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III-SEMESTER

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CORPORATE ACCOUNTING

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SYLLABI-BOOK MAPPING TABLE

CORPORATE ACCOUNTING

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UNIT- I ISSUES OF SHARES & GOODWILL & FINAL ACCOUNTS OF COMPANY

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Structure

1.1. INTRODUCTION

Company came into existence to solve the drawbacks of partnership and to form the large-scale operations. A company is an association of persons who contribute money or money's worth to carry on some agreed activity for their economic gain. The money contributed by them forms the capital of the company. It is an artificial person created by law. Section 3 of the Indian Companies Act, 1956 defines a Company as "Company formed and registered under this Act or an existing company." An existing company means a company formed and registered under any of the former Companies Acts.

Justice Lindley defines a Company as "A company is an association of many persons who contribute money or money's worth to a common stock and employs it for a common purpose. The common stock so contributed is denoted in money and is the capital of the company. The persons, who contribute it or to whom it belongs, are members."

The following are essential features of company

1. Legal person: It is created by law. It is considered as a person in the eyes of law.
2. Artificial person: It has no body and mind of its own. It can act only through other persons
elected for the purpose.
3. Perpetual succession: A company has a life of its own distinct from the life of its members.
So, the death of a member will not affect the life of the company.

4. Limited liability: The liability of the member is limited to the extent of the face value of the shares held by them.
5. Freely transferable: Shares of a company are freely transferred except in case of a private company.
6. Can buy and sell assets: A company at its own discretion can buy or sell any assets.
7. Can sue and be sued: A company like any other person can sue a third party and be sued.
8. Separation of ownership and management: A company is managed through a board of directors elected by its members. A member had no right to participate in the management of its day-to-day affairs.
9. Common seal: Every company should have a common seal of its own. It is like the signature of a natural person.
10. Dissolution: The company can be dissolved only by which creates it.

1.2. DIFFERENCES BETWEEN A PARTNERSHIP FIRM AND A COMPANY

S.No	Basis	Partnership Firm	Company
1.	Number of Persons	Minimum w partners and maximum is limited to 20 partners but in case of banking company it is limited to 10 partners.	In case of private company minimum members is 2 and maximum limited to 50 members. In case of a public company minimum is 7 members and maximum are unlimited.
2.	Law	Indian Partnership Act, 1932 applies	Indian companies Act, 1956 applies
3.	Registration	Registration under Indian partnership Act is only voluntary.	Registration under Indian Companies Act is Compulsory.
4.	Legal Status	Partnership does not get a separate legal status.	A company gets a separate legal status apart, from its members.
5.	Transferability	A partner cannot transfer his partnership share to another person. But a partner can transfer his share with the consent of all the other partners.	A member of a company can transfers his share freely to any person except in the case of a private company.
6.	Liability	A partner's liability is unlimited and joint and several.	A member's liability is limited to the face value of shares held by the member.
7.	Existence	A partner's life comes to an end when a partner either becomes insolvent or insane or dies. So, life of a partnership is short.	The death of a member will not affect the life of a company. A company has a long existence.
8.	Legal Restrictions	Legal restrictions are few.	Legal restrictions are many.
9.	Management	All partners have right to	Only board of

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		participate in the management of partnership business.	directions have to manage the company. Members of a company cannot interfere in the management of a company.
10.	Audit	Audit of partnership accounts are only voluntary.	Accounts of a company are to be compulsorily audited.
11.	Common Seal	There is no common seal.	Every company should have a common seal of its own.
12.	Distribution of Profit	All the profits are distributed among partners in the agreed profit-sharing ratio.	Only a part of the profit is distributed to members as dividend, another part is transferred to various reserves and the balance profit left is kept in the profit & loss A/c.
13.	Capital	There is the limit to the maximum capital a partnership can raise. Capital is not divided into shares.	Maximum amount of capital is limited to authorised capital. Capital of a company is divided into shares of uniform value.
14.	Insolvency	Insolvency or death of a partner result in insolvency of partnership.	Insolvency or death of partner does not result in winding up of a company.
15.	Solve of Account	Maintaining books of accounts is optional.	Maintaining of books of accounts is compulsory.
16.	Commencement of Business	There is no need to get any certificate to commence any business.	A public company can commence benefit only after obtaining certificate to commence business.

1.3. KINDS OF COMPANIES

Companies can be classified on various basis. They are:

A. On the Basis of Formation:

(i) Chartered Companies: They are incorporated on the basis of a charter issued by the king or sovereign of country. e.g., East India Company formed under a charter issued by the Queen of England.

(ii) Statutory Companies: Such companies are formed under special acts passed in parliament for each company separately. e.g., RBI, LIC, Damodar Valley Corporation.

(iii) Registered Companies: These companies are formed by registering them under the Indian companies Act. 1956.

B. On the Basis of Liability:

(i) Limited Companies: The liability of members is limited to the extent of face value of shares held by each member of a company.

(ii) Guarantee Companies: The liability of each member is extended to the amount of guarantee given by each member.

(iii) Unlimited Companies: The memorandum of association will specify that member's liabilities are unlimited. Such companies are rare now a days.

C. On the Basis of Involvement of Public Money:
(i) Private Companies: A private company is prohibited from inviting public to subscribe to the shares or debentures of the company. It cannot also accept deposits from public. Its shares cannot be freely transferred.
(ii) Public Companies: A public company can invite the public to subscribe to its shares or debentures. It can also accept deposits from the public. Its shares are freely transferable.

D. On the Basis of Share Holding Pattern:
(i) Holding Company: A company holding 51% or more of the paid-up share capital of another company is called a holding company.
(ii) Subsidiary Company: A company where 51% or more of its paid-up share capital is held by another company is called a subsidiary company.

E. Other Companies:
(i) Government Company: Where 51% or more of the paid-up share capital of a company is held by a Central Government or State Governments or both, it is called a Government company.
(ii) One-man Company: When almost all the shares are held by a single person except a few shares, then it is called a one-man company.

1.4. SOURCES OF FINANCE:

The company raises its finance through internal and external sources.

1.4.1 Internal sources include:
a) Share capital
b) Undistributed profits of the companies

1.4.2 External sources include:
a) Issue of debentures
b) Accepting deposits from the public
c) Loans from commercial banks
d) Loans from financial institutions – such as. Industrial Finance Corporation, State Finance Corporation, Industrial Development Bank of India, Industrial Credit and Investment Corporation of India etc.,

1.5. TYPES OF SHARE CAPITAL

All trading concerns should have a capital. The capital of the company is called share capital.

Authorised Capital or Registered Capital or Nominal Capital
This is the amount of capital a company is registered with. This is the maximum amount of capital a company can raise.
Issued Capital - It is the value of shares issued to the public. It will be equal to or less than the authorised capital.
Subscribed Capital - It is the value of shares subscribed by the public.
Called up Capital - It is the amount of capital called up on shares subscribed.
Paid-up Capital - It is the amount of capital called up and received from members.
Reserve Capital - It is that portion of uncalled number of subscribed shares which is reserved to be called up only at the time of winding up.

1.6. MEANING OF SHARE

The capital of the company is divided into different units of fixed amount. These units are called "Shares". For example, if the capital of the company is Rs. 3,00,000 and it is divided into 30,000 units of Rs.10 each. Rs. 10 each unit shall be called a share of the company. So, the share is a fractional part of the capital of the company.

1.6.1. Kinds of Shares

a) Participating preference shares

These preference shares have a right to share in the surplus profit remaining after paying fixed rate of dividend on preference shares and a reasonable rate of dividend on equity shares.

b) Non-participating preference shares

These preference shares have no right to participate in the surplus profit left after paying fixed rate of dividend on preference shares and a reasonable dividend on equity shares.

1.6.2. Equity Shares

These shares form a large part of the total shares of the company. Equity shares are also known as Ordinary Shares. Equity shareholders get dividend only after the payment to preference shareholders. When the company is wound up, they will be paid the capital only after the preference shareholders are paid. But only equity shareholders are given full voting right.

1.7. SHARES ISSUED FOR CASH

Public issue of shares is issued only for cash. Public issues should be in accordance with regulations of companies Act, and guidelines issued by SEBI. Public issue must be accompanied by a prospectus. The issues should be kept open for a minimum of three days. Application for shares must be made for a certain minimum of shares.

a) Minimum Subscription

Minimum subscription is the minimum number of shares for which public had to apply. Minimum subscription is fixed at 90% of shares issued to public. A company can proceed to allot shares only when applications received are equal to or in excess of minimum subscription. If applications received are less than the minimum subscription, the application money should be refunded to share applications and the company should also be wound up.

b) Under subscription

When subscription received is less than the issue size, it is called under subscription. There will be no difficulty in allotment to shares. All share applicants will receive the shares they have applied provided the applications are in order and minimum subscription has been received.

c) Oversubscription

Applications received are for more shares than the issue size. There will be difficulty in allotment of shares to share applicants.

1.8. STAGES IN RECEIVING SHARE CAPTIAL MONEY

The money payable on shares may be paid in instalments. They are share application money, allotment money and call money. Sometimes a company may ask the share applications to pay the entire share amount on the share application itself.

1.8.1. Share Application Money

Share applicants must pay a part of issue price along with share application. All share moneys are payable through a scheduled commercial bank only. Share application account is a personal account.

As per Companies Act, at least 5% of face value is payable along with share application. As per SEBI guidelines share application money should not be less than 25% of issue price.

ii)Share Allotment Money

After shares are allotted, shareholders are asked to pay another part of issue price called allotment money. Share allotment account is also a personal account.

1.8.2. Calls-in-Arrears

Some shareholders may not pay money payable on allotment or calls. The money not paid is called calls-in-arrears. Shareholders have to pay interest along with calls-in-arrears. The interest is payable at the rate specified in articles of association of the company. If an article of association of a company is silent on the rate of interest payable, then the rate of interest specified in Table A of Companies Act will apply. The rate of interest as per Table 'A' is 5%.

1.8.3. Calls-in-Advance

Some shareholders may pay the entire amount payable on shares along with allotment money. Sometimes a shareholder may pay second call money along with first call. Such call moneys received in advance is called calls-in-advance. A company can retain calls-in-advance only if articles of the company authorises. The company should pay interest on calls-in-advance till the advance money is adjusted towards respective calls. The rate to interest payable is the rate specified in the articles of the company. If the article of the company is silent, then the rate given in Table A of Companies Act applies. The rate specified in Table A is 6%

1.8.4. Calls –on-Shares

They may be uncalled and unpaid amount on shares after the receipt of allotment money. This uncalled and unpaid amount on shares may be demanded by a company in one or more calls. No call shall exceed 25% of nominal value. Time gab between two successive calls should not be less than one month. Share call account is also a personal account.

1.9. FORFEITURE OF SHARES

Forfeiture of shares is a penal action taken by a company on its members is as follows:

1. Shares can be forfeited only for non-payment of money due on shares. A company cannot forfeit shares for non-payment of loans, advances etc due from shareholders.
2. The shares can also be forfeited only after giving proper notice and a warning letter.
3. The articles of the company should contain a provision authorising its directors to forfeit the shares.
4. The board of directors must also pass a resolution for forfeiture of shares.
5. After forfeiture the shareholder's name is removed from the register of member.
6. The amount already paid by the defaulting shareholders will not be returned to him.

1.10. SURRENDER OF SHARES

Sometimes a shareholder may voluntarily return the shares to the company and give up his rights against the company. This is called surrender of shares. Surrender of shares for all practical purpose is treated as share forfeiture. The shareholders name will be removed from the register to members and money already paid by him will not be returned to him. It will be forfeited.

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a) Lien on Shares

A shareholder who is an employee, supplier or a customer may borrow or take and advance of money from the company. The borrower may deliver his shares with the company as security for debt. The company has a right to retain the shares till the borrows repay the money. This right to retain the shares is called lien on shares. When the borrower repays the amount in full, the company will also return the shares.

b) Reissue of Forfeited Shares

A company can reissue forfeited shares at any time it wants. The following other points should also be kept in mind:

1. Shares may be reissued any time
2. Shares may be reissued for any price.
3. But the reissue price should not be less than the amount unpaid by the original shareholders.
4. Shares may be reissued at a discount.
5. The discount allowed on reissue should not be more than the amount received from the original shareholders.
6. Discount allowed on reissue is debuted to share forfeited account.
7. If the reissued share was originally issued at discount, the reissue discount equal to original discount is debited to discount account. In other words, the original discount is re-recorded at the time of reissue.
8. If there is any surplus from the amount already paid by original shareholders after adjusting the reissue discount, it is a capital profit to the company. It should be credited to capital reserve account.
9. If only a part of forfeited shares is reissued, only the gain on reissued share is transferred to capital reserve.

1.11. RIGHT ISSUE

As per Section 81, of the Companies Act, every public company issuing further shares to increase its subscribed capital, after the expiry of two years from the date of incorporation or after the expiry of one year from the first allotment of shares after incorporation, should offer the shares to the existing shareholders. Other provisions relating to the rights issue are:

1. Right shares should be offered in proportion to the shares held by existing shareholders.
2. The offer letter should specifically state that every shareholder had a right to accept in full or part or reject the offer.
3. Unless anything contrary is included in the articles of the company, every shareholder had a right to renounce the offer in full or part to any person.
4. The board of directions have the right to allot the shares not taken by the shareholders, to any person which is beneficial to the company.

Usually rights shares are offered at a concessional price which is less than the prevailing market price of the company's shares. This offers an advantage to the shareholders. This advantage is called

'Value of Rights'. The following steps are followed to calculate the value of rights:

1. First compute the market value of shares a shareholder should possess to get a rights share. For example, if the rights are offered in the ration of 1:2, a person should possess 2 shares to get a rights share. If the market price per share in Rs.80. The market value of two shares held is Rs. 160 (i.e., 80×2).
2. Next, add the price of rights shares to the market value calculated as in (1) above. If the price of rights shares is Rs.50. The total value of three shares is Rs. 210 (i.e., 160+50).
3. Find the average price per share. The average price (210 ÷ 3) is Rs.70.
4. The value of rights is the difference between the market price and average price of the share i.e., Rs. 10 (80-70).

Illustration 1

XYZ company had decided to increase its subscribed capital by making a rights issue to the existing shareholders in the proportion of one new share for every two shares held. The market price of the shares at the time of rights announcement is Rs. 400. The rights shares are issued at Rs.100 per share. Calculate the value of rights.

Solution:

Particulars	Rs.
Marker value of two shares 400 x 2	800
Add: Issue price of rights share 100	100
Total value of 3 shares	900

Average price per share = 900/3 = Rs. 300

Value of rights = Market price per share – Average price per share

= 400 – 300 = Rs. 100.

Illustration 2

Sun Ltd. issued rights shares at Rs. 75 per share in the ratio of 1: 3. Market price of the company's share is Rs. 125 on the date of rights announcement. Compute the value of rights.

Solution:

Particulars	**Rs.**
Marker value of 3shares (125×3)	375
Add: Issue price of rights share	75
Total value of 4 shares	450

Average price of one share = 450/4 = Rs. 112.50.

Rights Value = Market price per share – Average price per share

= 125 – 112.50 = Rs. 12.50.

Journal Entries for the Issue of shares

Date	**Particulars**	**L.F**	**Dr. Rs.**	**Cr. Rs.**
1.	On receipt of share application money: Bank A/c Dr. To share application A/c		XX	XX
2.	On allotment – transfer of share application account to share capital: Share application A/c Dr. To Share capital A/c – (for share allotted) To Bank A/c (for application money		XX	XX XX

	returned) To Share allotment A/c To calls-in-Advance A/c To Share allotment A/c (Excess application money adjusted for calls- only in case of prorate allotment)			XX XX XX
3.	On allotment – for allotment money receivable: Share allotment A/c (Full allotment amount) Dr. Discount on issue of shares A/c (if shares are issued at discount) Dr. To Share Capital A/c To Securities premium A/c (if shares are issued at premium)		XX XX	XX XX

Note:

i. If shares are issued at premium and the question is silent about the instalment in which stage premium is included, it is assumed that premium is included in allotment money.

ii. If shares are issued at discount, it is always assumed that discount is allowed from allotment money.

4.	On receipt of allotment money: Bank A/c (actual amount received) * Dr. Calls-in-arrear A/c (allotment amount not paid) Dr. To share allotment A/c To calls-in-advance A/c *(full allotment amount (-) Excess application money adjusted (-) arrears)		XXX XXX	XXX XXX
5.	On call money receivable: Share call A/c Dr. To Share capital A/c		XXX	XXX
6.	On call money received: Bank allotment A/c (amount actually received) Dr. Calls-in-arrears A/c (call money not received) Dr. Calls-in-advance A/c (calls in advance received) Dr. To Share call A/c		XXX XXX XXX	XXX

Note:

i. If there is only one call, the call should be named Share First and Final call A/c.

ii. If there is more than one call, the last call on which full amount is received should be named.

iii. The entries 5 and 6 are repeated for every call.

On forfeiture of shares: Share capital A/c (only called up amount) Dr. Securities premium A/c (If not received) Dr. To Share call A/c To Calls-in-arrears A/c (arrears relating to forfeited shares) To Discount on issue of shares A/c (original discount on issue)		XXX XXX	XXX XXX XXX

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Note:

If calls-in-arrears A/c is not debited for arrears on allotment and calls, the above entry will be as follows:

Share capital A/c (only called up amount):	Dr.	XXX	
Securities A/c (If not received)	Dr.	XXX	
To share forfeited A/c (paid up amount)			XXX
To Discount on issue of shares A/c (original discount on issue)			XXX
To Share allotment A/c (for allotment arrears)			
To share calls A/c (for arrears on calls)			XXX
			XXX
On reissue forfeited shares:			
Bank A/c (amount received)	Dr.	XXX	
Discount on issue A/c (original discount if any)	Dr.	XXX	
Share forfeited A/c (discount on reissue over original discount)		XXX	
To Share capital A/c			XXX
To Securities premium A/c (issue price in excess of face value)			XXX
Transfer of gain on reissue to capital reserve account:			
Share forfeited A/c (only gain on reissued shares)	Dr.	XXX	
To Capital reserve A/c			XXX

1.12. ISSUE OF SHARES

Share issue may be broadly classified into 3 types based on price point of view. They are (a) issue at per (b) issue are discount (c) Issue at premium.

This may be shown as below in a chart:

Issue of shares

Issue at par   Issue at discount   Issue at premium

a) Issue at Par

Share is issued at a price equal to the face value of shares. There is no gain or loss to the company from the issue of share at par. The following entry may be given.

Bank A/c	Dr.	XXX	
To share capital A/c			XXX

b) Issue at Discount

Share is issued at a price lower than the face value of the shares. The discount allowed is a loss to the company, hence discount account should be debited. The maximum discount allowed is restricted to 10% of the face value of shares.

The following is the entry:

Bank A/c	Dr.	XXX	
Discount on issue of shares A/c	Dr.	XXX	
To share capital A/c			XXX

c) Issue at Premium

Share is issued at a price higher than its face value. The premium is a gain to the company. Hence it is credited to a separate account called Securities

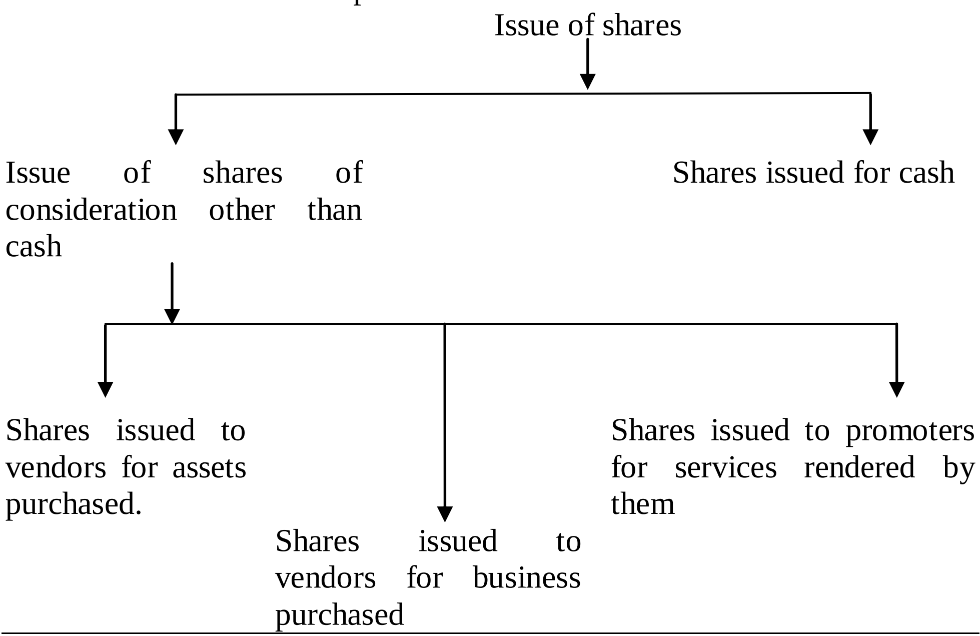
Premium account. There is no maximum limit to the premium a company may fix for its share issue. The following is the entry:

Bank A/c Dr.	XXX	
To share capital A/c		XXX
To Securities premium A/c		XXX

The securities premium cannot be used to pay dividend. The securities premium may be utilised for the following purposes:

i. To write off expenses, commission and brokerage on the issues of shares and debentures.
ii. To write off premium on redemption of preference shares and debentures.
iii. To issue fully paid bonus shares.
iv. To write off preliminary expenses.

The above classification is presented in a chart shown below:



1.13. ACCOUNTING ENTRIES FOR ISSUES OF SHARES AT PAR

1. To record the application money received:
   Bank A/c Dr.
   To Share Application A/c
2. For transfer on application money:
   Share Application A/c Dr.
   To Share capital A/c
3. To record the allotment money due:
   Share Allotment A/c Dr.
   To Share capital A/c
4. For receipt of allotment money:
   Bank A/c Dr.
   To Share Allotment A/c
5. To record the call money due:
   Particular call A/c Dr
   To Share capital A/c
6. For receipt of call money:
   Bank A/c Dr
   To Share Particular Call A/c

NOTES

Balance sheet of .... ltd. As on ....

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:			Cash at Bank		XXX
Authorised:			Discount on shares		XXX
____ Shares of Rs. ...... each at par		XXX			
Issued:					
____ Shares of Rs.		XXX			
each at par					
Subscribed:	XXX				
____ Shares of Rs.	XXX	XXX			
each at par					
Less: Calls-in-Arrears	XXX				
Paid up:	XXX	XXX			
____ Shares of Rs.		XXX			
each at par		XXX			
Add: Forfeited shares		XXX			XXX
Reserve and Surplus:					
Share premium					
Capital Reserve					

Illustration: 1

Fax ltd. Issued 10,000 equity shares of Rs. 10 each payable as to

Rs. 2 on application

Rs. 4 on allotment

Rs. 4 on first and final call.

All money was duty received on the issued shares. Pass journal entries prepare ledger accounts and show balance sheet.

Solution: Fancy ltd. Journal Entries

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To Equity share Application A/c (Being application money received on 10,000 shares @ Rs. 2 per share)		20,000	20,000
	Equity share Application A/c Dr. To Equity share capital A/c (Being application money transferred to equity share capital)		20,000	20,000
	Equity share allotment A/c Dr. To Equity share capital A/c (Being allotment money due on 10,000 shares @ Rs. 4 per share)		40,000	40,000
	Bank A/c Dr. To Equity share Allotment A/c (Being allotment money received on 10,000 shares @ Rs. 4 per share)		40,000	40,000

	Equity share first and final call A/c Dr. To Equity share capital A/c (Being call money due on 10,000 shares @ Rs. 4 per share)		40,000	40,000
	Bank A/c Dr. To Equity share first and final call A/c (Being final call money received on 10,000 shares @ Rs. 4 per share)		40,000	40,000

Fancy Ltd. Ledger Accounts

Dr	Bank Account	Cr.	
	Rs.		**Rs.**
To Equity share Application A/c	20,000	By Balance c/d	1,00,000
To Equity share Allotment A/c	40,000		
To Equity share first and final call A/c	40,000		
	1,00,000		1,00,000
To Balance b/d	1,00,000		

Equity Share Application Account

Dr Bank Account Cr.

	Rs.		**Rs.**
To Equity share Capital A/c	20,000	By Bank A/c	20,000
	20,000		20,000

Equity Share Allotment Account

Dr Bank Account Cr.

	Rs.		**Rs.**
To Equity share Capital A/c	40,000	By Bank A/c	40,000
	40,000		40,000

Equity Share First and Final call Account

Dr Bank Account Cr.

	Rs.		**Rs.**
To Equity share Capital A/c	40,000	By Bank A/c	40,000
	40,000		40,000

Equity Share Capital Account

Dr Bank Account Cr.

	Rs.		**Rs.**
By Balance c/d	1,00,000	By Equity share Application A/c	20,000
		By Equity share Allotment A/c	40,000
		By Equity share first and final call A/c	40,000
	1,00,000		1,00,000
		By Balance b/d	1,00,000

Balance sheet of Fancy Ltd. As on ....

Liabilities	**Rs.**	**Assets**	**Rs.**
Equity share capital: Authorised:	-	Cash at Bank	1,00,000
Issued: 10,000 shares of Rs. 10 each at par	1,00,000		
Subscribed and paid up: 10,000 shares of Rs. 10 each at par	1,00,000		
	1,00,000		1,00,000

1.14. ISSUE OF SHARE AT PREMIUM

When there is great demand for a company's share then that company issues its share at a price higher than the face value of share. The excess amount collected over and above the face value is called premium and such and issue is known as "Issue of share at premium". Premium can be received along with share allotment money. For example, a share face value of Rs. 100 issued at Rs. 110 at premium Rs. 10 is more than the face value and hence Rs. 10 is called premium.

Entry:

Share Allotment A/c Dr.
To share capital A/c
To share premium A/c

Illustration: 2

Galaxy ltd. Issued 6000 shares of Rs. 10 each at premium of Rs. 2 per share payable Rs. 2 on application, Rs. 5 on allotment (including premium) Rs. 3 on first call and Rs. 2 on final call. All these shares were duty subscribed due were fully received. Pass entries prepare ledger accounts and show the balance sheet.

Solution: Galaxy Ltd. Journal entries

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To Equity share Application A/c (Being application money received on 6,000 shares @ Rs. 2 per share)		12,000	 12,000
	share Application A/c Dr. To share capital A/c (Being application money transferred to share capital)		12,000	 12,000
	share allotment A/c Dr. To share capital A/c To share premium A/c (Being allotment money due on 6,000 shares including premium)		30,000	 18,000 12,000
	Bank A/c Dr. To share Allotment A/c (Being allotment money received)		30,000	 30,000
	share first call A/c Dr. To share capital A/c (Being first call money due on 6,000 shares @ Rs. 3 per share)		18,000	 18,000
	Bank A/c Dr. To share first call A/c (Being final call money received)		18,000	 18,000
	share final call A/c Dr. To share capital A/c (Being final call money due on 6,000 shares @ Rs. 2 per share)		12,000	 12,000
	Bank A/c Dr. To share final call A/c (Being final call money received)		12,000	 12,000

Galaxy Ltd. Ledger entries

Dr Bank Account Cr.

	Rs.		Rs.

NOTES

To share Application A/c	12,000	By Balance c/d	72,000
To share Allotment A/c	30,000		
To share first call A/c	18,000		
To share final call A/c	12,000		
	72,000		72,000
To Balance b/d	72,000		

Dr Share Application Account Cr.

	Rs.		Rs.
To share capital A/c	12,000	By Bank A/c	12,000
	12,000		12,000

Dr Share Allotment Account Cr.

	Rs.		Rs.
To share capital A/c To share premium A/c	18,000 12,000	By Bank A/c	30,000
	30,000		30,000

Dr Share Premium Account Cr.

	Rs.		Rs.
To Balance c/d	12,000	By share allotment	12,000
	12,000		12,000
		By Balance b/d	12,000

Dr Share First call Account Cr.

	Rs.		Rs.
To share capital A/c	18,000	By Bank a/c	18,000
	18,000		18,000

Dr Share Final call Account Cr.

	Rs.		Rs.
To share capital A/c	12,000	By Bank a/c	12,000
	12,000		12,000

Dr Share Capital Account Cr.

	Rs.		Rs.
To Balance c/d	60,000	By share Application A/c	12,000
		By share Allotment A/c	18,000
		By share first call A/c	18,000
		By share final call A/c	12,000
	60,000		60,000
		By Balance b/d	60,000

Balance sheet of Galaxy Ltd. As on ....

Liabilities	Rs.	Assets	Rs.
Equity share capital: Authorised:	-	Cash at Bank	72,000
Issued, Subscribed and paid up: 6,000 shares issued @ Rs. 10 each	60,000		

Reserve &Surplus: Share premium	12,000		
	72,000		72,000

NOTES

1.15. ISSUE OF SHARES AT DISCOUNT

Generally, a company is not allowed to issue shares at discount i.e., at a price less than the face value. Such an issue can be made only under special circumstances. For example, Rs. 10 face value shares are issued at Rs. 9 per share. Rs. 1 the difference between face value and issued price is called discount and debited to "Discount on shares Account".

However, such discount should not be more than 10% of the face value of the share. Higher rate is allowed only when permitted by the central government. Normally such discount is recorded at the time of allotment.

Entry:

Share Allotment A/c Dr.
Discount on shares A/c Dr.
To share capital A/c

Illustration: 3

Max ltd. Offered 20,000 shares of Rs. 10/- each at a discount of 10%. The shares were payable as under.

Rs. 3 on application
Rs. 4 on allotment (with adjustment of discount)
Rs. 2 on first and final call

Public applied for 16,000 shares and the shares have been duly allotted. All money due were received. Pass journal entries and prepare ledger accounts and show the balance sheet.

Solution:

Max ltd. Journal Entries

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To share Application A/c (Being application money received on 16,000 shares @ Rs. 3 per share)		48,000	 48,000
	share Application A/c Dr. To share capital A/c (Being application money transferred to equity share capital)		48,000	 48,000
	share allotment A/c Dr. Discount on shares A/c Dr. To share capital A/c (Being allotment money due on 16,000 shares with adjustment of discount)		64,000 16,000	 80,000
	Bank A/c Dr. To share Allotment A/c (Being allotment money received)		64,000	 64,000
	share first and final call A/c Dr. To share capital A/c (Being call money due on 16,000 shares @ Rs. 2 per share)		32,000	 32,000

	Bank A/c Dr. To share first and final call A/c (Being final call money received)		32,000	32,000

Dr **Max ltd. Ledger Accounts** Bank Account Cr.

	Rs.		Rs.
To share Application A/c	48,000	By Balance c/d	1,44,000
To share Allotment A/c	64,000		
To share first and final call A/c	32,000		
	1,44,000		1,44,000
To Balance b/d	1,44,000		

Dr Share Application Account Cr.

	Rs.		Rs.
To share capital A/c	48,000	By Bank A/c	48,000
	48,000		48,000

Dr Share Allotment Account Cr.

	Rs.		Rs.
To share capital A/c	64,000	By Bank A/c	64,000
	64,000		64,000

Dr Discount on Shares Account Cr

	Rs.		Rs
To share capital A/c	16,000	By Balance c/d	16,000
	16,000		16,000
To Balance b/d	16,000		

Dr Share First and Final call Account Cr.

	Rs.		Rs.
To share capital A/c	32,000	By Bank a/c	32,000
	32,000		32,000

Dr Share Capital Account Cr.

	Rs.		Rs.
To Balance c/d	1,60,000	By share Application A/c	48,000
		By share Allotment A/c	64,000
		By Discount on shares A/c	16,000
		By share first and final call A/c	32,000
	1,60,000		1,60,000
		By Balance b/d	1,60,000

Balance sheet of Max ltd. As on ....

Liabilities	Rs.	Assets	Rs.
Equity share capital: Authorised:	-	Cash at Bank A/c	1,44,000
Issued, Subscribed and paid up: 16,000 shares issued @ Rs. 10 each	1,60,000	Discount on shares	16,000
	1,60,000		1,60,000

Note: Discount on issue of shares is a capital loss. Till it is written it will appear on the asset side of the balance sheet.

1.16. OVER SUBSCRIPTION – REFUND OF APPLICATION MONEY

The Directors are at the discretion to allot the shares applied or may reject and refund the application money so received if it exceeds the number of shares issued.

Entry:

Share Application A/c Dr.
To Bank A/c

Illustration: 4

Chand and Co. invited applications for 1000 shares of Rs. 20 per share payable. Rs. 4 in application and Rs. 6 on allotment and the balance when required.

Application were received for 1200 shares. Application for 1000 shares were accepted by the directors and for 200 shares altogether rejected. Allotment money was received on the shares. Pass the necessary journal entries.

Solution:

Journal entries

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To share Application A/c (Being application money received on 1200 shares @ Rs. 4 per share)		4,800	4,800
	share Application A/c Dr. To share capital A/c (Being application money transferred to share capital)		4,000	4,000
	share Application A/c Dr. To Bank A/c (Being application money on 200 shares @ Rs. 4 per share refunded)		800	800
	share allotment A/c Dr. To share capital A/c (Being allotment money due on 1,000 shares @ Rs. 6 per share)		6,000	6,000
	Bank A/c Dr. To share Allotment A/c (Being allotment money received)		6,000	6,000

1.17. OVER SUBSCRIPTION – PRO-RATA ALLOTMENT

If the number of shares applied for is more than the number of shares issued, it is said to be over-subscribed. But the company can allot only shares equal to the shares issued by it. In that case the directors may either totally reject some of the applications or they may allot shares on " Pro-rata basis" and hence it is known as Pro-rata allotment.

This situation will not arise in full subscription (applications received equal to the issued numbers) or lesser subscription (applications received less than the issued numbers). Pro-rata will arise only on over subscription. At that time the company need not refund the excess application money received but the same can be adjusted on allotment money and call money due. Usually it is adjusted towards allotment.

Entry:

Share Application A/c Dr.
To Share Allotment A/c
(Being surplus money adjusted towards allotment)

Illustration: 5

Mala Company Ltd. Issued 10,000 shares of Rs. 10 each payable as below:

On application Rs. 2
On allotment Rs. 3
On first call Rs. 3
On final call Rs. 3

The public subscribed for 50,000 shares but the company allotted shares to the application as below:

For an application who had applied for 10,000 shares were rejected another applicant for 30,000 shares, were allotted only 5,000 shares and the remaining applicants were allotted on pro-rata basis. Prepare pro-rata allotment table.

Table showing Pro-rata Allotment

No. of Shares applied	No. of shares allotted	No. of shares rejected
10,000	Nil	10,000
30,000	5,000	25,000
10,000	5,000	Nil
	Shares on pro-rata basis	
50,000	10,000	35,000

Working for Surplus Application Money Adjusted toward Allotment:

Particulars	No. of shares x Rs.	Amount Rs.
Application		
Received	50,000 x 2	1,00,000
Less: Refunded	10,000 x 2	20,000
	40,000 x 2	80,000
Less: Refunded		
(30,000 – 5000)	25,000 x 2	50,000
	15,000 x 2	30,000
Less: Issued 5000 shares	10,000 x 2	20,000
Surplus adjusted towards allotment	5000 x2	10,000

Illustration: 6

Madura ltd. issued 50,000 shares of Rs. 10 each payable as to Rs. 3 on application, Rs. 4 on allotment and the balance on call. Applications for 70,000 shares had been received. Application for 8,000 shares was rejected and the remaining applications were allotted the 50,000 shares on pro-rata basis. The excess amount on applications was allotted the 50,000 shares on pro-rata basis. The excess amount on application was adjusted to the amount due on allotment and all the shareholders paid the calls. Journalise the transaction and prepare ledger accounts and balance sheet.

Solution:

Working:

1) Over subscription / Pro-rata Allotment:

Particulars	No. of shares x Rs.	Amount Rs.
No of Application		

Received Less: Issued	70,000 x 3 50,000 x 3	2,10,000 1,50,000
 Less: Refunded	20,000 x 3 8,000 x 3	60,000 24,000
Less: Refunded Surplus money to be adjusted in allotment money	12,000 x3	36,000

2) Allotment Money Due:

	Rs.
50,000 shares of Rs. 4 each	2,00,000
Less: Surplus Application money adjusted towards allotment	36,000
Money to be received	1,64,000

Madura Ltd. Journal entries

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To share Application A/c (Being application money received on 70,000 shares @ Rs. 3 per share)		2,10,000	 2,10,000
	share Application A/c Dr. To share capital A/c (Being application money received on 50,000 shares @ Rs. 3 per share transferred to share capital)		1,50,000	 1,50,000
	share Application A/c Dr. To Bank A/c (Being application money on 8000 shares @ Rs. 3 per share refunded)		24,000	 24,000
	share Application A/c Dr. To share capital A/c (Being surplus application money on 12,000 shares @ Rs. 3 per share adjusted towards allotment)		36,000	 36,000
	Share Allotment A/c Dr. To Share capital A/c (Being allotment money due on 50,000 shares @ Rs. 4 per share)		2,00,000	 2,00,000
	Bank A/c Dr. To share Allotment A/c (Being allotment money received on 50,000 shares less Rs. 36,000 surplus application money transferred)		1,64,000	 1,64,000
	Share First and final call A/c Dr. To share capital A/c (Being call money due on 50,000 shares @ Rs. 3 per share due)		1,50,000	 1,50,000
	Bank A/c Dr. To Share first and final A/c		1,50,000	 1,50,000

	(Being call money received)			

Dr **Madura Ltd. Ledger Accounts** Bank Account Cr.

	Rs.		**Rs.**
To share Application A/c	2,10,000	By share Application A/c	24,000
To share Allotment A/c	1,64,000	By Balance c/d	5,00,000
To share call A/c	1,50,000		
	5,24,000		5,24,000
To Balance b/d	5,00,000		

Share Application Account

Dr Cr.

	Rs.		**Rs.**
To share capital A/c	1,50,000	By Bank A/c	2,10,000
To Bank A/c	24,000		
To share Allotment A/c	36,000		
	2,10,000		2,10,000

Share Allotment Account

Dr Cr.

	Rs.		**Rs.**
To share capital A/c	2,00,000	By Share application/c	36,000
		By Bank A/c	1,64,000
	2,00,000		2,00,000

Dr Share First and Final call Account Cr.

	Rs.		**Rs.**
To share capital A/c	1,50,000	By Bank a/c	1,50,000
	1,50,000		1,50,000

Dr Share Capital Account Cr.

	Rs.		**Rs.**
To Balance c/d	5,00,000	By share Application A/c	1,50,000
		By share Allotment A/c	2,00,000
		By share first and final call A/c	1,50,000
	5,00,000		5,00,000
		By Balance b/d	5,00,000

Balance sheet of Madura Ltd. As on ....

Liabilities	**Rs.**	**Assets**	**Rs.**
Equity share capital: Authorised:	-	Cash at Bank A/c	5,00,000
Issued: 50,000 shares issued @ Rs. 10 each	5,00,000		
Subscribed and paid up: 50,000shares of Rs.10 each	5,00,000	To Balance b/d	5,00,000
	10,00,000		10,00,000

1.17.1. Calls-in-Arrears:

If any amount called on shares either on first call on second or final call is to be paid before or on the date fixed for payment. Such amount which is not paid is called “Calls-in-Arrears”. This calls-in-arrears is a loss to the company for the time being till it is realised. It should be shown on the liabilities side of the balance sheet as a deduction from the subscribed capital.

1.17.2. Calls-in-Advance:

The money received by the company in excess of what has been called up is known as "Calls-in-Advance". For the time being it is liability for the company. Therefore, it is credited to Calls-in-Advance Account. This can be shown on the liabilities side of the balance sheet till it is closed 6% p.a. interest is allowed as a maximum as per articles of association.

If calls-in-advance is received.

Entry:

Bank A/c Dr.
To calls-in-Advance A/c
(Being advance call money received)

When respective calls are made, the appropriate money so received is transferred to the particular call account.

Entry:

Calls-in-Advance A/c Dr.
To Particular Call A/c
(Being call money transferred)

Illustration: 7

XYZ is issued 50,000 shares of Rs. 10 each at par payable as follows: Rs. 3 on application; Rs. 4 on allotment and Rs. 3 on first and final call. The company received application for 40,000 shares and all of them were accepted. All sums due were received except the call money on 500 shares. Give journal entries, prepare ledger accounts and show the balance sheet.

Solution:

XYZ Ltd. Journal Entries

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To share Application A/c (Being application money received on 40,000 shares @ Rs. 3 per share)		1,20,000	 1,20,000
	share Application A/c Dr. To share capital A/c (Being application money transferred to share capital)		1,20,000	 1,20,000
	Share Allotment A/c Dr. To Share capital A/c (Being allotment money due on 40,000 shares @ Rs. 4 per each)		1,60,000	 1,60,000
	Bank A/c Dr. To share Allotment A/c (Being allotment money received)		1,60,000	 1,60,000
	Share First and final call A/c Dr. To share capital A/c (Being call money due on 40,000 shares @ Rs. 3 each)		1,20,000	 1,20,000
	Bank A/c Dr. To Share first and final A/c		1,18,500	 1,18,500

	(Being call money received except on 500 shares @ Rs. 3 each)			

XYZ Ltd. Ledger Accounts

Dr Bank Account Cr.

	Rs.		Rs.
To share Application A/c	1,20,000	By Balance c/d	3,98,500
To share Allotment A/c	1,60,000		
To share first and final call A/c	1,18,500		
	3,98,500		3,98,500
To Balance b/d	3,98,500		

Share Application Account

Dr Cr.

	Rs.		Rs.
To share capital A/c	1,20,000	By Bank A/c	1,20,000
	1,20,000		1,20,000

Share Allotment Account

Dr Cr.

	Rs.		Rs.
To share capital A/c	1,60,000	By Bank A/c	1,60,000
	1,60,000		1,60,000

Dr Share First and Final call Account Cr.

	Rs.		Rs.
To share capital A/c	1,20,000	By Bank a/c By Balance c/d	1,18,500 1,500
	1,20,000		1,20,000
To Balance b/d (Calls-in-arrears)	1,500		

Dr Share Capital Account Cr.

	Rs.		Rs.
To Balance c/d	4,00,000	By share Application A/c	1,20,000
		By share Allotment A/c	1,60,000
		By share first and final call A/c	1,20,000
	4,00,000		4,00,000
		By Balance b/d	4,00,000

Balance sheet of XYZ Ltd. As on ....

Liabilities	Rs.	Assets	Rs.
share capital: Authorised:	-	Cash at Bank A/c	3,98,500
Issued: 50,000 shares issued @ Rs. 10 each	5,00,000		
Subscribed and paid up: 40,000 share of Rs. 10 each Less: Calls-in-Arrears	4,00,000 1,500 3,98,500		3,98,500

1.18. FORFEITURE AND REISSUE

Forfeiture means the company to take back the shares for non-payment of any call money. If a shareholder fails to pay any call money on

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shares made by the company these shares may be taken back or cancelled as a penalty after a reasonable notice of not less than 14days. The company has no powers to forfeit the shares unless it is provided by the articles of Association. The shareholder ceases to be a member of company. The share capital is reduced on forfeiture and the money so received on it is appropriated and credited to "Forfeited Shares account".

Entry:

Share capital A/c Dr.	(No. of shares forfeited x amount called up)
To Particular call A/c	(No. of shares forfeited x amount unpaid)
To Forfeited shares A/c	(No. of shares forfeited x amount already paid)

As per Illustration 7, assuming that the directors forfeited the 500 shares for default of call money. Pass journal entry and shoe the balance sheet.

Write entries from No.1 to 6 as in illustration No. 8, then proceed to 7th entry for forfeiture as below.

share capital A/c Dr.	5,000	
To share first and final call A/c		1,500
To Forfeited shares A/c		3,500
(Being 500 shares forfeited for default of call money)		

Balance sheet of XYZ Ltd. As on ....

Liabilities	Rs.	Assets	Rs.
Equity share capital: Authorised:	-	Cash at Bank A/c	3,98,500
Issued: 50,000 shares issued @ Rs. 10 each	5,00,000		
Subscribed and paid up: 39,500share of Rs. 10 each Less: Forfeited shares	3,98,500 3,500 3,98,500		3,98,500

1.18.1. Re-issue of Forfeited shares

Forfeited shares can be re-issued at a price less than he face value. But it should not be less than the called-up value. The loss on re-issue of forfeited shares is debited to "Forfeited shares Account" and of there is any balance in "Forfeited Shares Account" the same will be a "Capital Profit". It should be transferred to "Capital Reserve Account".

The entry for re-issue of forfeited shares.

Entry:

Bank A/c Dr.	(No. of shares x Re-issue price)
Forfeited shares A/c Dr.	(No. of shares x Difference between face value and re-issue price)
To share Capital A/c	(No. of shares x Face value)

If there is any balance in forfeited shares Account, it should be transferred to capital Reserve Account and the entry.

Entry:

Forfeited shares A/c Dr.
To Capital Reserve A/c
(Being profit on forfeited shares transferred to Capital Reserve A/c)

Illustration: 8

William Co. Ltd., issues 10,000 shares of the value of Rs. 10 each payable Rs. 3 on the application, Rs. 3 on allotment and Rs. 4 on first and final call. All the shares are subscribed and duly allotted, and the call is made. All cash is received except the call money on 200 shares. These shares are forfeited by the directors and are re-issued as fully paid for Rs. 1,500.

Solution:William Co. Ltd., Journal entries

Date	Particulars		L.F	Debit	Credit
	Bank A/c To share Application A/c (Being application money received on 10,000 shares @ Rs. 3 per share)	Dr.		30,000	 30,000
	share Application A/c To share capital A/c (Being application money transferred to share capital)	Dr.		30,000	 30,000
	Share Allotment A/c To Share capital A/c (Being allotment money due on 10,000 shares @ Rs. 3 per share)	Dr.		30,000	 30,000
	Bank A/c To share Allotment A/c (Being allotment money received)	Dr.		30,000	 30,000
	Share First and final call A/c To share capital A/c (Being call money due on first and final call on 10,000 shares @ Rs. 4 per share)	Dr.		40,000	 40,000
	Bank A/c To Share first and final call A/c (Being call money received on first and final call on 9,800 shares @ Rs. 4 per share)	Dr.		39,200	 39,200
	Share capital A/c To Share First and final call A/c To Forfeited shares A/c (Being forfeiture of 200 shares for non-payment of first and final call money)	Dr.		2,000	 800 1,200
	Bank A/c Forfeited shares A/c To share capital A/c (Being re-issue of 200 forfeited shares as fully paid up for Rs. 1,500)	Dr. Dr.		1,500 500	 2,000
	Forfeited shares A/c To Capital Reserve A/c (Being profit on forfeited share transferred to capital reserve A/c)	Dr.		700	 700

William Co. Ltd. Ledger Accounts Forfeited Shares Account

Dr Cr.

	Rs.		Rs.
To share capital A/c	500	By share capital A/c	1,200

To Capital Reserve A/c	700		
	1,200		1,200

Capital Reserve Account

Dr Cr.

	Rs.		Rs.
To balance c/d	700	By Forfeited share A/c	700
	700		700
		By Balance b/d	700

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(Note: Students can prepare other accounts by themselves)

Illustration: 9

Kavery Ltd, issued 10,000 shares of Rs. 10/- each payable as Rs. 2 on application, Rs. 5 on allotment and Rs. 3 on first and final call. The public applied for 8000 shares which were allotted. All money due on shares were received except the final call money on 100 shares. These shares were forfeited and reissued at Rs. 8 per share.

Pass journals in the books of the company, prepare ledger accounts and also show the balance sheet.

Solution: Kavery Ltd. Journal entries

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To share Application A/c (Being application money received on 8,000 shares @ Rs. 2 per share)		16,000	 16,000
	share Application A/c Dr. To share capital A/c (Being application money transferred to share capital)		16,000	 16,000
	Share Allotment A/c Dr. To Share capital A/c (Being allotment money due on 8,000 shares @ Rs. 5 per share)		40,000	 40,000
	Bank A/c Dr. To share Allotment A/c (Being allotment money received)		40,000	 40,000
	Share First and final call A/c Dr. To share capital A/c (Being call money due on first and final call on 8,000 shares @ Rs. 3 per share)		24,000	 24,000
	Bank A/c Dr. To Share first and final call A/c (Being call money received on first and final call except on 100 shares)		23,700	 23,700
	Share capital A/c Dr. To Share First and final call A/c To Forfeited shares A/c (Being 100 shares @ Rs. 10 per share forfeited for non-payment of call money @ Rs. 3 per share)		1,000	 300 700
	Bank A/c Dr. Forfeited shares A/c Dr.		800 200	

	To share capital A/c (Being forfeited shares re-issued @ Rs. 8 per share)			1,000
	Forfeited shares A/c Dr. To Capital Reserve A/c (Being profit on forfeited share transferred to capital reserve)		500	500

Kavery Ltd. Ledger Accounts

Dr Bank Account Cr.

	Rs.		Rs.
To share Application A/c	16,000	By Balance c/d	80,500
To share Allotment A/c	40,000		
To share first and final call A/c	23,700		
To share Capital A/c	800		
	80,500		80,500
To Balance b/d	80,500		

Share Application Account

Dr Cr.

	Rs.		Rs.
To share capital A/c	16,000	By Bank A/c	16,000
	16,000		16,000

Share Allotment Account

Dr Cr.

	Rs.		Rs.
To share capital A/c	40,000	By Bank A/c	40,000
	40,000		40,000

Dr Share First and Final call Account Cr.

	Rs.		Rs.
To share capital A/c	24,000	By Bank a/c By Share capital A/c	23,700 300
	24,000		24,000

Forfeited Shares Account

Dr Cr.

	Rs.		Rs.
To share capital A/c	200	By share capital A/c	700
To Capital Reserve A/c	500		
	700		700

Share Capital Account

Dr Cr.

	Rs.		Rs.
To share first and final call A/c	300	By share Application A/c	16,000
To forfeited shares A/c	700	By share Allotment A/c	40,000
To Balance c/d	80,000	By share first and final call A/c	24,000
		By Bank A/c	800
		By Forfeited shares A/c	200
	81,000		81,000
		By Balance b/d	80,000

Capital Reserve Account

Dr Cr.

	Rs.		Rs.
To balance c/d	500	By Forfeited share A/c	500
	500		500
		By Balance b/d	500

Balance sheet of Kavery Ltd. As on ....

Liabilities	Rs.	Assets	Rs.
share capital: Authorised:	-	Cash at Bank A/c	80,500
Issued: 10,000 shares issued @ Rs. 10 each	1,00,000		
Subscribed and paid up: 8,000shares of Rs. 10 each Reserve and surplus Capital Reserve	80,000 500		
	80,500		80,500

Illustration: 10

Moon Ltd. Issued 20,000 shares of Rs.10 each at par payable Rs. 2 on applications, Rs. 3 on allotment and the balance in two calls of equal amount. Applications were received for 30,00 shares. The shares were allotted on pro-rata to the applications for 24,000 shares and remaining were rejected. Money overpaid on application was used towards the sums due on allotment. All money due were received except from Ram holding 1000 shares failed to pay both the calls. These shares were forfeited and later re-issued to Ravi at Rs. 9 as fully paid up. Pass journals prepare ledger accounts and balance sheet in the books of the company.

Solution:

Workings:

1) Pro-rata Allotment:

Particulars	No. of shares x Rs.	Amount Rs.
No of Application Received Less: No of shares issued or allotted	30,000 x 2 20,000 x 2	60,000 40,000
 Less: Rejected or refunded (30,000- 24,000= 6,000)	10,000 x 2 6,000 x 2	20,000 12,000
Surplus money to be adjusted in allotment money	4,000 x 2	8,000

2) Allotment Money Due:

	Rs.
20,000 shares of Rs. 3 each	60,000
Less: Surplus Application money adjusted towards allotment	8,000
Money to be received	52,000

Moon Ltd. Journal entries

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To share Application A/c		60,000	 60,000

	(Being application money received on 30,000 shares @ Rs. 2 per share)				
	share Application A/c To Bank A/c (Being application money on 6000 shares refunded @ Rs. 2)	Dr.		12,000	 12,000
	share Application A/c To share capital A/c (Being application money on 20,000 shares transferred to share capital)	Dr.		40,000	 40,000
	Share Allotment A/c To Share capital A/c (Being allotment money due on 20,000 shares @ Rs. 3 each)	Dr.		60,000	 60,000
	Share application A/c To share Allotment A/c (Being excess application money on 4,000 shares adjusted towards the sum due on allotment)	Dr.		8,000	 8,000
	Bank A/c To Share Allotment A/c (Being allotment money received less adjusted surplus money of Rs. 8000)	Dr		52,000	 52,000
	Share First call A/c To share capital A/c (Being call money due on first call on 20,000 shares @ Rs. 2.50)	Dr.		50,000	 50,000
	Bank A/c To Share first call A/c (Being first call money received on 19,000 shares @ Rs. 2.50 each)	Dr.		47,500	 47,500
	Share second and final call A/c To share capital A/c (Being second call money due on 20,000 shares @ Rs. 2.50 each)	Dr.		50,000	 50,000
	Bank A/c To Share second and final call A/c (Being second call money received on 19000 shares @ Rs. 2.50 each)	Dr.		47,500	 47,500
	Share capital A/c To Forfeited shares A/c To Share First Call A/c To Share second and final call A/c (Being 1000 shares forfeited for non-payment of first and second call money)	Dr.		10,000	 5,000 2,500 2,500
	Bank A/c Forfeited shares A/c To share capital A/c	Dr. Dr.		9,000 1,000	 10,000

	(Being 1000 forfeited shares re-issued @ Rs. 9 each)			
	Forfeited shares A/c Dr. To Capital Reserve A/c (Being profit on re-issued of forfeited shares transferred to capital reserve)		4,000	 4,000

Moon Ltd. Ledger Accounts

Dr Bank Account Cr.

	Rs.		Rs.
To share Application A/c	60,000	By share Application A/c	12,000
To share Allotment A/c	52,000	By Balance c/d	2,04,000
To share first call A/c	47,500		
To share second & final call A/c	47,500		
To share Capital A/c	9,000		
	2,16,000		2,16,000
To Balance b/d	2,04,000		

Dr Share Application Account Cr.

	Rs.		Rs.
To Bank A/c	12,000	By Bank A/c	60,000
To share capital A/c	40,000		
To share allotment	8,000		
	60,000		60,000

Dr Share Allotment Account Cr.

	Rs.		Rs.
To share capital A/c	60,000	By share application	8,000
		By Bank A/c	52,000
	60,000		60,000

Dr Share First call Account Cr.

	Rs.		Rs.
To share capital A/c	50,000	By Bank a/c By Share capital A/c	47,500 2,500
	50,000		50,000

Dr Share Second and Final call Account Cr.

	Rs.		Rs.
To share capital A/c	50,000	By Bank a/c By Share capital A/c	47,500 2,500
	50,000		50,000

Dr Share Capital Account Cr.

	Rs.		Rs.
To share first call A/c	2,500	By share Application A/c	40,000
To share second Final call A/c	2,500	By share Allotment A/c	60,000
To forfeited shares A/c	5,000	By share first call A/c	50,000

To Balance c/d	2,00,000	By second and final call A/c	50,000
		By Bank A/c	9,000
		By Forfeited shares A/c	1,000
	2,10,000		2,10,000
		By Balance b/d	2,00,000

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Dr Forfeited Shares Account Cr.

	Rs.		Rs.
To share capital A/c	1,000	By share capital A/c	5,000
To Capital Reserve A/c	4,000		
	5,000		5,000

Note: Students can prepare capital reserve account by themselves

Balance sheet on Moon Ltd. As on........

Liabilities	Rs.	Assets	Rs.
share capital: Authorised:	-	Cash at Bank A/c	2,04,000
Issued: 20,000 shares issued @ Rs. 10 each	2,00,000		
Subscribed: 20,000 share of Rs. 10 each Reserve and surplus Capital Reserve	2,00,000 4,000		
	2,04,000		2,04,000

1.19. UNDERWRITING

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

1.19.1. Pure Underwriting

Under pure underwriting, the underwriter's liability is conditional. Underwriter's liability arises only when there is shortfall in public subscription. When public issue is fully subscribed there is no liability for underwriters.

(a) Complete Underwriting:

If the whole issue of shares or debentures of a company is underwritten, it is called complete underwriting. The whole issue of shares or debentures may be underwritten either by a single underwriter or by many underwriters. In case of single underwriter, the entire unsubscribed portion is taken by him. In case of many underwriter's liability depends on the unsubscribed portion of the issue and subscriptions received by each underwriter.

(b) Partial Underwriting:

When only a portion of the shares or debentures issued by a company is underwritten, it is called partial underwriting. Again, this partial underwriting may be undertaken by a single underwriter or many underwriters for shares or debentures not underwritten, the company is treated as underwriter for than portion not underwritten. Unmarked applications are deducted from the shares or debentures not underwritten.

1.19.2. Firm Underwriting

Under firm underwriting, underwriters agree to take a certain number of shares irrespective of the public subscription. Even if public issue is oversubscribed, the underwriters agree to take the shares firm underwritten by them. In case of under subscription the underwriters have to take the shares not subscribed by public in addition to shares firm underwritten.

In case of firm underwriting also there may be partial underwriting or complete underwriting.

a) Complete Underwriting: The whole issue of shares of debentures issued by a company is underwritten. There may be one or more underwriters.

b) Partial Underwriting: A part of the shares or debentures issued by a company is underwritten. It is called partial underwriting. Again, there may be one or more underwriters.

1.19.3. Underwriter Vs Broker

Underwriter	Broker
(i) An underwriter undertakes to take up the shares not taken by the public.	He works to bring a relationship between the company and the public. He does not undertake to subscribe any shares.
(ii) Remuneration paid to an underwriter is called underwriting commission.	Remuneration paid to a broker is called Brokerage.
(iii) An underwriter must have contractual capacity.	A broker need not possess contractual capacity.
(iv) There is a contractual obligation to take up shares not subscribed by public.	There is no such contractual obligation.

1.19.4. Underwriting Commission

The remuneration paid to an underwriter for his services is called underwriting commission. Section 76of Companies Act, regulates payment of underwriting commission. They are:

i. The Articles of a company must authorise the payment of underwriting commission.
ii. Underwriting commission payable should not exceed.
   (a) In case of shares: 5% of the issue price of shares or the rate or amount authorised by the Articles of the company, whichever is lower.
   (b) In case of debenture: 2.5% of issue price of debenture or the amount or rate authorised by the articles of the company, whichever is lower.
iii. Commission is payable on shares and debentures not offered to the public for subscription. Underwriting commission is not paid on shares taken by promoters' employees, directors, their friends and business associates.

1.19.5. Brokerage

A company is free to engage the services of brokers and pay brokerage in addition to underwriting commission. As per SEBI guidelines maximum rate of brokerage is fixed at 1.5% in respect of all types of securities. No brokerage is payable on promoter's quota.

1.19.6. Marked and Unmarked Application

Shares or debentures issued by a company are usually underwritten by two or more underwriters each underwriter will put a seal/stamp bearing his name or code on applications distributed to his clients. This seal/stamp on the applications helps the company to distinguish the applications received from the underwriters such applications bearing the seal/stamp or an underwriter is called marked applications. Applications received directly from a company's office will not bear the stamp of any underwriter. Such applications not bearing the seal/stamp of any underwriter is called unmarked applications.

1.19.7. Determining the Liability of Underwriters

The liability of an underwriter depends on the nature underwriting agreement. The underwriter's liability under different agreements is discussed below:

Complete Underwriting

(a) If whole issue is underwritten by a single underwriter: If the entire issue if fully subscribed by the public, the underwriter has no liability to take shares or debentures. The underwriter receives his commission from the company. When the public subscribe only a part of the issue, the shares/ debentures not subscribed by the public has to be taken by underwriter. The underwriter has to pay for the shares/debentures he had taken after adjusting the underwriting commission due to him.

The following step may be followed for determining the underwriter's liability:

Particulars	No. of Shares
Gross Liability Less: Marked and unmarked applications	XXX XXX
Underwriters liability	XXX

Note: There is no need to make any distinction between marked and unmarked applications when there is only one underwriter.

(b) If whole of the issue is underwritten by many underwriters: If whole issue is fully subscribed, the underwriters have no liability. They will receive underwriting commission from the company.

If the issue is not fully subscribed underwriters' liability should be calculated as below:

Statement showing underwriters liability

Particulars	**Underwriters**			
	A	**B**	**C**	**Total**
Gross liability (No. of shares underwritten by each underwriter) Less: Marked application	X X	X X	X X	X X
 Balance Less: Unmarked applications (in gross liability ratio)	X X	X X	X X	X X
Transfer of surplus of an underwriter to others	X	X	X	X
Net liability of underwriters	X	X	X	X

1.19.8. Firm Underwriting

Sometimes underwriters undertake to subscribe a certain number of shares even if the issue is fully subscribed. Such shares the underwriters undertake to take even when there is full subscription is called shares "underwritten firm". For such shares the underwriters have priority over the public.

For calculating underwriter's liability, the shares "Firm underwritten" are treated in two ways as below:

1. The applications for shares "Underwritten firm" is treated as marked applications and deducted from the liability of respective underwriters.
2. The applications for shares "Underwritten firm" is treated like "unmarked applications and divided between the underwriters in gross liability ratio.

Note: The underwriter's liability will vary according to the treatment given to shares "Underwritten firm".

In the absence of any specific instructions, it is preferable to treat the shares "underwritten firm" as "marked applications".

Accounting Treatment

In the books of the company:

Date	Particulars	L.F	Dr. (Rs.)	Cr. (Rs.)
1.	For subscriptions received from the public: Bank A/c Dr. To Share capital A/c Debentures A/c Note: Discount on issue of shares/securities premium may be debited/credited as the case may be.		XXX	XXX
2.	For underwriting commission payable: Underwriting commission A/c Dr. To Underwriters A/c		XXX	XXX
3.	For shares/debentures taken by underwriters as part of their liability: Underwriters A/c Dr. To Share capital A/c / Debentures A/c		XXX	XXX
4.	Settlement of money: (i) Money received from underwriters: Bank A/c Dr. To underwriter A/c (Or) (ii) Money paid to underwriters: Underwriter A/c Dr. To Bank A/c		XXX XXX	XXX XXX

In the books of the underwriters:

Date	Particulars	L.F	Dr. (Rs.)	Cr. (Rs.)
1.	For underwriting commission earned: Company A/c Dr. To Underwriting commission A/c		XXX	XXX
2.	For shares/Debentures taken up part of			

	underwriting obligation: Shares A/c / Debentures A/c Dr. To Company A/c		XXX	XXX
3.	For settlement of money: (i) Money paid to company: Company A/c Dr. To Bank A/c (Or) (ii) Money received from company: Bank A/c Dr. To Company		XXX XXX	XXX XXX
4.	For shares/debentures sold: Bank A/c Dr. Profit and loss A/c (loss on sale) Dr. To Shares A/c / Debentures A/c To Profit and loss A/c (Profit on sale)		XXX XXX	XXX XXX
5.	For decrease in the value of shares in hand: Profit and loss A/c Dr. To share A/c / Debentures A/c		XXX	XXX
6.	Transfer of underwriting commission to profit and loss account Underwriting commission A/c Dr. To profit and loss A/c		XXX	XXX

Illustrations – 1 (Single underwriter, Complete underwriting)

Y Ltd. issued 60,000 equity shares of Rs. 10 each at par. The entire issue has been underwritten by Balaji & Co, for a commission of 4 %. The applications were received for 58,000 shares. All the applications were accepted. Give Journal entries.

Solution: Journal Entries

Date	Particulars	L.F	Dr. (Rs.)	Cr. (Rs.)
1.	Bank A/c Dr. To Equity share capital A/c (Being money received on 58,000 equity shares of Rs. 10 each issued at par)		5,80,000	5,80,000
2.	Underwriting commission A/c Dr. To Balaji & Co. Ltd., A/c (Being underwriting commission payable to underwriter)		24,000	24,000
3.	Balaji & Co. A/c Dr. To Equity share capital A/c (Being 2,000 equity shares not taken by		20,000	20,000

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	the public allotted to underwriter)			
4.	Balaji & Co. A/c Dr. To Bank A/c (Being balance paid to Balaji & Co)		4,000	4,000

Illustrations – 2 (Single underwriter, Complete underwriting)

Bala Ltd., issues 8,000 equity shares of Rs. 100 each at a premium of Rs. 25 per share and 600 debentures of Rs. 1,000 each at Rs. 950 per debenture. The whole of the issue has been underwritten by Broker & Co. For a commission of 2.5 % on the issue price of shares and 2% on nominal value of debentures. 7000 equity shares and 500 debentures were subscribed by the public. All the applications were accepted.

Give journal entries to record the above transactions assuming that all amounts due have been received.

Solution: Journal Entries

Date	Particulars	L.F	Dr. (Rs.)	Cr. (Rs.)
1.	Bank A/c Dr. To Equity share capital A/c To securities premium A/c (Being subscriptions received for 7,000 equity shares)		8,75,000	7,00,000 1,75,000
2.	Bank A/c Dr. Discount on issue of debentures A/c Dr. To Debentures A/c (Being subscription received for 500 debentures)		4,75,000 25,000	5,00,000
3.	Broker & Co., A/c Dr. To Equity share capital A/c To Securities premium A/c (Being 1,000 equity shares not taken by public allotted to Broker & Co.)		1,25,000	1,00,000 25,000
4.	Broker & Co., A/c Dr. Discount on issue of debentures A/c Dr. To Debentures A/c		95,000 5,000	1,00,000
5.	Underwriting commission A/c Dr. To Broker & Co., A/c (Being underwriting commission payable to Broker & Co.)		37,000	37,000

Working Calculation of underwriting commission:

Particulars	Rs.
(i) On shares = (8000 X 125) = Rs. 10,00,000 X 2.5/100 (ii) On debentures = (600 X 1000) = Rs. 6,00,000 X 2/100	25,000 12,000
Total	37,000

6.	Bank A/c Dr. To Broker & Co., A/c (Being balance due form Broker & Co., received)		1,83,000	1,83,000

Working note: Amount received form Broker & CO:

Particulars	Rs.
(i) Amount due for 1,000 shares allotted (1000 X 125) (ii) Amount due for 100 debentures allotted (100 X 950)	1,25,000 95,000
Total Less: Underwriting commission adjusted	2,20,000 37,000
Balance amount received	1,83,000

Summary

1. Entry for application money should be made for actual number of shares for which application has been received.
2. One should carefully note whether the shares are issued at par, at discount or at premium.
3. If there is arrears on allotment when shares were allotted on prorate basis, students should be very careful in calculating allotment arrears.
   First calculate the prorate ratio.
4. Secondly find the number of shares applied by the defaulting shareholders.
   To find the allotment arrears, the application money payable on the shares allotted. Should be deducted from the allotment money payable on the shares allotted.
5. At the time of forfeiture, one should note whether the shares are partly called up or fully called up. Only called up amount should be debited to share capital account.
6. The "Discount on issue of shares account" debited at the time of issues should always be credited at the time of forfeiture.
7. In forfeiture, "Securities premium account" should be debited only if premium has not been received on the forfeited shares.
8. Note the number of shares forfeited and the number of shares reissued. If only part of the forfeited shares is reissued, capital reserve should be calculated only for the shares reissued.
9. Opening of "Calls-in-arrears account" at each stage will make it easier in making share forfeiture entry and calculation of capital reserve.
10. In case of partial underwriting for the portion not underwritten, the company is treated as underwriter. The underwriter is given credit for underwritten portion only.

EXERCISES

I. Theory questions

A. Short answer questions:

1. What is share. Explain kinds of shares.
2. What is a stock? How it differs from shares?
3. Explain the situations where shares are issued for consideration other than cash?
4. What is 'Certificate of commencement of business'?
5. What is 'Certificate of incorporation'?

6. What is forfeiture of shares?
7. What is lien on shares? Explain.
8. What is surrender of shares? Explain.
9. What is allotment of shares?
10. What is prorate allotment of shares? Explain.
11. What is minimum subscription? Explain.
12. What is a preference share? What are the preferences they enjoy?
13. What is Equity or ordinary share? Explain.
14. What is reserve capital?
15. What is under subscription and over subscription?

B. Long answer question:

1. Define a company. How it differs from partnership?
2. What is public company? Differentiate it from a private company.
3. Explain various kinds of companies.
4. What is share capital? Explain authorized capital, issued capital, subscribed capital and paid up capital.
5. What is prospectus? Explain its contents.
6. What is underwriting? Explain.
7. What is firm underwriting?

II.PROBLEMS

A. Short answer problems

Issued at par:

1. Sun Ltd, issued 5,00,000 shares of Rs.10 each, payable as Rs.2 on application Rs.3 on allotment and the balance on calls. Application for 7,00,000 shares were received. The directors allotted the shares as follows:

To applicants for 3,50,000 shares-full allotment

To applicants for 2,50,000 shares-full allotment

To applicants for 1,00,000 shares-Nil

Give journal entries assuming that all sums due on allotment have been received and no call has been made.

(Ans: Application money transferred to allotment Rs.2,00,000 application money returned Rs.2,00,000)

Issued at premium:

1. ABC Ltd. issued 30,000 shares of Rs.10 each at a premium of Rs.4 per shares payable, Rs.4 on application, Rs.5 on allotment and Rs.5 on final call. The public applied for 50,000 shares. The company made prorate allotment to applicants for 40,000 shares and the remaining applications were rejected. One shareholder who applied for 1,000 shares failed to pay allotment money. Show journal entries for allotment stage only**. (Ans: Allotment arrears Rs.2,750, Amount received on allotment Rs.1,07,250)**

Issued at discount:

2. Kavi Ltd. issued 10,000 shares of Rs.100 each at 10% discount payable Rs.50 on application and Rs.40 on allotment. Applications were received for 9,500 shares and all the applications were accepted in full.

   One shareholder who was allotted 250 shares failed to pay the allotment money and his shares were for feature of the forfeited shares, 150 shares were reissued for Rs.85 as fully paid.

   Pass journal entries for forfeited and reissue only.

   (Ans: Share forfeited amount Rs.12,500, capital reserve Rs.6750)

Forfeiture and reissue:

3. B Ltd. issued 25,000 shares of Rs.100 each at a premium Rs.20 per share payable as Rs.30 on application (including premium of Rs.10), Rs.40 on allotment (including premium of Rs.10) and Rs.50 on first and final call. One shareholder holding 200 shares failed to pay allotment and call money. His shares were forfeited. 100 of the forfeited shares were reissued for Rs.90 as fully paid. Give entry for forfeiture and reissue only**. (Ans: Capital reserve Rs.1,000)**

Issued at premium, forfeiture and reissue:

4. Malar Ltd. forfeited 100 shares of Rs.100 shares of Rs.10 each issued at a premium of 20% (to be paid at the time of application money) on which allotment money of Rs.4 and first call money of Rs.3 were not received. The final call money of Rs.3 is not yet called. These shares were originally allotted in the ratio of 4:5. These shares were subsequently reissued at a discount of Re.1 per share credited as Rs.8 paid up. Pass journal entries in the books of Alex Ltd for forfeiture and reissue of shares. (ACS-Inter) **(Ans. Capital reserve Rs.75)**

Rights issue :

5. Z company offers its shareholder the right to buy one share of Rs.20 each at Rs.21 for every two shares held. The company declared a divined of Rs.3 per share. On the date of declaration of dividend and rights issue, the shares are quoted at a price of Rs.53 (cum-dividend and cum-right). Calculate the value of right.

(Ans: Value of rights Rs. 3 per share)

UNIT -II REDEMPTION OF PREFERENCE SHARES

Structure

2.1. INTRODUCTION

A going company cannot repay its capital to its shareholders. Capital of company acts as security to the creditors of the company. Repayment of capital amounts to reduction of capital. Reduction of capital is permitted only with the permission of a court. But section 80 of companies Act permits issue and redemption of redeemable preference share capital.

Conditions for issue and redemption of preference shares are:

1. Articles of Association of a company should authorise the issue of redeemable preference shares.
2. A company cannot issue irredeemable preference shares from 1.3.1997. A company cannot issue redeemable preference shares redeemable after 20 years.
3. Only fully paid redeemable preference shares can be redeemed.
4. Preference shares can be redeemed either at par or at premium.
5. Preference shares can be redeemed out of two sources only. They are:
   (i) Fully out of divisible profit or profit available for dividend.
   (ii) Fully out of proceeds of fresh issue of shares.
   (iii) Partly out of profit and partly out of fresh issue of shares.
6. When preference shares are redeemed out of divisible profit, divisible profit equal to nominal value of preference shares redeemable, should be transferred to a reserve account called 'Capital Redemption Reserve'.
7. Capital Redemption Reserve can be used for issue of fully paid bonus shares only
8. When shares are redeemed out of proceeds of fresh issue either preference shares or equity shares only are to be issued.
9. "Proceeds of fresh issue means"

(i) When fresh shares are issued at par: The nominal value of shares issued in the "proceeds of fresh issue" for redemption purpose.

(ii) When fresh shares are issued at premium: only the nominal value of shares issued is taken as "Proceeds of fresh issue". The securities premium received is not included in the "Proceeds of fresh issue".

(iii)When shares are issued at discount: The amount received from shareholder is considered as"

10. When preference shares are redeemed t premium, the redemption premium is a capital loss. It should be written off from securities premium or other profits.
11. 12.Redemption of preference shares should be carried out according to section 80 of companies Act and Articles of association of the company.
12. 13.Redemption of preference shares will not amount to reduction of authorized capital of the company.
13. 14.Fresh issue of equity shares will not amount to reduction of authorized capital of the company.
14. Sale of assets or issue of debentures is not considered as "Proceeds of fresh issue"
15. 16.Fixed assets should not be sold for mobilizing cash.

2.2 REDEMPION OF IRREDEEMABLE PREFRENCE SHARES

Companies Amendment Act,1996 prevents a company from issuing irredeemable after period of 20 years. Irredeemable preference shares or redeemable preference shares redeemable after 20 years issued before companies Amendment Act, 1996 should be redeemed on the due dates of redemption or immediately after the expiry of 20 years from the commencement Amendment Act,1996.

2.3. FAILURE TO REDEEM REDEEMBLE PREFRENCE SHARES ON THE DUE DATE

A Company may fail to redeem redeemable preference shares due to financial difficulties or non-availability of divisible profits. The preference shareholders are not creditors of the company. They cannot petition a court for winding up of the company.

The concerned company my get the consent of the company Law Board, on a petition made to it, to issue fresh redeemable preference shares equal to the exiting redeemable preference shares and dividend due on such shares.

2.4. FINDING MINIMUM FRESH ISSUE OF SHRES AND MINIMUM CAPITAL REDEMPITION RESERVE

2.4.1. Simple equation

Redeemable preference share capital = capital redemption reserve +Fresh issue

Fresh issue = Redeemable preferences shares – capital redemption reserve **(or)** Capital redemption reserve = Redeemable preference share capital- fresh issue.

2.4.2. Using algebraic equation to find minimum fresh issue:

Minimum fresh issue = [Redeemable preference share capital + Redemption premium- securities premium in the balance sheet – Divisible profits in the balance sheet] * 100/100 + % of premium on fresh issue or 100 - % of discount on fresh issue.

Note: The above equation will be used in the following circumstances:

1. Preference shares are redeemed at premium.
2. Fresh issue of shares are made at either premium or discount.
3. Securities premium given in the balance sheet and securities premium from fresh issue are not sufficient to write off redemption premium.

2.5. ACCOUNTING TREATMENT FOR REDEMPTIONOF PREFERENCE SHARES

1. Fresh issue of shares:

Fresh issue of shares may be either preference shares or equity shares. The fresh issue of shares may be made at par, at discount or at premium. The entries for the fresh issue are:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
(i) (a)	Issued at par: Bank A/c Dr. To Share Capital A/c		Xxx	 xxx
(b)	Issued at discount: Bank A/c Dr. Discount on issue of shares A/c Dr. To Share capital A/c		 xxx xxx	 xxx
(c)	Issued at premium: Bank A/c Dr. To Share capital A/c To Securities premium A/c		 Xxx	 xxx xxx
(ii)	Transfer of divisible profit to capital redemption reserve account: Divisible profits (individually A/c) To capital redemption reserve A/c Dr.	Xxx	 xxx	
(iii)	Arranging cash balance: Bank A/c Dr. To Assets (given in sum) or bank o/d bank loan A/c	 Xxx	 xxx	

Note: There may be profit or loss on sale of assets. They should be transferred to profit and loss account.

2. Redemption of preference shares:

Preference shares can be redeemed either at par or at premium. The entries

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
(i) (a)	Redemption at par: Transfer of preference share capital to preference shareholders: Redeemable preference share capital A/c Dr. To preference shareholder A/c		 XXX	 XXX
(b)	Payment of money to preference shareholders: Preference shareholders A/c Dr. To bank A/c		 XXX	 XXX
(ii) (a)	Redemption at premium: Transfer of preference share capital and redemption premium to preference shareholders: Redeemable preference share capital A/c Dr. Redeemable premium A/c Dr.		 XXX XXX	

	To Preference shareholders A/c			XXX
(b)	Payment of money to preference shareholders: Preference shareholders A/c Dr. To Bank A/c		XXX	 XXX
(iii)	Writing off Redemption premium: Security premium A/c Dr. Or Any other profits Dr. To Redemption premium A/c		 XXX XXX	 XXX

3. Issue of bonus shares

Capital Redemption Reserve can be used for issue of fully paid bonus shares only. It does not mean that bonus shares can be issued only from capital redemption reserve. Other profits like securities premium and divisible profits available can also be used for issue of bonus shares. Capital profits realised in cash is also available for bonus issue. The entries for bonus issue are:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
(i)	Transfer of reserve to bonus account: Capital redemption reserve A/c Dr. General reserve A/c Dr. Securities premium or other divisible Profit A/c (only when CRR is not sufficient for issue of bonus shares) Dr. To Bonus to equity shareholders A/c		 XXX XXX XXX	 XXX
(ii)	Issue of bonus share: Bonus to equity shareholders A/c Dr. To Equity share capital A/c		 XXX	 XXX

4. Redemption by conversion:

Preference shares can be redeemed by converting them into equity shares. Capital redemption reserve need not be created in case of redemption by conversion. The entries for conversion are:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
(i)	Transfer of preference share capital to preference shareholders account: Redeemable preference share capital A/c Dr. Redemption premium A/c (When redeemed at premium) Dr. To preference shareholders A/c		 XXX XXX	 XXX
(ii) (a)	Issue of equity shares to preference shareholders Issued at Par: Preference shareholders A/c Dr. To Equity share capital A/c		 XXX	 XXX
(b)	Issued at premium: Preference shareholders A/c Dr. To Equity share capital A/c To Securities premium		 XXX	 XXX XXX
(c)	Issued at discount: Preference shareholders A/c Dr. Discount on issue of shares A/c Dr. To Equity share capital A/c		 XXX XXX	 XXX

Note: Where equity shares are issued at premium to convertible preference shareholders, the nominal value of equity shares issued will be less than the nominal value of preference shares. Capital redemption reserve account should be created out of divisible profits to the extent of shortage.

2.6. TREATMENT OF PARTLY PAID PREFERENCE SHARES

As per Section 80 of companies Act, only fully paid preference shares can be redeemed. Where a question states to redeem preference shares which are partly paid, we should make a final call on preference shares and make them fully paid before redemption.

Sometimes there may be two classes of preference shares. One is fully paid and the other is partly paid. Then only fully paid preference shares are redeemed, leaving the partly paid preference shares.

2.7. TREATMENT OF CALLS-IN-ARREARS

According to section 80 of the Companies Act, only fully paid preference shares can be redeemed. If there are calls-in-arrears on some preference shares, these shares should be redeemed only after the receipt of calls-in-arrears. The entry for receipt of calls-in-arrears is:

Bank A/c Dr. XXX
To calls-in-arrears A/c XXX

A company has also a right to forfeit the shares on which there are calls-in-arrears. When the question specifically states that calls-in-arrears has been received, then the preference shares should be redeemed. Otherwise such preference shares on which there are calls-in-arrears should not be redeemed. But enough divisible profit balance should be left in the accounts to create capital redemption reserve account, to enable the redemption of preference shares later when preference shareholders pay the calls-in-arrears.

2.8. TREAMENT OF UNTRCEABLE PREFERENCE SHARE HOLDERS

A Company comes to know of untraceable shareholder only when cheques sent to preference shareholders are returned to the company. So, the entries for creation of capital redemption reserve or issue of fresh shares should be made for all the preference. Shares including the shares with untraceable shareholders. The amount unpaid to untraceable preference shareholders will continue to appear in the preference shareholders account. The unpaid balance in the preference shareholders account will appear on the liabilities side of balance sheet under the heading 'Current liabilities.

2.8.1. Issue of partly paid shares for redemption purpose

Fresh issue of shares may be made as fully paid up or partly paid up. In case fresh share issue is made partly paid up, the amount actually received excluding securities premium is taken as proceeds of fresh issue for redemption purpose.

2.9. BUY – BACK OF SHARES

Buy-back of shares means the repurchase of its own shares by the company. Section 77 (i) of companies Act, 1956 provides that company limited by share or limited by a guarantee and having share capital cannot buy its own shares. However, the companies (Amendment) Act, 1999 has inserted a new section 77A with effect from 31st October 1998 which allows a company to purchase its own equity shares or other specified securities.

The following are important reasons of buy-back of its share by a company:

1. A cash rich company may resort to buy- back of its shares when there are no alternative attractive investment opportunities.
2. A company's shares may be trading at a very low price than its real worth. In such circumstances a company management may decide to purchase its own shares in the market. To increase the value its shares.
3. Buy – back may enable a company to prevent the hostile takeovers by increasing the promoters holding.
4. Buy – back of shares does not impose any tax burden on the company. But a company has to pay corporate dividend tax on the payment of dividend to shareholders.
5. It increases the investors' confidence in the future growth of the company.
6. It reduces the number of outstanding shares and increases the Earning per share (EPS).
7. It enables a company to restructure its capital.

2.9.1. Terms and conditions for buy - back of shares

i. Articles of Association of a company must have a provision permitting the buy-back of its shares.
ii. Only fully paid shares can be bought back.
iii. A special resolution should be passed in the general meeting of the company.
iv. The buy – back must not exceed 25% of the total paid – up capital and free reserves of the company.
v. The debt – equity ratio should not be more than 2:1 after the buy – back.
vi. If the buy – back does not exceed 10% of the paid – up capital and free reserves of company, the buy – back may be authorized by a board resolution with effect from 23.10.2001 with as amendment to section 77A. But there should no further buy back through board resolution within 365 days from the first buy – back.
vii. Buy – back of shares of a company where its shares are listed in stock exchange the buy – back should be carried out in accordance with the regulation of the SEBI.
viii. Buy – back of shares should complete within a period of one year from the date of passing the resolution for buy – back.
ix. The shares bought – back should be extinguished and physically destroyed within seven days after completion of buy – back.
x. After the buy – back is completed, the company should not issue the same kind of shares within 6 months except issue of bonus shares allotment of shares under employee stock options and conversion of preference shares and debentures into equity shares.
xi. A company which has defaulted in repayment of deposit or interest payable there on , redemption of debentures or preference shares or payment of dividend to any shareholders or repayment of any term loan or interest there on to a bank is not allowed to buy – back its shares (section 77B).
xii. A company which has not filed annual return (Section 159), failed to pay dividend within 30 days from the date of declaration (Sec.207), and failure to disclose true and fair view in the balance sheet (Sec, 211) is not eligible to buy – back its shares.

xiii. The company should file a return in form. e. with the Registrar of companies giving the details of buy – back within 30 days from the date of completion of buy – back.

xiv. When buy – back is completed out of free reserves and /or securities premium. Free reserves equal to free value of shares bought back should be transferred to "Capital redemption reserve" account.

Accounting Treatment

1. Issue of shares – when buy-back is from proceeds of fresh issue:

S.No	Particular	Debit Rs.	Credit Rs.
(i)	Shares issue at par: Bank A/c Dr. To Share capital A/c	 XXX 	 XXX
(ii)	Shares issued at premium: Bank A/c Dr. To Share Capital A/c To Securities premium A/c	 XXX 	 XXX XXX
(iii)	When shares are issued at discount: Bank A/c Dr. Discount on issue of shares A/c Dr. To share capital	 XXX XXX 	 XXX

2. Creating capital redemption reserve-when buy-back is from free reserves or securities premium account.

General reserve A/c /Profit and loss A/c / Securities premium A/c To Capital redemption reserve A/c	XXX	 XXX

3. General reserve and securities premium

S.No	Particular	Debit Rs.	Credit Rs.
(i)	Purchase of own shares (a) Purchased at par: Equity share capital A/c Dr. To Equity shareholders A/c	 XXX 	 XXX
(ii)	(b) Purchased at premium Dr. Equity share capital A/c Dr. General reserve/Securities Premium A/c To Equity shareholders A/c	XXX (with face value) XXX (with premium)	XXX
	(b) Purchased at premium Equity share capital A/c Dr. To Equity shareholders A/c To Capital reserve A/c	XXX (with face value)	XXX XXX (with discount)
(ii)	(b) Purchased at premium Equity share capital A/c Dr. To Bank A/c	 XXX 	 XXX

4. Sale of investment /Assets to mobilize cash:

S.No	Particular	L.F	Debit Rs.	Credit Rs.

	Bank A/c Dr. To Investment A/c / Assets A/c			XXX	XXX

Illustration 1: (Finding out amount transferred to Capital Redemption Reserve)

From the following calculate the proceeds of fresh issue and amount of profit transferred to Capital redemption Reserve:

S.No	Preference shares to be redeemed	Fresh issue of shares for the purpose of redemption
(i)	Rs. 10,00,000 at 10% premium	Rs. 6,00,000 at 20% premium
(ii)	Rs. 10,00,000 at 10% unit	Rs. 6,00,000 at par
(iii)	Rs. 10,00,000 at par	Rs. 6,00,000 at 10% premium
(iv)	Rs. 10,00,000 at par	Rs. 6,00,000 at 10% discount
(v)	Rs. 10,00,000 at 10% premium	Rs. 6,00,000 at 10% discount

Solution:

Transfer to capital

Redemption reserve =	Nominal value of preference shares to be redeemed	Less: proceeds from fresh issue of shares

Working Note

(i) RR = 10,00,000 - 6,00,000 = 4,00,000
(ii) RR = 10,00,000 - 6,00,000 = 4,00,000
(iii) RR = 10,00,000 - 6,00,000 = 4,00,000
(iv) RR = 10,00,000 - 5,40,000 = 4,60,000
(v) RR = 10,00,000 - 5,40000 = 4,60,000

1. In case of (i) and (iii) fresh issues are made at premium. But as per section 78 securities premium is not included in the proceeds from fresh issue of shares.

2. In case of (iv) and (v) fresh issue of shares are made at discounts. The proceeds of fresh issue are the amount actually received. i.e., Nominal value – Discount on issue.

Illustration 2: (Redemption at par out of profit and fresh issue)

A company issued Rs. 2,00,000 redeemable preference shares on 1.4.2004. The shares are redeemable on or after 31.12.2012 in whole or part.

The following redemption was made out of profits:

On 31st March, 2012 Rs. 50,000

On 31st March, 2013 Rs. 50,000

In December 2013, the company issued equity shares of the face value of Rs. 60,000 at a premium of 5 %. On 31.12.2013 the company redeemed the balance preference shares.

Pass necessary journal entries to record the above transactions.

Solution Journal entries

Date	Particulars	L.F	Dr. (Rs)	Cr.(Rs)
31.3.2012 1.	Redeemable preference share capital A/c Dr. To preference shareholders A/c (Being preference share capital transferred to preference shareholders account)		50,000	50,000
2.	Preference shareholders A/c Dr. To Bank A/c (Being cash paid to preference shareholders)		50,000	50,000

3.	Profit and loss A/c Dr. To Capital redemption reserve A/c (Being divisible profit transferred to capital redemption reserve)		50,000	50,000
31.3.2012 1.	Redeemable preference share capital A/c Dr. To preference shareholders A/c (Being preference share capital transferred to preference shareholders account)		50,000	50,000
2.	Preference shareholders A/c Dr. To Bank A/c (Being cash paid to preference shareholders)		50,000	50,000
3.	Profit and loss A/c Dr. To Capital redemption reserve A/c (Being divisible profit transferred to capital redemption reserve)		50,000	50,000
31.12.2013 1.	Bank A/c Dr. To Equity share capital A/c To Securities Premium A/c (Being equity shares issued)		63,000	60,000 3,000
2.	Redeemable preference share capital A/c Dr. To Preference shareholders A/c (Being redeemable preference share capital transferred to preference shareholders account)		1,00,000	1,00,000
3.	Preference shareholders A/c Dr. To Bank A/c (Being cash paid to preference shareholders)		1,00,000	1,00,000
4.	Profit and loss A/c Dr. To Capital redemption reserve A/c (Being divisible profit transferred to capital redemption reserve)		40,000	40,000

Illustration 3: (Redemption at premium out of profit)

Shreya Ltd. made an issue of 1,000, 12% Redeemable preference shares of Rs. 100 each. Repayable at a premium of 10%. These shares are to be redeemed now out of accumulated reserves, which are more than the necessary sum required for redemption.

Show necessary entries in the books of the company, assuming that the premium on redemption of shares has to be written off against the company's securities premium account.

Solution: Journal Entries

Date	**Particulars**	**L.F**	**Dr. (Rs)**	**Cr.(Rs)**
1.	Redeemable preference share capital A/c Dr. Redemption premium A/c Dr. To preference shareholders A/c (Being preference share capital and		1,00,000 10,000	1,10,000

	redemption premium transferred to preference shareholders account)			
2.	Redeemable Preference shareholders A/c Dr. To Bank A/c (Being cash paid to preference shareholders)		1,10,000	1,10,000
3.	General Reserve A/c Dr. To Capital redemption reserve A/c (Being divisible profits transferred to capital redemption reserve account)		1,00,000	1,00,000
4.	Securities premium A/c Dr. To Redemption premium A/c (Being redemption premium written off against securities premium account)		10,000	10,000

Illustration 4: (Redemption at par, partly out of profit and fresh issue)

A company has as part of its capital 1,000 redeemable preference shares of Rs. 100 each fully paid up. When the shares became due for redemption, the company had Rs. 60,000 in its reserve fund. The company issued necessary equity shares of Rs. 25 each specifically for the purpose of redemption and received cash in full.

Make the necessary journal entries regarding the above transactions.

Solution: Journal Entries

Date	Particulars	L.F	Dr. (Rs)	Cr. (Rs)
1.	Reserve A/c Dr. To capital redemption A/c (Being divisible profit transferred to capital redemption reserve)		60,000	60,000
2.	Bank A/c Dr. To Equity share capital (Being 1,600 equity shares of Rs. 25 each issued at par)		40,000	40,000
3.	Redeemable Preference shareholders A/c Dr. To Preference shareholder A/c (Being redeemable preference share capital transferred to preference shareholders account)		1,00,000	1,00,000
4.	Preference shareholders A/c Dr. To Bank A/c (Being cash paid to preference shareholders)		1,00,000	1,00,000

Illustration 6: (Redemption at premium)

The following is the summarised-balance sheet of a company:

Liabilities	Rs.	Assts	Rs.
1000, 10 % preference shares of Rs. 100 each	1,00,000	Sundry assets	8,10,000
		Cash at bank	90,000
50,000 Equity shares of Rs. 10 each.	5,00,000		
General reserve	1,00,000		
Capital reserve	50,000		
Creditors	1,50,000		

	9,00,000		9,00,000

For the purpose of redemption of preference shares, made a fresh issue of 4,500 equity shares of Rs. 10 each at a premium of 10%. The preference shares were redeemed at a premium of 10%.

Show journal entries and prepare the balance sheet after redemption.

Solution: Journal Entries

Date	Particulars		L.F	Dr. (Rs)	Cr. (Rs)
1.	Bank A/c To Equity share capital A/c To Securities premium A/c (Being 4,500 equity shares of Rs. 10 each at 10% premium)	Dr.		49,500	 45,000 4,500
2.	General reserve A/c To Capital redemption reserve A/c (Being divisible profit transferred to capital redemption reserve)	Dr.		55,000	 55,000
3.	Redeemable preference share capital A/c Redemption premium A/c To Preference shareholders A/c (Being preference share capital Transferred to preference shareholders account)	Dr. Dr.		1,00,000 10,000	 1,10,000
4.	Preference shareholders A/c To Bank A/c (Being cash paid to preference shareholders)	Dr.		1,10,000	 1,10,000
5.	Securities premium A/c Capital reserve A/c To Redemption premium A/c (Being redemption premium written off against securities premium and capital reserve)	Dr. Dr.		4,500 5,500	 10,000

Balance Sheet of .... as on ....

Particulars	Notes No.	Rs.
I. Equity and liabilities: 1. shareholder's funds: (a) Share capital: 54,500 Equity shares of Rs. 10 each fully paid (b) Reserve and surplus	 1.	 5,45,000 1,44,500
Shareholder's fund 2. Non-Current liabilities: 3.Current liabilities		6,89,500 Nil 1,50,000
Total Equity and liabilities		8,39,500
II – Assets: 1.Non-Current Assets: Sundry assets 2. Current Assets: Cash and cash equivalent	 2.	 8,10,000 29,500
Total assets		8,39,500

Notes to Accounts – **Forming part of Balance sheet.**

Particulars	Rs.
1. Reserve and surplus: Capital redemption reserve	 55,000

General reserve Capital reserve	45,000 44,500
	1,44,500
2. Bank balance: Opening bank balance Add: Receipt from issue of equity shares	 90,000 49,500
 Less: Payment to preference shareholders	1,39,500 1,10,000
Cash and cash equivalent	29,500

2.10. DEBENTURES

A company raises long term funds partly through own fund (i.e., share capital) and partly by loan funds. A company issues shares to raise own fund (i.e., share capital). A company finds it difficult to borrow loan funds from a single lender. So, a company may issue debenture certificates of nominal value of Rs. 100, Rs. 500, Rs. 1,000 or even more to borrow money from the public. So, debenture is a certification issued by a company usually under its common seal, acknowledging the debt it borrowed from the public.

Section 2 (12) of Companies Act defines "a debenture includes debenture stock, bonds and other securities of a company whether constituting a charge on the assets of the company or not".

Hence, debenture is a document issued by a company acknowledging its debts usually secured by a charge on the company's assets.

2.14 Basic characteristics of debentures:

1. Debenture certificate specifies the money borrowed from the holder.
2. Interest is payable on debentures till it is redeemed.
3. Interest is payable at fixed rate and at fixed intervals specified in the issue document.
4. Debenture interest is payable even if there is o profit in a year. Debenture interest is a charge against company's assets.
5. Debenture issued without company's common seal is also valid.
6. The company may or may not create a charge on its assets in favour of debentures.
7. Debenture holders do not carry any voting rights at any meetings of the company.
8. Debenture holders are loan creditors of the company.

2.11. TYPES OF DEBENTURES

Based on Security given

(a) Secured or Mortgage debentures:

The company's assets are given as charge for the debentures. The charge may be either specific charge or floating charge.

Under specific charge certain specified assets of the company are given as charge to debentures. Under floating charge, the entire assets of the company are given as charge to the debentures.

(b) Unsecured or Naked debentures:

These debentures are issued without any charge on the assets of the company.

On the Basis of Registration

(a) Registered debentures:

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The details of debenture holders, the number of debentures held by each debenture holder is entered in the debenture ledger maintained by the company. The debentures are transferable by execution of transfer deed.

(b) Bearer debentures:

The company does not maintain nay records of the names and addresses of persons holding such debentures. These debentures are payable to bearer and transferable like a negotiable instrument by mere delivery. In such a case interest coupon are attached to each individual debenture. The interest and the principle amount on such a debenture is payable upon presentation and delivery of the coupons and debentures.

Based on Conversion

(a) Convertible debentures:

Debentures may be convertible into equity of preference shares of the company on certain dates or during certain periods on the basis of an agreement between the company and debenture holders. Sometimes debenture holders are given an option to convert their debentures into shares. These may be fully convertible or partly convertible into shares.

(b) Non-Convertible debentures:

Such debentures are not convertible into shares. The debentures are redeemed after the expiry of specified period.

On the Basis of Priority payment

(a) First debentures:

First debentures are those which are paid in priority over other debentures.

(b) Second debentures:

Second debentures are those which are paid after the redemption of first debentures.

Based on Redemption

(a) Redeemable debentures:

Redeemable debentures are redeemed after the expiry of certain agreed period in one lump sum or in instalments over a period or at the option of the company.

(b) Irredeemable debentures or perpetual debentures:

The debentures holders of irredeemable debentures have right to received interest form the company, during its lifetime. These debentures are redeemed only at the time of winding up of the company.

Difference Between Shares and Debentures

S.No.	Basis	Shares	Debentures
1.	Nature	It is part of own fund.	It is part of loan fund.
2.	Status of holders	Shareholders are owners of the company.	Debenture holders are loan creditors of the company.
3.	Name of holder	Holders of shares are called shareholders.	Holders of debentures are called debentures.
4.	Voting rights	A shareholder has the right to participate and vote in a meeting conducted by the company.	Debenture holders have no right to participate and vote in any of the company meetings.
5.	Reward	Shareholders receive dividend recommended by board of directors out of profit earned by the company.	Debenture holders receive interest at a fixed rate, even when a company does not earn any profit.
6.	Repayment	Share are redeemed at the time of winding up of the	All debentures are redeemable after an

		company (exemption – redemption of preference shares and buy back of equity shares).	agreed period.
7.	Security	Shares are always unsecured.	Debentures are usually offered security on the assets of the company.
8.	Conversion	There is no provision of converting shares into any other Securities.	Debentures convertible into shares may be issued.
9.	Discount on issue	Discount on issue of shares cannot exceed 10% of nominal value of shares issued.	Debentures may be issued at any rate or amount of discount. There is no limit to the discount offered on debentures issued.
10.	Nature of dividend and interest	Dividend is paid out of profit; hence it is and appropriation of profit.	Debenture interest is an expense and charged to profit.
11.	Management	Shareholders elect directors to run the company and indirectly participate in the management.	Debenture holders have no right to elect directors and cannot participate in the management.

2.12. DEBENTURE ISSUE

Debenture issue is classified as follows:

Debenture Issue

- On consideration basis
  - For cash
  - For consideration other than cash
    - For assets purchased
    - As collateral security
- On issue price basis
  - Par
  - Premium
  - Discount

Issue of Debentures for Cash

A. When entire debenture amount is received in one lump sum:

The journal entry is:

Bank A/c Dr. To Debenture A/c		XXX	 XXX

B. When debentures amount is received in instalment like application, allotment and call money:

The journal entries are:

Date	Particulars	L.F	Dr.(Rs)	Cr.(Rs.)
1.	For Receipt of application money: Bank A/c Dr. To Debenture application A/c		 XXX	 XXX
2.	For transfer of debenture application			

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	account to debenture account on allotment: Debenture application A/c Dr. To Debenture A/c		XXX	XXX
3.	For allotment money due: Debenture allotment A/c Dr. To Debentures A/c		XXX	XXX
4.	For allotment money received: Bank Dr. To Debenture allotment A/c		XXX	XXX
5.	For call money due: Debenture cal A/c Dr. To Debenture A/c		XXX	XXX
6.	For call money received: Bank A/c Dr. To Debenture call A/c		XXX	XXX

Debentures issued at Par:

When debentures are issued for a price equal to its nominal value, it is called issue at par. There is no profit or loss to the company.

Debenture issued at Premium

Debenture may be issued at premium. Premium on debenture is a capital profit and credited to "Securities premium account" as in the case of issue of shares. Premium on issue of debentures is also used for purpose as in utilization premium on issue of shares.

Debenture issued at Discount

Debenture may also be issued' at discount. Discount on issue of debentures is debited to "Discount on issue of debentures account". This should be written off from securities premium or any other profit.

Illustrations 1 (Issue of debentures at par for cash)

Arun Ltd., issues Rs. 1,000, 15 %, 5,000 1st mortgage debentures on which the amount payable is Rs. 200 on application, Rs. 300 on allotment and the balance in one call.

Pass Journal entries including those for cash.

Solution: Journal Entries

Date	Particulars	L.F	Dr.(Rs.)	Cr. (Rs.)
1.	Bank A/c Dr. To Debenture application A/c (Being application money received at Rs. 200 per debenture for 5,000 debentures)		10,00,000	10,00,000
2.	15% Debenture application A/c Dr. To 15% Debenture A/c (Being debenture application account transferred to debenture account)		10,00,000	10,00,000
3.	15% Debenture allotment A/c Dr. To 15% Debenture A/c (Being debenture allotment money at Rs. 300 per debenture due)		15,00,000	15,00,000
4.	Bank A/c Dr. To 15% Debenture allotment A/c (Being debenture allotment money received)		15,00,000	15,00,000
5.	15% Debenture final call A/c Dr. To 15% Debentures A/c (Being debenture final call money of Rs.		25,00,000	25,00,000

	500 per share due)			
6.	Bank A/c Dr. To 15% Debentures final call A/c (Being debenture final call money at Rs. 500 per debenture due)		25,00,000	25,00,000

Illustration 2 (Issue of debentures at premium)

Modern Ltd., issued, 1,000, 12% debenture of Rs. 1,000 each at Rs. 1,100 payables as follows:

Particulars	Rs.
On application	250
On allotment	450(including premium)
On first call	400

The debentures were fully subscribed, and the moneys received in full.

Show the necessary cash book and journal entries.

Solution: Cash book

Particulars	Rs.	Particulars	Rs.
To 12% Debenture application A/c	2,50,000	By Balance c/d	11,00,000
To 12% Debenture allotment A/c	4,50,000		
To 12% Debenture final call A/c	4,00,000		
	11,00,000		11,00,000

Journal Entries

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	12% Debentures applications A/c Dr. To 12% Debentures A/c (Being debentures application money transferred to debentures account)		2,50,000	2,50,000
2.	12% Debentures allotment A/c Dr. To 12% Debentures A/c To Securities premium A/c (Being debenture allotment money due)		4,50,000	3,50,000 1,00,000
3.	12% Debenture first and final call A/c Dr. To 12% Debentures A/c (Being debenture final call money due)		4,00,000	4,00,000

Illustration 3 (Issue of debentures at discount)

TV Components Ltd., issue 10,000, 12% debentures of Rs. 100 each at a discount of 5 % payable as follows:

Particulars	Rs.
On application	30
On allotment	45
On first call	20

Show journal entries including those for cash, if al instalments were received duly.

Solution: Journal Entries

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	Bank A/c Dr. To 12% Debenture application A/c (Being debentures applications money received at Rs. 30 per debenture on 10,000 debenture)		3,00,000	3,00,000
2.	12% Debenture application Dr. To 12% Debentures A/c (Being debentures application account transferred to debentures A/c)		3,00,000	3,00,000
3.	12% Debenture allotment A/c Dr. Discount on issue of debentures A/c Dr.		4,50,000 50,000	

	To 12% Debenture A/c (Being debenture allotment money at Rs. 450 per debenture due)			5,00,000
4.	Bank A/c Dr. To 12% Debenture allotment A/c (Being debenture allotment money received)		4,50,000	4,50,000
5.	12% Debenture first and final call A/c Dr. To 12% Debentures A/c (Being debenture call money due at Rs.20 per debentures)		2,00,000	2,00,000
6.	Bank A/c Dr. To 12% Debentures first and final call A/c (Being debentures final call money received)		2,00,000	2,00,000

2.17 ISSUE OF DEBENTURES FOR ASSETS PURCHASED

Sometimes a company may allot debentures to vendors of assets as consideration for purchase price. The following journal entries are made to record the transactions.

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	For assets purchased: Assets A/c (individually) Dr. To Vendor A/c		XXX	XXX
2.	On debentures issued: (a) When issued at par: Vendor A/c (for purchase consideration) Dr. To Debentures A/c		XXX	XXX
(b)	(b) When issued at premium: Vendor A/c Dr. To Debenture A/c To Securities premium A/c		XXX	XXX XXX
(c)	When issued at discount: Vendor A/c Dr. Discount on issue of debentures A/c Dr. To Debentures A/c		XXX XXX	XXX

Illustration 4 (Issue of debentures to Vendors)

X Ltd., purchases building worth Rs. 1,50,000, Plant and Machinery worth Rs. 1,40,000 and Furniture for Rs. 20,000 from Varadarajan and took over liabilities of Rs. 20,000 for a purchase consideration of Rs. 3,15,000.

B Ltd. paid the purchase consideration by issuing 12% debentures of Rs. 100 each at a premium of 5%.

Pass necessary journal entries.

Solution: Journal Entries

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	Building A/c Dr. Plant and machinery A/c Dr.		1,50,000 1,40,000 20,000	

	Furniture A/c Dr. Good will A/c (W.N.I) Dr. To Liabilities A/c To Varadarajan A/c (Being purchase of assets and assuming of liabilities of Varadarajan)		25,000	20,000 3,15,000
2.	Varadarajan A/c Dr. To 12% Debentures A/c (W.N.2) To Securities premium A/c (Being debentures issued to vendors at 5% premium)		3,15,000	3,00,000 15,000

Working note:

(1) Calculation of Goodwill:

Particulars	Rs.
Building	1,50,000
Plant and machinery	1,40,000
Furniture	20,000
Total assets purchased	3,10,000
Less: Liabilities	20,000
Net assets purchased	2,90,000
Purchase consideration	3,15,000
Excess price paid over net assets taken over debited to Goodwill account	(-) 25,000

(2) No. of debentures issued and securities premium:

Purchase consideration = Rs. 3,15,000

Issue price of debentures = Rs. 105.

No of debentures issued = 3,15,000 / 105 = 3,000 debentures

Securities premium = 3,000 X 5 = 15,000.

2.13.1. Debentures Issued as Collateral Security

A company security may be defined as subsidiary or secondary or additional security.

A company borrowing money from a bank or any financial institution gives its assets to lenders as principal security. Sometimes these lending institutions may demand additional security from the borrowing company. In such a situation the borrowing company may give its debentures as extra security for the loan taken. The debentures given as additional security is called "Collateral Security". The company does not receive any money for the debentures issued as collateral security.

2.13.1. Accounting Treatment of Collateral Security

There are two methods as follows:

(a) First method:

As no consideration is received for issue of debentures as collateral security, no entry is made in the book of the company. The issue of debenture is disclosed in the balance sheet as footnote. Only loan taken is recorded. So, the accounting treatment is as follows:

1.	For loan borrowed: Bank A/c Dr. To loan from bank A/c	XXX	XXX
2.	For issue of debenture as collateral security: No entry		

Balance sheet of ...... as on ....

Particulars	Rs.
I. Equity and Liability: 1. Shareholder's fund: 2. Non- current liabilities: Loan from bank	 XXX

Note: Debenture amount to Rs. XXX is issued as collateral security for loan taken from Bank amounting to Rs. XXX

(b) Second Method:

The debentures issued as collateral security is recorded in the books of the company. The accounting entry is:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	For loan taken: Bank A/c Dr. To loan from Bank A/c		 XXX	 XXX
2.	For issue of debenture: Debentures suspense A/c Dr. (Shown on assets side of B/s – Under miscellaneous expenditure) To Debenture A/c (Shown on the liabilities side under non-current liabilities)		 XXX	 XXX

Balance Sheet of .... as on ....

Particulars	Rs.
I. Equity and liabilities: 1. Shareholder's fund: 2. Non- current liabilities Loan from bank Debenture II. Assets: Miscellaneous expenditure: Debenture suspense account (issue as collateral security for loan taken)	 XXX XXX XXX

Illustration 7

S Ltd. borrowed Rs. 40,00,000 from Punjab National Bank. It issued debentures amounting to Rs. 45,00,000 as collateral security for the loan taken from the bank.

Show the accounting treatment for the above.

Solutions:

a) First method:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	For loan taken: Bank A/c Dr. To loan from PNB A/c (Being loan borrowed from PNB)		 40,00,000	 40,00,000
2.	For issue of debentures: No entry			

Balance sheet of S Ltd., as on ....

Particulars	Rs.
1. Equity and Liabilities: Non – current liabilities Loan from bank (Collaterally secured by debentures issued amounting to Rs. 45,00,000)	 40,00,000

b) Second method:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)

1.	For loan taken: Bank A/c Dr. To loan from Bank A/c		40,00,000	40,00,000
2.	For issue of debenture: Debentures suspense A/c Dr. To Debenture A/c		45,00,000	45,00,000

Balance Sheet of S Ltd., as on ....

I. Equity and Liabilities: Non –current liabilities: Loan from PNB Debentures account	 40,00,000 45,00,000
II. Assets Miscellaneous expenditure: Debenture suspense account (issued as collateral security for loan taken from PNB)	 45,00,000

2.13.3. Accounting for issue of Debentures when terms of Redemption is Given

The following combinations arise when issue price and redemption amount is combined.

They are:

I. Issued at par and redeemable at par.
II. Issued at par and redeemable at premium.
III. Issued at discount and redeemable at par.
IV. Issued at discount and redeemable at premium.
V. Issued at premium and redeemable at par.
VI. Issued at premium and redeemable at premium.

The following are the journal entries for issue of debentures for the various combination of issue price and redemption amount.

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	Issued at par and redeemable at par: Bank A/c Dr. To Debentures A/c (Face value)		 XXX	 XXX
2.	Issued at par and redeemable at premium: Bank A/c Dr. Loss on issue of debentures A/c Dr. (Premium on Redemption) To Debentures A/c (Face value) To Premium on redemption of debentures A/c		 XXX XXX	 XXX XXX
3.	Issued at discount and redeemable at par: Bank A/c (Amount received) Dr. Discount on issue of debentures A/c Dr. (discount allowed) To Debentures A/c (Face value) To Premium on redemption of debentures A/c		 XXX XXX	 XXX XXX
4.	Issued at discount and redeemable at premium Bank A/c (Amount received) Dr. Loss on issue of debentures A/c Dr. (Discount on issue & redemption premium) To Debenture A/c (Face value) To Premium on redemption of debentures A/c		 XXX XXX	 XXX XXX
5.	Issued at premium and redeemable at par:			

NOTES

	Bank A/c (Amount received) Dr. To Debenture A/c (Face value) To Securities premium A/c (Premium on issue)		XXX	 XXX XXX
6.	Issued at premium and redeemable at premium: Bank A/c (Amount received) Dr. Loss on issue of debentures A/c (redemption premium) Dr. To debentures A/c (Face value) To Securities premium A/c To Premium on redemption of debentures		 XXX XXX	 XXX XXX XXX

Note:

1. Premium on redemption of debentures account:

It is a provision for paying future liability. It is in the nature of personal account. It is shown in the liabilities side of balance sheet under current liabilities. Premium on redemption of debentures account is debited at the time of redemption of debentures.

2. Loss on issue of debentures:

Loss on issue of debenture account is debited with premium on redemption of debentures. It is a capital loss. It is usually written off over the life of debentures in instalments from securities premium or other profits.

Illustration 8

(Entries for issue of debentures when terms of redemption are given)

Given journal entries for the following:

(a) Issue of Rs. 1,00,000 – 9% Debentures at par and redeemable at par.

(b) Issue of Rs. 1,00,000 – 9% Debentures at premium of 5% but redeemable at par.

(c) Issue of Rs. 1,00,000 - 9% Debentures at a discount of 5% but redeemable at par.

(d) Issue of Rs. 1,00,000 – 9% Debentures at par but repayable at a premium of 5%

(e) Issue of Rs. 1,00,000 – 9% Debentures at a discount of 5% but redeemable at a premium.

Solution: Journal Entries

Date	**Particulars**	**L.F**	**Dr.(Rs.)**	**Cr.(Rs.)**
(a)	Bank A/c Dr. To 9% Debentures A/c (Being debentures issued at par which are redeemable at par)		1,00,000	 1,00,000
(b)	Bank A/c Dr. To 9% Debentures A/c To Securities premium A/c (Being debentures issued at premium which are redeemable at par)		1,05,000	 1,00,000 5,000
(c)	Bank A/c Dr. Discount on issue of debentures A/c Dr. To 9% Debentures A/c		95,000 5,000	 1,00,000
(d)	Bank A/c Dr. Loss on issue of debentures A/c Dr. To 9% Debentures A/c To Premium on redemption of debentures A/c (Being debentures issued at par which are		1,00,000 5,000	 1,00,000 5,000

NOTES

	redeemable at premium)			
(e)	Bank A/c Dr. Loss on issue of debentures A/c Dr. To 9% Debentures A/c To Premium on redemption of debentures A/c (Being debentures issued at discount which are redeemable at premium)		95,000 10,000	 1,00,000 5,000

2.14. ACCOUNTING TREATMENT OF DISCOUNT OR LOSS ISSUE OF DEBENTURES

The discount/loss on issue of debentures is a capital loss. It should be written off as early as possible. Until it is written off it is shown on the assets side under the head "Miscellaneous expenditure". There are two ways to write off discount on issue or loss on issue of debentures. They are as follows:

a) First alternative – Fixed instalment method:

This method is followed when the debentures are redeemed at the end of a specified period. The discount or loss on issue of debenture is divided over the life of debentures equally. So under this method equal amount is written of every year over the life of debentures.

b) Second alternative – Fluctuating or Variable instalment method (or) Reducing instalment method:

If debentures are repaid in a fixed amount in instalments over the life of the debentures, it is equitable to write off discount on issue of debentures or loss on issue of debentures in the ratio of debentures outstanding in each year. The amount of discount or loss on issue of debentures goes on decreasing every year. Initial year bear higher burden that the subsequent years.

The account entry for writing off discount or loss on issue of debentures is:

Profit and loss A/c Dr. XXX

To discount or loss on issue of debentures A/c XXX

Illustration 9 (Debenture discount – Written off in Fixed instalments)

Z Ltd., issued 5,000, 10% debentures of Rs. 100 each at a discount of 10%. The debentures are redeemed at the end of five years:

Show the discount account and give journal entries.

Solution: Ledger Account

Discount on issue of debentures account

Particulars	**Rs.**	**Particulars**	**Rs.**
1 year To Debenture A/c	 50,000	 By Profit and loss, A/c By Balance c/d	 10,000 40,000
	50,000		50,000
II Year To Balance b/d	 40,000	 By Profit and loss, A/c By Balance c/d	 10,000 30,000
	40,000		40,000
III Year To Balance b/d	 30,000	 By Profit and loss, A/c By Balance c/d	 10,000 20,000
	30,000		30,000
IV Year To Balance b/d	 20,000	 By Profit and loss, A/c By Balance c/d	 10,000 10,000
	20,000		20,000

NOTES

V Year To Balance b/d	10,000	By Profit and loss, A/c	10,000
	10,000		10,000

Working note:
(1) Total discount on issue of debentures = 5,000 X 100 X 10/100 = Rs. 50,000
(2) Annual instalment of discount to be written off:
Life of debentures = 5 years
Annual instalment = 50,000/ 5 = Rs. 10,000

Journal Entries

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1 year 1.	At beginning: Bank A/c Dr. Discount on issue of debentures A/c Dr. To 10% debentures A/c (Being 5,000 debentures issued at 10% discount)		4,50,000 50,000	5,00,000
2.	At the end of the year Profit and Loss A/c Dr. To Discount on issue of debentures A/c (Being 1/5 of discount on issue written off)		10,000	10,000
	II-year, III-year, IV year and V year At the end of each year: Profit and loss A/c Dr. To Discounts on issue of debentures (Being 1/5 of discount on issue written off)		10,000	10,000

2.15. DEBENTURE INTEREST

When a company issues debenture it is under an obligation to pay interest thereon at a fixed percentage periodically until the debentures are repaid. The payment of interest is compulsory, whether a company earns profit or not. Interest is always calculated on the face value of debentures irrespective of issue price, market price or redemption account. The Income Tax Act requires that a company must deduct income tax at the prescribed rate form the gross amount of interest payable. It means the company will pay only net amount of interest to debentures holders. Tax deducted is paid to the Government.

2.16. REDEMPTION OF DEBENTURES

Redemption of debentures means repayment of the amount due on debentures to debenture holders. Debentures should be redeemed in accordance with the terms and conditions of their issue/offer documents. Debentures may be redeemed at par or at premium.

2.16.1. Method of Redemption

The following methods of redemption are available:

1. Redemption in one lump sum amount after the expiry of a specified period.

Debentures are redeemed on due date of redemption or on maturity date of debentures.

The debentures may be redeemed:

(a) Out of capital
(b) Out of profit
(c) Out of provision –sinking fund method
(d) Out of provision –insurance policy method
2. By annual instalments or by draw of lots.
Again, the debentures may be redeemed:
(a) Out of capital
(b) Out of profit
3. By Conversion into shares.
4. By purchase of own debentures in the open market.
2.25 Redemption in One Lumpsum Amount
(a) Redemption out of profit:
Redemption out of profits means that the company would retain or withhold a part of divisible profits every year and utilize it for redemption of debentures on the due date. As per section 117C of Companies Act, the divisible profit retained should be transferred to Debenture Redemption Reserve. The accounting treatment is as given below:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	When debentures become due for redemption: Debentures A/c Dr. To Debentures holder's A/c		XXX	XXX

Note: If debentures are redeemed at premium – "Premium on redemption of debentures A/c" should be debited.

2.	For transfer of divisible profit to debenture Redemption Reserve account Profit and loss appropriation A/c Dr. To Debentures Redemption Reserve A/c		XXX	XXX
3.	For payment to debenture holders Debenture holder's A/c Dr. To Bank A/c		XXX	XXX
4.	For transferring Debenture redemption Reserve to general reserve. Debenture Redemption Reserve A/c Dr. To General Reserve A/c		XXX	XXX

Note: Debenture Redemption Reserve is a specific reserve. After the specific purpose is over there is no need for it. So, after redemption of debentures, the debentures redemption reserve is transferred to general reserve.

Illustration 10 (Redemption out of profit – in one lump sum amount)

Jai Ltd. has a balance of Rs. 4,00,000 in the profit and loss account. The company decided to foreign the payment of dividend and instead utilize profits to repay Rs. 3,50,000, 12% debentures on 30th June, 2013 at a premium of 10%. Debenture interest is payable annually on 31st December every year. The company also had a balance of Rs. 2,00,000 in the debenture redemption reserve every year. The company also had a balance of Rs. 2,00,000 in the debenture redemption reserve account.

Journalize the transactions relating to redemption of debentures.

Solution: Journal Entries

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
30.6.2013 1.	Debenture interest A/c Dr. To Bank A/c		21,000	21,000

NOTES

	(Being debenture interest upto 30th June paid)			
2.	12% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To debenture redemption reserve A/c (Being amount payable to debenture holders)		3,50,000 35,000	3,85,000
3.	Profit and loss appropriation A/c Dr. To Debentures redemption reserve A/c (Being divisible profits transferred to DRR A/c)		1,50,000	1,50,000
4.	Debenture holder's A/c Dr. To Bank A/c (Being amount payable to debenture holders paid)		3,85,000	3,85,000
5.	Debenture redemption reserve A/c Dr. To General reserve A/c (Being the balance in DRR account transferred to general reserve)		3,50,000	3,50,000
6.	Profit and loss A/c Dr. To Premium on redemption of debentures A/c (Being redemption premium written off against profit)		35,000	35,000

(b) Redemption out of capital:

Redemption out of capital indicates that the redemption is being done out of money not earned in the course of business. It means that the company has sufficient liquid funds to pay debentures. Otherwise the company has to issue shares or debentures or sell some of its assets or borrow money from banks/ financial institutions.

The accounting entries are:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	On debenture becoming due for payment Debentures A/c Dr. Premium on redemption of debentures (if redeemed at premium) Dr. To Dentures A/c		XXX XXX	XXX
2.	On payment to debenture holders Debenture holder's A/c Dr. To Bank A/c		XXX	XXX

Note: No entry need be made for transfer of divisible profit to debenture redemption reserve.

2.17. TYPES OF SINKING FUNDS

Sinking funds are of two types, they are as follows:

i. Cumulative sinking fund
ii. Non-Cumulative Sinking fund

i) Cumulative Sinking Fund

From second year onwards interest received from sinking fund investment is credited to sinking fund account and reinvested in outside securities together with annual appropriation. Annual instalment is found by referring to sink fund tale. The life of debenture and the rate of interest the sinking fund investment earns also influences annual appropriation to be made.

ii) Non- Cumulative Sinking Fund

The interest received from sinking fund is credited to profit and loss account. It is not invested again in sinking fund investments. Only annual appropriation is credited to sinking fund and invested in outside securities. In this case annual appropriations is found by dividing the debenture amount outstanding with the life of debentures in years. For example, Debentures of Rs. 10,00,000 is redeemable after 5 years. The annual appropriation is Rs. 2,00,000 (i.e., = 10,00,000/5).

The following are the entries relating to Debentures Sinking Fund/Debenture Redemption fund transactions:

In the first-year beginning:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	Entry for issue of debenture Bank A/c Dr. To Debenture A/c		XXX	XXX
2.	For appropriation of profit to Sinking Fund: Profit and loss appropriation A/c Dr. To Debenture Sinking Fund A/c		XXX	XXX
3.	For making investment: Debenture Sinking Fund Investment A/c Dr. To Bank A/c		XXX	XXX

In the second and subsequent years end:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	For receipt of interest from investment: Bank A/c Dr. To Debenture Sinking Fund A/c		XXX	XXX
2.	For appropriation of profit: Profit and loss appropriation A/c Dr. To Debenture Sinking Fund A/c		XXX	XXX
3.	For making investment: Debenture Sinking Fund Investment Dr. To Bank A/c		XXX	XXX

In the last year:

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1.	For receipt of interest from investment: Bank A/c Dr. To Sinking fund A/c		XXX	XXX
2.	For annual appropriation: Profit and loss appropriation A/c Dr. To Debenture sinking Fund A/c		XXX	XXX
3.	No investment the last year end			
4.	For sale of investments: Bank A/c Dr.		XXX	

	Debenture sinking fund A/c (Loss on sale of investments) Dr. To Debentures sinking fund investment A/c To Debenture sinking Fund A/c (Profit on sale of investments)		XXX	 XXX XXX
5.	For redemption of debentures: (i) For transferring debentures to debentures holders account: Debenture A/c Dr. To debenture holders A/c		XXX	XXX
	(ii) For payment to debenture holders: Debenture A/c Dr. To Bank A/c		XXX	XXX
6.	Transfer of balance in sinking fund to General reserve: Debenture sinking fund A/c Dr. To General reserve A/c		XXX	XXX

Illustration 12 (Sinking Fund Method)

A company issued 6% Debentures of Rs. 6,00,000 with a condition that they should be redeemed after 3 years at 10% premium. The amount set aside for the redemption of debenture is invested in 5% Government securities. The sinking fund table show that Rs. 0.31720856 at 5% compound interest in three years will become Re. 1. You are required to give journal entries and open ledger accounts for recording the transactions for three years.

Solution:

Annual appropriation = Rs. 6,60,000 X 0.31720856 = Rs. 2,09,357.65

Journal Entries

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
First year Jan 1	Bank A/c Dr. Loss on issue of debentures A/c Dr. To 6% Debentures A/c To Premium on redemption A/c (Being debentures issued at par and redeemable at premium)		6,00,000 60,000	6,00,000 60,000
Dec 31	Profit and loss appropriation A/c Dr To Sinking Fund A/c (Being investment made)		2,09,357.65	2,09,357.65
Dec 31	Sinking fund investment, A/c Dr. To Bank A/c (Being investment made)		2,09,357.65	2,09,357.65
Second yr Dec 31	Bank A/c Dr. To Sinking fund A/c (Being investment on SF investment received)		10,467.88	10,467.88
Dec 31	Profit and loss appropriation A/c Dr To Sinking Fund A/c		2,09,357.65	2,09,357.65

	(Being profit transferred to sinking fund account)			
Dec 31	Sinking fund investment, A/c Dr. To Bank A/c (Being annual appropriation and SFI interest invested)		2,19,825.53	2,19,825.53
Third year Dec 31	Profit and loss appropriation A/c Dr To Sinking Fund A/c (Being investment made)		2,09,357.65	2,09,357.65
Dec 31	Bank A/c Dr. To Sinking fund A/c (Being investment made)		21,459.16	21,459.16
Dec 31	Sinking fund A/c Dr. To General reserve A/c To Profit and loss A/c (Being the balance in sinking fund transferred to general reserve and profit and loss account)		6,60,000	6,00,000 60,000

Ledger Account Sinking Fund Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1 year Dec 31	To Balance c/d	2,09,357.65	Dec 31	By Profit and loss appropriation A/c	2,09,357.65
		2,09,357.65			2,09,357.65
II Year Dec 31	To Balance b/d	4,29,183.18	Jan 1 Dec 31 Dec 31	By Balance b/d By Bank A/c By Profit &loss appropriation A/c	2,09,357.65 10,467,88 2,09,357.65
		4,29,183.18			4,29,183.18
III year Dec 31	To General A/c To Profit and loss A/c	6,00,000 60,000	Jan 1 Dec 31 Dec 31	By Balance b/d By Bank A/c By Profit and loss appropriation A/c	4,29,183.18 21,459,16 2,09,357.66
		6,00,000.00			6,60,000.00

Sinking Fund Investment Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1 year Dec 31	To Bank A/c	2,09,357.65	Dec 31	By Balance c/d	2,09,357.65
		2,09,357.65			2,09,357.65
II Year Jan 1 Dec 31	To Balance b/d To Bank A/c	2,09,357.65 2,19,825.53	Dec 31	By Balance c/d	4,29,183.18
		4,29,183.18			4,29,183.18

III year Jan 1	To Balance b/d	4,29,183.18			
		4,29,183.18			

(d) Provision – Insurance policy method:

Under this method also profit equal to insurance premium payable is transferred to sinking fund account and premium is paid on the insurance policy in the beginning of every year.

An insurance policy is taken equal to amount payable to debenture holders on redemption date. The period of insurance policy will coincide with the duration of debentures, so the insurance policy will mature on the date of debentures. The insurance policy amount received is utilized to redeem the debentures.

The main difference between Sinking Fund method and Insurance Policy method are:

Basis	Sinking Fund	Insurance Policy
1. Time of investment	Investment is made at the end of every year.	Premium is paid in the beginning of every year.
2. Receipt of interest	Interest is received on investments made starting from second year.	No interest is received.
3. Amount of investment	Annual appropriation plus interest on investment is invested. So, investment goes on increasing.	Uniform premium amount is paid every year.
4. Risk of loss	There is risk of loss on sale of investment.	There is no risk of loss in realising policy amount. Policy amount is paid by insurance company on the maturity of policy.

Illustration 13 (Insurance Policy Method)

Sun ltd. issued 1,000 8% debentures of Rs. 100 each at par on 1stJanuary, 2001 repayable at a premium of 5% after 3 years. It was decided to take out an insurance policy for Rs. 1,05,000 to provide necessary cash for redemption of debentures. The annual premium in the policy is Rs. 32,500.

Show necessary journal entries and ledger accounts in the book of the company relating to issue and redemption of debentures.

Solution: Journal Entries

Date	**Particulars**	**L.F**	**Dr.(Rs.)**	**Cr.(Rs.)**
1.1.2001	Bank A/c Dr. Loss on issue of debentures A/c Dr. To Premium on redemption A/c To Premium on redemption A/c (Being debentures issued at par and redeemable at premium)		1,00,000 5,000	1,00,000 5,000
1.1.2001	Debenture redemption fund insurance policy A/c Dr. To Bank A/c (Being premium for insurance policy)		32,500	32,500

31.12. 2001	Profit and loss appropriation A/c Dr. To Debenture redemption fund A/c (Being profit transferred to redemption fund A/c)		32,500	32,500
1.1.2002	Debenture redemption fund insurance policy A/c Dr. To Bank A/c (Being premium paid on insurance policy)		32,500	32,500
31.12. 2002	Profit and loss appropriation A/c Dr. To Debenture redemption fund A/c (Being profit transferred to debenture redemption fund A/c)		32,500	32,500
1.1.2003	Debenture redemption fund insurance policy A/c Dr. To Bank A/c (Being premium paid on insurance policy)		32,500	32,500
31.12. 2003	Profit and loss appropriation A/c Dr. To Debenture redemption fund A/c (Being profit transferred to debenture redemption fund A/c)		32,500	32,500
31.12.2003	Bank A/c Dr. To debenture redemption fund insurance policy, A/c		1,05,000	1,05,000
31.1.2003	Debenture redemption fund insurance policy A/c Dr. To Debenture redemption fund A/c (Being the policy amount received in excess of premium paid)		7,500	7,500
31.12.2003	8% Debenture A/c Dr. Premium on redemption A/c To debentures holder's A/c (Being debentures transferred to debentures holders account)		1,00,000 5,000	1,05,000
31.12.2003	Debenture holder's A/c Dr. To Bank A/c (Being cash paid to debenture holders)		1,05,000	1,05,000
31.12.2003	Debenture redemption fund A/c Dr. To General reserve A/c (Being balance in debenture redemption fund transferred to general reserve)		1,00,000	1,00,000

Ledger Account 8% Debentures Account

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.2001	To Balance c/d	1,00,000	1.1.2001	By Bank A/c	1,00,000

		1,00,000			1,00,000
31.12.2002	To Balance c/d	1,00,000	1.1.2002	By Balance b/d	1,00,000
		1,00,000			1,00,000
31.12.2002	To Debenture holder's A/c	1,00,000	1.1.2003	By Balance b/d	1,00,000
		1,00,000			1,00,000

Debenture Redemption Fund Insurance Policy Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1.12.2001	To Bank A/c	32,500	31.1.2001	By Balance c/d	32,500
		32,500			32,500
1.12.2002 1.1.2002	To Balance b/d To Bank A/c	32,500 32,500	31.1.2002	By Balance c/d	65,000
		65,000			65,000
1.1.2003 1.1.2003 31.12.03	To Balance b/d To Bank A/c To Debenture redemption fund A/c	65,000 32,500 7,500	31.12.2003	By Balance b/d	1,05,000
		1,05,000			1,05,000

Debenture Redemption Fund Account

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.2001	To Balance c/d	32,500	31.12.2001	By Profit and loss appropriation A/c	32,500
		32,500			32,500
31.12.2001	To Balance c/d	65,000	1.1.2002 31.12.2002	By Balance b/d By Profit and loss appropriation A/c	32,500 32,500
		65,000			65,000
31.12.2003	To General A/c To Loss on issue of debentures A/c	1,00,000 5,000	1.1.2003 31.12.2003 31.12.2003	By Balance b/d By Profit and loss appropriation A/c By Debenture redemption fund insurance policy, A/c	65,000 32,500 7,500
		1,05,000			1,05,000

SUMMARY

IMPORTNT POINTS TO REMEMBER

- Only fully paid preference shares can be redeemed.
- Fully called preference shares with calls in arrears are also not redeemed till calls-in-arrears are received.
- Preference shares are redeemed only out of two "sources". They are redemption out of profit or out of fresh issue of shares or partly out of both.
- Sale of assets and issue of debenture helps to increase liquidity of a company. But it does not amount to "Proceeds of fresh issue".

- "Proceeds of fresh issue" of shares should be clearly understood:
  (i) If shares are issued at par – the nominal value of shares issued is "Proceeds of fresh issue".
  (ii) If shares are issued at discount – the actual amount received on issue is "proceeds of fresh issue".
  (iii) If shares are issued at premium – the nominal value of shares issued is "Proceeds of fresh issue".
  (iv) If fresh issue of shares is only partly called up and paid up – the amount actually received minus securities premium. If any, is "Proceeds of fresh issue".
- Capital Redemption Reserve can be utilized to issue fully paid bonus shares only.
- It is preferable to provide for loss on issue of debenture, if it is certain.
- Loss on issue of debentures include – Discount on issue of debentures + premium on redemption of debentures + Debenture issue expenses.
- Creation of debentures redemption reserve is mandatory when debenture redemption period exceeds 18 months.

EXERCISES

I. Theory question

A. Short answer questions:

1. What is meant by redeemable preference share?
2. How to redeem partly paid preference shares?
3. Can irredeemable preference share be redeemed?
4. What do you mean by 'Redemption out of capital'?
5. What is 'Redemption out of profit'?
6. What are divisible profits?
7. What is capital redemption reserve? How is it created?

B. Long answer questions:

8. What are the sources for redemption of preference shares? Explain.
9. What are the conditions for redemption of preference shares?
10. Why various conditions are imposed on redemption of preference shares?
11. What do you mean by "proceeds of fresh issue"? Explain.
12. What profit are available for transfer to capital redemption reserve?

1. (Redemption partly out of profit and capital) Sam Ltd., had as part of the share capital 20,000 preference shares of Rs. 100 each fully paid up. When the shares became due for redemption, the company had Rs. 12,00,000 in its Reserve Fund. The company issued necessary equity shares of Rs. 25 each specially for the purpose of redemption and received cash in full.

2. (Calculating capital redemption reserve) From the following information calculate the amount that should be transferred to capital Redemption Reserve account in each of the following cases:

Preference shares to be redeemed	Fresh issue of shares for the purpose of Redemption
(i) Rs. 80,000 at par	Rs. 7,00,000 at par
(ii) Rs. 8,00,000 at 10% par premium	Rs. 6,00,000 at par
(iii) Rs. 8,00,000 at par	Rs. 7,00,000 at 10% premium
(iv) Rs. 8,00,000 at 10% premium	Rs. 6,00,000 at 10% premium

(v) Rs. 8,00,000 at 10% premium	Rs. 6,00,000 at 10% Discount
(vi) Rs. 8,00,000 at par	Rs. 6,00,000 at 10% Discount

NOTES

3. **(Insurance Policy Method) Sri Ram** ltd., issued 10,000 9% debentures of Rs. 100 each at par on 1st July, 2007 repayable at a premium of 4% after 5 years. It was decided to take out an insurance policy for Rs. 1,20,000 to provide necessary cash for redemption of debentures. The annual premium in the policy is Rs. 40,000.

Show necessary journal entries and ledger accounts in the book of the company relating to issue and redemption of debentures.

4. Ameena company issued 9% Debentures of Rs. 8,00,000 with a condition that they should be redeemed after 5 years at 10% premium. The amount set aside for the redemption of debenture is invested in 3% Government securities. The sinking fund table show that Rs. 0.31720856 at 5% compound interest in three years will become Re. 1. You are required to give journal entries and open ledger accounts for recording the transactions for five years.

5. **(Redemption out of capital – in one lump sum amount)** Z Ltd issued 30,000 10% debentures of Rs. 100 each in April 2006. These debentures redeemable on 31st march, 2011 at 12% premium. Pass Journal entries for redemption of debentures.

UNIT – III FINAL ACCOUNTS ADJUSTMENTS

Structure

3.1. Adjustments
3.2. Managerial Remuneration
3.3. Profit and Loss Appropriation

3.1. ADJUSTMENTS

The prime objects of preparing trading account and profit and account is to know the true profit or loss of the business and the balance sheet is prepared to find the true financial position of the business for given period. Posting of closing entries like expenses, losses, gains and profit from trail balance to trading, profit and loss account is already learned. The true profit can be arrived only after taking into account the pending bills i.e., Outstanding expenses and incomes, prepaid expenses incomes received in advantage and depreciation etc. The purpose adjustment is to take into account all such details necessary to find real profit or loss and the true and fair view of the business.

Following are some common adjustments.

1. Closing Stock
2. Outstanding Expenses
3. Prepaid Expenses
4. Accrued Incomes
5. Incomes Received in Advance
6. Interest on capital
7. Interest on Drawings
8. Interest on Loans
9. Depreciation
10. Bad Debts
11. Provision for Bad & Doubtful Debts
12. Provision for Discount on Debtors and
13. Provision for Discount on Creditors

The above adjustments given outside the trail balance are to be considered while preparing the final accounts; (i.e., trading and profit and loss account and balance sheet) after passing the following adjusting entries. All the items given in the adjustments including closing stock will appear at two places in the final accounts.

1. Trading Account and Balance Sheet
(Or)
2. Profit and Loss Account and Balance Sheet

1. Closing Stock or Stock at End:

It is given outside the trial balance and represents the value of unsold goods at the year end. (It is valued at cost price or market price whichever is less.)

Example: The value of closing stock given outside the trial balance in adjustments on 31.12.1994 Rs.5000

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Closing Stock, A/c Dr. To Trading A/c (Being Closing Stock brought into records)		5,000	5,000

It is shown on the credit side of the trading account as an item of closing stock and again on the asset side of the balance sheet.

Trading Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By Closing Stock, A/c		5,000

Balance sheet as on 31st December1994

Liabilities	Rs.	Assets	Rs.
		Closing Stock	5000

2. Expenses Outstanding or Outstanding Expenses:

It represents expenses which have been incurred during the year but the payment in respect of which is yet to be made. In simple terms-expenses due but not paid are known as outstanding expenses creditors for expenses.

Example: Salaries paid given in trial balance is Rs. 5,500/

Adjustment: Salary for the month of December 1994 Rs. 500 are yet to be paid.

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Salaries A/c Dr. To Salaries outstanding A/c (Being December salary outstanding)		500	500

The above adjustment amount is added together with salaries account in the profit and loss account on debit side and again shown on the liabilities side of the balance sheet.

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Salaries A/c Add: Outstanding	5,500 500	 6,000			

Balance sheet as on 31st December1994

Liabilities	Rs.	Assets	Rs.
Outstanding Expenses: Salaries	 500		

3. Prepaid Expenses: An expense paid, but the benefit for which has not yet been received on the date of preparing final accounts is known as expenses paid in advance or prepaid expenses or unexpired expenses. Eg., Insurance Premium.

Example: Given in trial balance insurance premium paid Rs. 1500 as on 31st December 1994.

Adjustment: Prepaid insurance premium Rs. 750.

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Prepaid Insurance Premium A/c Dr. To Insurance Premium A/c (Being the insurance premium paid in Advance)		500	500

The above adjustment amount is deducted from the Insurance Premium in the Profit and Loss Account on the Debit side and shown on the Asset side of the Balance sheet.

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Insurance premium A/c Less: Prepaid	1,500 750	750			

Balance sheet as on 31st December1994

Liabilities	Rs.	Assets	Rs.
		Prepaid Expenses: Insurance Premium	750

4. Accrued Incomes: Incomes for which services have been rendered but remuneration not received are called as accrued incomes or incomes outstanding or income earned but not received. It is added with the relevant income the credit side of the profit and loss account and shown on the assets side of the balance sheet.

Example: Commission received given in trial balance is Rs. 450 (Cr.) as on 31st December 1994.

Adjustment: Commission accrued but not yet received Rs. 150.

Adjusting Entry

Date	Particulars	L.F	Dr(Rs.)	Cr.(Rs)
1994 Dec 31	Accrued commission A/c Dr. To Commission A/c (Being commission earned but not received)		150	150

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By Commission A/c Add: Accrued Commission but not yet received	450 150	600

Balance sheet as on 31st December1994

Liabilities	Rs.	Assets	Rs.
		Accrued Commission	150

5. Income Received in Advance: It represents the amount received on some account in respect of which full service has not been rendered and hence it is known as income in advance.

It is deducted from the appropriate income account on the credit side of the profit and loss account and subsequently shown on the liability side of the balance sheet as income received in advance.

Example: Rent received shown in the trial balance as on 31st December 1994, Rs. 6,500.

Adjustment: Rent received in advance is Rs. 500.

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Rend received A/C Dr. To Rent received in advance A/c (Being the rent received in advance)		500	500

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By rent received Less: Rent received in advance	6,500 500	6,000

Balance sheet as on 31st December1994

Liabilities	Rs.	Assets	Rs.
Rent received in advance	500		

6. Interest on capital: Generally, interest at a reasonable rate allowed on the capital invested by the proprietor in the business. This is necessary in order to assess the efficiency of the business. Otherwise the profits include the interest, would appear to be quite high. The amount of interest on capital is an expense to the business and a gain to the proprietor. So, it is debited to the profit and loss account and again added to the capital in the balance sheet on the liabilities side.

Example: The capital as on 31.12.94 is Rs. 50,000. Given in trial balance.Adjustment: Provide 6 % interest on capital.

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Interest on capital A/c Dr. To Capital A/c		3000	 3000

To bring interest on capital to profit and loss account the following Transfer entry is required.

Transfer Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Profit & Loss A/c Dr. To Interest on capital A/c		3000	 3000

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Interest on capital A/c	3,000				

Balance sheet as on 31st December1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Add: Interest on capital	50,000 3,000	 53,000			

7. Interest on Drawings: Drawings are cash or cheques withdrawn or goods or stock taken by proprietor for personal use. Just as the business allows interest on capital, it charges interest on drawings. This is a gain to the business and an expense to the proprietor. So, it is credited to the profit and loss account and again shown on the liability side of the balance sheet by way additions to the drawings, which are finally deducted from the capital.

Example: The trail balance shows the following:

Capital as on 31.12.94 Rs. 50,000

Drawing as on 31.12.94 Rs. 5,000

Adjustment: Charge interest on drawings 5%.

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Drawings A/c Dr. To Interest on drawing A/c		250	 250

To bring interest on drawings to profit and loss account the following Transfer entry is required.Transfer Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	To Interest on drawing A/c Dr. To Profit and Loss A/c (Being interest on drawing transferred to profit & loss A/c)		250	 250

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			To Interest on Drawing A/c		250

Balance sheet as on 31st December1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Add: Interest on capital	50,000 xxx				
	50,000				
Less:Drawings 5000 Add: Interest on drawing 250	5,250	44,750			

8. Interest on Loan: The amounts which are borrowed from banks, financial institutions and outsiders for business use are called loans. Interest is payable on these loans borrowed. The interest on loan is an expense for the business. Any amount outstanding will be added to the appropriate interest account on the debit side of the profits and loss account and again added with the particular loan account on the liability side of the balance sheet.

Example: The trail balance shows:

Bank loan @ 10% as on 31.12.94 Rs. 50,000

Interest paid Rs. 3,500

Adjustment: Provide for the interest on bank loan outstanding. Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Interest on bank Loan A/c Dr. To Interest outstanding A/c (Being the interest due on bank loan)		1,500	1,500

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Interest Add: Interest outstanding	3,500 1,500	 5,000			

Balance sheet As on 31st December1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Bank Loan @ 10% Add: Interest outstanding	50,000 1,500	 51,500			

Note: The interest bank loan for the year ending 31st December 1994 comes to Rs. 5000. But interest paid given in trial balance is Rs. 3,500. Hence Rs. 1500 is outstanding as on 31.12.94.

50000 x10/100 = Rs. 5000

(Rs. 5000 – Rs. 3500 = Rs. 1,500)

9. Depreciation: As seen in the preceding chapter, it means the decrease in the value of fixed assets year after year due to wear and tear because of constant use or due to lapse of time or it becomes obsolescence. This decrease in value of fixed assets is called depreciation. It is to be treated as a loss to the business. The various methods of ascertaining depreciation were discussed already in the earlier chapter.

Generally, depreciation is calculated at a certain percentage on the value of the asset and the amount so obtained is first shown on the debit side of the profit and loss account and then deducted from the book value of the concerned asset in the balance sheet on the asset side.

Example:The business has a furniture on 31 .12.94 of the value Rs. 15,000 which is given in trail balance.

Adjustment: Furniture is to be depreciated at 10%.

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Depreciation A/c Dr. To Furniture A/c		1,500	 1,500

To bring depreciation into profit and loss account the following Transfer entry is required.Transfer Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Profit & Loss A/c Dr. To Depreciation A/c (Being 10% depreciation on furniture transferred to profit & loss A/c)		1,500	 1,500

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Depreciation: Furniture A/c	 1,500				

Balance sheet As on 31st December1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Furniture Less: Depreciation @ 10%	15,000 1,500	 13,500

10. Bad Debts: Debts which are not recoverable from credit sales to debtors are termed as bad debts. It represents a loss and hence it has to be written off from debtors and shown on the debit side of the profit and loss account and deduct that amount from the sundry debtors account in the balance sheet on the asset side.

Example: The trail balance as on 31st December 1994 shows sundry debtors Rs. 10,500.

Adjustment: Rs. 500 is estimated to be irrecoverable and therefore is to be written off as bad debts.Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Bad debts A/c Dr. To sundry debtor's A/c (Being bad debts written off)		500	 500

To transfer bad debts to profit and loss account the following Transfer entry is required.Transfer Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Profit & loss A/c Dr. To Bad debts a/c (Being bad debts transferred to profit and loss A/c)		500	 500

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Bad debts A/c	500				

Balance sheet as on 31st December1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry Debtors Less: Bad debts written off	10,500 500	 10,000

11. Provision for Bad & Doubtful Debts: As seen earlier bad debts are the amount definitely irrecoverable and hence written off and removed from the sundry debtors. From the remaining balance number of sundry debtors some of the amount may or may not be recoverable. These are called doubtful debts.

To show the true position of sundry debtors, it is usual practice to calculate provision for bad and doubtful debts at a certain percentage, based on past experience on debtors.

While preparing final accounts the bad debts if any given in adjustment is first to be deducted from the sundry debtors and on the remaining balance amount only the "Provision for bad and doubtful debts" is to be calculated.

Provision for bad and doubtful debts is to be shown on the debit side of the profit and loss account and the same amount should be deducted from the sundry debtors (after deducting bad debts if any given in adjustment) in the balance sheet on the asset side.

Example: The trial balance shows:

Sundry debtors of a trader on 31.12.1994 stood at Rs. 10,000.

Adjustment: Provide 5% of this as provision for bad & doubtful debts.Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Profit & loss A/c Dr. To Provision for bad & doubtful debts A/c (Being 5% provision for bad & doubtful debts)		500	500

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Provision for bad & doubtful debts A/c	500				

Balance sheet As on 31st December1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry Debtors Less: Provision for bad & doubtful debts @ 5%	10,000 500	9,500

12. Provision for Discount on Debtors: You are aware that cash discount is allowed for prompt payments while preparing cash book. After providing provision for bad and doubtful debts, the remaining debtors represents good debtors. They are trying to pay their dues on time and avail themselves of the cash discount permissible. Therefore, such discount to provide for discount on debtors.

It is first shown on the debit side of the profit and loss account and then deducted from the good debtors in the balance sheet on the asset side. (i.e., after deducing new bad debts and new provision)

Example: The trail balance shown as on 31st December 1994 sundry debtors Rs. 10,500.

Adjustments: Bad debts to be written off Rs. 500; provide @ 5% provision for bad and doubtful debts and @ 2% provision for discount on debtors.

Calculation of Discount on Debtors

First deduct bad debts given in adjustments from sundry debtors (i.e.,) 10500 – 500 = Rs. 10000.

Secondly, calculate 5 % on the balance sundry debtors for bad and doubtful debts provision.

i.e., 10000 x 5/ 100 = Rs. 500

Thirdly calculate 2% on the balance sundry debtors' amount for provision for discount debts provision.

i.e., 10000 – 500 = Rs. 9500

9500 x 2 /100 = Rs. 190

Rs. 190 is the provision for discount on debtors.

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Profit & loss A/c Dr. To Provision for discount debtor's A/c (Being 2% provision for		190	190

	discount on debtors)			

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Provision for discount on debtor's A/c	190				

Balance sheet as on 31st December1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry Debtors Less: Provision for bad & doubtful debts @ 5%	10,500 500	
				10000	
			Less: Provision for bad & doubtful debts @ 5%	500	
				9500	
			Less: provision for discount on debtors @ 2 %	190	9310

13. Provision for Discount on Creditors: Similar to the provision for discount on debtors, provision has to be made for anticipated profit in respect of discount received from creditors and the true figure of the liability only will be shown in the balance sheet. The provision for discount on creditors is shown on the credit side of the profit and loss account and then the same is deducted from the sundry creditors in the balance sheet on the liability side.

Example: The trial balance shows sundry creditors at Rs. 5000in 31.12.94.

Adjustment:It is desired to make a provision for discount on sundry creditors at 2%

Adjusting Entry

Date	Particulars	L.F	Dr.(Rs.)	Cr.(Rs.)
1994 Dec 31	Provision for discount on creditors A/c Dr. To Profit & Loss A/c (Being 2% provision for discount on creditors)		100	100

Profit & Loss Account for the year ended 31st December 1994.

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			To Provision for discount on creditors A/c		100

Balance sheet as on 31st December1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors Less: Provision for discount on creditors @ 2%	5,000 100	4,900			

SPECIMEN: (For Treatment of Adjustments)

Trading and Profit and Loss Account of Thiru .... for the year ending............

Dr.					Cr.
Particulars	**Rs.**	**Rs.**	**Particulars**	**Rs.**	**Rs.**
To Opening stock		xxx	By Sales	xxx	
To purchase	xxx		Less: Sales Returns	xxx	xxx
Less: Purchases Returns	xxx	xxx	By Closing stock		xxx
To wages	xxx		By Gross Stock (transferred to		
Add: Outstanding wages	xxx xxx	xxx	P& L A/c)		xxx
To factory Rent Less: Prepaid Factory Rent	xxx	xxx			
To Gross Profit (transferred to P&L A/c)		xxx			
		xxx			xxx
To Gross Loss (transferred from Trading A/c)		xxx	To Gross Loss (transferred from Trading A/c)		xxx
To salaries	xxx xxx	xxx	By Commission Received	xxx	
Add: Outstanding Salaries	xxx		Add: Commission accrued but not yet received	xxx	xxx
To Insurance Premium Less: Prepaid Insurance Premium	xxx	xxx	By Rent received Less: Received in advance	xxx xxx	xxx
To Insurance on capital		xxx			
To Interest Loan Add: Interest on loan outstanding	xxx xxx	xxx			
Depreciation: (Fixed Assets – Buildings, Machinery, Furniture, etc.,)		xxx	By Interest on Drawings		xxx
To written off: (Intangible Assets – goodwill, patents, copyright)		xxx	By Provision for Discount on Creditors: Discount Received (T.B. Balance) Add: New provision (given in adjustment) Less: Old provision (T.B. Balance)	xxx xxx xxx	xxx
To Provision for Bad & Doubtful Debts: Bad debts (T.B. Balance) Add: New bad Debts (Given in Adjustment)	xxx xxx xxx		By Net Loss (Transferred to Capital A/c)		xxx
Add: New provision					

(Given Adjustment)	xxx				
	xxx				
Less: Old Provision (T.B. Balance)	xxx	xxx			
To provision for Discount on Debtors:					
Discount Allowed (T.B. Balance)	xxx				
Add: New provision (given in Adjustment)	xxx				
	xxx				
less: Old provision (T.B. Balance)	xxx	xxx			
To Net Profit (transferred to Capital A/c)		xxx			
		xxx			xxx

Balance Sheet of Thiru .... As on

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	xxx		Cash in Hand		xxx
Add: Interest on Capital	xxx		Cash in Bank		xxx
	xxx		Sundry Debtors	xxx	
Add: Net profit			Less: Bad Debts	xxx	
(or)				xxx	
Less: Net Loss	xxx		Less: Provision for bad		
	xxx		& Doubtful Debts	xxx	
Less: Drawings xxx				xxx	
Add: Interest on Drawings xxx	xxx		Less: Provision for Discount on Debtors	xxx	xxx
	xxx		Fixed Assets:		
Less: Income tax	xxx	xxx	(Buildings, Machinery, Furniture etc.)	xxx	
Sundry Creditors	xxx		Less: Depreciation	xxx	xxx
Less: Provision for Discount on Creditors	xxx	xxx	Intangible Assets: (Goodwill, patents, copyright)	xxx	
loan	xxx		Less: Depreciation	xxx	xxx
Add: Interest on loan outstanding	xxx	xxx	Prepaid Expenses		
Outstanding Expenses			Insurance Premium		xxx
			Accrued Incomes		
Wages	xxx		Commission		xxx
Salaries	xxx	xxx	Closing Stock		xxx
Income Received in Advance					
Rent		xxx			
		xxx			xxx

Illustration: 1

The following Trail Balance has been extracted from the books Mr. Varun on31.12.1993.**Trial Balance**

Particulars	Rs.	Particulars	Rs.
Machinery	4,000	Capital	9,000

Cash in Bank	1,000	Sales	12,000
Cash in hand	500	Bank Loan	4,000
Wages	1,000	Sundry Creditors	4,500
Purchases	8,000	Dividend Received	300
Stock 1.1.93	6,000		
Sundry Debtors	4,400		
Bills Receivable	2,900		
Rent	400		
Interest on Bank	-		
Loan	50		
Commission	250		
General Expenses	800		
Salaries	500		
	29,800		29,800

Adjustments:

1. Closing Stock Rs. 8,000 as on 31.12.1993
2. wages Outstanding Rs. 100
3. Salaries unpaid Rs. 100
4. Rend prepaid Rs. 150
5. Commission Due Rs. 50
6. Interest on Bank Loan not yet paid Rs. 400

Prepare Trading and Profit & Loss account for the year ending 31st December 1993, Balance sheet as on that date and pass adjusting entries also.

Solution:

Adjusting Entries

Date	Particular	L.F	Debit Rs.	Credit Rs.
1993 Dec. 31	Closing stock, A/c Dr. To Trading A/c (Being closing stock brought in records.)		8,000	8,000
Dec. 31	Wages A/c Dr. To wages outstanding A/c (Being wages outstanding)		100	100
Dec. 31	Salaries A/c Dr. To Salaries outstanding A/c (Being salaries outstanding)		100	100
Dec. 31	Rent prepaid A/c Dr. To Rend A/c (Being Rend prepaid)		150	150
Dec. 31	Commission A/c Dr. To Commission Outstanding A/c (Being Commission outstanding)		50	50
Dec. 31	Interest on Bank Loan A/c Dr. To Interest on Bank loan outstanding A/c (Being bank interest outstanding)		400	400

Trading and Profit & Loss Account of Mr. Varun for the year ending 31st December 1993

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		6,000	By sales		12,000
To Purchases		8,000	By Closing stock		8,000
To wages	1,000				
Add:Wages	100	1,100			
To Gross Profit (transferred to profit & Loss A/c)		4,900			
		20,000			20,000
To Rent	400		By Gross Profit (transferred from Trading A/c)		4,900
Less: Prepaid	150	250			
To Commission	250				
Add: Outstanding	50	300	By Dividend		300
To General Expenses		800			
To Salaries	500				
Add: Outstanding	100	600			
To Interest to Bank loan	50				
Add: Interest outstanding	400	450			
To Net profit (transferred to capital A/c)		2,800			
		5,200			5,200

Balance Sheet of Mr. Varun as on 31st December 1993.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
capital	9,000		Cash in Hand		500
Add: Net profit	2,800	11,800	Cash in Bank		1,000
Sundry Creditors		4,500	Sundry Debtors		4,400
Bank Loan	4,000		Bills receivable		2,900
Add: Interest outstanding	400	4,000	Machinery		4,000
			Prepaid rent		150
outstanding Expenses			Closing Stock		8,000
Wages	100				
Salaries	100				
Commission	50	250			
		20,950			20,950

Illustration: 2

The following Trial Balance was extracted from the books Mr. Arun on 30.6.1993.

Particulars	Dr. Rs.	Cr. Rs.
Capital		49,000
Drawings	4,000	
General Expenses	5,680	
Buildings	32,000	
Stock	32,400	
Coal	4,480	
Wages	14,400	

Taxes & Insurance		
Premium	2,630	
Debtors	12,560	
Creditors		5,760
Discount	1,100	
Loan @ 6%		15,000
Moped	7,500	
Rent	500	
Apprentice premium		1,800
Commission Received		2,460
Electricity Charges	2,810	
Bills Payable		7,700
Cash	160	
Bank overdraft		6,600
Indian Bank Shares	5,000	
Sales		1,30,720
Purchase	93,550	
Interest on Loan	450	
	219220	219220

Prepare Trading and Profit & Loss Account for the year ended 30.6.93 and Balance sheet as on that date after giving effect to the following Adjustments.

1. Closing Stock Rs. 47,000 as on 30.6.1993
2. Six months interest due on Loan.
3. Insurance Premium prepaid Rs. 230
4. Premium accrued but not yet received Rs. 200
5. Commission Received in advance Rs. 340

Solution:Trading and Profit & Loss Account of Mr. Arun for the year ending 30th June 1993.

Dr.					Cr.
Particulars	**Rs.**	**Rs.**	**Particulars**	**Rs.**	**Rs.**
To opening stock		32,400	By Sales		1,30,720
To Purchases		93,550	By Closing Stock		47,000
To Coal		4,480			
To wages		14,400			
To Gross Profit (transferred to P & L A/c)		32,890			
		1,77,720			1,77,720
To general Expenses		5,680	By Gross profit (transferred from Trading A/c)		32,890
To Taxes & Insurance Premium	2,630		By Apprentice Premium	1,800	
Less: Prepaid	230	2,400	Add: Accrued but not yet received	200	2,000
To Discount		1,100	By Commission	2,640	
To Rent		500			

			Less: Received in Advance	340	2,300
To Electricity Charges		2,810			
To Interest on loan	450				
Add: Outstanding	450	900			
To Net profit (transferred to capital A/c)		23,800			
		37,190			37,190

Balance Sheet of Mr. Arun as on 30th June 1993

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	49,000		Cash		160
Add: Net profit	23,800		Debtors		12,560
	72,800		Indian bank shares		5,000
Less: Drawings	4,000	68,800	Buildings		32,000
Creditors		5,760	Moped		7,500
Bills payable		7,700	Apprentice Premium		
Loan @ 6%	15,000		Accured but not received		250
Add: Interest Outstanding	450	15,450	insurance		
Bank Overdraft		6,600	Premium prepaid		230
Commission received in advance		340	Closing stock		47000
		1,04,650			1,04,650

3.2. MANAGERIAL REMUNERATION

Managerial remuneration payable by a Public Company or a Private company which is subsidiary of a public company is restricted to 11% of the net profit of the company for that financial year. Managerial persons include a manager or a managing director, whole time directors and part time directors. The limit of 11% does not include fees payable to directors for attending the board meeting or committee thereof. A company can have either a manager or managing director and not both.

1. Managerial remuneration when profits are inadequate or there is no profits:

Where any financial year a company has no profit or its profits are inadequate, it may pay the maximum of following remunerations depending on the capital of the company.

Where the effective capital is	Monthly remuneration payable shall not exceed
(i) Less than 1 crore	Rs. 40,000
(ii) Rs. 1 crore or more but less than Rs. 5 crores	Rs. 57,000
(iii) Rs. 5 crore or more but less than Rs. 15	Rs. 72,000

crores	
(iv) Rs. 15 crores or more	Rs. 87,500

The above limit does not include:
(1) Contribution to provident fund, super annuation fund or annuity fund to the extent not taxable under the Income Tax Act.
(2) Gratuity payable at a rate not exceeding half a month salary for each completed year of service.
(3) Encashment of leave at the end of tenure.

2. Managerial remuneration payable by companies having adequate profits:

The maximum remuneration payable to all managerial persons are limited to 11% of the net profit of the company. Within this over all limit, there is limit to remuneration payable to each category of managerial persons. They are as follows:

1. Part time directors:

(a) There is only one manager or managing director or whole-time director in addition to part time directors, remuneration to part time directors is limited to 1% of the profit of the company.

(b) There is no manager or managing director or whole-time director, remuneration to part time directors is limited to 3% of the profit of the company.

2. Manager:

Manger remuneration is limited to 5% of the profit of the company.

3. Managing director:

A director of a company authorized to look after the management of the company is called managing director. A managing directors' remuneration is limited to 5% of the profit of the company. A company can appoint more than one managing director, then the remuneration to managing directors is limited to 10% of the profits of the company.

4. Whole time directors:

Whole time directors are also called executive directors. Where there is only one whole time director, his remuneration is limited to 5% of the profit of the company. Where there are more than one whole time directors, the remuneration is limited to 10% of the profit of the company.

Calculation of profit or Managerial Remuneration

There are two approaches for calculating profit for managerial remuneration. They are:

(i) Gross profit approach.
(ii) Net profit approach.

(i) Gross profit approach:

Form the gross profit all allowable expenses are the deducted from gross profit and bounties and subsidies received from Government is added to gross profit. This may be presented in the following format.

Particulars	Rs.	Rs.
Gross profit as per profit and loss account Add: Bounties and subsidies received from government		xxx xxx
Less: Allowable expenses: All usual business expenses like salary, wages, rent, rates, tax insurance, repairs, stationery, audit fees, interest on borrowings and debentures	 xxx	xxx -

Depreciation as per Section 350	xxx	-
Director's fees	xxx	-
Damages and compensation payable as per law	xxx	-
Donations as per Income Tax Act	xxx	-
Bad Debts	xxx	-
Profit for calculation of managerial remuneration	-	xxx

(ii) Net approach:

Particulars	Rs.	Rs.
Net profits as per profit and loss account	-	xxx
Add: Expenses not allowable but debited to profit and loss account:		
Managing director's remuneration	xxx	
Provision for doubtful debts	xxx	
Damages and compensation paid voluntarily	xxx	
Provision for tax	xxx	
Preliminary expenses	xxx	
Depreciation as per profit and loss account	xxx	
Loss on sale of investment	xxx	
Manager salary and commission	xxx	
All appropriation items	xxx	
Capital expenditures	xxx	
Excess bonus paid over the amount payable as per payment of Bonus Act	xxx	xxx
		xxx
Less: Depreciation as per Section 350	xxx	
Less: Incomes not to be considered but credited in profit and loss account:		
Capital profit on sale of assets and investments (Excess of sale price over original cost)	xxx	
Profit on sale of undertaking	xxx	
		xxx
Profit for calculation of managerial remuneration	-	xxx

3.3. PROFIT AND LOSS APPROPRIATION

FORMAT OF PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. **Profit and Loss Appropriation a/c for the year ended** Cr.

To Transfer to Reserves	Xxx	By Balance brought forward from last year	Xxx
General Reserve	Xxx	Profit from the P&L a/c	Xxx
Sinking Fund	Xxx	Transfer from Provisions	Xxx
Expenses of Last Year	Xxx	Transfer from Reserves no longer required	Xxx
Interim Dividend	Xxx		
Proposed Dividend	Xxx		
Surplus carried to Balance Sheet	Xxx		
	xxxxxx		xxxxx

ILLUSTRATION: 1

X ltd. had earned Rs. 6,00,000 profit on 31.12.2007 which is appropriated as follows:

a) Rs. 50,000 towards debenture redemption fund;
b) 8% preference dividend (tax free), tax being 20% on Rs. 6,60,000
c) 10% ordinary dividend, tax being 20% on 20,00,000
d) Rs. 74,000 to general forward;
e) Balance to be carried forward;

Prepare Profit & Loss Appropriation a/c

SOLUTION:

Dr. **Profit and Loss Appropriation a/c** Cr.

	Rs.		**Rs.**
To. Debenture 90 redeem. Fund	50,000	By. Balance b/d	
Proposed pref. dividend	66,000	Net Profit b/d	6,00,000
Proposed equity dividend	2,00,000		
General Reserve	74,000		
surplus transferred to B/S	2,10,000		
	6,00,000		6,00,000

Summary

1. Familiarize the formats prescribed under the Companies Act for preparing final accounts.
2. Any additional information or adjustments given in a problem should be clearly understood before preparing final accounts.
3. Clearly notice the treatment of Interim dividend, final dividend and proposed dividend.
4. Also clearly note the treatment of Interim dividend, final dividend and proposed dividend.
5. Dividend received in an income and credited to profit and loss account.
6. Any item appearing in the trail balance is shown only once anywhere in profit and loss account or balance sheet.
7. An item given in adjustment should be shown at two places either in profit and loss account or balance sheet.

I. Theory Questions

A. Short answer:

1. What are included in the final accounts of a company?
2. What is appropriation of profits? Explain.
3. What is a provision? Explain.
4. What is revenue reserve? Give two examples.
5. What is unclaimed dividend? Explain its treatment in the final account?

B. Long answer:

1. State the guidelines regarding administrative ceilings on managerial remuneration.
2. Give a specimen from of balance sheet and statement of profit and loss of a company according to companies Act.
3. Explain the various items shown under the head ‘Non-current assets’ and ‘Current assets.
4. What is divisible profit? Explain.
5. How do you calculate the profit for the purpose of calculating managerial remuneration?

II. PROBLEMS

1. The provision for tax at the end of 31.3.01 stood at Rs. 3,00,000. During 2001-2002 the tax liabilityup to 31.3.2001 were settled for Rs. 2,74,000. Provision required in respect of 2001-2002 is Rs. 84,000
   Show how the relevant items will appear in profit and loss account, provision for tax account and balance sheet.

2. Compute managerial remuneration from the information given below to full time director:

   Net profit – Rs. 20,00,000
   Special depreciation – Rs. 20,000
   Provision for income tax – Rs. 1,00,000
   Ex-gratia payment Rs. 5,000
   Capital profit on sale of assets Rs. 7,000

UNIT – IV VALUATION OF GOODWILL

Structure

4.1. INTRODUCTION

Goodwill is an intangible but a real asset. There are so many businesses and so many factors giving rise to goodwill in each individual business. So, it is easy to describe but difficult to define. It represents the advantage a business possesses because of good name, reputation, location and connection of a business. Goodwill enables a business to earn more profit than the normal profit expected on the capital employed in a business.

The simplest definition acceptable to accounting professionals and courts is given by Dr. Canning – "Goodwill is the present value of firms anticipated excess earnings". Professor Dicksee says – "When a man pays for goodwill, he pays for something which places him in the position of being able to earn more money than he would be able to do by his own unaided efforts".

The above two definitions give importance to earn 'excess' profit.

4.2. FEATURES OF GOODWILL

- It is intangible.
- It is not a fictitious asset.
- It is valuable.
- It is the combination of many factors affecting the earning capacity of a business.
- It is not a separable asset. It cannot be sold separately. It can be sold only along with a business.
- It is an attracting force which brings in customers.

4.3. NEED FOR VALUATION OF GOODWILL

The valuation of goodwill is necessary in the following circumstances

1. In the case of a partnership:

At the time of admission of a new partner, upon retirement or death of a partner, sale of a firm to a company, amalgamation with another firm, (Or) change in profit sharing ratio among partners.

2. In the case of joint stock companies:

On the amalgamation of two or more companies, Absorption of a company by another company, one buys controlling interest is another company, when Government takes over a company.

3. In the case of companies not listed:

For valuation of shares for taxation purposes such as gift tax, estate duty, wealth tax etc when stock exchange price is not available.

4. In the case of sole trader:

At the time of sale of business or for tax purposes.

5. In the case of an individual:

In case of partitioning of property among various legal heirs, for calculation of estate duty, wealth tax etc, in case of death of an individual.

4.4. TYPES OF GOODWILL

Goodwill may be classified as (i) Purchased goodwill and (ii) Raised goodwill/self-generated goodwill.

(i) Purchased goodwill:

It arises when a business is purchased. The excess of the price paid for purchase of a business in excess of net tangible assets and other intangible assets like trademark, patents, etc., is the value/ price paid for goodwill. Only purchased goodwill is recorded in the books.

(ii) Raised goodwill/ Self-generated goodwill:

It is the goodwill generated by a business over a period of time on account of location, good management, good quality product and so on. It is difficult to place a value on it. Value will be based on subjective judgement of the valuer.

4.5. FACTORS AFFECTING GOODWILL

1. Location – nearness to the market, nearness to source of raw materials.
2. Nature of business – this includes many things such as nature of goods, standard of quality, nature of demand for the product.
3. Nature of market conditions – highly competitive, duopolistic, semi-monopolistic, near monopolistic.
4. Future competition – nature of entry barriers, like requirement of large capital, innovations etc.
5. Nature of management - highly skilled, following ethical practices, etc.
6. Possession of trademarks, copyrights and patents and brand popularity.
7. Possession of favourable contracts licences from government, etc.
8. Government’s industrial policy.
9. Stable political conditions.
10. Economic conditions like boom, recession, etc.

4.6. FACTORS DETERMINING THE VALUE OF GOODWILL

The following three factors mainly affect the value of goodwill. They are

1. Future maintainable profit
2. Normal rate of return
3. Capital employed

1. Future Maintainable Profit:

Goodwill is always paid for the future. The buyer is interested in knowing whether the business will maintain its profits in the future also. If chances of maintaining the profit are less, the buyer will not pay anything for the goodwill. For calculating future maintainable profit, the profit earned in the past is taken as the basis. The changes in incomes and expenses expected are adjusted with the past profit to ascertain the future maintainable profit:

Calculation of Future Maintainable Profit:

Particulars	Rs.
Profit earned in the last year/ Average of profits earned in so many years given	xxx
Add: Abnormal losses	xxx
Add: All expenses and losses incurred in the past but not likely to continue in the future	xxx

Add: Any savings/ Reduction in expenses expected	xxx
Add: Any trading income earned in the past but omitted to be accounted	xxx
Add: Any additional income/revenue expected	xxx
	xxx
Less: Abnormal incomes	xxx
Less: All incomes and revenues earned in the past but not likely to continue	xxx
Less: Any non-trading income earned in the past	xxx
Less: Any additional business expenses and losses expected	xxx
Less: Decrease in revenue /incomes expected	xxx
Future maintainable profit	xxx

The future maintainable profit is also called future expected profit, adjusted average profit, and average future maintainable profit.

Note: If trend in business conditions is given like increase in sales, Decrease in expenses, increase in percentage of margin etc., it should also be adjusted in the future maintainable profit.

Weighted Average Profit

Sometimes a business may show a clear trend of rising profits. In such cases weighted average profit may be used. More weightage is given to the latest year. If profits of 3 years are as follows: 2012 – Rs. 30,000, 2013 – Rs. 40,000, 2014 – Rs. 55,000, weight age 3 is given to the year 2014 and weightage one is given to the year 2012. Weighted average profit can be calculated as below:

Solution:

Years	Profit Rs.	Weights	Product
2012	30,000	1	30,000
2013	40,000	2	80,000
2014	55,000	3	1,65,000
		6	2,75,000

Weighted average profit = 2,75,000/ 6 = Rs. 45,833

2. Normal Rate of Return:

This is the rate of profit or return, which the investors would expect on their investments in a particular type of industry. Normal rate of return will not be uniform for all industries. The business risk varies from industry to industry. Hence the normal rate of return will also vary. In examination normal rate of return is usually given. Otherwise normal rate of return is calculated by adding rate of risk return to the rate of risk-free return. Risk free rate refers to the rate of return on risk free securities eg. Government securities. Rate of risk return is the extra rate of income investors expect for the risk they are taking by investing their money in the business.

So, Normal Rate of Return = Pure rate/ Risk free rate + Rate of risk return.

3. Capital employed:

Capital employed in a business is an important factor in determining the earning capacity of a business. There are two ways to calculate capital employed. They are: (i) Assets side approach and (ii) Liabilities side approach:

The term capital employed refers to Gross capital employed, Net Capital employed, Capital employed in the beginning of a year, Capital employed at the end of the year of Average capital employed.

Gross capital employed is the total of all assets (except Goodwill) at market value less depreciation. Net capital employed is the total of all assets (except Goodwill) at market value less depreciation as deducted by outside liabilities.

4.7. CALCULATION OF CAPITAL EMPLOYED

(i) Assets side approach:

Add: All fixed assets (except goodwill) Less depreciation / at Market value (if given) xxx

All current assets (less provision for doubtful debts, if any) xxx

Note: Item appearing on the assets side like profit and loss account (debit balance),

Deferred revenue expenditure like preliminary expenses, discount / expenses on

issue of shares / debentures, useless intangible assets, if any, non-trade investments, like Government securities, shares and debentures are excluded).

Less: All outside liabilities (e.g., creditors, bills payable, outstanding expenses, loans, debentures, Provision for tax/tax liability, liability for bills discounted, etc.) xxx

Capital employed at the end of the year xxx

Less: Half of the profit earned during the yearxxx

Average capital employed xxx

(ii) Liabilities side approach:

Add: paidup equity and preference share capital, all accumulated profits like profitand loss account (cr. Bal), general reserve, capital reserve, capital redemption reserve. xxx

Securities premium, profit on revaluation of assets and liabilities

Less: Goodwill, all worthless intangible assets, fictitious assets, deferred revenue expenditures, accumulated losses, non-trade ininvestmentsxxx

Capital at the end of the year xxx

Less: Half of the profit earned during the year xxx

Average capital employed xxx

Average capital employed = Capital employed in the beginning + Half of the profits earned during the year.

Note: For calculating capital employed at the end of the year, all assets and liabilities at eh end of theyear is considered. For calculating capital employed in the beginning of the year, all assets and liabilities at the beginning of the year is considered.

Average capital employed is commonly used for the purpose of calculating goodwill.

4.8. METHODS OF VALUATION OF GOODWILL

The various methods of valuation of goodwill is shown in the following:

1. Average Profits Method:

(Future Maintainable profit (or) Adjusted Average profits method)

(i) Number of year purchase of average profits:

Under this method it is assumed that the business will earn the adjusted average profit expected for certain number of years without any additional effort on the part of the buyer of the business. So, the seller is really to pay for goodwill a price equal to adjusted average profit as multiplied by a certain number of years agreed between the buyer and seller of the business. Usually the number of years agreed is 2 to 3 years.

Goodwill = Future maintainable profit

(or) Adjusted average profit x Given number of years

(ii) Capitalization of future maintainable profit:

Under this method, future maintainable profit/adjusted average profit is capitalized by applying normal rate of return on calculate normal capital employed. Goodwill is calculated as below:

Goodwill = Normal capital employed – Actual capital employed

So, excess of normal capital employed over actual capital employed is goodwill.

2. Super Profit Method:

Goodwill represents the value of excess earnings or additional earnings over the normal earnings. The excess of the adjusted average profits over the normal profit is called super profit. Normal profit is calculated as follows:

Normal profit = Average capital employed x Normal rate of return

(i) Purchase of super profit method:

Goodwill is the value paid for the capacity of a business to earn additional profit expected over normal profits. The goodwill is calculated as below:

Goodwill = Super profit x Number of years purchase

(ii) Sliding scale valuation of super profits:

This method is based on the logic that higher the super profit it will attract more competition. The result will be the super profit will start decreasing. The super profit is divided into different blocks. Each block of super profit is given a different weightage on a sliding scale. If super profit is Rs. 15,000 and divided into 3 blocks of Rs. 5,000 each, Maximum weightage 3 given first block, weightage 2 given to second block and weightage I given the 3rd block, the amount of goodwill be:

Particulars	**Rs.**
First block – Rs. 5,000 x 3 =	15,000
Second block – Rs. 5,000 x 2 =	10,000
Third block – Rs. 5,000 x 1 =	5,000
Value of Good will	30,000

(iii) Annuity method:

Goodwill is paid for profit expected in the future. So, the present value of future is calculated for a certain rate of interest and for a number of years for which super profit is expected. The present value of a rupee may be ascertained by referring to annuity Table or by using the following formula.

$$Q = \frac{1 - \left(1 + \frac{r}{n}\right)^{n}}{\frac{\mathrm{r}}{100}}$$

Where, Q = Present value of Re. 1

r = Rate of interest per annum

n = Number of years

Goodwill = Super profit x Annuity factor for Re. 1

Number of years purchase of average profit

Illustrations 1

M purchased a business from 'N' on 1st April, 2015. The profit earned in the past 3 year ending 31st March, 2015 and other information are:

1. Profit for the year ending 31.3.2015 is Rs. 73,500. It is including a non-trading income of Rs. 1,500 and a non-recurring expense of Rs. 2,000.

2. Profit for the year ending 31.3.2014 is Rs. 65,000. There was loss by theft of Rs. 5,000.

3. Profit for the year ending 31.3.2013 is Rs. 81,000. During the year the goods were damaged by fire amounting to Rs. 8,000.

Mr. M was employed with a firm with a salary of Rs. 24,000 per annum. N's was managed by a manager to whom a salary of Rs. 1,500 per month was paid. Now A wants to replace the manager. An also proposes to insure the business against theft and fire, the premium is estimated at Rs. 500 per month. Calculate the value of goodwill at 2 years purchase of average profit.

Solution:Calculation of normal profit:

Particulars	Rs.	Rs.
1. Year ending 31st March, 2015		
Profit earned	73,500	
Add: Non-recurring expenses	2,000	
	75,000	
Less: Non-trading income	1,500	74,000
2. Year ending 31.3.2014		
Profit earned	65,000	
Add: Loss by theft	5,000	70,000
3. Year ending 31.3.2013		
Profit earned	81,000	
Add: Loss by fire	8,000	89,000
Total normal profit		2,33,000

Average Profit = 2,33,000 / 3	76,000
Less: Salary of 'A' foregone	24,000
	52,000
Add: Manager salary not payable in future 1,500 x 12	18,000
	70,000
Less: Additional expenses expected in the future	
Insurance premium (500 x 12)	6,000
Adjusted average profit (Future Maintainable profit)	64,667

Illustration 2

Calculate the amount of goodwill at 3 years purchase of average profit of the past four years. The profit for the last 4 year is:

Year	Profit Rs.
2010	50,000
2011	58,500
2012	48,300
2013	51,400

Solution:

Average profit = $\frac{50,000 + 58,500 + 48,300 + 51,400}{4}$

$= \frac{2,08,200}{} \quad = \text{Rs. } 52,000$

4

Good will = Average profit x 3 year's purchase

= 52,050 x 3

= Rs. 1,56,150

Illustration 3

Balu purchased a business from Ramu on 1.4.2013. Profits earned by Ramu for the past 3 year ending 31st March were: 2011 – Rs. 75,000, 2012 – Rs. 90,000; 2013 – Rs. 81,000.

It was found that profit for the year 2011 included a non-recurring income of Rs. 3,000 and profit for the year 2013 was reduced by the Rs. 4,000 dues to an abnormal loss on account of fire. The properties of the business were not insured in the past, but it was thought prudent to insure the properties in the future and the premium was expected at Rs. 750 per month.

The goodwill is estimated at two years' purchase of the super profit. Calculate the value of goodwill of the business.

Solution:

Calculation of Average profit:

Particular	Rs.	Rs.
2011 – Profit	75,000	
Less: Non-recurring income	3,000	72,000
2012 – Profit		90,000
2013 – Profit	81,000	
Add: Loss by fire	4,000	85,000
Total normal profit		2,47,000

Average profit = 2,47,000 / 3 = Rs. 82,333

Less: Additional expenses expected in the future:

Insurance premium = 750 x 12 9,000

Adjust average profit 73,333

Goodwill = Adjusted average profit x 2 years purchase

= 73,333 x 2

= Rs. 1,46,666

Illustration 4

X, Y and Z are partners sharing profits and losses in the ration 3:2:1. It was provided in the partnership agreement that on the death or retirement of a partner, goodwill should be calculated on the basis of 3 years purchase of the average profits of the past 5 years. Z retires on 1st April, 2013. Profit for the past 5 years ending 31st March are: 2009- Rs. 40,000, 2010 – Rs. 55,000, 2011 – Rs. 52,000, 2012 – Rs. 71,000, 2013- Rs. 62,000. Calculate the amount of goodwill due to 'Z'.

Solution:

Average profit of part 5 years = $\frac{40{,}000 + 55{,}000 + 52{,}000 + 71{,}000 + 62{,}000}{5}$

Goodwill = Average profit x 3 years purchase= 56,000 x 3 = Rs. 1,68,000

Z's share of goodwill = 1,68,000 x 1/6= Rs. 28,000.

Illustration 5

B Ltd. proposes to purchase the business carried on by Mr. A. Goodwill for this purpose is agreed to be valued at three years purchase of the weighted average profits of the past four years. The appropriate weights to be used are:

2011 – 1, 2012 – 2, 2013 – 3, 2014 – 4. The profits for the four years are:

2011 – Rs. 85,000, 2012 – Rs. 91,000, 2013 – Rs. 1,04,000, 2014 – Rs. 1,18,000

Compute the value of the goodwill.

Solution:

Weighted average profit:

Year	Profit Rs.	Weights	Total Rs.
2011	85,000	1	85,000
2012	91,000	2	1,82,000
2013	1,04,000	3	3,12,000
2014	1,18,000	4	4,72,000
	Total	10	10,51,000

Weighted average profit = 10,51,000 / 10 = Rs. 1,05,100

Goodwill = average profit x 3 years purchase

= 1,05,100 x 3

= Rs. 3,15,300

Illustration 6

M Ltd. agreed to purchase the business of a sole trader. For that purpose, goodwill is to be valued at 3 years purchase of the average of previous 4 years adjusted average profits. The profits for the years ending 31.3.2016 to 31.3.2009 were as follows: Rs. 20,200, Rs. 24,800, Rs. 25,000 and Rs. 30,000. Following additional information is available as under:

(i) On 1.9.2008 a major repair expenditure to plant and machinery for Rs. 6,000 was charged to revenue. This was agreed to be capitalised for goodwill subject to 10% p.a. depreciation on diminishing balance method.

(ii) The closing stock for the year ending 31.3.2007 was over-valued by Rs. 2,400.

(iii) In order to cover cost of management, an annual charge of Rs. 4,800 should be made for valuation of goodwill.

Compute the value of goodwill.

Solution:

Calculation of adjusted average profits:

Particulars	Rs.	Rs.	Rs.
2006 – Profit			20,200
2007 Profit		24,800	
Less: Over valuation of closing stock		2,400	22,400
2008 – Profit		25,000	
Add: Over valuation		2,400	
		27,400	
Add: Expenditure on machinery wrongly charged to profit and loss A/c		6,000	
		33,400	

Less: Depreciation for 2008 – 6 months for Rs. 6,000 at 10% p.a.	300		
Depreciation for 2009 on Rs. 5,700 (6,000 - 300) at 10%	570	870	32,530
2009 – Profit			30,000
			1,05,000
Less: Cost of management (4,800 x 4)			19,200
Total adjusted profit for 4 years			85,930

Annual adjusted average profit = 85,930 ÷ 4 = Rs. 21,482.50

Goodwill = Adjusted average profit x 3 years purchase

= 21,482.50 x 3

= Rs. 64,447.50 (or) Rs. 64,448

4.9. CAPITALIZATION OF ADJUSTED AVERAGE PROFIT

Illustration 8

A company desirous of selling its business to another company has earned as average profit of Rs. 1,50,000 p.a. and the same amount of profit is likely to be earned in the future also except that:

1. Directors' fees of Rs. 15,000 per annum charged against such profits will not be payable by the purchasing company whose existing board can manage the new business also.
2. Rent at Rs. 35,000 p.a. which had been paid by the vendor company will not be incurred in the future since the purchasing company owns its own premises and the necessary accommodation can be provided.

The net assets, other than goodwill, were Rs. 17,50,000 and it was considered that a reasonable return on investment in this type of business would be 10%.

Solution:

Particulars	**Rs.**	**Rs.**
Average net profit		1,50,000
Add: Expenses not likely to be incurred in the future		
Directors' fees	15,000	
Rent	35,000	50,000
Adjust average profit/future maintainable profit		2,00,000

Particulars	Rs.
Capitalised value of the business = $\frac{\text{Future maintainable profit}}{\text{Normal rate of return}}$ = $\frac{2,00,000}{10} \times 100$	20,00,000
Less: Net assets, other than goodwill	17,50,000
Value of goodwill	2,50,000

Summary

1. Average capital employed is mainly used for valuing goodwill.
2. Clearly understand the various adjustments made in profits to determine future maintainable profit.
3. Also understand when weighted average profit is used.
4. For valuation of goodwill assets not used in business like non-trade

investments/outside investments are not included in capital employed.
5. For calculation of net assets value of shares all assets including assets not used in business like non-trade investments/outside investments are included in calculating net assets available for shareholders.
6. Non-recurring incomes and expenses or losses are excluded from profit for valuation of both goodwill and shares.

Exercise

1.Theory Questions

A. Short answer questions:

1. What do you understand by goodwill?
2. Name the methods of valuing goodwill?
3. What is purchased goodwill?
4. What is non-purchased goodwill?
5. What type of goodwill is shown in financial statements?
6. Name the different terms of capital employed.
7. What is gross capital employed?
8. What is net capital employed?
9. What is average capital employed?

B. Long term questions:

1. Explain the need or necessity for valuing goodwill.
2. Explain the various factors affecting the value of goodwill.
3. Explain the various methods of valuing goodwill.
4. 5. What is "Adjusted average expected profit"? Explain the procedure for calculation the same.

III. Problems

1. X Ltd. agreed to purchase the business of a partnership firm. The profit of the firm during the last four years ending 31st March are: 2009 – Rs. 2,20,000,2010 – Rs. 2,37,000, 2011 – Rs. 1,98,000 and 2012 – Rs. 2,25,000.
2. The following are available in respect of a business carried on by Nandini:

   (a) Profits earned – 2008 – Rs. 1,20,000
   2009 – Rs. 96,000
   2010 – Rs. 1,14,000

   (b) Profit of 2009 is reduced by Rs. 10,000 dues to stock destroyed by fire and profitsof 2008 included a non-recurring income of Rs. 6,000.

   (c)Profits of 2010 include Rs. 4,000 income on investment.

   (d) The stock is not insured, and it is thought prudent to insure stock in future. The insurance premium is estimated to be Rs. 3,000 p.a.

   (e) Fair remuneration on the proprietor is Rs. 30,000 p.a.

   You are requested to compute the value of goodwill on the basis of 2 years purchase of average profit of last 3 years.
3. Z Ltd. proposed to purchase the business carried on by X and Y. Goodwill for this purpose is agreed to be valued at 3 years purchase of the weighted average profits of the past four years.

   The appropriate weights and profits for the four years are as under:

Year	Weight	Profit (Rs. in Lakhs)
1997 -1998	1	1100
1998 -1999	2	1115
1999 - 2000	3	1145
2000 - 2001	4	1180

   On scrutiny of accounts, the following information is gathered:

   (i) On 1st December, 1999, major repairs were carried out on buildings incurring Rs. 30 lakhs which were charged to revenue. The above-mentioned sum was agreed to be capitalised for goodwill calculation

subject to adjustment of depreciation at 10% under written down value method.
(ii) Closing stock for the year 1999 -2000 was undervalued by Rs. 20 lakhs are to be considered for the purpose of valuation of goodwill.
(iii) To cover management cost, an annual charge of Rs. 20 lakhs are to be considered for the purpose of valuation of good will.
compute the value of goodwill.

4. (Capitalization of super profit) The following information is taken from the records of Gopi, a sole trader:
1. Profit earned in the last 4 years are: 2011 – Rs. 25,000, 2012 – Rs. Rs. 23,000, 2013 – Rs. 29,000, 2014 – Rs. 31,000. Salary to employee is likely to be increased by Rs. 3,000 form the next year. Loss of stock in floods amounted to Rs. 7,000 in 2013 and insurance claim of the Rs. 3,500 was received in 2014 an which was credited to profit and loss.
2. Average capital employed Rs. 2,50,000.
3. Normal rate of return 8%.
Calculate the goodwill of the business carried on by Mr. Gopi.

BLOCK - II LIQUIDATION OF COMPANY AND AMALGAMATION

UNIT – V VALUATION OF SHARES

Structure

5.1. VALUATION OF SHARES

Valuation of shares involves the use of financial and accounting data based on the objective and subjective consideration for a specific purpose. Hence, for ordinary transactions in shares, the price prevailing in the stock exchange may be taken as the proper value. But the transaction of a large block of company's shares and the non-availability of market price for such shares necessitates the valuation of shares.

5.2. VALUATION AND STOCK EXCHANGE PRICES

The stock exchange quotations are not generally acceptable at the transaction of a large block of company's shares, because the stock exchange price is determined on the interactions of demand and supply and business cycles.

In the words of the council of the London Stock Exchange "The stock exchange may be linked to a scientific recording instrument which registers, not its own actions and opinions but the action and opinions of private institutional investors all over the country and indeed the world. These actions and opinions are the result definitely do not represent valuation of a company by reference to its assets and its earning potential".

5.3. CIRCUMSTANCES WARRANTING VALUATION OF SHARES

The following circumstances warrant of shares for some specific purposes:

i) For the purpose of calculating the estate duty.
ii) For the purpose of formulating amalgamation adsorptions
iii) For the purpose of merger, acquisition and reconstruction scheme.
iv) For the purpose of purchase or sale of controlling shares.
v) For the purpose of purchase and sale of shares in private companies and other unquoted shares.
vi) For the purpose of valuation of gift tax, wealth tax etc.,
vii) For the purpose of converting one class of shares into another.
viii) For the purpose of pledging the shares as collateral security for a loan.
ix) For the purpose of compensating the shareholders by the central or state government when the undertaking is nationalized.

5.4. NEED FOR VALUATION

The need for valuation of shares of a company arises in the following situations:

a) If the shares are not listed, the quotation is not available. Then it is necessary to value such shares.
b) If the price is not valuable for a listed share, in the absence of transactions, then the necessity arises to value such shares.
c) If the market quotation does not reflect the true value of the shares.
d) For statutory valuation of the shares.
e) For the transfer of a large block of share.

5.5. FACTORSAFFECTING THE VALUE OF SHARES

The following factors affect the valuation of shares:

i) The nature of company's business
ii) The economic condition of the country and price level fluctuation.
iii) The capital market condition and demand and supply of shares
iv) The earning capacity of the company
v) Dividend declared by the company in the past and the rate of proposed dividend.
vi) The political and general economic condition of the country.
vii) Progress of the business and goodwill of the company.
viii) Proportion of capital and liability and net tangible assets of the company
ix) Types of management and capacity of the directors.

5.6. METHODS OF VALUATION OF SHARES

The following are the various methods for valuation of shares:

i) Net Asset or Intrinsic value Method
ii) Yield method
iii) Earning Capacity Method
iv) Fair Value Method

5.6.1. Net Assets Method

Under this method the net asset value of each share is arrived at by dividing the total value of the net assets of the company by its total number of equity shares. This method aims at finding out the possible value to the shares in the event of the company going into liquidation. The method is also known as Bread-up value method or Asset backing method or Intrinsic value method. This can be found out form the following formula.

$$\text{Net asset value of each share} = \frac{\text{Net Assets available for Equity shareholder}}{\text{Number of Equity Shares}}$$

Net asset available for equity shareholders = Net Assets– Preference Share Capital

Net Assets = Total realizable value of assets –Total of external liability

Assets available to equity shareholders may be calculated on the following basis:

Particulars	Rs	Rs
Assets at market value/ book value:		
Land and Building		xxxxxxx
Plant and Machinery		xxxxxxx
Cash		xxxxxxx
Bank balance		xxxxxxx

Debtors Bills receivable Stock Other assets		xxxxxxx xxxxxxx xxxxxxx xxxxxxx
Total realizable value of assets		xxxxxxx
Less: Outside Liabilities Creditors Bills payable Bank overdraft Debenture	xxxxxxxx xxxxxxxx xxxxxxxx xxxxxxxx xxxxxxxx	 xxxxxxxx
Net Assets Less: Amount payable to preference shareholders		xxxxxx xxxxxx
Net Assets available to equity shareholders		xxxxxxx

Note:

i) The value of goodwill and non-trading assets, if any, should also be included at their market value.

ii) If the market value of asset is not stated in the problem, then book value of the assets is to be considered.

5.6.2. Yield Method

Investors are interested in the income for their investment. Hence, the price they will be prepared to pay will depend upon the yield or the size of the dividend that an investor gets out of his holding. Under this method the value of share is obtained by comparing the expected rate of return with normal rate of return. This can be found out form the following formula.

Market value =Expected Rate of Return or Dividend
On yield basis Normal Rate of Return or Dividend * Paid up value per equity share

Expected Rate of Return = Expected Profit or Yield
Total paid up equity capital * 100

5.6.3. Earning Capacity Method

Under this method the value of share is found out by comparing the company's earning capacity and the normal rate of return on capital employed. This can be found out from the following formula.

Market value on
Earning basis = Rate of Earnings
Normal rate of Return * Paid-up value per share

Rate of earnings = Profit Earned
Capital Employed * 100

Expected profits may be calculated as follows:

Average Profit		xxxxx	
Less: Tax	xxxxx		
Profit after tax		xxxxx	
Less: Transfer to Reserve	xxxxxx		
Preference dividend	xxxxxxxxxxx		
Profit available to equity shareholders			xxxxxx

Note: The profit is found out by deducting reserves, income tax and preference dividend.

5.6.4. Fair value method

Fair value of shares is the simple average of net assets value and yield value. Fair value provides a better indication about the value of shares than the other methods. This can be found out from the following formula.

$$\text{Fair value} = \frac{\text{Intrinsic value} + \text{Yield value}}{2}$$

ILLUSTRATION: 1

Balance sheet of Naveen company as on 31.12.2007

Liabilities	Rs	Assets	Rs
20,000 Equity shares of Rs. 10 each	2,00,000	Good will	2,00,000
Employee's saving fund	1,50,000	Investment at cost (market value Rs. 2,50,000)	3,00,000
Employee's Provident fund	1,50,000	Stock at Cost	5,00,000
Creditors	6,00,000	Debtors	4,00,000
Profits and Loss A/C	3,70,000	Bank Balance	70,000
	14,70,000		14,70,000

The profits for the last five years were Rs. 15,000, Rs. 20,000, Rs. 25,000, Rs. 30,000, and Rs. 35,000 and the goodwill is to be valued based on three years purchase of the average annual profits for the last 5 years.

Calculation the price of the share based on Net asset value.

SOLUTION:

$$\text{Average Profit} = \frac{15,000 + 20,000 + 25,000 + 30,000 + 35,000}{5}$$

$$= \frac{1,25,000}{5}$$

$= 25,000//-$

Goodwill = Average Profit x No. of years of purchase

= Rs. 25,000 x 3

= Rs. 75,000

Particulars	Rs	Rs
Good will		75,000
Investment		2,50,000
Stock		5,00,000
Debtors		4,00,000
Bank Balance		70,000
		12,95,000
Less: Employee's Saving Fund	1,50,000	
Employee's Provident Fund	1,50,000	
Creditors	6,00,000	9,00,000
Net Assets		3,95,000

Intrinsic value per Equity share = Net Assets for Equity shareholders / No. of Equity Shares

= 3,95,000 / 20,000

= Rs. 19.75

ILLUSTRATION: 2Balance sheet of Nutown Company as on 31.12.2002

Liabilities	Rs	Assets	Rs
20,000 Equity shares of Rs. 10 each	2,00,000	Good will	10,000
		Machinery	1,00,000
6% Pref. shares of Rs. 100 each	50,000	Stock at Cost	30,000
Reserve Fund	50,000	Debtors	60,000
Profit & Loss A/c	20,000	cash	1,00,000
Debentures	12,000	preliminary expenses	40,000
Creditors	8,000		
	3,40,000		3,40,000

Depreciate machinery by Rs. 25,000. Average profit of last five years Rs. 15,000. Take goodwill based on 3 years purchases. Calculate the value of equity shares.

SOLUTIONS:Calculation of Net Assets

Particulars	Rs	Rs
Stock		30,000
Debtors		60,000
Cash		1,00,000
Machinery	1,00,000	
Less: Depreciation	25,000	75,000
Good will = Rs. 15,000 x 3 Years		45,000
		3,10,000
Less: Debentures	12,000	
Creditors	8,000	20,000
Net Assets		2,90,000

Net Assets = 2,90,000
Less: 6% preference share capital 50,000
Net Assets available for Equity shareholders 2,40,000

Intrinsic value per Equity share =Net Assets for Equity shareholders / No. of Equity Shares

= Rs. 2,40,000 / 2,000

= Rs. 120

ILLUSTRATION: 3 The following is the Balance Sheet of Essex. Ltd. As on December 31, 2007

Liabilities	Rs	Assets	Rs
3,000 Equity shares capital of Rs. 100 each	3,00,000	Cash in hand	2,000
		Cash at Bank	20,000
1,500 8% Preference share capital of Rs. 100 each	150,000	Sundry Debtors	80,000
General Reserve a/c	40,000	Stock in Trade	1,40,000

Profit & Loss A/c	10,000	Land& Building	2,05,000
Bank loan a/c	50,000	Furniture	30,000
Sundry Creditors A/C	15,000	Goodwill	70,000
		Discounton Shares	18,000
	5,65,000		5,65,000

The value of assets is assessed as follows:

i) Furniture to be depreciated at 10%

ii) Value of stock in trade, land and building and goodwill is estimated at Rs.1,20,000 Rs. 2,50,000 and Rs. 80,000 respectively

iii) Debtors are expected to realize80% of book value.

Find out the value of equity share.

SOLUTIONS:Calculation of Net Asset

Particulars	**Rs**	**Rs**
Cash in Hand		2,000
Cash at Bank		20,000
Sundry Debtors		64,000
Stock in Trade		1,20,000
Land and Building		2,50,000
Furniture less Deprecation		27,000
Goodwill		80,000
		5,63,000
Less: Bank Loan	50,000	
Sundry Creditors	15,000	65,000
Net Assets		4,98,000

Net Assets = 4,98,000

Less: Preference share Capital = 1,50,000

Net Assets for Equity Share Holders= 3,48,000

Intrinsic value per equity Shares = $\frac{3,48,000}{3,000}$

= 116

ILLUSTRATION: 4

From the following,calculate the value per equity shares:

2000,9% Preference shares Rs.100 each	2,00,000
50,000, Equity shares of Rs. 10 each Rs. 8 per share paid up	4,00,000
Expected profits per year before tax	2,18,000
Rate of Tax	50%
Transfer to General reserve every year	20% of the Profit
Normal Rate of Earning	15%

SOLUTIONS:Calculation of Profit available to Equity Shareholders

Particulars	**Rs.**
Expected Profits per year before tax Less: Tax @50%	2,18,000 1,09,000

Profit after tax Less: Transfer to General Reserve (1,09,000 X 20/100	1,09,000 21,800
Profit available for preference & Equity shareholders Less: Preference dividend (2,00,000 x 9%)	87,200 18,000
Expected Profit available to equity shareholders	69,200

Expected rate of Return = $\frac{\text{Expected profit}}{\text{Total paid up Equity share capital}} \times 100$

= 69,200/4,00,000X100

= 17.30%

Yield value per share = $\frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}} \times \text{paidup value per share}$

= 17.30/15 X 8 = 9.23

ILLUSTRATION: 8

From the following relating to Micro Ltd., calculate the value of share (i) if only a few shares are to be sold and (ii) if majority shares are to be sold.

a) Share capital: 20,000 shares of Rs. 100 each fully paid
b) Profits (after deduction of tax and dividend) for the last three years: Rs. 4,60,000
   Rs. 7,00,000, Rs. 5,50,000
c) Dividend paid for the last three years: 12%, 15%, and 18%
d) Normal rate of return 10%

Solution:

(i) When only a few shares are to be sold:

Average rate of dividend = $\frac{12+15+18}{3}$

= 15%

Yield value of equity share = $\frac{\text{Rate of dividend}}{\text{Normal rate of return}} \times \text{paid up value per share}$

= 15/10X100

= 150

(ii) When majority of shares are to be sold:

Average Profit = $\frac{4,60,000+7,00,000+5,55,000}{3}$

= 5,70,000

Expected rate of Return = $\frac{\text{Expected profit}}{\text{Total paid up Equity share capital}} \times 100$

= 5,70,000/20,00,000X100

= 28.50%

Yield value of equity share = $\frac{\text{Rate of dividend}}{\text{Normal rate of return}} \times \text{paid up value per share}$

= 28.50/10X Rs. 100

= 285

5.7 FAIR VALUE METHOD

ILLUSTRATION: 1

The yield value of KumarLtd's share is Rs. 291 and its intrinsic value per share is Rs. 297. Compute the fair value of shares of Kumar Ltd.

Solution:

Fair Value = $\frac{\text{Intrinsic Value + Yield Value}}{2}$	= $\frac{297+297= 588}{2}$ $\frac{}{2}$ = Rs 294

5.8 MORE THAN ONE METHOD

ILLUSTRATION: 1

On 31.12.2007 the Balance Sheet of V Ltd. Showed the following

On 31.12.2007 the fixed assets were indecently valued at Rs. 3,50,000 and goodwill at Rs. 50,000. The net Profit for the three years were: 2005- Rs. 51,600: 2006 – Rs. 52000; 2007 – Rs. 62000Of which 20% was placed to reserve. Fair investment return may be taken at 9%

Calculate the value of shares by

a) Net assets method and b) yield method

SOLUTION:Net Asset Method:

Calculation of Net Asset available to Equity shareholders		
Fixed Assets		3,50,000
Goodwill		50,000
Current Assets		2,00,000
		6,00,000
Less: 5% Debentures	1,00,000	
Current Liabilities	1,30,000	2,30,000
Net Assets		3,70,000

Intrinsic value of each share = $\frac{\text{Net Assets for Equity shareholders}}{\text{No. of Equity Shares}}$

= 3,70,000 / 40,000 = Rs. 9.25

A) Yield method

Calculation of Profits available to Equity shareholders	**Rs.**
Average profit = $\frac{51600 + 52000 + 620000}{3}$ = 165600/3	55,200
Less: Transfer to Reserve (55200x20/100)	11,040
Expected Profit available to Equity shareholders	44,160

Summary

1. The valuation of share is explained the shares.
2. Clearly understand the various methods of valuation shares.
3. Also understand when Yield method.
4. For the circumstances warranting valuation of shares.
5. For calculation of fair value method.
6. Understanding the sources for valuation and stock exchange prices.

Exercise

1.Theory Questions

A. Short answer questions:

1. Write a short note on the valuation.
2. What are the factors that influence valuation of shares?
3. What are the circumstances in which there may be a need for valuation of shares?
4. Explain the "Yield method" of valuing shares.

B. Long answer question

1. Explain the circumstances under which valuation of shares is essential.
2. Explain the various methods of valuation of shares.
3. Write short note on:
   a) net assets basis b) Earning basis c) Fair value.

II – Problems1. Balance sheet of Manoj company as on 31.12.2012

Liabilities	Rs	Assets	Rs
10,000 Equity shares of Rs. 10 each	1,00,000	Good will	3,00,000
Employee's saving fund	2,00,000	Investment at cost (market value Rs. 2,50,000)	50,000
Employee's Provident fund	3,00,000	Stock at Cost	1,50,000
Creditors	4,00,000	Debtors	5,00,000
Profitand Loss A/C	1,00,000	Bank Balance	1,00,000
	11,00,000		11,00,000

The profits for the last five years were Rs. 13,000, Rs. 10,000, Rs. 75,000, Rs. 20,000, and Rs. 15,000 and the goodwill is to be valued based on four years purchase of the average annual profits for the last 5 years.
Calculate the price of the share based on Net asset value.

2. The yield value of SulthanaLtd's share is Rs. 100 and its intrinsic value per share is Rs. 176. Compute the fair value of shares of SulthanaLtd.

UNIT - VI LIQUIDATION

Structure

6.1 LIQUIDATION MEANING

Liquidation or winding up is process, by which a company is dissolved, and its assets realized and applied in paying off the liabilities of the company. It there is any surplus after closing off the liabilities, it is distributed to its contributors according to their rights.

6.2 LIQUIDATION DEFINITION

"The process whereby its life is ended, and its property is administered for the benefit of its creditors and members. An administrator, called a Liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights" – Companies Act, 1965

6.3 REASONS FOR WINDING UP

A company may be wound up because of any one or more of the following reasons:

i) The main objects of the company for which it was established have been accomplished.
ii) If it has become impossible to carry out the main objects of the company.
iii) If the company has sold the business or the undertaking to another company or an individual.
iv) If the company is not in a position to pay its debts in full or it has become insolvent.

6.4 MODES OF WINDING UP

A company may be wound up in any of the following ways:

I. Compulsory winding up – by the court – sections 433 to 483 of companies Act.
II. Voluntary winding up which may be sub divided into:
   a) Members voluntary winding up
   b) Creditors voluntary winding up
III. Winding up under the Supervision of the Court (Secs. 522 to 527)

6.5 COMPUSORY WINDING UP BY COURT

A company can be compulsorily wound up through the court for the following reasons:

i) If the company itself has passed a special resolution or the winding up by the court.
ii) If a default is made in filing the statutory report with the Registrar or the statutory meeting has not been held within the prescribed time.
iii) If the company has not commenced its business for one year after the date of its incorporation or if it has suspended its business for one year.
iv) If the number of members of the company has fallen below two int eh case of a private company and seven in the case of a public company.
v) If the company is unable to pay the debts in full.

6.6 PETITION FOR COMPULSORY WINDING UP

The following persons may file a petition in the court for the winding up of company:

i) A shareholder or a contributory.
ii) The company itself when it passes a special resolution for the winding up of the company.
iii) One or more creditors including any contingent or perspective creditors.
iv) The registrar of Companies.
v) Any person authorized by Central Government.

Voluntary Winding Up

When a company is wound up at the instance of either the members or the creditors, the winding up is termed a voluntary winding up.

Circumstances under which as company may be wound up voluntarily:

i) When the period, if any, fixed for the duration of the company by the articles has expired.
ii) The event, if any, on the occurrence of which the company is to be wound up according to the articles, has occurred.
iii) If the company passes a special resolution to wind up the company voluntarily.

Commencement of Voluntary Winding up:

Voluntary winding up commences from the date on which the resolution is passed.

6.7 TYPES OF VOLUNTARY WINDING UP

Members' Voluntary Winding up:

When the company is wound up at the instance of the members of the company, it is called Members' voluntary winding up.

Creditors' Voluntary winding up:

When the company is wound up at the instance of the creditors' of the company it is termed as Creditors voluntary winding up.

Winding up under the supervision of the court

When a company is being wound up voluntarily, the court may order for the winding up under its supervision though the voluntary winding up continues. This type of winding up is sometimes called supervisory winding up. The objectives of this mode of winding up are to safeguard the interests of the company, shareholders and creditors.

Ground on which winding up under supervision of court is ordered

Application for the supervision of the court may be made by:

a) a contributory, or
b) a creditor, or
c) the company itself, or
d) the liquidator

6.8 LIQUIDATOR

Liquidator is a person appointed by the court or by the members in general meeting or by the creditors for the purpose of liquidation.

6.9 LIQUIDATOR'S FINAL STATEMENT OF ACCOUNT

A liquidator is appointed to liquidate a company. It is the duty of the liquidator to realize the assets and settle the accounts of third parties. After the completion of liquidation process, the liquidator mustprepare a statement which states the total cash realized and the amount disbursed to creditors, debenture holders and shareholders. Such a statement is known as Liquidators' final Statement Account.

6.10 CONTRIBUTORY

Contributory is a member or a shareholder who is liable to pay amount to the company at the time of winding up of company. Contributory may be of present of past members.

Present members are those whose names are recorded in the list a of company at the time of liquidation. If a member has paid all the money for the shares subscribed by him, his name is recorded in the List A

Past members are those persons whose names appear in the list B and whose names have been removed from the register of member prior to one year from the date of winding up.

6.11 PREFERENTIAL CREDITORS

Preferential creditors are those members who have preferential rights over the assets of the company. Preferential creditors have the priority over the unmortgaged assets of the company.

Examples:

i) Tax payable to the Government or local authority
ii) Four months wages and salaries payable to workers or employees Rs. 20,000 (w.e.f March 1997)
iii) Amount payable as arrears as per workmen compensation Act.
iv) Amount payable as arrears under Provident Fund Scheme and Pension Fund Scheme.
v) Amount payable as arrears under Employees State Insurance Act.

6.12 LIQUIDATOR'S REMUNARATION:

Liquidator is entitled to receive remuneration for the service rendered y him. The liquidator may receive remuneration as a percentage assetrealized and a percentage on the amount distributed to creditors on shareholders.

Commission on Assets Realised:

$$\text{Commission} = \text{Assets realized} \times \frac{\text{percentage of commission}}{100}$$

Commission on amount distributed to unsecured creditors:

Commission = Unsecured creditors X$\frac{\text{Percentage of Commission}}{100}$

In some circumstances, there may not be possibility to have enough money to pay off the liabilities of unsecured creditors. In such circumstances, commission will be calculated as follows:

Commission = cash available X $\frac{\text{percentage of commission}}{100 + \text{Percentage of Commission}}$

Note:

While calculating commission on unsecured creditors, preferential creditors are also to be included:

6.13 ORDER OF PAYMENT:

The liabilities are paid off in the following order of preference:

i) Liquidation expenses
ii) Liquidation Remuneration
iii) Secured creditors
iv) Debentures holders
v) Preferential creditors
vi) Unsecured creditors
vii) Preferential shareholders
viii) Equity shareholders

6.14 CLASSIFICATION OF ASSETS AND LIABILITES IN THE STATEMENTS OF AFFAIRS:

The various assets and liabilities are classified and given in various lists as shown below:

List A: Assets not specifically pledged on Mortgaged
List B: Secured creditors to the extent to which claims are estimated to be covered by assets specifically pledged:
List C: Preferential creditors
List D: Debenture holders secured by a floating charge.
List E: Unsecured creditors
List F: Amount due to preferential shareholders
List G: Equity shareholder's amount.
List H: surplus/ deficiency as regards members

SPECIMEN:STATEMENT OF AFFAIRS

ASSETS	ESTIMATED REALISABLE VALUE RS.
Assets not specifically pledged (as per list A)	
Balance at Bank, Cash in hand	xxx
Marketable securities	xxx
Bills Receivable	xxx
Trade Debtors	xxx
Loans & Advances	xxx
Unpaid calls	xxx
Stock-in- Trade	xxx
Work in progress	xxx
Freeholds property, land &Buildings	xxx
Lease hold Property	xxx
Plant &Machinery, Furniture Fittings , Utensils etc.	xxx
Investments other than marketable securities	xxx
Other property	xxx

<table>
<tr><td colspan="2">Assets specifically pledged (As per List B)
<table><tr><td>Assets</td><td>Estimated Realizable Value</td><td>Due to Secured Creditors</td><td>Defici rankir unsecu</td></tr></table>
Freehold Property
Estimated total assets available for pref. crs., Debenture holders secured by a floating charge and unsecured Crs.
Summary of Gross Assets
Gross realizable value of assets specifically pledged:
Specifically pledged xxxxx
Others xxxxx</td><td>xxx
xxx

xxx

xxx</td></tr>
<tr><td>Gross Liabilities</td><td>Liabilities</td><td></td></tr>
<tr><td>Xxx</td><td>Secured Creditors (As per List B)</td><td></td></tr>
<tr><td>Xxx</td><td>Preferential creditors (As per List C)</td><td>xxx</td></tr>
<tr><td></td><td>Estimated balance of assets available for debentures holders</td><td>xxx</td></tr>
<tr><td>Xxx</td><td>Debentures holders secured by a floating charge (As per List D)</td><td>xxx</td></tr>
<tr><td></td><td>Estimated surplus as regards Debentures holders</td><td>xxx</td></tr>
<tr><td>Xxx

Xxx</td><td>Unsecured creditors (As per List E)
Estimated unsecured balance of claims of creditors partly secured on specific assets, brought from preceding page
Trade Accounts and Bills payable
Contingent liabilities
Estimated surplus/ Deficiency as regards creditors
Estimated surplus as regards creditors

Issued and called up Capital:
Pref. shares of …. each called up (As per List F)
Equity shares of …. Each …. called up (As per List G)
Estimated Surplus / Deficiency as regards Members (or) Contributions (As per List H)</td><td>

xxx
xxx
xxx
xxx
xxxx

xxx
xxx
xxx</td></tr>
</table>

SPECIMEN:LIQUIDATORS FINAL STATEMENT OF ACCOUNTS

Receipts	**Estimated value Rs**	**Value realized Rs**	**Payments**	**Payments Rs.**	
Assets: Cash at Bank Cash in Hand Marketable			Legal charges: Liquidator's remuneration % on Rs…….		

Securities Bill Receivable Trade Debtors Stock in Trade Work in Progress Free hold property Plant and Machinery Furniture & Fittings Surplus from securities Unpaid calls at Commencement of winding up Amount received from Calls on contributions Made in the winding up Receipts per trading a/c			Realized % on Rs …….. distributed Auctioneers' and valuers' charges: Cost of possession Cost of notice Incidental outlay Total cost & charges Debenture holders: Creditors Preferential Unsecured Preference share capital Returns to contributories		-

CALCULATION OF LIQUIDATOR'S REMUNARATIONS

ILLUSTRATION 1

From the particulars given below, ascertain liquidator's remuneration:

Creditors to be paid Rs. 60,000
Amount available on hand Rs. 44,000

Commission to be given on the amount paid to creditors 10%

The available amount is not enough to pay all the creditors.

Remuneration =Amount available X <u>Percentage of commission</u>
100+ Percentage of Commission
= 44,000 X 10/100+10
= 44,000 X 10/110 = Rs. 4,000

ILLUSTRATION 2

The amount due to unsecured creditors is Rs. 3,00,000. The amount available for unsecured creditors before charging commission in Rs. 1,03,000

3% commission is to be paid on the amount paid to unsecured creditors. Calculate the liquidator's remuneration.

Solution:

Commission to be paid to liquidators = 1,03,000 X 3/103 = Rs.3,000

LIQUIDATOR'S FINAL STATEMENT OF ACCOUNTS

ILLUSTRATION 3

From the following information, prepare liquidator's final statement of account.

Cash at Bank	1,00,000
Surplus from securities	10,10,000
Expenses of Liquidation	30,000
Liquidator's Remuneration	7,000
Preferential Creditors	2,00,000
Unsecured Creditors	7,00,000

NOTES

Preference Shareholders	1,00,000
Equity shareholders	1,00,000

Solution:Liquidator's Final Statement of Account

Receipt	Estimated value	Value realized	Payments	Payment
Assets Realised			Liquidators Remuneration	7,000
Cash at Bank		1,00,000	Expenses of Liquidation	30,000
Surplus from securities		10,10,000	Preferential Creditors	2,00,000
			Unsecured Creditors	7,00,000
			Preference share holders	1,00,000
			Equity Shareholders (Bal Fig)	73,000
		11,10,000		11,10,000

ILLUSTRATION 6

The Hi-Tech went into liquidation. Its assets realized Rs. 3,50,000 excluding amounts realized by sale of securities held by the secured creditors.

Share Capital: 1000 share of Rs. 100 each	1,00,000
Secured creditors (Securities realized Rs. 40,000)	35,000
Preferential Creditors	6,000
Unsecured creditors	1,40,000
Debentures having floating charge	2,50,000
Liquidation expenses	5,000
Liquidator's Remuneration	7,500

Prepare liquidator's final statement of account.

SOLUTION:THE HI-TECH COMPANY (in Liquidation)Liquidator's Final Statement of Account

Receipt	Estimated value	Value realised	Payments	Amount
Assets Realised		3,50,000	Liquidator Remuneration	7,500
Surplus from Secured Creditors		5,000	Liquidation expenses	5,000
			Debenture having floating charge	2,50,000
			preferential creditors	6,000
			unsecured creditors (Bal Fig)	86,500
			86,500/1,40,000=0.62	
		3,55,000		3,55,000

ILLUSTRATION 7

ZYX Ltd. went into liquidation with following liabilities:

Secured creditors Rs. 22,000 (Securities realized Rs. 27,000)
Preferential Creditors Rs. 1,000
Unsecured Creditors Rs. 30,800

Liquidation expenses amounted to Rs. 300. He is entitled to a remuneration of 3% on the amounts realized (including securities with creditors) and 1 ½% on the amount paid to unsecured creditors. The various assets (excluding securities with creditors) realized amounted to Rs. 26,500. Prepare the liquidator's final statement of account.

Solution:

Receipt	**Estimated value**	**Value realised**	**Payments**	
Assets Realised			Liquidator Remuneration	2,042
Surplus from Secured Creditors Secured creditors		26,500	Liquidation expenses	300
(27,000 - 22,000)		5,000	preferential creditors	1,000
			unsecured creditors (Bal Fig)	28,158
			28158/30800 = 0.91	
		31,500		31,500

Working Notes:
Total assets realized = Rs. 26,500 + 27,000 = Rs. 53,500
3% on realized Rs. 53,000 X 3% = Rs. 1,605
1 1/2 % on Pref. Crs. Rs. 1,000 X 1 ½ % = Rs. 15
Amount available for unsecured Crs. & Remuneration
= 31,500 – (300 + 1,605 + 15 + 1000) = 28,550
Remuneration on unsecured creditors = 28,580 X 1.5/101.5 = Rs. 422
Total Remuneration = 1,605 + 15 + 422 = Rs. 2,042

STATEMENT OF AFFAIRS

ILLUSTRATION: 15

From the following information, prepare unsecured creditors as per list E.

Unsecured creditors		3,80,000
One Month's salary		4,000
Bills Payable		1,06,000
Bank Overdraft		40,000
Liability on Bills Discounted		60,000
Partly secured creditors		
(Total Creditors Rs. 2,00,000)	1,00,000	
Preferential Creditors		16,000

SOLUTION:Calculation of Unsecured Creditors as per List E

Particulars	Rs.
One month's Salary	4,000
Unsecured Creditors	3,80,000
Bills payable	1,06,000
Bank O/D	40,000
Liability on Bills Discounted	60,000
Partly secured creditors	1,00,000
Total	6,90,000

ILLUSTRAION: 16

N Co. went into voluntary liquidation on 1.3.2001. The following balances are taken from its books on that date:

Liabilities	Rs.	Assets	Rs.
Capital: 50,000 Equity shares of Rs. 10 each	5,00,000	Buildings	1,50,000
Debentures	2,00,000	Plant and Machinery	2,10,000
Bank Overdraft	30,000	Stock in Trade	95,000
Creditors	40,000	Book Debts 75,000 Less: Provision 10,000	65,000
		Calls in Arrears	1,00,000
		Cash	10,000
		Profit & Loss a/c	1,40,000
	7,70,000		7,70,000

Plant and Machinery and Buildings are valued at Rs. 1,50,000 and Rs. 1,20,000 respectively. On realization, losses of Rs. 15,000 are expected on stock. Book Debts will realize Rs. 70,000. Calls in arrears are expected to realize 90%. Bank O/D is secured against buildings. Preferential creditors for taxes and wages are Rs. 6,000 and miscellaneous expenses outstanding Rs. 2,000.

Prepare a statement of Affairs.

SOLUTION:

Statement of Affairs of N Co.as on 1.3.2001

ASSETS	ESTIMATED REALISABLE VALUE RS.
Assets not specifically pledged (as per list A)	
Balance at Bank, Cash in hand	10,000
Book Debts	70,000
Calls in arrears	90,000
Stock	80,000

Plant & Machinery	1,50,000
	4,00,000
Assets specifically pledged (As per List B)	

Assets	Estimated Realisable Value	Due to Secured Creditors	Deficiency ranking as unsecured
Buildings	1,20,000	30,000	-

Freehold Property Estimated total assets available for pref. crs., Debenture holders secured by a floating charge and unsecured Crs.	90,000
Summary of Gross Assets Gross realizable value of assets specifically pledged: Specificallypledged 1,20,000 Others 4,00,000 Gross Assets 5,20,000	4,90,000

Gross Liabilities	Liabilities	
30,000	To be deducted from surplus or added to deficiency as the case may be: Secured Creditors (As per List B) to the extent to which Assets are estimated to be covered by assets specifically pledged	6,000
6,000	Estimated balance of assets available for debentures holders Secured by a floating charge and unsecured creditors	4,84,000
2,00,000	Debentures holders secured by a floating charge (As per List D)	2,00,000
40,000	Estimated surplus as regards Debentures holders	2,84,000
2,000 2,78,000	Unsecured creditors (As per List E) Creditors 40,000 Miscellaneous expenses outstanding	42,000 2,42,000

	2,000 Estimated surplus as regards Creditors Issued and called up Capital: Issued Share Capital (As per List F) 50,000 Equity Shares of Rs. 10each Called up less Arrears irrecoverable (As per List G) Estimated Deficiency as regards Members (or) Contributions (As per List H)	 Nil 4,90,000 2,48,000

6.15 DEFICIENCY OR SURPLUS ACCOUNT

This account is prepared in the case of a company in liquidation to explain in a nutshell how the company lost money during its existence. It explains the deficiency or surplus. It is divided into two parts. The first part starts with the deficit on the given date (as the liquidator specifies, the minimum being three year) and contains every item that increase the deficiency. The second part starts with the surplus on the given date and includes all profits. If the total of the first exceeds the second, there would be a deficiency to the extent of the difference and a surplus vice-versa. This statement is a necessary adjunct to the statement of affairs as regards members and the deficiency shown in this account must agree with the one shown by the statement of affairs. The period covered by this account must commence on date not less than 3 years before the date of winding up order or from the date of formation of the company if the whole period of its existence is less than 3 years, unless the liquidator otherwise agrees.

Prescribed form of deficiency or surplus account

List H – Deficiency or surplus account

Item contributing to deficiency (or reducing surplus)	**Rs.**
1. Excess (if any) of capital and liabilities over assets on the ---- 19 --- as shown by balance sheet (copy annexed)	xxx
2. Net dividends and bonuses declared during the period form ----19 --- to the date of the statement	xxx
3. Net trading losses (after charging items shown in note to follow) for the same period	xxx
4. Losses other than trading losses written off or for which provision has been made in the books during the same period (given particulars or annex schedule)	xxx
5. Estimated losses now written off or for which provision had been made for the purpose of preparing the statement (give particulars or annex schedule)	xxx
6. Other items contributing to deficiency or reducing surplus-------	xxx
Item reducing deficiency (or contributing to surplus)	
7. Excess (if any) of assets over capital and liabilities on the----- 19----- to the date of statement	xxx
8. Net trading profit (after charging item shown in note below)	

for the period form---- 19 ----- to the date of statement.	xxx
9. Profits and income other than trading profits during the same period (give particulars or annex schedule)	xxx
10. Other items reducing deficiency or contributing to surplus	xxx
Deficiency / surplus (as shown by the statement of affairs)	xxx
Notes as to net trading profits and losses: Particulars are to be inserted here (so far as applicable) of the items mentioned below, which are to be taken into account in arriving at the amount of net trading profits or losses shown in this account: Provision for depreciation, renewals or diminution on value of fixed assets. Charges for Indian income tax and other Indian taxation on profits. Interest on debentures and other fixed loans, payment to directors made by the company and required by law to be disclosed in the accounts	
Exceptional or non-recurring receipts: -----	xxx
Balance being other trading profit and losses. Net trading profits and losses as shown in deficiency or surplus account above.	xxx
	xxx
Signature: Date 19 ………..	

Illustration 1

The following balances were extracted from the books of sudden Attack Ltd. on 31.12.2006 on which date a winding up order was made:

Share capital	Rs.
Equity shares – 20,000 shares of Rs. 10 each, Rs. 8 per share called up	1,60,000
Preference shares – 2,000 shares of Rs. 100 each fully paid	2,00,000
Calls-in-arrears on Equity shares – estimated to realize Rs. 600	1,000
15% debentures secured by first floating charge on the assets	2,00,000
Bank overdraft secured by a second floating charge on assets	1,00,000
Fully secured creditors (secured against Plant & Machinery)	60,000
Investment (estimated to realise Rs. 60,000)	80,000
Plant & Machinery – Secured to creditors estimated to realise Rs. 80,000	1,20,000
Land & Building – estimated to realise Rs. 80,000	40,000
Rent & taxes	4,000
Wages & Salaries	3,000
Bills payable	24,000
Sundry creditors	60,000
Bills receivable – estimated to realise Rs. 2,000	6,000
Debtors – estimated to realise 60 %	1,40,000
Bills discounted – Rs. 30,000 likely to rank	8,000
Contingent liability likely to materialize	6,000
Stock-in-trade – estimated to produce Rs. 38,000	60,000
Cash in hand and at bank	3,200

Entry for accrued salary of Rs. 4,000 and rent of Rs. 2,000 has still to be made in the books.

Prepare a statement of affairs and a deficiency A/c.

Solution:Statement of affairs of Sudden Attack Ltd. as on 31.12.2006

Assets	
Assets not specifically pledged as per List 'A'	Rs.
Cash in hand and at bank	3,200
Bills receivable	2,000
Sundry debtors (1,40,000 x 60%)	84,000
Calls in arrears	600
Stock-in-trade	38,000
Land & Building	80,000
Investment	60,000
	2,67,800
Assets specifically pledged as per list B: Estimated Realisable value Rs. / Due to secured creditors Rs. / Deficiency Rs. / Surplus Rs. Plant & Machinery 80,000 / 60,000 / - / 20,000	20,000
Estimated total assets available for preferential creditors, Debenture holders secured by a floating charge and unsecured creditors.	2,87,000
Summary of Gross assets: Gross realizable value of assets specifically Pledged 80,000 Other assets <u>2,67,800</u> <u>3,47,800</u>	

Liabilities

Gross Liabilities	(To be deducted from surplus or added to be deficiency as the case may be)	
60,000	Secured creditors as per List B to the extent to which claims are estimated to be covered by assets specifically pledged	<u>13,000</u>
13,000	Preferential creditors are per list 'C'	
2,00,000	Estimated balance of assets available for debenture holders and bank overdraft secured by a floating charge and for unsecured creditors (3,47,800 – 73,000)	2,47,800 <u>2,00,000</u> 74,800 <u>1,00,000</u> <u>-25,200</u>
	Debentures holders secured by first floating charge as per List D	
1,00,000	Bank overdraft secured by second floating charge as per List D	
	Deficiency as regards creditors secured by floating charge	<u>-98,000</u> - 1,23,200
	Unsecured creditors as per List E:	
24,000	Bills payable 24,000	
60,000	Trade creditors60,000	
8,000	Bills discounted like to be dishonoured 8,000	
<u>6,000</u>	Contingent liability 6,000	<u>-3,59,000</u>
4,71,000	Estimated deficiency as regards creditors	<u>4,82,800</u>
	Issued and called up capital: 2,000 preference shares of Rs. 100 each fully called and paid as per list F 2,00,000 20,000 equity shares of Rs. 10 each, Rs. 8 per share called up less arrears irrecoverable as per list G 1,59,000	

	Estimated deficiency as regards contributories	

List H Deficiency Account

		Rs.
Items contributing to deficiency:		
Excess of liabilities over assets (see working note)		3,60,000
Estimated losses now written off for which provision has been made for the purpose of preparing the statement:		
Investments	20,000	
Plant & Machinery	40,000	
Bills receivable	4,000	
Sundry debtors	56,000	
Bills discounted	8,000	
Contingent liability	6,000	
Stock-in-trade	22,000	
Rent & Salary outstanding	6,000	1,62,000
Items reducing deficiency		5,22,800
Land & Buildings (surplus on revaluation)		40,000
Deficiency as shown by statement of affairs		4,82,800

Working note:

Excess of capital and liabilities over assets Rs. 3,60,000 has been ascertained by preparing Balance sheet of Sudden Attack Ltd., as on 31.12.06

Balance Sheet of sudden Death Ltd., as on 31.12.06

Liabilities	Rs.	Assets	Rs.
Equity share capital	1,60,000	Calls in arrear	1,000
Preference share capital	2,00,000	Investment	80,000
15% debentures	2,00,000	Plant & Machinery	1,20,000
Bank overdraft	1,00,000	Land & Machinery	40,000
Rent & taxes	4,000	Bills receivable	6,000
Salary & wages	3,000	Sundry debtors	1,40,000
Bills payable	24,000	Stock-in-trade	60,000
Sundry creditors(secured)	60,000	Cash in hand & bank	3,200
Sundry creditors	60,000	P & L A/c (bal.fig)	3,60,000
	8,11,000		8,11,000

Summary

1. To understand the meaning ofliquidation.
2. Clearly understand the various types of voluntary winding up.
3. Understand with procedure in modes of winding up.
4. Create the Deficiency or surplus A/c (List H).
5. For calculation of liquidator's final statement of account.
6. Understanding the liquidator remuneration.

Exercise

1.Theory Questions

A. Short answers questions:

1. What is liquidation?
2. Define Liquidation.

3. Mention the methods of winding up of companies.
4. Who are called as contributories?
5. Who is a liquidator?
6. What is included in List D?
7. What are preferential creditors? Give two examples.

B. Long Question:

1. Explain the various mode of winding up.
2. Give the various reasons for winding up.
3. Explain the preferential creditors as given under the Indian companies Act.
4. What do you mean by the term "Contributory"? Describe the various types of contributories.

II. Problems

1. A Ltd, went into voluntary liquidation on 1.3.2011. The following balances are taken from its books on that date:

Liabilities	Rs.	Assets	Rs.
Capital: 30,000 Equity shares of Rs. 10 each	3,00,000	Buildings	1,00,000
Debentures	1,00,000	Plant and Machinery	2,00,000
Bank Overdraft	80,000	Stock in Trade	40,000
Creditors	1,20,000	Book Debts 85,000 Less: Provision 13,000	72,000
		Calls in Arrears	50,000
		Cash	8,000
		Profit & Loss a/c	1,30,000
	6,00,000		6,00,000

Plant and Machinery and Buildings are valued at Rs. 20,000 and Rs. 40,000 respectively. On realization, losses of Rs. 10,000 are expected on stock. Book Debts will realize Rs. 80,000. Calls in arrears are expected to realize 70%. Bank O/D is secured against buildings. Preferential creditors for taxes and wages are Rs. 9,000 and miscellaneous expenses outstanding Rs. 400.

Prepare a statement of Affairs.

2. From the following information, prepare unsecured creditors as per list E.

Unsecured creditors	1,00,000
One Month's salary	300
Bills Payable	2,10,000
Bank Overdraft	90,000
Liability on Bills Discounted	7,000
Partly secured creditors (Total Creditors Rs. 2,00,000)	3,00,000
Preferential Creditors	10,000

3. OPC Ltd. went into liquidation with following liabilities:

Secured creditors Rs. 44,000 (Securities realized Rs. 9,000)
Preferential Creditors Rs. 300
Unsecured Creditors Rs. 10,100

Liquidation expenses amounted to Rs. 600. He is entitled to a remuneration of 2% on the amounts realized (including securities with creditors) and 1 ½% on the amount paid to unsecured creditors. The various assets (excluding securities with creditors) realized amounted to Rs. 48,000.

Prepare the liquidator's final statement of account.

UNIT - VIICOMPANY FINAL ACCOUNTS

Structure

In case of sole trading concern or partnership firm the preparation of final accounts is not compulsory. But companies have a statutory obligation to prepare final accounts as required by Sections 209 and 210 of the companies Act 1956.The companies Act requires every company to prepare every year Trading a/c, Profit and Loss appropriation a/c and Balance Sheet.

7.1. PROVISION CONTAINED IN THE SECTONS 210 TO 220

Sections 210 to 220 of the companies Act 1956 deal with the legal position's relation to the final accounts of a company are given below:

i) Section 210 deals with the preparation and presentation of the final accounts of a company.

ii) Section 211 gives the form and contents of the balance sheet and profit and Loss a/c.

iii) Section 212 deals with the disclosure of certain in the Balance Sheet on a holding company in respect of its subsidiaries.

iv) Section 213 provides for extension of the financial year of the e holding company and subsidiary.

v) Section 214 makes provisions regarding rights of holding company's representatives and members to inspect books of accounts kept by any of its subsidiaries.

vi) Section 215 provides that the balance sheet and profit and Loss a/c of a company shall be authenticated on behalf of the board of directors by its manager or secretary, if any, and by not less than two directors of the company, one of whom shall be a managing director , where there is one.

vii) Section 216 provides that the profit and Loss a/c shall be treated as an annexure to the balance sheet and auditor's reports as an enclosure thereto.

viii) Section 217 provides that the report of the board of directors should be attached to every balance sheet laid before the shareholders in general meeting.

ix) Section 218 provides for penalty for improper issue circulation or publication of balance sheet or profit and loss a/c

x) Section 219 deals with the right of the member to get copies of Balance sheet and Profit and Loss a/c must be sent to the registrar within 30 days after the annual general meetings.

7.2. SCHEDULE VI, PART II OF COMPANIES ACT

Schedule VI contains list of items of income and expenditure which should be included in the profit and loss a/c. the profit and loss a/c of a company should give a true and fair view of the profit or loss of the company for the financial year. In case of a non-trading concern income and expenditure a/c is prepared instead of profit and loss a/c.

7.3. STATUTORY REQUIREMENTS AS TO PROFIT AND LOSS ACCOUNT

The important provisions are given below:

i) a) The turnover, that is, the aggregate amount for which sales are affected by the company.

b) Commission paid to sole selling agent.

c) Commission paid to other selling agents.

d) Brokerage and discount on sales other than usual trade discount

ii) a) Incase of manufacturing concerns the value of raw material consumed

b) Incase of trading concern the purchase made and the opening and the closing stocks.

c) Incase of services industry, the gross income derived from services rendered or supplied.

d) In case of company which falls under more than one category the total amounts are to be shown in respect of opening and closing stocks.

e) Incase of other companies, the gross income derived under different heads.

iii) In the case of all concerns having worked – in – progress the amounts for which such works have been completed at the commencement and at the end of the value of fixed assets.

iv) The amount provided for depreciation, renewals or diminution in the value of fixed assets.

i) The amount of interest on the company's debentures and other fixed loan, stating separately the amount of interest, if any, paid or payable to the managing director and the manager, if any.

ii) The amount of charge for Indian income tax

iii) The amount reserved for repayment of share capital and losses.

iv) a) The aggregate of any amounts set aside or proposed to be set aside to reserves.

b) The aggregate of the amounts withdrawn from such provisions.

v) a) The aggregate of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.

b) The aggregate of the amounts withdrawn from such provisions, as no longer required.

vi) Expenditure incurred on each of the following items separately:

a. Consumption of stores and spare parts.

b. Power and fuel.
c. Rent\repairs to building.
d. Repairs to machinery
e. Salaries, wages and bonus
   Contribution to provident and other funds
   Workmen and staff welfare expenses
f. Insurance
g. Rates and taxes
h. Miscellaneous expenses

vii) The amount of income from investment
viii) Profit or loss on investment.
ix) Dividend from subsidiary companies.
x) The aggregate amount of the dividends paid and proposed, and stating whether
xi) such amounts are subjected to deduction of income tax or not.
xii) Amount which are affected by any charge in the basis of accounting.
xiii) Payments provided or made during the financial year of the directors, the managing agent, secretaries and treasurers or manager, if any, by the company, the subsidiaries of the company of any other person.

7.4. PROFIT PRIOR TO INCORPORATION

1. Prepare profit and loss account/statement of profit with two columns, one for pre-incorporation period and the other for post-incorporation period.
2. Divide the gross profit in Sales ratio.
3. Expenses incurred in relation to time are divided in Time ratio.
4. Expenses incurred in relation to sales are divided in Sales ratio.
5. Some expenses are allotted to pre-incorporation period or to post-incorporation period on actual basis.
6. Profit and loss account/statement of profit is balanced to find the profit or loss for pre-incorporation period and post-incorporation period.
7. Pre-incorporation profits are credited to capital reserve account and loss is debited to goodwill account.
8. Post-incorporation profit is credited to profit and loss account and loss is debited to profit and loss account.

7.5. CALCULATION OF VARIOUS RATIOS

1. Time ratio:

It is the ratio between pre-incorporation period and post-incorporation period.

Pre-incorporation period is: The period from the commencement of the year to the date of incorporation.

Post-incorporation period is: The period from the date of incorporation to the last day of the financial year.

2. Weighted Time ratio:

Sometimes number of employees may increase or decrease. Sometimes wage and salary rate may be revised. So salaries and wages are to be apportioned in weighted Time ratio.

3. Sales ratio:

It is the ratio between sales in pre-incorporation period and post-incorporation period.

4. Weighted Sales ratio:

Sales may fluctuate between seasons in a year. Sales ratio is calculated giving weightage to increase/decrease in sales.

7.6. APPORTIONMENT OF EXPENSES

1. In Time ratio:

Expenses incurred on time/period basis are divided in Time ratio. The following expenses are apportioned in Time ratio:

Salaries, rent, interest, bank, charge, office expenses, stationery, postage, depreciation, audit fees, office travelling expenses, general travelling expenses, etc.

2. In Sales ratio:

Expenses incurred in relation to sales are apportioned in this ratio. The following are some expenses divided in sales ratio: Discount allowed, provision for doubtful debts, bad debts, advertisement, salesmen travelling expenses, packing charges, carriage outward, commission, etc.,

3. Pre-incorporation period expenses:

Interest on capital, andpartners or proprietor's salary.

4. Post-incorporation period expenses:

Preliminary expenses, directors' fees and remuneration, discount and expenses on issue of shares and debentures, share transfer, office expenses, debenture interest, etc.

Illustration 1

Nandy Ltd. took over the business of Ram brothers form 1st April 2014. It got the certificate to commence business from 1st business form 1st February, 2015. The company got its certificate of incorporation on 1st November, 2014.

It sales during the first 5 months of the year were double that of remaining months.

The company closes its books on 31st March.

Calculate Sales ratio and Time ratio.

Solution:

Time ratio:

Pre-incorporation period = 1st April, 2014 to 31st October 2014 = 7 months

Post-incorporation period = 1st November to 31st March, 2015 = 5 month

Time ratio =7.5

Sales ratio:

Months	2014	A	M	J	J	A	S	O	N	D	2015	J	F	M
Sales weightage		2	2	2	2	2	1	1	1	1		1	1	1

Pre-incorporation period sales weight age = 12

Post –incorporation sales weight age = 5

Sales ratio = 12.5

Illustration 2

A company incorporation on May 1, 2010 acquired a business with effort from 1st January, 2010. The general expenses are Rs. 14,220. Directors remuneration is Rs. 1,000 per month. Formation expenses amounted to Rs. 1,500. Rent, which till June 30th, 2010 was Rs. 100 per month, was increased to Rs. 3,000 per annum from 1st July, 2010. The manager of the earlier firm whose salary was Rs. 500 per month was made a director upon the incorporation and his remuneration thereafter is included in the figure of directors' remuneration. The first accounts are closed on 30th September, 2010. The gross profit for the period was Rs. 56,000.

Prepare profit and loss account for the period, if the net sales were Rs. 8,40,000; the monthly average for the first four months of 2010 being one-half of the remaining period.

Solution

Profit and loss account for the period from 1.1.2010 to 30.9.2010.

Particular	**Pre-incor -poration**	**Post- incor – poration**	**Particular**	**Pre-incor -poration**	**Post- incor - poration**
To General expenses (Time ratio)	6,320	7,900	By Gross Profit (Sales ratio)	16,000	40,000
To Director's remuneration (1000 x5)	-	5,000			
To Formation expenses (actual)	-	1,500			
To Rent (w.N.3)	400	950			
To Manager salary (500 x 4)	2000	-			
To Pre-incorporation profit transferred to capital reserve	7,280	-			
To post-incorporation profit-credited to profit and loss A/c	-	24,000			
	16,000	16,000		16,000	16,000

Working note:

(i) Time ratio:

Accounting period = 1.1.2010 to 31.9.2010

Date of incorporation = 1.5.2010

Pre-incorporation period = (1.1.2010 to 1.5.2010) = 4 months

post- incorporation period = (1.5.2010 to 30.9.2010) = 5msonths

Time ratio = 4:5

(ii) Sales ratio:

Months	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept

Sales weightage	1/2	½	½	½	1	1	1	1	1

Sales weightage for pre-incorporation period = 2
Sales weightage for post-incorporation period = 5
Sales ratio = 2.5
iii. Rent

Particulars	Rs.
Rent per month from 1st July = $\frac{3,000}{12}$	250
Rent for first 4 months upto April 2010 (100x4)	400
Rent for post-incorporation period: May and June = Rs. 100 x 2 July to Sept = Rs. 250 x 3	 200 750
	950

7.7. MANAGERIAL REMUNARATION

Under section 198 of the companies Act the total remuneration payable to all the managerial staff should not exceed 11% of the net profits. This 11% does not include any fees payable to directors for the meeting of board or committee.

In case of no profits or inadequate profits in any year, the minimum remuneration will be up to Rs. 50,000 p.a.

A whole-time director or a managing director may be paid either by way of a monthly remuneration or at as specified percentage of the net profit or both, such remuneration should not exceed.

a) 5% of the net profit for one such director.
b) 10% of the net profit for all of them together, if there are more than one director.

The total remuneration of a manager shall not normally exceed 5% of the net profit.

Managerial remuneration includes the4 expenditure incurred by the company in providing the following:

1. Rent free accommodation
2. Any other benefit or amenity free of charge or at a concessional rate.
3. Service or obligation
4. To affect an insurance on the life of, or to provide any pension annuity or gratuity for, any of the aforesaid persons, his spouse or child.

7.8. LIMITS TO MANAGERIAL REMUNERATION

The limits of managerial remuneration payable on various circumstances are listed below:

Managerial Personnel		Maximum Remuneration on net profit
i.	Overall limit to all the managerial persons	11%
ii.	All directors, when the company is having managing director, whole time director or manager.	1%
iii.	All directors, when the company is not having a managing director, whole time director or manager	3%
iv.	Manager	5%

v.	When there is one managing director or whole-time director	5%
vi.	When there are more than one managing director or whole-time directors	10%

7.9. REMUNERATION WHEN PROFITS AREINADEQUATE

If a company is not having sufficient profit, then the remuneration is based on the effective capital of the company as follows according to schedule Xlll.

Effective capital of the company		**Monthly remuneration payable shall not exceed**
i.	Less than Rs. 1 Crore	Rs. 75,000
ii.	Rs. 1 Crore to Rs. 5 Crore	Rs. 1,00,000
iii.	Rs. 5 Crore to Rs. 25 Crore	Rs. 1,25,000
iv.	Rs. 25 Crore to Rs. 100 Crore	Rs. 1,50,000
v.	Rs. 100 Crores or more	Rs. 2,00,000

7.10. DIVISIBLE PROFITS

Profits available for dividend to shareholders are known as divisible profits. Divisible profits are those which are legally available for dividend to shareholders.

The following rules should be followed in computation of such profit.

1. No dividend shall be declared of paid except out of profit for the year or of any previous years or out of both, or out of moneys provided by the central government or state government for the payment of dividend in pursuance of any guarantee given. Payment of dividend out of capital is illegal.
2. Profit for the purpose of dividend shall be computed after providing for depreciation under section 350
3. Provision has to be made for not only for the current year but also for arrears of depreciation in the past.
4. Past losses must be set off against the general reserve, if any, as part I of Schedule VI of the Companies Act.
5. Distribution of capital profits does not appear to have been prohibited.

7.11. DIVIDEND

A dividend is a share of the profits of a company distributed to the shareholders.

7.12. INTERIM DIVIDEND

Interim dividend is one which is declared and paid by the company in between two final dividends.

7.13. BALANCE SHEET

According to section 210 of the companies Act 1956 a company is required to prepare a Balance Sheet at the end of each trading period and it shall give a true and fair view of the of the company.

Section 211 gives the prescribed form of Balance sheet.

According to Section 210 of the Companies Act 1956 a company is required to prepare a Balance Sheet at the end of each trading period and it shall give a true and fair view of the company.

Section 211 gives the prescribed form the Balance Sheet.

Schedule VI Part I – From of Balance Sheet Balance Sheet of ----------- as on ------------

Figures for Previous year Rs.	**Liabilities**	**Figures for the current years Rs.**	**Figures for the current years Rs.**	**Assets**	**Figures for the current year Rs.**
	SHARE			FIXED ASSETS	
	CAPITAL			Goodwill	xxx
	Authorised:		xxx	Land and Building	xxx
	Issued &	xxx		Leaseholds	xxx
	Subscribed	<u>xxx</u>	xxx	Plant &Machinery	xxx
	Less: Calls in			Furniture & fittings	xx
	arrear			Patents, trademark,	xxx
	Add:		xxx	designs	
	Forfeited		xxx	Livestock	xxx
	shares		xxx	Vehicles	xxx
	RESERVES		xxx	INVESTMENTS:	
	AND		xxx	CURRENT	
	SURPLUS:			ASSETS, LOANS	
	Capital		xxx	AND ADVANCES	
	Reserves		xxx	A) Current	
	Capital		xxx	Assets	xxx
	Redem.		xxx	Interest accrued	xxx
	Reserve			Stores & spares	xxx
	Share		xxx	Loose tools	xxx
	Premium			Stock in Trade	xxx
	Other			Work in Progress	xxx
	Reserves		xxx	Sundry Debtors	xxx
	Sinking			Bank Balance	xxx
	Funds		xxx	Cash in Hand	
	SECURED		xxx	B) Loans &	
	LOANS			Advances	xxx
	Debentures		xxx	Advances	xxx
	Loans and			Bills of Exchanges	
	Advances			MISCELLANCEO	
	from Bank			US	xxx
	Loans and			EXPENDITRUE	xxx
	Advances			Preliminary	xxx
	from		xxx	Expenses,	
	Subsidiaries		xxx	Commission,	
	Other Loans		xxx	brokerage	xxx
	& Advances		xxx	underwriting	xxx
	UNSECURE		xxx	Discount allowed	xxx
	D LOANS		xxx	on the issue of	

NOTES

	Fixed		xxx	shares or	
	Deposits			debentures	xxx
	Loans &		xxx	Interest Paid out of	
	Advances		xxx	capital	
	form		xxx	Development	
	subsidiary		xxx	Expenditure	
	Short term	_______	xxx	PROFIT AND	
	loan	_		LOSS ACCOUNT	
	Other Loans		<u>xxx</u>	Profit & Loss a/c	______
	& Advances		<u>xxx</u>	(Debit balances)	xxx
	CURRENT LIABILITES AND PROVISIONS:				
	A) Current Liabilities				
	Acceptances				
	Sundry Creditors				
	Subsidiary Company				
	Advance Payment				
	Unclaimed Dividend				
	Other Liabilities				
	Interest accrued				
	B) Provisions				
	Provision for Tax				
	Proposed Dividend				
	Contingencies				
	Provident Fund				
	Pension & Staff benefit Scheme				
	Other provision				

7.14. VARIOUS ITEMS APPEARING IN THE BALANCE SHEET

i) Unclaimed Dividend

The dividend should be paid within 42 days from its declaration, if it is not paid, the company must within seven days from the date of the said period, transfer the unpaid amount of dividend to a special account to be called "Unpaid Dividend" or "Unclaimed Dividend" a/c. It is opened with a scheduled bank and it is a current liability. Hence, it will appear on the liability side of the balance sheet under the head current liabilities.

ii) Bills Receivable

It is a current asset. It will appear on the assets side of the Balance Sheet under the head "Current Assets, Loans and Advances".

iii) Loose Tools

It is an asset. It will appear on the asset side of the Balance sheet under the head "Fixed Assets".

iv) Livestock

It is an asset. It will appear on the asset side of balance sheet under the head "Fixed Assets".

v) Patents

It is an asset. It will appear on the asset side of Balance Sheet under the head "Fixed Assets".

vi) Preliminary expenses:

It is the amount spent for the creation or formation for the company. It is a fictitious asset. The amount of preliminary expenses which is not written off during the current year will appear on the assets side of a Balance sheet under the head "Miscellaneous Expenditure".

vii) Capital Redemption Reserve:

It is a reserve which is created at the time of redemption of preference shares out of the profits of the company. It will appear on the liability side of a Balance Sheet under the head "Reserves and Surplus".

viii) Calls in arrears

It is the amount which is not paid by the shareholders on the calls. The amount of calls in arrear must be deducted from the called-up capital of the company under the head "share Capital".

ix) Forfeited shares:

The number of forfeited shares will be added to the called-up capital of the company under the head "share capital".

x) Capital Reserve:

It is a reserve created out of capital profits. It is shown under the "Reserves and surplus".

xi) Contingent Liability:

A liability which may or may not occur in a future date is known as contingent liability. It will appear as a foot note under the liability side of the balance sheet.

xii) Provision for Tax:

It will appear on the liability side of a Balance sheet under the head "Current liabilities and Provisions".

7.15 IF AN ITEM APPEARS IN ADJUSTMENT, IT WILL APPEAR IN TRADING A/C AND BALANCE SHEET (OR) PROFIT & LOSS A/C AND BALANCE SHEET

		How deal with in	
Type of Adjustment	**Adjusting Journal**	**Trading a/c (or) Profit & Loss**	**Balance Sheet**

	Entry	a/c	
1) Closing Stock	Stock a/c Dr. To. Trading a/c	Credit side of Trading a/c	Assets side
2) Expenses owing/ Due/Accrued	Expenses a/c Dr. To. O/s Expenses a/c	Add. The outstanding expenses to the relevant account in trading a/c or P&L a/c	Liabilities side
3) Expenses prepaid / overpaid/ unexpired	Prepaid Expenses a/c Dr. To. Expenses a/c	Deduct from the account relating to an expense on the debit side of trading a/c or P & L a/c	Assets side
4) Outstanding (or) Accrued Income	O/s Income a/c Dr. To. Income a/c	Add to the income on the credit side of the P& L a/c	Assets side
5) Income Received in Advance	Income a/c Dr. To. Income Received in Advance a/c	Deduct from the income concerned on the credit side of P&L a/c	Liabilities Side
6) Depreciation on Assets	Depreciation a/c Dr. To. Assets a/c	Debit side of the P& L a/c	Deducted from the value of the Assets.
7) Bad Debts	Bad Debts a/c Dr. To. Sundry Debtors a/c	Debit side of P&L a/c	Deducted from Sundry Debtors.
8) Reserve for Bad and Doubtful Debts	P&L a/c Dr. To. Reserve for Bad and Doubtful Debts a/c	Debit side of P&L a/c	The amount of New Reserve alone is deducted from Sundry debtors.
9) Reserve for Discount on Debtors	P&L a/c Dr. To. Reserve for Discount a/c	Debit side of P& L a/c	The amount of reserve is deducted from Sundry debtors.
10) Reserve for Discount on Creditors	Reserve for Discount on Cr's a/c Dr. To. P&L	Credit side of P&L a/c	The amount of reserve is deducted from Sundry Creditors

	a/c		
11) Outstanding interest on Debenture	Interest on Deben. a/c Dr. To. O/s interest a/c	Debit side for P&L a/c	Added with debenture a/c on Liabilities side.
12) Loss by Fire	Insurance co., a/c Dr. P&L a/c Dr. To. Trading a/c	A) Value of stock lost in the credit side of trading a/c. B) Actual loss (total loss insurance claim) in the debit side of P&L a/c.	Show the insurance claim accepted in the assets side.
13) Goods distributed as free samples	Advertisement a/c Dr. To. Purchase a/c	Direct form Purchase in the Trading a/c	Shown in the debit side of the P&L a/c as free samples (or) advertisement expenses
14) Managers Commission	Profit & Loss a/c Dr. To. Comm. Payable a/c	Debit side of the p&L a/c	Liabilities side as commission payable.

Note: Commission on the net Profit

i) After charging such commission:

Commission Payable $= \text{Net Profit} \times \dfrac{\%\text{ of Commission}}{100+\text{ Rate of Commission}}$

ii) Before charging such commission:

Commission Payable $= \text{Net Profit} \times \dfrac{\%\text{ of Commission}}{100}$

7.16 P&L a/c AND BALANCE SHEET TREATMENT OF BAD DEBTS AND PROVISION FOR BAD AND DOUBTFUL DEBTS.

Dr. Profit & Loss a/c for the year ending ----------------- Cr.

	Rs.			Rs.

TO. Bad Debts (as in Trial Balance) Add: Reserve for Bad and Doubtful Debts (as in adjustment) Less: Reserve for Bad and Doubtful Debts (as in Trail Balance)	Xxx Xxx Xxx Xxxx	xxxxx			

Balance sheet as on ----------------

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry Debtors Less: Bad Debts (as in adjustment) Less: Reserve for Bad & Doubtful debts (as in adjustment)	Xxx Xxx xxx	xxx

If the old bad debts reserve is more than the new reserve

Dr. **Profit & Loss a/c.** Cr.

	Rs.	Rs.		Rs.	Rs.
To. Reserve for Bad & Doubtful debts (as in adjustments)	xxxxx	Xxx xxxxx	By Reserve for Bad and Doubtful debts (old) (as in Trail Balance)		Xxxx xxxxx

Treatment of reserve in profit & Loss a/c for discount on debtors.

Dr. **Profit & Loss a/c** Cr.

	Rs.	Rs.		Rs.	Rs.
To. Reserve for discount (as in the adjustment) Add: Discount Less: Reserve for discount (as in Trail Balance)	Xxxx Xxxxx Xxxxx xxxxx	xxxx			

Balance Sheet

Liabilities	Rs	Rs	Assets	Rs	Rs.
			S. Debtors Less: Reserve for Discounts (as in the adjustment)	Xxx xxxx	xxxx

if the following items appear in the trail balance instead of adjustment, they will appear in only one place:

a) b)	Outstanding expenses Income received in advance	Liabilities side of the Balance sheet.
c) d)	Outstanding income Prepaid expenses	Assets side of the Balance sheet.

e)	Closing stock	
f)	Depreciation	Debit side of the Profit and Loss a/c
g)	Debenture interest	Debit side of the profit and Loss a/c

CALCULATION OF MANAGERIAL REMURATION

ILLUSTRATION: 1

A company has fixed assets of Rs. 2,00,000 and profit after depreciation @5% p.a is Rs. 80,000 and the Income tax limit for depreciation is Rs. 8,000. Calculate:

a) 5% of the Net Profit as commission to Manager.
b) Tax provision at 50%

Solution:

Net Profit after depreciation	80,000
Less: 5% of the net profit as commission to Manager 82,000X 5/100	4,100
	75,900
Less: Income tax Provision (82,000 – 4,100) = 77,900 X 50/100	38,950
Net Profit after commission & Income tax Provision	36,950

Working Notes:

Net Profit after depreciation Rs. 80,000
Add: Actual Depreciation 2,00,000 X 5/100 = 10,000
Less: Limit for depreciation 8,000 2,000
Net Profit to be taken for calculating commission &Tax: 82,000

ILLUSTRATION: 2

From the following particular, determine the maximum remuneration available to a full-time director of a manufacturing company.

The profit and loss a/c of the company showed a net profit of Rs. 40,00,000 after considering the following items:

		Rs
Depreciation (including special depreciation of Rs. 40,000)		1,00,000
i)	Provision for income tax	2,00,000
ii)	Donation to Political parties	50,000
iii)	Ex- gratia payment to a worker	10,000
iv)	Capital profit on sale of assets	15,000

Solution:

	Rs	Rs
Net Profit as per P&L a/c		40,00,000
Add: Inadmissible items		
Special depreciations	40,000	
Provision for income tax	2,00,000	
Ex- gratia payment to a worker	10,000	2,50,000
		42,50,000
Less: Capital profit on sale of assets		15,000

Net profit for managerial remuneration		42,35,000

Note: Commission to full – time director at a maximum of 5% is permitted by law

Managerial remuneration = 42,35,000 X 5/100 = Rs. 2,11,750

ILLUSTRATION: 3

The following are the balances extracted from the company records. Calculate the remuneration of the managing director at 5% of the Net Profit, after charging such Commission.

Net Profit 38,786

Items considered for arriving at the above the net Profit:

a) Provision for taxation 39,000
b) Managing Director's remuneration paid 12,000
c) Formation expenses written off 4,000
d) Directors fees 2,500
e) Provision for doubtful debts 1,200
f) Depreciation allowable as per Income tax rules 12,000
g) Depreciation written off 12,880
h) Ex – gratia payment to employee (without any liability to theCompany) 2,000

Solution:

Statement of Profit for the purpose of Managerial remuneration

	Rs	Rs
Net Profit as per P&L a/c		38,786
Add: Inadmissible items		
Provision for Tax	39,000	
Managing Director's remuneration	12,000	
Formation expenses written off	4,000	
Excess Depreciation (12,880 - 12,000)	880	
Ex- gratia payment to employee	2,000	57,880
Net profit for managerial remuneration		96,666

Managing director's remuneration = 96,666 X 5/105 = Rs. 4,603

Less: Remuneration already paid 12,000

Due from Managing directors (-) 7,397

FINAL ACCOUNTS

ILLUSTRATION: 7

Authorised capital of Y ltd is Rs. 5,00,000 (50,000 shares of Rs. 10 each) on 31.12.2006. 25,000 shares were fully called up. On 31.12.2006 the following balances taken form the ledger of the company.

	Rs		Rs
Opening stock	50,000	Bonus	10,500
Sales	4,25,000	Sundry debtors	38,700
Purchases	3,00,000	Sundry creditors	35,200
Wages	70,000	Plant and machinery	80,500
Discounts allowed	4,200	Furniture	17,100
Discount received	3,150	Cash and bank	1,34,700
Insurance (paid up to	6,720	Reserve	25,000
31.3.07)	18,500	Loan from M.D	15,700

Salaries	6,000	Bad debts	3,200
Rent	8,950	Calls in arrears	5,000
General expenses	2,400	P and L A/C (cr.)	6,220
Printing and stationary	3,800		
Advertising			

Additional information was furnished:

a) Closing stock Rs. 91,500
b) Depreciation on plant and machinery, furniture @ 15% and 10% respectively
c) Wages, salaries and rent outstanding amounts Rs. 5,200 Rs. 1,200 Rs. 600 respectively
d) Dividend @5% on paid up share capital is to be provided prepare final accounts of the company.

Solution:

Trading and Profit and Loss a/c of Y ltd., for the year ended 31.12.2006

Liabilities		**Rs**	**Assets**	**Rs**
To Opening stock		50,000	By sales	4,25,000
Purchase		3,00,000	Closing stock	91,500
Wages =	70,000			
(+)outstanding	5,200	75,200		
Gross Profit		91,300		
		5,16,500		5,16,500
To Discount		4,200	By Gross Profit	91,300
Insurance =	6,720		Discount	3,150
(-) Prepaid	1,680	5,040		
To salary =	18,500			
(+) outstanding	1,200	19,700		
To Rent =	6,000			
(+) Outstanding	600	6,600		
To General expenses		8,950		
Printing and Stationary		2,400		
Advertisement		3,800		
Bonus		10,500		
Bad debts		3,200		
Depreciation				
Plant&Machine	12,075			
Furniture	1,710	13,785		
Net Profit		16,275		
		94,450		94,450

Dr. **Profitand Loss Appropriation a/c** Cr.

	Rs		**Rs**
To Proposed Dividend (2,50,000 – 5,000) X 5/100	12,250	By Balance b/d	6,220
To Balance carried to B/s	10,245	Profit & Loss a/c	16,275
	22,495		22,495

Balance Sheet of Y ltd as at 31st December 2006

liabilities	**Rs**	**Assets**	**Rs.**
Authorised shares capital:		Fixed Assets:	

50,000 & shares of Rs. 10each issued	5,00,000	P &M = 80,500	
issued & called up Capital 25,000		(-) Dep. 12,075	68,425
shares of Rs. 10 each	2,50,000	Furniture = 17,100	
Less: Calls in arrear	5,000	(-) Dep. 1,710	15,390
	2,45,000	Investment	-
General Reserve	25,000	Current Assets & Advances:	
Profit and loss a/c	10,245	Stock	91,500
Unsecured Loan:		Debtors	38,700
Loan form Directors	15,700	Cash & Bank	1,34,700
Current Liabilities & Provisions		Prepaid insurance	1,680
Creditors	35,200		
Outstanding Wages	5,200		
Outstanding Salaries	1,200		
Outstanding Rent	600		
proposed dividend	12,250		
	3,50,395		3,50,395

Summary

1. Theprovision contained in the sections 210 to 220understand.
2. Clearly understand the various types of calculation of various ratios.
3. Also understand with procedure in profit prior to incorporation account.
4. Create the statutory requirements as to profit and loss account.
5. Know the profit prior to incorporation.
6. Understanding the Final accounts.

Exercise

1.Theory Questions

A. Short answer questions:

1. What is final account?
2. What is profit prior toincorporation?
3. What is sales ratio?
4. What is time ratio?
5. Explain the Preliminary expenses**.**

B. Long question answer:

1. State the guidelines regarding administrative ceilings on managerial remuneration?
2. What is divisible profit?
3. Statement of profit prior incorporation.

II- Problems

1. Authorised capital of Moon ltd is Rs. 4,00,000 (40,000 shares of Rs. 10 each) on 31.12.2011. 80,000 shares were fully called up. On 31.12.2011 the following balances taken form the ledger of the company.

	Rs		Rs
Opening stock	20,000	Bonus	40,900
Sales	3,00,000	Sundry debtors	34,900
Purchases	1,00,000	Sundry creditors	40,100
Wages	40,000	Plant and machinery	30,100
Discounts allowed	2,900	Furniture	15,000
Discount received	1,000	Cash and bank	2,32,900
Insurance (paid up to	5,780	Reserve	70,000
31.3.07)	14,900	Loan from M.D	43,100
Salaries	6,700	Bad debts	400
Rent	4,870	Calls in arrears	6,000
General expenses	3,000	P and L A/C (cr.)	7,000
Printing and stationary	1,500		
Advertising			

Additional information was furnished:

a) Closing stock Rs. 25,000
b) Depreciation on plant and machinery, furniture @ 10% and 5% respectively
c) Wages, salaries and rent outstanding amounts Rs. 200 Rs. 100 Rs. 500 respectively
d) Dividend @ 4% on paid up share capital is to be provided prepare final accounts of the company.

2. Naz Ltd., took over the business of Ram brothers form 1stApril 2014. It got the certificate to commence business from 1st business form 1stFebruary, 2015. The company got its certificate of incorporation on 1stNovember, 2014.

Itssales during the first 5 months of the year were double that of remaining months.

The company closes its books on 31st March.

Calculate Sales ratio and Time ratio.

UNIT -VIII AMALGAMATIONS AND ABSORPTION

NOTES

Structure

8.1. MEANING

When two or more existing companies doing similar business combining by dissolution to form a new company is called amalgamation.

8.2. EXISTING COMPANY

A Ltd, B Ltd, C Ltd., are merging a New company ABC Limited.

Absorption Meaning

When one existing company takes over the business of one or more existing companies, it is called absorption. The companies whose business is taken over are liquidated and no new company is formed.

For Example:

Existing Company

A Ltd., B Ltd., are take over the company on X Ltd.,

8.3. DEFINITION

Amalgamation is described as “A state of things under which either two companies are joined so as to form a third entity, or one is absorbed into or blended with another”.

Advantages:

1. Management expenses, establishment charges are reduced.
2. Economics of large-scale production is available.
3. Competitions among the amalgamating companies are eliminated.
4. Bulk purchase of material and other factors of production reduce the cost of production due various discounts and reduced price.
5. Manufactured products can be easily marketed, and all the advantages of combination are available.
6. Research and development facilities are increased.

Disadvantages:

1. Amalgamation may result in over capitalization
2. The identity and good will of the old companies are lost.
3. It may create a monopoly situation.

8.4. PURCHASE CONSIDERATION

The price paid by the purchasing company to the liquidators of the selling company is called purchase consideration. The purchase price is made as per the agreement reached among the companies.

8.5. MANAGEMENT OF CALCULATING PURCHASE CONSIDERATION

The following are the different methods for calculating the amount of purchase consideration.

i) **Lump Sum Method:**
Under this method, the purchase consideration is the specific amount paid in lumpsum.

ii) **Net payment Method:**
Under this method, the purchase consideration is calculated by adding the various payments made by the purchasing company is the form of cash, shares and debentures.

iii) **Net Asset Method:**
This method is applied if the full details of purchase consideration payable by the purchasing company are not given. Under this method, the purchase consideration is calculated by adding the agreed value of assets taken over by the purchasing company and deduct there from the agreed value of liabilities which have been taken over by the purchasing company.

iv) **Value of share method:**
Under this method the purchase consideration is ascertain on the basis of the ration in which the shares of purchasing company are exchanged for the shares of selling company.

8.6. ACCOUNTING TREATMETS

Entries In The Books Ofselling Company

DATE	Particulars	L. F	Debit	Credit
i)	Transfer all the assets at book value: Realisation a/c DR To: Various Assets a/c (Being various Assets transferred to realization a/c)		Xxx	Xxx
	Note: i) If the purchasing company does not take over cash and bank balances, these should not be transferred to the realization a/c. ii) Other assets, even if they are not taken over by the purchasing company should be transferred. iii) Fictitious assets like preliminary expenses,			

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	discounts on shares or debentures, debit balances in the profit & Loss a/c etc. should not be transferred to the realization a/c. iv) Assets on which some provision has been made are transferred to the realization a/c at their gross figures and the balance in the provision a/c is transferred along with the other liabilities.			
ii)	Transfer those liabilities taken over by the purchasing company at their book value: Various Liabilities a/c Dr. To : Realisation a/c (Being various liabilities transferred to realization a/c)		Xxx	xxx
	Note: i) Only those liabilities taken over by the purchasing company are transferred. ii) Profit & Loss a/c , General reserve, sinking fund etc should not be transferred to t realization a/c iii) If there is any fund which partially represents liability and partially accumulated profits then theat portion which represents a liability should be transferred torealisation a/c.			
iii)	For Purchase consideration due: Purchasing Company, a/c Dr. To: Realisation a/c (Being the purchase consideration due)		Xxx	Xxx
iv)	For receipt of purchase consideration: Bank a/c Dr. Shares in purchasing company a/c		Xxx Xxx Xxx	Xxx

	Dr. Debentures in Purchasing company a/c Dr. To: Purchasing company (Being the purchase consideration received)			
v)	For assets sold by the vendor company not taken over by the purchasing company: Bank a/c Dr. To: Realisation a/c (Being the assets sold)		Xxx	Xxx
vi)	Liabilities paid by the vendor coy not taken over by the purchasing coy: Loss or if excess payment is made Liabilities a/c Dr. Realisation a/c Dr. To: Bank a/c (or) Profit or less payment is made: Liabilities a/c Dr. To: Bank a/c To: Realisation a/c Note: the profit or loss on settlement of the liabilities should be transferred to the realization a/c.		Xxx Xxx Xxx	Xxx Xxx xxx
vii)	For liquidation Expenses: a) If the expenses are met by the selling company: Realisation a/c Dr. To : Bank a/c (Being the liquidation expenses paid)		Xxx	xxx
	b) If the expenses met by the purchasing company; No Entry			
	c) If the liquidation expenses are to be reimbursed by the purchasing : 1. For payment of expenses; Purchasing Company a/c Dr. To: Bank 2. For getting the expenses reimbursed: Bank a/c Dr. To: Purchasing Company a/c		Xxx Xxx	Xxx Xxx
viii)	For settlement of pref. shareholder a) To transfer the preference			

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	share capital if excess payment is made: Preference share capital a/c Dr. Realization a/c Dr. To. Pref. shareholders a/c (or) If agree to accept less than the amount due: Preference share capital a/c Dr. To: Preference shareholders a/c To: Realisation a/c b) For settlement of the amount: Preference shareholders a/c Dr. To: Bank		Xxx Xxx Xxx Xxx	Xxx Xxx Xxx Xxx
ix)	Transfer of Profit or Loss on realization account: For Profit: Realisation a/c Dr. To: Equity shareholders a/c (OR) For Loss: Equity shareholder a/c Dr. To: realization a/c		Xxx Xxx	Xxx Xxx
x)	For transferring the equity share capital, accumulated profits etc., Equity share capital a/c Dr. General reserve a/c Dr. Dividend Equalisation fund a/c Dr. Share premium a/c Dr. Profit & Loss a/c Dr. Any other reserve or Profit a/c Dr. To: Equity shareholders a/c (Being all the accumulated profits and capital transferred)		Xxx Xxx Xxx Xxx Xxx Xxx	Xxxx
Xi	For transferring the accumulated losses and expenses not yet written off, if any: Equity shareholders a/c Dr. To: profit & Loss (loss) a/c To: Preliminary Expenses a/c To: Discount on shares a/c To: Discount on Debentures a/c (Being all accumulated losses transferred)		Xxx	Xxx Xxx Xxx Xxx
Xii	For final settlement: Equity shareholders a/c		Xxx	

	Dr. To: share in purchasing company To: Debentures in purchasing company To: Bank (Being the final settlement)			Xxx Xxx xxx

ENTRIES IN THE BOOKS OF PURCHASING COMPANY

DATE	Particulars	L.F.	Debit	Credit
i)	For the purchase consideration due: Business Purchase a/c Dr. To: Liquidators of the vendor coy. (Being the purchase consideration due)		Xxx	Xxx
ii)	For recording the assets and liabilities taken over: Various assets a/c Dr. *Goodwill a/c (Bal. Fig) Dr. To: Various liabilities a/c To: Business Purchase a/c To: Capital Reserve a/c *(Bal. Fig) (Being the assets and liabilities taken over recorded) Note: Only one item will appear		Xxx xxx	Xxx Xxx Xxx
iii)	For settlement of the purchase consideration Liquidators of the vendor company a/c Dr. To: Equity share capital a/c To: Debenture a/c To: Bank a/c (Being the final settlement made) Note: if the shares and debentures are issued at a premium or at a discount appropriate entry should be passed)		Xxx	Xxx Xxx xxx
Iv)	For meeting liquidation expenses of the vendor company directly: Good will a/c Dr. To: Bank (Being the liquidation expenses paid)		Xxx	Xxx

NOTES

8.7. TABLE SHOWING LIABILITIES, PROVISIONS, PROFIT & LOSSES

Liabilities	Accumulated Profits	Provisions	Accumulated Losses
Trade creditors Bills payable Bank o/d Outstanding exp Tax payable Unclaimed dividend Provident fund Pension fund Bank loan Debentures	Profit & loss a/c General reserve Dividend equalization Fund Sinking fund Capital reserve Capital redemption reserve Insurance fund Development rebate reserve Share premium Workmen's compensation fund Share forfeited a/c	Provisions for doubtful debts Provision for depreciation Investment fluctuation fund	Profit and loss a/c (Dr.) Preliminary exp. Discounted on issue of shares Discounted on issue of Debenture Underwriting commission

Accounting Standard – 14

8.8. ACCOUNTING FOR AMALGAMATIONS (AS – 14)

Accounting standard 14 was issued by the institute of chartered accountants on India. It is mandatory in nature and is applicable to all companies in India for accounting periods commencing on or after 1.4.1995.

8.9. TYPES OF AMALGAMATION

According to AS- 14 amalgamation fall into two categories. They are:

i) Amalgamation in the nature of merger.
ii) Amalgamation in the nature of purchase.

8.10. AMALGAMATION IN THE NATURE OF MERGER

When the following condition are satisfied, an amalgamation should be considered to be an amalgamation in the nature of merger.

i) All the assets and liabilities of the transferor company become the assets and liabilities of the transferee company after amalgamation.
ii) Shareholders holding not less than 90% of the face value of the equity shares of the transfer company (other than equity shares already hold) become equity shareholders of the transferee company by virtue of the amalgamation.
iii) The business of the transferor company is intended to be carried on, after amalgamation, by the transferee company.
iv) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

8.11. AMALGAMATION IN THE NATURE OF PURCHASE

Amalgamation which does not satisfy one or more conditions specified for amalgamations in the nature of merger should be treated as amalgamation in the nature of purchase.

8.12. METHOD OF ACCOUNTING FOR AMALAGATIONS

Accounting standard 14 defines the term consideration on as follows:

"Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company".

JOURNAL ENTRIES

Amalgamation Merger Pooling Interest Method

DATE	PARTICULARS	L.F	Debit	Credit
i)	For purchase consideration payable Business Purchase a/c Dr To: Liquidation of transferor coy. a/c (Being purchase consideration due)			
ii)	For Asset and liabilities taken: Various Assets a/c Dr To: various liabilities a/c To: Profit & loss a/c To: Reserves a/c (Being assets and liabilities taken over and reserves of transferor company recorded)			
	Note: the balancing figure will be treated as general reserve. If the purchase price exceeds the paid-up value of the transferor company's shares, the excess s reduced from the general reserve and even profit and loss a/c of the transferor company. It they are not enough; the general reserve and p&l a/c of the transferee company can also be used.			
iii)	For Payment of purchase price: Liquidator of Transferor company a/c Dr. To: Bank a/c To share capital a/c To share premium a/c (Being shares issued to settle purchase consideration)			
iv)	For expenses of winding up paid up transferee company: General Reserve a/c To Bank a/c			

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	(Being expenses of transferee co. paid as per agreement)			
v)	For formation expenses paid: Preliminary Expenses Dr. To Bank a/c (Being formation expenses paid)			
vi)	For payment of any debentures of transferor company: Debentures a/c Dr. To: Bank a/c (being the payment made to debenture holders of transferor co. as per agreement)			
vii)	For payment to creditors of transferor company: Creditors a/c Dr To: Bank a/c (being payment made to creditors as per agreement)			

Amalgamation in the nature of purchase
Purchase Method

Date	Particulars	L.F.	Debit	Credit
i)	For purchase consideration payable: Business Purchase a/c Dr To. Liquidation of Transferor coy. (Being purchase consideration due)			
ii)	For Assets and Liabilities take over: Various assets a/c Dr. Goodwill a/c To. Various liabilities a/c To. Business Purchases a/c To. Capital Reserve a/c (being assets and liabilities taken over and good will / capital reserve there in)			
iii)	For payment of purchase consideration: Liquidator of Transferor company a/c Dr To Bank a/c To share capita a/c To share premium a/c			

	To debenture a/c (Being purchase price paid)			
iv)	For expenses of liquidation agreed to be paid by transferee company: Goodwilla/c Dr. To Bank a/c (being expenses agreed to be paid)			
v)	For formation expenses of transferee company: Preliminary Expenses a/c To Bank a/c (Being formation expenses paid)			
vi)	For statutory reserves of the transferor coy. To be continued Amalgamation adjustment a/c Dr. To statutory Reserve a/c (being reserves to be continued)			
vii)	For settlement of debenturesholders or creditors of transferor coy. Debentures (Transferor coy) a/c Dr. Creditors (Transferor coy) a/c Dr. To. Debentures a/c To. Bank a/c (Being settlement of transferor company'sliabilities as per agreement)			

CALCULATIONOF PURCHASE CONSIDERATION
ILLUSTRATION 1

A Purchasing company agrees to issue three shares of Rs. 10 each paid up at market value of Rs. 15 per share for every 5 shares in the vendor company.

Find out the number and number of shares to be issued by the purchasing company if the vendor company has 1,00,000 shares of Rs. 10 each Rs.5 paid up.

SOLUTIONS:

No. of shares to be issued by the purchasing company = Rs. 1,00,000/5X3 = 60,000 shares.

Number of shares issued by the purchasing company:

Amount of share capital = 60,000 X 10 = 6,00,000

Amount of share Premium = 60,000 X 5 = 3,00,000

Total = 9,00,000

NOTES

ILLUSTRATION 2

A purchasing company agrees to issue 3 shares of Rs.10 each, Rs. 8 paid up for every 5 shares in vendor company.

Find the number of shares and number of shares to be issued by the purchasing company if the vendor company has Rs. 5,00,000 paid up share capital of Rs. 10 each Rs. 5 paid up.

SOLUTION:

No. of shares in vendor company = Rs 5,00,000/Rs 5= 1,00,000 shares

No. of shares to be issued by the purchasing coy = 1,00,000/5X3 = 60,000

Amount of share capital = 60,000 X Rs. 8 = Rs. 4,80,000

ILLUSTRATION 3

The capital of A, B and C partnership firm at the date of purchase by the limited company were Rs. 10,000 Rs. 6,000 Rs. 5,000. The partnership firm was converted into a limited company and assets and liabilities were sold to the company agreed to pay Rs. 8,000 more than the book value and machinery which was taken at Rs. 1,000 less than the book value.

Calculate Total Purchase Consideration.

SOLUTION:

Net Assets = Assets – Liabilities = Capital employed

Purchase consideration = Total Capital of A, B& C

Calculation of Purchase consideration

A's capital		10,000
B's capital		6,000
C's capital		5,000
		21,000
Less: Increases in value of liabilities	8,000	
Decrease in value of assets	1,000	9,000
Purchase consideration		12,000

8.13. NET PRESENT VALUE METHOD

It is one of DCF methods in which both future cash inflows and outflows from a project are discounted at a cost of capital rate. This gives present value of cash inflows and outflows. The difference between present value of cash inflows and outflows is called Net Present Value (NPV)

8.14. PROCEDURE FOR COMPUTATION OF NPV

(i) Ascertain the total cash inflows of the project and the time periods in which they arise.

(ii) Calculate the present value of cash inflows i.e., CFAT × PV factor

(iii) Ascertain the total cash outflows of the project and the time periods in which they occur.

(iv) Calculate the present value of cash outflows i.e., cash outflows × PV factor.

(v) Calculate NPV = Present value of cash inflows – Present value of cash outflows

(vi) Accept project if NPV is positive, else reject. If two projects are mutually exclusive, the project with higher NPV should be preferred.

8.15. MERITS OF NPV METHOD

(i) It recognises the time value of money.

(i) It uses the discount rate which is the firm's cost of capital.

(ii) It considers all cash flows over the entire life of the project.

(iii) NPV constitutes addition to the wealth of shareholders and thus focuses on the basic objective of financial management.

(iv) Since all cash flows are converted into present value (current rupees),different projects can be compared on NPV basis, thus, each project can be evaluated independent of others on its own merit.

8.16. LIMITATIONS OF NPV METHOD

(i) This method assumes that the discount rate i.e., firm's cost of capital is known. But the cost of capital is difficult to understand and measure in practice.

(ii) It may not give reliable answers while dealing with alternative projects under the conditions of unequal lives of projects.

(iii) Decisions arrived at may not be satisfactory when projects being compared involve different amounts of investment.

Summary

1. To understand meaning of absorption.
2. Clearly understand the existing company.
3. to understand with purchase consideration.
4. For calculation of Net present value.
5. Understanding the Amalgamation.

1.Theory Questions

A. Short answers questions:

1. What is Amalgamation?
2. What is Absorption?
3. What is Purchase Consideration?
4. What is net present value?
5. Define merger.

B. Long question answer:

1. What are the differences between Amalgamation and Absorption?
2. What are the types of Amalgamation?
3. Explain the concept of NPV?
4. What are the procedures to be followed to compute NPV?

II- Problems

1. ABC Limited agrees to issue 5 shares of Rs.10 each, Rs. 8 paid up for every 5 shares in vendor company.

Find the number of shares and numberof shares to be issued by the purchasing company if the vendor company has Rs. 5,00,000 paid up share capital of Rs. 10 each Rs. 5 paid up.

2. The capital of X, Y and Z partnership firm at the date of purchase by the limited company were Rs. 20,000 Rs. 12,000 Rs. 10,000. The partnership firm was converted into a limited company and assets and liabilities were sold to the company agreed to pay Rs. 8,000 more than the book value and machinery which was taken at Rs. 1,000 less than the book value.

Calculate Total Purchase Consideration.

BLOCK III HOLDING COMPANY ACCOUNTS

UNIT – IX EXTERNAL RECONSTRUCTION AND INTERNAL RECONSTRUCTION

Structure

9.1 MEANING

External Reconstruction means the winding up of an existing company and transfer of its assets and liabilities to a new company formed to take the place of the existing company. It usually involves the conversion of shareholder of the existing company into the shareholders of the new company.

9.2 PURPOSE OF RECONSTRUCTION

The purpose of reconstruction is to save the company from further losses and to increase its working efficiency.

9.3 NEW COMPANY

The new company is formed with similar name and with sameshareholders.

9.4 ACCOUNTING TREATMENT

The accounting treatment of external reconstruction is similar toamalgamation and absorption.

In Amalgamation, Absorption and External reconstruction, thereare two processes involved.

They are:

1) Liquidation of a company which closes its books and

2) Purchasing or taking over the business by a new company onan existing company, which opens its books.

9.5 DISTINCTION BETWEEN AMALGAMATION AND EXTERECONSTRUCTION

Amalgamation	External Reconstruction
Merging of two or more companiescarrying on similar business into one single company.	An existing company goes into liquidation for the purpose of reconstruction of a company's financial structure.

All amalgamating companies should go into liquidation.	it may take place either with or without the liquidation.
A new company is to be formed to take over the business.	No new formation, but the same company function under a new name.
The purpose of amalgamation is to bring about the combination or eliminate the competition.	The purpose of reconstruction is merely to reorganise a company which incurred heavy losses for many years.
The Central Government is empowered to order amalgamation of two or morecompanies.	Reconstruction of companies in national interest is not possible under the Act.

9.6 DISTINCTION BETWEEN ABSORPTION AND EXTERNAL RECONSTRUCTION

	Absorption	**External Reconstruction**
i)	An existing company takes over the business of one or more existing companies.	An existing company goes into liquidation for the purpose of reconstruction of a company's financial structure.
ii)	No formation of a company is necessary.	No new formation, but the same company functions under a new name.
iii)	The purpose of absorption is to purchase other business for expanding the activities or size of the business.	The purpose of reconstruction is merely to reorganise a company which incurred heavy losses for many years.

9.7 COMPARISON OF AMALGAMATION, ABSORPTION AND EXTERNALRECONSTRUCTION

	Amalgamation	**Absorption**	**External Reconstruction**
i)	Two or more similar companies go into liquidation.	Small company goes into liquidation.	One company goes into liquidation.
ii)	New company formed.	New company is not formed.	Same company is reformed in a new name

ILLUSTRATION 1

On 1st July, 2007 the balance sheet of Johny Ltd. was as under:

Liabilities	Rs.	Assets	Rs.
Authorised and issued capital: 3,000 6% cumulative pref. shares of Rs. 25 each fully paid 8,000 Equity shares of Rs. 50 each, fully paid 6% Debentures	 75,000 4,00,000 50,000 25,000	Goodwill a/c Sundry assets Cash Profit & Loss a/c	1,00,000 2,50,000 10,000 1,90,000

Creditors			
	5,50,000		5,50,000

Preference dividends were in arrears for two years.A scheme of reconstruction agreed upon was as under:
i) A new company to formed, called Johnson Ltd. with an authorised capital of Rs. 5,00,000 all in equity shares of Rs. 100 each.
ii) One equity share of Rs. 100 each fully paid in the new company to be issued in exchange of 3 preference shares in the old company.
iii) On equity share of Rs. 100 each fully paid in the newcompany to be exchanged for 4 equity shares in the oldcompany.
iv) Arrears of preference dividends to be cancelled.
v) Debenture holders to receive 50 equity shares in the new company as fully paid.
vi) Creditors to be taken over by the new company and immediately paid off.
vii) The new company to issue remaining equity shares for public subscription.
viii) The new company to take over old company's assets, subject to revaluation of sundry assets at Rs. 2,65,000.
Prepare the necessary ledger accounts in the books of Johny Ltd. and open the books of the new company of means of Journal entries, assuming that the public subscription was fully responded.
SOLUTION:
Calculation of Purchase consideration

i) ii) iii)	1,000 equity shares of Rs. 100 each fully paid to be issued to the preference shareholders 2,000 equity shares of Rs. 100 each to be issued as fully paid to the equity shareholders 500 equity shares of Rs. 100 each to be issued asfully paid to the debentureholders	Rs.1,00,000 2,00,000 50,000
	Total Purchase Consideration	3,50,000

IN THE BOOKS OF M/S. JOHNY LTD.
Dr.**Realisation a/c**Cr.

	Rs.		Rs.
To Goodwill To Sundry assets To Cash To Pref. shareholders a/c	1,00,000 2,50,000 10,000 25,000	By Creditors By M/s. Johnson Ltd. By Equity shareholders a/c -Loss on realisation	25,000 3,50,000 10,000
	3,85,000		3,85,000

Dr.**Equity Shareholders' Account** Cr.

	Rs.		Rs.
To Profit and Loss a/c To Realisation a/c - (loss) To Shares in M/s. Johnson Ltd.	1,90,000 10,000 2,00,000	By Equity Share Capital a/c	4,00,000
	4,00,000		4,00,000

Dr **Preference Shareholders' Accounts**Cr.

	Rs.		Rs.
To Shares in M/s. Johnson Ltd.	1,00,000	By Pref. Share Capital a/c By Realisation a/c	75,000 25,000
	1,00,000		1,00,000

IN THE BOOKS OF M/S. JOHNSON LTD.Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c Dr. To Liquidators of John Ltd. (Being the purchase consideration due) Goodwill a/c Dr. Sundry Assets a/cDr. Cash a/cDr. To Creditors a/c To Liquidators of M/s. John Ltd. (Being the business of M/s. Johnson Ltd taken over)		3,50,000 1,00,000 2,65,000 10,000 3,50,000	 3,50,000 25,000 3,50,000
	Liquidator of M/s John Ltd.Dr. To Equity Share Capital a/c (Being purchase consideration discharged by the issue of 3500 equity shares of Rs. 100 each as fully paid) Cash a/cDr. To Equity Share Capital a/c (Being issue of the remaining 1500equity shares) Creditors a/c Dr. To Cash a/c (Being cash paid to creditors)		 1,50,000 25,000	3,50,000 1,50,000 25,000

ILLUSTRATION 2

The following is the Balance Sheet of Play Boy as on 31st March 2008.

Liabilities	Rs.	Assets	Rs.
Authorised and Issued		Goodwill	55,000

Share Capital: 500 10% cumulative preference shares of Rs.100 each, fully paid 15,000 Equity shares of Rs. 10 each fully paid 7% debentures Sundry Creditors	50,000 1,50,000 20,000 30,000	Sundry Assets Cash Profit & Loss a/c	1,64,500 500 30,000
	2,50,000		2,50,000

A Scheme of reconstruction detailed below was agreed upon.

a) Good Boy Ltd., a new company to be formed with authorised capital of Rs. 3,25,000, all in equity shares of Rs. 10 each.

b) One equity share (Rs. 5 paid up) in the new company to issue for each equity shares in the old company.

c) 20 Equity shares (each Rs. 5 paid up) in the new company to be issued for each cumulative preference shares in the old company.

d) Debenture-holders to receive 2,000 equity shares, fully paid up in the new company.

e) Sundry Creditors to be taken over by the new company.

f) The remaining unissued equity shares to be taken over and paid for in full by the directors.

g) Good Boy Ltd. to take over old company's assets subject to a depreciation of Rs. 40,000 and adjusting the goodwill as required.

You are required to show the journal entries necessary to open the books of Good Boy Ltd. Show also the Balance Sheet of Good Boy Ltd after having effect to the scheme.

SOLUTION:

Calculation of Purchase Consideration

Rs.

Equity Shares : 15,000 shares as Rs. 5 paid up 75,000

Preference Shares : 10,000 shares as Rs. 5 paid. up50,000

Debenture holders : 2,000 shares as fully paid 20,000

27,000 1,45,000

Shares to be issued to Directors = 32,500 27,000 = 5,500

Journal Entriesin the Books of Good Boy Ltd.

Date	Particulars	L.F.	DebitRs.	CreditRs.
2008 Mar.31	Business Purchase a/c Dr. To Liquidators of Play Boy Ltd. (Being the purchase consideration due) Sundry Assets a/c Dr Cash a/c Dr Goodwill a/c (Bal. Fig.) To Sundry Creditors a/c To Liquidator of Play Boy Ltd. a/c (Being the assets and liabilities taken over)		1,45,000 1,24,500 500 50,000 1,45,000	 1,45,000 30,000 1,45,000 1,25,000

	Liquidator of Play Boy Ltd. a/c Dr To Equity share capital a/c (Rs. 5) To Equity share capital a/c (Rs.10) (Being discharge of purchase consideration) Cash a/c Dr To Equity Share Capital a/c (Being 5500 shares issued to directors)		55,000	20,000 55,000

Liabilities	Rs.	Assets	Rs.
Authorised Share Capital: 32,500 Equity shares of Rs. 10 each Issued & Paid up: 25,000 Equity shares of Rs.10 each Rs. 5 pershare paid 7,500 Equity shares ofRs. 10 each fully paid (All partly paid and 2000 fullypaid shares have been issued for consideration) Sundry Creditors	 3,25,000 1,25,000 75,000 30,000 2,30,000	Goodwill Sundry Assets Cash (500+55000)	50,000 1,24,500 55,500 2,30,000

Balance Sheet of Good Boy as on 1st April 2008

ILLUSTRATION 3

Kala Ltd's Balance Sheet showed the following position on 31st March 2008.

Liabilities	Rs.	Assets	Rs.
10,000 equity shares of Rs. 100 each Capital reserve Bank loan Trade creditors	 10,00,000 2,00,000 2,00,000 3,00,000 17,00,000	Fixed assets Current assets Cast at Bank Profit & Loss A/c	8,00,000 4,00,000 2,00,000 3,00,000 17,00,000

Mala Ltd. was incorporated to take the fixed assets and 60% of the current assets at an agreed value of Rs. 9,00,000 to be paid as Rs.7,40,000 in equityshares of Rs.10 each and the balance in 9% debentures. The debentures were accepted by bank in settlement of loan. Remaining current assets realised Rs.90,000. After meeting Rs.20,000 expenses of liquidation, all the remaining cash was paid to the creditors in full settlement.

Give journal entries in the books of both the companies and prepare the initial Balance Sheet of Mala Ltd.

SOLUTION:BOOKS OF KALA LTD. (SELLING COMPANY)

Journal entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.

31.3.08	Realisation A/c Dr To Fixed assets A/c To Current assets A/c (Being transfer of assets to realisation except cash at bank)		12,00,000 9,00,000	 8,00,000 4,00,000
	Mala Ltd. A/cDr To Realisation A/c (Being Purchase price receivable)		 7,40,000 1,60,000	9,00,000
	Shares in Mala Ltd. A/c Dr 9% Debentures in Mala Ltd. A/cDr To Mala Ltd.A/c (Being purchased price received in shares and debentures)		 90,000	9,00,000 90,000
31.3.08	Bank A/c Dr To Realisation A/c (Being amount realised for 40% of the current assets not taken over by Mala Ltd.)		2,00,000 20,000	 1,60,000 40,000 20,000
	Bank loan A/cDr. To 9% Debentures in Mala Ltd. To Realisation A/c (Being settlement of Bank Loan)		 3,00,000	 2,70,000 30,000
	Realisation A/cDr To Bank A/c (Being payment of liquidation expenses)		10,00,000 2,00,000	 12,00,000
	Trade creditors A/c Dr To Bank A/c To Realisation A/c (Being settlement of creditors by payment of all the cash available)		3,00,000 1,60,000	3,00,000 1,60,000
	Equity Share Capital			

	A/cDr Capital Reserve A/c To Equity shareholders A/c (Being transfer of capital and reserve)			
	Equity shareholders A/cDr To Profit & Loss A/c (Being transfer of accumulated loss)			
	Shareholders A/c Dr To Realisation A/c (Being loss on realisation)			

Working notes: Dr.Realisation a/cCr.

	Rs.		Rs.
To Fixed assets To Current assets To Bank (expenses)	8,00,000 4,00,000 20,000	By Mala Ltd. By Bank (40%of current assets) By Bank loan (rebate) By Creditors (discount) By Shareholders (loss)	9,00,000 90,000 40,000 30,000 1,60,000
	12,20,000		12,20,000

Dr.Bank a/c Cr.

	Rs		Rs.
To Balance b/d To Realisation A/c	2,00,000 90,000	By Realisation (expenses) By Creditors (Bal. fig)	20,000 2,70,000
	2,90,000		2,90,000

Dr.Shareholders A/C Cr.

	Rs.		Rs.
To P &L A/c To Realisation A/c (boss) To Shares in Mala Ltd.	3,00,000 1,60,000 7,40,000	By Share capital A/c By Capital reserve A/c	10,00,000 2,00,000
	12,00,000		12,00,000

Books of Mala Ltd. (purchasing company)(Journal entries)

Date	**Particulars**	**L.F.**	**DebitRs.**	**Credit Rs.**
31.3.95	Business purchase A/c Dr To Liquidator of Kala Ltd. (Being purchase price payable)		9,00,000	 9,00,000
	Fixed assets A/c Dr Current assets A/cDr 4,00,000 x 60/100 To Business purchase A/c To-Capital Reserve A/c (bal. fig)		8,00,000 2,40,000	 9,00,000 1,40,000

	(Being assets taken over and the capital profit thereon)		9,00,000	1,60,000 7,40,000
	Liquiditator of Kala Ltd. A/c.Dr. To 9% Debentures A/c To Share capital A/c (Being payment of purchase price in the form of shares and debentures)			

Balance Sheet of Mala Ltd. as on 31st March 1995

Liabilities	**Rs.**	**Assets**	**Rs.**
Share capital : 74,000 share of Rs. 10 each fully paid (all the shares were issued for consideration) Capital reserve 9% debentures	7,40,000 1,40,000 1,60,000	Fixed assets Current assets	8,00,000 2,40,000
	10,40,000		10,40,000

9.8 INTERNAL RECONSTRUCTIONMEANING

The claims of both the shareholders and creditors against acompany with a bad or sinking financial position necessitate a schemeof capital reconstruction which is known as Internal Reconstruction.

This arrangement made for one or more of the following purposes:

i) Reduction of share capital

ii) To differentiate the rights of different types of shareholders,debenture holders and creditors.

iii) To write off the accumulated losses of the company.

iv) To reduce the overvaluation of assets of the company.

9.9 ALTERATION OF SHARE CAPITAL

Alteration of share capital can be done under provision of Sections94 to 97 of the Companies Act 1956. This includes the following:

i) Increase of Share Capital:

Increasing the share capital by fresh issue of shares.

ii) Consolidation of Shares :

Consolidation of shares means conversion of all or part of existingshares of smaller denomination into shares of larger denominations.

iii) Sub-division of Shares:

Sub-division of shares means dividing all or part of the existing shares of larger denomination into shares of smaller denomination.

iv) Conversion of Shares into Stock:

Conversion of fully paid up shares into stock and vice-versa.

v) Cancellation of Unissued Shares:

The authorised share capital of a company can be reduced bycancelling unissued shares.

9.10 REDUCTION OF SHARE CAPITAL

Reduction of capital means cancellation of any paid-up sharecapital which is lost or unrepresented by available assets.

9.11 DIFFERENT METHODS OF CAPITAL REDUCTION

There are three methods of capital reduction
i) Reducing or extinguishing the uncalled liability ofshareholders.
ii) Reducing by returning the excess paid-up capital of thecompany which is found to be in
surplus of the needs of thecompany.
iii) Reducing or cancelling or writing off paid up capital which islost and not represented by
assets.

9.12 LEGAL PROVISIONS RELATING TO REDUCTION OF SHARE CAPITAL

A company can reduce the share capital as per Sec. 100 toSec 105 of the Indian Companies Act, 1956.
i)The Articles of Association of the company should permit suchreduction.
ii) A special resolution should be passed at shareholdersmeeting.
iii) If the capital reduction leads to reduction in the authorisedshare capital of the company, then the capital clause of thecompany must be altered. To alter the capital clausepermission from the Registrar of Companies must beobtained.
iv) The company has to obtain the confirmation of the court inrespect of such reduction.
The sanction of the court is not required for the following becausethe following reduction does not amount to capital reduction.
a) Forfeiture of shares for non-payment of any call or calls.
b) Surrender of shares
c) Omission to issue the unissued share capital which has notbeen taken or agreed to be taken
by any person.
d) Redemption of Preference shares.
e) Payment of interest out of capital.

9.13 CAPITAL REDUCTION ACCOUNT

Capital Reduction Account is a special temporary account opened in order to transfer any amount reduced from share capital or externalliabilities under a scheme of internal reconstruction. The appreciationin the value of asset is also credited to this account. Capital ReductionAccount is also called "Reconstruction Account" or "ReorganisationAccount"

9.14 DISPOSAL OF CAPITAL REDUCTION ACCOUNT

The amount available in the capital reduction account is used towrite off accumulated losses, intangible assets, over-valuation ofassets and so on. When the scheme is carried out, the account isclosed. If there is any balance in this account, it will be transferred tocapital reserve a/c.

9.15 ASSUMPTION OF CAPITAL REDUCTION:

i)The company's present position is bad but future will be good.
ii) The scheme shall have the approval of shareholders andcreditors.
iii) Shareholders and creditors are ready to contribute further money.

9.16 STEPS FOR RECONSTRUCTION

Step 1: Estimating the Losses:

In the formulation of capital reduction scheme, the first step is toestimate the total loss which a company suffered to date.

Step 2 Writing off the loss :

The loss so calculated is to be written off out of the sacrifice made by the shareholders, debentureholders, creditors etc.

Step 3: Compensating the various parties:

If loss is borne by equity shareholders alone there is no necessity of compensating them because they will automatically becompensated in future earnings.

When preference shareholders and debentureholders are alsoasked to suffer some loss they may be compensated by increasing therate of dividend and interest.

Step 4 Arranging the Working capital:

Working capital is important to any company without which itsurvival is impossible. Hence, the company has to provide workingcapital by issuing moreshares in the market, requestingDebentureholders to extend loan, any other short-term loan

DISTINCTION BETWEEN INTERNAL RECONSTRUCTION AND EXTERNALRECONSTRUCTION

	Internal Reconstruction	External Reconstruction
i)	It means that the scheme will becarried out by means of reductionof capital.	It means that the scheme will becarried out by liquidating theexistingcompany and incorporating immediately anothertotakeovercompanythebusiness of outgoing company.
ii)	Ininternalreconstruction, debenture holders, creditors may continue.	In external reconstruction, these parties will have to be settled
iii)	It is a slow and tedious process since the approval of all creditor, shareholder and the confirmation by the court is necessary.	It is a quick process because it can be brought about by the decision ofthe ordinaryshareholders.
iv)	In internal reconstruction, the company will be able to set off the past losses against future profits for Income tax purposes.	In external reconstruction lossescannot be carried forward forIncome tax purposes.
v)	Under this scheme the company is not liquidated.	Under this scheme company is liquidated.
vi)	No new company is formed.	New company is formed to take over the existing business.
vii)	Capital is reduced	No such reduction is made.
viii)	Accumulated losses are written off through capital reduction.	Accumulated losses of vendor company are transferred to equityshareholders account.

JOURNAL ENTRIES

Date	Particulars	L.F	**Debit**RS	**Credit**RS
	For reducing the equity capital without reducing the liability : Equity Share Capital a/c Dr To Capital Reduction a/c (Being the paid-up equity share capitalreduced)		XXXX	XXXX
	For reducing the face value and paidup value of equity capital: Eq. Share Capital a/cDr (Old share with full value) To Eq. Share Capital a/c (New share with reduced value) To Capital Reduction a/c (Being the face value and paid up value of Eq. share capital reduced)		XXXX	XXXX
	For reducing the Preference share: -% Pref. share capital a/c Dr. (Old share with old value) To -% Pref. Share Capital (New share with new value) To Capital Reduction (Being reduction of paid up value of P share)		XXXX	XXXX XXXX
	On sacrifice by the debenture holders / creditors: Debentureholders a/c Dr Creditors a/c Dr To Capital Reduction a/c (Being the claim of debenture holder & creditors reduced)		**XXXX** **XXXX**	**XXXX**
	For eliminating past losses andwriting down the value of assets: Capital Reduction a/c Dr To Profit & Loss a/c To Preliminary expenses a/c To Goodwill a/c To Discount on Debentures alc To Patents a/c To Plant &Machinery To Others (Being various losses written off andassets written down)		XXXX XXXX	XXXX XXXX XXXX XXXX XXXX XXXX XXXX XXXX

	For transferring the capital reduction a/c balance, if any Capital Reduction a/c Dr To Capital Reserve a/c (Being the balance of capital reduction a/c transferred to capital reserve a/c)			

ILLUSTRATION : 1

SON Company Ltd. passed resolution and received sanction of the court for the reduction of share capital by Rs. 2.50.000After the arrangement, the credit balance of capital reductionaccount was Rs. 2,50,000. The amount available was utilised forwrite off Profit and Loss a/c (Dr.) 1,05,000, reducing the value ofPlant and Machinery Rs. 45,000, Goodwill Rs. 20,000, InvestmentRs. 40,000. The balance available would be transferred to CapitalReserve. Pass Journal entry.

SOLUTION :Journal Entries

Date	Particulars	L.F.	DebitRs	CreditRs
	Capital Reduction a/c Dr To Profit and Loss a/c To Goodwill a/c To Plant and Machinery a/c To Investment a/c To Capital Reserve a/c (Bal.Fig.) (Being accumulated losses & assets are reduced & balance is transferred to capital reserve)		2,50,000	1,05,000 20,000 45,000 40,000 40,000

ILLUSTRATION : 2Balance Sheet of a company as on 31st March 2007.

Liabilities	Rs.	Assets	Rs.
Share Capital (Rs.10) Creditors	1,00,000 50,000 1,50,000	Fixed Assets Current Assets Profit & Loss a/c Goodwill	50,000 30.000 50.000 20.000 1.50.000

Reduce Rs. 7 per share and wipe off losses. Give Journal entries.

SOLUTION Journal Entries

Date	Particulars	L.F.	Debit	Credit
	Equity Share Capital a/c (Rs. 10)Dr. To Equity Share Capital (Rs. 3) a/c To Capital Reduction a/c (Being conversion of Rs. 10 shares into Rs. 3 shares each fully paid up)		1,00,000 70,000	 30.000 70,000

	Capital Reduction a/c To Profit & Loss a/c To Goodwill a/c (The accumulated loss & Goodwill written off)			50,000 20,000

Short answers Questions.

1. What is External reconstruction?
2. What are the internal reconstructions?
3. Explain the accounting treatment of external reconstructions.
4. Define External reconstruction.

(B) Long Answer.

1. On 1st July, 2007 the balance sheet of Xavier Ltd. was as under:

Liabilities	Rs.	Assets	Rs.
Authorised and issued capital: 3,000 6% cumulative pref. shares of Rs. 25 each fully paid 8,000 Equity shares of Rs. 50 each, fully paid 6% Debentures Creditors	75,000 4,00,000 50,000 25,000	Goodwill a/c Sundry assets Cash Profit & Loss a/c	1,00,000 2,50,000 10,000 1,90,000
	5,50,000		5,50,000

Preference dividends were in arrears for two years.A scheme of reconstruction agreed upon was as under:

i) A new company to formed, called Xavier Ltd. with an authorised capital of Rs. 5,00,000 all in equity shares of Rs. 100 each.

ii) One equity share of Rs. 100 each fully paid in the new company to be issued in exchange of 3 preference shares in the old company.

iii) On equity share of Rs. 100 each fully paid in the newcompany to be exchanged for 4 equity shares in the oldcompany.

iv) Arrears of preference dividends to be cancelled.

v) Debenture holders to receive 50 equity shares in the new company as fully paid.

vi) Creditors to be taken over by the new company and immediately paid off.

vii) The new company to issue remaining equity shares for public subscription.

viii) The new company to take over old company's assets, subject to revaluation of sundry assets at Rs. 2,65,000.

Prepare the necessary ledger accounts in the books of John Ltd. and open the books of the new company of means of Journal entries, assuming that the public subscription was fully responded.

2. SUN Company Ltd. passed resolution and received sanction of the court for the reduction of share capital by Rs. 2.50.000After the arrangement, the credit balance of capital reductionaccount was Rs. 2,50,000. The amount available was utilised forwrite off Profit and Loss a/c (Dr.) 1,05,000, reducing the value ofPlant and Machinery Rs. 45,000, Goodwill Rs. 20,000, InvestmentRs. 40,000. The balance available would be transferred to CapitalReserve. Pass Journal entry.

UNIT – X HOLDING COMPANY ACCOUNTS

Structure

10.1 Introduction:

Economies of Large scale production have given impetus to business combinations. Mergers and acquisitions have become the order of the day in the corporate world. Acquiring controlling interest in a company provides control over its working without affecting its independent existence and identity. The 'Holding Company' method of business combination facilitates creation of closely linked group of companies with interest in mutual wellbeing. Thus, acquiring control over other companies has become a favourite method to build up an industrial empire.

10.2 Definitions:

A holding company is a company which controls another company known as subsidiary company by owning its majority of the shares carrying voting rights or controlling the composition of its board of directors. Accounting Standard 21 on Consolidated Financial Statements gives the following definitions:

A subsidiary is an enterprise that is controlled by another enterprise (known as the parent)

A parent is an enterprise that has one or more subsidiaries.

A group is a parent and all its subsidiaries

Thus, the Accounting Standard calls the holding company, a parent.

10. 3 Advantages of holding companies:

Holding companies have been used extensively to further the combination movement. Particularly in the United States of America, the holding company device was found to be useful in bringing a number of companies under one control, and it is only when the combination movement gathered momentum that holding companies became popular. The advantages of holding companies are as under:-

1. Subsidiary companies maintain their separate identities and as such they maintain their goodwill.

2. The public may not be aware of the existence of combination among the various companies and, therefore, the fruits of monopoly or near monopoly may be enjoyed without resentment in the minds of the people.

This, however, is clearly a disadvantage from the social point of view, because, if there is a monopoly, the public ought to know

3. The persons controlling the holding company need invest a comparatively small amount in order to control the subsidiary companies. If, for example, A, a holding company, has two subsidiaries, B and C and if B and C in turn have three subsidiaries each, the persons who

have the majority of shares in A will be able to control eight other companies. Had these companies been amalgamated, a much larger amount would have been required in order to control the concerns.

This, again, is a disadvantage from the social point of view, because it may lead to irresponsibility.

4. By maintaining the separate identities of various companies, it would be possible to carry forward losses for income tax purposes.

5. Each subsidiary company has to prepare its own accounts and, therefore, the financial position and profitability of each undertaking is known

6. Should it be found desirable that the control of the holding company be given up, it can be easily arranged; all that is required is that the shares in the subsidiary companies should be disposed of in the market.

10.4 Disadvantages of holding companies:

The disadvantages of holding companies are the following:

1. There is a possibility of fraudulent manipulation of accounts, especially if the accounts of various companies are made up to different dates

2. Inter-company transactions are often entered at fanciful or unduly low prices in order to suit those who control the holding companies

3. There is the danger of the oppression of minority shareholders

4. There may be accounting difficulties in appraising the financial position of companies due to inter-company transactions carried on at too high or too low prices

5. The shareholders in the holding company may not be aware of the true financial position of the subsidiary companies

6. Similarly, the creditors and outside shareholders in the subsidiary companies may not also be aware of the true financial position

7 The subsidiary companies may be forced to appoint persons of the choosing of holding companies as directors or other officers at unduly high remuneration.

Whatever the advantages and disadvantages, the holding company has come to stay and the law now wisely tries to regulate its working. The law has defined a holding company and a subsidiary company. Private companies, subsidiary to a public company, do not enjoy the privileges given to private companies. Also the law compels the holding company to give information about the subsidiary companies.

10.5 Inter-company holdings:

In India, a subsidiary company is not allowed to acquire shares in its holding company. But if the subsidiary company had acquired shares in the holding company before it became the subsidiary or before the commencement of the Companies Act, 1956, the company can continue to hold the shares [section 42 (3)]. However, the subsidiary company will not be able to exercise any voting rights at the meetings of the members of the holding company

From the accounts point of view, the profits belonging to the subsidiary company will have to be calculated taking into consideration the fact that it will have a right on the profit of the holding company also which, in turn, will claim its share of the profits of the subsidiary company. A proper calculation of the subsidiary company's profit is obviously necessary for ascertaining minority interest. But, as has been pointed out already, cost of control cannot be calculated without ascertaining the holding company's share of capital profits of the subsidiary company This will again require taking into account profits of the holding company up to the date the holding company acquired control over the subsidiary company It will be remembered that profits of the subsidiary company, even if revenue in nature up to the date of acquisition of control, are capital from the point of view of the holding company. This will include that part of profits also which the subsidiary company claims from the holding company Calculations of profits mentioned above will require algebraically equations, these are illustrated below.

While consolidating the balance sheets, paid up value of shares held by the subsidiary company will be deducted from the share capital of the holding company. Any excess amount paid (over the paid up amount) should be added to Cost of Control or Goodwill.

10.6 Mutual Owings

In preparing consolidated balance sheet, sums owed by holding company to its subsidiary and vice versa have to be eliminated. For instance if holding company owes Rs. 1,00,000 to its subsidiary, this sum will be deducted both from the total debtors and total creditors in the consolidated balance sheet. The same applies to bills accepted by either of them and held by the other as bills receivable. However, bills receivable which have been got discounted or which have been endorsed in favour of creditors will not be eliminated and will appear in the balance sheet as a liability, since the company which has accepted the bills will have to pay on the due dates to the outsiders i.e. the banks who discounted the bills or endorsees in whose favour the bills have been endorsed. Like- wise, debentures issued by either company and held by the other company as investments will also be eliminated from debentures on the liabilities side and from investments on the assets side. But in such a case, the difference in the purchase price of debentures and the paid up value of the same is shown as cost of control or capital reserve. Also, internal contingent liabilities, that is, sums that may have to be paid by the holding company to the subsidiary company or vice versa are not shown by way of a note in the consolidated balance sheet.

Illustration 1 :

J Ltd. acquired as investment 15,000 shares in S Ltd. for Rs. 1,55,000 on 1st July, 1999. The balance sheets of the two companies on 31st March, 2000 were as follows:-

Liabilities	J Ltd Rs	S Ltd Rs	Assets	J Ltd Rs	S Ltd Rs
Equity Shares of Rs. 10 each fully paid	9,00,000	2,50,000	Machinery	7,00,000	1,50,000
General Reserve	1,60,000	40,000	Furniture	1,00,000	70,000
Profit & Loss Account	80,000	25,000	Investment	1,55,000	--
Bills Payable	40,000	20,000	Stock	1,00,000	50,000
Creditors	50,000	30,000	Debtors	60,000	35,000
			Cash at Bank	90,000	40,000
			Bills Receivable	25,000	20,000
	12,30,000	3,65,000		12,30,000	3,65,000

The following additional information is provided to you

(i)General Reserve appearing in the balance sheet of S Ltd. has remained unchanged since 31st March, 1999.(ii) Profit earned by S Ltd. for the year ended 31st March, 2000 amounted to Rs. 20,000

(iii) On 1st February, 2000 J Ltd. sold to S Ltd. goods costing Rs. 8,000 for Rs. 10,000.25% of these goods remained unsold with S Ltd. on 31st March, 2000. Creditors of S Ltd include Rs. 4,000 due to J Ltd. on account of these goods(iv) Out of S Ltd.'s acceptances, Rs. 15,000 are those which have been accepted in favour of J Ltd. Out of these, J Ltd. had

endorsed by 31st March, 2000 Rs. 8,000 worth of bills receivable

in favour of its creditors

You are required to draw a consolidated balance sheet as at 31st March, 2000

Solution:

(i) Capital Profits:Rs General Reserve 40,000

Profit & Loss Account balance as on 31st March,

1999 (Rs. 25,000-Rs. 20,000) 5,000

Profit earned during the current year up to the date

of acquisition ofshares Rs. 20,000 x 3/12= Rs. 5,000 5,000

50,000

H Ltd.'s share= Rs. 50,000 x (15,000/25,000) =Rs. 30,000.

Minority shareholders' share = Rs. 50,000-Rs. 30,000= Rs. 20,000

(ii) Revenue Profit:

Profit earned during the current year subsequent to the acquisition of

SharesRs. 20,000 x 9/12= Rs. 15,000

H Ltd.'s share Rs. 15,000 x (15,000/25,000)=Rs. 9,000

Minority shareholders' share Rs. 15.000-Rs. 9,000= Rs. 6,000

(iii) Capital Reserve on acquisition of shares:

Paid up value of 15,000 shares of S Ltd 1,50,000

H Ltd.'s share of capital profits30,000

1,80,000

Less: Cost of shares 1,55,000

Capital Reserve 25,000

(iv) Minority Interest

Paid up value of 10,000 shares held by minority

Shareholders 1,00,000

Capital Profits 20,000

Revenue Profits 6,000

1,26,000

Alternatively:

Paid up value of 10,000 shares 1,00,000
General Reserve Rs. 40,000 x (10,000/25,000) 16,000
Profit & Loss Account Rs. 25,000 x (10,000/25,000) 10,000
1,26,000

(v) Unrealised profit in respect of stock:

(Rs. 10,000 - Rs. 8,000) x 25/100 = Rs. 500.

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2000

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Equity Share			Machinery:		
Capital		9,00,000		7,00,000	
Minority			H Ltd.	1,50,000	8,50,000
Interest		1,26,000	S Ltd.		
Capital		25,000	Furniture:	1,00,000	
Reserve			H ltd:	70,000	1,70,000
General		1,60,000	S ltd:		
Reserve			Stock	1,00,000	
Profit &			H ltd:	50,000	
Loss	80,000		S ltd:	1,50,000	
Account:					
H Ltd.			Less:		
Add: H			Unrealised	500	1,49,500
Ltd.'s share	9,000		profit		
of	89,000		Debtors	60,000	
S Ltd.'S			H ltd:	35,000	
Post	500	88,500	S ltd:	95,000	
acquisition					
profits	40,000		Less:		
Less:	20,000		Mutual	4,000	91,000
Unrealised	60,000		Owings		
profit	7,000	53,000	Cash at		
Bills			Bank:	90,000	
payable:	50,000		H ltd:	40,000	
H ltd:	30,000		S ltd:		
S ltd:	80,000	76,000	Bills		
			Receivable:	25,000	
Less:	4,000		H ltd:	20,000	
Mutual			S ltd:	45,000	
owings					
Creditors:			Less:		
H ltd:			Mutual	7,000	38,000
S ltd:			Owings		
Less:					
Mutual					
Owings					
		14,28,500			14,28,500

10.7 Contingent liabilities

Transactions which may become liabilities in future are shown as contingent liabilities, as footnotes to the Balance Sheet. For example, bill endorsed to creditors and discounted with bank, investment in party paid shares, etc.

Any contingent liability involving a third party must continue to be shown ass a footnote to the consolidated Balance Sheet. However any contingent liabilities involving the holding company and its subsidiaries alone must be eliminated by not showing them as footnotes to the Balance Sheet.

Unrealised Profits

Usually, there will be transactions between the holding company and the subsidiary company involving profits and losses Suppose, H Ltd. (the holding company) buys from 5 Lad (the subsidiary company) goods of the value of Rs. 20,000 on which S Ltd has put a profit of 25% on selling price. It means that S Ltd. has made a profit of Rs. 5,000 on goods sold to H. Ltd. If H Ltd is able to sell these goods, it does not matter because the whole profit-the Rs. 5000 charged by S. Ltd and whatever profit H Ltd. makes-is realised. But if the goods remain unsold and are taken in stock at the close of the financial year, the profit charged by S Lid remains unrealised and it will no be proper to credit the Profit and Loss Account with such a profit Either a reserve should he created or the value of closing stock written down If a portion of the goods has been sold. Proportionate reserve should be created for unrealised profit on unsold goods. But if there are outside shareholders in the subsidiary company, they will treat the profit made by the subsidiary company as realised. Similarly, if the holding company sells goods to S Ltd and the goods remain unsold, the holding company can treat the profits as realised so far as the outside shareholders are concerned. This means that the reserve to be created in respect of unrealised profit should be reduced by the share applicable to the outside shareholders Suppose, H Ltd holds 3,000 shares in S Ltd. out of the total 4,000 shares. During the year, S Ltd. sold goods costing Rs. 50,000 to H Ltd. at a profit of 20% on cost. At the end of the year, H Ltd. has still in stock a portion of these goods and this was valued by H Ltd. at Rs. 30,000 (cost to H Ltd.). The total unrealised profit is Rs 30,000 x 20/120 or Rs. 5,000. Since the outside shareholders have one-fourth interest, Rs. 1,250, i.e., 5000/4 may be treated as realised and a reserve of the remaining balance, viz., Rs 3,750 created by debit to the Profit and Loss Account.

The point will also arise when fixed assets are transferred at a profit or loss. It will have to be treated exactly in the same way in which sale of goods is treated.

The modern practice is to create the whole of the profit mentioned in these paragraphs as unrealised without adjustment for minority interest. Hence, a reserve equal to the total unrealised profit may be created.

Illustration 1:

On 31st March, 2000 the Balance Sheets of H Ltd and its subsidiary S Ltd. stood as follows:-

Liabilities	H Ltd	S Ltd	Assets	H Ltd	S Ltd
Equity			Fixed		
Share			Assets	5,50,000	1,00,000
Capital	8,00,000	2,00,000	75%		
General			Shares in		
Reserve	1,50,000	70,000	S Ltd. (at		
Profit and			cost)		
Loss			Stock	2,80,000	-
Account			Other		
Creditors		55,000	Current	1,05,000	1,77,000
	90,000		Assets		
		80,000			
	1,20,000			2,25,000	1,280,000
	11,60,000	4,05,000		11,60,000	4,05,000

Draw a consolidated balance sheet as at 31st March, 2000 after taking into consideration the following information also :-

(i)H Ltd. acquired the shares on 31st July 1999.

(ii) S Ltd. earned a profit of Rs. 45,000 for the year ended 31st March, 2000.

(iii) In January, 2000 S Ltd. sold to H Ltd. goods costing Rs. 15,0O0 for Rs. 20,000 On 31st March, 2000 half of these goods were lying as unsold in the go downs of H Ltd.

Solution:

Working Notes:

(i) Capital Profits: **Rs**

General Reserve 70,000

Profit & Loss Account as on 31st March, 1999
(Rs. 55,000 - Rs.45,000) 10,000

Current year's profit up to 31st July 1999, the date of acquisition ofsharesRs. 45,000 x 4/12= Rs. 15,000 15,000

$\boxed{95,000}$

H Ltd.'s share = Rs. 95,000 x 75/100 =Rs. 71,250

Minority shareholders' share = Rs. 95,000 x 25/100 = Rs. 23,750

(ii) Revenue Profits:

Profits from 1st August, 1999 to 31st March, 2000
i.e., for 8 months Rs. 45,000 x 8/12 Rs. = 30,000

H Ltd's share = Rs. 30,000 x 75/100 Rs. = 22,500

Minority shareholders' share Rs. 30,000 x 25/100 = RS. 7,500

(iii) Unrealised profit in respect of stock with H Ltd.:

Total profit charged by S Ltd. = Rs. 20,000 - Rs. 15,000 =Rs. 5,000

Since only half of the goods remained unsold as on 31st March, 2000 the unrealised profit Rs. 5,000 x 1/2 = Rs. 2,500

(iv) Cost of control or goodwill:

Amount paid for acquiring 75% shares of S Ltd 2,80,000

Less: Paid up value of 75% shares of S Ltd 1,50,000

H Ltd.'s share of capital profits <u>71,250</u>2,80,000

Cost of control $\boxed{58,750}$

(v) Minority Interest

Paid up value of 25% shares of S Ltd.50,000

Add: Share in capital profits 23,750

Add: Share in reserve profits 7,500

$\boxed{81,250}$

Or

Paid up value of 25% shares in S Ltd.50,000

25% of General Reserve as on 31st March,
2000 Rs. 70,000 x 25/100 17,500 25% of
Balance of Profit & Loss Account
as on 31st March, 2000= Rs. 55,000 x25/10013,750

$\boxed{81,250}$

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2000

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Equity			Goodwill		58,750
Share			Other		
Capital		8,00,000	Fixed		
Minority			Assets:		
Interest			H Ltd		
General		81,250	S Ltd		
Reserve			Stock	5,50,000	
Profits &			H Ltd	<u>1,00,000</u>	6,50,000
Loss		1,50,00	S Ltd		
Account:				1,05,000	
H Ltd			Less:	<u>1,77,000</u>	
Add:			Unrealised	2,82,000	
Share in S			Profit		
ltd profit					
Less :	90,000		Other	<u>2,500</u>	2,79,500
Unrealised			current		
profit			asset		
Creditors:			H Ltd		
H Ltd	<u>22,500</u>		S Ltd		
S Ltd	1,12,500			2,25,000	
				<u>1,28,000</u>	3,53,000
	<u>2,500</u>	1,10,000			
	1,20,000				
	<u>80,000</u>	2,00,000			
		13,41,250			13,41,250

Revaluation of assets and liabilities:

When holding company acquires controlling interest in a subsidiary, it may revalue the assets and liabilities to reflect their current values. These revised values may form the basis for determining the value of shares for the purpose of acquisition.

Any profit or loss on revaluation of the assets and the outside liabilities has to be adjusted in the respective assets and liabilities in the consolidated Balance Sheet, if it is not already done. The same profit or loss has to be included in the computation of 'capital profits', as already explained earlier.

(A) Short Answers Questions:

1. What is Holding company?
2. Define Holding.
3. What is a contingent liability?
4. What are the mutual Owings?
5. What is revaluation of assets?

(B) Long Answer

1.On 31st March, 2000 the Balance Sheets of H Ltd and its subsidiary S Ltd. stood as follows:-

Liabilities	H Ltd	S Ltd	Assets	H Ltd	S Ltd
Equity Share Capital General Reserve Profit and Loss Account Creditors	 8,00,000 1,50,000 90,000 1,20,000	 2,00,000 70,000 55,000 80,000	Fixed Assets 75% Shares in S Ltd. (at cost) Stock Other Current Assets	 5,50,000 2,80,000 1,05,000 2,25,000	 1,00,000 - 1,77,000 1,280,000
	11,60,000	4,05,000		11,60,000	4,05,000

Draw a consolidated balance sheet as at 31st March, 2000 after taking into consideration the following information also :-

(i)H Ltd. acquired the shares on 31st July 1999.

(ii) S Ltd. earned a profit of Rs. 45,000 for the year ended 31st March, 2000.

(iii) In January, 2000 S Ltd. sold to H Ltd. goods costing Rs. 15,0O0 for Rs. 20,000 On 31st March, 2000 half of these goods were lying as unsold in the go downs of H Ltd.

UNIT XI LIQUIDATION OF COMPANIES

Structure

11.1 LIQUIDATION MEANING

Liquidation or winding up is process, by which a company is dissolved, and its assets realized and applied in paying off the liabilities of the company. It there is any surplus after closing off the liabilities, it is distributed to its contributors according to their rights.

11.2 LIQUIDATION DEFINITION

"The process whereby its life is ended, and its property is administered for the benefit of its creditors and members. An administrator, called a Liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights" – Companies Act, 1965

11.3 REASONS FOR WINDING UP

A company may be wound up because of any one or more of the following reasons:

i) The main objects of the company for which it was established have been accomplished.
ii) If it has become impossible to carry out the main objects of the company.
iii) If the company has sold the business or the undertaking to another company or an individual.
iv) If the company is not in a position to pay its debts in full or it has become insolvent.

11.4 LIQUIDATOR

Liquidator is a person appointed by the court or by the members in general meeting or by the creditors for the purpose of liquidation.

11.5 LIQUIDATOR'S FINAL STATEMENT OF ACCOUNT

A liquidator is appointed to liquidate a company. It is the duty of the liquidator to realize the assets and settle the accounts of third parties. After the completion of liquidation process, the liquidator mustprepare a statement which states the total cash realized and the amount disbursed to creditors, debenture holders and shareholders. Such a statement is known as Liquidators' final Statement Account.

11.6 PREFERENTIAL CREDITORS

Preferential creditors are those members who have preferential rights over the assets of the company. Preferential creditors have the priority over the unmortgaged assets of the company.

Examples:

i) Tax payable to the Government or local authority

ii) Four months wages and salaries payable to workers or employees Rs. 20,000 (w.e.f March 1997)

iii) Amount payable as arrears as per workmen compensation Act.

iv) Amount payable as arrears under Provident Fund Scheme and Pension Fund Scheme.

v) Amount payable as arrears under Employees State Insurance Act.

11.7 LIQUIDATOR'S REMUNARATION

Liquidator is entitled to receive remuneration for the service rendered y him. The liquidator may receive remuneration as a percentage asset realized and a percentage on the amount distributed to creditors on shareholders.

Commission on Assets Realised:

$$\text{Commission} = \text{Assets realized} \times \frac{\text{percentage of commission}}{100}$$

Commission on amount distributed to unsecured creditors:

$$\text{Commission} = \text{Unsecured creditors} \times \frac{\text{Percentage of Commission}}{100}$$

In some circumstances, there may not be possibility to have enough money to pay off the liabilities of unsecured creditors. In such circumstances, commission will be calculated as follows:

$$\text{Commission} = \text{cash available} \times \frac{\text{percentage of commission}}{100 + \text{Percentage of Commission}}$$

Note:

While calculating commission on unsecured creditors, preferential creditors are also to be included:

11.8 ORDER OF PAYMENT

The liabilities are paid off in the following order of preference:

i) Liquidation expenses

ii) Liquidation Remuneration

iii) Secured creditors

iv) Debentures holders

v) Preferential creditors

vi) Unsecured creditors

vii) Preferential shareholders

viii) Equity shareholders

11.9 CLASSIFICATION OF ASSETS AND LIABILITES IN THE STATEMENTS OF AFFAIRS:

The various assets and liabilities are classified and given in various lists as shown below:

List A: Assets not specifically Pledged on Mortgaged

List B: Secured creditors to the extent to which claims are estimated to be covered by assets specifically pledged:

List C: Preferential creditors

List D: Debenture holders secured by a floating charge.

List E: Unsecured creditors

List F: Amount due to preferential shareholders

List G: Equity shareholder's amount.

List H: surplus/ deficiency as regards members

SPECIMEN: STATEMENT OF AFFAIRS

ASSETS	ESTIMATED REALISABLE VALUE RS.
Assets not specifically pledged (as per list A)	
Balance at Bank, Cash in hand	xxx
Marketable securities	xxx
Bills Receivable	xxx
Trade Debtors	xxx
Loans & Advances	xxx
Unpaid calls	xxx
Stock-in- Trade	xxx
Work in progress	xxx
Freeholds property, land &Buildings	xxx
Lease hold Property	xxx
Plant &Machinery, Furniture Fittings , Utensils etc.	xxx
Investments other than marketable securities	xxx
Other property	xxx
Assets specifically pledged (As per List B)	xxx
Assets / Estimated Realizable Value / Due to Secured Creditors / Deficiency ranking unsecured	xxx
	xxx
Freehold Property	
Estimated total assets available for pref. crs., Debenture holders secured by a floating charge and unsecured Crs.	xxx
Summary of Gross Assets	
Gross realizable value of assets specifically pledged:	
Specifically pledged xxxxx	
Others xxxxx	

Gross Liabilities	Liabilities	
Xxx	Secured Creditors (As per List B)	
Xxx	Preferential creditors (As per List C)	xxx
	Estimated balance of assets available for debentures holders	xxx
Xxx	Debentures holders secured by a floating charge (As per List D)	xxx
	Estimated surplus as regards Debentures holders	xxx
Xxx	Unsecured creditors (As per List E)	
	Estimated unsecured balance of claims of creditors partly secured on specific assets, brought from preceding page	xxx
	Trade Accounts and Bills payable	xxx
	Contingent liabilities	xxx
Xxx	Estimated surplus/ Deficiency as regards creditors	xxx
	Estimated surplus as regards creditors	xxxx
	Issued and called up Capital:	xxx
	Pref. shares of …. each called up (As per List F)	xxx
	Equity shares of …. Each …. called up (As per List G)	xxx
	Estimated Surplus / Deficiency as regards Members (or) Contributions (As per List H)	

SPECIMEN: LIQUIDATORS FINAL STATEMENT OF ACCOUNTS

Receipts	Estimated value Rs	Value realized Rs	Payments	Payments Rs.	
Assets:			Legal charges:		
Cash at Bank			Liquidator's		
Cash in Hand			remuneration		
Marketable Securities			% on Rs…….		
Bill Receivable			Realized		
Trade Debtors			% on Rs ……..		
Stock in Trade			distributed		
Work in Progress			Auctioneers' and		
Free hold property			valuers' charges:		
Plant and Machinery			Cost of possession		
Furniture & Fittings			Cost of notice		
Surplus from securities			Incidental outlay		
Unpaid calls at			Total cost & charges		
Commencement of			Debenture holders:		
winding up			Creditors		
Amount received from			Preferential		
Calls on contributions			Unsecured		
Made in the winding up			Preference share		
Receipts per trading a/c			capital		
			Returns to		
			contributories		

11.10 CALCULATION OF LIQUIDATOR'S REMUNARATIONS

ILLUSTRATION 1

From the particulars given below, ascertain liquidator's remuneration:

Creditors to be paid Rs. 60,000

Amount available on hand Rs. 44,000

Commission to be given on the amount paid to creditors 10%

The available amount is not enough to pay all the creditors.

$$\text{Remuneration} = \text{Amount available} \times \frac{\text{Percentage of commission}}{100 + \text{Percentage of Commission}}$$

= 44,000 X 10/100+10

= 44,000 X 10/110 = Rs. 4,000

ILLUSTRATION 2

The amount due to unsecured creditors is Rs. 3,00,000. The amount available for unsecured creditors before charging commission in Rs. 1,03,000

3% commission is to be paid on the amount paid to unsecured creditors. Calculate the liquidator's remuneration.

Solution:

Commission to be paid to liquidators = 1,03,000 X 3/103 = Rs.3,000

11.11 LIQUIDATOR'S FINAL STATEMENT OF ACCOUNTS

ILLUSTRATION 3

From the following information, prepare liquidator's final statement of account.

Cash at Bank		1,00,000
Surplus from securities		10,10,000
Expenses of Liquidation		30,000
Liquidator's Remuneration	7,000	
Preferential Creditors	2,00,000	
Unsecured Creditors		7,00,000
Preference Shareholders	1,00,000	
Equity shareholders		1,00,000

Solution:

Liquidator's Final Statement of Account

Receipt	Estimat ed value	Value realized	Payments	Payment
Assets Realised			Liquidators Remuneration	7,000
Cash at Bank		1,00,000	Expenses of Liquidation	30,000
Surplus from securities		10,10,000	Preferential Creditors	2,00,000
			Unsecured Creditors	7,00,000
			Preference share holders	1,00,000
			Equity Shareholders (Bal Fig)	73,000
		11,10,000		11,10,000

ILLSUTRATION 3

The relate to a company which has gone into liquidation is as follows:

Preferential Creditors	10,000	
Unsecured Creditors		32,000
Debentures		10,000

Assets realized Rs. 39,650, liquidation expenses amounted to Rs. 1,000. The liquidators is entitled to a remuneration of 2% on amounts paid to unsecured creditors other than preferential creditors.

SOL**UTIONS:**

Liquidator's Final Statement of Account

Receipt	Estimated value	Value realized	Payments	
Assets Realised		39,650	Liquidators Remuneration	366
			Expenses of Liquidation	1,000
			Debentures	10,000
			Preferential	10,000

			Creditors Unsecured Creditors (Bal Fig) (Re. 0.57 Per rupee)	18,284
		39,650		39,650

Working Note:

i) Amount available to unsecured creditors &liquidators' remuneration
= 18,650 (39,650 – (10,000+10,000+1,000)

ii) Liquidators Remuneration = 18,650 X 2/102 = 366

iii) Settlement to unsecured creditors = (Rs. 18,284 /32,000) = 0.57 per rupee.

ILLUSTRATION 4

The Ultra Optimist went into liquidation. Its assets realized Rs. 3,50,000 excluding amounts realized by sale of securities held by the secured creditors.

Share Capital: 1000 share of Rs. 100 each	1,00,000
Secured creditors (Securities realized Rs. 40,000)	35,000
Preferential Creditors	6,000
Unsecured creditors	1,40,000
Debentures having floating charge	2,50,000
Liquidation expenses	5,000
Liquidator's Remuneration	7,500

Prepare liquidator's final statement of account.

SOLUTION:

THE ULTRA OPTIMIST COMPANY (in Liquidation)
Liquidator's Final Statement of Account

Receipt	Estimated value	Value realised	Payments	Amount
Assets Realised		3,50,000	Liquidator Remuneration	7,500
Surplus from Secured Creditors		5,000	Liquidation expenses	5,000
			Debenture having floating charge	2,50,000
			preferential creditors	6,000
			unsecured creditors (Bal Fig)	86,500
			86,500/1,40,000=0.62	
		3,55,000		3,55,000

NOTES

ILLUSTRATION:5

The Balance sheet of XYZ Ltd. at the time of Liquidation is given below:

Balance sheet of XYZ Ltd.as on 1st Jan. 2008

Liabilities	Rs.	Assets	Rs.
Equities share capital (Rs. 10)	2,00,000	Fixed Assets	2,00,000
Debentures	1,00,000	Stock	50,000
Loans	50,000	sundry Debtors	1,25,000
Creditors	50,000	Cash	5,000
		Profit & Loss a/c	20,000
	4,00,000		4,00,000

Fixed assets are sold for Rs. 1,20,000 to a debenture's holder holding Rs. 40,000 debenture and cash are received after setting off. Cash realized from debtors was Rs. 80,000 and the liquidation expenses amounted to Rs. 1000. Liquidator is paid Rs. 1000 fixed allowance plus 2% commission on collection including cash in hand Rs. 5,000 as remuneration. Stock in sold for Rs. 10,000.

Prepare the Liquidator's statement of accounts.

SOLUTIONS

XYZ Ltd. (in Liquidation)

Liquidator's Final Statement ofAccount

Receipt	Estimated value	Value realised	Payments	Rs.
Assets Realized aftersetting off		80,000	Liquidation expenses	1,000
Debtors	1,25,000	80,000	Liquidation Remuneration:	
Stock	50,000	10,000	Fixed allowance 1,000	
Cash in Hand	5,000	5,000	2% on Rs. 1,75,000 3,500	4,500
			Debentures	60,000
			Unsecured:	
			Loan Creditors	50,000
			Creditors	50,000
			Equity shareholders (B/F)	9,500
		1,75,000		1,75,000

ILLUSTRATION: 6

From the following information, prepare unsecured creditors as per list E.

Unsecured creditors		3,80,000
One Month's salary		4,000
Bills Payable		1,06,000
Bank Overdraft		40,000
Liability on Bills Discounted		60,000
Partly secured creditors		
(Total Creditors Rs. 2,00,000)	1,00,000	

Preferential Creditors	16,000

SOLUTION:

Calculation of Unsecured Creditors as per List E

Particulars	Rs.
One month's Salary	4,000
Unsecured Creditors	3,80,000
Bills payable	1,06,000
Bank O/D	40,000
Liability on Bills Discounted	60,000
Partly secured creditors	1,00,000
Total	6,90,000

DEFICIENCY OR SURPLUS ACCOUNT

This account is prepared in the case of a company in liquidation to explain in a nutshell how the company lost money during its existence. It explains the deficiency or surplus. It is divided into two parts. The first part starts with the deficit on the given date (as the liquidator specifies, the minimum being three year) and contains every item that increase the deficiency. The second part starts with the surplus on the given date and includes all profits. If the total of the first exceeds the second, there would be a deficiency to the extent of the difference and a surplus vice-versa. This statement is a necessary adjunct to the statement of affairs as regards members and the deficiency shown in this account must agree with the one shown by the statement of affairs. The period covered by this account must commence on date not less than 3 years before the date of winding up order or from the date of formation of the company if the whole period of its existence is less than 3 years, unless the liquidator otherwise agrees.

Prescribed form of deficiency or surplus account

List H – Deficiency or surplus account

Item contributing to deficiency (or reducing surplus)	**Rs.**
1. Excess (if any) of capital and liabilities over assets on the ---- 19 --- as shown by balance sheet (copy annexed)	xxx
2. Net dividends and bonuses declared during the period form ----19 --- to the date of the statement	xxx
3. Net trading losses (after charging items shown in note to follow) for the same period	xxx
4. Losses other than trading losses written off or for which provision has been made in the books during the same period (given particulars or annex schedule)	xxx
5. Estimated losses now written off or for which provision had been made for the purpose of preparing the statement (give particulars or annex schedule)	xxx
6. Other items contributing to deficiency or reducing surplus-------	xxx
Item reducing deficiency (or contributing to surplus)	
7. Excess (if any) of assets over capital and liabilities on the----- 19----- to the date of statement	xxx

8. Net trading profit (after charging item shown in note below) for the period form---- 19 ----- to the date of statement.	xxx
9. Profits and income other than trading profits during the same period (give particulars or annex schedule)	xxx
10. Other items reducing deficiency or contributing to surplus	xxx
Deficiency / surplus (as shown by the statement of affairs)	xxx
Notes as to net trading profits and losses: Particulars are to be inserted here (so far as applicable) of the items mentioned below, which are to be taken into account in arriving at the amount of net trading profits or losses shown in this account: Provision for depreciation, renewals or diminution on value of fixed assets. Charges for Indian income tax and other Indian taxation on profits. Interest on debentures and other fixed loans, payment to directors made by the company and required by law to be disclosed in the accounts	
Exceptional or non-recurring receipts: -----	xxx
Balance being other trading profit and losses. Net trading profits and losses as shown in deficiency or surplus account above.	xxx
	xxx
Signature: Date 19 ………..	

Illustration 2

Shri. B. Rose is appointed liquidator of a company in a voluntary liquidation on 1.7.2006 and the following balances are extracted from the books on that date:

Liabilities	Rs.	Assets	Rs.
Share capital:		Machinery	60,000
32,000 shares of Rs. 5 each	1,60,000	Leasehold properties	80,000
Provision for bad debts	20,000	Stock-in-trade	2,000
Debentures	1,00,000	Book debts	1,20,000
Bank overdraft	36,000	Investments	12,000
Liabilities for purchases	40,000	Calls in arrears	10,000
		Cash in hand	2,000
		Profit & Loss A/c	70,000
	3,56,000		3,56,000

The assets are revalued as under:
Investment at Rs. 8,000
Stock in trade at Rs. 4,000
Machinery at Rs. 1,20,000
Leasehold properties at Rs. 1,46,000
Bad debts are Rs. 4,000; Doubtful debts are Rs. 8,000, estimated to realise Rs. 4,000.
The bank overdraft is secured by deposit of title deeds of leasehold properties.
Preferential creditors for tax and wages Rs. 2,000
Telephone rent owing is Rs. 160

You are required to prepare (i) Statement of affairs as regards creditors and contributories and (ii) deficiency or surplus A/c.

Solution:

Statement of affairs of …….. as on 1.7.2006

Assets	Estimated Realisable value
Assets not specifically pledged (as per list A)	Rs.
Cash in hand	2,000
Trade debtors (1,20,000 – 4,000 – 4,000)	1,12,000
Calls-in-arrears	10,000
Investments	8,000
Stock	4,000
Machinery	1,20,000
	2,56,000
Assets specifically pledged as per list B :	
Estimated Realisable value Rs. / Due to secured creditors Rs. / Deficiency Rs. / Surplus Rs.	
Leasehold properties 1,46,000 / 36,000 / / 1,10,000	
Estimated surplus from assets specifically pledged	1,10,000
Estimated total assets available for preferential creditors, Debenture holders secured by a floating charge and unsecured creditors.	3,66,000
Summary of Gross assets:	
Gross realizable value of assets specifically Pledged 1,46,000	
Other assets <u>2,56,000</u>	
4,02,000	

Gross Liabilities	Liabilities	
36,000	Secured creditors as per List B to the extent to which claims are estimated	-
2,000	to be covered by assets specifically pledged	<u>2,000</u>
	Preferential creditors are per list 'C'	3,64,000
1,00,000	Estimated balance of assets available for debenture holders secured by a	<u>1,00,000</u>
	floating charge and unsecured creditors	2,64,000
	Debentures holders secured by first floating charge as per List D	<u>40,160</u>
	Estimated surplus as regards	2,23,840
40,160	debenture holders:	<u>1,60,000</u>
	Unsecured creditors as per List E:	<u>63,840</u>
	Liabilities for purchase 40,000	
	Telephone Rent outstanding	

	160	
1,78,160	Estimated surplus as regards creditors Issued & Called up capital (as per List G) Estimated surplus as regards contributories as per List H	

Note: It is assumed that calls in arrears can be fully realized.

Deficiency or surplus A/c (List H)

Items reducing surplus:	**Rs.**
Excess of capital and liabilities over assets i.e., Profit & loss A/c	70,000
Estimated losses now written off for which provision has been made for the purpose of preparing the statement:	
Investments: (Rs. 12,000 – Rs. 8,000) 4,000	
Preferential creditors for taxes & wages 2,000	
Telephone rent outstanding 160	6,160
	76,160
Items contributing to surplus:	
Machinery (Rs. 1,20,000 – Rs. 60,000) 60,000	
Leasehold properties (Rs. 1,46,000 – Rs. 80,000) 66,000	
Stock (Rs. 4,000 – Rs. 2,000) 2,000	
Provision for Bad debts: 20,000	
less: Bad debts 4,000	
Doubtful debts 4,0008,00012,000	1,40,000
Surplus as shown by statement of affairs	63,840

Summary

1. The liquidation meaning the understand.
2. Clearly understand the various types of voluntary winding up.
3. Also understand with procedure in modes of winding up.
4. Create the Deficiency or surplus A/c (List H).
5. For calculation of liquidator's final statement of account.
6. Understanding the liquidator remuneration.

1.Theory Questions

A. Short answer questions:

1. What is liquidation?
2. Define Liquidation.
3. Who is a liquidator?
4. What is included in List D?
5. What are preferential creditors? Give two examples.

B. Long Question:

1. Give the various reasons for winding up.
2. Explain the preferential creditors as given under the Indian companies Act.

II. Problems

1. X Ltd, went into voluntary liquidation on 1.3.2011. The following balances are taken from its books on that date:

Liabilities	Rs.	Assets	Rs.
Capital: 30,000 Equity shares of Rs. 10 each	3,00,000	Buildings	1,00,000
Debentures	1,00,000	Plant and Machinery	2,00,000
Bank Overdraft	80,000	Stock in Trade	40,000
Creditors	1,20,000	Book Debts 85,000 Less: Provision 13,000	72,000
		Calls in Arrears	50,000
		Cash	8,000
		Profit & Loss a/c	1,30,000
	6,00,000		6,00,000

Plant and Machinery and Buildings are valued at Rs. 20,000 and Rs. 40,000 respectively. On realization, losses of Rs. 10,000 are expected on stock. Book Debts will realize Rs. 80,000. Calls in arrears are expected to realize 70%. Bank O/D is secured against buildings. Preferential creditors for taxes and wages are Rs. 9,000 and miscellaneous expenses outstanding Rs. 400.

Prepare a statement of Affairs.

2. From the following information, prepare unsecured creditors as per list E.

Unsecured creditors	1,00,000
One Month's salary	300
Bills Payable	2,10,000
Bank Overdraft	90,000
Liability on Bills Discounted	7,000
Partly secured creditors (Total Creditors Rs. 2,00,000)	3,00,000
Preferential Creditors	10,000

BLOCK - IV BANKING COMPANY ACCOUNTS, HR ACCOUNTING

UNIT - XII ACCOUNTS FOR BANKING COMPANIES

Structure

12.1 INTRODUCTION

"Bank" is a comprehensive term for a number of institutions carrying on certain kinds of financial business. In a narrow sense, it may be defined as the place for keeping money and valuables safely, the money being paid out on the customer's order, i.e., cheques. The banking regulation Act 1949 defines banking as "accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise an withdraw able by cheque, draft, order or otherwise". Therefore any company which engages itself in the from the public for financing its business activities will not be treated as doing business of banking. Till 1949, there was no special legislation to regulate banking companies but since that year the Banking Regulation Act applies to corporate entities carrying on the business of banking in India. Such companies are also subject to the companies act 1956. All the nationalised banks are also governed by the Banking Regulation Act but regulations regarding appointment of director and disposal of profits etc., do not apply to them.

12.2 BUSINESS OF BANKING COMPANIES

A bank deals in money. It buys and sells money in the same way as trader buys goods for resale at a profit. It buys money from depositors and sells in to borrowers. Section 6 of the Banking Regulation Act contains a detailed list of the forms of business a banking company may carry on, in addition to its banking forms of business a banking company may carry on, in addition to its banking business. These forms of business are:

i. Borrowing, raising or taking up of money;
ii. Lending or advancing money;
iii. Drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes and other instruments;
iv. Granting and issuing of letters of credit, traveller's cheques and circular notes;
v. Buying, selling dealing in bullion,
vi. Buying and selling, on commission, underwriting and dealing in stock, shares, debentures, bonds, etc.
vii. Receiving of all kinds of scrips or valuables on deposit or for safe custody;
viii. Providing of safe deposit vaults;
ix. Collecting and transmitting of money and securities;

x. Carrying on and transacting every kind of guarantee and indemnity business;
xi. Undertaking and executing trusts;
xii. Contracting for public and private loans and negotiating and issuing the same'
xiii. Undertaking the administration of estates as executor, trustee or otherwise;
xiv. The acquisition, construction, maintenance and alternation of any building or works necessary or convenient for the purpose of the company;
xv. Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into accounts or otherwise dealing with all or any part of the property and rights of the company.
xvi. Acquiring and undertaking the whole or any part of the business of any person or company when such business is of a nature enumerated or described in this sub-section.
xvii. Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company.
xviii. Any other form of business which the Central Government may, by notification in the 'Official Gazette", specify as a form of business in which it is for banking company to engage.

In this chapter, we are mainly concerned with the technique of preparing the final accounts of the banking companies;

12.3 LEGAL REQUIREMENTS

The important provisions relating to final accounts of a banking company are as follows;

1. Prescribed form: As per Section 29 to 33 of the banking regulation act, every banking company is required to prepare a balance sheet in accordance with Form A set out in the Third Schedule and a Profit and Loss account in conformity with form 15 of the same schedule. The formats have been revised w.e.f 1st April 1991. In other words, the final accounts for the year ending 31st March 1992 and onwards are to be prepared in the new formats.

2.Accounting year: On account of the amended provision of the Income Tax Act 1961 requiring every company to close its accounts on 31st March each year, w.e.f financial year ending 31st March 1989, now a banking company also closes its accounts on 31st March each year.

3. Prohibition of Trading: According to Sec. 8, a banking company cannot directly or indirectly deal in the business of buying or selling or bartering of goods, except in connection with the realisation of security given to or held by it engage in any trade or buy, sell or barter goods for others otherwise that in connection with bills of exchange received for collection or negotiation or for the administration of estates as executor, trustee or otherwise.

4. Non-banking assets: A banking company may have to take possession of certain assets charged in its favour on account of the failure of a debtor to repay the loan in time. According to Sec 9, a banking company cannot hold any immovable property however acquired, except for its own use, for any period exceeding seven years from the date of acquisition thereof. Gain or loss on sale of such an asset has to be shown separately in the Profit & Loss Account of the banking company.

5. Share capital: In order to ensure that no banking company commences or carries on business with a weak and vulnerable capital structure, Section 11 lays down the following minimum limits of paid up capital and reserves to be complied with by a banking company which wishes to commence or carry on business in India.

Types of Banking	Aggregate value of paid up capital and reserves
1. In the case of a banking company incorporated outside India:	**Rs.**
(a) If in has a place or places of business in the city of Bombay or Calcutta or both	20 Lakhs
(b) If it has places of business elsewhere	15 Lakhs
2. In the case of a banking company incorporated in India:	
(a) If it has places of business in more than one state and if it has a place or places of business in Bombay or Calcutta or both	10 Lakhs
(b) If it had place of business in more than one state but not in Bombay or Calcutta	5 Lakhs
(c) If it has all its places of business in one state none of which is situated in the of Bombay or Calcutta – for the principal place of business plus	10 Lakhs
(i) in respected of each of its other places of business situated in the same district plus	10,000
(ii) in respect of each place of business situated elsewhere in the state otherwise than in the same district subject to an overall limit of 5 lakhs	25,000
(d) If it has one place of business and that also not in Bombay or Calcutta	50,000
(e) If it has all its places of business in one state or more which is or are situated in the city of Bombay or Calcutta plus	5 lakhs
in respect of each place of business situated outside the city of Bombay or Calcutta as the case may be subject to an overall limit of	25,000 10 Lakhs

The above requirements apply to those banks which were established before 1962. The Banking companies (Amendment) Act 1962 raised the minimum amount of the value of the paid up capital to Rs. 5 lakhs for any Indian bank commencing business after the commencement of that Act.

(6) Reserve Fund: Every banking company incorporated in India is required under section 17(1) of ht Act to create a Reserve fund and to transfer to such fund, before any dividend is declared, a sum equal to not less than 25% of the profit, as disclosed in the profit and loss account. Such reserve is termed as “statutory reserve”. This section does not apply to banking companies incorporated outside India. The Central Government may, on the recommendation of the Reserve Bank, exempt a banking company form this restriction if the aggregate amount of reserves and share premium amount is not less than the paid up capital of the banking company.

(7) Payment of Dividend: Section 15 prohibits payments of dividend by any banking company until all of its capitalised expenses have been completely written off. These capitalised expenses include preliminary expenses, organisation expenses, share-selling commission, brokerage, amounts of losses incurred and any other expenditure which is not represented by tangible assets. Payment of dividend out of the profits is considered inappropriate when capitalised expenses are outstanding.

A banking company may, however, pay dividends on its shares without writing off the following:

i. Depreciation in the value of its investment is approved securities where such depreciation has not actually been capitalised otherwise accounted for as loss.
ii. Depreciation in the value of its investments in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditors of the banking company.
iii. Bad debts, if any, where adequate provision has been made to the satisfaction of the auditors of the banking company (Section 15)

(8) Payment of commission, Brokerage, etc.: According to sec. 13, a banking company cannot pay out directly or indirectly any commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, exceeding $2_{1/2}$ % of the paid up value of the shares.

(9) Charge on Uncalled Capital: Under Sec. 14, a banking company cannot undertaking or any property of the bank except with the written permission of the Reserve Bank of India certifying that the charge will not be detrimental to the interest of the depositors.

(10) Subsidiary companies: In order to prevent the banking company from carrying on trading activities indirectly by acquiring controlling interest, it has been provided that a banking company can form a subsidiary company only one or more of the following purposes:

i. The undertaking and executing of trust;
ii. The undertaking of the administration of estates as executor, trustee or otherwise;
iii. The carrying on business of banking exclusively outside India, with the prior permission of the Reserve Bank.
iv. Such other purposes as are incidental to banking business (Section 19)

(11) Cash Reserves: Under Sec. 18 every banking company business (Section 19) Scheduled bank shall maintain a cash reserve with itself or with the Reserve Bank or the state bank of India or any other bank notified by the central Government in this behalf a sum equal to at least 3% of its time and demand liabilities in India.

Under Sec. 42, a Scheduled bank is also required to maintain with the Reserve Bank, an average daily balance of 3% of its total time and demand liabilities in India. The Reserve Bank has power to increases this percentages upto 20% by a notification in the official gatteze (At present CRR is 7 .5% w.e.f. 10.11.2007)

(12) Statutory Liquidity Ratio: According to Sec. 24 (2A) of the Banking Regulation Act, every banking company in India whether scheduled or non-scheduled, is required to maintain in India in cash, gold, or unencumbered approved securities an amount which is not less than 25% of the total of its demand and time liabilities in India. This is known as

"Statutory Liquidity Ratio". The Reserve Bank has the power to increase this ratio upto 40%. At present, the norm for S.L.R, as per RBI is 25%.

(13) Loans and Advances: Section 20 of the Banking Regulation Act, imposes certain restrictions on the loans granted by banks to persons connected with their management. This section as amended by the Amending Act of 1968 is as follows:

a. No banking company can grant loans and advances on the security of its own shares;
b. The banking company should not enter into any commitment for giving any loan or advance to:
   i. Any of its directors;
   ii. To a firm in which any of its directors is interested as partner, manager, employee or guarantor.
   iii. To any company of which any of the directors of the banking company is a director, manager, guarantor or
   iv. To any individual with whom any of its directors is a partner or a guarantor.

(14) Limits as to Investments in shares and Debentures: Reserve Bank of India has removed limits on investments made by the banks in the equity and debentures issues of 17 financial institutions. These includes IDBI, IFCI, ICICI, EXIM Bank of India, IRBI, NABARD, NHB, UTI, LIC, GIC, RCTFC, TDICI, Tourism Financial Corporation of India, etc.

To above restrictions on granting of loans and advances were introduced by an amendment in 1968 in the Banking Regulation Act.

12.4 PREPARATION OF PRFOIT AND LOSS ACCOUNT

Bank are required to prepare final accounts for each financial year. i.e., their books are closed each year on 31st March. But fro internal purpose, banks usually close their books on 31th September called half yearly closing. The profit & Loss account of a banking company has to be prepared in Form 'B' of schedule III, attached to the Banking Regulation Act 1949. Form 'B' of schedule III, attached to the Banking Regulation Act 1949. Form 'B' is given below: **Form 'B'**

Third Schedule

Form of Profit and Loss Account

Profit and Loss Account for the year ended 31st March (000's omitted)

	Schedule No.	Year ended on 31.3...... (current year) Rs.	Year ended on 31.3.... (previous year) Rs.
I. Income : Interest earned Other income	 13 14	 xxx xxx	
Total			
II. Expenditure : Interest expended Operating expenses Provisions and contingencies	 15 16	 xxx xxx xxx	
Total			
III. Profit / Loss: Net Profit/Loss (-) for the year Profit/Loss (-) brought		 xxx xxx	

forward			
Total			
IV. Appropriations: Transfer to statutory reserves Transfer to other reserves Transfer to Govt. /proposed dividend Balance carried over to balance sheet		 xxx xxx xxx xxx	
Total			

Schedules to be annexed with Profit and Loss Account

Schedule 13: Interest Earned

	Year ended on 31.3..... (current year) Rs. in '000	Year ended 31.3..... (previous year) Rs. in '000
I. Interest/ Discount on Advances/ Bills II. Income on investments III. Interest on balances with RBI other inter-bank funds IV. Others	xxxx xxx xxx xxx xxx	 xxx

Schedule 14: Other Income

		Year ended on 31.3... (current year) Rs. in '000	**Year ended 31.3..... (previous year) Rs. in '000**
I. Commission, Exchanges and Brokerage II. Profit on sale of investment Less: Loss on sale of investments III. profit on revaluation of investments Less: Loss on revaluation of investments IV. Profit on sale of land, Building and other assets Less: Loss on sale of Land, Building and other assets V. Profit on Exchanges transactions Less: Loss on Exchanges transactions VI. Income earned by way of dividends etc. from subsidiaries/ Companies and or joint venture abroad/ in India VII. Miscellaneous Income	 xxx xxx xxx xxx xxx xxx xxx xxx xxx	 xxx xxx xxx xxx xxx xxx	
		xxx	

Schedule 15: Interest Expended

	Year ended on 31.3... (current year) Rs. in '000	Year ended 31.3..... (previous year) Rs. in '000
I. Interest on Deposit II. Interest on RBI/ Inter-bank Borrowing III. Others	xxx xxx xxx	
	xxx	

Schedule 16 : Operating Expenses

	Year ended on 31.3... (current year) Rs. in '000	Year ended 31.3..... (previous year) Rs. in '000
1. Payments to and provisions for employees 2. Rent, taxes and lighting 3. Printing and Stationery 4. Advertisement and Publicity 5. Depreciation of bank's property 6. Director's fees, allowances and expenses 7. Auditors fees, allowances and expenses 8. Law charges 9. Postages, telegrams, telephones, etc. 10. Repairs & Maintenance 11. Insurance 12. Other expenditure	xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx	xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx
Total	xxx	xxx

Profit and loss account

Illustration 1:

From the following particulars, prepare a profit and loss A/c of new bank Ltd., for the year ended 31.12.1996.

	Rs. (in 000)		Rs. (in '000)
Interest on loans	260	Interest on cash credits	225
Interest on fixed deposits	280	Rent and taxes	20
Rebate on bills discounted	50	Interest on overdrafts	56
Commission charged to customers	9	Directors and auditors fees	4
Establishment expenses	56	Interest on savings bank accounts	70
Discount on bills discounted	200	Postage and telegrams	2
		Sundry charges	2

Interest on current accounts	45		
Printing and advertisements	3		

Solution:New Bank Ltd.

Profit and loss Account for the year ended 31.12.96

	Schedule No.	Year ended 31.12.96 (Current year) Rs. (in '000)	Year ended 31.12.95 (Previous year) Rs. (in'000)
I. Income Interest earned Other income	 13 14	 741 9	
Total		750	
II. Expenditure Interest expended Operating expenses Provisions and contingencies	 15 16	 395 87	
Total		482	
III. Profit / Loss: Net profit for the year (I-II) Profit brought forward		 268 -	
Total		268	
IV. Appropriations: Transfer to statutory reserve (25% of 268) Transfer to other reserves Transfer to Government/ proposed dividend Balance carried over to balance sheet	 -	 67 - 201	
		268	

Note: Transfer to statutory reserve is now increased to 25% of Net profit from the earlier 20%.

Working notes:Schedule 13 : Interest earned

	Rs. (in '000)
Interest on loans Discount on bills discounted Interest on cash credits Interest on over drafts	260 200 225 56
Total	741

Note: Rebate on bills is the closing rebate and it will be shown in schedule 5 in balance sheet.

Schedule 14 : Other Income

	Rs. (in '000)
Commission charged to customers	9
	9

Schedule 15 : Interest expended

	Rs. (in '000)
Interest on fixed deposits Interest on current accounts	280 45

Interest on saving bank accounts	70
	395

Schedule 16 : Operating expenses

	Rs. (in '000)
Establishment expenses Printing and advertisements Rent and Rates Director's and Auditors fees Postages & Telegrams Sundry charges	56 3 20 4 2 2
	87

Illustration 2

From the following information relating to Lakshmi Bank Ltd., prepare the Profit & Loss a/c for the year ended 31st December, 1987.

	Rs.		Rs.
Rent received	72,000	Salaries and allowances	2,18,000
Exchange and commission	32,800	Postages	
		Sundry charges	5,600
Interest on fixed deposits	11,00,000	Directors & Auditors fees	4,000
Interest on saving bank A/cs	2,72,000	Printing	16,800
		Law charges	8,000
Interest on overdrafts	2,16,000	Locker rent	3,600
Discount on bills discounted	7,80,000	Transfer fees	1,400
		Interest on loan	2,800
Interest on current accounts	1,68,000		10,36,000
Interest on cash credits	8,92,000		
Depreciation on bank propert	20,000		

Solution:The Lakshmi Bank Ltd.

Profit and loss Account for the year ended 31.12.1987

	Schedule No.	Year ended 31.12.95 (Previous year) Rs. (in'000)
I. Income Interest earned Other income	 13 14	 29,24,000 1,09,000
Total		30,33,000
II. Expenditure Interest expended Operating expenses Provisions and contingencies	 15 16	 15,40,000 2,76,800 -
Total		18,16,800
III. Profit / Loss: Net profit for the year (I-II) Profit brought forward	 	 12,16,200
Total		12,16,200

IV. Appropriations: Transfer to statutory reserve (25% of Net profit) Transfer to other reserves Transfer to Government/ proposed dividend Balance carried over to balance sheet		304,050 - - 9,12,150
		12,16,200

Note: Transfer to statutory reserve has been increased to 25% recently.

Working notes:Schedule 13 : Interest earned

	Rs.
Interest on overdrafts Discount on bills discounted Interest on cash credits Interest on loans	2,16,000 7,80,000 8,92,000 10,36,000
Total	29,24,000

Schedule 14 : Other Income

	Rs.
Locker rent Transfer fees Exchange and commission Rent	1,400 2,800 32,800 72,000
	1,09,000

Schedule 15 : Interest expended

	Rs.
Interest on fixed deposits Interest on saving bank accounts Interest on current A/cs	11,00,000 2,72,000 1,68,000
	15,40,000

Schedule 16 : Operating expenses

	Rs.
Depreciation on bank property Salaries and allowances Postage Sundry charges Directors and Auditors fees Printing Law charges	20,000 2,18,000 5,600 4,000 16,800 8,000 3,600
	2,76,800

Balance sheet

The balance sheet of a banking company has to be prepared in Form 'A' of Schedule III attached to the Bank Regulation Act 1949. Form 'A' is reproduced as follows:

From A

From at Balance Sheet

Balance Sheet of .... (here enter name of the banking company) as on 31.3. (year)

	Schedule No.	**As on 31.3..... (current year)**	**As on 31.3...(previous year) Rs.**

		Rs.	
Capital and liabilities: Capital Reserve and surplus Deposits Borrowings Other liabilities and provisions	 1 2 3 4 5		
Total			
Assets Cash and balance with RBI Balance with banks and money at call and short notice Investment Advance Fixed assets Other assets	 6 7 8 9 10 11		
Total			
Contingent liabilities Bills for collection	12		

Schedule 1: Capital

	As on 31.3..... (current year) Rs.	As on 31.3...(previous year) Rs.
I. For Nationalised banks: Capital (fully owned by central Govt.)		
Total		
II. For banks incorporated outside India Capital i) (The amount bought in by banks by way of start-up capital as prescribed by RBI should be shown under this head) ii) Amount of deposit kept with the RBI under section 11 (12) of the banking Regulation Act. 1949.		
Total		
(iii) For other banks Authorised capital (shares of Rs.... each) Issued capital (shares of Rs... each) Subscribed capital (shares of Rs ... each) Called up capital (shares of Rs... each) Less: Calls unpaid Add: Forfeited shares		

Schedule 2: Reserve and surplus

	As on 31.3..... (current year Rs.	As on 31.3...(previous year) Rs.
(i) Statutory Reserve		

Opening Balance Additions during the year Deductions during the year (ii) Capital Reserve Opening balance Additions during the year Deductions during the year (iii) Share premium Opening balances Additions during the year Deductions during the year (iv) Revenue and other Reserves Opening Balance Additions during the year Deduction during the year (v) Balance in Profit and loss account		
Total (i, ii, iii, iv & v)		

Schedule 3 : Deposits

	As on 31.3..... (current year) Rs.	**As on 31.3...(previous year) Rs.**
A. I. Demand Deposits (i) From Banks (ii) From others II. Savings bank deposits III. Term deposits (i) From banks (ii) From others		
Total (I, II and III)		
B. (i) Deposits of branches in India (ii) Deposits of branches outside India		
Total		

Schedule 4: Borrowings

	As on 31.3..... (current year) Rs.	**As on 31.3...(previous year) Rs.**
I. Borrowing in India (i) Reserve Bank of India (ii) Other banks (iii) Other institutions and agencies II. Borrowings outside India Total (I & II)		
Secured borrowing included in I and II above Rs.		

Schedule : 5 Liabilities and Provisions

	As on 31.3..... (current year) Rs.	**As on 31.3...(previous year) Rs.**
i. Bills payable ii. Inter-office adjustment (net) iii. Interest accrued		

iv. Other (including provisions)		
Total		

Schedule 6 : Cash and Balance with Reserve Bank of India

	As on 31.3.....(current year) Rs.	**As on 31.3...(previous year) Rs.**
I. cash in hand (including foreign currency notes) II. Balances with Reserve Bank of India (i) In Current account (ii) In other accounts		
Total (I and II)		

Schedule 7 : Balances with banks and money at call and short notice

	As on 31.3..... (current year) Rs.	**As on 31.3...(previous year) Rs.**
I. In India (i) Balance with banks (a) In current accounts (b) In other deposit accounts (ii) Money at all and short notice (a) With banks (b) With other institutions		
Total (I and II)		
II. Outside India (i) In current accounts (ii) In other deposit accounts (iii) Money at call and short notice Total (I, II & III) Grand total (I and II)		

Schedule 8 : Investment

	As on 31.3..... (current year) Rs.	**As on 31.3...(previous year) Rs.**
I. Investments in India in (i) Government securities (ii) Other approved securities (iii) Shares (iv) Debentures and bond (v) Subsidiaries and/or joint ventures (vi) Other investments (to be specified		
Total		
II. Investment outside India in (i) Government securities (including local authorities) (ii) Subsidiaries and/or joint venture abroad (iii) Other investments (to be specified)		

Total Grand total (I and II)		

Schedule 9 : Advances

	As on 31.3..... (current year) Rs.	As on 31.3...(previous year) Rs.
A. (i) Bills purchases and discounted (ii) Cash credits overdraft and loans (iii) Term loans		
Total		
B. (i) Secured by tangible assets (ii) Covered by bank/ Government guarantee (iii) Unsecured		
Total		
C. I. Advances in India (i) Priority sectors (ii) Public sectors (iii) Banks (iv) others		
Total		
II. Advance outside India (i) Due from banks (ii) Due from others (a) Bills purchased and Discounted (b) Syndicated loans (c) Others		
Total Grand Total (I and II)		

Schedule 10 : Fixed Assets

	As on 31.3..... (current year) Rs.	As on 31.3...(previous year) Rs.
I. Premises At cost on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date II. Other Fixed assets (including furniture and fixtures) At cost as on 31st March at the preceding year Additions during the year Deductions during the year Depreciation to date		
Total (I and II)		

Schedule 11 : Other Assets

	As on 31.3..... (current year)	As on 31.3...(previous

	Rs.	**year) Rs.**
I. Inter-office adjustments (net) II. Interest accrued III. Tax paid in advance/ tax deducted at source IV. Stationery and stamps V. Non banking assets acquired in satisfaction of claims VI. Others		
Total		

(a) In case there is any unadjusted balance of loss, the same may be shown under item with appropriate foot note.

Schedule 12 : Contingent Liabilities

	As on 31.3..... (current year) Rs.	**As on 31.3...(previous year) Rs.**
I. Claims against the bank not acknowledged as debts II. Liabilities for partly paid investment III. Liabilities on account of outstanding forward exchange contracts IV. Guarantees given on behalf of constituents (a) India (b) Outside India V. Acceptance endorsements and other obligations VI. Other items for which the bank is contingently liable		
Total		

Illustration 1

On 31st December 1986. The following balances stood in the books of Asian Bank Ltd., after preparation of its profit and Loss account.

Share capital	Rs. (in ‘000)
Issued and subscribed	4,000
Reserve fund (under section 17)	6,200
Fixed deposits	42,600
Savings bank deposit	19,000
Current accounts	23,200
Money at call and short notice	1,800
Investment	25,000
Profit and Loss Account(cr) 1st Jan 1986	1,350
Dividend for 1985	400
Premises	2,950
Cash in hand	380
Cash in RBI	10,000
Cash with other Banks	6,000
Bills discounted and purchased	3,800
Loans, cash credits and over drafts	51,000
Bills payable	70

Unclaimed dividend Rebate on bills discounted Short loans(borrowing from other banks) Furniture Other assets Net profit for 1986	60 50 4,750 1,164 336 1,550

Prepare balance sheet of the bank as on 31st December 1986.

Solution:Asian Bank Ltd.

Balance Sheet as on 31.12.1986

	Schedule No.	As on 31.12.86 (Rs. in '000')
Capital and liabilities		
Capital	1	4,000
Reserve & Surplus	2	8,700
Deposits	3	84,800
Borrowings	4	4,750
Other Liabilities & Provision	5	180
		1,02,430
Assets:		
Cash and balance	6	10,300
Balance with Banks & Money at call and short notice	7	7,800
Investment	8	25,000
Advances	9	54,800
Fixed assets	10	4,114
Other assets	11	336
		1,02,430
Contingent Liabilities	12	Nil
Bills for collection	-	Nil

Schedule 1 : Capital

Issued and subscribed share capital	4,000

Schedule 2 : Reserve and surplus

Reserve fund		6,200
Profit and loss a/c (1.1.86)	1,350	
Less: Dividend for 1985	400	
950.0		
Add: Net profit for 1980 after deducting statutory reserve (15,50,000 – (15,50,000 x 25%)) 1162.5		2,112.5
Statutory reserve		387.5
		8,700

Note: Transfer to statutory reserve now is at 25% of Net profit.

Schedule 3: Deposits

Fixed deposits	42,000
Savings bank deposits	19,000
Current accounts	23,200
	84,800

Schedule4 : Borrowings

Short loans	4,750

Schedule5 : Other liabilities and provisions

Bills payable	70
Unclaimed dividend	60

Rebate on bills discounted	50
	180

Schedule6 : Cash and balances with RBI

Cash in hand Cash in RBI	380 10,000
	10,380

Schedule7 : Balance with banks and money at call and short notice

Money at call and short notice Cash with other banks	1800 6000
	7800

Schedule 8: Investment

Investment	25,000

Schedule 9: Advances

Bills discounted and purchased Loans, cash credits and overdrafts	3,800 51,000
	54,800

Schedule 10 : Fixed Assets

Premises Furniture	2,950 1,164
	4,114

Schedule 11: Other assets

Other assets	336
	Nil

Schedule 12 : Contingent liabilities

Bills for collection	Nil

12.5 INSURANCE COMPANY

Insurance is form of contract under which one party agrees in return of a consideration topayanagreedamountofmoneytoanotherpartytocompensateforaloss,damage orsomeuncertainevent.Therearetwotypesofinsurancei.e.,LifeinsuranceandGeneralInsurance.

LifeInsurance– underthistypeofinsurancethecorporationguaranteestopayacertainsumof moneytothepolicyholderonreachingacertainageoronhisdeathwhicheverisearlier.Lifeinsurancehasanelementbothofprotectionandinvestment.

GeneralInsurance– itincludesallothertypesofinsuranceexceptlifeinsurance.e.g.–Fire, Marine,Accident,Theft.etc.Underthistypeofinsurancetheinsurerundertakestoindemnifythelosssufferedbytheinsuredonhappeningofacertaineventinconsiderationforafixedpremium.

InsuranceRegulatoryandDevelopmentAuthority(IRDA)

Inordertoregulatetheinsurancebusiness,thegovernmentsetupin1996,theInsuranceRegulatory Authority(IRA). Now thisauthority is known as the Insurance Regulatory andDevelopmentAuthority.In2002,theauthoritycamewithregulationsforthe preparationofthe financialstatementofinsurancecompanies.

PreparationofFinancialStatements

FinalAccountsofLifeInsuranceCompanies

Thefinalaccountsofalifeinsurancecompanyconsistof(a)RevenueAccount,(b) P&LA/cand(c)BalanceSheet.

RevenueAccount(FormA-RA)

RevenueAccountispreparedasperthe provisionsofIRDAregulations2002and complies with the requirements of schedule A as follows:

Form – A – RA

Name of the insurer
Registration No. and Date of Registration with the IRDA
Revenue account for the year ended 31st March 20…. policy holders Account (Technical Account)

Particulars	Schedule	Current year Rs. '000	Previous year Rs. '000
Premiumsearned–net (a) Premium (b) Reinsurance ceded (c) Reinsurance accepted Incomefrominvestments (a) Interest,dividends &rent–Gross (b) Profitonsale/redemption ofinvestments (c) (Lossonsale/redemption ofinvestments) (d) Transfer/Gainonrevaluation/change infairvalue* Otherincome(tobespecified)Total(A) Commission OperatingExpensesrelatedtoinsurance business ProvisionfordoubtfuldebtsBaddebtswrittenoffProvisionfortaxProvisions(otherthantaxation) (a) Fordiminution inthevalueofinvestments(net) (b) Others(tobespecified)Total(B) BenefitsPaid(Net)InterimBonusespaidChangeinvaluation ofliabilityinrespectoflifepolicies (a) Gross** (b) AmountcededinReinsurance (c) AmountacceptedinReinsurance Total(C) Surplus(Deficit)(D)=(A)-(B)-(C) Appropriations TransfertoShareholders' Account	1 2 3 4		

12.6 Profit and loss account

Combined profit and loss account is prepared for a general insurance company, conducting one or more business.

Operating profit or loss of each kind of business is transferred from revenue account to profit and loss account.

Any incomes not related to specific business are added to the operating profits resulting in "Total A".

Expenses and Losses not connected to any specific business are added up as " Total B" and it is subtracted from "Total A" it ascertain profit before tax.

After providing for tax and making appropriations for dividend and transfer to reserves, balance of profit is added to the balance brought forward from previous year. The Net balance of profit or loss is transferred to balance sheet.

Balance sheet

Balance sheet is a summarised presentation of schedules 5 to 15.

It contains sources of funds which is the Total of schedules 5,6,7 representing share capital, reserves and surplus and borrowings respectively.

Application of Funds is arrived at by adding up investments, Loan, Fixed assets representing schedules 8, 9, 10 respectively and then adding Net current assets to that total. Net current assets is the difference between current assets represented by cash and bank balances (Schedule 11) and advantages and other assets (Schedule 12) and current liabilities and provisions represented by schedules 13 & 14 respectively. Miscellaneous expenditure representing accumulated losses is shown as schedule 15.
Any contingent liabilities are shown as a foot note to the Balance sheet.

FORM B – PL

Name of the insurer:

Registration No. and Date of Registration with the IRDA

Profit and Loss account for the year ended 31st March 20......

Shareholders' Account (Non- technical Account)

No	Particulars	Schedule	Current year (Rs. '000)	Previous year (Rs. '000)
1. 2. 3.	Opening profit /(Loss) (a) Fire Insurance (b) Marine Insurance (c) Miscellaneous Insurance Income from Investments (a) Interest, dividend & rent –gross (b) Profit on sale of investments Less: Loss on sale of investments Other income (To be specified)			
	Total (A)			
4.	Provisions (Other than taxation)			

5.	(a) For diminution in the tax value of Investments (b) For doubtful debts (c) Other (To be specified) Other expenses (a) Expenses other than those related to Insurance business. (b) Bad debts written off (c) Other (To be specified)			
	Total (B)			
	Profit before Tax(A-B) Provisions for taxation			

Appropriations:
(a) Interim dividends paid during the year.
(b) Proposed final dividend
(c) Dividend distribution
(d) Transfer to any reserves or other accounts.
(To be specified)
Balance of profit / loss brought forward from last year.
Balance carried forward to Balance sheet.
Notes: To form B-RA and B-PL.
(a) Premium income received from business concluded in and outside India shall by separately disclosed.
(b) Reinsurance premiums whether on business ceded or accepted are to be brought into account 'gross' (i.e., before deducting commissions) under the head 'Reinsurance premiums'.
(c) Claims incurred shall comprise claims paid specific claims settlement costs where ever applicable and changes in the outstanding provisions for claims at the year end.
(d) Items of expenses and income in excess of one percent of the total premium (less reinsurance) or Rs. 5,00,000 whichever is higher, shall be shown as a separate line time.
(e) Fees and expenses connected with claims shall be included in claims.
(f) Under the sub-head "Other" shall be included items like foreign exchanges gains or losses and others item.
(g) Interest, dividends and rentals receivable in connection with in investment should be stated at gross amount, the amount of income tax deducted at source being included under " advances taxes paid and taxes deducted at source".
(h) Income from rent shall include only the realised rent. It shall not include any 'Notional rent".

FORM B-BS

Name of the Insurer:
Registration No. and Date of Registration with the IRDA

Balance Sheet as at 31st March 20......

Particulars	**Schedule**	**Current year (Rs. '000)**	**Previous year (Rs. '000)**
Source of Funds Share capital	5		

Reserves and surplus	6		
Fair value changes account			
Borrowings	7		
Total			
Application of Funds			
Investments	8		
Loans	9		
Fixed Assets	10		
Current Assets			
Cash and Bank Balances	11		
Advances and other assets	12		
Sub Total (A)			
Current liabilities	13		
Provisions	14		
Sub Total (B)			
Net current assets(c) = (A) – (B)			
Miscellaneous Expenses			
(To the extent not written off or adjusted) Debit Balance in Profit and loss Account	15		
Total			

Illustration 1:

Prepare from the following a life Insurance revenue A/c and balance sheet as on 31.3.2006.

	Rs.		Rs.
Claims by death	16,890	Outstanding interest on	
Agent's salaries &		advances (31.32006)	
allowances	6,420	Bonus paid with claims	1,944
Surrender values paid	2,810	Endowment assurance	
Actuarial expenses	1,520	matured	2,700
Premiums	94,836	Annuities paid	
Commissions to agents	8,900	Interest revenue	24,415
Salaries	13,500	Rent, Rates & Taxes	1,350
Medical fees	1,200	General charges	19,060
Travelling expenses	1,800	Fees received	5,475
Directors fees	900	Bonus paid in cash	1,860
Agents balances	750	Advertisement	172
Claim expenses	1,432	Consideration for	2,825
Premium		annuities	726
outstanding(1.4.2005)	2,134	Printing & Stationary	
Premium		Claims O/S (1.4.05)	12,853
outstanding(31.3.2005)	3,143	Claims O/S (31.3.06)	650
Investment	1,46,700	Loans on policies	2,376
Share capital	2,00,000	Loans on mortgages	3,735
Sundry creditors	9,200	Freehold premises	38,300
Life Assurance fund		Furniture & fittings	2,90,560
(1.4.05)	3,53,672	Cash on hand &	1,22,000
Reserve fund	1,46,000	deposits	64,100
			76,300

Solution:Revenue Account for the ended 31-3-2006

Particulars	**Schedule**	**Current year (Rs. '000)**	**Previous year (Rs. '000)**
Premium earned –Net: Interest revenue Other Incomes (To be specified): Consideration for annuities granted Fees received	1	92,702 19,060 12,853 172	
Total (A)		1,24,787	
Commission Operating expenses related to Insurance Business	2 3	8,900 34,051	
Total (B)		42,951	
Benefits paid (Net):	4	50,046	
Total (C)		50,046	
Surplus (D) = (A) – (B) – (C) **Appropriations:** Transfer to shareholders account Balance beings funds for future appropriations		31,790 - - 31,790	
Total (D)		31,790	

Balance sheet as on 31-3-2006

Particulars	**Schedule**	**Current year (Rs. '000)**	**Previous year (Rs. '000)**
Sources of Funds: Share capital Reserves and surplus Borrowings	 5 6 7	 2,00,000 5,31,462 -	
Total		7,31,462	
Application of Funds: Investments Loans Fixed assets	 8 9 10	 1,46,700 3,28,860 1,86,700	
Total		6,62,260	
Current Assets: Cash and Bank Balances Advances and other assets	 11 12	 76,300 5,837	
Sub-Total (A)		82,137	
Current liabilities Provisions	13 14	12,935 -	
Sub-Total (B)		12,935	
Net current assets (A-B)		69,202	
Total		7,31,462	

(A) Short Answer Questions:

1. What is bank account?
2. What are the Legal requirements?
3. Explain the Insurance company?

(B) Long answer Questions:

1. From the following particulars, prepare a profit and loss A/c of new bank Ltd., for the year ended 31.12.1996.

	Rs. (in 000)		Rs. (in '000)
Interest on loans	260	Interest on cash credits	225
Interest on fixed deposits	280	Rent and taxes	20
Rebate on bills discounted	50	Interest on overdrafts	56
Commission charged to customers	9	Directors and auditors' fees	4
Establishment expenses	56	Interest on savings bank accounts	70
Discount on bills discounted	200	Postage and telegrams	2
Interest on current accounts	45	Sundry charges	2
Printing and advertisements	3		

2. Prepare from the following a life Insurance revenue A/c and balance sheet as on 31.3.2006.

	Rs.		Rs.
Claims by death	16,890	Outstanding interest on advances (31.32006)	
Agent's salaries & allowances	6,420	Bonus paid with claims	1,944
Surrender values paid	2,810	Endowment assurance matured	2,700
Actuarial expenses	1,520	Annuities paid	
Premiums	94,836	Interest revenue	24,415
Commissions to agents	8,900	Rent, Rates & Taxes	1,350
Salaries	13,500	General charges	19,060
Medical fees	1,200	Fees received	5,475
Travelling expenses	1,800	Bonus paid in cash	1,860
Directors fees	900	Advertisement	172
Agents balances	750	Consideration for	2,825
Claim expenses	1,432	annuities	726
Premium outstanding(1.4.2005)	2,134	Printing & Stationary	
Premium outstanding(31.3.2005)	3,143	Claims O/S (1.4.05)	12,853
		Claims O/S (31.3.06)	650
Investment	1,46,700	Loans on policies	2,376
Share capital	2,00,000	Loans on mortgages	3,735
Sundry creditors	9,200	Freehold premises	38,300
Life Assurance fund (1.4.05)	3,53,672	Furniture & fittings	2,90,560
Reserve fund	1,46,000	Cash on hand &	1,22,000
		deposits	64,100
			76,300

UNIT XIII INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Structure

INTRODUCTION

International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent, not-for-profit organization called the International Accounting Standards Board (IASB). The goal of IFRS is to provide a global framework for how public companies prepare and disclose their financial statements. IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting. Having an international standard is especially important for large companies that have subsidiaries in different countries. Adopting a single set of world-wide standards will simplify accounting procedures by allowing a company to use one reporting language throughout. A single standard will also provide investors and auditors with a cohesive view of finances. Currently, over 100 countries permit or require IFRS for public companies, with more countries expected to transition to IFRS by 2015. Proponents of IFRS as an international standard maintain that the cost of implementing IFRS could be offset by the potential for compliance to improve credit ratings.IFRS is sometimes confused with IAS (International Accounting Standards), which are older standards that IFRS has replaced.

13.1 MEANING

International Financial Reporting Standards (IFRS) set common rules so that financial statements can be consistent, transparent and comparable around the world. IFRS are issued by the International Accounting Standards Board (IASB). They specify how companies must maintain and report their accounts, defining types of transactions and other events with financial impact. IFRS were established to create a common accounting language, so that businesses and their financial statements can be consistent and reliable from company to company and country to country.

13.2 UNDERSTANDING INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

IFRS are designed to bring consistency to accounting language, practices and statements, and to help businesses and investors make educated financial analyses and decisions. The IFRS Foundation sets the standards to “bring transparency, accountability and efficiency to financial markets around the world fostering trust, growth and long-term financial stability in the global economy.” Companies benefit from the IFRS because investors are more likely to put money into a company if the company's business practices are transparent.

The U.S. Securities and Exchange Commission (SEC) has said it won't switch to International Financial Reporting Standards, but will continue reviewing a proposal to allow IFRS information to supplement U.S. financial filings. GAAP has been called "the gold standard" of accounting. However, some argue that global adoption of IFRS would save money on duplicative accounting work, and the costs of analyzing and comparing companies internationally.

IFRS are sometimes confused with International Accounting Standards (IAS), which are the older standards that IFRS replaced. IAS was issued from 1973 to 2000, and the International Accounting Standards Board (IASB) replaced the International Accounting Standards Committee (IASC) in 2001.

13.3 STANDARD IFRS REQUIREMENTS

IFRS covers a wide range of accounting activities. There are certain aspects of business practice for which IFRS set mandatory rules.

- Statement of Financial Position: This is also known as a balance sheet. IFRS influences the ways in which the components of a balance sheet are reported.
- Statement of Comprehensive Income: This can take the form of one statement, or it can be separated into a profit and loss statement and a statement of other income, including property and equipment.
- Statement of Changes in Equity: Also known as a statement of retained earnings, this documents the company's change in earnings or profit for the given financial period.
- Statement of Cash Flow: This report summarizes the company's financial transactions in the given period, separating cash flow into Operations, Investing, and Financing.

In addition to these basic reports, a company must also give a summary of its accounting policies. The full report is often seen side by side with the previous report, to show the changes in profit and loss. A parent company must create separate account reports for each of its subsidiary companies.

13.4 IFRS VS AMERICAN STANDARDS

Differences exist between IFRS and other countries' Generally Accepted Accounting Principles (GAAP) that affect the way a financial ratio is calculated. For example, IFRS is not as strict on defining revenue and allow companies to report revenue sooner, so consequently, a balance sheet under this system might show a higher stream of revenue than GAAP's. IFRS also has different requirements for expenses; for example, if a company is spending money on development or an investment for the future, it doesn't necessarily have to be reported as an expense (it can be capitalized).

Another difference between IFRS and GAAP is the specification of the way inventory is accounted for. There are two ways to keep track of this, first in first out (FIFO) and last in first out (LIFO). FIFO means that the most recent inventory is left unsold until older inventory is sold; LIFO means that the most recent inventory is the first to be sold. IFRS prohibits LIFO, while American standards and others allow participants to freely use either.

13.5 INTERNATIONAL FINANCIAL REPORTING STANDARDS - ADVANTAGES & DISADVANTAGES

As the business world becomes closer in its financial and trade ties, many countries are moving towards International Financial Reporting Standards (IFRS), common accounting rules that define how transactions should be reported and what information should be disclosed in financial statements. This unitary set of standards has solved many problems while creating others.

Advantage:

(i) Greater Comparability

Companies that use the same standards to prepare their financial statements can be compared to each other more accurately. This is especially important when comparing companies located in different countries, as they might otherwise be using different rules and methodologies to prepare their statements. This increase in comparability has helped investors better determine where their investment dollars should go.

(ii) More Flexibility

IFRS uses a principles-based, rather than rules-based, philosophy. A principles-based philosophy means that the goal of each standard is to arrive at a reasonable valuation and that there are many ways to get there. This gives companies the freedom to adapt IFRS to their particular situation, which leads to more easily read and useful statements.

Disadvantage:

(i) Not Globally Accepted

The United States has not yet adopted International Financial Reporting Standards and other countries continue to hold out as well. This makes accounting by foreign-based companies that do business in America difficult as they often have to prepare financial statements using IFRS and another set using American Generally Accepted Accounting Principles.

(ii) Standards Manipulation

There is a downside to the flexibility that IFRS allows: companies can utilize only the methods they wish to, allowing the financial statements to show only desired results. This can lead to revenue or profit manipulation, can be used to hide financial problems in the company and can even encourage fraud. For example, changing the method of inventory valuation can bring more income into the current year's profit and loss statement, making the company appear more profitable than it really is.

While IFRS requires that changes to the application of the rules must be justifiable, it is often possible for companies to "invent" reasons for making the changes. Stricter rules would ensure that all companies are valuing their statements the same way.

(iii) Increased Costs

A small company would be impacted by a country's adoption of IFRS in the same way a larger one would. However, small businesses do not have as many resources at their disposal to implement the changes and train staff. This results in smaller companies bringing in accountants or other outside consultants to help make the changeover. These smaller companies will bear more of a financial burden than larger ones in this area.

A. Short answer

1. What are International Financial Reporting Standards (IFRS)?
2. What is Greater Comparability?
3. Explain the increased cost?

B. Long answer

1. Difference between IFRS vs American Accounting Standards.
2. Explain the international financial reporting standards - advantages & disadvantages.

UNIT XIV - HUMAN RESOURCE ACCOUNTING

Structure

INTRODUCTION

Human Resources are the most valuable resources of any organisation. The success or failure of an organisation mainly depends on the quality, calibre and character of the people who are employed in the organisation. Different organisations employ different classes of workers according to the requirements of the job/ work. In educational institutions, teachers, who put in a lot of hard work, are responsible for the overall development of the students. But, their hand work and efforts are not assigned any monetary value and not shown anywhere in the balance sheet of the concerned educational institution. Similarly, in corporate sector, the directors, considered as the pillars of the company, are responsible to make any vital decisions on various aspects so as to enhance the earning capacity of the company. The potential investors are willing to invest their hard earned money in those companies where eminent directors are present. Unfortunately, the contributions of directors towards development of company are not accounted are not given a place in this balance sheet of the company. Even in Indian history, the contributions of great leaders like Mahatma Gandhi, sardar vallabhbhaipatel and jawaharalal Nehru cannot be forgotten in the freedom movement of India. But no one made efforts to assign any monetary value to such individuals in the balance sheet of the nation. So, human elements are completely ignored while recording the transactions in the books of accounts. Unless the efforts and contributions of people are measured in terms of money, it is not possible to understand the real value of human beings present in the organisation. In order to ascertain the value of human beings, a new system of accounting had been evolved which is popularly known as "Human Resource Accounting"(HRA)

14.1 MEANING HRA

HRA refers to accounting for people as an 'Organisational resource'. It involves measuring the costs incurred by business firms and other organisations to recruit, select, hire, train, and develop 'human assets'. It also includes measuring the economic value of people to organisation. It serves both the internal and external users, providing management (inter users), with relevant data on which to base recruiting training and other development decisions and supplying investors, lenders and other external users of financial statements with information concerning the investment in and utilisation of human resources in the organisation.

DEFINITIONSOF HRA

(i) Woodriff, "HRA is an attempt to identify and report investments made in human resources of an organisation that are presently not accounted for in conventional accounting practice. Basically, it is an information system that tells the management what changes over time are occurring to the human resources of the business".

(ii) The American Accounting Association's Committee, "HRA is the process of identifying and measuring data about human resources and communicating this information to interested parties".

(iii) Stephen Knauf, "HRA is the measurement and quantification of human organisational inputs such as recruiting, training, experience and communication.

Objectives of Human Resources Accounting

Some of the objectives that HR accounting should fulfil include:

1. Help in monitoring the utilization of human resources
2. Help in decision making and implementation of management principles by showing the financial significances of various choices and practices
3. Aid in human assets analysis
4. To furnish decision makers with cost value information so that decision about acquiring, developing, and training as well as maintaining of human assets can be cost-effective

14.2 Methods of Human Resource Accounting

Scholars have been developing methods of calculating an employee's worth to a company since late 17th century. Several methods have been in use but they all fall under either cost approach or value approach.

1.Cost approach

Under cost approach, we have two methods:

1. **The acquisition cost model –** this method involves capitalizing the costs of human recruitment in the balance sheet as opposed to charging it in the P&L statements. The process of value determination involves amortizing the amount capitalized over a time span, such as from when an employee is employed to when he/she retires.
2. **Replacement cost approach** – this method considers the cost incurred in replacing an employee. It factors in expenses such as recruitment, compensation, selection and teaching costs. This method can be used to determine whether to replace or dismiss the worker.

2. Value approach

There are a few approaches under this method.

1. **Present value(worth) of later earnings** – this method determines how valuable a worker's future input is today
2. **Value to the organization** – top talents may be fought over by different departments in the same company. The department that has the highest bid should get the employee, and that highest bid is the value of the employee, to be integrated into that department's investment base.
3. **Expense model** – this model divides employees into two categories: those that make executive strategic decisions and those who execute those decisions. It then determines the value of an employee by working the: real capital cost, performance assessment and current worth of forthcoming wages and salary payments.

Advantages of Human Resource Accounting:

Many organizations, particularly in the USA, are following the human resource accounting approach. In our country, too, there is a need for establishing systems which can generate monetary and non – monetary information about human beings in the organizations, particularly about managerial talents whose dearth is felt by business organization.

This is due to the fact that human resource accounting offers following advantages:

1. It helps in giving valuable information to the management for effective planning and managing human resources.
2. It helps in measurement of standard cost of recruiting, selecting, hiring and training people and organization can select a person with highest expected realizable values.
3. Human resource accounting can change the attitude of managers completely, thereby, they would try to maximize the expected value of human resources and effective use of human resources in the organization.
4. It also provides necessary data to devise suitable promotion policy congenial work environment and job satisfaction to the people.

Problems in Human Resource Accounting:

There are certain operational problems in human accounting because it attempts to measure intangibles. Therefore, subjective factors may play crucial role.

Thus, the major operational problems involved in human resource accounting are of the following types:

1. There is no well-set standard accounting practice for measuring the Value of human resources. In the case of financial accounting, there are certain specified standards which every organization follows. However, in the case of human resource accounting, there are no such standards.Therefore, various organizations that adopt human asset valuation use their own models. With the result, value of human assets of two organizations may not be comparable.
2. The valuation of human assets is based on the assumption that the Employees may remain with the organization for certain specified period. However, this assumption may not hold true in today’s context because of increased human resource mobility.
3. There is a possibility that human resource accounting may leas to the dehumanization in the organization if the valuation is not done correctly or results of the valuation are not utilized properly.
4. There is also a possibility that trade unions may oppose the use of human resource accounting. They may want parity of wages/ salaries and value of employees.

14.3 Principles of Government accounting

There are many principles of Human Resources. Here are eight of them to understand and apply appropriately to make HR practices transparent and relevant for the future.

1. Recruitment to retirement.

HR is all about dealing with employees from recruitment to retirement. It includes manpower planning, selection, training and development, placement, wage and salary administration, promotion, transfer, separation, performance appraisal, grievance handling, welfare administration, job evaluation and merit rating, and exit interview. Precisely, it deals with planning, organizing, staffing, directing, and controlling of people.

2. People (men) behind the machine count.

Previously, it was the machine behind the man that counted. Today, people are the real power to drive organizations forward. Machines only assist people. Ultimately, the machine is servant to men, not the other way around.

3. Hire for attitude, recruit for skills.

Attitude is the key to employee engagement and success. Hence, HR leaders must emphasize attitude rather than experience. It is better to hire a new job seeker with high attitude and no experience than one with a rotten attitude and years of experience. If employees possess a good attitude, they will have the ability absorb the knowledge, skills, and abilities that are essential to perform their tasks effectively in the workplace.

4. Appreciate attitude but respect intelligence.

It is true that both attitude and intelligence are essential to improve the organizational bottom line. If HR leaders find it is tough to get both, they should choose attitude over intelligence as it helps accomplish organizational goals and objectives.

5. Hire slow, fire fast.

HR leaders must be slow in hiring the right talent for their organizations. They must look for the right mindset, skill set, and tool set in job seekers during recruitment. If they find that bad apples entered into their basket, they must be removed quickly to contain further damage to their organizations.

6. Shed complexity, wed simplicity.

People today prefer to work in flat organizations rather than tall ones. Tall organizations often have hierarchies with a bureaucratic mindset that doesn’t work in the present context. Gen Yers are happy to work with partners rather than with bosses. So shed complexity and wed simplicity to achieve organizational excellence and effectiveness.

7. HR leaders are king and queen makers.

Presently, there is an impression globally that HR leaders are king and queen makers. They cannot become kings and queens. They are perceived as people who become ladders for others to climb to higher positions. It is due to the roles and responsibilities they undertake. HR leaders are masters of their trades, not jacks of other trades. They know everything about HR, but they don’t necessarily know much about other aspects in the organization. CEOs are masters in their own domains and jacks of other domains. They are masters in their areas and know something about others areas. Thus, HR leaders must acquire knowledge about other areas and acquire technical and business acumen to become kings and queens—the chief executives.

8. To serve is to lead and live.

Mahatma Gandhi once remarked, “The best way to find yourself is to lose yourself in the service of others.” HR leaders must serve people with pleasure without any pressure. They must become torchbearers of human capital and knowledge. They must learn, unlearn, and relearn to stay relevant.

(A) Short answer:

1. What is Human Resource accounting?
2. Define: Human Resource accounting?
3. What are the values of the organisation?

(B) Long answer:

1. Explain the HRA.
2. What are advantages and disadvantages of HRA?
3. Explain the Methods of HRA.

DISTANCE EDUCATION – CBCS – (2018 – 2019 Academic Year Onwards) Question Paper Pattern – Accounting (UG Programs)

Time: 3 Hours
Maximum: 75 Marks

Part – A (10 x 2 = 20 Marks)

Answer all questions

1.What is share?

2. What are divisible profits?

3. What is capitalexpenditure? Give two examples.

4. What do you understand by purchase consideration?

5.Write a short note on depreciation.

6. What is profit prior to incorporation?

7. What is meant by deficiency account?

8. Define internal reconstruction

9.Define holding company.

10.Explain the termliquidation.

Part – B (5 x 5 = 25 Marks)

Answer all questions choosing either (A) or (B)

11. (A) Define a Company. State at least four characteristics of company.

(or)

(B) Briefly explain the types of preference shares.

12. (A) The following underwriting of shares takes place:

A – 6,000 shares; B – 2,500; C – 1,500 shares

The issue consists of 10,000 shares. The total subscription was 7,100 shares and the forms included the following marked Forms:

A – 1000 shares; B – 2,000 shares; C – 500 shares.

Show the allocation of liability of underwriters.

(or)

(B) Amutha company decided to purchase a business. Its profit for the last 5 years are: 2003 – Rs. 25,000; 2004 – Rs. 35,000; 2005- Rs. 31,000; 2006 – Rs. 37,000; 2007 – Rs. 42,000. The reasonable remuneration of the proprietor of the business is Rs. 6,000 p.a., but it has not been taken into accountfor calculation of above-mentioned profit. Calculate goodwill on the basis of three years purchase of the average profit.

13. (A) The capital contributed byA, B&C partnership firm at the date of purchase by the Limited company were Rs. 20,000 Rs. 12,000 Rs. 10,000. The partnershipfirm wasconverted into a limited company and assets and liabilities were sold to the company agreed to pay Rs. 8,000 more than the book value and machinerywhich was taken at Rs. 1,000 less than the book value.Compute Purchase Consideration.

(or)

(B) SUN Ltd. passed resolution and received sanction of the court forthe reduction of share capital by Rs. 2.50.000. After the arrangement, the credit balance of capital reduction account was Rs. 2,50,000. The amount available was utilized for write off Profit and Loss a/c (Dr.) 1,05,000, reducing thevalue of Plant and Machinery Rs. 45,000, Goodwill Rs. 20,000, InvestmentRs. 40,000. The balance available would be transferred to Capital Reserve. Pass Journal entries.

14. (A)A liquidator of a company in voluntary liquidation is entitled to a remuneration of 3% on the amounts realised (excluding the cash on hand) and T 2% on the amounts distributed to the unsecured creditors. Unsecured creditors including preferential creditors of Rs. 5,000 amounted to Rs. 40,000. Debenture holders were paid Rs. 51,875 together with interest. Preferential creditors were paid in full, Rs. 510 were spent as costs of liquidation. Cash on hand Rs. 1,000 and assets realised Rs. 79,000. Find out liquidator's total remuneration.

(or)

(B). On 1st July 2007 the balance sheet of John Ltd. was as under:

Liability	Rs.	Assets	Rs.
Authorities and issued capital: 3,000 6% cumulative pref. shares of Rs. 25 each fully paid 8,000 equity shares of Rs. 50 each fully paid 6% Debentures Creditors	 75,000 4,00,000 50,000 25,000	Goodwill Sundry assets Cash Profit & Loss a/c	1,00,000 2,50,000 10,000 1,90,000
	5,50,000		5,50,000

Preference dividends were in arrears for two years. A scheme of reconstruction agreed upon was as under:

i) A new company to formed, called Johnson Ltd. with an authorised capital of Rs. 5,00,000 all in equity shares of Rs. 100each.
ii) One equity share of Rs. 100 each fully paid in the new company to be issued in exchange of 3 preference shares in old company.
iii) On equity share of Rs. 100 each fully paid in the new company to be exchanged for 4 equity shares in the old company.
iv) Arrears of preference dividends to be cancelled.
v) Debenture holders to receive 50 equity shares in the new company as fully paid.
vi) Creditors to be taken over by the new company and immediately paid off.

vii) The new company to issue remaining equity shares for public subscription.
viii) The new company to take over old company's assets, subject to revaluation of sundry assets at Rs. 2,65,000.
Prepare the necessary ledger accounts in the books of John Ltd. and open the books of the new company of means of Journal entries, if the public subscription was fully responded.

15. (A) What are the differences betweenIFRSAmerican Accounting Standards?

(or)

(B) What are the principles of Government Accounting?

Part – C (3 x 10 = 30 Marks)

Answer any threeout of five questions

16. Shakura Ltd. invited the public to subscribe 10,000 equity shares of Rs. 100 each at a premium of Rs. 10 per share. Payment was to be made as follows: On application Rs. 20; on allotment Rs. 40 (including premium); on first call Rs. 30; on final call Rs. 20. Applications totaled for 13,000 shares; applications for 2,000 shares were rejected and allotment was made proportionately to the remaining applications. The directors made both the calls and all the moneys were received except the final call on 300 shares which were forfeited. Later 200 of these forfeited shares were issued as fully paid @ Rs. 85 per share.

Journalize these transactions including cash transactions.

17. The following is the Balance Sheet of EX. Ltd. As on December 31, 2007

Liabilities	**Rs**	**Assets**	**Rs**
3,000 Equity shares capital of Rs. 100 each	3,00,000	Cash in hand Cash at Bank	2,000 20,000
1,500 8% Preference share capital of Rs. 100 each	150,000	Sundry Debtors	80,000
General Reserve a/c	40,000	Stock in Trade	1,40,000
Profit & Loss A/c	10,000	Land& Building	2,05,000
Bank loan a/c	50,000	Furniture	30,000
Sundry Creditors A/C	15,000	Goodwill	70,000
		Discounton Shares	18,000
	5,65,000		5,65,000

The value of assets is assessed as follows:

i) Furniture to be depreciated at 10%

ii) Value of stock in trade, land and building and goodwill is estimated at Rs.1,20,000 Rs. 2,50,000 and Rs. 80,000 respectively

iii) Debtors are expected to realize80% of book value.

Find out the value of equity share.

18.. Moon Ltd. went into liquidation with following liabilities:
Secured creditors Rs. 88,000 (Securities realized Rs. 18,000)
Preferential Creditors Rs. 600
Unsecured Creditors Rs. 20,200
Liquidation expenses amounted to Rs. 1200. He is entitled to a remuneration of 3% on the amounts realized (including securities with creditors) and 2 ½% on the amount paid to unsecured creditors. The various assets (excluding securities with creditors) realized amounted to Rs. 96,000.Prepare the liquidator's final statement of account.

19. Briefly explain the term Responsibility Accounting.

20. Authorized capital of Z Ltd is Rs. 5,00,000 (50,000 shares of Rs. 10 each) on
31.12.2006. 25,000 shares were fully called up. On 31.12.2006, the following
balances taken from the ledger of the company.

Particulars	Rs.	Particulars	Rs.
Opening stock	50,000	Bonus	10,500
Sales	4,25,000	Sundry debtors	38,700
Purchases	3,00,000	Sundry creditors	35,200
Wages	70,000	Plant &Machine	80,000
Discount allowed	4,200	Furniture	17,100
Discount received	3,150	Cash and bank	1,34,000
Insurance (paid up to 31.3.07)	6,720	Reserve	25,000
Salaries	18,500	Loan for M. D	15,700
Rent	6,000	Bad debts	3,200
General expenses	8,950	Calls in arrears	5,000
Printing and stationary	2,400	P and L a/c (cr.)	6,220
Advertising	3,800		

Additional information's were furnished:
(a) Closings stock Rs. 91,500
(b) Depreciation on plant and machinery, furniture @ 15% and 10% respectively.
(c) Wages salaries and rent outstanding amounts Rs. 5,200 Rs 1,200 and Rs. 600 respectively.
(d) Dividend @ 5% on paid up share capital is to be provided. Prepare final accounts of the company.