23,200**

Step 2: *Calculation of the Value of Goodwill*

Value of Goodwill = Adjusted (Simple) Average Annual Profits × Number of years of purchase
= 1,23,200 × 2
= **₹2,46,400**

II. Weighted Average Profits Method

Step 1: *Calculation of Adjusted Average (weighted) Profits*

Financial Year	Profits (₹)	Weights	Product (₹)
2008–09	1,60,000	1	1,60,000
2009–10	1,68,000	2	3,36,000
2010–11	1,80,000	3	5,40,000
2011–12	1,84,000	4	7,36,000
2012–13	1,88,000	5	9,40,000
		15	**27,12,000**

Adjusted Weighted Average Profits = 27,12,000 ÷ 15
= 1,80,800 – Tax @ 30%
= 1,80,800 – 54,240
= **₹1,26,560**

Step 2: *Calculation of the Value of Goodwill*

Value of Goodwill = Adjusted (Simple) Average Annual Profits × Number of years of purchase
= 1,26,560 × 2
= **₹2,53,120**

III. Super Profits Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Simple Average Profits = ₹1,23,200 (As calculated in the previous method)

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	(₹)
Buildings	12,00,000
Machinery	6,00,000
Furniture	2,00,000
Stock	3,00,000
Debtors	1,00,000
Cash and Bank	50,000
	24,50,000
Less: Outside Liabilities	
Debenture	(5,00,000)
Creditors	(3,00,000)
Bills payable	(80,000)
Bank loan	(7,70,000)
Capital Employed at the end of the year	8,00,000
Less: Half of the current-year profit before tax Half of 1,88,000	(94,000)
Average Capital Employed	**7,06,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 7,06,000 × 10%
= **₹70,600**

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	1,23,200
Less: Normal Profit (Step 3)	(70,600)
Super Profit	**52,600**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 52,600 × 5
= **₹2,63,000**

Alternatively

III. Super Profits Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Weighted Average Profits = ₹1,26,560 (As calculated in the previous method)

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	**(₹)**
Buildings	12,00,000
Machinery	6,00,000
Furniture	2,00,000
Stock	3,00,000
Debtors	1,00,000
Cash and Bank	50,000
	24,50,000
Less: Outside Liabilities	
Debenture	(5,00,000)
Creditors	(3,00,000)
Bills payable	(80,000)
Bank loan	(7,70,000)
Capital Employed at the end of the year	8,00,000
Less: Half of the current-year profit before tax	
Half of 1,88,000	(94,000)
Average Capital Employed	**7,06,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 7,06,000 × 10%
= ₹70,600

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	1,26,560
Less: Normal Profit (Step 3)	(70,600)
Super Profit	**55,960**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 55,960 × 5
= **₹2,79,800**

Illustration 26

From the following information, calculate the value of goodwill under:

(i) Three years' purchase of Super Profits Method

(ii) Capitalisation of Super Profits Method

(a) Average Capital Employed: ₹8,70,000

(b) Net Profits of the firm for the past three years were: ₹1,22,000; ₹98,500 and ₹1,75,500.

(c) Managerial Remuneration if employed elsewhere: ₹18,000 per annum

(d) Normal Rate of Return: 10%

[Bangalore University, B.Com Nov/Dec 2014, Section B]

SOLUTION

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable profits*

Simple Average Profits = 1,22,000 + 98,500 + 1,75,500 ÷ 3
= 3,96,000 ÷ 3
= ₹1,32,000

Adjusted Average Profits = ₹1,32,000 – 18,000 (Managerial Remuneration)
= **₹1,14,000**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Average Capital Employed = ₹8,70,000 (given)

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 8,70,000 × 10%
= ₹87,000

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	1,14,000
Less: Normal Profit (Step 3)	(87,000)
Super Profit	**27,000**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 27,000 × 3
= **₹81,000**

II. Capitalisation of Super Profits

Goodwill as per the Capitalisation of Super Profit Method = $\frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$

= 27,000 ÷10 × 100
= ₹2,70,000

Illustration 27

The following is the Balance Sheet of Sharath Ltd. as on 31 December 2014:

Liabilities	(₹)	Assets	(₹)
10,000 Equity Shares of ₹20 each fully paid	2,00,000	Land and Building	1,68,000
Profit and Loss A/c	40,000	Plant and Machinery	1,20,000
Debentures	30,000	Furniture	10,000
Trade Creditors	40,000	5% Tax-free Government Bonds	20,000
Provision for Tax	18,000	Stock	24,000
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:
2010: ₹34,000
2011: ₹38,000
2012: ₹36,000
2013: ₹40,000
2014: ₹38,000.

On 31 December 2014, Land and Building were re-valued at ₹1,90,000; Plant and Machinery at ₹1,42,000 and Furniture at ₹8,000. 10% represents a fair commercial rate of return on investment in the company. Find the value of goodwill.

(i) Five years' purchase of Average Super Profits for the last five years

(ii) Capitalisation of Super Profit Method

(iii) Annuity Method, present value of an annuity of ₹1 for five years at 10% is ₹3.78.

[Bangalore University, B.Com Nov/Dec 2015, Section C]

SOLUTION

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Simple Average Profits = 34,000 + 38,000 + 36,000 + 40,000 + 38,000 ÷ 5
= 1,86,000 ÷ 5
= ₹37,200

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	(₹)
Land and Building	1,90,000
Plant and Machinery	1,42,000
Furniture	8,000
Stock	24,000

Particulars	(₹)
Book debts	12,000
Cash	4,000
	3,80,000
Less: Outside Liabilities	
Debentures	(30,000)
Trade Creditors	(40,000)
Provision for Tax	(18,000)
Proposed Dividend	(30,000)
Capital Employed at the end of the year	2,62,000
Less: Half of the current-year profit before tax Half of 38,000	(19,000)
Average Capital Employed	**2,43,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 2,43,000 × 10%
= ₹24,300

3

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	37,200
Less: Normal Profit (Step 3)	(24,300)
Super Profit	**12,900**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 12,900 × 5
= ₹64,500

II. Capitalisation of Super Profits

$$\text{Goodwill as per the Capitalisation of Super Profit Method} = \frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$$

= 12,900 ÷ 10 × 100
= ₹1,29,000

III. Annuity Method

Goodwill as per Annuity Method = Super Profit × Annuity Value
=12,900 × 3.78
= **₹48,762**

Illustration 28

X Ltd. agreed to purchase the business of a sole trader and for that purpose goodwill is to be valued at three years' purchase of the average of previous four years' adjusted profit. The profits for the years ending 31 March 2013, 2014, 2015 and 2016 were given as: ₹40,000; ₹48,000; ₹50,000 and ₹60,000 respectively.

Following additional information is available.

(i) On 01 January 2015, a major repair expenditure to Plant and Machinery for ₹12,000 was charged to the Profit and Loss Account. This was agreed to be capitalised for goodwill, subject to 10% per annum depreciation on Reducing Balance Method.

(ii) The closing stock for the year ending 2014 was overvalued by ₹4,800.

(iii) In order to recover the cost of management, an annual charge of ₹9,600 should be made for valuation of goodwill.

Compute the value of goodwill.

[Bangalore University, B.Com Nov/Dec 2016, Section B]

Solution

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Particulars	2013 (₹)	2014 (₹)	2015 (₹)	2016 (₹)
Profits	40,000	48,000	50,000	60,000
Add: Capital Expenditure treated as Revenue Expenditure (Major overhaul repair)	-	-	12,000	-
Less: Depreciation on major repair to be considered as Capital Expenditure (12,000 × 10/100)			(1,200)	(1,080)
Less: Overvaluation of Closing Stock (2014)		(4,800)		
Add: Overvaluation of Opening Stock (2015) (if Closing Stock is overvalued, then, certainly Opening Stock also reflects the overvalued value)			4,800	
Less: Annual charge towards Management Cost	(9,600)	(9,600)	(9,600)	(9,600)
Adjusted Annual Profits for the period of four years	**30,400**	**33,600**	**56,000**	**49,320**

Step 2: *Calculation of Weighted Average Profits*

Year	Adjusted profits (₹)	Weights	Product (₹)
2014	30,400	1	30,400
2015	33,600	2	67,200
2016	56,000	3	1,68,000
2017	49,320	4	1,97,280
		10	**4,62,880**

Weighted Average Profits = 4,62,880 ÷ 10 = ₹46,288

Step 3: *Calculation of the Value of Goodwill*

Value of Goodwill = Weighted Average Profits × Number of years of purchase

= 46,288 × 3

= ₹1,38,864

SUMMARY

- Goodwill of a business conveys trustworthiness, approval or the image of the business in the market. Goodwill is the additional worth associated with a business organisation, which is exceptionally higher when compared to the other similar businesses and it is over and above the intrinsic value of its own net assets.
- **Goodwill** is defined as, 'the expected future earnings, if more than the normal return on investment, the capitalisation of this surplus is generally termed as Goodwill.'
- The nature of goodwill is classified into Dog, Cat, Rat and Rabbit. It is also classified into personal, inherent, free or no goodwill.
- The types of goodwill are purchased goodwill and non-purchased or inherent and raised goodwill.
- The legal concept of goodwill, prescribes that goodwill need not necessarily be measured in terms of extraordinary goodwill. Economic concept signifies that the unreported assets of the business help to make **Super Profits**. Accounting concept recognises goodwill in terms of the firm's ability to earn profits over and above its regular profits.
- Features of Goodwill:
  - It is an intangible asset.
  - It is a real asset and not fictitious one, as its existence can be felt through the extra earning capacity of the business.
  - As it is a real asset, it can be realised by its possible sale.
  - It is the extra value in non-physical form over and above the physical value of the physical assets.
  - It can be valued only if it can be transferred from one business to another, there is no value of goodwill, if it cannot be transferred from one business to another.
- Components of goodwill are: the technological edge that the business enjoys, the number of patents, licenses, trademarks, copyrights and franchises the firm has to its credit, any competitive advantage, namely, long-term contracts at low or remunerative prices, availability of resources at reasonable prices, locational advantage, managerial efficiency, employee morale, loyal customers, etc.
- Factors influencing the value of goodwill are: firm's earning capacity, nature of industry, nature of business, size of the business, nature or quality of products and services, stable nature of the business.

- There are four methods of computing goodwill. They are:
  - Average Profits or Simple Profits Method
  - Super-Profits Method
  - Capitalisation Method
  - Annuity Method
- **Value of Goodwill under Average Profits Method**

  Step 1: Calculation of Adjusted Average Profits or Adjusted Future Maintainable Profits

  Step 2: Calculation of Adjusted Average Profits

  Adjusted Average Profits (using Simple Average Method)

  = Overall Adjusted Profits for all the given years/Number of Years

  Weighted Adjusted Average Profits (using Weighted Average Method)

  = Overall Adjusted Profits multiplied with the respective weights/Total of Weights

  Step 3: Calculation of Goodwill

  Value of Goodwill = Adjusted Average Profits × Number of years of Purchase
- **Value of Goodwill under Super Profits Method**

  Step 1: Calculation of Adjusted Average Profit (discussed earlier)

  Step 2: Calculation of Average Capital Employed (either assets or Liability-based Approach)

  Step 3: Calculation of Normal Profits

  Normal Profits = Average Capital Employed × Normal Rate of Return

  Step 4: Calculation of Super Profits

Adjusted Average Profits (Step 1)	xxx
Less: Normal Profit (Step 3)	(xxx)
Super Profit	xxx

  Step 5: Calculation of Goodwill

  Goodwill = Super Profit × Number of Years of Purchase
- **Value of Goodwill under Capitalisation Method**
  - Capitalisation of Average Profit Method
  - Capitalisation of Super Profit Method

  I. Capitalisation of Average (Future) Profit Method

  Step 1: Calculation of Adjusted Average Profits

  Step 2: Calculation of the Capitalised (Total) Value of the aforementioned Adjusted Average Profits by using the following formula:

$$\text{Capitalised Value of the Business} = \frac{\text{Adjusted Average Profits}}{\text{Normal Rate of Return}} \times 100$$

Step 3: Compute the Actual Capital Employed in the business (Net Assets of the business) according to the method explained in the Super Profit Method earlier

Step 4: Compute the Value of Goodwill

Capitalised (Total) Value of the business	xxx
Less: Capital employed in the business	xxx
Value of Goodwill as per Capitalisation of Average Profits	xxx

II. Capitalisation of Super Profit Method

$$\text{Goodwill as per Capitalisation of Super Profit Method} = \frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$$

- **Value of Goodwill under Annuity Method**

  Goodwill as per Annuity Method = Super Profit × Annuity Value

THEORY QUESTIONS

3

Section A

1. What is Goodwill?
2. When does Super Profit arise in a business?
3. Mention any two factors determining the Value of Goodwill. **[Nov/Dec 2005/2006/2012]**
4. What is Average Capital Employed? **[Nov/Dec 2005/2009]**
5. What is meant by Normal Rate of Return? **[Nov/Dec 2005/2008/2010]**
6. What is Super Profit? **[Nov/Dec 2006/2007/2009/2011]**
7. Closing Capital Employed is ₹6,00,000; Net Profit for the current year is ₹1,20,000. What is the Average Capital Employed? **[Nov/Dec 2006]**
8. State any four circumstances necessitating the valuation of Goodwill. **[Nov/Dec 2007/2014]**
9. What is Non-purchased Goodwill? **[Nov/Dec 2008]**
10. Define the term Goodwill. **[Nov/Dec 2009/2011]**
11. Mention the different methods of Valuation of Goodwill. **[Nov/Dec 2012]**
12. State any four circumstances that necessitate the Valuation of Goodwill in case of joint-stock companies. **[Nov/Dec 2013]**
13. How is Goodwill calculated under Weighted Average Method? **[Nov/Dec 2013]**
14. What do you mean by Maintainable Profits? **[Nov/Dec 2014]**
15. Given, Closing Capital Employed is ₹5,00,000 and Net Profit for the current year is ₹2,25,000. What is the Average Capital Employed? **[Nov/Dec 2014]**
16. Closing capital employed is ₹12,00,000; Net Profit for the current year is ₹2,40,000. What is the Average Capital Employed? **[Nov/Dec 2015]**

17. State any two features of Goodwill. **[Nov/Dec 2016]**

Section B

1. Briefly explain the different methods of the Valuation of Goodwill. **[Nov/Dec 2010]**
2. Briefly explain the factors affecting the Valuation of Goodwill. **[Nov/Dec 2013]**
3. Zed Co. Ltd. decided to purchase the business of CEE BEE Ltd. for ₹2,00,000 on 1 January 2017. Its profits for the last four years are as follows:

   2012: ₹50,000; 2013: ₹62,500; 2014: ₹60,000 and 2015: ₹57,500.

   The owner looked after the business. The remuneration from alternative employment, if not engaged in the business, for the owner, comes to ₹7,500 per annum.

   Find the Amount of Goodwill if it is valued on the basis of three years' purchase for the Average Net Profit of the last four years.

   (Average Profit: ₹50,000; Goodwill: ₹1,50,000)
4. From the following information, calculate the Value of Goodwill, taking three years' purchase of Super Profit:
   (i) Average capital employed is ₹9, 00,000.
   (ii) Net Trading Profits for the preceding three years were ₹1, 61,400, ₹1, 36,050, and ₹1,68,750 respectively.
   (iii) Expected return on capital invested in the same type of business is 12%.
   (iv) Fair remuneration to the proprietor for his service is ₹18,000.
   (v) Total assets are worth ₹9, 84,000 and current liabilities are ₹45,000.

   (Super Profit: ₹29,400; Goodwill: ₹88,200)
5. During the last three years, the profits of a company were ₹50,000, ₹48,000 and ₹52,000 respectively. The average capital employed is ₹3, 00,000 and in a similar business, return on capital employed is 10%. The present value of ₹0.367209 annuity for three years at 5% per annum return is ₹1. Find out the goodwill by Annuity Method based on Super Profit.

   (Goodwill: ₹55,064)
6. From the following particulars, compute Value of Goodwill by Annuity Method:
   (i) Average Capital Employed: ₹6,25,000
   (ii) Normal Rate of Return: 10%
   (iii) Profit of the previous three years were ₹88,500, ₹72,000 and ₹85,000.
   (iv) Profit of ₹72,000 has been arrived at, after writing off abnormal loss of ₹3,000 and profit of ₹85,000 includes a non-recurring income of ₹3,750.
   (v) Goodwill is to be estimated on the basis of three years' purchase of Super Profit.

   (Average Profit: ₹81,583; Super Profit: ₹19,083; Goodwill: ₹1, 50,000)
7. The average adjusted profits of the last four years were calculated to be ₹20,000. It is estimated that reasonable managerial remuneration is ₹5,000 per annum and reasonable return on capital invested in such business is 10%. The net capital invested in such a business is ₹80,000.

   Calculate the value of goodwill on the basis of three years' purchase of Average Super Profit.

   (Goodwill: ₹21,000)
8. The net profits of a company after providing for taxation for the past five years were ₹78,000, ₹82,000, ₹88,000, ₹93,000 and ₹99,000. The capital employed in the business is ₹8,00,000; on which, a reasonable rate of 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 the Goodwill of the business on the basis of an Annuity of Super Profits, taking the present value of an annuity of ₹1 for the five years at 10% interest as ₹3.78.

(Goodwill: ₹30,240)

9. From the following information, calculate Goodwill under:
   (i) Purchase of Super Profit Method
   (ii) Annuity Method
   (iii) Capitalisation of Super Profit Method

   Capital employed is ₹1,50,000, Normal rate of return is 10%, present value of annuity of ₹1 for five years at 10% is ₹3.78 and net profits for the five years were ₹14,400, ₹15,400, ₹16,900, ₹17,400 and ₹17,900 respectively.

   The profit included non-recurring profits on an average basis of ₹1,000; out of which, it was deemed that even non-recurring profits had a tendency of appearing at the rate of ₹600 per annum.

   (Average Profit: ₹16,400; Super Profit: ₹1,000; Goodwill: Purchase Method: ₹5,000; Annuity Method: ₹3,780; Capitalisation Method: ₹10,000)

PRACTICAL QUESTIONS

3

Section C

1. The following particulars are available with respect to the business carried on by a trader:
   (i) Profits earned in 2015: ₹1,00,000; 2016: ₹1,20,000; 2017: ₹1,10,000
   (ii) Normal rate of return is 10%
   (iii) Capital employed is ₹6,00,000
   (iv) Present value of an annuity of ₹1 for five years at 10% is ₹3.78
   (v) The profits included non-recurring profits on an average basis of ₹8,000; out of which, it was deemed that even non-recurring profits had a tendency of appearing at the rate of ₹2,000 per annum.

   You are required to calculate goodwill:
   (a) As per five years' purchase of Super Profits Method
   (b) As per capitalisation of Super Profit Method, and
   (c) As per Annuity Method

   (Goodwill: (a) ₹2,20,000; (b) ₹4,40,000 (c) ₹66,320; Super Profit: ₹44,000)

2. The tangible value of assets is ₹1,00,000. The expected future profit is ₹25,000. The assets include investments of ₹10,000 in 5% government papers, purchased at face value. Find out the different value of goodwill from expected future profit and super profit:
   (i)
      (a) By three years' purchase of expected profits
      (b) By five years' purchase of super profits
   (ii) By capitalisation @10% of (a) profit and of (b) super profit

(iii) By finding present value of annuity of (a) profit and of (b) super profit. ₹1 is the present value of 0.190762 invested every year at the rate of 5% for the agreed period.

((i) (a) ₹73,500 (b) ₹77,500; Average Profit: ₹16,400; Super Profit: ₹1,000; Goodwill: Purchase Method: ₹5,000; Annuity Method: ₹3,780; Capitalisation Method: ₹10,000)

3. From the following information, prepare a statement showing:
   (i) Capital Employed
   (ii) Average Capital Employed
   (iii) Goodwill on the basis of five years' purchase of Average Super Profit Method

ABC LTD.
Balance Sheet
As on 31 December 2017

Liabilities	(₹)	Assets	(₹)
20,000 Equity Shares of ₹10 each	2,00,000	Goodwill	30,000
1,000 9% Preference Shares of ₹100 each	1,00,000	Fixed Assets	3,50,000
Reserves and Provisions (provision for taxation ₹20,000)	2,00,000	Investments (Non-Trade) (6% Government loans)	45,000
10% Debentures	90,000	Current Assets	2,00,000
Creditors	60,000	Share Selling Commission	10,000
		Discount on Issue of Debentures	15,000
	6,50,000		**6,50,000**

The current market value of the plant included in fixed assets is ₹15,000 more. The average profit of the company (after deductions for interest on debentures and government taxes) is ₹68,000.

Expected rate of return is 10%. Rate of depreciation on fixed assets is 10%.

Assume that, taxation already provided for is sufficient, value of fixed assets in the balance sheet is after deduction of depreciation and depreciation on increased value of plant is provided.

(Capital Employed: ₹3,95,000; Average Capital Employed: ₹3,63,100; Goodwill: ₹1,37,450)

4. The Balance Sheet of Shashank Enterprises discloses the following financial positions as on 31 March 2017:

Liabilities	(₹)	Assets	(₹)
30,000 Shares of ₹10 each fully paid	3,00,000	Goodwill	30,000
Capital Reserve	60,000	Building	1,75,000
Sundry Creditors	71,000	Plant and Machinery	90,000
Provision for Taxation	55,000	Stock	1,15,000
Profit and Loss A/c	26,000	Book Debts less provision	95,000
		Cash at Bank	7,000
	5,12,000		**5,12,000**

3

Ascertain the value of goodwill with the help of the following information:

(i) Provision for tax and depreciation has been made adequately in the Books of Accounts.

(ii) Income tax rate can be taken at 50%.

(iii) The rate (average) of dividend declared by the company for the past five years was 15%.

(iv) The reasonable return on capital invested in the class of business done by the company is 12%.

(Goodwill: ₹56,640)

5. From the following information available to you, ascertain the value of goodwill, under the Super Profit Method, of Alex Ltd., which is in the business of retail trading.

Balance Sheet as on 31 March 2017

Liabilities	(₹)	Assets	(₹)
5,000 Shares of ₹100 each fully paid	5,00,000	Goodwill	50,000
Bank Overdraft	1,16,700	Building	2,20,000
Sundry Creditors	1,81,000	Plant and Machinery	2,00,000
Provision for Taxation	39,000	Stock	3,00,000
Profit and Loss Appropriation A/c	1,13,300	Book Debts *less* provision	1,80,000
	9,50,000		**9,50,000**

Profit for the last few years has been as follows:

I: (-)₹40,000 (loss due to prolonged strike)

II: ₹80,000

III: ₹1,03,000

IV: ₹1,16,000

V: ₹1,30,000

Tax is given to be at the rate of 40%, but the rate is likely to be 50% henceforth. Dividends were distributed at the rate of 10% on the paid-up capital for the years II and III and at 15% in year IV and year V. The market price of the shares is at ₹125 as on 2017. Profits till 2017 have been ascertained after debiting ₹40,000 as remuneration to the Managing Director. The government has approved a remuneration of ₹60,000, w.e.f. 1 April 2017. The company has been able to secure a contract for supply of material at advantageous prices. The advantage has been valued at ₹40,000 per annum for the next five years.

(Goodwill: ₹79,000)

6. The Balance Sheet of H Ltd. as on 31 March 2017 is as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital ₹10	10,00,000	Goodwill	1,00,000
Reserves and Surplus	4,00,000	Building	3,00,000
Sundry Creditors	3,00,000	Plant and Machinery	8,00,000
		Investment	1,00,000
		Stock	2,00,000
		Book Debts less provision	1,50,000
		Cash and Bank	50,000
	17,00,000		**17,00,000**

Profit before tax for 2001–02 amounted to ₹6,00,000, including ₹10,000 as interest on investment. However, an additional amount of ₹50,000 per annum shall be required to be spent for smooth running of the business.

Market values of building, and plant and machinery are estimated at ₹9,00,000 and ₹10,00,000 respectively. In order to match the given figures, further depreciation to the extent of ₹40,000 has to be provided. Income tax rate is to be assumed at 50%. Return on capital is to be taken at 20% before tax.

(Goodwill: ₹1,66,000)

7. The Balance Sheet of Star Ltd. as on 30 June 2017 was as follows:

Liabilities	(₹)	Assets	(₹)
10% Preference Share Capital	2,00,000	Fixed Assets	7,60,000
40,000 Equity Shares of ₹10 each.	4,00,000	Investments (6% Govt. Loan)	80,000
Reserves (including provision for tax ₹40,000)	4,00,000	Current Assets	4,00,000
9% Debentures	2,00,000	Preliminary Expenses	30,000
Creditors	70,000		
	12,70,000		**12,70,000**

Average Profit of the company after tax is ₹1,20,000. Fixed Assets are undervalued by ₹20,000. Normal rate of return is ascertained to be 10%.

You are required to value the goodwill of the company at four times the Super Profits.

(Goodwill: ₹1,02,000)

8. The Balance Sheet of G Ltd. is as follows on 31 December 2017:

Liabilities	(₹)	Assets	(₹)
Share Capital of ₹10 each	10,00,000	Fixed Assets	8,00,000
General Reserves	4,00,000	Investments (6% Govt. Loan)	2,00,000
Profit and Loss A/c	2,00,000	Current Assets	8,00,000
Current Liabilities	2,00,000		
	18,00,000		**18,00,000**

Profit for 2015: ₹2,60,000

Profit for 2016: ₹2,50,000

Profit for 2017: ₹3,00,000

The goodwill may be taken as four years' purchase of Average Super Profits. Normal return on capital employed is 15%. The current assets are to be taken as ₹8,40,000. Ascertain the value of goodwill.

(Goodwill: ₹86,000)

4 Valuation of Shares

CHAPTER OUTLINE

4.1 VALUATION OF SHARES

A joint stock company form of business organisation is formed by raising its capital requirement from the general public, by way of issue of shares. The value at which the shares are issued to investing public for subscription is termed as Face Value or Par Value. This value appears in the balance sheets of the company. The investors or the company itself obtains the market price (quotation price) of the shares through the stock exchange. A stock exchange is a place where the shares are bought and sold by the buyers or the sellers on the basis of the market price of the shares quoted at the stock exchange. The market price of the shares fluctuates depending on the demand and supply of the shares in the market. As the market price is subject to fluctuation and is purely dependent on the demand and supply factor, the market price of the share does not reflect the true worth of the shares. For this reason, value of shares is computed on some reasonable or commonly accepted basis.

It is a process through which the fair value of shares of a company is determined. There are many situations requiring the computation of true worth or value of shares. The price quoted by the stock market has its own limitations. It is also difficult to ascertain the value of shares of those firms that are not listed on the stock exchange and if the quoted price is volatile, exact value cannot be determined. Value of shares also cannot be ascertained if shares are bought and sold in bulk. The aforementioned situations require ascertaining true value of the shares. The method or process of arriving at the fair, intrinsic or market value of shares is termed as Valuation of Shares.

Section 2(84) of the Companies Act 2013 defines ‘Share’ as a share in the share capital of the company and includes stock. It is further defined by the act as a ‘Type of Security’. Section 44 of the Companies Act 2013 mentions that the shares of any member in a company shall be movable property. It is transferrable in the manner provided by the articles of the company.

4.2 NEED FOR VALUATION OF SHARES

As the quoted price in the stock exchange is inadequate, firms need to arrive at the true or fair value of the shares on some reasonable or acceptable basis. Following are the list of circumstances, which would require the company to value its shares:

1. In the event of amalgamation or absorption of the companies
2. In the event of restructuring or reconstruction of the company
3. In the event of payment of taxes by the company
4. When one class of shares is converted into another class of shares
5. When block of shares is to be purchased by a company
6. When the company intends to acquire the controlling interest in another company by acquiring majority through holding more that 51% shares
7. When the shares have to be bought and sold and active market does not exist
8. When the company's shares that have to be exchanged are not listed in the stock exchange
9. For the purpose of settlement of consideration payable or compensation payable on compulsory acquisition of shares of such company, under the scheme of nationalisation by the government
10. If the law requires to do so
11. In the event of transfer of Indian company shares by the non-resident
12. In the event of availing loan from a bank and also for determining the security margin, feasibility report submitted to the bank should comprise of the intrinsic value of shares.
13. In order to safeguard the interest of the dissenting shareholders (shareholders not in the favour of scheme of amalgamation) of the company and for settlement of their claims
14. When the shares of a private company are purchased or sold
15. In the event of valuation of assets of finance or investment companies

4.3 DETERMINANT FACTORS INFLUENCING VALUATION OF SHARES

Several factors influence the value of the firm directly or indirectly. Any firm intending to value its shares may have to be aware of the following influential factors that determine the value of shares.

1. **Firm's Earning Capacity:** If a firm is competitive is nature and is able to fare better than its counterparts with reasonable earning capacity, this may strengthen the value of shares of the company.

2. **Demand and Supply of Shares:** Demand and Supply of the shares of a company is one of the important factors affecting the value of shares.
3. **Goodwill** of the company is also a deciding factor, which affects the value of shares sometimes.
4. **Monopolistic Stand Enjoyed by the Firm in the Market:** If a firm is enjoying a monopolistic situation in the market, either due to no competition or very few competitors, this may augment the firm's earning capacity, in turn boosting up the value of the shares in the market.
5. **Dividend declared by the company in the recent past** primarily affects the value of shares.
6. **General political, social and economic conditions** impact the value of shares.
7. **Government Assistance and Support:** If the policies framed by the government favour any particular industry, it may boost the profitability and in turn resulting in an increased value of shares.
8. **Yield on shares of other companies in the industry and dividend declared by other companies** in the past also determines the value of shares.
9. **Net Tangible Assets:** Net tangible assets of the company also determine the value of shares of the firm.
10. **Efficiency of Managers**: It is a determining factor influencing the value of shares. Right decision of the manager will have a considerable impact on the firm's earning capacity, leading to increased profitability and enhanced value of shares.

4.4 TYPES OF VALUE OF SHARES

The different types of value of shares are listed as follows:

1. **Nominal Value:** The value of share appearing in the Capital Clause of the Memorandum of Association of the company is termed as Nominal Value, Face Value or Par Value of the shares. This is the value that reflects in the balance sheet of the company. If the Issue Price is more than the Nominal Value of the shares, it is termed as Share Premium and if it is less than the Nominal Value of shares, it is termed as Issue at Discount.
2. **Book Value:** The book value of the company is arrived at, after dividing the total capital of the company by the total number of issued shares. Here, the total capital is calculated by taking into account the Share Capital, free Reserves and Surplus, including the Accumulated Profits.
3. **Market Value:** The price at which a share or security is bought and sold in the stock market is Fair Market Value or Quoted Price or the Market Price. This value is determined by the market forces, namely, demand and supply of shares.
4. **Intrinsic Value:** Intrinsic Value of shares is calculated by dividing the realisable amount of all the real assets, excluding the external assets, by the total number of shares. The only difference between this value and the Book Value is that under Book Value, Total Capital of the company is calculated taking into account the historical values; whereas, under Intrinsic Value, the Total Capital/Total Assets is arrived at by taking realisable value into account.

5. **Fair Value:** This value is calculated by taking the average of Market Value and Intrinsic Value and hence termed as average of intrinsic and market values.

4.5 METHODS OF VALUATION OF SHARES

There are four methods of valuing shares. They are:

1. Intrinsic Value Method, Net Assets Method, Asset Backing Method, Balance Sheet Method
2. Yield Method, Dividend Yield Method
3. Earning Capacity Method
4. Fair Value Method

4.5.1 Intrinsic Value Method/Net Asset Method

The basic assumption under this method is that the company would be wound up. Therefore, the assets are taken into account on the basis of their realisable values and not on their historical figures.

Under this method, the present value (realisable values) of all the assets of the company along with the value of Goodwill is considered. This value is generally termed as Gross Market Value of all the Assets. From the Gross Market Value of all the Assets, the Outsiders' Liability – such as Debentures, Creditors, Bills Payable, Bank Overdraft, Outstanding Expenses, and Income Received in Advance, Provision for Taxation – are deducted, to arrive at intrinsic value of shares.

4

Particulars	(₹)	(₹)
Goodwill	xxx	
Tangible Assets	xxx	
Investments (Non-Trading)	xxx	
Current Assets	xxx	
Total Assets		xxx
Less: Outside Liabilities		
Debentures	xxx	
Loans	xxx	
Provisions	xxx	
Current Liabilities	xxx	(xxx)
Net Assets available for all categories of shareholders		xxx
Less: Preference Share Capital	xxx	
Arrears of Preference Dividend	xxx	
Premium on Redemption of Preference Shares	xxx	(xxx)
Net Assets Available for Equity Shareholders		**xxx**

Value of Equity Shares under Intrinsic Value Method

$$= \frac{\textbf{Net Assets available to Equity Shareholders}}{\textbf{Number of Equity Shares}}$$

4.5.2 Yield Method or Dividend Yield Method

Under this method, the value of equity shares is calculated on the assumption that the company will not be wound up but will continue to function. Due to this assumption, the assets are not taken at the realisable values; instead, the divisible profits of the company or the profits available for dividend distribution are taken into account.

Under this method, Average Annual Profits of the company are calculated after providing for taxation and reserves and from the balance Average Annual Profits, the amount payable to preference shareholders is deducted. The resulting balance is the Average Annual Profit available for dividend distribution to the equity shareholders.

After ascertaining the Average Annual Profits available for dividend distribution to the equity shareholders, the next step is to ascertain the Expected Rate of Dividend or Return on Equity Shares. This is calculated by dividing the Average Annual Profits available for dividend distribution to the equity shareholders with the Total Paid-up Equity Share Capital.

As discussed earlier in the Valuation of Goodwill module, while calculating Average Profits, non-recurring incomes have to be deducted and the non-recurring expenses have to be added.

Value of Equity Shares under Dividend Yield Method

Rate of Dividend Method

Value per Equity Share

$$= \frac{\textbf{Return on Equity Shares or Expected Rate of Dividend}}{\textbf{Normal Rate of Return on Equity Shares}} \times \textbf{Paid-up Value of each Equity Share}$$

Capitalisation of Divisible Profits

$$\textbf{Capitalised Value of Profits} = \frac{\textbf{Profits available for Dividend Distribution}}{\textbf{Normal Rate of Return}} \times \textbf{100}$$

$$\textbf{Value per Equity Share} = \frac{\textbf{Capitalised Value of Profits}}{\textbf{Number of Equity Shares}}$$

$$\textbf{Value per Equity Share} = \frac{\textbf{Capitalised Value of Profits}}{\textbf{Equity Paid-up Capital}} \times \textbf{Paid-up Value of a Share}$$

(This formula is to be used when different paid-up amounts of various types of shares are given)

4.5.3 Earning Capacity Method

This method is an improvement over the Dividend Yield Method. The Rate of Dividend declared by the company is less than the Rate of Earnings, as a result of the retentions in the form of retained earnings by the company. Due to this, it is important that the valuation of shares is on the basis of earnings and not on the dividend declared.

Under this method, the Rate of Earnings is calculated by dividing the total profits of the company by the capital employed. After which, the market value of shares is ascertained by using the following formula:

Value of Equity Shares under Earnings Capacity Method

$$= \frac{\textbf{Rate of Earnings}}{\textbf{Normal Rate of Return on Equity Shares}} \times \textbf{Paid-up Value of each Equity Share}$$

4.5.4 Fair Value Method

This method values shares, both on the basis of fair value or yield value. This is to cater to those investors who are interested in income as well as the safety of their investments.

Value of Equity Shares under Fair Value Method

$$= \frac{\textbf{Intrinsic Value of Shares + Yield (Market) Value of Shares}}{\textbf{2}}$$

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4.6 VALUATION OF RIGHTS ISSUE

As per Section 62 of the Companies Act 2013, if any company is aiming to raise its subscribed capital by issue of further shares, such shares must be offered first to its existing equity shareholders in proportion to their shareholdings.

Rights Issue means that the company intending to issue fresh equity is required to make its offering first to the existing shareholders in the proportion of their holdings. But the existing equity shareholders are not obligated to take up the offer made by the company; they have the option to renounce (transfer) their rights to receive such shares to others. The shareholders are given only one pre-emptive right to either accept or reject the offer made by the company.

The two main objectives of offering shares to the existing shareholders is firstly, to ensure equitable distribution of shares and secondly, to ensure that the voting rights are not afflicted by fresh issue of equity shares.

4.6.1 Computation of Value of Right Shares

The Value of Rights Issue is computed on the basis of Market Price and Issue Price of the share, along with the ratio of the existing and new shares. It can be computed on the basis mentioned below:

Value of Right Issue

$$= \frac{\text{Number of Rights Shares (Market Price/Issue Price)}}{\text{Number of Existing Shares}} + \text{Number of Right Shares}$$

Illustration 1 **(Intrinsic Value Method)**

On 31 March 2017, the balance sheet of Veena Ltd. disclosed the following position:

liabilities	(₹)	Assets	(₹)
Issued Capital (₹10 each)	40,000	Fixed Assets	50,000
Profit and Loss A/c	2,000	Current Assets	20,000
Reserve	9,000	Goodwill	4,000
Debentures	10,000		
Current Liabilities	13,000		
	74,000		**74,000**

On 31 March 2017, the fixed assets were independently valued at ₹35,000 and the goodwill at ₹5,000. Ascertain the intrinsic value of a share.

SOLUTION

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Fixed Assets	35,000	
Current Assets	20,000	
Goodwill	5,000	60,000
Less: External Liabilities		
Debentures	10,000	
Current Liabilities	13,000	23,000
Net Assets or Intrinsic Value of Shares		**37,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{37{,}000}{4{,}000^*}$$

$$= \text{₹}\mathbf{9.25} \text{ per equity share}$$

$$(\text{*Number of Equity Shares} = \frac{40{,}000}{\text{₹}10} = 4{,}000)$$

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Illustration 2 **(Intrinsic Value Method)**

From the following information, find out the value of each share:

Balance Sheet of Sheshadri Ltd. on 31 March 2017

Liabilities	(₹)	Assets	(₹)
Share Capital: 20,000 Equity Shares of ₹10 each	2,00,000	Goodwill	37,500
Reserves	1,75,000	Buildings	1,75,000
Profit and Loss A/c	25,000	Machinery	1,50,000
Debentures	80,000	Investments	75,000
Current Liabilities	25,000	Current Assets	40,000
		Debtors	22,500
		Preliminary Expenses	5,000
	5,05,000		**5,05,000**

Buildings and Investments were re-valued at ₹1,50,000 and ₹1,12,500 respectively on 31 December 2017. With regard to Goodwill, two years' purchase of the average profits of the last three years. The profits in the last three years were ₹30,000, ₹37,500 and ₹40,000.

SOLUTION

Calculation of Value of Goodwill

$$\text{Average Annual Profits of the last three years} = \frac{30{,}000 + 37{,}500 + 40{,}000}{3}$$

$$= \frac{1{,}07{,}500}{3}$$

$$= ₹35{,}833$$

Goodwill = Average Profit × Number of years of purchase

= 35,833 × 2

= ₹71,667

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Goodwill	71,667	
Buildings	1,50,000	
Investment	1,12,500	
Machinery	1,50,000	
Current Assets	40,000	
Debtors	22,500	
Gross Total Assets		5,46,667
Less: External Liabilities		
Debentures	80,000	
Current Liabilities	25,000	1,05,000
Net Assets or Intrinsic Value of Shares		**4,41,667**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{4,41,667}{20,000}$$

$$= ₹22.08 \text{ per equity share}$$

Note: Preliminary expenses are fictitious assets and not realisable assets and hence should not be considered while calculating the net assets.

Illustration 3 **(Intrinsic Value Method)**

Find the profits of the company, whose balance sheet on 31 December 2017 is given as follows, after taking into account all working expenses and provision for depreciation and taxation:

2013: ₹35,000
2014: ₹37,500
2015: ₹40,000
2016: ₹45,000
2017: ₹42,500

Balance Sheet as on 31 December 2017

Liabilities	(₹)	Assets	(₹)
Share Capital: 20,000 Equity Shares of ₹10 each	2,00,000	Buildings	1,50,000
Profit and Loss A/c	45,000	Machinery	40,000
Current Liabilities	30,000	Debtors	1,00,000
Provision for Tax	15,000	Stock	16,000
Proposed Dividend	35,000	Cash	19,000
	3,25,000		**3,25,000**

Machinery and buildings were valued at ₹42,500 and 1,55,000 respectively. The normal rate of return is assumed at 8%. Ascertain the value of shares, after taking into account the value of goodwill, based on three years' purchase of average profits of the last five years.

Solution

Calculation of Goodwill for the purpose of Valuation Shares

Step 1: *Calculation of Average Profits*

$$\text{Average Profits} = \frac{35,000 + 37,500 + 40,000 + 45,000 + 42,500}{5}$$

$$= \frac{2,00,000}{5}$$

$$= ₹40,000$$

4

Step 2: *Calculation of Average Capital Employed*

Particulars	(₹)
Buildings	1,55,000
Machinery	42,500
Debtors	1,00,000
Stock	16,000
Cash	19,000
	3,32,500
Less: Sundry Liabilities	
Current Liabilities	(30,000)
Provision for Tax	(15,000)
Proposed Dividend	(35,000)
Capital Employed at the end of the year	2,52,500
Less: Half of the current-year profit before tax Half of 42,500 (current-year profit)	(21,250)
Average Capital Employed	**2,31,250**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*

= 2,31,250 × 8%

= ₹18,500

4

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	40,000
Less: Normal Profit (Step 3)	18,500
Super Profit	**21,500**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase

= 21,500 × 3

= **₹64,500**

Computation of Value of Shares

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Goodwill	64,500	
Building	1,55,000	

(*Contd.*)

Particulars	(₹)	(₹)
Investment	42,500	
Machinery	1,00,000	
Current Assets	16,000	
Debtors	19,000	
Gross Total Assets		3,97,000
Less: External Liabilities		
Current Liabilities	(30,000)	
Provision for Tax	(15,000)	
Proposed Dividend	(35,000)	(80,000)
Net Assets or Intrinsic Value of Shares		**3,17,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{3,17,000}{20,000}$$

= ₹**15.85** per equity share

Illustration 4 **(Intrinsic Value Method with Preference Shares)**

The balance sheet of Ram Ltd. is as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital: 5,000 8% Preference Shares of ₹10 Each	50,000	Fixed Assets	2,25,000
10,000 Equity Shares of ₹10 Each	1,00,000	Preliminary Expenses	5,000
General Reserves	5,000	Discount on Debentures	5,000
Debenture Redemption Fund	10,000	Profit and Loss A/c	10,000
Depreciation Fund	5,000		
10% Debentures	50,000		
Creditors	25,000		
	2,45,000		**2,45,000**

Interest on debentures is outstanding for one year and preference dividends are in arrears for two years. Ascertain the value of preference and equity shares, assuming:

(i) Preference shares are preferential to capital and arrears of dividend are payable only at the time of company winding up.

(ii) Preference shares are not preferential to capital and arrears of dividend are payable in priority.

(iii) Preference shares are preferential to capital only.

(iv) Preference shares are not preferential for the payment of capital and arrears of dividend.

SOLUTION

Computation of the Value of Shares

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Fixed Assets (*Less:* Depreciation Fund)	2,20,000	
Gross Total Assets		2,20,000
Less: External Liabilities		
10% Debentures	50,000	
Creditors	25,000	(75,000)
Net Assets or Intrinsic Value of Shares		1,45,000
Less: One Year's Debenture Interest Due 50,000 @ 10%		(5,000)
Net Assets or Intrinsic Value of Shares		**1,40,000**

Notes:

1. Debenture redemption fund is an accumulated profit and depreciation fund is a liability.
2. When depreciation fund is mentioned in the question, it indicates that the value of assets that reflect the original cost. Hence, at the time of calculating net assets, depreciation fund must be deducted from the value of fixed assets. However, if the question mentions the market value of the assets, depreciation fund need not be deducted.

4

Step 2: *Intrinsic Value per Equity Share*

Situation 1: Preference shares are preferential to capital and arrears of dividend are payable only at the time of the company winding up.

Particulars	(₹)	(₹)
Net Assets or Intrinsic Value, as calculated previously		1,40,000
Less: Preference Capital	50,000	
Arrears of Preference Dividend of two years: 50,000 @ 8% for two years	8,000	58,000
Intrinsic Value for Equity Shares		**82,000**

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Intrinsic Value for Equity Shares}}{\text{Number of Equity Shares}}$$

$$= \frac{82,000}{10,000 \text{ shares}}$$

$$= \text{₹}\mathbf{8.20} \text{ per share}$$

Situation 2: Preference shares are not preferential to capital and arrears of dividend are payable in priority

Particulars	(₹)
Net Assets or Intrinsic Value, as calculated previously	1,40,000
Less: Arrears of Preference Dividend of two years: 50,000 @ 8% for two years	8,000
Intrinsic Value for Equity Shares	**1,32,000**

$$\text{Intrinsic Value per Share} = \frac{\text{Intrinsic Value for Equity Shares}}{\text{Number of Equity Shares}}$$

$$= \frac{1,32,000}{10,000 \text{ Equity shares} + 5,000 \text{ Preference Shares}}$$

$$= ₹8.80 \text{ per share}$$

Intrinsic Value per Equity Share = ₹8.80 per share

$$\text{Intrinsic Value per Preference Share} = 8.8 + \frac{8,000 \text{ (Preference dividend)}}{5,000 \text{ shares}}$$

$$= 8.80 + 1.60$$

$$= 10.40 \text{ per share}$$

Situation 3: Preference shares are preferential to capital only.

Particulars	(₹)
Net Assets or Intrinsic Value, as calculated previously	1,40,000
Less: Preference Capital	50,000
Intrinsic Value for Equity Shares	**90,000**

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Intrinsic Value for Equity Shares}}{\text{Number of Equity Shares}}$$

$$= \frac{90,000}{10,000 \text{ shares}}$$

$$= ₹9.00 \text{ per share}$$

$$\text{Value of one Preference Share} = \frac{50,000}{5,000}$$

$$= ₹10 \text{ per share}$$

Situation 4: Preference shares are not preferential for the payment of capital and arrears of dividend.

$$\text{Intrinsic Value of one share} = \frac{\text{Intrinsic Value for Shares}}{\text{Number of Shares}}$$

$$= \frac{1,40,000}{15,000 \text{ shares } (10,000 + 5,000 \text{ shares})}$$

$$= ₹9.33 \text{ per share}$$

Illustration 5 **(Intrinsic Value per Preference and Equity Shares – when partly paid shares are notionally converted into fully paid shares)**

The following figures relate to M/s. Swastik Ltd.

Particulars	(₹)
Share Capital:	
10% Preference Shares of ₹100 each	5,00,000
5,000 Equity Shares of ₹100 each, ₹50 called up	2,50,000

(*Contd.*)

Particulars	(₹)
5,000 Equity Shares of ₹100 each, ₹25 called up	1,25,000
5,000 Equity Shares of ₹100 each fully called up	5,00,000
Reserves	5,00,000
Profit and Loss A/c	25,000

All the assets of the company were re-valued at the end of the year and it was found that Land appreciated by ₹1,25,000.

The preferential shareholders have an additional claim, to the extent of 5%, on the balance assets (surplus). With the assumption of liquidation, find out the value per preference and equity share.

Solution

Note: While ascertaining the value of shares, if there are any partly paid shares, it can be assumed that the remaining amount has been called up and fully paid (notionally called up and fully paid). With this treatment, all the shares would become fully paid-up shares.

Computation of Value of Shares

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares (Liability-based Approach)*

Particulars	(₹)	(₹)
Tangible Assets (Share Capital and Reserves and Surplus)		19,00,000
Add: Appreciation of Assets		1,25,000
Net Assets or Intrinsic Value of Assets		20,25,000
Add: Notional Call made		
5,000 Equity Shares at ₹50 per share	2,50,000	
5,000 Equity Shares at ₹75 per share	3,75,000	6,25,000
		26,50,000
Less: Preference Share Capital		(5,00,000)
		21,50,000
Less: Equity Share Capital fully called and paid up (15,000 shares of ₹100 each)		(15,00,000)
Surplus		6,50,000
Less: 5% Surplus to be transferred to Preference Shareholders (6,50,000 @ 5%)		(32,500)
Balance (Surplus) available to Equity Shareholders		**6,17,500**

Ascertainment of Net Assets or Intrinsic Value available to Equity Shareholders

Equity Share Capital	15,00,000
Balance (Surplus) available to Equity Shareholders	6,17,500
Net Assets or Intrinsic Value	**21,17,500**

$$\text{Intrinsic Value per Equity Share} = \frac{21,17,500}{15,000}$$
$$= ₹141.17 \text{ per share}$$

After calculating the intrinsic value per fully paid share, the intrinsic value of partly paid share is calculated as follows:

Intrinsic Value per Partly-paid Equity Share = Intrinsic Value per Fully-paid Equity Share – Uncalled Capital per Share

Intrinsic Value per Fully-paid Equity Share = ₹141.17

Intrinsic Value per Equity Share of ₹50 paid = ₹141.17 – 50.00 = ₹91.17

Intrinsic Value per Equity Share of ₹75 paid = ₹141.17 – 75.00 = ₹66.17

$$\text{Intrinsic Value per Preference Share} = \frac{\text{Preference Share Capital + Surplus}}{\text{Number of Preference Shares}}$$
$$= \frac{5,00,000 + 32,500}{5,000}$$
$$= ₹106.50 \text{ per share}$$

Illustration 6 **(Intrinsic Value per Preference and Equity Shares – when partly paid shares are not converted into fully paid shares)**

Following is the balance sheet of Roshan Ltd., as on 31 December 2017:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Goodwill	50,000
10,000 Equity Shares of ₹100 each fully paid	10,00,000	Buildings	9,00,000
7,500 Equity Shares of ₹100 each ₹50 paid	3,75,000	Machinery	8,00,000
5,000 Equity Shares of ₹10 each fully paid	50,000	Furniture	4,00,000
2,500 Equity Shares of ₹10 each ₹5 paid	12,500	Investments	1,50,000
Reserves	8,00,000	Stock	2,25,000
Profit and Loss A/c	1,25,000	Debtors	1.75,000
Creditors	4,00,000	Bills Receivable	50,000
		Cash	2,500
		Discount on Issue of Shares	10,000
	27,62,500		**27,62,500**

Determine the value of shares, assuming that there was a contingent liability of ₹5,000 and Machinery, Buildings and Goodwill were re-valued at ₹8,50,000, 9,50,000 and 60,000, respectively.

Solution

Computation of the Value of Shares

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Goodwill	60,000	
Buildings	9,50,000	
Machinery	8,50,000	
Furniture	4,00,000	
Investments	1,50,000	
Stock	2,25,000	
Debtors	1.75,000	
Bills Receivable	50,000	
Cash	2,500	28,62,500
Less: External Liabilities		
Creditors	(4,00,000)	
Contingent Liability	(5,000)	(4,05,000)
Net Assets or Intrinsic Value available to Equity Shareholders		**24,57,500**

Ascertainment of Unit Value of Capital

4

$$\text{Unit Value of Capital} = \frac{\text{Net Assets or Intrinsic value available to equity shareholders}}{\text{Equity Share Capital}}$$

$$\text{Unit Value of Capital} = \frac{24{,}57{,}500}{14{,}37{,}500\ (10{,}00{,}000 + 3{,}75{,}000 + 50{,}000 + 12{,}500)}$$

$$= ₹1.71$$

Intrinsic Value per Equity Share

(i) Value of ₹100 (fully) paid-up share = 100 × 1.71 = ₹171.00

(ii) Value of ₹50 (partly) paid-up share = 50 × 1.71 = ₹85.50

(iii) Value of ₹10 (fully) paid-up share = 10 × 1.71 = ₹17.10

(iv) Value of ₹5 (partly) paid-up share = 5 × 1.71 = ₹8.55

Illustration 7 **(Yield Method – Based on Rate of Dividend)**

Compute the value of equity share from the following information:

(i) 5,000 of 10% preference shares of ₹100 each

(ii) 20,000 equity shares of ₹10 each

(iii) Profits for the years are given as follows:

2014: ₹2,00,000

2015: ₹2,00,000

2016: ₹1,90,000

2017: ₹2,05,000

(iv) Tax rate to be assumed at 30%

Transfer to General Reserves = 20% of profits

Normal Rate of Return = 20%

SOLUTION

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the year	(₹)
2014	2,00,000
2015	2,00,000
2016	1,90,000
2017	2,05,000
Total Profits	7,95,000
Average Annual Profits (7,95,000 ÷ 4)	1,98,750
Less: Income Tax @ 30%	59,625
Average Annual Profits after Tax (PAT)	1,39,125
Less: Transfer to Reserve @ 20%	27,825
Amount available for Distribution of Dividend	1,11,300
Less: Preference Dividend @ 10% on ₹5,00,000	50,000
Amount available for Equity Dividend	**61,300**

Calculation of Rate of Dividend

$$\text{Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{61{,}300}{2{,}00{,}000} \times 100$$

$$= 30.65\%$$

Normal Rate of Return = 20%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{30.65}{20} \times 10$$

$$= ₹15.33$$

4

Illustration 8 **(Yield Method – Based on Capitalisation of Divisible Profits)**

Compute the value of equity share and preference share from the following information given:

(i) 1,000 10% Preference Shares of ₹100 each
(ii) 10,000 equity shares of ₹10 each, ₹8 per share paid up
(iii) Expected Profits per year (before tax): ₹2,10,000
(iv) Tax rate to be assumed at 50%
(v) Transfer to General Reserves: 20% of profits
(vi) Normal Rate of Earning for Equity Share: 20%
(vii) Normal Rate of Earning for Preference Share: 12%

SOLUTION

Computation of Value of Shares on the basis of Yield Method (Capitalisation of Divisible Profits)

Profits for the year	(₹)
Average Annual Earnings before Tax	2,10,000
Less: Income Tax @ 50%	1,05,000
Average Annual Profits after Tax (PAT)	1,05,000
Less: Transfer to Reserve @ 20%	21,000
Amount available for Distribution of Dividend	84,000
Less: Preference Dividend @ 10% on ₹1,00,000	10,000
Amount available for Equity Dividend	**74,000**

4

Calculation of Value per Equity Share

Capitalised Value of Profits for Equity Shareholders

$$= \frac{\text{Amount available for Equity Dividend}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{74{,}000}{20} \times 100$$

$$= ₹3{,}70{,}000$$

$$\text{Value per Equity Share} = \frac{\text{Capitalised Value of Profits for Equity Shares}}{\text{Number of Equity Shares}}$$

$$= \frac{3{,}70{,}000}{10{,}000}$$

$$= ₹37.00 \text{ per share}$$

Calculation of Value per Preference Share

Capitalised Value of Profits (Dividend) for Preference Shareholders

$$= \frac{\text{Dividend for Preference Shareholder}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{10,000}{12} \times 100$$

$= ₹83,333$

$$\text{Value per Preference Share} = \frac{\text{Capitalised Value of Profits for Preference Shares}}{\text{Number of Preference Shares}}$$

$$= \frac{83,333}{1000}$$

$= ₹83.33$ per share

Illustration 9 **(Earnings Capacity Method – Based on Rate of Earnings)**

Compute the value of equity share from the following information:

(i) 1,000 of 10% preference shares of ₹100 each
(ii) 10,000 equity shares of ₹10 each, ₹8 per share paid up
(iii) Expected Profits per year (before tax): ₹1,50,000
(iv) Tax rate to be assumed at 50%
(v) Transfer to general reserves: 20% of profits
(vi) Normal rate of return: 30%

Solution

Computation of Value of Shares on the basis of Earnings Capacity Method (Rate of Earnings)

Profits for the Year	(₹)
Average Annual Earnings before Tax	1,50,000
Less: Income Tax @ 50%	75,000
Average Annual Profits after Tax (PAT)	75,000
Less: Transfer to Reserve @ 20%	15,000
Amount available for Distribution of Dividend	60,000
Less: Preference Dividend @ 10% on ₹1,00,000	10,000
Amount available for Equity Dividend	**50,000**

Calculation of Rate of Earnings

$$\text{Rate of Earnings} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{50,000}{80,000} \times 100$$

$= 62.5\%$

Normal Rate of Return = 30%

$$\text{Value per Equity Share} = \frac{\text{Rate of Earnings}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{62.5}{30} \times 8$$
$$= ₹16.67 \text{ per share}$$

Illustration 10 **(Fair Value Method)**

From the following balance sheet given, ascertain the value of equity of share on Fair Value basis:

Liabilities	(₹)	Assets	(₹)
1,000 of 10% Preference Shares of ₹100 each, fully paid	1,00,000	Land and Building	2,00,000
5,000 Equity Shares of ₹100 each, fully paid	5,00,000	Furniture	1,55,000
Profit and Loss A/c	2,00,000	Investments (Face Value: ₹1,00,000)	85,000
Creditors	55,000	Stock (Market Value)	1,60,000
		Debtors	1,40,000
		Cash	1,00,000
		Preliminary Expenses	15,000
	8,55,000		**8,55,000**

Land and Building to be valued at ₹4,40,000. The current year profit included in profit and loss account reflecting in the balance sheet is ₹1,90,000 (before transfer to reserve). The annual transfer to reserve is @ 20% of the net profit. Preference shares have preferential rights to capital and dividend and normal rate of return is 15%.

4

Solution

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Buildings	4,40,000	
Furniture	1,55,000	
Investment	85,000	
Stock (Market Value)	1,60,000	
Debtors	1,40,000	
Cash	1,00,000	
Gross Total Assets		10,80,000
Less: External Liabilities: Creditors		(55,000)
Net Assets or Intrinsic Value of Shares		10,25,000
Less: Preference Capital		(1,00,000)
Net Assets or Intrinsic Value of Equity Shares		**9,25,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{9,25,000}{5,000}$$

$$= ₹185 \text{ per equity share}$$

Computation of Value of Shares by Yield Method

Particulars	(₹)
Profit for the Current Year	1,90,000
Less: Transfer to Reserve @ 20%	38,000
	1,52,000
Less: Preference Dividend (1,00,000 @ 10%)	10,000
Profit available for Equity Dividend	**1,42,000**

Calculation of Rate of Dividend

$$\text{Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$\text{Rate of Dividend} = \frac{1,42,000}{5,00,000} \times 100$$

Rate of Dividend = 28.40%

Normal Rate of return = 15%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{28.40}{15} \times 100$$

$$= ₹189.33 \text{ per share}$$

Computation of Fair Value of Equity Share

Fair Value of the Share

$$= \frac{\text{Intrinsic Value of the Share + Yield (Rate of Dividend) Value of the Share}}{2}$$

$$= \frac{185.00 + 189.33}{2}$$

$$= 187.17 \text{ per equity share}$$

COMPREHENSIVE ILLUSTRATION

Illustration 11 **(Yield Method)**

From the following information, calculate the value of an equity share under Yield Method.

(i)	5,000 of 9% Preference Shares of ₹100 each:	₹5,00,000
(ii)	1,25,000 Equity Shares of ₹10 each, ₹8 per share paid up:	₹10,00,000
(iii)	Expected Profits before Tax:	₹5,45,000
(iv)	Rate of Taxation:	40%
(v)	Transfer to General Reserve:	20% of profit every year
(vi)	Normal Rate of Earnings from this type of business:	15%

[Bangalore University, B.Com Nov/Dec 2005/2010, Section B]

Solution

Computation of Value of shares on the basis of Yield Method

Particulars	(₹)
Expected Profits before Tax	5,45,000
Less: Income Tax @ 40%	2,18,000
Expected Profit after Tax	3,27,000
Less: Transfer to Reserve @ 20%	65,400
Amount available for Distribution of Dividend	2,61,600
Less: Preference Dividend @ 9% on ₹5,00,000	45,000
Amount available for Equity Dividend	**2,16,600**

Calculation of Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{2{,}16{,}600}{10{,}00{,}000} \times 100$$

$$= 21.66\%$$

Normal Rate of Return = 15%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{21.66}{15} \times 8$$

$$= ₹11.552 \text{ per share}$$

Illustration 12 **(Yield Method)**

Following information relates to Deepika Ltd.

(i)	4,000 of 10% Preference Shares of ₹100 each:	₹4,00,000
(ii)	5,000 equity shares of ₹100 each:	₹5,00,000
(iii)	Average Profits before Tax:	₹3,22,580
(iv)	Tax Rate:	38%
(v)	Transfer to be made to Reserve:	20%
(vi)	Normal Rate of Return:	15%

Ascertain the value of each equity share under Yield Method.

[Bangalore University, B.Com Nov/Dec 2006, Section B]

SOLUTION

Computation of Value of Shares on the basis of Yield Method (Expected Rate of Return/Rate of Dividend)

Particulars	(₹)
Average Profits before Tax	3,22,580
Less: Income Tax @ 40%	1,22,580
Expected Profit after Tax	2,00,000
Less: Transfer to Reserve @ 20%	40,000
Amount available for Distribution of Dividend	1,60,000
Less: Preference Dividend @ 10% on ₹4,00,000	40,000
Amount available for Equity Dividend	**1,20,000**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{1{,}20{,}000}{5{,}00{,}000} \times 100$$

$$= 24\%$$

Normal Rate of Return = 15%

$$\text{Value of per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{24}{15} \times 100$$

$$= ₹160 \text{ per share}$$

4

Alternatively,

Computation of the Value of Shares on the basis of Yield Method (Capitalisation of Divisible Profits)

Capitalised Value of Profits for Equity Shareholders

$$= \frac{\text{Amount available for Equity Dividend}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{1,20,000}{15} \times 100$$

$$= ₹8,00,000$$

$$\text{Value per Equity Share} = \frac{\text{Capitalised Value of Profits for Equity Shares}}{\text{Number of Equity Shares}}$$

$$= \frac{8,00,000}{5,000}$$

$$= ₹160 \text{ per share}$$

Illustration 13 **(Intrinsic Value or Net Asset Method)**

Following is the balance sheet of Nischal Ltd., as on 31 March 2007:

Liabilities	(₹)	Assets	(₹)
8,000 class 'A' Equity Shares	4,00,000	Fixed Assets	7,60,000
10,000 class 'B' Equity Shares	3,00,000	Current Assets	2,40,000
Reserves and Surplus	1,00,000		
Current Liabilities	2,00,000		
	10,00,000		**10,00,000**

4

Nishanth Ltd. is interested in purchasing substantial number of equity shares of Nischal Ltd. For this purpose, you are requested to ascertain the intrinsic value of each class of equity share, assuming that the value of fixed assets is 20% more and the value of current assets is 10% less.

[Bangalore University, B.Com, Nov/Dec 2008, Section B]

SOLUTION

Computation of the value of shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Fixed Assets	7,60,000	
Add: Increase in the Value of Fixed Assets by 20%	1,52,000	9,12,000
Current Assets	2,40,000	
Less: Decrease in the Value of Current Assets by 10%	(24,000)	2,16,000
Gross Total Assets		11,28,000
Less: External Liabilities		
Current Liabilities		(2,00,000)
Net Assets or Intrinsic Value of Shares		**9,28,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{9,28,000}{18,000\ (10,000 + 8,000)}$$

$$= ₹51.55 \text{ per share}$$

Illustration 14 **(Yield Method)**

Following is the balance sheet of Pooja Ltd., as on 31 March 2007:

Liabilities	(₹)	Assets	(₹)
Equity Shares of ₹10 each	8,00,000	Fixed Assets	12,00,000
Reserve Fund	1,00,000	Current Assets	3,00,000
12% Debentures	2,00,000		
Current Liabilities	4,00,000		
	15,00,000		**15,00,000**

The profits of the company for the past three years before charging interest on debentures were ₹1,52,000; ₹1,56,000 and ₹1,54,000, respectively. Normal rate of return is 12%. You are required to ascertain the yield value of shares, assuming that 20% of the profit is transferred to reserve fund each year (Ignore taxation).

[Bangalore University, B.Com Nov/Dec 2007, Section B]

4

Solution

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the year	(₹)
Year 1	1,52,000
Year 2	1,56,000
Year 3	1,54,000
Total Profits	4,62,000
Average Annual Profits (4,62,000 ÷ 3)	1,54,000
Less: Interest on Debentures (12% on ₹2,00,000)	24,000
Adjusted Average Profits (PAT)	1,30,000
Less: Transfer to Reserve @ 20%	26,000
Amount available for Distribution of Equity Dividend	**1,04,000**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{1,04,000}{8,00,000} \times 100$$

$$= 13\%$$

Normal Rate of Return = 12%

$$\text{Value of per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{13}{12} \times 10$$

$$= ₹10.83 \text{ per share}$$

Illustration 15 **(Yield Method)**

From the following particulars of Vinod Ltd., compute the value of shares under Yield Method:

(i) Equity Shares of ₹10 each: ₹8, 00,000

(ii) Profits for the last three years:

I: ₹75,000

II: ₹78,000

III: ₹87,000

(iii) 20% is transferred to reserve

(iv) Normal Rate of Return: 10%

[Bangalore University, B.Com Nov/Dec 2008, Section B]

SOLUTION

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the Year	(₹)
Year 1	75,000
Year 2	78,000
Year 3	87,000
Total Profits	2,40,000
Average Annual Profits (2,40,000 ÷ 3) (PAT)	80,000
Less: Transfer to Reserve @ 20%	16,000
Amount available for Distribution of Equity Dividend	**64,000**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{64{,}000}{8{,}00{,}000} \times 100$$

$$= 8\%$$

Normal Rate of Return = 10%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{8}{10} \times 10$$
$$= ₹8.00 \text{ per share}$$

Computation of Value of Shares on the basis of Yield Method (Capitalisation of Divisible Profits)

Capitalised Value of Profits for Equity Shareholders

$$= \frac{\text{Amount available for Equity Dividend}}{\text{Normal Rate of Return}} \times 100$$
$$= \frac{64,000}{10} \times 100$$
$$= ₹6,40,000$$

$$\text{Value per Equity Share} = \frac{\text{Capitalised Value of Profits for Equity Shares}}{\text{Number of Equity Shares}}$$
$$= \frac{6,40,000}{80,000}$$
$$= ₹8.00 \text{ per share}$$

Illustration 16 **(Net Asset Method)**

Following are the particulars of Naveen Ltd.

Particulars	(₹)
Equity Shares of ₹10 each	4,00,000
5% Debentures	1,00,000
Current Assets	2,00,000
Fixed Assets	5,50,000
Current Liabilities	1,30,000
Goodwill	50,000

Compute the value of shares under Net Assets Method.

[Bangalore University, B.Com Nov/Dec 2009, Section B]

SOLUTION

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Fixed Assets	5,50,000	
Current Assets	2,00,000	
Goodwill	50,000	
Gross Total Assets		8,00,000
Less: External Liabilities		
Current Liabilities		(1,30,000)
5% Debentures		(1,00,000)
Net Assets or Intrinsic Value of Shares		**5,70,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{5,70,000}{40,000}$$

$$= ₹14.25 \text{ per share}$$

Illustration 17 **(Yield Method)**

From the following details, calculate the value of each equity share on the basis of Yield Method.

(i)	10,000 of 9% preference shares of ₹100 each:	₹10,00,000
(ii)	2,50,000 equity shares of ₹10 each, ₹8 paid:	₹20,00,000
(iii)	Expected Profits per year before Tax:	₹10, 90,000
(iv)	Rate of Taxation:	40%
(v)	Transfer to General Reserve:	20%
(vi)	Normal Rate of Return:	15%

[Bangalore University, B.Com, Nov/Dec 2011, Section B]

SOLUTION

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the Year	(₹)
Expected Profits per year before Tax	10,90,000
Less: Tax @ 40%	4,36,000
Profit After Tax (PAT)	6,54,000
Less: Transfer to Reserve @ 20%	1,30,800
Amount available for Distribution of Dividend	5,23,200
Less: Preference Dividend 9% of ₹10,00,000	90,000
Amount available for Distribution of Equity Dividend	**4,33,200**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{4,33,200}{20,00,000} \times 100$$

$$= 21.66\%$$

Normal Rate of Return = 15%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{21.66}{15} \times 10$$

$= ₹11.552$ per share

Illustration 18 **(Yield Method)**

From the following information, calculate the value of equity shares under Yield Method.

(i) The paid-up share capital of X Ltd. consists of 10,000 of 15% preference shares of ₹100 each fully paid and 2,00,000 equity shares of ₹10 each, ₹6 paid up.

(ii) The average profits of the last three years before tax was ₹8,50,000. Provision for taxation is made at 30% and 20% of the profit after tax is transferred to reserves every year. Normal rate of return is 8%.

[Bangalore University, B.Com Nov/Dec 2013, Section B]

SOLUTION

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the year	**(₹)**
Average Profits before Tax	8,50,000
Less: Tax @ 30%	2,55,000
Profit after Tax (PAT)	5,95,000
Less: Transfer to Reserve @ 20%	1,19,000
Amount available for Distribution of Dividend	4,76,000
Less: Preference Dividend 15% of ₹10,00,000	1,50,000
Amount available for Distribution of Equity Dividend	**3,26,000**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{3,26,000}{20,00,000} \times 100$$

$$= 16.30\%$$

Normal Rate of Return = 15%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{16.30}{8} \times 6$$

$= ₹12.23$ per share

Illustration 19 **(Net Asset Method)**

Following are the particulars of SR Ltd.:

Particulars	(₹)
Fixed Assets	4,00,000
Current Assets	2,50,000
50,000 equity shares of ₹10 each	5,00,000
5,000, 8% preference shares of ₹100 each	5,00,000
Bank overdraft	40,000
6% Debentures	2,00,000
Other Current Liabilities	60,000
Goodwill	1,00,000

The market value of fixed assets is 12% more than the book value and that of current assets is 5% less than the book value. There is an unrecorded liability of ₹5,000. Assuming that preference shares have no priority as to dividend or to repayment of capital, ascertain the value of equity shares.

[Bangalore University, B.Com Nov/Dec 2014, Section B]

SOLUTION

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Goodwill		1,00,000
Fixed Assets	4,00,000	
Add: Increase in the Value of Fixed Assets by 12%	48,000	4,48,000
Current Assets	2,50,000	
Less: Decrease in the Value of Current Assets by 5%	(12,500)	2,37,500
Gross Total Assets		7,85,500
Less: External Liabilities		
Bank Overdraft	40,000	
6% Debentures	2,00,000	
Other Current Liabilities	60,000	
Unrecorded Liability	5,000	3,05,000
Net Assets or Intrinsic Value of Shares		**4,80,500**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{4,80,500}{(50,000 + 5,000)}$$

= ₹8.74 per share

Illustration 20 **(Yield Method)**

Following information relates to Preethi Ltd.:

(i)	8,000 of 10% Preference Shares of ₹100 each:	₹8,00,000
(ii)	10,000 Equity Shares of ₹100 each:	₹10,00,000
(iii)	Average Profit before Tax:	₹6,45,160
(iv)	Rate of Tax:	38%
(v)	Transfer to be made to Reserve:	20%
(vi)	Normal Rate of Return:	15%

Ascertain the value of equity shares under Yield Method.

[Bangalore University, B.Com, Nov/Dec 2015, Section B]

Solution

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the year	(₹)
Average Profits before Tax	6,45,160
Less: Tax @ 38%	2,45,160
Profit After Tax (PAT)	4,00,000
Less: Transfer to Reserve @ 20%	80,000
Amount available for Distribution of Dividend	3,20,000
Less: Preference Dividend 10% of ₹8,00,000	80,000
Amount available for Distribution of Equity Dividend	**2,40,000**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{2,40,000}{10,00,000} \times 100$$

$$= 24\%$$

Normal Rate of Return = 15%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{24}{15} \times 100$$

= ₹160 per share

Illustration 21 **(Net Assets Method)**

Following is the balance sheet of a limited company, as on 31 March 2016. Calculate the value of the equity share under Net Assets Method, after taking the following data into consideration.

(i) Debenture interest is due for two years.

(ii) Current assets include book debts; of which, ₹10,000 was bad but no provision has been made in this regard.

(iii) There was an outstanding liability of ₹8,000.

Balance Sheet as on 31 March 2016

Liabilities	(₹)	Assets	(₹)
10,000, 8% Preference Shares of ₹10 each	1,00,000	Fixed Assets	4,00,000
30,000 Equity Shares of ₹10 each	3,00,000	Preliminary Expenses	20,000
Debenture Redemption Fund	50,000	Discount on Debentures	5,000
6% Debentures	1,00,000	Current Assets	2,50,000
Depreciation Fund	1,00,000	Profit and Loss A/c	25,000
Current Liabilities	50,000		
	7,00,000		**7,00,000**

[Bangalore University, B.Com Nov/Dec 2016, Section B]

Solution

4

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Fixed Assets	4,00,000	
Current Assets (2,50,000 – 10,000)	2,40,000	
Gross Total Assets		6,40,000
Less: External Liabilities		
6% Debentures	1,00,000	
Depreciation Fund	1,00,000	
Current Liabilities (50,000 + 8,000 (Outstanding Liability))	58,000	
Debenture Interest Due (1,00,000 × 6/100 × 2 years)	12,000	(2,70,000)
Net Assets or Intrinsic Value of Shares		3,70,000
Less: Preference Share Capital		1,00,000
Net Assets or Intrinsic Value of equity shareholders		**2,70,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{2,70,000}{30,000}$$

$$= ₹9 \text{ per share}$$

Illustration 22 **(Net Assets Method with Notional call made on Unpaid Capital)**

The following figures were extracted from the books of Elegant Ltd.:

Particulars	(₹)	(₹)
Share Capital:		
9% Preference Shares of ₹100 each		3,00,000
Equity Shares:		
1,000 Equity Shares of ₹100 each, ₹50 called up	50,000	
1,000 Equity shares of ₹100 each, ₹25 called up	25,000	
1,000 Equity shares of ₹100 each, fully called up	1,00,000	1,75,000
Total Share Capital		4,75,000
Reserves and Surplus:		
General Reserve	2,00,000	
Profit and Loss A/c	50,000	2,50,000
		7,25,000

On fair valuation of all the assets of the company, it is found that they have an appreciation of ₹75,000.

The Articles of Association provided that in case of liquidation, the preference shareholders will have a further claim to the extent of 10% of the surplus assets.

Ascertain the value of each preference and equity share, assuming liquidation. Ignore expenses of winding up.

[Bangalore University, B.Com Nov/Dec 2005, Section C]

Solution

Note: While ascertaining the value of shares, if there are any partly paid shares, it can be assumed that the remaining amount has been called up and fully paid (notionally called up and fully paid). With this treatment, all the shares would become fully paid-up shares.

Computation of Value of Shares

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares (Liability-based Approach)*

Particulars	(₹)	(₹)
Tangible Assets (Share Capital and Reserves and Surplus) (4,75,000 + 2,50,000)		7,25,000
Add: Appreciation of Assets		75,000
Net Assets or Intrinsic Value of Shares		8,00,000
Add: Notional Call made		
1,000 Equity Shares at ₹50 per share	50,000	
1,000 Equity Shares at ₹75 per share	75,000	1,25,000
		9,25,000
Less: Preference Share Capital		(3,00,000)
		6,25,000
Less: Equity Share Capital fully called and paid up (3,000 shares of ₹100 each)		(3,00,000)
		3,25,000
Less: 5% Surplus to be transferred to Preference Shareholders (3,25,000 @ 10%)		(32,500)
Balance (Surplus) available to Equity Shareholders		**2,92,500**

Ascertainment of Net Assets or Intrinsic Value available to Equity Shareholders

Equity Share Capital	3,00,000
Balance (Surplus) available to Equity Shareholders	2,92,500
Net Assets or Intrinsic Value	**5,92,500**

$$\text{Intrinsic Value per Equity Share} = \frac{5,92,500}{3,000}$$

$$= ₹197.50 \text{ per share}$$

After calculating the intrinsic value per fully-paid share, the intrinsic value of partly paid share is calculated as follows:

Intrinsic Value per Partly-paid Equity Share = Intrinsic Value per fully-paid Equity Share – Uncalled Capital per share

Intrinsic Value per Fully-paid Equity Share = ₹197.50

Intrinsic Value per Equity Share of ₹50 paid = ₹197.50 – 50.00 = ₹147.50 per share

Intrinsic Value per Equity Share of ₹75 paid = ₹197.50 – 75.00 = ₹122.50 per share

$$\text{Intrinsic Value per Preference Share} = \frac{\text{Preference Share Capital + Surplus}}{\text{Number of Preference Shares}}$$

$$= \frac{3,00,000 + 32,500}{3,000}$$

$$= ₹110.83 \text{ per share}$$

Illustration 23 **(Net Assets Method and Yield Method)**

Following is the balance sheet of Surya Ltd., as on 31 March 2006:

Liabilities	(₹)	Assets	(₹)
Equity Share Capital (₹10 each)	16,00,000	Goodwill	2,00,000
Reserves and Surplus	3,00,000	Other Fixed Assets	24,00,000
10% Debentures	4,00,000	Current Assets	4,00,000
Creditors	4,00,000		
Provision for Tax	3,00,000		
	30,00,000		**30,00,000**

On the given date, an independent valuation of Goodwill and other Fixed Assets was made at ₹3,00,000 and ₹30,00,000 respectively. Current assets include debtors ₹2,00,000; out of which, 15% is bad. The net profits of the company for the past three years were ₹2,40,000, ₹2,80,000 and ₹3,05,000; of which, 20% was placed to reserve. The normal rate of return is 10%. Calculate the value of share as per Net Assets Method and Yield Method.

[Bangalore University, B.Com Nov/Dec 2006/2011, Section C]

4

SOLUTION

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Goodwill	3,00,000	
Other Fixed Assets	30,00,000	
Current Assets (4,00,000 – 30,000)*	3,70,000	
Gross Total Assets		36,70,000
Less: External Liabilities		
10% Debentures	4,00,000	
Creditors	4,00,000	
Provision for Tax	3,00,000	(11,00,000)
Net Assets or Intrinsic Value of Equity Shareholders		(25,70,000)

(₹30,000 = 2,00,000 × 15%)

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{25,70,000}{1,60,000}$$

$$= ₹16.06 \text{ per share}$$

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the Year	(₹)
Year 1	2,40,000
Year 2	2,80,000
Year 3	3,05,000
Total Profits	8,25,000
Average Annual Profits (8,25,000 ÷ 3) (PAT)	2,75,000
Less: Transfer to Reserve @ 20%	55,000
Amount available for Distribution of Equity Dividend	**2,20,000**

Calculation of Expected Rate of Return/Rate of Dividend

Expected Rate of Return/Rate of Dividend

$$= \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{2,20,000}{16,00,000} \times 100$$

$$= 13.75\%$$

Normal Rate of Return = 10%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{13.75}{10} \times 10$$

$$= ₹13.75 \text{ per share}$$

Computation of Value of Shares on the basis of Yield Method (Capitalisation of Divisible Profits)

Capitalised Value of Profits for Equity Shareholders

$$= \frac{\text{Amount available for Equity Dividend}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{2,20,000}{10} \times 100$$

$$= ₹22,00,000$$

$$\text{Value per Equity Share} = \frac{\text{Capitalised Value of Profits for Equity Shares}}{\text{Number of Equity Shares}}$$

$$= \frac{22,00,000}{1,60,000}$$

$$= ₹13.75 \text{ per share}$$

Illustration 24 **(Net Assets Method, Yield Method and Fair Value Method)**

From the given balance sheet and other information, you are required to ascertain the value of equity shares under:

(i) Intrinsic Value Method

(ii) Yield Value Method and

(iii) Fair Value Method (Ignore Taxation)

Liabilities	(₹)	Assets	(₹)
2,000 Shares of ₹100 each	2,00,000	Land and Buildings	1,10,000
General Reserve	40,000	Plant and Machinery	1,30,000
Profit and Loss A/c	32,000	Patents and Trade Marks	20,000
Creditors	1,28,000	Stock	48,000
Bills Payable	60,000	Debtors	88,000
		Cash and Bank	52,000
		Preliminary Expenses	12,000
	4,60,000		**4,60,000**

An independent expert valued the assets of the company as follows:

Land and Buildings: ₹2,40,000
Goodwill: ₹1,60,000
Plant and Machinery: ₹1,20,000

The other assets are worth their book value. The profits of the company have been as follows:

2004–05: ₹80,000
2005–06: ₹90,000
2006–07: ₹1,06,000

The company follows the practice of transferring 25% of profits to general reserve. Normal rate of return is 12%.

[Bangalore University, B.Com Nov/Dec 2007/2014, Section C]

4

Solution

Computation of the Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Goodwill	1,60,000	
Land and Buildings	2,40,000	
Plant and Machinery	1,20,000	
Patents and Trade Marks	20,000	
Stock	48,000	
Debtors	88,000	
Cash and Bank	52,000	
Gross Total Assets		7,28,000
Less: External Liabilities		
Creditors	(1,28,000)	
Bills Payable	(60,000)	(1,88,000)
Net Assets or Intrinsic Value of Shares		**5,40,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{5,40,000}{2,000}$$

= ₹270 per equity share

4

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the year	(₹)
Year 1	80,000
Year 2	90,000
Year 3	1,06,000
Total Profits	2,76,000
Average Annual Profits (2,76,000 ÷ 3) (PAT)	92,000
Less: Transfer to Reserve @ 25%	23,000
Amount available for Distribution of Equity Dividend	**69,000**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{69{,}000}{2{,}00{,}000} \times 100$$
$$= 34.50\%$$

Normal Rate of Return = 12%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$
$$= \frac{34.50}{12} \times 100$$
$$= ₹287.50 \text{ per share}$$

Computation of Fair Value of Equity Share

Fair Value of the Share

$$= \frac{\text{Intrinsic Value of the Share} + \text{Yield (Rate of Dividend) Value of the Share}}{2}$$
$$= \frac{270 + 287.50}{2}$$
$$= ₹278.75 \text{ per equity share}$$

Illustration 25 **(Asset Backing Method and Yield Method)**

The following details are obtained from the books of Niharika Ltd., as on 30 June 2008:

	Particulars	(₹)
(i)	Share Capital:	
	(a) 5,000 Equity Shares of ₹10 each fully paid-up	50,000
	(b) 5,000 Equity Shares of ₹10 each, ₹7.50 per share paid up	37,500
	(c) 5,000 Equity Shares of ₹10 each, ₹5 per share paid up	25,000
(ii)	General Reserve	25,000
(iii)	Liabilities	62,500
(iv)	Fixed Assets	90,000
(v)	Current Assets	1,00,000
(vi)	Normal Average Profit (less tax)	15,000
(vii)	Estimated rate for capitalisation purpose is 10%	
(viii)	Transfer 20% of profits after tax to general reserve	

Calculate the value of each type of shares by:

(i) Asset Backing Method

(ii) Yield Method

[Bangalore University, B. Com Nov/Dec 2008/2009, Section C]

SOLUTION

Computation of Value of Shares

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares (Asset-based Approach)*

Particulars	(₹)	(₹)
Fixed Assets	90,000	
Current Assets	1,00,000	
Gross Total Assets		1,90,000
Less: External Liabilities		(62,500)
		1,27,500
Add: Notional Call made		
5,000 Equity Shares at ₹2.50 per share	12,500	
5,000 Equity Shares at ₹5.00 per share	25,000	(37,500)
Net Assets or Intrinsic Value of Shares		**1,65,000**

$$\text{Intrinsic Value per Equity Share} = \frac{1,65,000}{15,000}$$

$$= ₹11 \text{ per share}$$

After calculating the intrinsic value per fully paid share, the intrinsic value of partly paid share is calculated as follows:

Intrinsic Value per partly-paid Equity Share

= Intrinsic Value per fully-paid Equity Share – Uncalled Capital per Share

(i) Intrinsic Value per fully-paid equity share = ₹11

(ii) Intrinsic Value per equity share of ₹7.50 paid = ₹11.00 – 2.50 = ₹8.50

(iii) Intrinsic Value per equity share of ₹5.00 paid = ₹11.00 – 5.00 = ₹6.00

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the Year	(₹)
Average Profits before Tax	15,000
Less: Transfer to Reserve @ 20%	3,000
Amount available for Distribution of Dividend	**12,000**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{12,000}{1,12,500} \times 100$$

$$= 10.67\%$$

Normal Rate of Return = 10 %

$$\text{Value per Fully-paid Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{10.67}{10} \times 10$$

$$= ₹10.67 \text{ per share}$$

$$\text{Value per Partly-paid Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{10.67}{10} \times 7.50$$

$$= ₹8.00 \text{ per share}$$

$$\text{Value per Partly-paid Equity share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{10.67}{10} \times 5.00$$

$$= ₹5.33 \text{ per share}$$

Illustration 26 **(Asset Backing Method, Yield Method and Fair Value Method)**

On 31 March 2010, the balance sheet of Sanjana Ltd. was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Land and Building	2,20,000
5,000 shares of ₹100	5,00,000	Plant and Machinery	95,000
Profit and Loss A/c	1,03,000	Stock	3,50,000
Bank Overdraft	20,000	Sundry Debtors	1,55,000
Creditors	77,000		
Provision for Tax	45,000		
Proposed Dividend	75,000		
	8,20,000		**8,20,000**

The net profits of the company after deducting all working charges and providing for depreciation and taxation were given as follows:

Financial Year	Profit (₹)
2005–06	85,000
2006–07	96,000
2007–08	90,000
2008–09	1,00,000
2009–10	95,000

On 31 March 2010, Land and Building were re-valued at ₹2,50,000, Plant and Machinery at ₹50,000 and Goodwill at ₹1,50,000. The normal rate of return is 10%.

You are required to ascertain the value of equity shares under:

(i) Intrinsic Value Method

(ii) Yield Method and

(iii) Fair Value Method

[Bangalore University, B.Com Nov/Dec 2010, Section C]

SOLUTION

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Goodwill	1,50,000	
Land and Building	2,50,000	
Plant and Machinery	1,50,000	
Stock	3,50,000	
Sundry Debtors	1,55,000	
Gross Total Assets		10,55,000
Less: External Liabilities		
Bank Overdraft	20,000	
Creditors	77,000	
Provision for Tax	45,000	
Proposed Dividend	75,000	(2,17,000)
Net Assets or Intrinsic Value of Shares		**8,38,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{8,38,000}{5,000}$$

$$= ₹167.60 \text{ per equity share}$$

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the year	(₹)
Year 1	85,000
Year 2	96,000
Year 3	90,000
Year 4	1,00,000

(*Contd.*)

Profits for the year	(₹)
Year 5	95,000
Total Profits	4,66,000
Average Annual Profits (4,66,000 ÷ 5) (PAT)/**Amount available for Distribution of Equity Dividend**	**93,200**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{93{,}200}{5{,}00{,}000} \times 100$$

$$= 18.64\%$$

Normal Rate of Return = 10%

$$\text{Value per Equity share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{18.64}{10} \times 100$$

$$= ₹186.40 \text{ per equity share}$$

Computation of Fair Value of Equity Share

Fair Value of the Share

$$= \frac{\text{Intrinsic Value of the Share} + \text{Yield (Rate of Dividend) Value of the Share}}{2}$$

$$= \frac{167.60 + 186.40}{2}$$

$$= 177.00 \text{ per equity share}$$

4

Illustration 27 **(Asset Backing Method, Yield Method and Fair Value Method)**

Following is the balance sheet of B Co. Ltd. as on 31 March 2012.

Liabilities	(₹)	Assets	(₹)
30,000 Equity Shares of ₹10 each	3,00,000	Fixed Assets	4,00,000
6% Preference Shares of ₹10 each	60,000	Investments	50,000
General Reserve	50,000	Current Assets	2,00,000
Profit and Loss A/c	40,000	Preliminary Expenses	10,000
5% Debentures	1,00,000		
Creditors	80,000		
Bills Payable	30,000		
	6,60,000		**6,60,000**

Average annual profit is ₹80,000. Company transfers 10% of its profits every year to general reserve, normal return on capital employed is 10%.

Compute the value of shares by:

(i) Intrinsic Value Method

(ii) Yield Method

(iii) Fair Value Method

[Bangalore University, B.Com Nov/Dec 2012, Section C]

SOLUTION

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Fixed Assets	4,00,000	
Investments	50,000	
Current Assets	2,00,000	
Gross Total Assets		6,50,000
Less: External Liabilities		
5% Debentures	1,00,000	
Creditors	80,000	
Bills Payable	30,000	(2,10,000)
Net Assets or Intrinsic Value of Shares		4,40,000
Less: Preference Share Capital		(60,000)
Net Assets or Intrinsic Value of Equity Shares		**3,80,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{3,80,000}{30,000}$$

$$= ₹12.67 \text{ per equity share}$$

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the Year	(₹)
Average Annual Profits	80,000
Less: Transfer to General Reserve @ 10%	(8,000)
Amount available for Dividend Distribution	72,000
Less: Preference Dividend @ 6% on ₹60,000	(3,600)
Amount available for Equity Dividend	**68,400**

Calculation of Expected Rate of Return/Rate of Dividend

$$\text{Expected Rate of Return/Rate of Dividend} = \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{68{,}400}{3{,}00{,}000} \times 100$$

$$= 22.80\ \%$$

Normal Rate of Return = 10%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{22.80}{10} \times 10$$

$$= ₹22.80 \text{ per share}$$

Computation of Fair Value of Equity Share

Fair Value of the Share

$$= \frac{\text{Intrinsic Value of the Share + Yield (Rate of Dividend) Value of the Share}}{2}$$

$$= \frac{12.67 + 22.80}{2}$$

$$= ₹\ 17.74 \text{ per equity share}$$

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Illustration 28 **(Asset Backing Method, Yield Method and Fair Value Method)**

The balance sheet of NV Ltd. as on 31 March 2012 is given as follows:

Liabilities	(₹)	Assets	(₹)
Equity Shares of ₹100 each	10,00,000	Fixed Assets	11,00,000
15% Preference Shares of ₹100 each	6,00,000	Stock	3,50,000
General Reserve	80,000	Debtors	4,50,000
Profit and Loss A/c	1,60,000	Cash and Bank	2,00,000
Sundry Creditors	1,40,000		
Bills Payable	1,20,000		
	21,00,000		**21,00,000**

Additional Information

(i) Realisable value of fixed assets is ₹5,00,000 and of stock is ₹3,00,000.

(ii) Of the debtors, ₹50,000 is doubtful.

(iii) The average profits of the company (before providing for taxation at 30%) is ₹6,50,000.

(iv) The company transfers 20% of the profits after tax to reserve fund.

(v) Normal rate of return is 12% on net capital employed.

Find out the Intrinsic Value, Yield Value and Fair Value of Equity Shares.

[Bangalore University, B.Com Nov/Dec 2013, Section C]

SOLUTION

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Fixed Assets	5,00,000	
Stock	3,00,000	
Debtors (4,50,000 – 50,000)	4,00,000	
Cash and Bank	2,00,000	
Gross Total Assets		14,00,000
Less: External Liabilities		
Creditors	1,40,000	
Bills Payable	1,20,000	(2,60,000)
Net Assets or Intrinsic Value of Shares		11,40,000
Less: Preference Share Capital		(6,00,000)
Net Assets or Intrinsic Value of Equity Shares		**5,40,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{5,40,000}{10,000}$$

$$= ₹54.00 \text{ per equity share}$$

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the Year	(₹)
Average Annual Profits before Tax	6,50,000
Less: Provision for Taxation @ 30%	1,95,000
Average Annual Profits after Tax (PAT)	4,55,000
Less: Transfer to General Reserve @ 20%	(91,000)
Amount available for Dividend Distribution	**3,64,000**
Less: Preference Dividend @15% on ₹6,00,000	(90,000)
Amount available for Equity Dividend	**2,74,000**

Calculation of Expected Rate of Return/Rate of Dividend

Expected Rate of Return/Rate of Dividend

$$= \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{2{,}74{,}000}{10{,}00{,}000} \times 100$$

$$= 27.40\%$$

Normal Rate of Return = 12%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{27.40}{12} \times 100$$

$$= ₹228.33 \text{ per share}$$

Computation of Fair Value of Equity Share

Fair Value of the Share

$$= \frac{\text{Intrinsic Value of the Share + Yield (Rate of Dividend) Value of the Share}}{2}$$

$$= \frac{54 + 228.33}{2}$$

$$= ₹141.17 \text{ per equity share}$$

Illustration 29 **(Asset Backing Method, Yield Method and Fair Value Method)**

Following is the summarised balance sheet of Adarsh Ltd., as on 31 March 2016

Balance Sheet as on 31 March 2016

Liabilities	(₹)	Assets	(₹)
Share Capital		Goodwill	1,00,000
40,000 Shares of ₹10 each	4,00,000	Fixed Assets	4,50,000
Reserve Fund	1,00,000	Current Assets	1,90,000
Profit and Loss A/c	35,000	Preliminary Expenses	25,000
9% Debentures	1,00,000		
Current Liabilities	1,30,000		
	7,65,000		**7,65,000**

For the purpose of valuation of shares, fixed assets were valued at ₹5,00,000 and goodwill at ₹1,50,000. There is a necessity of RBD at 10% on debtors of ₹75,000. It is found that stock was overvalued by ₹9,000.

The net profit for three years were ₹69,000, ₹71,800 and ₹90,200, respectively, after taxation. Out of this profit, 20% was placed to reserve, the proportion being considered reasonable in the industry in which the company is engaged and where the normal rate of return is 10%.

Compute the value of equity shares by Net Assets Method and Yield Method and also calculate the fair value of shares.

[Bangalore University, B.Com Nov/Dec 2016, Section C]

SOLUTION

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars		(₹)	(₹)
Goodwill		1,50,000	
Fixed Assets		5,00,000	
Current Assets:	1,90,000		
Less:			
RBD:	₹7,500		
Overvaluation of Stock:	₹9,000	1,73,500	
Gross Total Assets			8,23,500
Less: External Liabilities			
9% Debentures		1,00,000	
Current Liabilities		1,30,000	(2,30,000)
Net Assets or Intrinsic Value of Equity Shares			**5,93,500**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{5,93,500}{40,000}$$

$$= ₹14.84 \text{ per equity share}$$

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the Year	(₹)
Year 1	69,000
Year 2	71,800
Year 3	90,200
Total Profits	2,31,000
Average Annual Profits ₹2,31,000 ÷ 3 (PAT)	77,000
Less: Transfer to General Reserve @ 20%	(15,400)
Amount available for Equity Dividend	**61,600**

Calculation of Expected Rate of Return/Rate of Dividend

Expected Rate of Return/Rate of Dividend

$$= \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{61{,}600}{4{,}00{,}000} \times 100$$

$$= 15.40\%$$

Normal Rate of Return = 10%

$$\text{Value per Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per Share}$$

$$= \frac{15.40}{10} \times 10$$

$$= ₹15.40 \text{ per equity share}$$

Computation of Fair Value of Equity Share

Fair Value of the Share

$$= \frac{\text{Intrinsic Value of the Share + Yield (Rate of Dividend) Value of the Share}}{2}$$

$$= \frac{14.84 + 15.40}{2}$$

$$= ₹15.12 \text{ per equity share}$$

SUMMARY

- Valuation of Shares is a process through which the fair value of shares of a company is determined. There are many situations requiring the computation of true worth or value of shares.
- Valuation of shares is done in the event of amalgamation, absorption, reconstruction, for the purpose of payment of taxes, for the purpose of converting one class of security into another, etc.
- The factors determining valuation of shares are: firm's earning capacity; demand and supply; goodwill; monopolistic stand enjoyed by the firm in the market; dividend declared by the company in the recent past; general political, social and economic conditions; government assistance and support; yield on shares of other companies in the industry and dividend declared by the other companies in the past; net tangible assets of the company; efficiency of the managers, etc.
- The types of values of shares are: Nominal Value, Book Value, Market Value, Intrinsic Value and Fair Value.

- Methods of Valuation of Shares:
  - Intrinsic Value Method or Net Assets Method or Asset Backing Method or Balance Sheet Method
  - Yield Method or Dividend Yield Method
  - Earning Capacity Method
  - Fair Value Method

I. Intrinsic Value Method:

Value of Equity Shares under Intrinsic Value Method

$$= \frac{\text{Net Assets available to Equity Shareholders}}{\text{Number of Equity Shares}}$$

II. Yield Method or Dividend Yield Method:

Rate of Dividend Method

Value per Equity Share

$$= \frac{\text{Return on Equity Shares or Expected Rate of Dividend}}{\text{Normal Rate of Return on Equity Shares} \times \text{Paid-up Value of each Equity Share}}$$

Capitalisation of Divisible Profits

$$\text{Capitalised Value of profits} = \frac{\text{Profits available for Dividend Distribution}}{\text{Normal Rate of Return}} \times 100$$

$$\text{Value per Equity Share} = \frac{\text{Capitalised Value of Profits}}{\text{Number of Equity shares}}$$

$$\text{Value per Equity Share} = \frac{\text{Capitalised Value of Profits}}{\text{Equity Paid-up Capital}} \times \text{Paid-up Value of a Share}$$

(This formula is to be used when different paid-up amounts of various types of shares are given)

III. Earning Capacity Method:

Value of Equity Shares under Earnings Capacity Method

$$= \frac{\text{Rate of Earnings}}{\text{Normal Rate of Return on Equity Shares}} \times \text{Paid-up value of each Equity Share}$$

IV. Fair Value Method:

Value of Equity Shares under Fair Value Method

$$= \frac{\text{Intrinsic Value of Shares} + \text{Yield (Market) Value of Shares}}{2}$$

- **Valuation of Right Shares**

$$\text{Value of Right Issue} = \frac{\text{Number of Rights Shares (Market price} - \text{Issue Price)}}{\text{Number of Existing Shares} + \text{Number of Right Shares}}$$

THEORY QUESTIONS

Section A

1. What are the needs/reasons/circumstances under which shares are valued? **[Nov/Dec 2005/2008/2014/2016]**
2. How do you calculate Intrinsic Value of Shares? **[Nov/Dec 2009/2012]**
3. State any two factors to be considered for Valuation of Shares. **[Nov/Dec 2007/2010]**
4. How do you calculate the value of shares under Break-up Value Method? **[Nov/Dec 2007]**
5. What is the Fair Value per Share? **[Nov/Dec 2008/2012]**
6. State the methods of Valuation of Shares. **[Nov/Dec 2009/2010/2011]**
7. How is value of shares determined under Yield Value Method? **[Nov/Dec 2013]**
8. Profit available to equity shareholders is ₹4,50,000; Normal rate of return is 15% and number of equity shares are 25,000. Find out value of equity shares. **[Nov/Dec 2013]**
9. How do you calculate the Value of Shares (face value same) when they are differently paid? **[Nov/Dec 2014]**
10. Fixed Assets: ₹10,00,000; Current Assets: ₹8,00,000; Arrears of Preference Dividend: ₹40,000; 5% Preference Share Capital: ₹4,00,000; Current Liabilities: ₹3,00,000; 6% Debentures: ₹2,00,000. Calculate Net Assets available to equity shareholders. **[Nov/Dec 2015]**
11. Distinguish between Intrinsic Value and Market Value of Shares.
12. State the meaning of the term Net Assets.
13. How do you determine Fair Value of Shares?
14. Explain Break-up Value Method.
15. How are partly-paid shares ascertained under Net Asset Method?

4

Section B

1. What are the reasons/circumstances under which shares are valued? **[Nov/Dec 2007/2012]**
2. What are the various methods of Valuation of Shares?
3. Explain the circumstances under which valuation of shares is considered necessary?
4. S Ltd. has 50,000 equity shares of ₹10 each, ₹8 Paid and 40,000 of 7% preference shares of ₹10 each. The company transfers 10% of divisible profits to General Reserve every year. The expected profit before tax is ₹10,00,000 and the tax rate is 65%. The normal rate of dividend is 16%. Find out the value of equity shares. **(Value of Equity Shares: ₹35.88)**
5. A Co. wishes to purchase the shares of B Co. as on 31 December 2017.

Balance Sheet of B Co. as on 31 December 2017

Liabilities	(₹)	Assets	(₹)
Share Capital	6,00,000	Fixed Assets less Depreciation	7,30,000
Reserves	1,00,000	5% Government Securities	60,000
Profit and Loss A/c	25,000	Current Assets	2,70,000

(*Contd.*)

Liabilities	(₹)	Assets	(₹)
8% Debentures	2,00,000	Preliminary Expenses	16,500
Creditors	80,000		
Provision for Taxation	71,500		
	10,76,500		**10,76,500**

The provision for taxation is only for the year and is at 55% of the net profits. Other companies in the same line of business show an income of 10% on capital employed.

The Director of A Co. seeks you advice as to the amount he is required to pay for the shares of B Co. Advise him suitably.

(Value of Shares to be paid: ₹6,30,000)

6. The balance sheet of ABC Ltd. is given as follows. Assuming that the value of Goodwill will be ₹86,250 and realisable value of fixed assets to be ₹6,03,750, compute the value of shares by Asset Valuation Method:

Liabilities	(₹)	Assets	(₹)
Share Capital	6,90,000	Fixed Assets	8,62,500
Reserves	1,55,250	Current Assets	3,45,000
Profit and Loss A/c	34,500	Goodwill	69,000
10% Debentures	1,72,500		
Creditors	2,24,250		
	12,76,500		**12,76,500**

(Value of Equity Shares: ₹9.25)

7. Mr Singh holds 5,000 shares in Blue Bell Ltd. The paid-up capital of which is 3,000 shares of ₹1 each. It is also ascertained that:
   (i) The average annual profit of such company after tax is ₹5,000.
   (ii) The expected normal return for the type of business carried on by the company is 8%.

   Mr Singh requires you to value his shareholdings based on the aforementioned information.

(Value of Equity Shares: ₹2.08)

8. From the following particulars, ascertain the value of equity shares under Asset Backing and Yield Methods:

Particulars	(₹)
80,000 Equity Shares of ₹10 each, ₹8 paid	6,40,000
40,000 Equity Shares of ₹10 each	4,00,000
2,500, 8% Preference Shares of ₹100 each	2,50,000
General Reserve	2,00,000
Profit and Loss (Cr.)	1,50,000
Average Profits	2,00,000
Expected Normal Rate of Return	10%

(Value of Equity Shares: ₹13 (Asset Backing Method); ₹15 (Yield Method))

9. From the following particulars, ascertain the value of Mr Y's shareholdings under the Asset Backing and Yield Methods:

Authorised Capital of X Co. Ltd.	(₹)
20,000 Equity Shares of ₹15 each, ₹10 paid up	2,00,000
1,000, 5% Preference Shares of ₹100 each	1,00,000
General Reserve	69,000
Profit and Loss (Cr.)	1,50,000
Average Profits	36,000
Expected Normal Rate of Return	8%

Mr Y holds 200 preference shares and 3,000 equity shares in X Co. Ltd.

(Value of Equity Shares: ₹78,125 (Asset Backing Method); ₹74,750 (Yield Method))

10. Find out the value of each share from the following information. For the purpose of valuation of shares, Goodwill needs to be taken at three times the average annual profits of the last four years.

Year 1: ₹22,500

Year 2: ₹30,000

Year 3: ₹37,500

Year 4: ₹60,000

Balance Sheet of MN Ltd.

Liabilities	(₹)	Assets	(₹)
Share Capital (₹100 each)	3,00,000	Goodwill	1,50,000
Reserves	1,50,000	Investments	2,25,000
Profit and Loss A/c	52,500	Stock	3,75,000
10% Debentures	3,00,000	Debtors	2,10,000
Creditors	2,25,000	Cash	67,500
	10,27,500		**10,27,500**

(Value of Goodwill: ₹1,12,500; Value of Equity Shares: ₹155)

11. From the following information given, ascertain the value of shares on basis of Net Asset Backing Method and on Dividend Yield basis:

Particulars	(₹)
80,000 Equity Shares of ₹10 each, ₹8 paid	6,40,000
11,000 Equity Shares of ₹10 each	1,10,000
900, 6% Preference Shares of ₹100 each	90,000
Creditors	15,000
Reserves	7,000
Average Profits	17,000
Expected Normal Rate of Return	9%
Transfer to Reserves	10% of the profits

(Value of Equity Shares: ₹10.70 (Asset Backing method); ₹12.22 (Yield Method))

12. Ascertain the value of shares by:
    (i) Net Asset Method
    (ii) Yield Method

Liabilities	(₹)	Assets	(₹)
Share Capital (₹10 each)	8,00,000	Goodwill	50,000
Reserves	1,00,000	Fixed Assets	10,00,000
Profit and Loss A/c	50,000	Current Assets	4,00,000
8% Debentures	1,00,000		
Creditors	3,00,000		
Bank Overdraft	1,00,000		
	14,50,000		**14,50,000**

On 31 December 1998, the fixed assets were valued at ₹12,00,000 and goodwill at ₹75,000. The net profits for the last three years were ₹75,000; ₹78,000 and ₹87,000 of which 20% was placed to reserves. The normal rate of return is expected to be at 10%.

(Value of Equity Shares: ₹25.40 (Asset Backing Method); ₹19.87 (Yield Method))

PRACTICAL QUESTIONS

Section C

1. Following is the balance sheet of a company as on 31 December 2017:

Liabilities	(₹)	Assets	(₹)
Share Capital (₹10 each)	8,00,000	Goodwill	1,00,000
1,000, 6% Preference Shares of ₹100 each	1,00,000	Land and Building	6,00,000
Reserves	2,50,000	Plant and Machinery	3,00,000
5% Debentures	1,00,000	Stock	1,50,000
Creditors	1,00,000	Debtors	1,50,000
		Cash	40,000
		Preliminary Expenses	10,000
	13,50,000		**13,50,000**

Normal return on capital employed for valuation of goodwill is 10%. The Land and Building are worth ₹7, 00,000, and Plant and Machinery are worth ₹2,80,000. Goodwill is to be valued on the basis of three years' purchase of super profits. The profits and losses of the company for the past five years were:

	Profit (₹)	Loss (₹)
2000	1,80,000	
2001	2,60,000	
2002	-	40,000
2003	-	20,000
2004	1,30,000	

Companies engaged in similar businesses pay 12% dividend on their equity shares. Ascertain the fair value of each equity share.

(Value of Equity Shares: ₹12.75 (Asset Backing Method); ₹10.00 (Yield Method) and ₹11.37 (Fair Value Method))

2. The following is the summarised balance sheet of Sigma Ltd. as on 31 December 2017:

Liabilities	(₹)	Assets	(₹)
Share Capital (₹100 each)	3,00,000	Fixed Assets	8,00,000
7,000, 8% Preference Shares of ₹100 each	7,00,000	Stock	2,00,000
Reserves	1,00,000	Debtors	2,00,000
Profit and Loss A/c	1,00,000	Bank	50,000
Creditors	50,000		
	12,50,000		**12,50,000**

The net profits of the company for the past five years before charging tax were as follows:

	Profit (₹)
2013	1,80,000
2014	2,00,000
2015	1,80,000
2016	1,50,000
2017	1,00,000

Another company, engaged in the same line of business, pays a dividend of 10% and its shares are quoted in the stock exchange at ₹11. Assuming a taxation provision of 50% of the profits and an appropriation of 10% of the balance to reserves, ascertain the value of each equity share of the company.

(Value of Equity Shares: ₹563 (Asset Backing Method)

3. The balance sheet of S Ltd. is given as follows:

Liabilities	(₹)	Assets	(₹)
12,000 Equity Shares of ₹100 each	12,00,000	Goodwill	9,00,000
6,000, 8% Preference Shares of ₹100 each	6,00,000	Plant and Machinery	15,00,000
Debentures	18,00,000	Stock	21,00,000

(*Contd.*)

Liabilities	(₹)	Assets	(₹)
General Reserve	9,00,000	Debtors	12,60,000
Creditors	13,50,000	Cash at Bank	4,05,000
Profit and Loss A/c	3,15,000		
	61,65,000		**61,65,000**

The market value of plant and machinery, at the date on which the given balance sheet was drawn, was ₹14,10,000; ₹6,75,000 is the appropriate amount to be attached to Goodwill.

Find the value per share under the following conditions:

(i) If the Preference Shares are preferential, both to capital as well as dividend, and normal rate on them is estimated to be 8%.

(ii) If the Preference Shares are preferential, both to capital and dividends, and normal rate on them is estimated to be 5%.

(iii) If Preference Shares and Equity Shares are to be treated at par in liquidation.

((i) Value of Equity Shares: ₹100 and Value of Preference Shares: ₹175
(ii) Value of Equity Shares: ₹160 and Value of Preference Shares: ₹145
(iii) Value of Equity Shares: ₹150 and Value of Preference Shares: ₹150)

4. From the following information given and the balance sheet of A Ltd. on 31 December 2017, find out the value of its equity shares with the help of Fair Value Method:

Liabilities	(₹)	Assets	(₹)
8,000 Equity Shares of ₹100 each	8,00,000	Buildings	1,40,000
2,000, 8% Preference Shares of ₹100 each	2,00,000	Furniture	6,000
Reserves	3,00,000	Stock	9,00,000
Profit and Loss A/c	10,20,000	Investments	6,70,000
Creditors	96,000	Debtors	5,60,000
		Bank	1,20,000
		Preliminary Expenses	20,000
	24,16,000		**24,16,000**

(i) The company's prospects for 2016 are good.

(ii) Buildings are now worth ₹7, 00,000.

(iii) Profits for the last three years have shown an annual increase of ₹50,000. The annual transfer to reserve is 25% of Net Profit.

(iv) Preferential shares are preferential as to capital and dividend.

(v) Normal rate of return is expected at 15%.

(Value of Equity Shares: ₹332.50 (Asset Backing method);
₹586.67 (Yield Method) and ₹459.56 (Fair Value Method))

5. On 31 December 2017, the balance sheet of R Ltd. was as follows:

Liabilities	(₹)	Assets	(₹)
5,000 Equity Shares of ₹100 each	5,00,000	Buildings	2,20,000
Profit and Loss A/c	1,03,000	Furniture	95,000
Creditors	20,000	Stock	3,50,000
Bank Overdraft	77,000	Debtors	1,55,000
Provision for Taxation	45,000		
Dividend Equalisation	75,000		
	8,20,000		**8,20,000**

The net profits of the company, after deducting all working charges and providing depreciation and taxation, were given as follows:

2013: ₹85,000

2014: ₹96,000

2015: ₹90,000

2016: ₹1,00,000

2017: ₹95,000

On 31 December 2014, Land and Buildings were valued at ₹2,50,000, and Plant and Machinery at ₹1,50,000. In view of the nature of the business, it is considered that 10% is a reasonable return on tangible capital.

Find out the value of the company's share, after taking into account the revised values of fixed assets and your own valuation of Goodwill based on five years' purchase of the annual super profits. Calculate Super Profit on Average Capital Employed for this purpose.

(Value of Goodwill: ₹1, 08,250; Value of Equity Shares: ₹174.25)

5

Company Final Accounts

CHAPTER OUTLINE

5.1 INTRODUCTION

Companies registered under the Companies Act, 1956 (Revised Companies Act, 2013), are required to prepare financial statements, namely, Balance Sheet, Statement of Profit and Loss and related notes to accounts, in accordance with the Schedule VI of Companies Act 1956. This is to bring uniformity and harmonisation in the accounting and reporting practises of the companies. Companies prepare financial statements to communicate information regarding the whereabouts of the company, channelisation of their funds and the future prospects to the stakeholders. The financial statements give an assurance to the stakeholders about their investments and make companies accountable for every amount spent.

5.2 STATUTORY PROVISIONS REGARDING PREPARATION OF COMPANIES' FINAL ACCOUNTS

As per Section 128 of the Companies Act, 2013, every company shall prepare and keep at its registered office, books of accounts and other relevant books, documents and financial statements that give true and fair view of the state of affairs of the company; such books shall be kept on accrual basis and according to the Double Entry System of Accounting.

As per Section 129 of the Companies Act, 2013, the financial statements shall give true and fair view of the state of affairs of the company or companies, comply with the notified accounting standards under Section 133, and shall be in the form or forms as may be provided for different class or classes of companies, as prescribed in Schedule III. Furthermore, the Board of Directors of the company shall lay financial statements at every annual general meeting of a company.

Financial Statements are the statements where the financial data is compiled, collected and classified in a systematic manner, according to the accounting principles, to assess the financial position of an enterprise as regards its profitability, efficiency, solvency and growth potential. The statements are very helpful to the wide range of users in making economic decisions.

Financial Statements, as per Section 2(40) of the Companies Act, 2013, include,

1. A balance sheet at the end of the financial year
2. A profit and loss account, or in case of a company carrying on any activity not for profit, an income and expenditure account for the financial year
3. Cash Flow statement for the financial year
4. A statement of changes in equity, if applicable
5. Any explanatory note annexed to, or forming part of, any document referred to un sub-clause (i) to sub-clause (iv)

Sections 209 to 220 of the Companies Act, 1956 are the sections to be considered for preparation of final accounts of joint stock companies. Section 209 deals with maintaining books of accounts on accrual basis and as per Double-entry System of Bookkeeping. Section 210 of the Companies Act, 1956 thoroughly deals with the preparation and presentation of financial statements of joint stock companies. Section 211 prescribes the formats and contents of Statement of Profit and Loss Account and Balance Sheet. Section 215 deals with authentication of companies' final accounts. Sections 216 to 220 deals with the guidelines to be observed while preparing and presenting the financial statements.

5.3 FORMAT OF REVISED SCHEDULE VI

The Ministry of Corporates Affairs specified the format of Schedule VI vide Notification No. S.O. 447(E), dated 28 February 2011, as follows:

A. General Instructions
B. Part I – Form of Balance Sheet
C. General Instructions for Preparation of Balance Sheet
D. Part II – Form of Statement of Profit and Loss
E. General Instructions for Preparation of Statement of Profit and Loss

A. General Instructions

1. Where compliance with the requirements of the Act, including the Accounting Standards as applicable to companies, requires any change in treatment or disclosure including addition, amendment, substitution or deletion in the head/sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements of the Schedule VI shall stand modified accordingly.
2. The disclosure requirements specified in Parts I and II of this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 1956. Additional disclosures specified in the Accounting Standards shall be made in the notes to accounts, or by way of additional statement unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act, 1956 shall be made in the notes to accounts in addition to the requirements set out in this Schedule.
3. Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required: (a) narrative descriptions or disaggregation of items recognised in those statements and (b) information about items that do not qualify for recognition in those statements. Each item on the face of the Balance Sheet and the Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements, including the notes to accounts, a balance shall be maintained between providing excessive detail that may not assist users of financial statements and not providing important information as a result of too much aggregation.
4. Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as below: Turnover Rounding-off (i) less than one hundred crore rupees to the nearest hundred, thousand, lakh or million, or decimal thereof; (ii) one hundred crore rupees or more to the nearest lakh, million or crore, or decimals thereof. Once a unit of measurement is used, it should be used uniformly in the Financial Statements.
5. Except in the case of the first Financial Statement laid before the Company (after its incorporation), the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given.
6. For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards. This part of Schedule sets out the minimum requirements for disclosure on the face of the Balance Sheet and the Statement of Profit and Loss (hereinafter referred to as Financial Statements for the purpose of this Schedule) and notes. Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the Company's financial position or performance or to cater to industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act, 1956 or under the Accounting Standards.

B. PART I – Form of Balance Sheet

Name of the Company ………………
Balance Sheet as on ……………………

(₹ In ……………)

Particulars	Note No.	Figures at the end of Current Reporting Period	Figures at the end of Previous Reporting Period
EQUITY AND LIABILITIES			
1. Shareholders' Funds			
a. Share Capital (A)		xxx	xxx
b. Reserves and Surplus (B)		xxx	xxx
c. Money received against Share Warrants		xxx	xxx
2. Share Application Money pending allotment		xxx	xxx
3. Non-current Liabilities			
a. Long-term Borrowings (C)		xxx	xxx
b. Deferred Tax Liabilities (Net)		xxx	xxx
c. Other Long-term Liabilities		xxx	xxx
d. Long-term Provisions		xxx	xxx
4. Current Liabilities			
a. Short-term Borrowings (E)		xxx	xxx
b. Trade Payables		xxx	xxx
c. Other Current Liabilities (F)		xxx	xxx
Total		**xxx**	**xxx**
ASSETS			
1. Non-current Assets			
a. Fixed Assets			
i. Tangible Assets (G)		xxx	xxx
ii. Intangible Assets (H)		xxx	xxx
iii. Capital Work-in-progress		xxx	xxx
iv. Intangible Assets under development		xxx	xxx
b. Non-current Investments (I)			
c. Deferred Tax Assets (Net)		xxx	xxx
d. Long-term Loans and Advances (J)		xxx	xxx
e. Other Non-current Assets		xxx	xxx
2. Current Assets			
a. Current Investments (K)		xxx	xxx
b. Inventories (L)		xxx	xxx
c. Trade Receivables		xxx	xxx
d. Cash and Cash Equivalents (M)		xxx	xxx
e. Short-terms Loans and Advances		xxx	xxx
f. Other Current Assets		xxx	xxx
Total		**xxx**	**xxx**

C. General Instructions for Preparation of Balance Sheet

1. **Share Capital:** The balance sheet of companies should disclose the number and the amount of shares authorised, issued, subscribed, fully paid and shares that are subscribed but not fully paid. Face value of shares, terms of any security convertible into equity or preference shares, calls in arrears, calls received in advance and shares forfeited.
2. **Reserves and Surplus:** The reserves and surplus of the companies are to be classified as per their nature, namely: Capital Reserve, Debenture Redemption Reserve, Securities Premium Reserve, etc. Surplus, if any, showing the allocations and appropriations, such as dividend, bonus shares and transfers to and from reserves. Those reserves that are meant to be invested elsewhere have to be treated as fund.
3. **Long-term Borrowing:** The borrowings of the company, mostly in the form of Bonds, Debentures, Term Loans, Deposits and Deferred Payment Liabilities. They are further classified into secured and unsecured. The notes to accounts should contain all the details about the Rate of Interest on Debentures and Securities in the descending order of their maturity and redemption.
4. **Current Liabilities:** This particular head consists of Trade Payables, inclusive of Creditors, Bills Payable, Bank Overdraft and Other Liabilities.
5. **Other Current Liabilities:** This heading mainly accounts for maturities of Long-term Debt or Financial Lease Obligations, Interest accrued or received in advance along with Unpaid Dividend.
6. **Short-term Provisions:** The provisions under this head include provisions of specific nature and provisions for employee benefits.
7. **Tangible Assets:** They include Land and Building, Plant and Equipment, Furniture and Fixtures, Vehicles and Office Equipment of specific nature. Any asset that has been held under any form of lease has to be separately specified. Any amount of write-offs, depreciations and amortisations, if any, have to be clearly indicated.
8. **Intangible Assets:** They comprise of Goodwill, Trademarks, Patents, Brands, Copyrights, Patents, Licenses, etc. Any amount written off has to be clearly indicated along with the basis or guideline observed at the time of writing-off of the asset.
9. **Non-Current Investments:** Any investments made by the company in the form of investment in property, equity instruments, preference shares, government securities or bonds and debentures.
10. **Inventories:** The notes to accounts should clearly indicate about the mode of valuation of inventories and the inventory-in-transit, if any. The various forms of inventories are Raw Materials, Work-in-progress, Finished Goods, Stock in Trade, Stores and Spares, Loose Tools and others.
11. **Trade Receivables:** The total amount of trade receivables outstanding for a period exceeding six months from the date they are due for payment should be separately stated and separately

classified as secured, unsecured and doubtful. Allowances for bad and doubtful debts shall be disclosed separately.

12. **Cash and Cash Equivalents:** These are generally classified into cash-in-hand, at banks, cheques or drafts on hand. Any amount of bank deposit with more than 12 months maturity shall be disclosed separately.
13. **Short-term Loans and Advances:** Any amount of loans and advances forwarded to related parties and they have to be further classified into, secured, unsecured and doubtful. Any allowances for bad and doubtful loans and advances will have to be disclosed under separate headings. Loans and Advances due by directors shall be disclosed separately.
14. **Other Current Assets:** These are the assets that do not fit into any other asset category and hence categorised under an all-inclusive heading.
15. **Contingent Liabilities:** These are generally classified as claims against the company, not acknowledged as Debt, Guarantees, etc.

D. PART II – Form of Statement of Profit and Loss Account

Name of the Company ………………

Profit and Loss Statement for the year ended ……………………

(₹ in ……………)

Particulars	Note No.	Figures at the end of Current Reporting Period	Figures at the end of Previous Reporting Period
1. Revenue from Operations		xxx	xxx
2. Other Income		xxx	xxx
3. Total Revenue (1+2)		**xxx**	**xxx**
4. Expenses:			
a. Cost of Materials Consumed		xxx	xxx
b. Purchases of Stock-in-trade		xxx	xxx
c. Changes in inventories of Finished Goods, Work-in-progress and Stock-in-trade		xxx	xxx
d. Employee Benefit Expense		xxx	xxx
e. Finance Costs		xxx	xxx
f. Depreciation and Amortisation Expense		xxx	xxx
g. Other Expense		xxx	xxx
h. Total Expenses		xxx	xxx
5. Profit before Exceptional and Extra-ordinary items of Tax (3-4)		xxx	xxx
6. Exceptional Items		xxx	xxx
7. Profit before Extraordinary Items and Tax (5-6)		xxx	xxx

(*Contd.*)

Particulars	Note No.	Figures at the end of Current Reporting Period	Figures at the end of Previous Reporting Period
8. Extraordinary Items		xxx	xxx
9. Profit before Tax (7-8)		xxx	xxx
10. Tax Expense:			
a. Current Tax		xxx	xxx
b. Deferred Tax		xxx	xxx
11. Profit (or Loss) for the period from Continuing Operations (9 – 10)		xxx	xxx
12. Profit (or Loss) from Discontinuing Operations		xxx	xxx
13. Tax Expense of Discontinuing Operations		xxx	xxx
14. Profit (or Loss) from Discontinuing Operations (After Tax) (12-13)		xxx	xxx
15. Profit (or Loss) for the period (11 + 14)		**xxx**	**xxx**
16. Earnings per Equity Share			
a. Basic		xxx	xxx
b. Diluted		xxx	xxx

E. General Instructions for Preparation of Statement of Profit and Loss

Section 210 prescribes the provisions related to preparation and presentation of statement of profit or loss:

1. **Revenue from Operations:** It includes any form of revenue by way of sale of products or services and any other operating revenue. Any amount of excise duty has to be deducted from revenues from operations.
2. **Other Receipts:** This includes any other receipts other than revenue from operations. Namely, Interest and other Financial Services Revenue.
3. **Finance Costs:** These are generally classified into Interest Expenses, other Borrowing Costs and Net Gain or Loss on account of foreign currency transactions and translations.
4. **Employee Benefit Expenses:** Salaries, Wages, contribution to provident fund and other funds, and any related expenses on ESOP Schemes and Staff Welfare Expenses are to be included under this heading.
5. **Depreciation and Amortisation Expenses:** This heading comprises of depreciation on account of any tangible assets, along with amounts written-off or amortised.

5.4 REVISED SCHEDULE VI

Every company registered under the Act shall prepare its Balance Sheet, Statement of Profit and Loss and notes thereto, in accordance with the manner prescribed in Schedule VI of the Companies Act, 1956. To harmonise the disclosure requirements with the Accounting Standards and to converge with the new reforms, the Ministry of Corporate Affairs vide Notification No. S.O. 447(E), dated 28 February 2011, replaced the existing Schedule VI of the Companies Act, 1956 with the revised one.

Governments vide Notification No. F.N. 2/6/2008 – C.L-V dated 30 March 2011, made the revised Schedule VI applicable to all companies for the financial year commencing from 01 April 2011. The requirements of the Revised Schedule VI, however, do not apply to companies as referred to in the proviso to Section 211 (1) and Section 211 (2) of the Act, i.e., any insurance or banking company, or any company engaged in the generation or supply of electricity or to any other class of company for which a form of Balance Sheet and Profit and Loss Account has been specified in or under any other Act governing such class of company.

5.4.1 Key Features of Revised Schedule VI –Balance Sheet

The key features of the revised schedule are as follows:

1. The revised schedule contains General Instructions, Part I – Form of Balance Sheet; General Instructions for Preparation of Balance Sheet, Part II – Form of Statement of Profit and Loss; General Instructions for Preparation of Statement of Profit and Loss.
2. Revised Schedule VI has eliminated the concept of ‘schedule’ and such information is now to be furnished in the notes to accounts.
3. The revised schedule gives prominence to Accounting Standards (AS), i.e., in case of any conflict between the AS and the Schedule, AS shall prevail.
4. The revised schedule prescribes a vertical format for presentation of Balance Sheet, therefore, no option to prepare the financial statement in horizontal format. It ensures application of a uniform format.
5. All assets and liabilities classified into current and non-current and presented separately on the face of the Balance Sheet.
6. Number of shares held by each shareholder holding more than 5% shares now needs to be disclosed.
7. Details pertaining to aggregate number and class of shares allotted for consideration other than cash, bonus shares and shares bought back, will need to be disclosed only for a period of five years immediately preceding the date of the Balance Sheet.
8. Any debit balance in the Statement of Profit and Loss will be disclosed under the head ‘Reserves and Surplus’. Earlier, any debit balance in Profit and Loss Account carried forward after deduction from uncommitted reserves was required to be shown as the last item on the asset side of the Balance Sheet.

9. Specific disclosures are prescribed for Share Application money. The application money not exceeding the capital offered for issuance and to the extent not refundable will be shown separately on the face of the Balance Sheet. The amount in excess of subscription or if the requirements of minimum subscription are not met will be shown under ‘Other Current Liabilities’.
10. The term ‘Sundry Debtors’ has been replaced with the term ‘Trade Receivables’. Trade Receivables are defined as dues arising only from goods sold or services rendered in the normal course of business. Hence, amounts due on account of other contractual obligations can no longer be included in the trade receivables.
11. The old Schedule VI required separate presentation of debtors outstanding for a period exceeding six months based on the date on which the bill/invoice was raised; whereas, the revised Schedule VI requires separate disclosure of ‘trade receivables outstanding for a period exceeding six months from the date the bill/invoice is due for payment’.
12. ‘Capital Advances’ are specifically required to be presented separately under the head ‘Loans and Advances’ rather than including elsewhere.
13. Tangible Assets under lease are required to be separately specified under each class of assets. In the absence of any further clarification, the term ‘under lease’ should be taken to mean assets given on operating lease in the case of lessor and assets held under finance lease in the case of lessee.
14. In the old Schedule VI, details of only capital commitments were required to be disclosed. Under the revised Schedule VI, other commitments also need to be disclosed.

5.4.2 Key Features of Revised Schedule VI – Statement of Profit and Loss

1. The name has been changed to ‘Statement of Profit and Loss’ from ‘Profit and Loss Account,’ as contained in the old Schedule VI.
2. Unlike the old Schedule VI, the revised Schedule VI lays down a format for the presentation of Statement of Profit and Loss. This format of Statement of Profit and Loss does not mention any appropriation item on its face. Further, Revised Schedule VI format prescribes such below-the-line adjustments to be presented under ‘Reserves and Surplus’ in the Balance Sheet.
3. As per the revised Schedule VI, any item of income or expense, which exceeds one per cent of the revenue from operations or ₹100,000 (earlier 1% of total revenue or ₹5,000), whichever is higher, needs to be disclosed separately.
4. In respect of companies other than finance companies, revenue from operations need to be disclosed separately as revenue from: (a) sale of products, (b) sale of services and (c) other operating revenues.
5. Net exchange gain/loss on foreign currency borrowings to the extent considered as an adjustment to interest cost needs to be disclosed separately as Finance Cost.

6. Break-up in terms of quantitative disclosures for significant items of Statement of Profit and Loss, such as raw material consumption, stocks, purchases and sales have been simplified and replaced with the disclosure of ‘broad heads’ only. The broad heads need to be decided based on materiality and presentation of true and fair view of the financial statements.

5.5 TREATMENT OF SPECIAL ITEMS

5.5.1 Provision for Taxation

As per Part II, Schedule VI, the Profit and Loss account of a company must set out the amount of a charge for Indian Income Tax and other Indian taxation on profits. A company is liable to pay income tax and such tax is treated as a charge against the profits of the accounting year. It is not possible to exactly determine the actual amount of tax payable at the time the final accounts are prepared. Therefore, liability for tax is estimated and provided for while preparing the final accounts. Such provision is a charge against profit.

5.5.2 Advance Payment of Tax

Advance tax is payable on all incomes other than capital gains and casual income. The advance tax is payable during the financial year when the last assessed income or current income in case of a company exceeds ₹2,500.

5.5.3 Managerial Remuneration

The Companies Act has laid down restrictions on the remuneration to be paid to the directors, managers and managing directors. Under Section 198 of the Companies Act, 1956, the total remuneration payable to the directors, managers and managing directors should not exceed 11% of the net profits of the company for that financial year.

5.5.4 Depreciation

Section 205 of the Companies Act, 1956, prescribes the methods of charging depreciation. The relevant extracts thereof are as follows, depreciation shall be provided either:

(a) To the extent specified in Section 350; or

(b) In respect of each item of depreciable asset, for such an amount as is arrived at by dividing ninety five per cent of the original cost thereof to the company by the specified period in respect of such asset; or

(c) On any other basis approved by the Central Government which has the effect of writing off by way of depreciation ninety five per cent of the original cost to the company of each such depreciable asset on the expiry of the specified period; or

(d) As regards any other depreciable asset, for which, no rate of depreciation has been laid down by the Act or rules made thereunder, on such basis as may be approved by the Central Government by the general order published in the Official Gazette or by any special order in any particular case:

Provided that where depreciation is provided for in the manner laid down in clause (b) or clause (c), then, in the event of the depreciable asset being sold, discarded, demolished or destroyed the written down value thereof at the end of the financial year in which the asset is sold, discarded, demolished or destroyed, shall be written off in accordance with the proviso to Section 350.

(e) 'Specified Period' in respect of any depreciable asset shall mean the number of years at the end of which at least ninety-five per cent of the original cost of the asset to the company will have been provided for by way of depreciation, if depreciation were to be calculated in accordance with the provisions of Section 350.

5.5.5 Interest on Debentures

Wherever a company issues debentures, it undertakes to pay interest thereon at a fixed percentage. As the debentures acknowledge a debt, the payment of interest on the debt is obligatory on the part of the company issuing them, irrespective of whether the company earns profit or not. Thus, interest payable on debentures is a charge against the profits of the company. Interest on debentures is normally payable half-yearly and is calculated at the fixed percentage on the nominal value of debentures issued and not on the issue price. Thus, the issue of debentures at par or at a premium or at a discount would not make any difference for the purpose of calculating interest on debentures. But, the effective rate of interest on the amount paid by the debenture holders would invariably differ in each of the above cases.

According to Income Tax Act, 1961, a company is liable to deduct income tax at the prescribed rate from the gross amount of interest payable on debentures before the actual payment is made to the debenture holders and to deposit it with the government. The balance amount, after deduction of income tax, is actually payable to the debenture holders. This is known as deduction of tax at source.

It is important to note in this connection, if the debentures are tax-free, the company will pay the income tax on such interest, on behalf of the debenture holders. However, the interest paid by the company has to be grossed up for calculating the interest expense of the company.

5.5.6 Dividends

A dividend is a payment made by a company to its shareholders, usually as a distribution of profits. When a company earns a profit or surplus, it can re-invest it in the business (called retained earnings), and pay a fraction of this reinvestment as a dividend to shareholders. In India, companies declaring or distributing dividend, are required to pay a Corporate Dividend Tax, in addition to the tax levied on their income. Dividend received is exempt in the hands of the shareholders, in respect of which the company has paid Corporate Dividend Tax.

5.5.7 Rules Regarding Payment of Dividend

Dividend can be paid out of following sources:

1. Out of current year's profit.
2. Out of past year's profit lying in Profit and Loss Account.
3. Out of past year's profit earned and transferred to reserves.
4. Out of the money provided by the central government or the state government for payment of dividend.

Dividend should be paid out of:

1. The profit of the company for the financial year, or
2. Profit(s) for the previous financial years(s), which have not been transferred to reserves, or
3. Out of both

Dividend shall be declared/paid only after providing for depreciation in accordance with Schedule II of the Companies Act, 2013. Before declaration of dividend out of profit in any financial year, the company may transfer a percentage of its profits to Reserves (at its discretion) for that financial year.

Dividend shall not be declared/paid by a company from its reserves other than free reserves. Dividend should not be declared out of the Securities Premium Account or the Capital Redemption Reserve Account or Revaluation Reserve or Amalgamation Reserve or out of profit on re-issue of forfeited shares or out of profit earned profit to the incorporation of the company.

Dividend includes interim dividend. The Board of Directors of the company may declare interim dividend. Such dividend shall be declared:

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1. Out of Surplus profit in the Profit and Loss Account, and
2. Profits of the financial year in which such interim dividend is sought to be declared.

5.5.8 Transfer to Reserves

No amount needs be transferred to Reserves if the dividend declared does not exceed 10% of its profits for that year as specified. No dividend can be declared and paid in excess of 10%, unless minimum amount prescribed, as follows, is transferred to Reserves. Rules have been prescribed for transferring to reserves in excess of 10% of profits. There is no restriction on transfer of up to 10% of profits.

Rate of Dividend		% of Current Profits to be transferred to Reserves
Exceeding	**up to**	
10.0%	12.5%	2.5%
12.5%	15.0%	5.0%
15.0%	20.0%	7.5%
20.0%		10.0%

5.6 PREPARATION OF PROFIT AND LOSS ACCOUNT AND BALANCE SHEET IN PRESCRIBED FORM, AS PER SCHEDULE VI (2011 REVISED FORMAT)

Illustration 1

State the heading under which the following items are shown in the balance sheet of a company.

(i) Preliminary Expenses
(ii) Discount on Issue of Shares and Debentures
(iii) Forfeited Share Capital Account
(iv) Goodwill
(v) Bank Overdraft
(vi) Provision for Taxation

[Bangalore University, Nov/Dec 2016]

Solution

Preliminary Expenses	Asset side – Other Current Assets
Discount on Issue of shares and Debentures	Asset side – Other Current Assets
Forfeited Share Capital Account	Liability side
Goodwill	Asset side – Intangible Asset
Bank Overdraft	Liability side – Other Current Liability
Provision for Taxation	Liability side – Short-term Provisions

Illustration 2

Under what notes do you show the following items in the balance sheet of a company?

(i) Provision for Taxation
(ii) Live Stock
(iii) Work-in-progress
(iv) Bills Payable
(v) Patterns
(vi) Accrued Interest on Investments
(vii) Goodwill
(viii) Fixed Deposit from Public Share Premium
(ix) Share Premium
(x) Discount on Issue of Debentures

(xi) Bank Overdraft

(xii) Proposed Dividend

[Bangalore University, Nov/Dec 2015]

Solution

Provision for Taxation	Liability side – Short-term Provisions
Live Stock	Asset side – Tangible Assets
Work-in-progress	Asset side – Inventories
Bills Payable	Liability side – Trade Payables
Patterns	Asset side – Intangible Assets
Accrued Interest on Investments	Asset side – Other Current Assets
Goodwill	Asset side – Intangible Assets
Fixed Deposit from Public	Liability side – Short-term Borrowings
Share Premium	Liability side – Reserves and Surplus
Discount on Issue of Debentures	Asset side – Other Current Assets
Bank Overdraft	Liability side – Trade Payables
Proposed Dividend	Liability side – Short-term Provisions

Illustration 3

Under what headings are the following items (given in trail balance) shown in the final accounts of a Joint Stock Company.

(i) Discount on Issue of Shares

(ii) Livestock

(iii) Discount Earned

(iv) Accrued Interest on Investments

(v) Goodwill Written Off

(vi) Patents and Trademarks

(vii) Work-in-progress

(viii) Goodwill

[Bangalore University, Nov/Dec 2013]

Solution

Discount on Issue of Shares	Asset side – Other Current Assets
Livestock	Asset side – Tangible Assets
Discount Earned	Income statement – Other Receipts

(*Contd.*)

Accrued Interest on Investments	Asset side – Other Current Assets
Goodwill Written Off	Asset side – Other Current Assets
Patents and Trademarks	Asset side – Intangible Assets
Work-in-progress	Asset side – Inventories
Goodwill	Asset side – Intangible Assets

Illustration 4

Following particulars have been obtained from the accounts of a company:

(i)	Managing Director's Remuneration paid	₹20,000
(ii)	Provision for Bad Debts	₹10,000
(iii)	Provision for Taxation	₹1,50,000
(iv)	Depreciation Written Off	₹80,000
(v)	Depreciation allowable as per Income Tax Provision	₹70,000
(vi)	Loss on Sale of Investments	₹50,000
(vii)	Preliminary Expenses Written Off	₹20,000
(viii)	Net Profit after considering the above items	₹4,50,000

Compute the net profit for the purpose of managerial remuneration and calculate managing director's remuneration at 5% of net profit.

[Bangalore University, Nov/Dec 2009/ 2010/2011]

Solution

	(₹)	(₹)
Net Profit		4,50,000
Add: Depreciation as per Accounting Provisions		80,000
		5,30,000
Less: Depreciation as per Income Tax Provisions		70,000
		4,60,000
Add: Provisions		
Provision for Taxation	1,50,000	
Provision for Bad Debts	10,000	
Remuneration of Managing Director	20,000	1,80,000
Profit for Calculation of Managerial Remuneration		**6,40,000**

Managing Director's Remuneration at 5% of Net Profit $= 6,40,000 \times \frac{5}{100} = 32,000$

Illustration 5

From the following particulars, prepare Profit and Loss Appropriation Account.

(i) Profit and Loss Account balance from last year: ₹1,25,000
(ii) Net Profit for the year before tax: ₹10,80,000
(iii) Provision for tax: 40%
(iv) Transfer to general reserve: ₹1,05,000; and to dividend equalisation fund: ₹80,000
(v) Dividend on 8% preference shares of ₹6,00,000
(vi) Dividend at 12.5% on 1,00,000 equity shares of ₹10 each, ₹8 called up (calls in arrears ₹25,000)
(vii) Transfer of ₹75,000 to Development Reserve

[Bangalore University, Nov/Dec 2012]

SOLUTION

Particulars	(₹)	(₹)
Net Profit before Tax		10,80,000
Less: Tax @ 40% (10,80,000 × 40%)		4,32,000
Net Profit after Tax		6,48,000
Add: Profit and Loss Balance of Previous Year		1,25,000
		7,73,000
Less: Transfer to General reserve	1,05,000	
Transfer to Dividend Equalisation Fund	80,000	
Transfer to Development Reserve	75,000	
Dividend on Preference Shares (6,00,000 × 8%)	48,000	
Dividend on Equity Shares (1,00,000 × 8 = 8,00,000 – 25,000 = 7,75,000 × 12.5%)	96,875	
CDT (48,000 + 96,875 = 1,44,875 × 16.2225%)	23,502	4,28,377
Surplus carried over to Balance Sheet		**3,44,623**

Illustration 6

From the following particulars of Well-done Company Ltd., prepare Profit and Loss Appropriation Account:

(i) Net Profit before Tax: ₹35,00,000
(ii) Provision for Taxation: 40%
(iii) Transfer to Reserve Fund: 20% of Profit after tax
(iv) Share Capital: 60,000, 15% Preferences Shares of ₹100 each; 60,000 Equity Shares of ₹100 each; 60,000 Equity Shares of ₹100 each, ₹75 paid.
(v) Proposed Dividend to Equity Shareholders: 20%

(vi) Profit and Loss Account Balance form last year: ₹4,00,000

[Bangalore University, Nov/Dec 2010]

SOLUTION

Particulars	(₹)	(₹)
Net Profit before Tax		35,00,000
Less: Tax @ 40% (35,00,000 × 40%)		14,00,000
Net Profit after Tax		21,00,000
Add: Profit and Loss Balance of previous year		4,00,000
		25,00,000
Less: Transfer to Reserve Fund (20% of 21,00,000)	4,20,000	
Dividend on Preference Shares (60,000 × 100 × 15%)	9,00,000	
Dividend on Equity Shares (60,000 × 75 × 20%)	9,00,000	22,20,000
Surplus carried over to Balance Sheet		**2,80,000**

Illustration 7

From the following particulars of Rajesh Ltd., prepare Profit and Loss Appropriation Account:

(i) Net Profit before Tax: ₹16,75,000

(ii) Provision for Taxation: 33.5%

(iii) Transfer to Reserve Fund: 20% after tax

(iv) Share Capital: 30,000, 15% Preference Shares of ₹100 each; 30,000, Equity Shares of ₹100 each, ₹75 paid

(v) Proposed Dividend to Equity Shareholders: 20%

(vi) Profit and Loss account Balance brought forward: ₹2,00,000

[Bangalore University, Nov/Dec 2007/2011/2013]

SOLUTION

Particulars	(₹)	(₹)
Net Profit before Tax		16,75,000
Less: Tax @ 33.50% (16,75,000 × 33.50%)		5,61,125
Net Profit after Tax		11,13,875
Add: Profit and Loss Balance of previous year		2,00,000
		13,13,875
Less: Transfer to Reserve Fund (11,13,875 × 20%)	2,22,775	
Dividend on Preference Shares (30,000 × 100 × 15%)	4,50,000	
Dividend on Equity Shares (30,000 × 75 × 20%)	4,50,000	11,22,775
Surplus carried over to Balance Sheet		**1,91,100**

Illustration 8

The following ledger balances are extracted from the books of a trading company limited for the year ended 31 March 2016. You are required to prepare Company Final Accounts in the vertical format.

Particulars	Debit	Credit
Equity Share Capital	-	2,00,000
Gross Profit (Revenue Profit)	-	2,00,000
General Reserve	-	30,000
Buildings (Original Cost: ₹2,00,000)	1,20,000	-
10% Debenture	-	1,00,000
Plant and Machinery	2,00,000	-
Rent, Rates and Insurance	20,000	-
Advertising	10,000	-
Salary	20,000	-
Director's Fees	10,000	-
General Expenses	10,000	-
Profit and Loss A/c	-	50,000
Printing and Stationery	10,000	-
Preliminary Expenses	20,000	-
Goodwill	20,000	-
Cash and Bank Balances	30,000	-
Debtors and Creditors	80,000	20,000
Investment	50,000	-
Total	**6,00,000**	**6,00,000**

Additional Information:

(i) Provide for Bad Debts: ₹5,000

(ii) Debenture interest is outstanding for the whole year

(iii) Provide for Income Tax: ₹15,000

(iv) Outstanding Salary: ₹2,000

(v) Prepaid Insurance: ₹1,000

(vi) Depreciate building by 10% on original cost and Plant and Machinery by 10% on reducing balance

(vii) The directors propose 15% dividend to equity shareholders. Ignore Corporate Dividend Tax.

(viii) Write off Preliminary Expenses by 25% and Goodwill by 20%.

Note: Write note to accounts wherever necessary.

[Bangalore University, B.Com Nov/Dec 2016, Section C]

Solution

Statement of Profit or Loss for the year ended 31 March 2016

Particulars	Note	Amount (₹)
Gross Profit		2,00,000
Less: Employee Benefit Expenses	13	22,000
Finance Cost	14	10,000
Depreciation and Amortisation	15	49,000
Other Expenses	16	64,000
Profit before Tax		55,000
Less: Tax		15,000
Profit after Tax		**40,000**

Balance Sheet as on 31 March 2016

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	2,00,000
b. Reserves and Surplus	2	90,000
2. Share Application Money pending Allotment		-
3. Non-current Liability (10% Debentures)		1,00,000
a. Long-term Liabilities	3	-
4. Current Liabilities		
a. Short-term Borrowings	4	-
b. Other Current Liabilities	5	32,000
c. Short-term Provisions	6	45,000
Total		**4,67,000**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	7	2,96,000
b. Investments	-	50,000
c. Other Non-current Assets	-	-
2. Current Assets		
a. Trade Receivables	8	75,000
b. Cash and Cash Equivalents	9	30,000
c. Short-term Loans and Advances	10	-
d. Other Current Assets	11	16,000
Total		**4,67,000**

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Notes:

(1) *Share Capital*

Particulars	Amount (₹)
Equity Share Capital	2,00,000
	2,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Surplus Opening Balance		50,000
General Reserve		30,000
Surplus	40,000	
Less: Appropriations (Proposed Dividend)	30,000	10,000
		90,000

(3) *Long-term Liabilities*

Particulars	Amount (₹)
10% Debentures	2,00,000
	2,00,000

(4) *Short-term Borrowings*

Particulars	Amount (₹)
Short-term Borrowings	NIL
	NIL

(5) *Other Current Liabilities*

Particulars	Amount (₹)
Creditors	20,000
Outstanding Debenture Interest (10% of ₹1,00,000)	10,000
Outstanding Salary	2,000
	32,000

(6) *Short-term Provisions*

Particulars	Amount (₹)
Proposed Dividend (15% of ₹2,00,000)	30,000
Provision for Taxation	15,000
	45,000

5

(7) *Fixed Assets*

Particulars		Amount (₹)
Buildings	1,20,000	
Less: Depreciation (10% of ₹2,00,000)	20,000	1,00,000
Plant and Machinery	2,00,000	
Less: Depreciation (10% of ₹2,00,000)	20,000	1,80,000
Goodwill	20,000	
Less: Goodwill Written Off	4,000	16,000
		2,96,000

(8) *Trade Receivables*

Particulars		Amount (₹)
Debtors	80,000	
Less: Provision for Bad Debts	5,000	75,000
		75,000

(9) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balance	30,000
	30,000

(10) *Other Current Assets*

Particulars		Amount (₹)
Preliminary Expenses	20,000	
Less: Preliminary Expenses Written Off	5,000	15,000
Prepaid Insurance		1,000
		16,000

(11) *Short-term Loans and Advances*

Particulars	Amount (₹)
Short-term Loans and Advances	NIL
	NIL

(12) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salary	20,000	
Add: Outstanding Salary	2,000	22,000
		22,000

5

(13) *Finance Cost*

Particulars	Amount (₹)
Interest on Debentures	10,000
	10,000

(14) *Depreciation and Amortisation Expenses*

Particulars		Amount (₹)
Depreciation on Building	20,000	
Depreciation on Plant	20,000	
Amortisation of Preliminary Expenses	4,000	
Amortisation of Goodwill	5,000	
		49,000

(15) *Other Expenses*

Particulars		Amount (₹)
Rent Rates and Taxes	20,000	
Less: Prepaid Rent	1,000	19,000
Advertising		10,000
Director's Fees		10,000
General Expenses		10,000
Printing and Stationery		10,000
Provision for Bad Debts		5,000
		64,000

5

Illustration 9

The following trail balance has been extracted from the books of Subhash Ltd., as on 31 March 2015. You are required to prepare the financial statements.

Debit Balances	(₹)	Credit Balances	(₹)
Land and Building (Original Cost: ₹3,00,000)	1,40,000	Share Capital	2,00,000
Furniture (Original Cost: ₹15,000)	8,000	General Reserve	30,000
Plant and Machinery (Original Cost: ₹2,00,000)	1,00,000	8% Debentures	1,00,000

(*Contd.*)

Debit Balances	(₹)	Credit Balances	(₹)
Investments	6,000	Bank Overdraft	1,500
Preliminary Expenses	4,000	Sundry Creditors	10,000
Advance Income Tax	8,000	Securities Premium	6,000
Printing and Stationery	1,200	Gross Profit	1,14,000
Stock on 31 March 2015	1,28,000	Sinking Fund	40,000
Salaries	8,000	Profit and Loss A/c (1 April 2014)	8,500
Debtors	70,000		
Cash on hand	2,000		
Cash at bank	24,000		
Interest	2,000		
Debenture Interest	4,000		
Director's Fees	2,000		
Rent, Rates and Insurance	2,800		
	5,10,000		**5,10,000**

Adjustments:

(i) Provide Depreciation on

(a) Land and Building at 5% on straight line basis

(b) Furniture, and Plant and Machinery at 20% on reducing balance basis

(ii) Provide ₹5,000 for Bad Debts

(iii) Provide the Audit Fees of ₹2,500, Provision for Income Tax: ₹14,000 and Debenture Interest for ₹6,000

(iv) Insurance prepaid: ₹800

(v) Write off half of the Preliminary expenses

(vi) Directors have recommended:

(a) Transfer of ₹10,000 to Sinking Fund

(b) Transfer of ₹4,000 to General Reserve

(c) Equity Dividend at 8% on Paid-up Capital

[Bangalore University, B.Com Nov/Dec 2005/2009/2015, Section C]

5

Solution

Statement of Profit or Loss for the year ended 31 March 2015

Particulars	Note	Amount (₹)
1. Revenue from Operations (Gross Profit)		1,14,000
2. Other Income		Nil
3. Total Revenue (1 + 2)		**1,14,000**
4. Expenses:		
a. Cost of Materials Consumed		Nil
b. Employee Benefit Expenses	11	8,000
c. Finance Cost	12	12,000
d. Depreciation and Amortisation	13	38,600
e. Other Expenses	14	12,700
5. Total Expenses (a to e)		**71,300**
6. Profit before Tax (III-V)		42,700
Less: Provision for Income Tax		14,000
Net Profit after Tax		**28,700**
Add: Profit and Loss Balance of previous years		8,500
Net Profit before Transfer		37,200
Less: Proposed Dividend		16,000
Transfer to General Reserves		4,000
Transfer to Sinking Fund		10,000
Surplus carried over to Balance Sheet		**7,200**

Balance Sheet of Subhash Ltd., as on 31 March 2015

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	2,00,000
b. Reserves and Surplus	2	97,200
2. Share Application Money pending Allotment		-
3. Non-current Liability		
a. Long-term Liabilities (8% Debentures)	3	1,00,000
4. Current Liabilities		
a. Trade Payables	4	11,500
b. Other Current Liabilities		-
c. Short-term Provisions	5	38,500
Total		**4,47,200**

Particulars	Note	Amount (₹)
ASSETS		
1. Non-Current Assets		
a. Fixed Assets	6	2,11,400
b. Investments		6,000
c. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	7	65,000
b. Inventories	8	1,28,000
c. Cash and Cash Equivalents	9	26,000
d. Short-term Loans and Advances		
e. Other Current Assets	10	10,800
Total		**4,47,200**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)
Equity Share Capital	2,00,000
	2,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
General Reserves	30,000	
Add: Transfer during the year	4,000	34,000
Sinking Fund	40,000	
Add: Transfer during the year	10,000	50,000
Securities Premium		6,000
Profit and Loss Account (Surplus)		7,200
		97,200

(3) *Long-term Liabilities*

Particulars	Amount (₹)
8% Debentures	1,00,000
	1,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	1,500
Bank Overdraft	10,000
	11,500

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Audit Fees	2,500
Outstanding Interest on Debentures	6,000
Provision for Income Tax	14,000
Proposed Dividend (8% of ₹2,00,000)	16,000
	38,500

(6) *Fixed Assets*

Particulars		Amount (₹)
Land and Building	1,40,000	
Less: Depreciation @ 5% on 3,00,000	15,000	1,25,000
Furniture	8,000	
Less: Depreciation @ 20% on 8,000	1,600	6,400
Plant and Machinery	1,00,000	
Less: Depreciation @ 20% on 1,00,000	20,000	80,000
		2,11,400

(7) *Trade Receivables*

Particulars		Amount (₹)
Debtors	70,000	
Less: Provision for Bad Debts	5,000	65,000
		65,000

(8) *Inventories*

Particulars	Amount (₹)
Closing Stock	1,28,000
	1,28,000

(9) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balance (24,000 + 2,000)	26,000
	26,000

(10) *Other Current Assets*

Particulars		Amount (₹)
Preliminary Expenses	4,000	
Less: Preliminary Expenses Written Off (1/2)	2,000	2,000
Prepaid Insurance		800
Advance Income Tax		8,000
		10,800

(11) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salary		8,000
		8,000

(12) *Finance Cost*

Particulars		Amount (₹)
Interest		2,000
Interest on Debentures	4,000	
Add: Outstanding Interest	6,000	10,000
		12,000

(13) *Depreciation and Amortisation Expenses*

Particulars		Amount (₹)
Depreciation on Land and Building	15,000	
Depreciation on Plant and Machinery	20,000	
Depreciation on Furniture	1,600	
Amortisation of Preliminary Expenses	2,000	38,600
		38,600

(14) *Other Expenses*

Particulars		Amount (₹)
Printing and Stationery		1,200
Director's Fees		2,000
Rent, Rates and Insurance	2,800	
Less: Prepaid Insurance	800	2,000
Outstanding Audit Fees		2,500
Provision for Bad Debts		5,000
		12,700

Illustration 10

Prepare the final accounts from the following trail balance as on 31 March 2013.

Debit Balances	(₹)	Credit Balances	(₹)
Calls in Arrears	5,000	Share Capital	5,00,000
Premises	7,50,000	Sales	10,00,000
Machinery	1,50,000	Reserve Fund	1,80,000
Furniture	50,000	Profit and Loss A/c	35,000
Purchases	6,80,000	Creditors	75,000
Wages	1,25,000	10% Debentures	4,00,000
Salaries	60,000	Bills Payable	10,000
Interim Dividend (including Corporate Dividend Tax)	20,000	Reserve for Bad and Doubtful Debts (01 April 2012)	1,000
Goodwill	2,00,000		
Debtors	60,000		
Bills Receivable	43,000		
Bad Debts	2,000		
Debenture Interest (up to 30 September 2012 after 25% tax)	15,000		
Stock on 01 April 2012	41,000		
	22,01,000		**22,01,000**

Adjustments:

(i) The stock on 31 March 2013 was valued at ₹80,000

(ii) Depreciate Machinery and Furniture by 10%

(iii) Maintain Reserve for Bad Debt at 5% on debtors

(iv) Directors proposed a final dividend at 15%

(v) Debenture Interest is unpaid for 6 months

[Bangalore University, B.Com Nov/Dec 2014, Section C]

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2013

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales)		10,00,000
2. Other Income		Nil
3. Total Revenue (1 + 2)		**10,00,000**

(*Contd.*)

Particulars	Note	Amount (₹)
4. Expenses:		
a. Purchases		6,80,000
Less: Difference in Closing and Opening Stock (80,000-41,000)		(39,000)
b. Employee Benefit Expenses	11	1,85,000
c. Finance Cost	12	40,000
d. Depreciation and Amortisation	13	20,000
e. Other Expenses	14	4,000
5. Total Expenses (a to e)		**8,90,000**
6. Profit before Tax (3-5)		1,10,000
Add: Profit and Loss Balance of previous years		35,000
Net Profit before Transfer		1,45,000
Less: Proposed Dividend		86,295
Surplus carried over to Balance Sheet		**58,705**

Balance Sheet as on 31 March 2013

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	4,95,000
b. Reserves and Surplus	2	2,38,705
2. Share Application Money pending Allotment		-
3. Non-Current Liability		
a. Long-term Liabilities (8% Debentures)	3	4,00,000
4. Current Liabilities		
a. Trade Payables	4	85,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	91,295
Total		**13,10,000**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	9,30,000
b. Intangible Assets (Goodwill)		2,00,000
c. Other Non-current Assets	-	-
2. Current Assets	-	
a. Trade Receivables	7	1,00,000
b. Inventories	8	80,000

(*Contd.*)

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Particulars	Note	Amount (₹)
c. Cash and Cash Equivalents	9	-
d. Short-term Loans and Advances	-	-
e. Other Current Assets	10	-
Total		**13,10,000**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)
Equity Share Capital	5,00,000
Less: Calls in arrears	5,000
	4,95,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Reserve Fund		1,80,000
Profit and Loss A/c		58,705
		2,38,705

(3) *Long-term Liabilities*

Particulars	Amount (₹)
8% Debentures	4,00,000
	4,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	75,000
Bills payable	10,000
	85,000

(5) *Short-term Provisions*

Particulars		Amount (₹)
Outstanding Interest on Debentures (4,00,000 @ 10% = 40,000 – 15,000)		25,000
Proposed Dividend (4, 95,000 × 15%)	74,250	
Add: Corporate Dividend Tax (74,250 × 16.2225 %)	12,045	
	86,295	
Less: Interim Dividend and Corporate Dividend Tax	20,000	66,295
		91,295

(6) *Fixed Assets*

Particulars		Amount (₹)
Premises		7,50,000
Machinery	1,50,000	
Less: Depreciation @ 10%	15,000	1,35,000
Furniture	50,000	
Less: Depreciation @ 10%	5,000	45,000
		9,30,000

(7) *Trade Receivables*

Particulars		Amount (₹)
Debtors	60,000	
Less: Provision for Bad Debts @5%	3,000	57,000
Bills Receivable		43,000
		1,00,000

(8) *Inventories*

Particulars	Amount (₹)
Closing Stock	80,000
	80,000

(9) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balance	NIL
	NIL

(10) *Other Current Assets*

Particulars		Amount (₹)
Other Current Assets		NIL
		NIL

(11) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salary		1,25,000
Wages		60,000
		1,85,000

(12) *Finance Cost*

Particulars		Amount (₹)
Interest on Debentures	15,000	
Add: Outstanding Interest (4,00,000 × 10% = 40,000 – 15,000)	25,000	40,000
		40,000

(13) *Depreciation and Amortisation Expenses*

Particulars		Amount (₹)
Depreciation on Machinery	15,000	
Depreciation on Furniture	5,000	20,000
		20,000

(14) *Other Expenses*

Particulars		Amount (₹)
Bad Debts		2,000
Reserve for Bad Debts (60,000 × 5%)	3,000	
Less: Opening Reserve for Bad Debt	1,000	2,000
		4,000

Illustration 11

Following is the trail balance of XYZ Ltd., as on 31 March 2013.

Particulars	Debit (₹)	Credit (₹)
Stock as on 01 April 2012	2,08,000	-
Sales	-	21,60,000
Excise Duty	40,000	-
Purchases	17,00,000	-
Wages	3,00,000	-
Discount	74,960	40,000
Furniture	4,00,000	-
Salary	1,48,000	-
Rent	37,800	-
Sundry Expenses	20,280	-
Profit and Loss A/c as on 01 April 2012	-	2,04,240
Goodwill	2,60,000	-
Share Capital	-	10,00,000

(*Contd.*)

Particulars	Debit (₹)	Credit (₹)
Debtors and Creditors	2,94,000	2,86,000
Machinery	3,68,000	-
Cash and Bank	1,05,200	-
Reserve Fund	-	2,06,000
Patents	1,20,000	-
10% Debentures	-	2,00,000
Interest on Debentures	20,000	-
	40,96,240	**40,96,240**

Additional Information:

(i) Closing Stock as on 31 March 2013: ₹8,80,000

(ii) Depreciate Furniture at 10% and Machinery at 15%

(iii) Write off ₹60,000 from goodwill and ₹20,000 from patents

(iv) Provision for Taxation: 30%

(v) Proposed Dividend: 15%

(vi) Corporate Dividend Tax: 16.225%

[Bangalore University, B.Com Nov/Dec 2013, Section C]

Solution

Statement of Profit or Loss for the year ended 31 March 2013

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales)		21,60,000
2. Other Income (Discount Received)		40,000
3. Total Revenue (1 + 2)		**22,00,000**
4. Expenses:		
a. Raw Material consumed plus Excise Duty (Purchases)		17,40,000
Less: Difference in Closing and Opening Stock (8,80,000 – 2,08,000)		(6,72,000)
b. Employee Benefit Expenses (Salaries and Wages)	11	4,48,000
c. Finance Cost	12	20,000
d. Depreciation and Amortisation	13	1,75,200
e. Other Expenses	14	1,33,040
5. Total Expenses (a to e)		**18,44,240**
6. Profit before Tax (3-5)		3,55,760
Less: Provision for Income Tax (30% of 3,55,760)		1,06,728
Net Profit after Tax		**2,49,032**
Add: Profit and Loss Balance of previous years		2,04,240

(*Contd.*)

Particulars	Note	Amount (₹)
Net Profit before Transfer		4,53,272
Less: Proposed Dividend		1,50,000
Less: Corporate Dividend Tax (1, 50,000 × 16.225 %)		24,338
Surplus carried over to Balance Sheet		**2,78,934**

Balance Sheet of XYZ Ltd., as on 31 March 2013

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	10,00,000
b. Reserves and Surplus	2	4,84,934
2. Share Application Money pending Allotment		-
3. Non-Current Liability		
a. Long-term Liabilities (10% Debentures)	3	2,00,000
4. Current Liabilities		
a. Trade Payables	4	2,86,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	2,81,066
Total		**22,52,000**
ASSETS		
1. Non-Current Assets		
a. Fixed Assets	6	6,72,800
b. Intangible Assets	7	3,00,000
c. Investments		
d. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	8	2,94,000
b. Inventories	9	8,80,000
c. Cash and Cash Equivalents	10	1,05,200
d. Short-term Loans and Advances	-	-
e. Other Current Assets	-	-
Total		**22,52,000**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)
Equity Share Capital	10,00,000
	10,00,000

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(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		2,78,934
Reserve Fund		2,06,000
		4,84,934

(3) *Long-term Liabilities*

Particulars	Amount (₹)
10% Debentures	2,00,000
	2,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	2,86,000
	2,86,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Proposed Dividend (10,00,000 @ 15%)	1,50,000
Provision for Tax	1,06,728
Corporate Dividend Tax	24,338
	2,81,066

(6) *Fixed Assets*

Particulars		Amount (₹)
Furniture	4,00,000	
Less: Depreciation @ 10% on 4,00,000	40,000	3,60,000
Machinery	3,68,000	
Less: Depreciation @ 15% on 3,68,000	55,200	3,12,800
		6,72,800

(7) *Intangible Assets*

Particulars		Amount (₹)
Goodwill	2,60,000	
Less: Written Off	60,000	2,00,000
Patents	1,20,000	
Less: Written Off	20,000	1,00,000
		3,00,000

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(8) *Trade Receivables*

Particulars		Amount (₹)
Debtors		2,94,000
		2,94,000

(9) *Inventories*

Particulars	Amount (₹)
Closing Stock	8,80,000
	8,80,000

(10) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balance	1,05,200
	1,05,200

(11) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salary and Wages (1,48,000 + 3,00,000)		4,48,000
		4,48,000

(12) *Finance Cost*

Particulars		Amount (₹)
Interest on Debentures		20,000
		20,000

(13) *Depreciation and Amortisation Expenses*

Particulars		Amount (₹)
Depreciation on Furniture	40,000	
Depreciation on Plant and Machinery	55,200	
Goodwill Written Off	60,000	
Patents Written Off	20,000	1,75,200
		1,75,200

(14) *Other Expenses*

Particulars		Amount (₹)
Rent	37,800	
Sundry Expenses	20,280	
Discount Allowed	74,960	133,040
		1,33,040

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Illustration 12

Following are the balances of Minu Sandhya Ltd., as on 31 March 2011. You are required to prepare final accounts of the company after taking additional information into consideration:

Debit Balances	(₹)	Credit Balances	(₹)
Premises	30,72,000	Share Capital	40,00,000
Plant	33,00,000	12% Debentures	30,00,000
Stock on 01 April 2010	7,50,000	Profit and Loss A/c	2,62,500
Debtors	8,70,000	Creditors	7,70,000
Goodwill	2,50,000	Sales	41,50,000
Bank Balance	4,06,500	General Reserve	2,50,000
Calls in Arrears	75,000	Reserve for Doubtful Debts as on 01 April 2010	35,000
Interim Dividend	3,92,500		
Purchases	18,50,000		
Preliminary Expenses	50,000		
Wages	9,79,800		
General Expenses	68,350		
Salaries	2,02,250		
Bad Debts	21,100		
Debenture Interest Paid	1,80,000		
	1,24,67,500		**1,24,67,500**

Additional Information:

(i) Closing Stock is valued at ₹10,50,000

(ii) Depreciate of Plant at 15%

(iii) Write off ₹5,000 from Preliminary Expenses

(iv) Half-year's Debenture Interest is due

(v) Transfer ₹25,000 to General Reserve

(vi) Ignore Corporate Dividend Tax

[Bangalore University, B.Com Nov/Dec 2007/2011, Section C]

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2011

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales)		41,50,000
2. Other Income		-
3. Total Revenue (1 + 2)		**41,50,000**

(*Contd.*)

Particulars	Note	Amount (₹)
4. Expenses:		
a. Raw Material Purchased		18,50,000
Less: Difference in Closing and Opening Stock (10,50,000 – 7,50,000)		(3,00,000)
b. Employee Benefit Expenses (Salaries and Wages)	11	11,82,050
c. Finance Cost	12	3,60,000
d. Depreciation and Amortisation	13	5,00,000
e. Other Expenses	14	54,450
5. Total Expenses (a to e)		**36,46,500**
6. Profit before Tax (3-5)		5,03,500
Add: Profit and Loss Balance of previous years		2,62,500
Net Profit before Transfer		**7,66,000**
Less: Proposed Dividend (Interim)		3,92,500
Less: Transfer to General Reserve		25,000
Surplus carried over to Balance Sheet		**3,48,500**

Balance Sheet of Minu Sandhya Ltd., as on 31 March 2011

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	39,25,000
b. Reserves and Surplus	2	6,23,500
2. Share Application Money pending Allotment		-
3. Non-Current Liability		
a. Long-term Liabilities (12% Debentures)	3	30,00,000
4. Current Liabilities		
a. Trade Payables	4	7,70,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	1,80,000
Total		**84,98,500**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	58,77,000
b. Intangible Assets (Goodwill)		2,50,000
c. Investments		-
d. Other Non-current Assets		-

(*Contd.*)

Particulars	Note	Amount (₹)
2. Current Assets		
a. Trade Receivables	7	8,70,000
b. Inventories	8	10,50,000
c. Cash and Cash Equivalents	9	4,06,500
d. Short-term Loans and Advances		-
e. Other Current Assets	10	45,000
Total		**84,98,500**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	40,00,000	
Less: Calls in arrears	75,000	39,25,000
		39,25,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		3,48,500
General Reserve	2,50,000	
Add: Transfer to General Reserve	25,000	2,75,000
		6,23,500

(3) *Long-term Liabilities*

Particulars	Amount (₹)
12% Debentures	30,00,000
	30,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	7,70,000
	7,70,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Interest on Debentures (30,00,000 × 12% × 6/12)	1,80,000
	1,80,000

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(6) *Fixed Assets*

Particulars		Amount (₹)
Plant	33,00,000	
Less: Depreciation @ 15% on 33,00,000	4,95,000	28,05,000
Premises		30,72,000
		58,77,000

(7) *Trade Receivables*

Particulars		Amount (₹)
Debtors		8,70,000
		8,70,000

(8) *Inventories*

Particulars	Amount (₹)
Closing Stock	10,50,000
	10,50,000

(9) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balance	4,06,500
	4,06,500

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(10) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	50,000	
Less: Preliminary Expenses Written Off	5,000	45,000
		45,000

(11) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salary	2,02,250	
Wages	9,79,800	11,82,050
		11,82,050

(12) *Finance Cost*

Particulars		Amount (₹)
Interest on Debentures	1,80,000	
Add: Outstanding Interest on Debentures (30,00,000 × 12% × 6/12)	1,80,000	3,60,000
		3,60,000

(13) *Depreciation and Amortisation Expenses*

Particulars		Amount (₹)
Depreciation on Plant		4,95,000
Preliminary Expenses Written Off		5,000
		5,00,000

(14) *Other Expenses*

Particulars		Amount (₹)
General Expenses		68,350
Bad Debts	21,100	
Less: Opening Reserve for Bad Debts	35,000	(13,900)
		54,450

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Illustration 13

Bangaari Manufacturing Company, having an authorised capital of ₹10,00,000, had issued 20,000 shares of ₹10 each. The other details as on 31 March 2008 were as follows:

Particulars	(₹)	Particulars	(₹)
Stock (01 April 2007)	93,210	Audit Fees	625
Manufacturing Wages	64,490	Furniture	2,500
Purchases	2,10,730	Returns Outward	4,905
Carriage Inwards	6,760	Returns Inward	6,320
Carriage Outwards	4,630	Commission Paid	4,320
Advance Payment of Income Tax	7,145	Preliminary Expenses	3,000
Bank Loan (5%)	25,000	Transfer Fee	20
Interest on Bank Loan	625	Sales	3,84,950
Sundry Debtors	82,200	Investments	75,000
Sundry Creditors	46,110	Equipment	6,250
Profit and Loss A/c (01 April 2007) (Cr.)	4,320	Share Capital	2,00,000
Cash and Bank Balance	4,390	Calls in arrears	500
Machinery	71,305	Salary and Allowances, etc.	12,500
Electricity Charges:			
Factory	7,105		
Office	1,700		

Additional Information:

(i) Write off 1/3 of the Preliminary Expenses

(ii) Machinery to be Depreciated by 10% and Furniture by 5%

(iii) Manufacturing Wages due: ₹945 and Salary due: ₹600

(iv) Interest on bank loan has been paid up to 30 September 2007 only

(v) The Closing Stock was ₹62,420 and equipment were valued at ₹5,000 at the end of the year

(vi) Create a reserve of 5% on debtors for Doubtful Debts

(vii) A further reserve of 2.5% is to be created on debtors for discount

(viii) The directors have proposed to pay a dividend of 5% (on Paid-up Capital) for the current year, after providing ₹11,500 for taxation

(ix) Provide Corporate Dividend Tax at 16.2225%

Prepare the final accounts of the company.

[Bangalore University, B.Com Nov/Dec 2008, Section C]

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2008

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales *Less:* Return Inwards) (3,84,950 – 6,320)		3,78,630
2. Other Income (Transfer fee)		20
3. Total Revenue (1 + 2)		**3,78,650**
4. Expenses: (2,10,730 – 4,905 + 6,760)		
a. Purchases (*Less:* Return outwards and *Add:* Carriage inwards)		2,12,585
Add: Difference in Opening and Closing Stock (93,210 – 62,420)		30,790
b. Employee Benefit Expenses (Salaries and Wages)	**11**	78,535
c. Finance Cost	**12**	1,250
d. Depreciation and Amortisation	**13**	9,505
e. Other Expenses	**14**	24,442
5. Total Expenses (a to e)		**3,57,107**
6. Profit before tax (3-5)		21,543
Less: Provision for Taxation		11,500
Profit after Tax		10,043
Add: Profit and Loss Balance of previous years		4,320
Net Profit before Transfer		**14,363**
Less: Proposed Dividend (1,99,500 × 5%)		9,975
Less: Corporate Dividend Tax (9,975 × 16.2225%)		1,618
Surplus carried over to Balance Sheet		**2,770**

Note: Difference in Op. Stock and Cl. Stock to be Added
Difference in Cl. Stock and Op. Stock to be Deducted

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Balance Sheet of Bangaari Manufacturing Company, as on 31 March 2008

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	1,99,500
b. Reserves and Surplus	2	2,770
2. Share Application Money pending Allotment		-
3. Non-Current Liability		
a. Long-term Liabilities (Bank loan)	3	25,000
4. Current Liabilities		
a. Trade Payables	4	46,110
b. Other Current Liabilities		-
c. Short-term Provisions	5	25,263
Total		**2,98,643**
ASSETS		
1. Non-Current Assets		
a. Fixed Assets	6	71,550
b. Intangible Assets		NIL
c. Investments		75,000
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	7	76,138
b. Inventories	8	62,420
c. Cash and Cash Equivalents	9	4,390
d. Short-term Loans and Advances		-
e. Other Current Assets	10	9,145
Total		**2,98,643**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	2,00,000	
Less: Calls in arrears	500	1,99,500
		1,99,500

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		2,770
		2,770

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(3) *Long-term Liabilities*

Particulars	Amount (₹)
Bank Loan	25,000
	25,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	46,110
	46,110

(5) *Short-term Provisions*

Particulars	Amount (₹)
Provision for Taxation	11,500
Proposed Dividend (1, 99,500 × 5%)	9,975
Corporate Dividend Tax (9,975 × 16.2225%)	1,618
Outstanding Interest on Bank Loan	625
Outstanding Salaries	600
Outstanding Manufacturing Wages	945
	25,263

(6) *Fixed Assets*

Particulars		Amount (₹)
Machinery	71,305	
Less: Depreciation @ 10% on 71,305	7,130	64,175
Equipment (6,250-1,000) Depreciation		5,000
Furniture	2,500	
Less: Depreciation @ 5% on 2,500	125	2,375
		71,550

(7) *Trade Receivables*

Particulars		Amount (₹)
Debtors	82,200	
Less: Reserve for Bad Debts 5% of 82,200	4,110	
	78,090	
Less: Provision @ 2.5% on Reserve for Bad Debt of 78,090	1,952	76,138
		76,138

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(8) *Inventories*

Particulars	Amount (₹)
Closing Stock	62,420
	62,420

(9) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balance	4,390
	4,390

(10) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	3,000	
Less: Preliminary Expenses Written Off	1,000	2,000
Advance Income Tax		7,145
		9,145

(11) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salary	12,500	
Add: Outstanding Salary	600	13,100
Wages	64,490	
Add: Outstanding Wages	945	65,435
		78,535

(12) *Finance Cost*

Particulars		Amount (₹)
Interest on Bank Loan	625	
Add: Outstanding Interest on Bank Loan	625	1,250
		1,250

(13) *Depreciation and Amortisation Expenses*

Particulars		Amount (₹)
Depreciation on Machinery (71,305 × 10%)	7,130	
Depreciation on Furniture (2,500 × 5%)	125	
Depreciation on Equipment (6,250 – 5,000)	1,250	
Preliminary Expenses Written Off (3,000 × 1/3)	1,000	9,505
		9,505

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(14) *Other Expenses*

Particulars		Amount (₹)
Electricity Charges:		
Factory	7,105	
Office	1,700	8,805
Audit Fees		625
Commission Paid		4,320
Reserve for Bad Debts		4,110
Provision for Discount on Debtors		1,952
Carriage Outwards		4630
		24,442

Illustration 14

Following is the trail balance of Chaitra Ltd., as on 31 March 2006:

Debit Balances	(₹)	Credit Balances	(₹)
Buildings	5,00,000	Equity Share Capital	3,00,000
Plant and Machinery	2,00,000	12% Preference Share Capital	2,00,000
Purchases	2,50,000	Reserve Fund	1,50,000
Salary	60,000	10% Debentures	2,00,000
Debtors	2,30,000	Sales	6,00,000
Bills Receivable	80,000	Creditors	1,75,000
Director's Fees	20,000	Bills Payable	90,000
Bad Debts	5,000	Returns	20,000
Returns	15,000	Profit and Loss A/c (1 April 2005)	60,000
Wages	15,000	Interest on Investments	18,000
Opening Stock	45,000		
Loose Tools	60,000		
Goodwill	80,000		
Discount on Issue of Shares	20,000		
Cash and Bank Balances	33,000		
12% Investments (1 April 2005)	2,00,000		
	18,13,000		**18,13,000**

Adjustments:

(i) Closing Stock is valued at ₹1,40,000

(ii) Outstanding Wages ₹2,500

(iii) Write off 10% of Goodwill
(iv) Write off 10% of Discount on Issue of Shares
(v) Debenture Interest is outstanding for the whole year
(vi) Write off 5,000 further Bad Debts and create Reserve for Doubtful Debts @ 5%
(vii) Buildings, and Plant and Machinery to be depreciated by 5% and 10% respectively
(viii) Transfer 25,000 to Reserve Fund
(ix) The directors propose 15% dividend to equity shareholders.

You are required to prepare the company's final account.

[Bangalore University, B.Com Nov/Dec 2006/2017, Section C]

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2006

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales *Less:* Sales Returns) (6,00,000 – 15,000)		5,85,000
2. Other Income (Interest on Investments ₹18,000 + 6,000 Outstanding (2,00,000 × 12% = 24,000 – 18,000 = 6,000)		24,000
3. Total Revenue (1 + 2)		**6,09,000**
4. Expenses:		
a. Purchases *Less:* Purchase Returns (2,50,000 – 20,000)		2,30,000
Less: Difference in Closing and Opening Stock (1,40,000 – 45,000)		(95,000)
b. Employee Benefit Expenses (Salaries and Wages)	11	77,500
c. Finance Cost	12	20,000
d. Depreciation and Amortisation	13	55,000
e. Other Expenses	14	41,250
5. Total Expenses (a to e)		**3,28,750**
6. Profit before Tax (3-5)		2,80,250
Less: Provision for Taxation		NIL
Profit after Tax		2,80,250
Add: Profit and Loss balance of previous years		60,000
Net Profit before Transfer		**3,40,250**
Less: Transfer to General Reserve		25,000
Less: Proposed Dividend on Equity Shares (2,00,000 × 12%)		24,000
Less: Proposed Dividend on Equity Shares (3,00,000 × 15%)		45,000
Less: Corporate Dividend Tax (69,000 × 16.2225%)		11,195
Surplus carried over to Balance Sheet		**2,35,055**

5

Balance Sheet of Chaitra Ltd., as on 31 March 2006

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	5,00,000
b. Reserves and Surplus	2	3,92,055
2. Share Application Money pending Allotment		-
3. Non-Current Liability		
a. Long-term Liabilities	3	2,00,000
4. Current Liabilities		
a. Trade Payables	4	2,65,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	1,02,695
Total		**14,59,750**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	7,15,000
b. Intangible Assets (Goodwill)		72,000
c. Investments		2,00,000
d. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	7	2,93,750
b. Inventories	8	1,40,000
c. Cash and Cash Equivalents	9	33,000
d. Short-term Loans and Advances		-
e. Other Current Assets	10	6,000
Total		**14,59,750**

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Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	3,00,000	
12% Preference Share Capital	2,00,000	5,00,000
		5,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		2,35,055
Reserve Fund (1,50,000 + 25,000)		1,75,000
Discount on Issue of Shares (20,000 – 2,000)		(18,000)
		3,92,055

(3) *Long-term Liabilities*

Particulars	Amount (₹)
10% Debentures	2,00,000
	2,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	1,75,000
Bills Payable	90,000
	2,65,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Wages	2,500
Outstanding Debenture Interest	20,000
Proposed Dividend on	
• Equity Shares (3,00,000 × 15%)	45,000
• Preference Shares (2,00,000 × 12%)	24,000
Corporate Dividend Tax	11,195
	1,02,695

(6) *Fixed Assets*

Particulars		Amount (₹)
Building	5,00,000	
Less: Depreciation @ 5% on 5,00,000	25,000	4,75,000
Plant and Machinery	2,00,000	
Less: Depreciation	20,000	1,80,000
Loose Tools		60,000
		7,15,000

(7) *Trade Receivables*

Particulars		Amount (₹)
Debtors	2,30,000	
Less: Bad Debts (additional)	5,000	
	2,25,000	
Less: Reserve for Bad Debt @ 5%	11,250	2,13,750
Bills Receivable		80,000
		2,93,750

5

(8) *Inventories*

Particulars	Amount (₹)
Closing Stock	1,40,000
	1,40,000

(9) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balance	33,000
	33,000

(10) *Other Current Assets*

Particulars	Amount (₹)
Outstanding Interest on Investments (24,000 – 18,000)	6,000
	6,000

(11) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salary		60,000
Wages	15,000	
Add: Outstanding Wages	2,500	17,500
		77,500

(12) *Finance Cost*

Particulars	Amount (₹)
Outstanding Interest on Debentures (2,00,000 × 10%)	20,000
	20,000

(13) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Building (5,00,000 × 5%)	25,000
Depreciation on Plant and Machinery (2,00,000 × 10%)	20,000
Goodwill Written Off (80,000 × 10%)	8,000
Discount on Issue of Shares Written Off (20,000 × 10%)	2,000
	55,000

(14) *Other Expenses*

Particulars		Amount (₹)
Bad Debts	5,000	
Add: Additional Bad Debts	5,000	
	10,000	
Add: Reserve for Doubtful Debts (2,30,000 – 5,000 = 2,25,000 × 5%)	11,250	21,250
Director's Fees		20,000
		41,250

Illustration 15

On 31 March 2010, the following ledger balances were extracted from the books of Bhavani Manufacturing Company Ltd.:

Debit Balances	(₹)	Credit Balances	(₹)
Calls in arrears	37,500	Equity Share Capital	23,00,000
Plant and Machinery	18,00,000	Bills Payable	1,90,000
Stock (1 April 2009)	3,75,000	General Reserve	1,25,000
Furniture	36,000	Profit and Loss A/c	72,500
Sundry Debtors	4,35,000	6% Debentures	15,00,000
Buildings	15,00,000	Sales	24,80,000
Purchases	9,25,000	Reserve for Doubtful Debts	17,500
Interim Dividend paid	3,75,000	Sundry Creditors	2,30,000
Rent	24,000		
General Expenses	24,500		
Debenture Interest	45,000		
Preliminary Expenses	25,000		
Manufacturing Expenses	65,500		
Goodwill	1,45,000		
Wages	4,24,000		
Cash in hand	39,500		
Cash at Bank	1,91,500		
Director's Fees	28,500		
Bad Debts	10,500		
Commission paid	36,000		
Salaries	72,500		
4% Government Securities	3,00,000		
	69,15,000		**69,15,000**

5

Additional Information:

(i) Depreciate Plant and Machinery by 10% and Furniture by 5%

(ii) Write off Preliminary Expenses by 20%

(iii) Transfer ₹25,000 to General Reserve

(iv) Provide for Income Tax: ₹62,500

(v) Half-year's Debenture Interest is outstanding

(vi) Provide for Final Dividend at 5%. Ignore Corporate Dividend Tax

(vii) Maintain Provision for Doubtful Debts at the rate of 5% on Sundry Debtors

(viii) The stock on 31 March 2010 was estimated to be ₹5,04,000

You are required to prepare the final accounts.

[Bangalore University, B.Com Nov/Dec 2010, Section C]

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2010

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales)		24,80,000
2. Other Income		-
3. Total Revenue (1 + 2)		**24,80,000**
4. Expenses:		
a. Purchases		9,25,000
Less: Difference in Closing and Opening Stock (5,04,000 – 3,75,000)		(1,29,000)
b. Employee Benefit Expenses	13	4,96,500
c. Finance Cost	14	90,000
d. Depreciation and Amortisation	15	1,86,800
e. Other Expenses	16	1,93,250
5. Total Expenses (a to e)		**17,62,550**
6. Profit before Tax (3-5)		7,17,450
Less: Provision for Taxation		62,500
Profit after Tax		6,54,950
Add: Profit and Loss Balance of previous years		72,500
Net Profit before Transfer		**7,27,450**
Less: Proposed Dividend on equity shares (23,00,000 – 37,500) × 5%		1,13,125
Less: Interim Dividend		3,75,000
Less: Transfer to General Reserve		25,000
Surplus carried over to Balance Sheet		**2,14,325**

Balance Sheet of Bhavani Manufacturing Company Ltd., as on 31 March 2010

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	22,62,500
b. Reserves and Surplus	2	3,64,325
2. Share Application Money pending Allotment		-
3. Non-current Liability		
a. 6% Debentures	3	15,00,000
4. Current Liabilities		
a. Trade Payables	4	4,20,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	2,20,625
Total		**47,67,450**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	31,54,200
b. Intangible Assets	7	1,45,000
c. Investments	8	3,00,000
d. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	9	4,13,250
b. Inventories	10	5,04,000
c. Cash and Cash Equivalents	11	2,31,000
d. Short-term Loans and Advances		-
e. Other Current Assets	12	20,000
Total		**47,67,450**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	23,00,000	
Less: Calls in arrears	37,500	22,62,500
		22,62,500

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		2,14,325
General Reserve (1,25,000 + 25,000)		1,50,000
		3,64,325

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(3) *Long-term Liabilities*

Particulars	Amount (₹)
6% Debentures	15,00,000
	15,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	2,30,000
Bills Payable	1,90,000
	4,20,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Interest on Debentures (15,00,000 × 6 ÷ 100 × ½)	45,000
Provision for Income Tax	62,500
Proposed Dividend (22,62,500 × 5%)	1,13,125
	2,20,625

(6) *Fixed Assets*

Particulars		Amount (₹)
Plant and Machinery	18,00,000	
Less: Depreciation @ 10% on 18,00,000	1,80,000	16,20,000
Furniture	36,000	
Less: Depreciation @ 5% on 36,000	1,800	34,200
Building		15,00,000
		31,54,200

(7) *Intangible Assets*

Particulars	Amount (₹)
Goodwill	1,45,000
	1,45,000

(8) *Non-current Investments*

Particulars	Amount (₹)
4% Government Securities	3,00,000
	3,00,000

5

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	4,35,000	
Less: Provision for Doubtful Debts	21,750	4,13,250
		4,13,250

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	5,04,000
	5,04,000

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash in hand	39,500
Cash at Bank	1,91,500
	2,31,000

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	25,000	
Less: Preliminary Expenses Written Off	5,000	20,000
		20,000

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Salary	72,500
Wages	4,24,000
	4,96,500

(14) *Finance Cost*

Particulars	Amount (₹)
Interest on Debentures	45,000
Add: Outstanding Interest on Debentures	45,000
	90,000

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Furniture	1,800
Depreciation on Plant and Machinery	1,80,000
Preliminary Expenses Written Off	5,000
	1,86,800

(16) *Other Expenses*

Particulars		Amount (₹)
Bad Debts	10,500	
Add: Closing Reserve for Bad and Doubtful Debts (4,35,000 × 5%)	21,750	
	32,250	
Less: Opening Reserve for Bad and Doubtful Debts	17,500	14,750
Rent		24,000
General Expenses		24,500
Manufacturing Expenses		65,500
Director's Fees		28,500
Commission		36,000
		1,93,250

Illustration 16

Following is the trail balance of P.K. Ltd., as on 31 March 2014.

Debit Balances	(₹)	Credit Balances	(₹)
Opening Stock	1,50,000	Equity Share Capital	5,00,000
Purchases	3,80,000	Purchase Return	10,000
Wages	60,000	Sales	11,50,000
Carriage	2,000	Discount Received	6,300
Furniture	25,000	Surplus Account	1,70,000
Salaries	12,000	Sundry Creditors	33,700
Rent	15,000	General Reserve	82,000
Trade Expenses	11,000	Bills Payable	13,000
Sundry Debtors	54,000	Provision for Doubtful Debts	3,000
Plant and Machinery	12,00,000		
Cash at Bank	21,500		
Patents	9,000		
Bills Receivable	14,000		
Bad Debts	6,500		
Discount Allowed	8,000		
	19,68,000		**19,68,000**

Additional Information:

(i) Stock on 31 March 2014: ₹2,00,000

(ii) Depreciate Plant and Machinery at 12%, Furniture at 10% and Patents at 20%.

(iii) Further Bad Debts amounted to ₹4,000. Provide 5% on Debtors for Bad Debts.

(iv) Provide for Income Tax at 35% and for Corporate Dividend Tax at 16.2225%

(v) The Board of Directors recommended a dividend of 25%.

Prepare final accounts of the company.

[Bangalore University, B.Com Nov/Dec 2014, Section C]

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2014

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales)		11,50,000
2. Other Income (Discount Received)		6,300
3. Total Revenue (1 + 2)		**11,56,300**
4. Expenses:		
a. Purchases (Purchases *Less:* Returns *Add:* Carriage)		3,72,000
Less: Difference in Closing and Opening Stock (2,00,000 – 1,50,000)		(50,000)
b. Employee Benefit Expenses	13	72,000
c. Finance Cost	14	-
d. Depreciation and Amortisation	15	1,48,300
e. Other Expenses	16	44,000
5. Total Expenses (a to e)		**5,86,300**
6. Profit before Tax (3-5)		5,70,000
Less: Provision for Taxation @ 35%		1,99,500
Profit after Tax		3,70,500
Add: Profit and Loss balance of previous years		1,70,000
Net Profit before Transfer		**5,40,500**
Less: Proposed Dividend on Equity Shares @ 25%		1,25,000
Less: CDT on Dividend @ of 16.2225%		20,278
Less: Transfer to General Reserve		-
Surplus carried over to Balance Sheet		**3,95,222**

Balance Sheet of P.K. Ltd., as on 31 March 2014

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	5,00,000
b. Reserves and Surplus	2	4,77,222
2. Share Application Money pending Allotment		

(*Contd.*)

Particulars	Note	Amount (₹)
3. Non-current Liability		
a. Long-term Liability	3	-
4. Current Liabilities		
a. Trade Payables	4	46,700
b. Other Current Liabilities		-
c. Short-term Provisions	5	3,44,778
Total		**13,68,700**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	10,78,500
b. Intangible Assets	7	7,200
c. Investments	8	-
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	9	61,500
b. Inventories	10	2,00,000
c. Cash and Cash Equivalents	11	21,500
d. Short-term Loans and Advances		-
e. Other Current Assets	12	-
Total		**13,68,700**

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Notes:

(1) Share Capital

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		5,00,000
		5,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		3,95,222
General Reserve		82,000
		4,77,222

(3) *Long-term Liabilities*

Particulars	Amount (₹)
Long-term Liability	NIL
	NIL

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	33,700
Bills Payable	13,000
	46,700

(5) *Short-term Provisions*

Particulars	Amount (₹)
Provision for Taxation	1,99,500
Proposed Dividend	1,25,000
CDT on Equity Dividend	20,278
	3,44,778

(6) *Fixed Assets*

Particulars		Amount (₹)
Plant and Machinery	12,00,000	
Less: Depreciation @ 12% on 12,00,000	1,44,000	10,56,000
Furniture	25,000	
Less: Depreciation @ 10% on 25,000	2,500	22,500
		10,78,500

(7) *Intangible Assets*

Particulars	Amount (₹)
Patents	9,000
Less: Written off @ 20%	1,800
	7,200

(8) *Non-current Investments*

Particulars	Amount (₹)
Long-term Liability	NIL
	NIL

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	54,000	
Less: Additional Bad Debts	4,000	
	50,000	
Less: Reserve for Bad and Doubtful Debts	2,500	47,500

(*Contd.*)

5

Particulars		Amount (₹)
Bills Receivable		14,000
		61,500

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	2,00,000
	2,00,000

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash at Bank	21,500
	21,500

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
		NIL
		NIL

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Salary	12,000
Wages	60,000
	72,000

(14) *Finance Cost*

Particulars	Amount (₹)
	NIL
	NIL

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Furniture	2,500
Depreciation on Plant and Machinery	1,44,000
Patents Written Off	1,800
	1,48,300

(16) *Other Expenses*

Particulars		Amount (₹)
Bad Debts	6,500	
Add: Additional Debts	4,000	
	10,500	
Add: Closing Reserve for Bad and Doubtful Debts	2,500	
(54,000 – 4,000) × 5%	13,000	
Less: Opening Reserve for Bad and Doubtful Debts	3,000	10,000
Rent		15,000
Trade Expenses		11,000
Discount Allowed		8,000
		44,000

Illustration 17

Sunrise Ltd. had an authorised capital of ₹3,00,000 in equity shares of ₹10 each. Its trail balance as on 31 March 2017 is given below:

Particulars	(₹)
Premises	1,50,000
Calls in arrears	3,750
Plant and Machinery	1,65,000
Interim Dividend	16027
Corporate Dividend Tax on Interim Dividend	2773
Stock (1 April 2016)	37500
Fixtures	3,600
Debtors	43,500
Goodwill	12,500
Cash in hand	375
Cash at Bank	19,950
Purchases	92,500
Preliminary Expenses	2,500
Wages	42,433
General Expenses	8,417
Freight and Carriage	6,557
Salaries	7,250
Director's Fees	2,863
Bad Debts	1,050

(*Contd.*)

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Particulars	(₹)
Debenture Interest paid	4,500
Called-up Capital	2,00,000
6% Debentures	1,50,000
Profit and Loss Account (01 April 2016) (Cr.)	7,250
Bills Payable	19,000
Creditors	25,000
Sales	2,07,500
General Reserve	12,500
Bad Debts Provision (01 April 2016)	1,750

Additional Information:

(i) Provide for RBD at 5% on Debtors
(ii) Of the debtors, ₹250 are further bad
(iii) Closing Stock: ₹47,500
(iv) Depreciate Plant and Machinery by 10%
(v) Write off Preliminary Expenses of ₹250
(vi) Provide for Debenture Interest due

Prepare final accounts of the company.

Solution

5

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales)		2,07,500
2. Other Income		-
3. Total Revenue (1 + 2)		**2,07,500**
4. Expenses:		
a. Purchases		92,500
Less: Difference in Closing and Opening Stock (47,500 – 37,500)		(10,000)
b. Employee Benefit Expenses	13	49,683
c. Finance Cost	14	9,000
d. Depreciation and Amortisation	15	16,750
e. Other Expenses	16	19,550
5. Total Expenses (a to e)		**1,77,483**

(*Contd.*)

Particulars	Note	Amount (₹)
6. Profit before Tax (3-5)		30,017
Less: Provision for Taxation		-
Profit after Tax		30,017
Add: Profit and Loss balance of previous years		7,250
Net Profit before Transfer		**37,267**
Less: Interim Dividend		16027
Less: CDT on Interim Dividend		2723
Less: Transfer to General Reserve		-
Surplus carried over to Balance Sheet		**18,517**

Balance Sheet of Sunrise Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	1,96,250
b. Reserves and Surplus	2	31,017
2. Share Application Money pending Allotment		
3. Non-Current Liability		
a. Long-term Liability (6% Debentures)	3	1,50,000
4. Current Liabilities		
a. Trade Payables	4	44,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	4,500
Total		**4,25,767**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	3,02,100
b. Intangible Assets	7	12,500
c. Investments	8	-
d. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	9	41,088
b. Inventories	10	47,500
c. Cash and Cash Equivalents	11	20,325
d. Short-term Loans and Advances		-
e. Other Current Assets	12	2,250
Total		**4,25,767**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	2,00,000	
Less: Calls in arrears	3,750	1,96,250
		1,96,250

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		18,517
General Reserve		12,500
		31,017

(3) *Long-term Liabilities*

Particulars	Amount (₹)
6% Debentures	1,50,000
	1,50,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	25,000
Bills payable	19,000
	44,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Interest on Debentures	4,500
	4,500

(6) *Fixed Assets*

Particulars		Amount (₹)
Plant and Machinery	1,65,000	
Less: Depreciation @ 10% on 1,65,000	16,500	1,48,500
Premises		1,50,000
Fixtures		3,600
		3,02,100

(7) *Intangible Assets*

Particulars	Amount (₹)
Goodwill	12,500
	12,500

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	NIL
	NIL

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	43,500	
Less: Additional Bad Debts	250	
	43,250	
Less: Reserve for Bad and Doubtful Debts @ 5% on 43250	2,162	41,088
		41,088

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	47,500
	47,500

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash in hand	375
Cash at Bank	19,950
	20,325

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	2,500	
Less: Preliminary Expenses Written Off	250	2,250
		2,250

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Salary	7,250
Wages	42,433
	49,683

(14) *Finance Cost*

Particulars	Amount (₹)
Debenture Interest	4,500
Less: Outstanding Debenture Interest	4,500
	9,000

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Plant and Machinery	16,500
Preliminary Expenses Written Off	250
	16,750

(16) *Other Expenses*

Particulars		Amount (₹)
General Expenses		8,417
Freight and Carriages		6,557
Director's Fees		2,863
Bad Debts	1,050	
Add: Additional Bad Debts	250	
	1,300	
Add: Closing Reserve for Bad and Doubtful Debts	2,163	
	3,463	
Less: Opening Reserve for Bad and Doubtful Debts	1,750	1,713
		19,550

5

Illustration 18

The following is the trail balance of Excel Company Ltd., as on 31 March 2008:

Particulars	Debit (₹)	Credit (₹)
Paid-up Capital	-	2,00,000
Reserve Fund	-	34,000
Provident Fund	-	6,000

(*Contd.*)

Particulars	Debit (₹)	Credit (₹)
Goodwill	30,000	-
Machinery	50,000	-
Livestock	10,000	-
Buildings	74,000	-
8% Mortgage Loans	-	60,000
Sundry Debtors	90,000	-
Sundry Creditors	-	32,000
Opening Stock	92,000	-
Bills Receivable and Bills Payable	8,000	10,980
Advance Payment of Income Tax	8,000	-
Cash at Bank	22,000	-
Purchase of Raw Materials	1,76,000	-
Sales	-	3,67,400
Returns	4,800	2,000
Discount	4,000	2,000
Investments	16,000	-
Manufacturing Wages	64,000	-
Carriage Inwards	2,000	-
Factory Expenses	28,000	-
Office Salary	13,000	-
Office Furniture	10,000	-
Preliminary Expenses	10,000	-
Bad Debts	3,000	-
Provident Fund Contribution	1,000	-
Director's Fees	2,400	-
Interest on Debentures	2,400	-
Dividend on Investment	-	960
Profit and Loss Account (01 April 2007)	-	5,260
	7,20,600	**7,20,600**

Prepare final accounts of company with the following information:

(i) Closing Stock was valued at ₹76,760

(ii) Write off Preliminary Expenses by 50%

(iii) Interest on Debentures is paid for six months up to 30 September 2016

(iv) Provide Depreciation at 10% on Machinery, 5% on Buildings and 6% on Office Furniture.

(v) Transfer to Reserve Fund: ₹4,000

5

Solution

Statement of Profit or Loss for the year ended 31 March 2008

Particulars	Note	Amount (₹)
1. Revenue from Operations (3,67,400 – 4,800)		3,62,600
2. Other Income (Discount Received and Dividend on Investments) (2,000 + 960)		2,960
3. Total Revenue (1 + 2)		**365,560**
4. Expenses:		
a. Purchases [1,76,000 + 2,000 (Carriage Inwards) – 2,000 (Purchase Returns)]		1,76,000
Less: Difference in Opening and Closing Stock (92,000 – 76,760)		15,240
b. Employee Benefit Expenses	13	77,000
c. Finance Cost	14	4,800
d. Depreciation and Amortisation	15	14,300
e. Other Expenses	16	38,400
5. Total Expenses (a to e)		**3,25,740**
6. Profit before Tax (3 – 5)		39,820
Less: Provision for Taxation		-
Profit after Tax		39,820
Add: Profit and Loss Balance of previous years		5,260
Net Profit before Transfer		**45,080**
Less: Interim Dividend		-
Less: CDT on Interim Dividend		-
Less: Transfer to General Reserve		4,000
Surplus carried over to Balance Sheet		**41,080**

Balance Sheet of Excel Company Ltd., as on 31 March 2008

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	2,00,000
b. Reserves and Surplus	2	79,080
2. Share Application Money pending Allotment		
3. Non-Current Liability		
a. Long term liability 8% mortgage loans	3	60,000
4. Current Liabilities		
a. Trade payables	4	48,980
b. Other Current Liabilities		-
c. Short Term Provisions	5	2,400
Total		**3,90,460**

(*Contd.*)

5

Particulars	Note	Amount (₹)
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	1,34,700
b. Intangible Assets	7	30,000
c. Investments	8	16,000
d. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	9	98,000
b. Inventories	10	76,760
c. Cash and Cash Equivalents	11	22,000
d. Short-term Loans and Advances		-
e. Other Current Assets	12	13,000
Total		**3,90,460**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		2,00,000
		2,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		41,080
General Reserve	34,000	
Add: Transfer to General Reserve	4,000	38,000
		79,080

(3) *Long-term Liabilities*

Particulars	Amount (₹)
8% Mortgage Loans	60,000
	60,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	32,000
Bills Payable	10,980
Provident Fund Contribution	6,000
	48,980

5

(5) Short-term Provisions

Particulars	Amount (₹)
Outstanding Interest on Mortgage Loans (Debentures)	2,400
	2,400

(6) *Fixed Assets*

Particulars		Amount (₹)
Plant and Machinery	50,000	
Less: Depreciation @ 10% on 50,000	5,000	45,000
Premises	74,000	
Less: Depreciation @ 5% of 74,000	3,700	70,300
Furniture	10,000	
Less: Depreciation @ 6% of 10,000	600	9,400
Livestock		10,000
		1,34,700

(7) *Intangible Assets*

Particulars	Amount (₹)
Goodwill	30,000
	30,000

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	16,000
	16,000

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	90,000	
Bills Receivables	8,000	98,000
		98,000

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	76,760
	76,760

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash at Bank	22,000
	22,000

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	10,000	
Less: Preliminary Expenses Written Off (50%)	5,000	5,000
Advance Payment of Income Tax		8,000
		13,000

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Wages	64,000
Office Salaries	13,000
	77,000

(14) *Finance Cost*

Particulars	Amount (₹)
Debenture Interest	2,400
Add: Outstanding Debenture Interest	2,400
	4,800

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Plant and Machinery	5,000
Depreciation on Buildings	3,700
Depreciation on Furniture	600
Preliminary Expenses Written Off (50%)	5,000
	14,300

(16) *Other Expenses*

Particulars		Amount (₹)
Discount Allowed		4,000
Factory Expenses		28,000
Bad Debts		3,000
Contribution to Provident Fund		1,000
Director's Fees		2,400
		38,400

Illustration 19

The following is the trail balance of Excel Company Ltd., as on 31 March 2008:

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital	-	6,00,000
Calls in arrears	32,000	-
Reserve Fund	-	5,00,000
Buildings	3,60,000	-
Fixed Deposits	-	2,00,000
Wages	60,000	-
Machinery	1,78,000	-
Furniture	1,60,000	-
Purchases and Sales	4,20,000	10,50,000
Salary	1,20,000	-
Debtors and Creditors	4,40,000	3,00,000
Bills Receivable and Bills Payable	1,22,000	1,80,000
Director's Fees	40,000	-
Returns	30,000	40,000
Freight	20,000	-
Manufacturing Expenses	10,000	-
Opening Stock	1,30,000	-
Interim Dividend	42,736	-
Corporate Dividend Tax on Interim Dividend	7,264	-
Audit Fees	30,000	-
Profit and Loss Account	-	54,000
Tools	76,000	-
Preliminary Expenses	1,20,000	-
Debentures	-	2,00,000
Interest on Debentures	28,000	-
Investments	5,00,000	-
Goodwill	1,04,000	-
Insurance and Taxes	40,000	-
Printing and Stationery	30,000	-
Cash and Bank Balances	24,000	-
	31,24,000	**31,24,000**

Prepare final accounts of company with the following information:

(i) Closing Stock: ₹1,60,000
(ii) Prepaid Insurance: ₹3,000
(iii) Transfer ₹1,20,000 to Reserve Fund
(iv) Depreciate Building by 2% and Furniture by 5%
(v) Write off 25% of Preliminary Expenses and 10% of goodwill
(vi) Directors proposed a total dividend of 25%

Statement of Profit or Loss for the year ended 31 March 2008

Particulars	Note	Amount (₹)
1. Revenue from Operations (10,50,000 – 30,000)		10,20,000
2. Other Income		-
3. Total Revenue (1 + 2)		**10,20,000**
4. Expenses:		
a. Purchases (4,20,000 – 40,000)		3,80,000
Less: Difference in Closing and Opening Stock (1,60,000 – 1,30,000)		(30,000)
b. Employee Benefit Expenses	13	1,80,000
c. Finance Cost	14	28,000
d. Depreciation and Amortisation	15	55,600
e. Other Expenses	16	1,67,000
5. Total Expenses (a to e)		**7,80,600**
6. Profit before Tax (3 – 5)		2,39,400
Less: Provision for Taxation		-
Profit after Tax		2,39,400
Add: Profit and Loss Balance of previous years		54,000
Net Profit before Transfer		**2,93,400**
Less: Proposed Dividend (Proposed Dividend* – Interim Dividend and CDT on Interim Dividend) (1,42,000* – 42,736 – 7,264)		92,000
Less: CDT on Proposed Dividend @ 16.995%		15,636
Less: Interim Dividend		42,736
Less: CDT on Interim Dividend @ 16.995		7,264
Less: Transfer to General Reserve		1,20,000
Surplus carried over to Balance Sheet		**15,764**

Note: *Proposed Dividend = 6,00,000 – 32,000 (Calls in arrears)
= 5,68,000 × 25%
= 1,42,000

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Balance Sheet of Excel Company Ltd., as on 31 March 2008

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	5,68,000
b. Reserves and Surplus	2	6,35,764
2. Share Application Money pending Allotment		
3. Non-Current Liability		
a. Long-term Liability (Debentures)	3	4,00,000
4. Current Liabilities		
a. Trade Payables	4	4,80,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	1,07636
Total		**21,91,400**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	7,58,800
b. Intangible Assets	7	93,600
c. Investments	8	5,00,000
d. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	9	1,60,000
b. Inventories	10	5,62,000
c. Cash and Cash Equivalents	11	24,000
d. Short-term Loans and Advances		-
e. Other Current Assets	12	93,000
Total		**21,91,400**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		6,00,000
Less: Calls in arrears		32,000
		5,68,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		15,764
General Reserve	5,00,000	
Add: Transfer to General Reserve	1,20,000	6,20,000
		6,35,764

5

(3) *Long-term Liabilities*

Particulars	Amount (₹)
Debentures	2,00,000
Fixed Deposits	2,00,000
	4,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	3,00,000
Bills Payable	1,80,000
	4,80,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Proposed Dividend and CDT on Proposed Dividend (92,000 + 15,636)	1,07,636
	1,07,636

(6) *Fixed Assets*

Particulars		Amount (₹)
Plant and Machinery		1,78,000
Building	3,60,000	
Less: Depreciation @ 2% of 3,60,000	7,200	3,52,800
Furniture	1,60,000	
Less: Depreciation @ 5% of 1,60,000	8,000	1,52,000
Tools		76,000
		7,58,800

(7) *Intangible Assets*

Particulars	Amount (₹)
Goodwill	1,04,000
Less: Goodwill Written Off by 10%	10,400
	93,600

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	5,00,000
	5,00,000

5

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	4,40,000	
Bills Receivables	1,22,000	5,62,000
		5,62,000

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	1,60,000
	1,60,000

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balances	24,000
	24,000

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	1,20,000	
Less: Preliminary Expenses Written Off	30,000	90,000
Prepaid Insurance		3,000
		93,000

5

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Wages	60,000
Office Salaries	1,20,000
	1,80,000

(14) *Finance Cost*

Particulars	Amount (₹)
Debenture Interest	28,000
	28,000

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Building	7,200
Depreciation on Furniture	8,000
Goodwill Written Off	10,400
Preliminary Expenses Written Off	30,000
	55,600

(16) *Other Expenses*

Particulars		Amount (₹)
Director's Fees		40,000
Freight		20,000
Manufacturing Expenses		10,000
Audit Fees		30,000
Insurances and Taxes	40,000	
Less: Prepaid Insurance	3,000	37,000
Printing and Stationery		30,000
		1,67,000

Illustration 20

From the following information of Vikas Company Ltd., prepare final accounts of the company as on 31 March 2017.

Particulars	Debit (₹)	Credit (₹)
Purchases and Sales	2,21,340	3,21,600
Equity Share Capital	-	2,00,000
5% Preference Share Capital	-	40,000
Stock as on 01 April 2016	58,290	-
Preference Dividend (up to 30 September 2016)	1,000	-
CDT on Preference Dividend paid	170	-
Provision for Bad Debts	-	1,200
Interest Received (Tax deducted at source: ₹600)	-	2,000
Wages	32,656	-
Motor Lorry Expenses	11,790	-
Motor Lorry (Cost: ₹36,000)	18,480	-
Debtors and Creditors	56,740	51,300
Rates and Insurance	2,434	-
Land (Cost)	1,76,000	-
Profit and Loss A/c (1 April 2016)	-	13,910
Director's Fees	6,000	-
Bad Debts	1,540	-
Investments	11,600	-
Salaries	15,780	-
Balance at Bank	16,190	-
	6,30,010	**6,30,010**

5

Adjustments:

(i) ₹6,000 to be transferred to General Reserve

(ii) Stock as on 31 March 2017 was ₹65,260

(iii) Provision for Bad Debts to be increased to ₹1,500

(iv) A dividend of 10% on Equity Share Capital has to be provided for

(v) Provide for Manager's Commission at the rate of 5% on profit remaining after charging such commission

(vi) Provide for Balance of Preference Dividend

(vii) Depreciate vehicles at 20% of Cost Price

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations Sales		3,21,600
2. Other Income (Interest received + TDS) (2,000 + 600)		2,600
3. Total Revenue (1 + 2)		**3,24,200**
4. Expenses:		
a. Purchases		2,21,340
Less: Difference in Closing and Opening Stock (65,260 – 58,290)		(6,970)
b. Employee Benefit Expenses	13	48,436
c. Finance Cost	14	-
d. Depreciation and Amortisation	15	7,200
e. Other Expenses	16	22,064
5. Total Expenses (a to e)		**2,92,070**
6. Profit before Tax (III-V)		32,130
Less: Provision for Taxation		-
Profit after Tax		32,130
Add: Profit and loss balance of previous years		13,910
Net Profit before Transfer		**46,040**
Less: Proposed Equity Dividend		20,000
Less: Proposed Preference Dividend		1,000
Less: CDT on Proposed Preference and Equity Dividend @ 16.995%		3,570
Less: Preference Dividend paid		1,000
Less: CDT on Preference Dividend paid (1,000 @ 16.995%)		170
Less: Provision for Manager's Commission		1530*
Less: Transfer to General Reserve		6,000
Surplus carried over to Balance Sheet		**12,770**

Note: Manager's Commission = 32,132 (Profit before tax) × 5 ÷105 = 1,530*

Balance Sheet of Vikas Company Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	2,40,000
b. Reserves and Surplus	2	18,770
2. Share Application Money pending Allotment		
3. Non-Current Liability		
a. Long-term Liability	3	-
4. Current Liabilities		
a. Trade Payables	4	51,300
b. Other Current Liabilities		
c. Short-term Provisions	5	26,100
Total		**3,36,170**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	1,87,280
b. Intangible Assets	7	-
c. Investments	8	11,600
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	9	55,240
b. Inventories	10	65,260
c. Cash and Cash Equivalents	11	16,190
d. Short-term Loans and Advances		-
e. Other Current Assets	12	600
Total		**3,36,170**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		2,00,000
5% Preference Share Capital		40,000
		2,40,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		12,770
Transfer to General Reserve		6,000
		18,770

5

(3) *Long-term Liabilities*

Particulars	Amount (₹)
Long-term Liability	NIL
	NIL

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	51,300
	51,300

(5) *Short-term Provisions*

Particulars	Amount (₹)
Proposed Equity Dividend	20,000
Proposed Preference Dividend	1,000
CDT on Proposed Preference and Equity Dividend @ 16.995%	3,570
Provision for Manager's Commission	1,530
	26,100

(6) *Fixed Assets*

Particulars		Amount (₹)
Motor Lorry	18,480	
Less: Depreciation @ 20% on Cost Price (36,000)	7,200	11,280
Land		1,76,000
		1,87,280

5

(7) *Intangible Assets*

Particulars	Amount (₹)
Intangible Asset	NIL
	NIL

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	11,600
	11,600

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	56,740	
Less: Provision for Bad Debts	1,500	55,240
		55,240

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	65,260
	65,260

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balances	16,190
	16,190

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Tax deducted at Source (on Interest Received)		600
		600

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Wages	32,656
Office Salaries	15,780
	48,436

(14) *Finance Cost*

Particulars	Amount (₹)
Finance Cost	NIL
	NIL

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Motor Lorry	7,200
	7,200

(16) *Other Expenses*

Particulars		Amount (₹)
Motor Lorry Expenses		11,790
Rates and Insurance		2,434
Director's Fees		6,000
Bad Debts	1,540	
Add: New Provision for Bad Debts	1,500	
	3,040	
Less: Old Provision for Bad Debts	1,200	1,840
		22,064

Illustration 21

From the following information on Syntax Company Ltd., prepare final accounts of the company as on 31 March 2017.

Particulars	Debit (₹)	Credit (₹)
Sales	-	7,00,000
Profit and Loss A/c (31 March 2017)	-	30,060
Equity share capital (₹10 each)	-	2,00,000
Sundry Creditors	-	35,000
Reserve Fund	-	31,000
Discount	-	10,000
Stock (1 April 2016)	1,50,000	
Purchases	4,90,000	
Wages	1,00,000	
Discount	14,000	
Salaries	15,000	
Rent	9,900	
Sundry Expenses	34,100	
Equity Dividend paid along with CDT	10,000	
Interim Dividend paid along with CDT	8,000	
Debtors	75,000	
Machinery	58,000	
Cash	20,400	
Bank	12,000	
Loan to Employees	6,500	
Bad Debts	3,160	
	10,06,060	**10,06,060**

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Adjustments:

(i) Rent outstanding was ₹1,900
(ii) Stock as on 31 March 2017 was ₹1,64,000
(iii) Depreciate Machinery at 10%
(iv) Six-months insurance was unexpired at ₹1,500 per annum
(v) Provide reserve for Doubtful Debts at 5%
(vi) Provide reserve for Discount on Creditors at 5%
(vii) Make a provision for Tax, to the extent of ₹30,000
(viii) Proposed Dividend was at 10%
(ix) Manager's Commission is 10% on net profit after tax, before charging such commission

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales)		7,00,000
2. Other Income (Discount Received)		10,000
3. Total Revenue (1 + 2)		**7,10,000**
4. Expenses:		
a. Purchases		4,90,000
Less: Difference in Closing and Opening Stock (1,64,000 – 1,50,000)		(14,000)
b. Employee Benefit Expenses	13	1,15,000
c. Finance Cost	14	-
d. Depreciation and Amortisation	15	5,800
e. Other Expenses	16	64,310
5. Total Expenses (a to e)		**6,61,110**
6. Profit before Tax (III-V)		48,890
Less: Provision for Taxation		30,000
Profit after Tax		18,890
Less: Provision for Manager's Commission (18,890 × 10%)		1,890
Profit after Tax		17,000
Add: Profit and Loss Balance of previous years		30,060
Net Profit before Transfer		**47,060**
Less: Proposed Equity Dividend		20,000
Less: CDT on Proposed Equity Dividend @ 16.2225%		3,245
Less: Equity Dividend paid		10,000
Less: Interim Dividend paid		8,000
Surplus carried over to Balance Sheet		**5,815**

5

Balance Sheet of Syntex Company Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	2,00,000
b. Reserves and Surplus	2	36,815
2. Share Application Money pending Allotment		
3. Non-current Liability		
a. Long-term Liability	3	-
4. Current Liabilities		
a. Trade Payables	4	33,250
b. Other Current Liabilities		
c. Short-term Provisions	5	57,035
Total		**3,27,100**

(*Contd.*)

Particulars	Note	Amount (₹)
ASSETS		
1. Non-Current Assets		
a. Fixed Assets	6	52,200
b. Intangible Assets	7	-
c. Investments	8	-
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	9	71,250
b. Inventories	10	1,64,000
c. Cash and Cash Equivalents	11	32,400
d. Short-term Loans and Advances (loans to employees)		6,500
e. Other Current Assets	12	750
Total		**3,27,100**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		2,00,000
		2,40,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		5,815
Reserve Fund		31,000
		36,815

(3) *Long-term Liabilities*

Particulars	Amount (₹)
Long-term Liability	NIL
	NIL

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	35,000
Less: Reserve for Discount on Creditors @ 5%	1,750
	33,250

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Rent	1,900
Proposed Equity Dividend	20,000
CDT on Proposed Preference and Equity Dividend @ 16.995%	3,245
Provision for Taxation	30,000
Provision for Manager's Commission	1,890
	57,035

(6) *Fixed Assets*

Particulars		Amount (₹)
Machinery	58,000	
Less: Depreciation @ 10% on 58,000	5,800	52,200
		52,200

(7) *Intangible Assets*

Particulars	Amount (₹)
Intangible Asset	NIL
	NIL

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	NIL
	NIL

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	75,000	
Less: Reserve for Doubtful Debts	3,750	71,250
		71,250

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	1,64,000
	1,64,000

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash	20,400
Bank	12,000
	32,400

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Prepaid Insurance		750
		750

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Wages	1,00,000
Office Salaries	15,000
	1,15,000

(14) *Finance Cost*

Particulars	Amount (₹)
Finance Cost	NIL
	NIL

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Machinery	5,800
	5,800

(16) *Other Expenses*

Particulars		Amount (₹)
Discount Allowed		14,000
Rent	9,900	
Add: Outstanding Rent	1,900	11,800
Sundry Expenses	34,100	
Less: Prepaid Insurance	750	
Less: Reserve for Discount on Creditors	1,750	31,600
Bad Debts	3,160	
Add: Reserve for Doubtful Debts (75,000 × 5%)	3,750	6,910
		64,310

Illustration 22

The following balances have been extracted from the books of National Trading Corporation Ltd., as on 31 March 2017:

Particulars	Debit (₹)	Credit (₹)
Premises	30,72,000	-
Plant	33,00,000	-
Furniture	2,00,000	-
Bills Payable	-	3,70,000
Creditors	-	4,00,000
Stock as on 1 April 2016	7,50,000	-
Debtors	8,70,000	-
Goodwill	50,000	-
Cash at Bank	14,06,500	-
Calls in arrears	75,000	-
Interim Dividend paid	3,92,500	-
CDT on Interim Dividend paid	43,175	-
Sales	-	41,50,000
General Reserve	-	12,50,000
Provision for Bad Debts	-	35,000
Purchases	18,50,000	-
Preliminary Expenses	50,000	-
Wages	9,79,800	-
Salaries	2,02,250	-
Debenture Interest paid	1,80,000	-
Bad Debts	21,100	-
General Expenses	68,350	-
Equity Share Capital	-	40,00,000
12% Debentures	-	30,00,000
Profit and Loss Account (1 April 2016)	-	3,05,675
	1,35,10,675	**1,35,10,675**

Additional Information:

(i) Issued and subscribed Share Capital consists of 4,00,000 equity shares of ₹10 each, fully called up

(ii) Write off Preliminary Expenses to the extent of ₹5,000

(iii) Half-year's Interest on Debentures is due

(iv) Depreciate Plant by 15% and Furniture by 10%

5

(v) Create a provision for Bad Debts @ 5% on debtors

(vi) Provide for Income Tax @ 38.5%

(vii) Stock on 31 March 2017 was valued at ₹10,10,000

(viii) A claim of ₹25,000 for Workmen's Compensation is being disputed by the company

Prepare final accounts of the company as on 31 March 2017.

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations (Sales)		41,50,000
2. Other Income		-
3. Total Revenue (1+ 2)		**41,50,000**
4. Expenses:		
a. Purchases		18,50,000
Less: Difference in Closing and Opening Stock (10,10,000 – 7,50,000)		(2,60,000)
b. Employee Benefit Expenses	13	11,82,050
c. Finance Cost	14	3,60,000
d. Depreciation and Amortisation	15	5,20,000
e. Other Expenses	16	97,950
5. Total Expenses (a to e)		**37,50,000**
6. Profit before Tax (3-5)		4,00,000
Less: Provision for Taxation @ 38.5% of 4,00,000		1,54,000
Profit after Tax		2,46,000
Add: Profit and Loss Balance of previous years		3,05,675
Net Profit before Transfer		**5,51,675**
Less: Interim Dividend paid		3,92,500
Less: CDT on Interim Dividend paid		43,175
Surplus carried over to Balance Sheet		**1,16,000**

Balance Sheet of National Trading Corporation Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital (40,00,000 – 75,000 calls in arrears)	1	39,25,000
b. Reserves and Surplus	2	13,66,000
2. Share Application Money pending Allotment		-
3. Non-current Liability		
a. Long-term Liability	3	30,00,000

(*Contd.*)

Particulars	Note	Amount (₹)
4. Current Liabilities		
a. Trade Payables	4	7,70,000
b. Other Current Liabilities		
c. Short-term Provisions	5	3,34,000
Total		**93,95,000**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	60,57,000
b. Intangible Assets	7	50,000
c. Investments	8	-
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	9	8,26,500
b. Inventories	10	10,10,000
c. Cash and Cash Equivalents	11	14,06,500
d. Short-term Loans and Advances		-
e. Other Current Assets	12	45,000
Total		**93,95,000**

Footnote: Contingent Liabilities ₹25,000

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	40,00,000	
Less: Calls in arrears	75,000	39,25,000
		39,25,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		1,16,000
General Reserve		12,50,000
		13,66,000

(3) *Long-term Liabilities*

Particulars	Amount (₹)
12% Debentures	30,00,000
	30,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Bills Payable	3,70,000
Creditors	4,00,000
	7,70,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Interest on Debentures	1,80,000
Provision for Taxation	1,54,000
	3,34,000

(6) *Fixed Assets*

Particulars		Amount (₹)
Premises		30,72,000
Plant and Machinery	33,00,000	
Less: Depreciation @ 15% on 33,00,000	4,95,000	28,05,000
Furniture	2,00,000	
Less: Depreciation @ 10% on 2,00,000	20,000	1,80,000
		60,57,000

(7) *Intangible Assets*

Particulars	Amount (₹)
Goodwill	50,000
	50,000

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	NIL
	NIL

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	8,70,000	
Less: Provision for Bad Debts @ 5%	43,500	8,26,500
		8,26,500

5

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	10,10,000
	10,10,000

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash at Bank	14,06,500
	14,06,500

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	50,000	
Less: Preliminary Expenses Written Off	5,000	45,000
		45,000

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Wages	9,79,800
Office Salaries	2,02,250
	11,82,050

(14) *Finance Cost*

Particulars	Amount (₹)
Debenture Interest paid	1,80,000
Add: Outstanding Debenture Interest paid	1,80,000
	3,60,000

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Plant	4,95,000
Depreciation on Furniture	20,000
Preliminary Expenses Written Off	5,000
	5,20,000

(16) *Other Expenses*

Particulars		Amount (₹)
General Expenses		68,350
Bad Debts	21,100	
Add: Provision for Bad Debts (31 March 2017)	43,500	
(87,00,000 × 5%)	64,600	
Less: Provision for Bad Debts (01 April 2016)	35,000	29,600
		97,950

Illustration 23

The following balances appeared in the books of Brilliant Ltd., as on 31 March 2017:

Particulars	Debit (₹)	Credit (₹)
Equity Shares of ₹10 each, fully paid up	-	6,00,000
General Reserve	-	2,30,000
Unclaimed Dividend	-	526
Trade Creditors	-	42,858
Buildings (at cost)	2,50,000	-
Purchases	5,00,903	-
Sales	-	10,83,947
Manufacturing Expenses	3,50,000	-
Establishment Charges	26,814	-
General Charges	31,078	-
Machinery (at cost)	2,30,000	-
Furniture (at cost)	35,000	-
Opening Stock	1,72,058	-
Book Debts	1,02,380	-
Investments	2,88,950	-
Provision for Depreciation on Fixed Assets	-	91,000
Advance payment of Income Tax	50,000	-
Cash at Bank	72,240	-
Director's Fees	1,800	-
Interest on Investments	-	8,544
Profit and Loss Account (01 April 2016)	-	16,848
Staff Provident Fund	-	37,500
	21,11,223	**21,11,223**

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From the aforementioned information and the following information, prepare the company's final accounts for the year ended 31 March 2017:

(i) The Stock on 31 March 2017 was valued at ₹1,48,680

(ii) Provide ₹29,000 for Depreciation of Fixed Assets and ₹8,000 for Managing Director's Remuneration

(iii) Interest accrued on investments amounted to ₹2,750

(iv) Make a provision of ₹50,000 for Income Tax

(v) The directors propose a dividend @ 8% after transfer of ₹25,000 to General Reserve. Also provide for corporate dividend tax @ 16.2225%

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations		10,83,947
2. Other Income (Outstanding Interest on Investments and Interest on Investments: 2,750 + 8,544)		11,294
3. Total Revenue (1 + 2)		**10,95,241**
4. Expenses:		
a. Purchases		5,00,903
Less: Difference in Opening and Closing Stock (1,72,058 – 1,48,680)		23,378
b. Employee Benefit Expenses	13	-
c. Finance Cost	14	-
d. Depreciation and Amortisation Expenses	15	29,000
e. Other Expenses	16	4,17,692
5. Total Expenses (a to e)		**9,70,973**
6. Profit before Tax (3-5)		1,24,268
Less: Provision for Taxation		50,000
Profit after Tax		74,268
Add: Profit and loss balance of previous years		16,848
Net Profit before Transfer		**91,116**
Less: Transfer to General Reserve		25,000
Less: Proposed Dividend paid		48,000
Less: CDT on Proposed Dividend paid		7,787
Surplus carried over to Balance Sheet		**10,329**

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Balance Sheet of Brilliant Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	6,00,000
b. Reserves and Surplus	2	2,65,329
2. Share Application Money pending Allotment		
3. Non-Current Liability		
c. Long-term Liability	3	-
4. Current Liabilities		
a. Trade Payables	4	42,858
b. Other Current Liabilities		38,026
c. Short-term Provisions	5	2,04,787
Total		**11,51,000**
ASSETS		
1. Non-Current Assets		
a. Fixed Assets	6	4,86,000
b. Intangible Assets	7	-
c. Investments	8	2,88,950
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	9	1,02,380
b. Inventories	10	1,48,680
c. Cash and Cash Equivalents	11	72,240
d. Short-term Loans and Advances		-
e. Other Current Assets	12	52,750
Total		**11,51,000**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		6,00,000
		6,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss Account		10,329
General Reserve	2,30,000	
Less: Transfer to General Reserve	25,000	2,55,000
		2,65,329

(3) *Long-term Liabilities*

Particulars	Amount (₹)
Long-term Liability	NIL
	NIL

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	42,858
	42,858

(5) *Short-term Provisions*

Particulars	Amount (₹)
Unclaimed Dividend	526
Staff Provident Fund	37,500
	38,026

(6) *Fixed Assets*

Particulars		Amount (₹)
Buildings	2,50,000	
Machinery	2,30,000	
Furniture	35,000	
	5,15,000	
Less: Provision for Depreciation of Fixed Assets	29,000	4,86,000
		4,86,000

(7) *Intangible Assets*

Particulars	Amount (₹)
Intangible Assets	NIL
	NIL

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	2,88,950
	2,88,950

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors		1,02,380
		1,02,380

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	1,48,680
	1,48,680

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash at Bank	14,06,500
	14,06,500

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Advance Payment of Income Tax		50,000
Outstanding Interest on Investments		2,750
		52,750

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)
Salaries and Wages	NIL
	NIL

(14) *Finance Cost*

Particulars	Amount (₹)
Interest on Liability	NIL
	NIL

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Provision for Depreciation on Fixed Assets	29,000
	29,000

(16) *Other Expenses*

Particulars		Amount (₹)
Manufacturing Expenses		3,50,000
Establishment Charges		26,814
General Charges		31,078
Director's Fees		1,800
Outstanding Managing Director's Remuneration		8,000
		4,17,692

Illustration 24

Alpha Manufacturing Company Ltd. was registered with a nominal capital of ₹6,00,000 in equity shares, of ₹10 each. The following is the list of balances extracted from its books on 31 March 2017:

Particulars	(₹)
Furniture	7,200
Calls in arrears	7,500
Plant and Machinery	3,30,000
Freight and Carriage	13,115
Salaries	14,500
Director's Fees	5,725
Business Premises	3,00,000
Interim Dividend paid	37,500
Stock on 01 April 2016	75,000
Sundry Debtors	87,000
Goodwill	25,000
Cash in hand	750
Cash at Bank	39,900
Purchases	1,85,000
Preliminary Expenses	5,000
Wages	84,865
General Expenses	6,835
Advertising	10,000
Bad Debts	2,110
Debenture Interest paid	9,000
Equity Share Capital	4,00,000
6% Debentures	3,00,000
Profit and Loss Account (Cr.)	14,500
Bills Payable	38,000
Sundry Creditors	50,000
Sales	4,15,000
General Reserve	25,000
Bad Debts Reserve (1 April 2016)	3,500

The following adjustments have to be made:

(i) Depreciate Plant and Machinery by 5%, Business Premises by 2% and write off ₹1,200 on Furniture.

(ii) Write off ₹1,000 from Preliminary Expenses.

(iii) Provide for half year's Debenture Interest.

(iv) The reserve for bad debts on 31 March 2017 should be equal to 1% of sales.

(v) Director's fees are outstanding to the extent of ₹275 and salaries ₹500.

(vi) Goods of the value of ₹1,500 were distributed as free samples during the year. But no entry in this respect has been made.

(vii) The stock on 31 March 2017 was valued at ₹95,000.

You are required to prepare the company's final accounts for the year ending 31 March 2017.

Solution

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations		4,15,000
2. Other Income		-
3. Total Revenue (1+ 2)		**4,15,000**
4. Expenses:		
a. Purchases (1,85,000 – 1,500 goods distributed as free samples)		1,83,500
Less: Difference in Closing and Opening Stock (95,000 – 75,000)		(20,000)
b. Employee Benefit Expenses	13	99,865
c. Finance Cost	14	18,000
d. Depreciation and Amortisation	15	24,700
e. Other Expenses	16	40,120
5. Total Expenses (a to e)		**3,46,185**
6. Profit before Tax (3 – 5)		68,815
Less: Provision for Taxation		-
Profit after Tax		68,815
Add: Profit and loss balance of previous years		1,4500
Net Profit before Transfer		**83,315**
Less: Interim Dividend paid		37,500
Surplus carried over to Balance Sheet		**45,815**

Balance Sheet of Alpha Manufacturing Company Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	3,92,500
b. Reserves and Surplus	2	70,815
2. Share Application Money pending Allotment		-

(*Contd.*)

Particulars	Note	Amount (₹)
3. Non-Current Liability		
a. Long-term Liability (6% Debentures)	3	3,00,000
4. Current Liabilities		
a. Trade Payables	4	88,000
b. Other Current Liabilities		9,775
c. Short-term Provisions	5	-
Total		**8,61,000**
ASSETS		
1. Non-Current Assets		
a. Fixed Assets	6	6,13,500
b. Intangible Assets	7	25,000
c. Investments	8	-
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	9	82,850
b. Inventories	10	95,000
c. Cash and Cash Equivalents	11	40,650
d. Short-term Loans and Advances		-
e. Other Current Assets	12	4,000
Total		**8,61,000**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	4,00,000	
Less: Calls in arrears	7,500	3,92,500
		3,92,500

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss Account		45,815
General Reserve		25,000
		70,815

(3) *Long-term Liabilities*

Particulars	Amount (₹)
6% Debentures	3,00,000
	3,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	50,000
Bills Payable	38,000
	88,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Interest on Debentures	9,000
Outstanding Director's Fees	275
Outstanding Salary	500
	9,775

(6) *Fixed Assets*

Particulars		Amount (₹)
Furniture	7,200	
Less: Depreciation	1,200	6,000
Plant and Machinery	3,30,000	
Less: Depreciation @ 5%	16,500	3,13,500
Premises	3,00,000	
Less: Depreciation @ 2%	6,000	2,94,000
		6,13,500

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(7) *Intangible Assets*

Particulars	Amount (₹)
Goodwill	25,000
	25,000

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	NIL
	NIL

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	87,000	
Less: Reserve for Bad Debts	4,150	82,850
		82,850

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	95,000
	95,000

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash in hand	750
Cash at Bank	39,900
	40,650

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	5,000	
Less: Preliminary Expenses Written off	1,000	4,000
		4,000

(13) *Employee Benefit Expenses*

Particulars	Amount (₹)	Amount (₹)
Wages		84,865
Salaries	14,500	
Add: Outstanding Salaries	500	15,000
		99,865

(14) *Finance Cost*

Particulars	Amount (₹)
Interest on Debentures	9,000
Add: Outstanding Interest on Debentures $\left(3{,}00{,}000 \times \frac{6}{100} \times \frac{6}{12}\right)$	9,000
	18,000

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Furniture	1,200
Depreciation on Plant and Machinery	16,500
Depreciation on Premises	6,000
Preliminary Expenses Written Off	1,000
	24,700

(16) *Other Expenses*

Particulars		Amount (₹)
General Expenses		6,835
Advertising	10,000	
Add: Goods distributed as free samples	1,500	11,500
Freight and Carriage		13,115
Director's Fees	5,725	
Add: Outstanding Director's Fees	275	6,000
Bad Debts	2,110	
Add: Reserve for Bad Debts (New)	4,150	
	6,260	
Less: Reserve for Bad Debts (Old)	3,500	2,760
		40,120

Illustration 25

Following are the balances of Popular Automobiles Ltd., as on 31 March 2017:

Particulars	Debit (₹)	Credit (₹)
Stock (1 April 2016)	16,300	-
Purchases and Sales	1,24,000	1,88,000
Wages	13,200	-
Salaries	12,400	-
Rent	4,800	-
Interest	-	2,000
Commission	600	-
Profit and Loss Appropriation Account	-	22,400
Vehicles	10,000	-
Reserve Fund	-	18,000
Cash	3,400	-
Debtors and Creditors	18,000	17,400
Bills Receivable and Bills Payable	8,200	3,800
Equity Share capital	-	1,00,000
Bad Debts	900	-
Preliminary Expenses	6,000	-
Investments	17,100	-
Discounts	3,200	4,600
6% Debentures	-	40,000

(*Contd.*)

Particulars	Debit (₹)	Credit (₹)
Debenture Interest	2,400	-
Goodwill	12,000	-
Furniture	9,400	-
Plant and Machinery	48,000	-
Land and Building	87,000	-
Returns	4,600	5,000
Transfer Fees	-	300
	4,01,500	**4,01,500**

Additional Information:

(i) Closing Stock: ₹32,500

(ii) Salaries Outstanding: ₹600

(iii) Depreciate Furniture by 6%, and Plant and Machinery by 5%

(iv) Reserve for Doubtful Debts: 5%

(v) Transfer ₹11,000 to Reserve Fund

(vi) Goods of ₹12,000 were destroyed by Fire and Insurance Co. agreed to pay ₹8,200

(vii) Write off 1/5 of Preliminary Expenses

(viii) Proposed Dividend: ₹10,000

(ix) Provision for Taxation: ₹1,000

(x) Corporate Dividend Tax on proposed dividend at the rate of 16.2225%

(xi) Provide for Debenture Interest

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SOLUTION

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations (2,00,000 – 4,600)		1,95,400
2. Other Income (Transfer Fee, Interest and Discount Received) = (300 + 2,000 + 4,600)		6,900
3. Total Revenue (1 + 2)		**2,02,300**
4. Expenses:		
a. Purchases		1,24,000
Less: Return Outwards		(5,000)
Less: Difference in Closing and Opening Stock (32,500 – 16,300)		(16,200)
b. Employee Benefit Expenses	13	26,200
c. Finance Cost	14	2,400

(*Contd.*)

Note: Goods destroyed worth ₹12,000 by fire has been added to sales (1,88,000 + 12,000) = ₹2,00,000

Particulars	Note	Amount (₹)
d. Depreciation and Amortisation	15	4,164
e. Other Expenses	16	14,200
5. Total Expenses (a to e)		**1,49,764**
6. Profit before Tax (3-5)		52,536
Less: Provision for Taxation		1,000
Profit after Tax		51,536
Add: Profit and Loss Balance of previous years		22,400
Net Profit before Transfer		**73,936**
Less: Proposed Dividend Paid		10,000
Less: CDT on Proposed Dividend Paid @ 16.2225%		1,622
Less: Transfer to General Reserve		11,000
Surplus carried over to Balance Sheet		**51,314**

Balance Sheet of Popular Automobiles Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	1,00,000
b. Reserves and Surplus	2	80,314
2. Share Application Money pending Allotment		
3. Non-Current Liability		
a. Long-term Liability	3	40,000
4. Current Liabilities		
a. Trade Payables	4	21,200
b. Other Current Liabilities		600
c. Short-term Provisions	5	12,622
Total		**2,54,736**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	1,51,436
b. Intangible Assets	7	12,000
c. Investments	8	17,100
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	9	25,300
b. Inventories	10	32,500
c. Cash and Cash Equivalents	11	3,400
d. Short-term Loans and Advances		-
e. Other Current Assets	12	13,000
Total		**2,54,736**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		1,00,000
		1,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss Account		51,314
General Reserve	18,000	
Less: Transfer to General Reserve	11,000	29,000
		80,314

(3) *Long-term Liabilities*

Particulars	Amount (₹)
6% Debenture	40,000
	40,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	17,400
Bills Payable	3,800
	21,200

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Salary	600
Proposed Dividend	10,000
Corporate Dividend Tax on Proposed Dividend	1,622
Provision for Taxation	1,000
	13,222

(6) *Fixed Assets*

Particulars		Amount (₹)
Vehicles		10,000
Furniture	9,400	
Less: Depreciation @ 6%	564	8,836
Plant and Machinery	48,000	

(*Contd.*)

5

Particulars		Amount (₹)
Less: Depreciation @ 5%	2,400	45,600
Land and Building		87,000
		1,51,436

(7) *Intangible Assets*

Particulars	Amount (₹)
Goodwill	12,000
	12,000

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments	17,100
	17,100

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors	18,000	
Less: Reserve for Doubtful Debts	900	17,100
Bills Receivable		8,200
		25,300

5

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	32,500
	32,500

(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash	3,400
	3,400

(12) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	6,000	
Less: Preliminary Expenses Written Off	1,200	4,800
Outstanding Insurance Claim		8,200
		13,000

(13) *Employee Benefit Expenses*

Particulars		Amount (₹)
Wages		13,200
Salaries	12,400	
Add: Outstanding Salary	600	13,000
		26,200

(14) *Finance Cost*

Particulars	Amount (₹)
Debenture Interest (6% of 40,000)	2,400
	2,400

(15) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Preliminary Expenses Written Off	1,200
Depreciation on Furniture	564
Depreciation on Plant and Machinery	2,400
	4,164

(16) *Other Expenses*

Particulars		Amount (₹)
Loss due to goods destroyed by fire (Extraordinary Expense) (12,000-8,200)		3,800
Rent		4,800
Commission		600
Discount		3,200
Bad Debts	900	
Add: Reserve for Doubtful Debts	900	1,800
		14,200

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Illustration 26

From the following trail balance as on 31 March 2017 and other particulars, prepare a Statement of Profit and Loss for the year ended 31 March 2017 and Balance Sheet as on that date in the books of Global Incorporation Ltd.

Debit Balances	(₹)	Credit Balances	(₹)
Closing Stock	30,000	20,000 Equity Shares of ₹10 each, fully paid up	2,00,000
Sundry Debtors (more than 6 months ₹4,000)	50,000	Balance of Trading account	1,22,000
Plant and Machinery	2,25,000	Dividend Received (Tax deducted at Source: ₹400)	1,250
Goodwill	14,500	Interest Received (Tax deducted at Source: ₹200)	750
Land and Building	90,000	Sundry Creditors	39,000
Salaries and Wages	27,500	General Reserve	1,50,000
Rent	7,500	Provisions for Bad Debts	2,500
Selling Expenses	12,500	Provision for Income Tax	21,000
Advances (including advance payment of tax: ₹49,000)	50,000		
Cash at Bank	10,000		
Deposit with Excise authorities	7,500		
Investment at Cost (Market Value: ₹15,000)	12,000		
	5,36,500		**5,36,500**

Additional Information

(i) Provide depreciation on Land and Building at 2.5%. Provide depreciation on Plant and Machinery at 10%

(ii) Provision for Bad Debts should be maintained at 7%

(iii) Net realisable value of Closing Stock: ₹28,500

(iv) Income tax to be provided at 55%

(v) The net balance of provision for income tax and advance payment against tax should be shown in the balance sheet.

(vi) Bonus shares have been issued from general reserves to the existing shareholders in the ratio of one against existing four shares

(vii) The directors have proposed a dividend of 8% on the existing equity share capital and resolved to transfer the balance in the surplus account to general reserve.

(viii) Bonus shares will not be entitled to dividend in the current year.

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations (Gross Profit = Balance of Trading Account)		1,22,000
2. Other Income (Dividend received including TDS and Interest received including TDS) (1,250 + 400 + 750 + 200)		2,600
3. Total Revenue (1 + 2)		**1,24,600**
4. Expenses:		
a. Employee Benefit Expenses	13	27,500
b. Depreciation and Amortisation	14	24,750
c. Other Expenses	15	22,500
5. Total Expenses (a to c)		**74,750**
6. Profit before Tax (3-5)		49,850
Less: Provision for Taxation @ 55%		27,418
Profit after Tax		22,432
Less: Proposed Dividend paid @ 8% of ₹2,00,000		16,000
Less: CDT on Proposed Dividend paid @ 16.2225%		2,596
Surplus carried over to Balance Sheet		**3,836**

Balance Sheet of Global Incorporation Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	2,50,000
b. Reserves and Surplus	2	1,03,836
2. Share Application Money pending Allotment		
3. Non-current Liability		
a. Long-term Liability	3	-
4. Current Liabilities		
a. Trade Payables	4	39,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	67,014
Total		**4,59,850**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	2,90,250
b. Intangible Assets	7	14,500

(*Contd.*)

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Particulars	Note	Amount (₹)
c. Investments	8	12,000
d. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	9	46,500
b. Inventories	10	28,500
c. Cash and Cash Equivalents	11	10,000
d. Short-term Loans and Advances	12	58,100
e. Other Current Assets		-
Total		**4,59,850**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	2,00,000	2,50,000
(+) issue of bonus shares (1:4)	50,000	
		2,50,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
General Reserve	1,50,000	
Add: Transfer from Profit for the year	3,836	
	1,53,836	
Less: Unutilised Amount for Issue of Bonus Shares	50,000	1,03,836
(Bonus Shares issued in the ratio of 1:4)		
i.e. 2,00,000 ÷ 4 = ₹50,000 bonus shares		**1,03,836**

(3) *Long-term Liabilities*

Particulars	Amount (₹)
Long-term Liability	NIL
	NIL

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	39,000
	39,000

(5) *Short-term Provisions*

Particulars	Amount (₹)	Amount (₹)
Provision for Taxation	21,000	
Add: Provision for Tax @ 55%	27,418	48,418
Proposed Dividend (2,00,000 × 8%)		16,000
CDT on Proposed Dividend Paid @ 16.2225%		2,596
		67,014

(6) *Fixed Assets*

Particulars		Amount (₹)
Land and Building	90,000	
Less: Depreciation @ 2.5%	2,250	87,750
Plant and Machinery	2,25,000	
Less: Depreciation @ 10%	22,500	2,02,500
		2,90,250

(7) *Intangible Assets*

Particulars	Amount (₹)
Goodwill	14,500
	14,500

(8) *Non-current Investments*

Particulars	Amount (₹)
Investments (at cost ₹15,000)	12,000
	12,000

(9) *Trade Receivables*

Particulars		Amount (₹)
Debtors:		
Outstanding for more than 6 months	4,000	
Others	46,000	
	50,000	
Less: Provision for Bad Debts	3,500	46,500
		46,500

(10) *Inventories*

Particulars	Amount (₹)
Closing Stock	28,500
	28,500

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(11) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash at Bank	10,000
	10,000

(12) *Short-term Loans and Advances*

Particulars	Amount (₹)	Amount (₹)
Advance Payment of Tax		49,000
TDS on Discount Received		400
TDS on Interest Received		200
Deposit with Excise Authorities		7,500
Other Advances (50,000 – 49,000)		1,000
		58,100

(13) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salaries and Wages		27,500
		27,500

(14) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Land and Building	2,250
Depreciation on Plant and Machinery	22,500
	24,750

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(15) *Other Expenses*

Particulars		Amount (₹)
Rent		7,500
Selling Expenses		12,500
Provision for Bad Debts @ 7% on ₹50,000 Debtors	3,500	
Less: Provision for Bad Debts (old)	2,500	1,000
Loss on Realisable Value of Stock (Book Value: ₹30,000 – Realisable Value: ₹28,500)		1,500
		22,500

Illustration 27

Following is the balance sheet of Magnum Ltd., as on 31 March 2017:

Particulars	Debit (₹)	Credit (₹)
Stock (1 April 2016)	1,86,420	-
Purchases and Sales	7,18,210	11,69,000
Returns	12,680	9,850
Manufacturing Wages	1,09,740	-
Sundry Manufacturing Expenses	19,240	-
Carriage Inwards	4,910	-
18% Bank loan	-	50,000
Interest on Bank Loan	4,500	-
Office Salaries and Expenses	17,870	-
Audit Fees	8,600	-
Director's Remuneration	26,250	-
Preliminary Expenses	6,000	-
Freehold Premises	1,64,210	-
Plant and Machinery	1,28,400	-
Furniture	5,000	-
Loose Tools	12,500	-
Debtors and Creditors	1,05,400	62,220
Cash in hand	19,530	-
Cash at Bank	96,860	-
Advance Payment of Income Tax	84,290	-
Profit and Loss A/c as on 1 April 2016	-	38,640
Equity Share Capital	-	4,00,000
	17,30,610	**17,30,610**

Additional Information

(i) On 31 March 2017, Outstanding Manufacturing Wages and Outstanding Office Salaries stood at ₹1,890 and ₹1,200 respectively. On the same date, stock was valued at ₹1,60,520 and loose tools at ₹10,000.

(ii) Provide for interest on bank loan for 6 months.

(iii) Depreciation on Plant and Machinery is to be provided at 15%, while on Office Furniture it is to be at 10%.

(iv) Write off one-third of balance of Preliminary Expenses

(v) Make a provision for Income Tax at 35% of profits

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(vi) The directors have proposed dividend at 15% for the year ending 31 March 2017, after a transfer of 5% of Net Profits to General Reserve. Also make a provision for tax on distributed profits at 10% of the Proposed Dividend.

Solution

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations Sales less returns (11,69,900 – 12,680)	11	11,57,220
2. Other Income	12	-
3. Total Revenue (1 + 2)		**11,57,220**
4. Expenses:		
a. Purchases		7,18,210
Less: Return Outwards		(9,850)
Add: Carriage Inward		4,910
Less: Difference in Opening and Closing Stock (1,86,420 – 1,60,520)		25,900
b. Employee Benefit Expenses	13	1,30,700
c. Finance Cost	14	9,000
d. Depreciation and Amortisation	15	24,260
e. Other Expenses	16	54,090
5. Total Expenses (a to e)		**9,57,220**
6. Profit before Tax (3-5)		2,00,000
Less: Provision for Taxation @ 35%		70,000
Profit after Tax		1,30,000
Less: Transfer to Reserve @ 5% of 1,30,000		6,500
		1,23,500
Add: Profit and Loss Balance of previous years		38,640
Net Profit after Tax		**1,62,140**
Less: Proposed Dividend paid @ 15% of ₹4,00,000		60,000
Less: CDT on Proposed Dividend paid @ 16.2225%		9,734
Surplus carried over to Balance Sheet		**92,406**

Balance Sheet of Magnum Ltd., as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	4,00,000
b. Reserves and Surplus	2	98,906
2. Share Application Money pending Allotment		

(*Contd.*)

Particulars	Note	Amount (₹)
3. Non-Current Liability		
a. 18% Bank Loan	3	50,000
4. Current Liabilities		
a. Trade Payables	4	62,220
b. Other Current Liabilities		7,590
c. Short-term Provisions	5	1,39,734
Total		**7,58,450**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	2,77,850
b. Intangible Assets		-
c. Investments		-
d. Other Non-current Assets		-
2. Current Assets		
a. Trade Receivables	7	1,05,400
b. Inventories	8	1,60,520
c. Cash and Cash Equivalents	9	1,16,390
d. Short-term Loans and Advances		-
e. Other Current Assets	10	98,290
Total		**7,58,450**

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Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital		4,00,000
		4,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss A/c		92,406
General Reserve		6,500
		98,906

(3) *Long-term Liabilities*

Particulars	Amount (₹)
18% Bank Loan	50,000
	50,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	62,220
	62,220

(5) *Short-term Provisions*

Particulars	Amount (₹)
Provision for Taxation	70,000
Proposed Dividend	60,000
Corporate Dividend Tax on Proposed Dividend	9,734
	1,39,734

(6) *Other Current Liabilities*

Particulars	Amount (₹)
Outstanding Salary	1,200
Outstanding Manufacturing Wages	1,890
Outstanding Interest on Bank Loan	4,500
	7,590

(7) *Fixed Assets*

Particulars		Amount (₹)
Freehold Premises		1,64,210
Plant and Machinery	1,28,400	
Less: Depreciation @ 15%	19,260	1,09,140
Furniture	5,000	
Less: Depreciation @ 10%	500	4,500
		2,77,850

(8) *Intangible Assets*

Particulars	Amount (₹)
Intangible Assets	NIL
	NIL

(9) *Non-current Investments*

Particulars	Amount (₹)
Investments	NIL
	NIL

(10) *Trade Receivables*

Particulars		Amount (₹)
Debtors		1,05,400
		1,05,400

(11) *Inventories*

Particulars	Amount (₹)
Closing Stock	1,60,520
	1,60,520

(12) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash in hand	19,530
Cash at Bank	96,860
	1,16,390

(13) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	6,000	
Less: Preliminary Expenses Written Off (1/3)	2,000	4,000
Advance Payment of Tax		84,290
Loose Tools	12,500	
Less: Depreciation on Loose Tools	2,500	10,000
		98,290

Note: Loose tools can be taken under Fixed Assets also.

(14) *Employee Benefit Expenses*

Particulars		Amount (₹)
Manufacturing Wages	1,09,740	
Add: Outstanding manufacturing wages	1,890	1,11,630
Salaries	17,870	
Add: Outstanding Salary	1,200	19,070
		1,30,700

(15) *Finance Cost*

Particulars	Amount (₹)
Interest on Bank Loan	4,500
Add: Outstanding Interest on Bank Loan (50,000 @ 18% for 6 months)	4,500
	9,000

(16) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Preliminary Expenses Written Off (1/3)	2,000
Depreciation on Furniture	500
Depreciation on Plant and Machinery	19,260
Depreciation on Loose Tools (12,500 – 10,000)	2,500
	24,260

(17) *Other Expenses*

Particulars		Amount (₹)
Sundry Manufacturing Expenses		19,240
Audit Fees		8,600
Director's Remuneration		26,250
		54,090

SUMMARY

- Companies registered under Companies Act, 1956 (Revised Companies Act, 2013), are required to prepare financial statements, namely Balance Sheet, Statement of Profit and Loss and related notes to accounts in accordance with the Schedule VI of Companies Act, 1956.
- As per Section 128 of the Companies Act, 2013, every company shall prepare and keep at its registered office, books of accounts and other relevant books and documents and financial statements that give true and fair view of the state of affairs of the company, and such books shall be kept on accrual basis and according to the double entry system of accounting.
- Financial statements are the statements where the financial data is compiled, collected and classified in a systematic manner according to the accounting principles, to assess the financial position of an enterprise as regards to its profitability, efficiency, solvency and growth potential.
- As per Section 129 of the Companies Act, 2013, the financial statements shall give true and fair view of the state of affairs of the company or companies, comply with the notified accounting standards under Section 133 and shall be in the form or forms as may be provided for different class or classes of companies as prescribed in Schedule III.
- Section 210 of the Companies Act, 1956, thoroughly deals with preparation and presentation of financial statements of joint-stock companies.
- Section 211 prescribes the formats and contents of statement of profit and loss account and balance sheet.

- Section 215 deals with the authentication of company final accounts. Sections 216 to 220 deal with the guidelines to be observed while preparing and presenting the financial statements.
- The disclosure requirements specified in Parts I and II of this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 1956.
- Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required
- The revised schedule contains: General Instructions, Part I – Form of Balance Sheet; General Instructions for Preparation of Balance Sheet, Part II – Form of Statement of Profit and Loss, and General Instructions for Preparation of Statement of Profit and Loss.
- As per Part II, Schedule VI, the profit and loss account of a company must set out the amount of a charge for Indian income tax and other Indian taxation on profits. A company is liable to pay income tax and such tax is treated as a charge against the profits of the accounting year.
- Advance tax is payable on all incomes other than capital gains and casual income. The advance tax is payable during the financial year when the last assessed income or current income in case of a company exceeds ₹2,500.
- The Companies Act has laid down restrictions on the remuneration to be paid to the directors, managers and the managing director. Under Section 198 of the Companies Act, 1956, the total remuneration payable to the directors, managers and managing director should not exceed 11% of the net profits of the company for that financial year.
- Section 205 of the Companies Act, 1956, prescribes the methods of charging depreciation. The relevant extracts thereof are as follows: depreciation shall be provided either to the extent specified in Section 350 or in respect of each item of depreciable asset; for such an amount as is arrived at by dividing ninety-five per cent of the original cost thereof to the company by the specified period in respect of such asset.
- Wherever a company issues debentures, it undertakes to pay interest thereon at a fixed percentage. As the debentures acknowledge a debt, the payment of interest on the debt is obligatory on the part of the company issuing them, irrespective of the fact whether the company earns profit or not.
- A dividend is a payment made by a Company to its shareholders, usually as a distribution of profits. When a company earns a profit or surplus, it can re-invest it in the business (called retained earnings), and pay a fraction of this reinvestment as a dividend to shareholders.
- No amount need be transferred to Reserves if the dividend declared does not exceed 10% of its profits for that year as specified. No dividend can be declared and paid in excess of 10%, unless minimum amount prescribed as under is transferred to Reserves. Rules have been prescribed for transferring to reserves in excess of 10% of profits. There is no restriction on transfer up to 10% of profits.

THEORY QUESTIONS

Section A

1. Give two examples of Contingent Liabilities.
[Bangalore University, Nov/Dec 2005/2010/2014]
2. What is the permissible monthly remuneration to a managerial person, in case of inadequate profits, when the effective capital is between 5 crore and 25 crore?
[Bangalore University, Nov/Dec 2005]
3. State under what headings the following items will appear in the balance sheet of a company:
   (i) Calls Unpaid
   (ii) Loose Tools
[Bangalore University, Nov/Dec 2005/2012]
4. Distinguish between Interim Dividend and Final Dividend.
[Bangalore University, Nov/Dec 2006/2013]
5. What are Contingent Liabilities? **[Bangalore University, Nov/Dec 2006]**
6. How do you treat the following items in the company's balance sheet?
   (i) Debentures
   (ii) Preliminary Expenses
[Bangalore University, Nov/Dec 2006]
7. Distinguish between Profit and Loss Account, and Profit and Loss Appropriation Account
[Bangalore University, Nov/Dec 2007/2010]
8. How do you treat Unclaimed Dividend in the final accounts of company?
[Bangalore University, Nov/Dec 2007/2015]
9. What is the maximum rate of Managerial Remuneration payable, as per Companies Act, 1956?
[Bangalore University, Nov/Dec 2007/2009]
10. What is Contingent Liability? Give two examples. **[Bangalore University, Nov/Dec 2008]**
11. What is a Profit and Loss Appropriation Account?
[Bangalore University, Nov/Dec 2008/2012]
12. State under what headings will the following items appear in the balance sheet of a company:
(i) Deposits with Port Trust
(ii) Securities Premium
(iii) Live Stock
(iv) Fixed Deposits Accepted
[Bangalore University, Nov/Dec 2008]
13. How do you treat the following items in a company's balance sheet?
   (i) Debentures
   (ii) Preliminary Expenses

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(iii) Calls in Arrears
(iv) Securities Premium

[Bangalore University, Nov/Dec 2009]

14. What is Unclaimed Dividend? **[Bangalore University, Nov/Dec 2010/2011]**
15. How do you treat Preliminary Expenses in the final accounts of company?
[Bangalore University, Nov/Dec 2011]
16. How do you treat the following items in a company's balance sheet?
(i) Debentures
(ii) Loose Tools
(iii) Securities Premium
(iv) Calls in Arrears
[Bangalore University, Nov/Dec 2011]
17. State any four Non-current Assets. **[Bangalore University, Nov/Dec 2013]**
18. What do you mean by Calls in Arrears? **[Bangalore University, Nov/Dec 2014/2015]**
19. State under what headings will the following items appear in the balance sheet of a company:
(i) Fixed Deposits accepted from public
(ii) Securities Premium
(iii) Proposed Dividend
(iv) Calls in advance
[Bangalore University, Nov/Dec 2015]
20. What is Corporate Dividend Tax? **[Bangalore University, Nov/Dec 2016]**
21. How do you treat Advance Tax paid in company's final accounts?
[Bangalore University, Nov/Dec 2016]

PRACTICAL QUESTIONS

Section B

1. Mention the guidelines given by the government for transfer of profits to reserves, based on dividends.
2. From the following particulars, prepare Profit and Loss Appropriation Account
(i) Profit and Loss Account Balance from last year: ₹62,500
(ii) Net Profit for the year before tax: ₹5, 40,000 (provision for tax 40%)
(iii) Transfer to General Reserve: ₹2,500. Dividend Equalisation Fund: ₹40,000 and Development Reserve: ₹37,500
(iv) Dividend on 7.5% Preference Shares: ₹3,00,000
(v) Dividend at 12.5% on 50,000 equity shares of ₹10 each, ₹7.50 called up (Calls in arrears: ₹13,000)
(vi) Corporate Dividend Tax: 10%

[Bangalore University, Nov/Dec 2005]

3. Following particulars have been obtained from the accounts of a company:
   (i) Remuneration of Managing Director: ₹20,000
   (ii) Provision for Bad Debts: ₹10,000
   (iii) Provision for Taxation: ₹1,50,000
   (iv) Depreciation Written Off: ₹80,000
   (v) Loss on Sale of Investments: ₹70,000
   (vi) Depreciation allowable according to Income Tax Provisions: ₹70,000
   (vii) Net Profit after considering the above items: ₹4,50,000

   Calculate the remuneration of the managing director at 5% of net profit. The net profit should be as per provisions of the Companies Act.

   [**Bangalore University, Nov/Dec 2005/2009/2014]**

4. Eshwar Ltd. earned a net profit of ₹4,00,000 after considering the following items:
   (i) Depreciation: ₹80,000
   (ii) Preliminary Expenses: ₹40,000
   (iii) Provision for Taxation: ₹2,20,000
   (iv) MD's Remuneration paid: ₹60,000
   (v) Director's Fees: ₹20,000
   (vi) Bonus paid: ₹30,000
   (vii) Profit on Sale of Fixed Asset: ₹30,000

   (Original Cost: ₹40,000; WDV: ₹22,000)

   Compute the net profit for the purpose of managerial remuneration and calculate the managing director's remuneration at 5% of net profits.

   [Bangalore University, Nov/Dec 2006]

5. From the following particulars, prepare Profit and Loss Appropriation Account.
   (i) Profit and Loss Balance brought forward: ₹1,00,000
   (ii) Net Profit before Tax (Provision for Taxation 40%): ₹8,75,000
   (iii) Transfer to Reserve Fund: ₹1,25,000
   (iv) The Share Capital consists of the following:
      a. 10,000, 12% Preference Shares of ₹100 each fully paid
      b. 10,000 Equity Shares of ₹100 each ₹80 paid.
   (v) The directors propose a dividend of 20% on equity shares

   [Bangalore University, Nov/Dec 2006]

6. From the following particulars of Madan Ltd., calculate the remuneration of the managing director at 5% of net profit:
   (i) Remuneration of Managing Director: ₹10,000
   (ii) Provision for Bad Debts: ₹5,000
   (iii) Provision for Taxation: ₹75,000
   (iv) Depreciation written off: ₹40,000
   (v) Loss on Sale of Investments: ₹35,000
   (vi) Depreciation allowable according to Income Tax Provisions ₹35,000
   (vii) Net Profit after considering the above items ₹2,25,000

   [Bangalore University, Nov/Dec 2008]

7. From the following particulars of Naija Ltd., prepare Profit and Loss Appropriation Account for the year ended 31 March 2008:

(i) Profit and Loss Account Balance brought forward: ₹31,500
(ii) Net Profit before Tax (provision for taxation 40%): ₹2,70,000
(iii) Transfer to General Reserve: ₹26,250
(iv) Dividend on 7.5% Preference Shares of (1,500 shares of ₹100 each): ₹1,50,000
(v) Dividend at 12.5% on 25,000 equity shares of ₹10 each, ₹7.50 paid
(vi) Corporate Dividend Tax: 16.995%

[Bangalore University, Nov/Dec 2008]

Section C

1. From the following information of ABC Company Ltd., prepare final accounts of the company as on 31 March 2017.

Particulars	(₹)
Profit and Loss A/c (Cr.)	33,500
Transfer Fees	3,250
Rent (Cr.)	15,000
Sales	18,08,500
Sundry Creditors	1,20,250
Bank Overdraft	3,78,500
4% Debentures	2,50,000
Equity Share Capital	10,00,000
Calls in arrears	5,000
Interest Bank	45,500
Debenture Interest (for ½ year to 30.9.2016)	5,000
Cash in hand	4,000
Bank Current A/c	10,000
Bad Debts	12,750
Repairs	23,250
Business Expenses	30,500
Commission and Brokerage	33,750
Advertisement	7,500
Bills Receivable	67,250
Sundry Debtors	1,33,000
Goodwill	1,87,500
Loose Tool	75,000
Plant and Machinery	3,75,000
Freehold Land	6,25,000
Manufacturing Expenses	31,500
Wages	6,52,500
Materials Purchased	6,16,250

(*Contd.*)

5

Particulars	(₹)
Furniture	75,000
Taxes and Insurance	27,500
Patents	1,87,500
Carriage Inward	28,750
Discount and Rebates	15,000
Preliminary Expenses	5,000
Stock as on 1 April 2016	3,32,500

Adjustments

(i) Outstanding Liability for Wages and Business Expenses was ₹12,500 and ₹12,500 respectively.
(ii) Create Debenture Redemption reserve by ₹10,000
(iii) Provision for Income Tax: ₹1,20,000
(iv) Provide depreciation on Plant and Machinery at 5%; Loose Tools at 20%; Patents at 10% and Furniture at 10%
(v) Stock Value as on 31 March 2017 was ₹3,54,000
(vi) Preliminary Expenses to be written off: ₹2,500
(vii) Proposed Dividend was at 10% and Dividend Tax to be provided at 16.2225%
(viii) Provide 2% on debtors as doubtful after writing off ₹10,750 as bad debts.

(Net Profit: ₹1,90,610; Surplus: ₹8,610 and Balance Sheet: ₹40, 45,110)

2. Following is the trail balance of Z Co. Ltd., as on 31 March 2012:

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital	-	1,50,000
12% Preference Share Capital	-	1,00,000
Reserve Fund	-	75,000
Buildings	2,50,000	-
10% Debentures	-	1,00,000
Plant and Machinery	1,00,000	-
Purchases and Sales	1,25,000	3,00,000
Salary	30,000	-
Debtors and Creditors	1,15,000	87,500
Bills	40,000	45,000
Director's Fees	10,000	-
Bad Debts	2,500	-
Returns	7,500	10,000
Wages	7,500	-
Opening Stock	22,500	-
Profit and Loss A/c on 1 April 2011	-	30,000

(*Contd.*)

Particulars	Debit (₹)	Credit (₹)
Loose Tools	30,000	-
Goodwill	40,000	-
Discount on Issue of shares	10,000	-
Cash and Bank Balances	16,500	-
Investments	1,00,000	-
Interest on Investments	-	9,000
	9,06,500	**9,06,500**

Adjustments:

(i) Closing Stock is valued at ₹80,000

(ii) Debenture Interest is outstanding for the whole year

(iii) Write off ₹3,000 further bad debts and create reserve for doubtful debts at 5%

(iv) Buildings, and Plant and Machinery to be depreciated by 5% and 10% respectively

(v) Transfer ₹15,000 to Reserve Fund

(vi) The directors propose 15% dividend to equity shareholders.

You are required to prepare the company's final accounts

[Bangalore University, 2012, Section C]

(Net Profit: ₹1, 40,125; Surplus: ₹1,17, 528; Balance Sheet: ₹7,29,875)

3. The following trail balance has been extracted from the books of Excellent Trading Corporation Ltd., as on 31 March 2016. The authorised capital to the company consists of 20,000 equity shares of ₹100 each and 10,000, 8% preference shares of ₹100 each.

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital	-	20,00,000
Preference Share Capital	-	4,00,000
Purchases	22,13,500	-
Sales	-	32,16,000
Stock-in-trade (1 April 2015)	5,28,800	-
Preference Dividend up to 30 September 2015	16,000	-
Preference for Bad Debts	-	14,000
Interest on Investments	-	18,000
Wages	3,18,600	-
Motor Car Expenses	1,25,900	-
Vehicles (Cost: ₹3,60,000)	1,84,800	-
Debtors	5,67,400	-
Creditors	-	4,53,000
Rates and Insurance	24,300	-
Freehold Land (at cost)	17,00,000	-

(*Contd.*)

5

Particulars	Debit (₹)	Credit (₹)
Director's Remuneration	-	1,39,000
Bad Debts	60,000	-
Investments	1,20,000	-
Salaries	1,53,200	-
Balance at Scheduled Banks	1,63,500	-
	62,40,000	**62,40,000**

You are also given the following additional information:

(i) Stock-in-trade on 31 March 2016 was ₹6,52,600
(ii) Provision for Doubtful Debts to be increased to ₹20,000
(iii) A dividend of 12% on equity share capital is recommended
(iv) Vehicles are to be depreciated at 20%
(v) Unexpired Insurance is ₹1,500
(vi) Wages Outstanding: ₹5,000; and Salaries: ₹10,000
(vii) An office building was constructed during the year by engaging company's own workers. No entry has been has been passed in respect of the above items.

You are required to prepare final accounts of the company for the year ended 31 March 2016, as required under the Companies Act, 1956.

(Net Profit: ₹3, 41,800; Surplus: ₹1, 58,800; Balance Sheet: ₹6, 52,000)

4. The following balances appeared in the books of the Sunshine Co. Ltd., as on 31 March 2017:

Particulars	Amount (₹)	Particulars	Amount (₹)
Stock as on 01 April 2016	6,65,000	Bank Current Account	20,000
Discount on rebates	30,000	Cash in hand	8,000
Carriage inwards	57,500	Debenture Interest (for ½ year to 30 September 2016)	10,000
Patterns	3,75,000	Bank Interest (Dr.)	91,000
Rates, Taxes and Insurance	55,000	Preliminary Expenses	10,000
Furniture and Fixtures	1,50,000	Calls in arrears	10,000
Materials Purchased	12,32,500	Equity Share Capital (2,00,000 shares of ₹10 each)	20,00,000
Wages	13,05,000	4% Debentures (repayable after 10 years)	5,00,000
Coal and Coke	63,000	Bank Overdraft	7,57,000
Freehold Land	12,50,000	Sundry Creditors (for goods)	2,40,500
Plant and Machinery	7,50,000	Sales	36,17,000
Engineering Tools	1,50,000	Rents (Cr.)	30,000
Goodwill	3,75,000	Transfer Fees	6,500

(*Contd.*)

Particulars	Amount (₹)	Particulars	Amount (₹)
Sundry Debtors	2,66,000	Profit and Loss A/c (Cr.)	67,000
Bills Receivable	1,34,500	Bad Debts	25,500
Advertisement	15,000		
Commission and Brokerage	67,500		
Business Expenses	56,000		
Repairs	46,500		

Additional Information

(i) The stock (valued at Cost or Market Value, whichever is lower) as on 31 March 2017 was ₹7,08,000. Outstanding Liability for Wages: ₹25,000 and for Business Expenses: ₹25,000

(ii) Dividend was declared at 10% on Paid-up Capital

(iii) Plant and Machinery at 15%, Engineering Tools at 20%, Patterns at 10% and Furniture and Fixtures at 10%. Provide 2% on debtors as doubtful debts after writing off ₹21,500 as bad debts

(iv) Write off Preliminary Expenses: ₹5,000 and create Debenture Redemption Reserve: ₹50,000. Provide ₹1,40,000 for Income Tax

Prepare Profit and Loss Account for the year ended 31 March 2017 and Balance Sheet as on that date, in accordance with the Companies Act, 1956, giving as much information as necessary. Ignore previous year's figures.

(Net Profit: ₹2,15,610; Surplus: ₹33, 610; Balance Sheet: ₹39, 70,110)

5. From the following trail balance of Sri Shankar Corporation Ltd., as on 31 March 2016, prepare the final accounts in the prescribed form:

Particulars	Debit (₹)	Credit (₹)
Equity Share Capital	-	3,00,000
Reserve Fund	-	1,50,000
Furniture	40,000	-
Buildings	80,000	-
Wages	50,000	-
Sundry Debtors and Creditors	1,60,000	1,80,000
Investments	60,000	-
Interim Dividend	30,000	-
CDT on Interim Dividend	5,099	-
Audit Fees	10,000	-
Director's Fees	15,000	-
Freight Charges	15,000	-
Printing and Stationery	12,000	-
Purchases and Sales	2,40,000	3,80,000
Returns	20,000	10,000

(*Contd.*)

5

Particulars	Debit (₹)	Credit (₹)
Bills Receivable and Payable	50,000	20,000
Machinery	80,000	-
Profit and Loss Appropriation A/c	-	20,000
Cash at Bank and in hand	52,901	-
Forfeited Shares A/c	-	10,000
Calls in arrears	20,000	-
Goodwill	50,000	-
Stock (1 April 2016)	60,000	-
Salary	20,000	-
Total	**10,70,000**	**10,70,000**

Additional Information:

(i) Stock on 31 March 2017 was valued at ₹1,20,000
(ii) Depreciate building by 10%
(iii) Interest on Investments accrued ₹12,000
(iv) Make provision for taxation: ₹25,000
(v) Transfer ₹20,000 to Reserve Fund
(vi) Write off bad debts: ₹10,000

(Net Profit: ₹37,000; Surplus: ₹1,901; Balance Sheet: ₹6,86,901)

6. The following balances appeared in the books of the Pioneer Flour Mills Co. Ltd., as on 31 March 2017:

Particulars	Amount (₹)	Particulars	Amount (₹)
Equity Share Capital	60,00,000	Furniture	2,00,000
General Reserve	25,00,000	Stock	17,20,580
Unclaimed Dividend	65,260	Book Debts	17,83,800
Trade Creditors	10,78,580	Investments	28,89,500
Buildings	10,00,000	Cash at Bank	19,22,400
Purchases	50,09,030	Director's Fees	18,000
Sales	1,18,39,470	Interim Dividend	6,00,000
Manufacturing Expenses	35,90,000	Advance Payment of Income Tax	85,440
		Profit and Loss A/c on 1 April 2016 (Cr.)	8,00,000
Establishment Charges	2,68,140	Staff Provident Fund	3,75,000
General Charges	3,10,780	Corporate Dividend Tax	60,000
Plant and Machinery	20,00,000		

From these balances and the following information, prepare the company's balance sheet as on 31 March 2017 and its Profit and Loss Account for the year ended on that date:

(i) The Stocks of wheat and flour on 31 March 2017 were valued at ₹14,86,800.
(ii) Depreciation is to be provided on the WDV of fixed assets at the following rates:

Building: 5%; Plant and Machinery: 15%; Furniture: 10%

(iii) A claim of ₹25,000 for Workmen's Compensation is being disputed by the company

(iv) Provide ₹15,000 for the company's contribution to the staff provident fund

(v) Establishment includes ₹60,000 paid to the manager, who is entitled to remuneration at 5% of profit before such remuneration

(vi) Make a provision for Income Tax at 35%

(vii) Interest accrued on investments amounted to ₹27,500

(Net Profit: ₹13,57,067; Surplus: ₹9,25,547; Balance Sheet: ₹1,17,40,000)

7. The trail balance of M Ltd. for the year ended on 31 March 2017 was as follows:

Debit Balances	Amount (₹)	Credit Balances	Amount (₹)
Materials Used	3,50,000	Sales (including 5% sales tax)	9,45,000
Cost of Labour	1,50,000	Sale of Scrap	100
Stock of Finished Goods and work in progress on 31 March 2016	50,000	Rent Received	2,000
Wages: Factory Staff	15,000	Discounts	2,750
Managerial Remuneration	50,000	Recovered against fire claim regarding stock	5,000
Salaries: Clerical Staff	75,000	Equity Share Capital	25,000
Insurances: Workmen's Compensation	1,500	9% Preference Share Capital	8,000
General Insurances – Fire	2,000	Creditors	1,56,000
Executive's Insurance	1,500	Provision for Taxation	55,000
Maintenance:		Profit and Loss A/c	13,750
Building	1,000	General Reserve	50,000
Plant and Machinery	12,500		
Rent and Rates of premises and hire of plant	20,000		
Heat, Light and Power	15,000		
Experimental and Laboratory Expenses	10,000		
Canteen Expenses	5,000		
Staff Welfare Expenses	2,500		
Motor Expenses	12,500		
Professional Charges	2,800		
Postage and Telephones	3,500		
Books, Printing and Stationery	11,000		
Sundry Expenses	10,000		
Carriage and Packaging on Sales	3,300		
Discounts	5,000		

(*Contd.*)

Debit Balances	Amount (₹)	Credit Balances	Amount (₹)
Debtors	1,78,000		
Freehold Property	50,000		
Plant and Machinery	12,500		
Fixtures and Fittings – Offices	3,500		
Office Machinery and Equipment	3,000		
Motor Car and Van	6,500		
Stock of material at 31 March 2016	1,20,000		
Bank	38,000		
Sales Tax paid	42,000		

Additional Information:

(i) Depreciation is to be provided at the following rates on WDV: Plant and Machinery at 15%; Fixtures and Fittings at 10%; Office Machinery at 15%; Motor Car and Van at 20%

(ii) The stock of finished goods and work in progress as on 31 March 2017 was ₹35,000.

(iii) Provide for Preference Dividend and Equity Dividend at 10%.

(iv) Provision for CDT is also to be made at 16.2225%

(v) The total taxation liability is estimated as ₹86,000; of which, ₹44,000 relates to the current year.

(vi) Debtors include ₹10,000 deposited as security against government contracts.

(vii) The work manager is paid partly by salary and partly by a commission; he is entitled to a commission of 5% on the amount by which the surplus in the factory cost exceeds 20% of the sales for the period. Charge the commission, if any, in the profit and loss account.

(Net Profit: ₹81,439; Surplus: ₹1,04,647; Balance Sheet: ₹4,42,525)

5

8. Following balances were extracted from the books of Excellent Ltd. for the year ended 31 March 2016:

Particulars	(₹)
Buildings (Cost: ₹40,000)	30,000
Furniture (Cost: ₹1,000)	500
Motor Vehicles (Cost: ₹3,500)	3,000
Equity Shares of Companies (Market Value: ₹22,000)	20,000
500 Preference Shares of ₹10 each of companies (₹6 paid up)	3,000
Stock-in-trade at cost	20,000
Sundry Debtors	14,000
Cash at Bank	8,750
Share Capital	50,000
5% Mortgage Debenture	10,000
Provision for Taxation	10,000
Sundry Creditors	5,500

(*Contd.*)

Particulars	(₹)
Discount on Issue of Debentures	400
Profit and Loss A/c (Cr.)	1,000
Gross Profit	50,000
Dividend received on Investments (Gross: ₹1,000)	700
Salaries and Wages	10,000
Director's Fees	400
Interest on Debentures	500
Auditor's Fees (including ₹100 for Income Tax presentation)	650
Miscellaneous Trade Expenses	11,000
Advances against construction of building	5,000

Prepare the profit and loss account of the company for the year ended 31 March 2017 and the balance sheet in the form prescribed under the Companies Act, 1956, after taking into account the following additional information:

(i) Provide 10% depreciation p.a. on original cost of all fixed assets

(ii) The company had a contract for the construction of a building at ₹1,00,000, which is still incomplete

(iii) Provide for ₹10,000 as taxation liability for the year ending 31 March 2017

(iv) Write back ₹200 liability included in sundry creditors

(v) Due to change in the basis of valuation of stock, stock value comes down to ₹18,000. This has not been considered as yet

(vi) Debtors more than six months ₹4,000

(vii) Discount on issue of debentures is to be completely written off.

(Net Profit: ₹21,800; Surplus: ₹12,800; Balance Sheet: ₹98,100)

Model Test Paper-1

III Semester B.Com Examination
CORPORATE ACCOUNTING

[Time: 3 hours] **[Max Marks: 70]**

SECTION A

1. **Answer any five sub-questions. Each question carries 2 marks.** **($5 \times 2 = 10$)**

(i) Give the meaning of Complete Underwriting.
(ii) Distinguish between Pure and Firm Applications.
(iii) What is Sales Ratio?
(iv) How is Goodwill calculated under Weighted Average Method?
(v) Distinguish between Intrinsic Value and Market Value of Shares.
(vi) State the meaning of the term Net Assets.
(vii) What is a Profit and Loss Appropriation Account?

SECTION B

Answer any three questions. Each question carries 6 marks. **($3 \times 6 = 18$)**

2. ABC Ltd. issued 50,000 shares of ₹10 each, with a premium of 10%. Mr Sen underwrote 75% of the issue. The company receives application only for 60% of the issue; out of which, 20,000 were marked applications bearing the official stamp of Mr Sen. The commission as per the Underwriting Agreement was agreed at 5% of the issue price. Assess the Liability of Mr Sen, along with the commission payable to him.

(Net Liability of Mr Sen: ₹17,500; ABC Ltd.: 2,500;
Underwriting Commission: ₹1,875)

3. X Ltd was incorporated on 1 May 2016. It acquired a running business as from 1 January 2016. Information for the year ended 31 December 2016 is given as follows:

Particulars	(₹)	Particulars	(₹)
To Salaries	80,000	By Gross Profit	4,00,000
To General Expenses	20,000		
To Carriage on sales	30,000		
To Advertisement	40,000		
To Interest on Debentures	12,000		
To Director Fees	8,000		
To Audit Fees	10,000		
To Interest to Vendors (up to 30 June)	20,000		
To Depreciation	40,000		
To Net Profit	1,40,000		
Total	**4,00,000**		**4,00,000**

Sales up to 1 May 2016 were ₹4,00,000 and after 1 May 2016, the sales were ₹16,00,000. Prepare a Statement showing the profit prior to and after incorporation.

(Pre-incorporation Profit: ₹2,667; Post-incorporation Profit: ₹1,37,333)

4. From the following particulars relating to business of Mr X, compute the value of goodwill on the basis of three years' purchase of Super Profits, taking the average of four years. Capital invested is ₹60,000 and the market rate of interest on investment is 15%. Managerial remuneration of Proprietor, if employed elsewhere, would be ₹15,000 p.a. Trading results are as follows:

   2001: ₹30,000 (Profits)

   2002: ₹36,000 (Profits)

   2003: ₹4,000 (Loss)

   2004: ₹44,000 (Profits)

(Average Profits: ₹26,500; Normal Profits: ₹9,000;
Super Profits: ₹2,500; Goodwill: ₹7,500)

5. From the following particulars, calculate the value of an equity share under Yield Method:

(i)	2,500, 9% Preference Shares of ₹100 each:	₹2,50,000
(ii)	62,500 Equity Shares of ₹10 each, ₹8 per share paid up:	₹5,00,000
(iii)	Expected profits before tax:	₹2,72,500 rate of tax 40%
(iv)	Transfer to General Reserve:	20% of profit every year
(v)	Normal Rate of Earnings from this type of business:	15%

(Profit available to Equity Shareholders: ₹1,08,300;
Expected Rate of Return: 21.66%;
Value per Equity Share = ₹11.552 per share)

6. State the headings under which the following items will be shown in the balance sheet of a company.
   (i) Goodwill
   (ii) Patterns
   (iii) Book Debts
   (iv) Advances Paid
   (v) Work in Progress
   (vi) Security Deposit
   (vii) Loose Tools
   (viii) Advance Tax
   (ix) Discount on Issue of Shares
   (x) Fixed Deposit with Bank

((i) Fixed Assets (ii) Fixed Assets (iii) Current Assets (iv) Loans and Advances (v) Current Assets (vi) Fixed Assets (vii) Fixed Assets (viii) Loans and Advances (ix) Misc. Exp (x) Current Assets)

SECTION C

Answer any three questions. Each question carries 14 marks. **(3 × 14 = 42)**

7. Brigade Ltd. issued 1,00,000 equity shares of ₹10 each, at a premium of ₹5 per share. The entire issue was underwritten by four underwriters: P, Q, R and S in the ratio of 4:3:2:1 respectively. In addition to this, Firm Underwriting was 2,000, 2,000, 1,000 and 1,000, respectively for P, Q, R and S. The applications received by the company were 85,000; of which, marked forms were 20,000, 19,000, 16,000 and 10,000 respectively for P, Q, R and S.

   Calculate the liability for each of the underwriter, assuming:
   (i) Shares underwritten are treated as Unmarked Applications
   (ii) Shares underwritten are treated as Marked Application

   Also ascertain the commission payable to each of the underwriters. Liability of the underwriters when shares written are treated as unmarked applications.

((i) P: 9,429 shares; Q: 3,571 shares; R: 1,000 shares and S: 1,000 shares; (ii) P: 9,714 shares; Q: 3,286 shares; R: 1,000 shares and S: 1,000 shares; Commission payable to P: ₹15,000; Q: ₹11,250; R: ₹7,500 and S: ₹3,750)

8. Manohar Ltd. was incorporated on 1 May 2016 to take over the business of Sunder and Co. from 1 January 2016.
   (i) Gross Profit Ratio was constant throughout the year
   (ii) Sales for January and October were 1.5 times the average monthly sales, while sales for December were twice the average monthly sales
   (iii) Bad Debts are shown after adjusting a recovery of ₹7,000 of bad debts for a sale made in July 2010
   (iv) Manager's salary was increased by ₹2,000 p.m. from 1 May 2016
   (v) All investments were sold in April 2012.

The following figures were given by Manohar Ltd. for the year ending 31 December 2016:

Particulars	(₹)	Particulars	(₹)
To Rent and Taxes		By Gross Profit	10,64,000
To Salaries, including manager's salary of ₹85,000		By Interest on Investment	36,000
To Carriage Outward	14,000		
To Printing and Stationery	18,000		
To Interest on Debentures	25,000		
To Sales Commission	30,800		
To Bad Debts (related to sales)	91,000		
To Underwriting Commission	26,000		
To Preliminary Expenses	28,000		
To Audit Fees	45,000		
To Loss on Sale of Investments	11,200		
To Net Profit	3,90,000		
	11,00,000		**11,00,000**

Prepare a Statement of Profit and Loss, showing allocation of Pre-incorporation and Post-incorporation Profits, after considering the following information:

(Pre-incorporation Profit: ₹1,71,900; Post-incorporation Profit: ₹2,18,100)

9. On 31 December 2016, the balance sheet of a limited company disclosed the following position:

Liabilities	(₹)	Assets	(₹)
Share Capital	4,00,000	Fixed Assets	5,00,000
Reserves	90,000	Current Assets	2,00,000
Profit and 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 this date, the fixed assets were independently valued at ₹3,50,000 and the goodwill at ₹50,000. The net profits for the three years were given as: 2001: ₹51,600; 2002: ₹52,600; 2003: ₹51,650; of which, 20% was replaced to reserve. This proportion is 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:

(i) Net Assets Method

(ii) Yield Method

(Net Assets Method: ₹9.25 per share; Yield Method: ₹10.35 per share)

10. The following information is given:
    (i) Capital Employed: ₹75,000
    (ii) Normal Rate of Return: 10%
    (iii) Present Value of Annuity of ₹1 for 5 years at 10% = 3.78
    (iv) Net Profits for five years:
    2012: ₹7,200
    2013: ₹7,700
    2014: ₹8,450
    2015: ₹8,700
    2016: ₹8,950

    The profits included non-recurring profits on an average basis of ₹500; out of which, it was deemed that even non-recurring profits had a tendency of appearing at the rate of ₹600 per annum.

    You are required to calculate Goodwill:
    (a) As per Annuity Method
    (b) As per five years' Purchase of Super Profits Method
    (c) As per Capitalisation of Super Profit Method

(Average Profit: ₹8,000; Super Profits: ₹500;
Goodwill as per Annuity Method: ₹3,780;
Goodwill as per five years' purchase of Super Profits Method: ₹5,000;
Goodwill as per Capitalisation of Super Profit Method: ₹10,000)

11. Following is the trial balance of SK Ltd. as on 31 March 2016:

Debit Balances	(₹)	Credit Balances	(₹)
Opening Stock	75,000	Share Capital	2,50,000
Purchases	1,90,000	Purchase Return	5,000
Wages	30,000	Sales	5,75,000
Carriages	1,000	Discount	3,150
Furniture	12,500	Surplus Account	85,000
Salaries	6,000	Sundry Creditors	16,850
Rent	7,500	General Reserve	41,000
Trade Expenses	5,500	Bills Payable	6,500
Sundry Debtors	27,000	Provision for Doubtful Debts	1,500
Plant and Machinery	6,00,000		
Cash at Bank	10,750		
Patents	4,500		
Bills Receivable	7,000		
Bad Debts	3,250		
Discount Allowed	4,000		
	9,84,000		**9,84,000**

Additional Information

(i) Stock on 31 March 2015: ₹1,00,000

(ii) Depreciate Plant and Machinery at 12%, Furniture at 10% and Patents at 20%.

(iii) Bad Debts amounted to ₹2,000.

(iv) Provide 5% on debtors for Bad Debts

(v) Provide for Taxation at 35% and Corporate Dividend Tax at 14%

(vi) The Board of Directors recommended a Dividend of 25%.

Prepare a Statement of Profit and Loss for the year ended 31 March 2016 and a Balance Sheet as on that date.

(Net Profit: ₹1, 85,250; Balance Sheet Total: ₹6, 84,350)

Model Test Paper-2

III Semester B.Com Examination
CORPORATE ACCOUNTING

[Time: 3 hours] **[Max Marks: 70]**

SECTION A

1. Answer any five sub-questions. Each question carries 2 marks. **(5 × 2 = 10)**

(i) Who are Underwriters?
(ii) What are the conditions as to the payment of Underwriting Commission?
(iii) How do you treat loss prior to incorporation in the books of accounts?
(iv) State any two features of Goodwill.
(v) What is Super Profit?
(vi) State the methods of Valuation of Shares.
(vii) Give the meaning of Advance Payment of Tax.

SECTION B

Answer any three questions. Each question carries 6 marks. **(3 × 6 = 18)**

2. Sunshine Ltd. issued 4,00,000 equity shares of ₹10 each. The entire issue was underwritten by P, Q, R & S in the ratio of 4:3:2:1 respectively. Application received in all were 3,50,000 shares; of which, marked applications were as follows:

   P = 1,50,000; Q = 1,00,000; R = 30,000 & S = 20,000 shares. Calculate the Underwriters' Liability and the commission receivable by them.

   (Net Liability of R and S is 36,667 and 13,333, respectively)

3. A Co. Ltd. was incorporated on 1 August 2017 to take over the business of B Co. Ltd. as from 1 April 2017. The books of accounts were closed on 31 March 2018. With the help of the following details, prepare a Statement of Profit and Loss Account, showing profit prior to and after incorporation:

Particulars	(₹)	Particulars	(₹)
Salaries and Allowances	60,000	Gross Profit	2,00,000
Rent and Taxes	23,000		
General Expenses	7,200		
Director's Fees	3,000		
Selling Expenses	4,000		
Discount on Sales	1,000		
Advertisement	3,000		
Audit Fees	4,500		
Formation Expenses	1,800		
Miscellaneous Expenses	1,500		
Interest on Debentures	1,400		
Interest to Vendors (up to 30 September 2017)	6,000		
Repairs to Building	1,200		
Depreciation	2,400		
Net Profit	80,000		
	2,00,000		**2,00,000**

Other information:

(i) Rent was paid at 1,000 per month up to 1 August 2017 and thereafter, it was increased to ₹2,000 per month.

(ii) The average monthly sales for the first four months during the year was ₹60,000; whereas, the average monthly sales for the subsequent period was ₹70,000.

(Pre-incorporation Profit: ₹23,000; Post-incorporation Profit: ₹57,000)

4. From the following information, calculate the value of goodwill taking three years' purchase of Super Profit:
   (i) Average Capital Employed: ₹9,00,000
   (ii) Net Trading Profits for the preceding three years were: ₹1,61,400; ₹1,36,050; and ₹1,68,750.
   (iii) Expected Return on Capital invested in the same type of business is 12%
   (iv) Fair Remuneration to the proprietor for his service is ₹18,000
   (v) Total Assets: ₹9,84,000 and Current Liabilities: ₹45,000

(Super Profit: ₹29,400; Goodwill: ₹88,200)

5. The balance sheet of ABC Ltd. is given below. Assuming that the value of goodwill will be ₹86,250 and realisable value of fixed assets to be ₹6,03,750, compute the value of shares by Asset Valuation Method:

Liabilities	(₹)	Assets	(₹)
Share Capital	6,90,000	Fixed Assets	8,62,500
Reserves	1,55,250	Current Assets	3,45,000
Profit and Loss A/c	34,500	Goodwill	69,000
10% Debentures	1,72,500		
Creditors	2,24,250		
	12,76,500		**12,76,500**

(Value of Equity Share: ₹9.25 per share)

6. State the headings under which the following items will be shown in the balance sheet of a company.
   (i) Discount on Issue of Shares
   (ii) Livestock
   (iii) Discount Earned
   (iv) Accrued Interest on Investment
   (v) Goodwill Written Off
   (vi) Patents and Trademarks
   (vii) Work in Progress
   (viii) Goodwill

((i) Misc. Exp. (ii) Current Assets (iii) P/L A/c Cr. (iv) P/L A/c Cr. (v) P/L A/C Dr. (vi) Fixed Assets (vii) Current Assets (viii) Fixed Assets)

SECTION C

Answer any three questions. Each question carries 14 marks. **($3 \times 14 = 42$)**

7. Primax Ltd. issued 2,00,000 equity shares of ₹10 each, at a premium of ₹2 per share. The entire issue was underwritten in the ratio of 3:2:3:2 respectively, by A, B, C and D along with Firm Underwriting of ₹7,000, ₹5,000, ₹6,000 and ₹4,000, respectively, for A, B, C and D. They are entitled to a commission as per the guidelines of SEBI and the law in force.

   The company received applications for 1,65,000 shares exclusive of Firm Underwriting; out of which, marked forms were, 50,000, 51,000, 36,000 and 15,000 respectively in favour of A, B, C and D.

   Ascertain the liability of each underwriter with the following assumptions:
   (i) Firm Underwriting as Marked Applications
   (ii) Firm Underwriting as Unmarked Applications

   Also, calculate Underwriting Commission payable to all the underwriters.

((i) A: 7,000 shares; B: 5,000 shares; C: 8,400 shares and D: 14,600 shares; (ii) A: 7,000 shares; B: 5,000 shares; C: 8,400 shares and D: 14,600 shares; Commission Payable to A: ₹18,000; B: ₹12,000; C: ₹18,000 and D: ₹12,000)

8. XYZ Ltd. was incorporated on 1 May 2017 to take over the business of ABC and Co. from 1 January 2017. Figures as given by XYZ Ltd. for the year ending 31 December 2017 are as under:

Particulars	(₹)	Particulars	(₹)
Rent and Taxes	90,000	Gross Profit	10,64,000
Salaries including Manager's Salary of ₹85,000	3,31,000	Interest on Investments	36,000
Carriage Outward	14,000		
Printing and Stationery	18,000		
Interest on Debentures	25,000		
Sales Commission	30,800		

(*Contd.*)

Particulars	(₹)	Particulars	(₹)
Bad Debts (related to sales)	91,000		
Underwriting Commission	26,000		
Preliminary Expenses	28,000		
Audit Fees	45,000		
Loss on Sale on Investments	11,200		
Net Profit	3,90,000		
	11,00,000		**11,00,000**

Prepare a Statement of Profit and Loss Account showing allocation of Pre-incorporation and Post-incorporation Profits, after considering the following information:

(i) All investments were sold in April 2017

(ii) Manager's salary increased by ₹2,000 from 1 May 2017

(iii) Bad debts are shown after adjusting a recovery of ₹7,000 of bad debt for a sale made in July 2015.

(iv) Sales for January and October were 1.5 times the average monthly sales, while sales for December were twice the average monthly sales.

(v) Gross Profit Ratio was constant throughout the year.

(Pre-incorporation Profit: ₹1,71,900; Post-incorporation Profit: ₹2,18,100)

9. The balance sheet of Zebra Ltd. is given as follows:

Liabilities	(₹)	Assets	(₹)
12,000 Equity Shares of ₹100 each	12,00,000	Goodwill	9,00,000
6,000, 8% Preference Shares of ₹100 each	6,00,000	Plant and Machinery	15,00,000
Debentures	18,00,000	Stock	21,00,000
General Reserve	9,00,000	Debtors	12,60,000
Creditors	13,50,000	Cash at Bank	4,05,000
Profit and Loss Account	3,15,000		
	61,65,000		**61,65,000**

The market value of plant and machinery at the date on which the above balance sheet was drawn was ₹14,10,000; ₹6,75,000 is the appropriate amount to be attached to goodwill.

Find the value per share under the following conditions:

(i) If the preference shares are preferential both to capital as well as to dividend, and normal rate on them is estimated to be 8%.

(ii) If the preference shares are preferential both to capital; and dividends and normal rate on them is estimated to be 5%

(iii) If the preference shares and equity shares are to be treated at par in liquidation.

((i) Value of Equity Shares: ₹100 and Value of Preference Shares: ₹175

(ii) Value of Equity Shares: ₹160 and Value of Preference Shares: ₹145

(iii) Value of Equity Shares: ₹150 and Value of Preference Shares: ₹150)

10. The balance sheet of Dheeraj Enterprises discloses the following financial positions as on 31 March 2017:

Liabilities	(₹)	Assets	(₹)
30,000 shares of ₹10 each, fully paid	3,00,000	Goodwill	30,000
Capital Reserve	60,000	Buildings	1,75,000
Sundry Creditors	71,000	Plant and Machinery	90,000
Provision for Taxation	55,000	Stock	1,15,000
Profit and Loss Account	26,000	Book Debts less Provision	95,000
		Cash at Bank	7,000
	5,12,000		**5,12,000**

Ascertain the value of goodwill with the help of the following information:

(i) Provision for tax and depreciation has been made adequately in the books of accounts.

(ii) Income tax rate can be taken at 50%

(iii) The rate (average) of dividend declared by the company for the past five years was 15%.

(iv) The reasonable return on capital invested in the class of business done by the company is 12%.

(Goodwill: ₹56,640)

11. Following is the trial balance of XYZ Ltd., as on 31 March 2013

Particulars	Dr. (₹)	Cr. (₹)
Stock as on 01 April 2012	2,08,000	-
Sales	-	21,60,000
Excise Duty	40,000	-
Purchases	17,00,000	-
Wages	3,00,000	-
Discount	74,960	40,000
Furniture	4,00,000	-
Salary	1,48,000	-
Rent	37,800	-
Sundry Expenses	20,280	-
Profit and Loss A/c as on 01 April 2012	-	2,04,240
Goodwill	2,60,000	-
Share Capital	-	10,00,000
Debtors and Creditors	2,94,000	2,86,000
Machinery	3,68,000	-
Cash at Bank	1,05,200	-
Reserve Fund	-	2,06,000
Patents	1,20,000	-
10% Debentures	-	2,00,000
Interest on Debentures	20,000	-
	40,96,240	**40,96,240**

Additional Information:

(i) Closing Stock as on 31 March 2013: ₹8,80,000
(ii) Depreciate Furniture at 10% and Machinery at 15%
(iii) Write off ₹60,000 from Goodwill and ₹20,000 from Patents
(iv) Provision for Taxation: 30%
(v) Proposed Dividend: 15%
(vi) Corporate Dividend Tax: 16.225%

(Net Profit: ₹32,694; Balance Sheet: ₹16,42,934)

Bangalore University Question Paper Nov/Dec 2015

III Semester B.Com Examination Nov/Dec 2015
CORPORATE ACCOUNTING

[Time: 3 hours] **[Max Marks: 70]**

SECTION A

1. **Answer any five sub-questions. Each question carries 2 marks.** **(5 × 2 = 10)**

(i) State any two advantages of Underwriting.

(Refer: Page 1.4)

(ii) What ratios are normally used to apportion Pre- and Post-incorporation Incomes and Expenses?

(Refer: Page 2.3)

(iii) How do you treat loss prior to incorporation in the books of accounts?

(Refer: Page 2.3)

(iv) Closing Capital Employed: ₹12,00,000

Net Profit for the current year: ₹2,40,000

What is Average Capital Employed?

(Average Capital Employed = 12,00,000 – (1/2 of 2,40,000) = ₹10,80,000)

(v) Fixed Assets: ₹10,00,000; Current Assets: ₹8,00,000; Arrears of Preference Dividend: ₹40,000; 5% Preference Share Capital: ₹4,00,000; Current Liabilities: ₹3,00,000; 6% Debentures: ₹2,00,000. Calculate Net Assets available to equity shareholders.

Working: (Total Assets = 18,00,000; Total Liabilities = 5,00,000; Assets available to shareholders = (TA-TL = 13,00,000); Assets available to shareholders – Preference Share Capital and Arrears Preference Dividend = 13,00,000 – 4,40,000 = 8,60,000)

(Net Assets available to Equity Shareholders = ₹8,60,000)

(vi) What is meant by Calls in Arrears?

(Refer: Page 5.5)

(vii) What is meant by Unclaimed Dividend? Where do you show the same in the company's balance sheet?

(Refer: Page 5.5)

SECTION B

Answer any three questions. Each question carries 6 marks. **(3 × 6 = 18)**

2. A company issued 1,00,000 shares of ₹10 each. The whole issue was fully underwritten by A, B, C and D as follows: A: 40,000; B: 30,000; C: 10,000 and D: 20,000. The company received applications for 90,000 shares, of which, marked applications were as follows: A: 44,000; B: 22,000; C: 2,000 and D: 18,000. Determine the liability of each underwriter.

(Refer: Illustration 20 Page 1.30)

3. Saurabh has invested a sum of ₹6,00, 000 in his own business, which is very profitable one. The annual profit earned from his business is 1, 20,000, which included a sum of ₹20,000 received as compensation for acquisition of part of his business. The money could have been invested in deposits for a period of 5 years at 10% interest and he could earn ₹14,400 per annum in alternative employment, considering 2% as fair compensation for the risk involved in the business. Calculate the Value of Goodwill of his business on Capitalisation of Super Profits at Normal Rate of Return of 12%.

(Refer: Illustration 20 Page 3.40)

4. Following information relates to Preethi Ltd.:

8,000, 10% Preference Shares of ₹100 each:	₹8,00,000
10,000 Equity Shares of ₹100 each:	₹10,00,000
Average Profit before Tax:	₹6,45,160
Rate of Tax:	38%
Transfer to be made to Reserve:	20%
Normal Rate or Return:	15%

Ascertain the value of equity shares under Yield Method.

(Refer: Illustration 20 Page 4.31)

5. Nanda Ltd. had purchased a business on 1 April 2015. The company received its Certificate of Incorporation on 1 September 2015. The average monthly sale for the period before incorporation was 25% more than the average monthly sale for the period after incorporation. The total sales during the year were ₹13,25,000.

Ascertain:
(i) Time Ratio
(ii) Sales Ratio
(iii) Pre and Post-incorporation Sales **(Refer: Illustration 5 Page 2.7)**

6. Under what notes (heading) do you show the following items in the balance sheet of a company:

	Answers
(i) Provision for Taxation	Short-term Provisions
(ii) Live Stock	Tangible Assets
(iii) Work in Progress	Inventories
(iv) Bills Payable	Trade Payables
(v) Patterns	Intangible Assets

		Answers
(vi)	Accrued Interest on Investments	Other Current Assets
(vii)	Goodwill	Intangible Assets
(viii)	Fixed Deposit from Public	Short-term Borrowing
(ix)	Share Premium	Reserves and Surplus
(x)	Discount on Issue of Debentures	Other Current Assets
(xi)	Bank Overdraft	Trade Payables
(xii)	Proposed Dividend	Short-term Provisions

SECTION C

Answer any three questions. Each question carries 14 marks. **(3 × 14 = 42)**

7. Raj Ltd. invited applications from the public for 2,50,000 shares of ₹10 each, at a premium of ₹5 per share.

   The entire issue was underwritten by underwriters A, B, C and D to the extent of 30%, 20%, 20% and 20% respectively, with the provision of Firm Underwriting of 7,500 shares, 2,500 shares, 5,000 shares and 2,500 shares respectively. The company received applications for 1,75,000 shares, excluding Firm Underwriting; out of which, marked applications were as follows:

   A: 47,000 shares; B: 52,500 shares; C: 25,000 shares and D: 20,000 shares

   Prepare a Statement showing Net Liability of underwriters, treating
   (i) Firm Underwriting as Marked Applications
   (ii) Firm Underwriting as Unmarked Applications

   (Refer: Illustration 22 Page 1.33)

8. The following is the balance sheet of Sharath Ltd., as on 31 December 2014:

Liabilities	(₹)	Assets	(₹)
10,000 Equity Shares of ₹20 each, fully paid	2,00,000	Land and Building	1,68,000
Profit and Loss A/c	40,000	Plant and Machinery	1,20,000
Debentures	30,000	Furniture	10,000
Trade Creditors	40,000	5% Tax-free Government Bonds	20,000
Provision for Tax	18,000	Stock	24,000
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:

   2010: ₹34,000; 2011: ₹38,000; 2012: ₹36,000; 2013: ₹40,000; 2014: ₹38,000.

   On 31 December 2014, Land and Building were re-valued at ₹1,90,000, Plant and Machinery at ₹1,42,000, and Furniture at ₹8,000. 10% represents a fair commercial rate of return on investment in the company. Find the Value of Goodwill.

(i) Five years' purchase of average super profits for the last five years
(ii) Capitalisation of Super Profit Method
(iii) Annuity Method, present value of an annuity of ₹1 for 5 years at 10% is ₹3.78.

(Refer: Illustration 27 Page 3.51)

9. On 31 March 2015, the balance sheet of Sadhana Ltd. was as follows:

Liabilities	(₹)	Assets	(₹)
Share Capital: 5000 Shares of ₹100 each	5,00,000	Land and Building	2,20,000
Profit and Loss Account	1,03,000	Plant and Machinery	95,000
Bank Overdraft	20,000	Stock	3,50,000
Creditors	77,000	Debtors	1,55,000
Provision for Tax	45,000		
Proposed Dividend	75,000		
	8,20,000		**8,20,000**

The five years' Net Profit of the company, after deducting all working charges and providing for depreciation and taxation, are given as follows:

2011: 85,000; 2012: 96,000; 2013: 90,000; 2014: 1,00,000; 2015: 95,000

On 3 March 2015, Land and Building was re-valued at ₹2,50,000, Plant and Machinery at ₹1,50,000 and Goodwill at ₹1, 50,000. The normal rate of return is 10%. You are required to ascertain the value of equity under:

(i) Intrinsic Value Method
(ii) Yield Value Method
(iii) Fair Value Method **(Refer: Illustration 26 Page 4.41)**

10. Anirudha Ltd. took over the business of Shankar on 1 April 2014 and it was incorporated on 1 July 2014. The Profit and Loss Account of Anirudha Ltd., on 31 March 2014 was as follows:

Particulars	(₹)	Particulars	(₹)
To Commission (Sales)	2,625	By Gross Profit	98,000
To Advertising	5,250	By Bad Debts Recovered	500
To Managing Director's Remuneration	9,000		
To Depreciation	2,800		
To Salaries	18,000		
To Insurance	600		
To Preliminary Expenses written off	700		
To Rent and Taxes	3,000		
To Discount	350		
To Bad Debts	1,250		
To Net Profit	54,925		
	98,500		**98,500**

Further Details:

i. The average monthly sales after incorporation were twice the average monthly sales before.
ii. Rent, which was paid for the first 3 months at ₹200 per month, increased by ₹50 per month for the balance of the period.
iii. Bad debts of ₹350 related only to the period after 1 September 2014 and the balance related to the sales made up to 1 September 2014.
iv. The bad debts realised belong to the bad debts, which were written off during 2013-14.

Find out the profits before and after incorporation.

(Refer: Illustration 22 Page 2.36)

11. The following trial balance has been extracted from the books of Subhash Ltd., as on 31 March 2015. You are required to prepare the financial statements:

Debit Balances	(₹)	Credit Balances	(₹)
Land and Building (Original Cost: 3,00,000)	1,40,000	Share Capital	2,00,000
Furniture (Original Cost: ₹15,000)	8,000	General Reserve	30,000
Plant and Machinery (Original Cost: ₹2,00,000)	1,00,000	8% Debentures	1,00,000
Investments	6,000	Bank Overdraft	1,500
Preliminary Expenses	4,000	Sundry Creditors	10,000
Advance Income Tax	8,000	Securities Premium	6,000
Printing and Stationery	1,200	Gross Profit	1,14,000
Stock on hand on 31 March 2015	1,28,000	Sinking Fund	40,000
Salaries	8,000	Profit and Loss Account (1 April 2014)	8,500
Debtors	70,000		
Cash on hand	2,000		
Cash at Bank	24,000		
Interest	2,000		
Debenture Interest	4,000		
Directors Fees	2,000		
Rent Rates and Insurance	2,800		
	5,10,000		**5,10,000**

Adjustments:

(i) Provide Depreciation on:
  a. Land and Building at 5% on straight-line basis
  b. Furniture, and Plant and Machinery at 20% on reducing balance basis

(ii) Provide ₹5,000 for Bad Debts

(iii) Provide the Audit Fees: ₹2,500; Provision for Income Tax: ₹14,000; and Debenture Interest for ₹6,000
(iv) Insurance Prepaid: ₹800
(v) Write off half of the Preliminary Expenses
(vi) Directors have recommended:
  a. Transfer of ₹10,000 to Sinking Fund
  b. Transfer of ₹4,000 to General Reserve
  c. Equity Dividend at 8% on Paid-up Capital

(Refer: Illustration 2 Page 5.22)

Bangalore University Question Paper Nov/Dec 2016

III Semester B.Com Examination Nov/Dec 2016
CORPORATE ACCOUNTING

[Time: 3 hours] **[Max Marks: 70]**

SECTION A

1. **Answer any five sub-questions. Each question carries 2 marks.** **(5 × 2 = 10)**

(i) Give the meaning of Firm Underwriting.

(Refer: Page 1.7)

(ii) Distinguish between Marked and Unmarked Applications.

(Refer: Page 1.8)

(iii) What is Profit Prior to Incorporation?

(Refer: Page 2.2)

(iv) What is Corporate Dividend Tax?

(Refer: Page 5.11)

(v) How do you treat Advance Tax Paid in company final accounts?

(Refer: Page 5.10)

(vi) Why do shares need to be valued?

(Refer: Page 3.5)

(vii) State any two features of Goodwill.

(Refer: Page 3.4)

SECTION B

Answer any three questions. Each question carries 6 marks. **(3 × 6 = 18)**

2. A company issued 50,000 shares. These shares were underwritten as follows:
X: 10,000 shares
Y: 15,000 shares
Z: 5,000 shares.

In addition, there was a Firm Underwriting as follows:

X: 5000 shares

Y: 2000 shares

Z: 1000 shares

The total subscription was for 40,000 shares and the firms included the following marked forms:

X: 10000 shares

Y: 10000 shares

Z: 5000 shares

Determine the total liability of underwriters and the company.

(Refer: Illustration 26 Page 1.38)

3. A company was incorporated on 1 April 2016 to take over the business of a firm as from 1 January 2016. All profits made from this earlier period were to the benefit of the company but interest on the purchase price of ₹5,00,000 is to be paid at 6% p.a. to the vendor up to 1 June 2016. The following was the Profit and Loss Account for the year ended 31 December 2016.

Profit and Loss Account for the year ended 31 December 2016

Particulars	₹	Particulars	₹
To Management Expenses	30,000	By Gross Profit (Operating Profit)	2,00,000
To Bad Debts	2,500		
To Director's Fees	10,000		
To Interest to Vendor	12,500		
To Preliminary Expenses	5,000		
To Depreciation	10,000		
To Net Profit	1,30,000		
	2,00,000		**2,00,000**

Out of bad debts written off, ₹1,000 related to the period prior to incorporation and the balance relating to the Post-incorporation Period. Prepare Profit and Loss Account and apportion the profit between Prior and Post-incorporation Periods, assuming that the sales were spread evenly over the entire period.

(Refer: Illustration 24 Page 2.41)

4. X Limited agreed to purchase the business of a sole trader and for that purpose, goodwill is to be valued at three years' purchase of the average of previous four years' adjusted profit. The profits for the years ending 31 March 2013; 2014; 2015 and 2016 were as follows: ₹40,000; ₹48,000; ₹50,000 and ₹60,000 respectively.

   Following additional information is available:

   (i) On 01 January 2015, major repair expenditure to Plant and Machinery for ₹12,000 were charged to Profit and Loss account. This was agreed to be capitalised for goodwill, subject to 10% per annum depreciation on Reducing Balance Method.

(ii) The closing stock for the year ending 2014 was overvalued by ₹4,800.

(iii) In order to recover cost of management, an annual charge of ₹9,600 should be made for valuation of goodwill.

Compute the Value of Goodwill. **(Refer: Illustration 28 Page 3.53)**

5. Following is the balance sheet of a limited company as on 31 March 2016. Calculate the value of the equity share under Net Assets Method, after taking the following data into consideration.
   (i) Debenture Interest is due for two years.
   (ii) Current assets include book debts; of which, ₹10,000 were bad but no provision has been made in this regard.
   (iii) There was an outstanding liability of ₹8,000.

Balance Sheet as on 31 March 2016

Liabilities	(₹)	Assets	(₹)
10,000, 8% Preference Shares of ₹10 each	1,00,000	Fixed Assets	4,00,000
30,000 Equity Shares of ₹10 each	3,00,000	Preliminary Expenses	20,000
Debenture Redemption Fund	50,000	Discount on Debentures	5,000
6% Debentures	1,00,000	Current Assets	2,50,000
Depreciation Fund	1,00,000	Profit and Loss Account	25,000
Current Liabilities	50,000		
	7,00,000		**7,00,000**

(Refer: Illustration 21 Page 4.32)

6. State the headings under which the following items will be shown in the balance sheet of a company.
   (i) Preliminary Expenses
   (ii) Discount on Issue of Shares
   (iii) Forfeited Share Capital
   (iv) Goodwill
   (v) Bank Overdraft
   (vi) Provision for Taxation

(Refer: Illustration 1 Page 5.13)

SECTION C

Answer any three questions. Each question carries 14 marks. **(3 × 14 = 42)**

7. A limited company issued 1,00,000 equity shares of ₹100 each. M, N, O and P underwrite the entire issue in the proportion of 30%, 30%, 20% and 20% respectively in consideration of commission in cash at 4%. They also apply for Firm Share Application in the following manner: M: 3000 shares
   N: 2000 shares
   O: 2000 shares and
   P: 3000 shares

Beside, in the firm applications, the public apply for 60,000 shares; of which, marked applications are follows: M: 10000 shares; N: 6000 shares; O: 8000 shares and P: 16000 shares. Show the number of shares to be taken up by each of the underwriters, assuming Firm Applications as Marked and Unmarked and the commission payable to underwriters under each case.

(Refer: Illustration 27 Page 1.39)

8. G Limited took over the business of H Limited on 01 April 2015 and it was incorporated on 01 July 2015.

   The Profit and Loss Account of G limited on 31 March 2016 was as follows:

   (i) The average monthly sales after incorporation were twice the average monthly sales before.

   (ii) Rent, which was paid for the first three months at the rate of ₹2,000 per month, was increased by ₹500 per month for the balance of the period.

   (iii) Bad Debts of ₹3,500 related to the period after 01 September 2015 and the balance related to the sales made up to 01 September 2015.

   (iv) The bad debts recovered belonged to the bad debts, which were written off in 2014.

   Find out the profits before and after incorporation of the company.

Profit and Loss Account for the year ended 31 March 2016

Particulars	(₹)	Particulars	(₹)
To Commission on Sales	26,250	By Gross Profit (Operating Profit)	9,80,000
To Advertising	52,500	By Bad Debts Recovered	5,000
To MD's Remuneration	90,000		
To Depreciation	28,000		
To Salaries	1,80,000		
To Insurance	6,000		
To Preliminary Expenses	7,000		
To Rent and Taxes	30,000		
To Discount	3,500		
To Bad Debts	12,500		
To Net Profit	5,49,250		
	9,85,000		**9,85,000**

(Refer: Illustration 13 Page 2.16)

9. The balance sheet of Venu is as follows on 31 December 2002:

Liabilities	(₹)	Assets	(₹)
Share Capital: Equity Shares of ₹10 each	5,00,000	Fixed Assets	4,00,000
General Reserves	2,00,000	Investment (6% Govt. Bonds)	1,00,000
Profit and Loss Account	1,00,000	Current Assets	4,00,000
Current Liabilities	1,00,000		
Total	**9,00,000**	**Total**	**9,00,000**

Net Profit after Taxation is as follows:

2000: 1,30,000

2001: 1,25,000

2002: 1,50,000

The normal rate of return is 15%. The current assets are to be taken as ₹4,20,000. Ascertain the goodwill under:

(i) Four years' purchase of Super Profits
(ii) Capitalisation of Super Profits
(iii) Annuity of Super Profits taking the present value of an annuity of ₹1 for five years at 10% interest as ₹3.78

(Refer: Illustration 21 Page 3.41)

10. Following is the summarised balance sheet of Adarsh Ltd. as on 31 March 2016

Balance Sheet as on 31 March 2016

Liabilities	(₹)	Assets	(₹)
Share Capital		Goodwill	1,00,000
40,000 Shares of ₹10 each	4,00,000	Fixed Assets	4,50,000
Reserve Fund	1,00,000	Current Assets	1,90,000
Profit and Loss A/c	35,000	Preliminary Expenses	25,000
9% Debentures	1,00,000		
Current Liabilities	1,30,000		
	7,65,000		**7,65,000**

For the purpose of valuation of shares, fixed assets were valued at ₹5,00,000 and goodwill at ₹1,50,000. There is a necessity of RBD at 10% on debtors of ₹75,000. It is found that stock was overvalued by ₹9,000.

The net profit for three years was ₹69,000, ₹71,800 and ₹90,200, respectively, after taxation. Out of this profit, 20% was placed to reserve, the proportion being considered reasonable in the industry in which the company is engaged and where the normal rate of return is 10%.

Compute the value of equity shares by Net Assets Method and Yield Method and also calculate the fair value of shares.

(Refer: Illustration 29 Page 4.47)

11. The following ledger balances are extracted from the books of a trading company limited for the year ended 31 March 2016. You are required to prepare company final accounts in the vertical format.

Particulars	Debit	Credit
Equity Share Capital	-	2,00,000
Gross Profit (Revenue Profit)	-	2,00,000
General Reserve	-	30,000
Buildings (Original Cost: ₹2,00,000)	1,20,000	-
10% Debenture	-	1,00,000
Plant and Machinery	2,00,000	-
Rent, Rates and Insurance	20,000	-
Advertising	10,000	-
Salary	20,000	-
Director's Fees	10,000	-
General Expenses	10,000	-
Profit and Loss A/c	-	50,000
Printing and Stationery	10,000	-
Preliminary Expenses	20,000	-
Goodwill	20,000	-
Cash and Bank Balances	30,000	-
Debtors and Creditors	80,000	20,000
Investment	50,000	-
Total	**6,00,000**	**6,00,000**

Additional Details:

(i) Provide for bad debts: ₹5,000

(ii) Debenture Interest is outstanding for the whole year

(iii) Provide for Income Tax: ₹15,000

(iv) Outstanding Salary: ₹2,000; and Prepaid Insurance: ₹1,000

(v) Depreciate Building by 10% on Original Cost, and Plant and Machinery by 10% on reducing balance

(vi) The directors propose 15% dividend to equity shareholders. Ignore Corporate Dividend Tax.

(vii) Write off preliminary expenses by 25% and goodwill by 20%.

Note: Write note to accounts wherever necessary.

(Refer: Illustration 1 Page 5.18)

Bangalore University Question Paper Nov/Dec 2017

III Semester B.Com Examination Nov/Dec 2017
CORPORATE ACCOUNTING

[Time: 3 hours] **[Max Marks: 70]**

SECTION A

1. **Answer any five sub-questions. Each question carries 2 marks.** **(5 × 2 = 10)**

   i. Who is an Underwriter?

   (Refer: Page 1.2)

   ii. What is Sales Ratio? Give an example.

   (Refer: Page 2.4)

   iii. State any four factors affecting Goodwill.

   (Refer: Page 3.6)

   iv. How do you ascertain Intrinsic Value of Shares?

   (Refer: Page 4.3)

   v. Distinguish between Interim Dividend and Final Dividend.

   (Refer: Page 5.11)

   vi. What is Contingent Liability? Give an example.

   (Refer: Page 5.6)

   vii. Given that the Closing Capital Employed is ₹7,50,000 and the Net Profit for the current year is ₹2,80,000, what is the Average Capital Employed?

   SOLUTION

   Average capital employed = Closing capital employed – ½ of current year's profit
   Average capital employed = 7, 50,000 – ½ of 2,80,000 = ₹6,10,000

SECTION B

Answer any three questions. Each question carries 6 marks. **($3 \times 6 = 18$)**

2. ABC Ltd. issued 1,00,000 shares of ₹10 each. These shares are underwritten as follows:
   P: 50,000 shares
   Q: 30,000 shares
   The public applied for 80,000 shares, which included marked applications, as follows:
   P: 12,000 shares and
   Q: 4,000 shares
   You are required to determine the liability of the underwriters.

SOLUTION

Statement Showing Liability of Underwriters

Particulars	P (Shares)	Q (Shares)	ABC Ltd. (Shares)
Gross Liability	50,000	30,000	20,000
Less: Unmarked Applications (80,000- 16,000 Marked Applications)	-	-	64,000
Balance	50,000	30,000	-44,000
Less: Credit of Surplus of company given to P and Q in the ratio of 5:3 ($44,000 \times 5 \div 8$ and $44,000 \times 3 \div 8$)	27,500	16,500	+44,000
Balance	22,500	13,500	-
Less: Marked Applications	12,000	4,000	-
Net Liability	**10,500**	**9,500**	**NIL**

3. A limited company was registered on 01 January 2016 to buy the business of Govind Bros. from 01 October 2015.
   The accounts of the company for the period ended 30 September 2016 disclosed a Gross Profit of ₹95,820 and the following expenses were incurred:
   (i) Salary: ₹15,000 (there were 4 workers in the Pre-incorporation Period and 7 in the Post-incorporation Period)
   (ii) Wages: ₹5,280 (there were 4 workers in the Pre-incorporation Period, at ₹80 per month per worker, and 5 workers in the Post-incorporation Period, at ₹100 per month per worker)
   (iii) Director's Fees: ₹8,000
   (iv) Sales: ₹2,40,000; of which, ₹40,000 related to Pre-incorporation Period
   You are required to prepare a Statement of Profit and Loss, showing the apportionment between Pre and Post-incorporation Periods.

SOLUTION

Profit Before and After Incorporation

Particulars	Basis of Allocation	Pre (₹) Incorporation	Post (₹) Incorporation	Total
Revenue from operations	Sales (1:5)	15,970	79,850	95,820
Other Income	-	-	-	
Total Revenue (A)		**15,970**	**79,850**	**95,820**
Expenses: Employee benefit expenses: Salaries (WN 3) Wages (WN 2)	 Actual Actual	 2,400 960	 12,600 4,500	 15,000 5,280
Other expenses: Director's fees	Post-Inc	-	8,000	8,000
Total Expenses (B)		**3,360**	**25,100**	**28,280**
Net Profit (A – B)		**-**	**54,750**	
Capital Profits (A – B)		**12,610**	-	

Working notes:

(1) *Calculation of Time Ratio and Sales Ratio*
Pre-incorporation period (October 2015 to December 2015) = 3 months
Post-incorporation period (January 2016 to September 2016) = 9 months
Time Ratio = **3:9 or 1:3**
Sales prior to incorporation = ₹40,000
Sales post-incorporation = ₹2,00,000
Sales ratio = **1:5**

(2) *Wages of Factory Staff*
Wages before incorporation:
Pre-incorporation period × Number of factory staff × Rate
$3 \times 4 \times 80 =$ **₹960**
Wages after incorporation:
Post-incorporation period × Number of factory staff × Rate
$9 \times 5 \times 100 =$ **₹4,500**

(3) *Salaries of Office Staff*
Simple time ratio = 1:3
Weighted time ratio = (1 × 4 office staff):(3 × 7 office staff)
= **4:21**
Salaries before incorporation: ₹15,000 × 4 ÷ 25 = **₹2,400**
Salaries after incorporation: ₹15,000 × 21 ÷ 25 = **₹12,600**

4. The Net Profits of a business for the past five years are ₹80,000, ₹84,000, ₹90,000, ₹94,000 and ₹92,000 respectively. The capital employed in the business is ₹8,00,000. Normal rate of

return expected is 10% of the average capital employed. It is expected that the company will be able to maintain its Super Profits for the next five years. Calculate Goodwill on the basis of:
(i) Five years' purchase of Super Profits
(ii) Annuity of Super Profits (p.v. of annuity of one rupee for five years at 10% is ₹3.78)

SOLUTION

I. Super Profit Method

Step 1: *Calculation of Adjusted Average Profits/Future Maintainable Profits*

Simple Average Profits = 80,000 + 84,000 + 90,000 + 94,000 + 92,000 ÷ 5
= 4,40,000 ÷ 5
= ₹88,000

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Average Capital Employed (given) = ₹8,00,000

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 8,00,000 × 10%
= ₹80,000

Step 4: *Calculation of Super Profits*

Adjusted Average profits (Step 1)	88,000
Less: Normal Profit (Step 3)	(80,000)
Super Profit	**8,000**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 8,000 × 5
= ₹40,000

II. Annuity Method

Goodwill as per Annuity Method = Super Profit × Annuity Value
= 8,000 × 3.78
= ₹30,240

5. Following are the particulars of Anurag Co. Ltd.

Particulars	(₹)
Fixed Assets	8,00,000
Current Assets	5,00,000
50,000 Equity Shares of ₹10 each	5,00,000
5000, 8% Preference Shares of ₹100 each	5,00,000
Bank Overdraft	40,000
6% Debentures	2,00,000
Other Current Liabilities	60,000
Goodwill	1,00,000

The market value of fixed assets is 12% more than the book value and that of current assets is 5% less than the book value. There is an unrecorded liability of ₹5,000. Determine the Intrinsic Value of Equity Shares.

SOLUTION

Computation of Value of Shares by Net Asset Method

Step 1: *Ascertainment of Net Assets/Intrinsic Value of Shares*

Particulars	(₹)	(₹)
Fixed Assets: 8,00,000 × 112 ÷ 100	8,96,000	
Current Assets: 5,00,000 × 95 ÷ 100	4,75,000	
Goodwill	1,00,000	
Gross Total Assets		**14,71,000**
Less: External Liabilities		
Bank Overdraft	40,000	
6% Debentures	2,00,000	
Other Current Liabilities 60,000		
Add: Unrecorded Liability 5,000	65,000	**3,05,000**
Net Assets or Intrinsic Value of Shares		**11,66,000**

Step 2: *Intrinsic Value per Equity Share*

$$\text{Intrinsic Value per Equity Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares and Preference Shares}}$$

$$= \frac{11,66,000}{55,000}$$

$$= ₹21.20 \text{ per share}$$

6. State the headings under which the following items are shown in the balance sheet of a company:

	Solution
(i) Prepaid Expenses	Asset Side – Other Current Assets
(ii) Proposed Dividend	Liability Side – Short-term Provisions
(iii) Calls in advance	Liability Side – Share Capital (Add)
(iv) Patents	Asset Aide – Intangible Assets
(v) Short-term Investments	Assets Side – Investments
(vi) Loan to employees	Assets Side – Short-term Loans and Advances

SECTION C

Answer any three questions. Each question carries 14 marks: **(3 × 14 = 42)**

7. Ram Ltd. issued 1,00,000 equity shares of ₹10 each, at a premium of ₹5 per share. The entire issue was underwritten by underwriters A, B, C and D to the extent of 30%, 30%, 20% and

20% respectively, with the provision of Firm Underwriting of 3000, 2000, 1000 and 1000 shares respectively. The underwriters were entitled to a commission of 2.5% on the issue price of shares.

The company received applications for 70,000 shares from public; out of which, applications for 19,000, 10,000, 21,000 and 8,000 shares were marked in favour of A, B, C and D respectively.

Calculate the Net Liability of the underwriter, if:

(i) Firm Applications are treated as Marked Forms

(ii) Firm Applications are treated as Unmarked Forms

Also calculate the Underwriting Commission payable.

SOLUTION

Statement Showing the Liability of Underwriter

- When Firm Underwritten Shares are treated as Marked Applications

Particulars	A (30%) (Shares)	B (30%) (Shares)	C (20%) (Shares)	D (20%) (Shares)	Total (100%) (Shares)
Gross Liability	30,000	30,000	20,000	20,000	1,00,000
Less: Marked Applications (including FUW)	22,000	12,000	22,000	9,000	65,000
Balance	8,000	18,000	–2,000	11,000	35,000
Less: Unmarked Applications (5,000 × 3:3:2:2)	1,500	1,500	1,000	1,000	5,000
Balance	6,500	16,500	–3,000	10,000	30,000
Less: Surplus of C transferred to A, B and D in the ratio of 3:3:2	1,125	1,125	+3,000	750	-
Net Liability	5,375	15,375	-	9,250	30,000
Add: Firm Underwriting	3,000	2,000	1,000	1,000	7,000
Total Liability	**8,375**	**17,375**	**1,000**	**10,250**	**37,000**

Marked Application plus Firm Underwriting:

A = 19,000 + 3,000 = 22,000

B = 10,000 + 2,000 = 12,000

C = 21,000 + 1,000 = 22,000

D = 8,000 + 1,000 = 9,000

Unmarked Applications = Total Applications – Marked Applications

= 70,000 – 65,000 (22,000 + 12,000 + 22,000 + 9,000)

= 5,000

Statement Showing the Liability of Underwriter

- When Firm Underwritten Shares are treated as Unmarked Applications

Particulars	A (30%) (Shares)	B (30%) (Shares)	C (20%) (Shares)	D (20%) (Shares)	Total (100%) (Shares)
Gross Liability	30,000	30,000	20,000	20,000	1,00,000
Less: Marked Applications (excluding FUW)	19,000	10,000	21,000	8,000	58,000
Balance	11,000	20,000	-1,000	12,000	42,000
Less: Unmarked Applications ($19,000 \times 3:3:2:2$)	5,700	5,700	3,800	3,800	19,000
Balance	5,300	14,300	-4,800	8,200	23,000
Less: Surplus of C transferred to A, B and D in the ratio of 3:3:2	1,800	1,800	+4,800	1,200	-
Net Liability	3,500	12,500	-	7,000	23,000
Add: Firm Underwriting	3,000	2,000	1,000	1,000	7,000
Total Liability	**6,500**	**14,500**	**1,000**	**8,000**	**30,000**

Total Applications = 70,000 + 7,000 (Firm Underwriting) = 77,000

Marked Application = 19,000 + 10,000 + 21,000 + 8,000 = 58,000

Unmarked Applications (including Firm Underwriting)

= Total Applications – Marked Applications

= 77,000 – 58,000

= 19,000

Calculation of Commission Payable to the Underwriters:

$A = 30,000 \times 2.5 \div 100 \times ₹10 = 7,500$

$B = 30,000 \times 2.5 \div 100 \times ₹10 = 7,500$

$C = 20,000 \times 2.5 \div 100 \times ₹10 = 5,000$

$D = 20,000 \times 2.5 \div 100 \times ₹10 = 5,000$

8. MK Ltd. was incorporated on 01 August 2016 to take over the running business of PQ Ltd., from 01 April 2016. Prepare a Statement of Profit and Loss, showing the profit prior to and after incorporation of the company, with the help of the following additional information, and the details for the year ended 31 March 2017.

Additional Information:

(i) Rent was paid at ₹1,000 per month up to 01 August 2016 and thereafter, it was increased to ₹2,000 per month.

(ii) The average monthly sales up to 01 August 2016 were ₹60,000 and since then, the average monthly sales were ₹70,000.

Profit and Loss Account for the year ending 31 March 2017

Particulars	(₹)	Particulars	(₹)
To Salaries and Allowances	60,000	By Gross Profit b/d	2,00,000
To Rent and Taxes	23,000		
To Director's Fees	3,000		
To Selling Expenses	4,000		
To Discount on Sales	1,000		
To Advertisement	7,500		
To Preliminary Expenses written off	3,300		
To Interest on Debentures	1,400		
To Interest to Vendors (up to 30 September 2016)	6,000		
To Repairs to Buildings	2,400		
To Depreciation	8,400		
To Net Profit c/d	80,000		
	2,00,000		**2,00,000**

SOLUTION

Profit Before and After Incorporation

Particulars	Basis of Allocation	Ratio	Total	Pre (₹)	Post (₹)
			(₹)	Incorporation	
Revenue from Operations (Gross Profit)	Sales	3:7	2,00,000	60,000	1,40,000
Other Income	-	-	-	-	-
Total Revenue (A)	**-**	**-**	**2,00,000**	**60,000**	**1,40,000**
Expenses: Employee Benefit Expenses: Salaries and Allowances	Time	1:2	60,000	20,000	40,000
Finance Cost: Interest on Debentures Interest to Vendors	Post-Inc. Revised Time	- 2:1	1,400 6,000	- 4,000	1,400 2,000
Depreciation and Amortisation Expenses: Depreciation Preliminary Expenses Written Off	Time Actual	1:2 Post-Inc.	2,400 3,300	800 -	1,600 3,300

(*Contd.*)

Particulars	Basis of Allocation	Ratio	Total (₹)	Pre (₹) Incorporation	Post (₹) Incorporation
Other Expenses:					
Rent	Time	WN	20,000	4,000	16,000
Taxes (23,000 – 20,000)	Time	1:2	3,000	1,000	2,000
Director's Fees	Post-Inc.	Actual	3,000	-	3,000
Selling Expenses	Sales	3:7	4,000	1,200	2,800
Discount on Sales	Sales	3:7	1,000	300	700
Advertisement	Sales	3:7	7,500	2,250	5,250
Repairs to Building	Time	1:2	1,200	400	800
General Expenses	Time	1:2	7,200	2,400	4,800
Total Expenses (B)			**1,20,000**	**36,350**	**83,650**
Net Profit (A-B)			**80,000**	**-**	**56,350**
Capital Profit (A-B)				**23,650**	**-**

Working Notes

(1) *Time Ratio*

Pre-incorporation Period (April to July 2013) = 4 Months

Post-incorporation Period (August 2013 to March 2014) = 8 Months

Time Ratio = 4:8 or 1:2

(2) *Revised Time Ratio to calculate Interest to Vendors*

= Date of Purchase to Date of Incorporation: Date of Incorporation to Date of Repayment of Loan

(Interest is paid up to 30 September 2013)

= 1 April 2013 to 31 July 2013: 1 August 2013 to 30 September 2013

= 4:2 or 2:1

(3) *Sales Ratio*

Pre-incorporation Sales = ₹60,000 × 4 = 2,40,000

Post-incorporation Sales = ₹70,000 × 8 = 5,60,000

Sales Ratio = 2,40,000:5,60,000 or 24:56 or 3:7

(4) *Rent Paid*

Pre-incorporation Period = 1,000 × 4 = ₹4,000

Post-incorporation Period = 2,000 × 8 = ₹16,000

9. The balance sheet of Sadanand Co. Ltd., as on 31 March 2017, is as follows:

Liabilities	(₹)	Assets	(₹)
6,000 Preference Shares of ₹100 each	6,00,000	Fixed Assets	10,00,000
10,000 Equity Shares of ₹100 each	10,00,000	Stock	3,50,000
General Reserve	80,000	Debtors	4,50,000
Profit and Loss A/c	1,60,000	Cash at Bank	2,00,000
Sundry Creditors	1,60,000		
Total	**20,00,000**	**Total**	**20,00,000**

The profits of the company (before providing for taxation at 40%) and the rate of dividend for the past five years are as follows:

Financial Year	Profit (₹)	Rate of Dividend (%)
2012–13	3,70,000	8
2013–14	4,10,000	10
2014–15	4,40,000	12
2015–16	4,30,000	15
2016–17	4,60,000	15

You are required to calculate the Goodwill of the company on the basis of:

(i) Five years' purchase of Super Profits
(ii) Capitalisation of Super Profits Method
(iii) Annuity Method (p.v. of annuity of ₹1 for five years at 10% is 3.78)

SOLUTION

Step 1: *Calculation of Adjusted Average Profits*

Particulars	(₹)
Profits for five years (3,70,000 + 4,10,000 + 4,40,000 + 4,30,000 + 4,60,000)	21,10,000 ÷ 5
Average Profits	4,22,000
Less: Income Tax @ 40%	1,68,800
Adjusted Average Profits	**2,53,200**

Step 2: *Calculation of Average Capital Employed (Asset-based Approach)*

Particulars	(₹)
Fixed Assets	10,00,000
Stock	3,50,000
Debtors	4,50,000
Cash and Bank	2,00,000
	20,00,000
Less: Sundry Liabilities	
Creditors	(1,60,000)
Capital Employed at the end of the year	**18,40,000**
Less: Half of the current-year profit before tax Half of 3,60,000 (current-year profit)	(1,80,000)
Average Capital Employed	**16,60,000**

Step 3: *Calculation of Normal Profits*

Normal Profits = Average Capital Employed × Normal Rate of Return*
= 16,60,000 × 12%
= 1,99,200

(*Normal rate of return is arrived at by taking average of rate if dividend)

Normal Rate of Return = 8 + 10 + 12 + 15 + 15 = 60/5 = 12

Step 4: *Calculation of Super Profits*

Adjusted Average Profits (Step 1)	2,53,200
Less: Normal Profit (Step 3)	1,99,200
Super Profit	**54,000**

Step 5: *Calculation of Goodwill*

Goodwill = Super Profit × Number of years of purchase
= 54,000 × 5
= ₹2,70,000

10. The following details are obtained from RK Ltd. as on 31 December 2016:

Particulars	(₹)
20,000 Equity Shares of ₹10 each, fully paid up	2,00,000
20,000 Equity Shares of ₹10 each, ₹7.50 paid up	1,50,000
20,000 Equity Shares of ₹10 each, ₹5 paid up	1,00,000
General Reserves	1,00,000
Liabilities	2,50,000
Fixed Assets	3,60,000
Current Assets	4,40,000

The normal average profit (after tax) of the company is estimated at ₹60,000 and the estimated rate of capitalisation is 10%. Transfer to general reserve is 20%. Calculate the value of each type of the shares by:

(i) Asset Backing Method and
(ii) Yield Method

SOLUTION

Computation of Value of Shares

Step 1: Ascertainment of Net Assets/Intrinsic Value of Shares (Asset-based Approach)

Particulars	(₹)	(₹)
Fixed Assets	3,60,000	
Current Assets	4,40,000	
Gross Total Assets		**8,00,000**

(*Contd.*)

Particulars	(₹)	(₹)
Less: External Liabilities:		(2,50,000)
		5,50,000
Add: Notional Call made		
20,000 Equity Shares at ₹2.50 per share	50,000	
20,000 Equity Shares at ₹5.00 per share	1,00,000	(1,50,000)
Net Assets or Intrinsic Value of Shares		**4,00,000**

$$\text{Intrinsic Value per Equity Share} = \frac{4,00,000}{60,000}$$

$$= ₹6.67 \text{ per share}$$

After calculating the intrinsic value per fully paid share, the intrinsic value of partly paid share is calculated as follows:

Intrinsic Value per partly-paid Equity Share = Intrinsic Value per fully-paid Equity Share – Uncalled Capital per share

(i) Intrinsic Value per fully-paid Equity Share = ₹6.67

(ii) Intrinsic Value per Equity Share of ₹7.50 paid = ₹6.67 – 2.50 = ₹4.17

(iii) Intrinsic Value per Equity Share of ₹5.00 paid = ₹6.67 – 5.00 = ₹1.67

Computation of Value of Shares on the basis of Yield Method (Rate of Dividend)

Profits for the year	(₹)
Average Profits after Tax	60,000
Less: Transfer to Reserve @ 20%	12,000
Amount available for Distribution of Dividend	**48,000**

Calculation of Expected Rate of Return/Rate of Dividend

Expected Rate of Return/Rate of Dividend

$$= \frac{\text{Amount available for Equity Dividend}}{\text{Equity Paid-up Capital}} \times 100$$

$$= \frac{48,000}{4,50,000} \times 100$$

$$= 10.67\ \%$$

Normal Rate of Return = 10 %

- Value per Fully-paid Equity Share $= \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up value per share}$

$$= \frac{10.67}{10} \times 10$$

$$= ₹10.67 \text{ per share}$$

- Value per Partly-paid Equity Share $= \dfrac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up value per share}$

$$= \frac{10.67}{10} \times 7.50$$

$$= ₹8.00 \text{ per share}$$

- Value per Partly-paid Equity Share $= \dfrac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value per share}$

$$= \frac{10.67}{10} \times 5.00$$

$$= ₹5.33 \text{ per share}$$

11. From the following trial balance of Sony Co. Ltd. as on 31 March 2017, prepare final accounts in the prescribed form (vertical format):

Debit Balances	(₹)	Credit Balances	(₹)
Buildings	5,00,000	Equity Share Capital	3,00,000
Plant and Machinery	2,00,000	12% Preference Share Capital	2,00,000
Purchases	2,50,000	Reserve Fund	1,50,000
Salary	60,000	10% Debentures	2,00,000
Debtors	2,30,000	Sales	6,00,000
Bills Receivable	80,000	Creditors	1,75,000
Director's Fees	20,000	Bills Payable	90,000
Bad Debts	5,000	Returns	20,000
Returns	15,000	Profit and Loss A/c (1 April 2005)	60,000
Wages	15,000	Interest on Investments	18,000
Opening Stock	45,000		
Loose Tools	60,000		
Goodwill	80,000		
Discount on Issue of Shares	20,000		
Cash and Bank Balances	33,000		
12% Investments (1 April 2005)	2,00,000		
	18,13,000		**18,13,000**

Adjustments:

(i) Closing Stock is valued at ₹1,40,000
(ii) Outstanding Wages: ₹2,500
(iii) Write off 10% of Goodwill
(iv) Write off 10% of Discount on Issue of Shares
(v) Debenture Interest is outstanding for the whole year
(vi) Write off 5,000 further Bad Debts and create Reserve for Doubtful Debts at 5%
(vii) Buildings, and Plant and Machinery to be depreciated by 5% and 10%, respectively.
(viii) Transfer 25,000 to Reserve Fund

(ix) The directors propose 15% dividend to equity shareholders.

SOLUTION

Statement of Profit or Loss for the year ended 31 March 2017

Particulars	Note	Amount (₹)
1. Revenue from Operations (Less: Sales Returns ₹15,000)		5,85,000
2. Other Income (Interest on Investments ₹18,000 + 6,000 Outstanding (2,00,000 × 12%) – 18,000 = 6,000)		24,000
3. **Total Revenue (1 + 2)**		**6,09,000**
4. Expenses:		
a. Purchases (Less: Purchase returns ₹20,000)		2,30,000
Less: Difference in Closing and Opening Stock (1,40,000-45,000)		(95,000)
b. Employee Benefit Expenses (Salaries and Wages)	11	77,500
c. Finance Cost	12	20,000
d. Depreciation and Amortisation	13	55,000
e. Other Expenses	14	41,250
5. **Total Expenses (a to e)**		**3,28,750**
6. Profit before Tax (3-5)		2,80,250
Less: Provision for Taxation		NIL
Profit after Tax		2,80,250
Add: Profit and Loss Balance of previous years		60,000
Net Profit before Transfer		**3,40,250**
Less: Proposed Dividend on Equity Shares (2, 00,000 × 12%)		24,000
Less: Proposed Dividend on Equity Shares (3,00,000 × 15%)		45,000
Less: Corporate Dividend Tax (69,000 × 16.2225%)		11,195
Surplus carried over to Balance Sheet		**2,35,055**

Balance Sheet of Sony Co. Ltd. as on 31 March 2017

Particulars	Note	Amount (₹)
1. Shareholders' Funds		
a. Share Capital	1	5,00,000
b. Reserves and Surplus	2	3,92,055
2. Share Application Money pending Allotment		-
3. Non-Current Liability		
a. Long-term liabilities	3	2,00,000

(*Contd.*)

Particulars	Note	Amount (₹)
4. Current Liabilities		
a. Trade Payables	4	2,65,000
b. Other Current Liabilities		-
c. Short-term Provisions	5	1,02,695
Total		**14,59,750**
ASSETS		
1. Non-current Assets		
a. Fixed Assets	6	7,15,000
b. Intangible Assets		72,000
c. Investments		2,00,000
d. Other Non-current Assets		
2. Current Assets		
a. Trade Receivables	7	2,93,750
b. Inventories	8	1,40,000
c. Cash and Cash Equivalents	9	33,000
d. Short-term Loans and Advances		-
e. Other Current Assets	10	6,000
Total		**14,59,750**

Notes:

(1) *Share Capital*

Particulars	Amount (₹)	Amount (₹)
Equity Share Capital	3,00,000	
12% Preference Share Capital	2,00,000	5,00,000
		5,00,000

(2) *Reserves and Surplus*

Particulars		Amount (₹)
Profit and Loss Account		2,35,055
Reserve Fund (1,50,000 + 25,000)		1,75,000
Discount on Issue of Shares (20,000 – 2,000)		(18,000)
		3,92,055

(3) *Long-term Liabilities*

Particulars	Amount (₹)
10% Debentures	2,00,000
	2,00,000

(4) *Trade Payables*

Particulars	Amount (₹)
Creditors	1,75,000
Bills Payable	90,000
	2,65,000

(5) *Short-term Provisions*

Particulars	Amount (₹)
Outstanding Wages	2,500
Outstanding Debenture Interest	20,000
Proposed Dividend on	
• Equity Shares (3,00,000 × 15%)	45,000
• Preference Shares (2,00,000 × 12%)	24,000
Corporate Dividend Tax	11,195
	1,02,695

(6) *Fixed Assets*

Particulars		Amount (₹)
Building	5,00,000	
Less: Depreciation @ 5% on 5,00,000	25,000	4,75,000
Plant and Machinery	2,00,000	
Less: Depreciation	20,000	1,80,000
Loose Tools		60,000
		7,15,000

(7) *Trade Receivables*

Particulars		Amount (₹)
Debtors	2,30,000	
Less: Bad Debts (additional)	5,000	
	2,25,000	
Less: Reserve for Bad Debt @ 5%	11,250	2,13,750
Bills receivable		80,000
		2,93,750

(8) *Inventories*

Particulars	Amount (₹)
Closing Stock	1,40,000
	1,40,000

(9) *Cash and Cash Equivalents*

Particulars	Amount (₹)
Cash and Bank Balance	33,000
	33,000

(10) *Other Current Assets*

Particulars	Amount (₹)	Amount (₹)
Preliminary Expenses	3,000	
Less: Preliminary Expenses Written Off	1,000	2,000
Advance Income Tax		7,145
		9,145

(11) *Employee Benefit Expenses*

Particulars		Amount (₹)
Salary		60,000
Wages	15,000	
Add: Outstanding Wages	2,500	17,500
		77,500

(12) *Finance Cost*

Particulars	Amount (₹)
Outstanding Interest on Debentures (2,00,000 × 10%)	20,000
	20,000

(13) *Depreciation and Amortisation Expenses*

Particulars	Amount (₹)
Depreciation on Building (5,00,000 × 5%)	25,000
Depreciation on Plant and Machinery (2,00,000 × 10%)	20,000
Goodwill Written Off (80,000 × 10%)	8,000
Discount on Issue of Shares Written Off (20,000 × 10%)	2,000
	55,000

(14) *Other Expenses*

Particulars		Amount (₹)
Bad Debts	5,000	
Add: Additional Bad Debts	5,000	
	10,000	
Add: Reserve for Doubtful Debts (2,30,000 – 5,000 = 2,25,000 × 5%)	11,250	21,250
Director's Fees		20,000
		41,250