BAOU
Education for All

Dr. Babasaheb Ambedkar
Open University
(Established by Government of Gujarat)

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BBA/DBA

SEMESTER - 2

BBACC202

DBACC202

Corporate Accounting

Message for the Students

Dr. Babasaheb Ambedkar Open (University is the only state Open University, established by the Government of Gujarat by the Act No. 14 of 1994 passed by the Gujarat State Legislature; in the memory of the creator of Indian Constitution and Bharat Ratna Dr. Babasaheb Ambedkar. We Stand at the seventh position in terms of establishment of the Open Universities in the country. The University provides as many as 54 courses including various Certificate, Diploma, UG, PG as well as Doctoral to strengthen Higher Education across the state.

On the occasion of the birth anniversary of Babasaheb Ambedkar, the Gujarat government secured a quiet place with the latest convenience for University, and created a building with all the modern amenities named 'Jyotirmay' Parisar. The Board of Management of the University has greatly contributed to the making of the University and will continue to this by all the means.

Education is the perceived capital investment. Education can contribute more to improving the quality of the people. Here I remember the educational philosophy laid down by Shri Swami Vivekananda:

> ***"We want the education by which the character is formed, strength of mind is Increased, the intellect is expand and by which one can stand on one's own feet".***

In order to provide students with qualitative, skill and life oriented education at their threshold. Dr. Babaasaheb Ambedkar Open University is dedicated to this very manifestation of education. The university is incessantly working to provide higher education to the wider mass across the state of Gujarat and prepare them to face day to day challenges and lead their lives with all the capacity for the upliftment of the society in general and the nation in particular.

The university following the core motto 'स्वाध्याय: परमम् तप:' does believe in offering enriched curriculum to the student. The university has come up with lucid material for the better understanding of the students in their concerned subject. With this, the university has widened scope for those students who are not able to continue with their education in regular/conventional mode. In every subject a dedicated term for Self Learning Material comprising of Programme advisory committee members, content writers and content and language reviewers has been formed to cater the needs of the students.

Matching with the pace of the digital world, the university has its own digital platform Omkar-e to provide education through ICT. Very soon, the University going to offer new online Certificate and Diploma programme on various subjects like Yoga, Naturopathy, and Indian Classical Dance etc. would be available as elective also.

With all these efforts, Dr. Babasaheb Ambedkar Open University is in the process of being core centre of Knowledge and Education and we invite you to join hands to this pious *Yajna* and bring the dreams of Dr. Babasaheb Ambedkar of Harmonious Society come true.

Prof. Ami Upadhyay
Vice Chancellor,
Dr. Babasaheb Ambedkar Open University,
Ahmedabad.

Dr. Babasaheb Ambedkar Open University
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BBA/DBA

SEMESTER - 2

BBACC202

DBACC202

CORPORATE ACCOUNTING

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BBA
SEMESTER-2 CORE
CORPORATE ACCOUNTING
BLOCK: 1

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UNIT-1 ACCOUNTING FOR SHARE CAPITAL

1.1 Introduction of Company

1.2 Types of Company

1.3 Types of Shares

1.4 Share Capital

1.5 Important Terminology

1.6 Forfeiture of Share

1.7 Share Premium & Share Discount

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❖ **Exercise**

1.1 Introduction of Company

A company represents the third stage in the evolution of forms of business organizations – the first two being sole-proprietorship and partnership firms. As distinct from these two, a company enjoys a separate legal status. The ownership here is divorced from management. The shareholders contribute towards the finances of the company but all of them do not and cannot participate in the management of the company. The company is managed by the Board of Directors elected by the shareholders. Thus, in the company, which is a form of business organization, a shareholder simply acts as a rentier of capital. Companies in our country are governed by the provisions of the Companies Act, 1956.

Definition of a Company: In the words of Justice Lindley, "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 companies Act defines a company as "a company formed and registered under 2013 Companies Act or an existing company".

1.2 Types of Company

- **Chartered Company:** This is a type of company that came into existence through Royal Charter. Before the advent of company legislation, it was common for kings to borrow money from groups of merchants and in return give them the privilege of carrying on business either within the country or outside the country. This privilege was conferred through a Royal Charter.

- **Statutory Company:** A company incorporated under any special statue (act) passed either by the central or state legislature is called statutory company. Such companies are governed by their respective act and are not required to have any memorandum or articles of association. Changes in their structure are possible only by legislative amendments.

- **Government Company:** A company of which not less than 51% of the paid-up share capital is held by the central government or by the state government or by any two or more of them together shall be a government company.

- **Foreign Company:** A company which is incorporated outside India but which has a place of business in India is termed as a foreign company.

- **Registered Company:** A company formed by the registration under the Companies Act – 2013 is known as Registered Company. These companies may be limited by shares or limited by guarantee or unlimited companies.

  - **Limited by Shares:** It is a company having the liability of its member limited by memorandum to the amount unpaid, if any, on the shares respectively held by them.

  - **Limited by Guarantee:** A guarantee company is a company of which liability of its members is limited by memorandum to such amounts as the members may undertake by memorandum to contribute and to meet out the deficiency of the assets of the company in the event of its being wound up.

  - **Unlimited Company:** A company not having any limit on the liability of its member is an unlimited company.

Besides above divisions, registered companies can be further classified into private or public limited companies.

(i) Private Company: A private company means a company which has a minimum paid up capital of Rs. 1 Lakh or such higher capital as may be prescribed and which by its articles:

- ♦ Restricts the rights to transfer the share of its member
- ♦ Restricts the number of members to a number not exceeding 200.
- ♦ Restricts or prohibits an invitation to the general public to subscribe the share or debentures of the company.

A private limited company may be registered with only two members. It is required to add the words ‘private limited’ at the end of its name.

(ii) Public Company: Public company means, a company which is not a private company, a company needs minimum seven persons for its registration.

1.3 Types of Shares

A share in a company is one of the units into which the total share capital of a company is divided. Shares are of two types.

1. **Preference share:** Preference shares are those which carry the following preferential rights over other classes of shares. Examples: cumulative or non-cumulative, participating or non-participating, convertible or non-convertible, redeemable or irredeemable.
2. **Equity shares:** Shares which are not preference shares are termed as equity shares. These shares do not carry any preferential right.

1.4 Share Capital

Meaning: The sum total of the nominal value of share of a company is called as its share capital. There are some categories of share capital.

- **Authorized capital:** It is the minimum amount of share capital which a company can raise for the time being. It is mentioned in the company's memorandum and is also termed as "nominal" or "registered" capital.
- **Issued capital:** It is that part of the authorized capital which is represented by the nominal value of shares offered for subscription.
- **Subscribed Capital:** It is the part of the issued capital which has been allotted to the public.
- **Called-Up Capital:** It is that portion of the subscribed capital which has been called up by the company.
- **Paid up capital:** It is that portion of the called-up capital against which payment has been received.

Share capital shown in the balance sheet in the following form:

ABC COMPANY Balance Sheet as on….

Capital liability		Amt
Share Capital		
Authorized capital		
…… Eq. Shares of Rs. …. Each		……
…… Pref. Shares of Rs. …. each		……
		…
Issued Capital		
…… Eq. Shares of Rs. …. Each		……
…… Pref. Shares of Rs. …. each		……
		…
Subscribed Capital		
…… Eq. Shares of Rs. …. Each		
Rs…. Called Up	……	
…… Pref. Shares of Rs. …. each		
Rs…. Called Up	……	
Less calls paid-up	……	
(i) By Directors …..		
(ii) By others …..	……	
	……	
Add: Forfeited Shares	……	

Calls in Advance	……	…….
Reserve and Surplus		…….
		……..

1.5 Important Terminology

- **Under Subscription:** A Company may not receive application for the all the shares offered by it to the public.
  For E.g. it might have offered 10000 shares to the public but application might have been received only for 8000 shares. Such a situation is called under subscription.

- **Over Subscription:** A company may receive application for a larger number of shares than offered by it to public for subscription. In this case company has been refunded money to the applicants as per pro-rata base or any other system.

- **Calls in advance:** A shareholder can pay unpaid amount on shares held by him even though the amount may not have been called up by the company. It's called calls in advance. Journal Entry will be as…

  Bank A/c Dr.

  To Share Allotment A/c

  To calls in Advance A/c

  When a Company make a call…

  Calls in Advance A/c Dr.

  To share call A/c

- **Calls in Arrears:** A shareholder may not pay the call when it becomes due. Companies charge interest on calls in arrears. Journal entry will be as ….

  Calls in Arrears A/c Dr.

  To share Call A/c

  When outstanding amount received journal entry will be….

  Bank A/c Dr.

  To Calls in Arrears A/c

1.6 Forfeiture of Shares

If the shareholder fails to make payment of the money called upon by the company for which he is liable to pay on the shares held him, in specified time, a company can forfeit his shares after the due procedure.

The person whose shares are forfeited, his name is cancelled from the member's register and he loses all the rights of a member. The procedure for forfeiting shares is contained in the article of the company which must be strictly observed.

The company can re-issue the forfeited shares by the discount or premium. At the time of reissued of such shares, company must receive the minimum amount equal to the amount which was outstanding on those shares.

The company can forfeit the shares for the following:

- When a member fails to pay the amount due on shares within the period allowed by the company, the directors serve a notice to the members there after, asking him to pay the amount due within two weeks with interest. The notice also contains a warning that the shares would be forfeited if he fails to pay the amount of share within this fixed extended period.
- On expiry of this further period of two weeks, if the shareholder does not pay the amount due, the directors would forfeit his shares by passing a resolution in the Board's meeting. A notice of forfeiture is sent to the member concerned. But the Shareholder is liable to pay the amount till the forfeited share not reissue.

1.7 Share Premium & Share Discount

When the Shares are issued at a higher price than the face value (nominal), the shares are said to have been issued at a premium. The company can issue the shares at premium when the circumstances are favorable. Company possesses high goodwill in the market. Profitability of the company is high enough. The market price of the company's share is also high.

When the company issues the shares at a premium the amount received in excess of the nominal value of the shares is credited in share premium account. This amount can used for declaring dividend, bonus shares issued, writing off preliminary expenses etc.

It is considered just like capital of the company and if it is to be used for any purpose. Then permission of the court is required just as in case of reduction of capital. E.g. when the company issues share of Rs.100 face value in Rs.150 then the more amount of face value Rs.50 is called premium.

- **Share Discount**

When the profitability of the Company is not satisfactory, the investors will not ready to purchase the shares new issued. At that time company must give some attraction to them. When the company issues the shares at a price less than its face value, it is said that company has issued the shares at a discount.

When the Shares are issued at discount, share capital account is credited with its face value but the discount given i.e. the amount received less is debited to a separate account named as 'Share Discount' account and the same will be written off in future years.

1.8 Re-Issue of Forfeited Shares

The forfeited shares are the asset of the company. The directors decide that at what value it will be reissued. But the minimum price at which they can be received had been laid down in the Act.

At the time of reissue of such shares, Company must receive the minimum amount equal to the amount which was outstanding on those shares. More than Amount also can be received on reissued of forfeited shares. the maximum amount of discount can be given by the company is equal to the capital amount forfeited by the company in this case company does not makes any loss.

When all forfeited shares are reissued the balance for forfeited amount is transferred to capital reserve account and forfeited account will be closed.

- **Issue forfeiture and re-issue of shares practical**

1. At par issued Shares:

ABC Ltd. Co. has issued 1, 00,000 equity shares of Rs. 10 each. The amount was called up as under:

On application per share Rs. 2.00

On allotment per share Rs. 3.00

On first call per share Rs. 2.50

On final call per share Rs. 2.50

- Company has received applications for all shares
-The amounts due on allotment and calls were called for at appropriate time and all necessary amounts was received in due time. Pass necessary journal entries in the books of the company and necessary account also prepared.

Ans. as per application: 1, 00,000 shares x 2 Rs. Each = 2, 00,000

As per allotment: 1,00,000 shares x 3 Rs. Each = 3, 00,000

As per first call: 1, 00,000 shares x 2.50 Rs. Each = 2, 50,000

As per final call: 1, 00,000 shares x 2.50 Rs. Each = 2, 50,000

Journal entries in the books of ABC Co. LTD

Date	Particulars	L.F.	Debit	Credit
1	Bank a/c Dr. To share Application (being the amount of share application money received)		2,00,000	 2,00,000
2	Share application a/c Dr. To equity Share capital a/c		2,00,000	 2,00,000

	(Being the amount of sanctioned application money)			
3	Equity Share Allotment a/c Dr. To Equity Share Capital a/c (being the amount due on allotment)		3,00,000	3,00,000
4	Bank a/c Dr. To equity share allotment a/c (being the amount due on allotment received)		3,00,000	3,00,000
5	Equity share first call a/c Dr. To equity share capital a/c (being the amount due on first call)		2,50,000	2,50,000
6	Bank a/c Dr. To equity share first call a/c (being the amount due on first call received)		2,50,000	2,50,000
7	Equity share final call a/c Dr. To equity share capital a/c (being the amount due on final call)		2,50,000	2,50,000
8	Bank a/c Dr. To equity share final call (being the amount due on final call received)		2,50,000	2,50,000

Ledger Book of ABC Co. Ltd.

To Balance c/f	10,00,000	By equity share application a/c	2,00,000
		By equity share allotment a/c	3,00,000
		By equity share first call a/c	2,50,000
		By equity share final call a/c	2,50,000
	10,00,000		**10,00,000**

Bank a/c

By equity share application a/c	2,00,000	To Balance c/f	10,00,000
By equity share allotment a/c	3,00,000		
By equity share first call a/c	2,50,000		

By equity share final call a/c	2,50,000		
	10,00,000		**10,00,000**

2. Share issued at Premium:

Abb Ltd. Co. has issued 50,000 equity Shares each of Rs.10 at 10% premium. The amount is called as under:

With application per share Rs.2.50
With allotment Rs.4.00 [With premium]
With final call Rs.4.50

The company has received applications for 48,000 shares and all applications were sanctioned allotment money and call money were called upon at appropriate time and were received in due time. Pass necessary journal entries in the books of the company.

<u>Solution:</u>

Premium amount: 10 Rs. at 10% premium = 1 Rs. premium	
On application: 4800 shares x 2.50 per share	1,20,000
On allotment: 4800 shares x 3 per share	1,44,000
Premium: 4800 shares x 1 per share	48,000
On final call: 4800 shares x 4.50 per share	2,16,000

Journal entries in the books of ABB Co. LTD

Date	Particulars	L.F.	Debit	Credit
1	Bank a/c Dr. To share Application (being the amount of share application money received)		1,20,000	 1,20,000
2	Equity Share Application a/c Dr. To Equity Share Capital a/c (being the sanctioned amount transferred to share capital)		1,20,000	 1,20,000
3	Equity Share Allotment a/c Dr. To Share Premium a/c To Share Capital a/c (being the amount due on allotment with premium Rs. 1 per share)		1,92,000	 48,000 1,44,000

4	Bank a/c Dr. To equity share allotment a/c (being the amount due on allotment received with premium)		1,92,000	 1,92,000
5	Equity share final call a/c Dr. To equity share capital a/c (being the amount due on final call)		2,16,000	 2,16,000
6	Bank a/c Dr. To equity share final call a/c (being the amount due on final call received)		2,16,000	 2,16,000

3. Calls in Arrears:

The authorized share capital of RIL Co. is divided into 5, 00,000 equity shares of Rs. 10 each. The company issued 2, 00,000 equity shares the amount to be called for as under:

With application Rs. 3.50 per share

With allotment Rs. 3.00 per share

With final call Rs. 3.50 per share

The company has received applications for 2,20,000 shares. Applications for excess shares were rejected and the application money thereon was refunded.

Except the final call money on 250 shares held by one shareholder, all the amounts were received for allotment and call money. Pass journal entries in the books of the company.

Solution:

Journal entries in the books of RIL Co. LTD

Date	Particulars	L.F.	Debit	Credit
1	Bank a/c Dr. To share Application a/c (being the amount of share application money received)		7,70,000	 7,70,000
2	Equity Share Application a/c Dr. To equity share Capital a/c To Bank a/c		7,70,000	 7,00,000 70,000

	(being the sanctioned amount transferred to share and the amount refunded on rejected application)			
3	Equity Share Allotment a/c Dr. To Equity Share Capital a/c (being the amount due on allotment)		6,00,000	 6,00,000
4	Bank a/c Dr. To equity share allotment a/c (being the amount of allotment received)		6,00,000	 6,00,000
5	Equity share final call a/c Dr. To equity share capital a/c (being the amount due on final call)		7,00,000	 7,00,000
6	Bank a/c Dr. Calls in arrears a/c Dr. To equity share final call a/c (being the amount is received on final call except on 250 shares)		6,99,125 875	 7,00,000

4. When shares issued at par are Forfeiture:

The authorized capital of Sunayana Co. Ltd. consisted of 1, 00,000 shares of Rs. 10 each. The company issued all the shares in 2024 payable as follows:

On application per share Rs. 1.50
On allotment per share Rs. 2.00
On first call per share Rs. 4.00
On final call per share Rs. 2.50

Company has received applications for all the shares. Company called up amount on due of allotments and calls were received except 10,000 shares held by one shareholder were forfeited in January 2024 on non-payment of final call. These shares were reissued at Rs. 5 per share. Write journal entries to record the transactions.

Solution:

Working notes
On application: 1, 00,000 x 1.5 = 1, 50,000 Rs.
On allotment: 1, 00,000 x 2 = 2, 00,000 Rs.
On first call: 1, 00,000 x 4 = 4, 00,000 Rs.
On final call: 1, 00,000 x 2.5 = 2, 50,000 Rs.

Less calls in arrears = 10000 x 2.5 = 25000 Rs.
Forfeited shares = 10000 equity shares
Capital = 10000 x 10 = 1, 00,000 Rs.
Forfeited amt = 10000 x 7.5 (1.5 + 2 + 4) = 75000 Rs.
Calls in arrears = 10000 x 2.5 = 25000 Rs.

Re issued shares:
Capital = 10000 x 10 = 1, 00,000
Bank = 10000 x 5 = 50000
Forfeited a/c = 10000 x 5 = 50000
Capital reserve: 75000 – 50000 = 25000 Rs.

Journal entries in the books of SUNAYANA Co. LTD

Date **Jan 24**	**Particulars**	**L.F.**	**Debit**	**Credit**
	Bank a/c Dr. To Equity share Application (being the amount of share application money received)		1,50,000	 1,50,000
	Equity Share Application a/c Dr. To equity share Capital a/c (being the sanctioned amount transferred to share capital)		1,50,000	 1,50,000
	Equity Share Allotment a/c Dr. To Equity Share Capital a/c (being the amount due on allotment)		2,00,000	 2,00,000
	Bank a/c Dr. To equity share allotment a/c (being the amount of allotment received)		2,00,000	 2,00,000
	Equity share first call a/c Dr. To equity share capital a/c (being the amount due on first call)		4,00,000	 4,00,000
	Bank a/c Dr. To equity share first call a/c (being the amount is received on first call)		4,00,000	 4,00,000
	Equity share final call a/c Dr. To equity share capital a/c (being the amount due on final call)		2,50,000	 2,50,000

	Bank a/c Dr. Call in arrears a/c Dr. To equity share final call (being the amount is received on final call except on 10,000 shares)		2,25,000 25,000	 2,50,000
	Equity share capital a/c Dr. To forfeited shares a/c To call in arrears a/c (being that share are forfeited)		1,00,000	 75,000 25,000
	Bank a/c Dr. Forfeited shares a/c Dr. To equity share capital a/c (being that re issued shares which are forfeited)		50,000 50,000	 1,00,000
	Forfeited shares a/c Dr. To capital reserve a/c (being that bal. amt of forfeited transferred to capital reserve a/c)		25,000	 25,000

❖ **Exercise:**

- **Long Questions:**

  (1) Explain the types of Company.
  (2) Explain the types of shares.
  (3) Explain Forfeiture of Shares.

- **Explain the following terms:**

  (1) Authorized capital
  (2) Issued capital
  (3) Subscribed Capital
  (4) Called-Up Capital
  (5) Paid up capital
  (6) Under Subscription
  (7) Over Subscription
  (8) Calls in advance
  (9) Calls in arrears
  (10) Share Premium
  (11) Share Discount

- **Practical:**

1. On 1-1-2024 M & M Ltd. issued 50,000 shares of Rs. 10 each to the public at a price of Rs. 12 per share which was payable on application Rs. 5 [including premium], On allotment Rs. 4 and the balance was payable on 1-6-24.

Applications were received for 70,000 shares when the subscription list was closed on 31-1-12024. Out of the money received, Rs. 40,000 was returned and Rs.60,000 was transferred to allotment. Allotment money was paid on 15-2-24. The amount due on first and final call was paid on 1-6-24 with the exception of 500 shares. These 500 shares were forfeited on 30-9-24 and were reissued at Rs. 8 per share on 1-11-24. Give journal entries.

2. Rajput Ltd. issued 1,000 equity shares each of Rs. 10 at a premium of Rs. 2 per share payable as under:

On application per share Rs. 3.00
On allotment per share Rs. 5.00 [including premium]
On first call per share Rs. 2.00
On final call per share Rs. 2.20

Applications were received for 1,600 shares from which 100 applications were refused and allotment was made pro-rata to the remaining applications. Raj to whom 100 shares were allotted failed to pay money due on first call and Nikum who had applied for 150 shares also failed to pay moneys due on final call.

These shares were forfeited and 150 shares inclusive of 100 shares forfeited from Raj were reissued at Rs. 7 per share.

3. Jayesh Co. Ltd. issued 60,000 equity shares of Rs. 10 each at a discount of 10% in public. Applications were received three times more.

Shares were allotted as under:
To refuse allotment to applicants for 80,000 shares,
To give full allotment to applicants for 20,000 shares.

Money overpaid on applications was employed in account of sums due and allotment.

Amount payable per share was as under:

On application per share Rs. 2.00
On allotment per share Rs. 2.50
On first call per share Rs. 2.50
On final call per share Rs. 2.00

Ramesh Gupta was allotted 2,000 shares pro-rata failed to pay moneys due on allotment, first call and final call. So, his shares were forfeited.

Out of these forfeited shares 1,000 shares were reissued as fully paid up at Rs. 7 per share.

Pass necessary journal entries recording the above transactions in the books of the company.

4. The Orient Co. Ltd. issued 2, 00,000 shares of Rs. 10 each payable as under:
On application per share Rs. 1.00
On allotment per share Rs. 3.00 [including Rs. 2 premium]
On first call per share Rs. 4.00
On final call per share Rs. 4.00

Subscriptions were received for 3, 17,000 share by 23rd April, 2024 and 30th April, 2024 shares were allotted as under:

(1)	Allotment in full [out of which two applicants for 4,000 shares each have paid allotment money in full]	38,000 shares
(2)	Allotment of 2/3rd shares applied for	1,60,000 shares
(3)	Allotment of 1/4th shares applied for	2,000 shares

Applications for 31,000 shares were totally rejected and applications money was returned to them on 6th May, 2024. The amounts due on calls were received on due dates with the exception of the final call on 100 shares. These were forfeited on 15th November, 2024 and were reissued on 16th November, 2024 at Rs. 9 per share.

Give journal entries; prepare cash book and necessary accounts. State how these transactions, will appear in the balance sheet.

5. S.I.V. Co. Ltd. issued 50,000 shares of Rs. 10 each at a premium of Rs. 2.50 to the public. The amount payable was as follows:

On application per share Rs. 2.00
On allotment per share Rs. 4.50 [including premium]
On first call per share Rs. 4.00
On second and final call per share Rs. 2.00

Applications were received for 75,000 shares and pro-rata allotment was made to the applications was adjusted against the amount due on allotment.

Ila to whom 100 shares were allotted failed to pay allotment money on non-payment of first call money. Also, her shares were forfeited after first call.

Vaishali to whom 150 shares were allotted failed to pay last two calls and her shares were forfeited after second call.

100 forfeited shares of Ila and 100 shares of Vaishali were reissued as fully paid at Rs. 8 per share to Meghana.

Pass necessary journal entries.

6. Enjoy Co. Ltd. issued to public 50,000 Equity shares of Rs. 10 each at a premium of Rs. 2.50. The amount payable was on application Rs. 2 per share, on allotment Rs. 4.50 (including premium) on first call Rs. 4 per share, on second call Rs. 2 per share.

Applications were received for 75000 shares & prorata allotment was made to the applicant of 50000 shares. Remaining applications were rejected.

Money overpaid on application was adjusted against the amount due on allotment.

Anand to whom 100 shares were allotted failed to pay allotment money & her shares were forfeited after first call.

Uming to whom 150 shares were allotted failed to pay last two calls; 7 of her shares were forfeited.

100 forfeited shares of Anand and 100 shares of Uming were reissued as fully paid at Rs. 8 per share to Mr. Smile.

Pass necessary journal entries.

UNIT-2 BUY-BACK OF SHARES

2.1 Introduction

2.2 Meaning and Definition of Buy-back of Share

2.3 Reasons for Buy-back of Share

2.4 Objectives of Buy-back of Share

2.5 Advantages and Disadvantages of Buy-back of Share

2.6 Laws Related to Buy-back of Share

2.7 Conditions of Buy back of Share

2.8 Disclosure (Disclose / Advertise) of Buy-back of Shares

2.9 Process of Buy back of Share

2.10 Solvency Declaration of Companies

2.11 Register of Buy back of Share

2.12 Change in Share Capital

2.13 Methods of Buyback

2.14 Escrow Accounts

2.15 Penalty

2.16 Accounting treatment of Buy back of Share

2.17 Conclusion

❖ Exercises

2.1 Introduction

Buy-back of shares is governed by the section 68 of Companies Act, 2013. This section empowers companies to buy back their own shares or other securities from the market, while Sections 69 and 70 of the Act also allow companies to buy back shares. Section 68 regulates Buy-back of share for both listed and unlisted companies. Section 67 of the Companies Act, 2013 regulates Buy back of share for private limited companies and unlisted public limited companies. The SEBI (Buy-back of Securities) Regulations, 2018 regulate buy-back of shares for listed companies. The Listing Obligations and Disclosure Requirements Regulations, 2015 provide for the necessary sections for buyback of shares.

Share capital is a very essential part of a listed or unlisted company. Share capital can be of two types i.e. Equity Share Capital and Preference Share Capital. Share capital of a company is divided into small denomination of shares and allotting shares of the company to the members or Shareholders, who have a right to receive dividend as income. A shareholder has the right to vote in general meetings of the company or the right to receive dividends or such other benefits as may be prescribed. The option is left to the shareholder whether he wants to transfer the shares to another person.

But there are some provisions in the Companies Act which allow shareholders to sell their shares directly to the company and such provisions of buy-back of share is known as Buy back of share. It can be understood as a process by which a company buys back its share from its shareholder or a shareholder can take some action to sell shares to the company.

2.2 Meaning and Definition of Buy Back of Share:

Buy Back of Share is a process when a company buys back its shares from existing shareholders. The company usually buys back shares at a price above the market price. This reduces the number of shares outstanding in the market. In this case, it reduces the number of shares outstanding, giving each remaining shareholder a larger percentage ownership of the company. In general, It is believed that the management of the company is optimistic about the future and believes that current market share price is low. Companies buy back shares because, they want to increase their share price, to increase the intrinsic value of the shares, to restructure the system of debt, to mix the equity and to demonstrate their position in the market as financially strong etc. Companies buy back shares also to enhance internal control of the company, and to receive stock for employee stock option plans or pension plans.

Thus, if Buy Back of Share is to be defined, it can be as "A share buyback is when a company repurchases its own shares from its shareholders for the purpose of increasing the value of the company by taking Number of shares in the market is less. Such a purchasing (repurchase) of Shares is called Buyback. Companies will buy back shares to increase the value of shares still available (by way of reducing supply) or to eliminate any risk from shareholders seeking a controlling stake.

2.3 Reasons of Buy back of Share

As per CompanyAct 2013, this act of Buy-back of shares, has the following reasons mentioned as under:

"It is a mistaken belief that Buy-back of share the only cause of adverse to take possession of (to take overs) shares. In this context, it is worth listing five reasons the favoured legislation allows companies to buy back their shares.

(1) Transfer excess cash to shareholders

(2) Increasing the underlying share value

(3) Supporting stock prices during temporary weakness.

(4) To achieve or maintain a target capital structure.

(5) Undesirable bid to take possession of (to take-over bids).

A company resorting to a brief buy-back may have excess cash, and it may not have found a suitable way to invest such surplus cash, during such periods of the company may hopefully decide to redeem the surplus cash by buying back its shares and investors gain their faith in the company at a later time when the company expands. Secondly, the company may consider buying back its shares even after the buyback process in order to increase the share price of the remaining shares in the market. Because after buy-back share, the number of marketable shares decreases and hence the price increases. Thirdly, through no fault of the Company, but it can happen sometimes dut to a recession in the stock market. However this time may be temporary but it may continue for a long time, at that time the management can take a decision.

2.4 Objectives of Buy back of Share

Shares may be buy-back for one or more of the following reasons of the company.

(1) To increase the holding by the promoters
(2) To increase earnings per share.
(3) To rationalize capital formation by writing down capital that is not represented by available assets.
(4) To support share value.
(5) To stop the takeover bid (proposal).
(6) It is not necessary for the business to pay additional cash.

Actually boom-bust is the best strategy to maintain share price, and it can be done by buying back shares from the open market at a premium over the prevailing market price.

2.5 Advantages and Disadvantages of Buy-back of Share

Advantages of Buy-back of share: Buy back of share becomes beneficial for the company:

- **Boosting Confidence in the governing body:** Investors in the company and Board of Director can increase confidence, because these investors know that the directors are never willing to redeem the excess cash if that company will not be able to earn more than an alternative of investment or cost of capital.
- **Increase shareholder value**: In general, the repurchase of share is good for shareholders. The laws of supply and demand dictate that, with less market share, the share price will increase. However, in the company decrease in profits will happen because there will be no longer earning of interest on the cash, this is more than made up by the reduction in the number of shares.
- **High share price:** Repurchase of share or a buyback means that the company's earnings are now divided into fewer shares, i.e. excess earnings per share (EPS). In this theory, the higher earnings per share lead to higher stock prices that encourages the right thing.
- **Takeover Reduce opportunities**: Repurchase of share uses excess cash of the company. In the money market, a redemption on excess cash can drag down a company's overall performance. Thus, Cash rich companies are encouraged to buy back stock that allows the company to get a better redemption on excess cash and prevent itself from becoming a takeover target.
- **Return on Equity (ROE) Increases:** Return on equity (ROE) from Re-purchase of share may increase. This effect is greater when shares are repurchased. This may be the most profitable course of action for the company if the stock is undervalued.

- **Psychological Effects:** When a company buys its own stock it is essentially telling the market that company thinks that the value of the shares of the company is low, by this there may be favourable psychological effects on the market. Stock buybacks allows a company to provide additional cash to shareholders without increasing dividends. If cash is temporary in nature it may prove more beneficial to provide value to shareholders through buybacks rather than increasing dividends.
- **Excellent tool for Financial planning:** In case of profit making, companies with high dividend-payment whose share prices are falling, buy backs, actually hurt their bottom lines as dividends attract tax. Buybacks and subsequent cancellation of shares can reduce dividend outflows.
- **Tax:** Exemption is available only if the shares are sold on a recognized stock exchange and if the sale is subject to Securities Transaction Tax (STT) has been paid. In a buyback scheme, neither the sale takes place on a recognized exchange nor the STT is paid. Therefore, you will have to pay income tax on your long-term capital gain on the buyback after deducting the acquisition cost of your shares and get the benefit of indexation from year to year of purchase.

Disadvantages of Buy back of share: Let us see how Buy back of shares become unprofitable for a company.

- **Negative signal:** A Buy back of share announcement can send negative hint rather than signaling better operating prospects to the market; buyback signals can completely drown out more powerful conflicting signals about a company's future. Buybacks may be avoided if acquisitions are disrupted, business restructuring is prolonged, financial results decline, and general profitability of key markets declines.
- **Backfire:** A buyback can be backfire for a company competing in a high-growth industry, as the company may have or find more important new opportunities to spend money. In such cases, long-term investors will respond to a buyback announcement by selling shares of the company.

  A share buyback scheme can be a big disadvantage for a company when it overpays for its own shares. indeed, buying into an overpriced market is foolish. Instead, the company should put the money into assets that can be easily converted into cash. Thus, when the market is trading below its fair value, the company's shares can be bought back at a discount; Strictly speaking, a company should repurchase its shares only when its stock is trading below its expected value and when no better investment opportunities are available, to ensure maximum benefit to existing shareholders.

2.6 Laws Related to Buy-back of Share

Clause 68, Company Act 2013, Prescribes sources of Repurchase or **Buy back** of shares or other specified securities by the company, which is as follows:

(1) Unutilized Reserve: Company can repurchase its shares from Unutilized reserves but an amount equal to the nominal value of the shares purchased and capital redemption reserve should be deposited.

(2) Share Premium account.

(3) Income of any share or specified as earlier issued same type of shares, of same categories of shares, or securities will be bought back from the proceeds.

2.7 Conditions of Buy-back of Share

The conditions mentioned in clause 68 for buyback, are as follows:

(1) It must be authorized by the articles of association of the company.

(2) A special resolution has been passed in the general meeting of the company to authorize the buyback.

   (a) If the buyback is 10 percent or less of the total paid-up equity share capital, then there is no need to pass a resolution in the general meeting instead a simple resolution of the board is sufficient.

   (b) However, no buy-back offer shall be made within 365 days from the date of operation of the buy-back offer.

(3) Buy-back is 25 percent or less of total paid-up equity share capital and free reserves.

(4) No payment is due under Buy-back of shares viz. in payment of deposit or interest payable thereon, Redemption of Debentures or Preference Shares, Payment of Dividends, if declared, to all shareholders within a prescribed period of 30 days from the date of declaration of dividend and Any term loan payable to any financial institution or bank or payment of interest thereon.

(5) To file annual return, there is no default in payment of dividends and compliance with the provisions of form and content of annual accounts;

(6) The debt-to-equity ratio of the company after such buy-back is not more than twice the capital and its free reserves.

(7) All shares or other specified securities for buyback are fully paid up.

(8) Buy-back of shares or other specified securities listed on any recognized stock exchange is in accordance with the sections made by the Securities and Exchange Board of India in this behalf.

(9) The Board of Directors must have formed an opinion that the company will not be insolvent within one year from the date of buy-back.

2.8 Disclosure (Disclose / Advertise) of Buy-back of Shares

The notice of meeting in which it is proposed to pass a special resolution for buy back must be accompanied by an explanatory statement:

(1) Full and complete disclosure of all material facts Required for Buy Back
(2) Class of securities intended to be repurchased under buy back
(3) Amount to be invested under buy back.
(4) Time-limit for completion of buy-back

2.9 Process of Buy-back of Share

(1) After passing a special/board resolution, Where the company proposes to buy back its shares, it will announce in at least one English National daily, Hindi National daily and regional language daily newspaper where registered office of the Company is situated.
(2) The public announcement shall specify a date, which will be the "specified date" for the purpose of naming the shareholders to whom the letter of offer is to be sent.
(3) A public notice containing the disclosures specified in the sections and schedule to SEBI will be given.
(4) Draft offer letter filed by merchant banker to SEBI and the offer letter will be sent to the members of the company.
(5) A copy of the board resolution authorizing the buyback will be filed with SEBI and the stock exchange.
(6) The date of opening of the offer should not be earlier than seven days or later than 30.
(7) The days after the specified date the buy-back offer shall be open for a period not less than 15 days and not more than 30 days.
(8) A company opting for buy-back through public offer or tender offer should open an escrow account.

2.10 Solvency Declaration of Companies

Where the company sub-section 17 (3) under section 68 has passed a special resolution or a board resolution has been passed to buy back its own shares or other specified securities under certain circumstances, before filing such buy back in the form, liability is indicated and verified by affidavit and such an opinion makes that the Company is able to meet its obligations. A statement that all affairs of the company have been thoroughly investigated, a statement that the company will not become insolvent within the next one year and a statement that all financial matters of the company are true and correct Alongwith the former two directors of the company, one of the Managing Directors must sign the form.

2.11 Register of Buy-back of Share

Register of Buy-back of share to be maintained, should enter the following details in it:

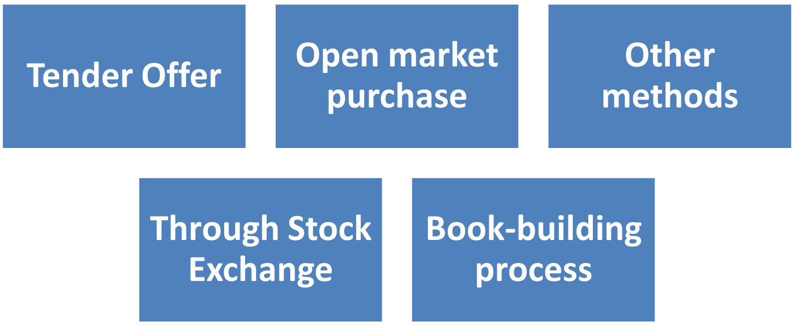
(a) Value of Buy-back of share made
(b) Date of cancellation of share
(c) Date of physical destruction of share
(d) Other details may be prescribed

The shares or securities purchased shall be physically destroyed within seven days from the last date of such buy-back.

2.12 Changes in Share Capital

There are many ways in which a company can return wealth to its shareholders, However, Share price appreciation and dividends pay. These are the two most common ways for companies to share their wealth with investors. Give value to shareholders and buy back their shares at above market value. This is usually done to instill confidence in the shareholders. Protecting the company from a hostile take-over has always been seen as the main driving force behind this reform. The company can use the excess cash available to buy back its shares and bring down the number of floating shares, resulting in the claimant being untraceable. It is a worthwhile investment or profitable acquisition. These may be specific reasons why a company may resort to buying back its shares, these methods are as follows.

2.13 Methods of Buyback



(1) Tender Offer:

Shareholders may be presented with a tender offer by the company to submit the tender all their shares within a specified time frame. The tender offer will determine both the number of shares the company wants to repurchase and the price range they are willing to pay (almost always at a premium to the market price). When investors accept the offer, will state the number of shares they wish to tender along with the price they are willing to accept. Once the company gets all the offers, it will look for the right mix to buy the shares at the lowest price.

(2) Open market purchase:

(a) Through Stock Exchange: Another option the company has is that, the Shares are to be brought from the open market, such as the individual investor at market price. However, it is important to note that when a company announces a buyback it is generally seen as a positive thing by the market, which often causes the share price to rise.

(b) Book-building process: For buy-back of shares, Companies can also use a book building process. The book building process is a method of price discovery that helps determine the market value of securities. If the book building option is used, then the draft prospectus has to be filed with SEBI. The prospectus should contain all the details of the offer, except the price at which the securities will be offered (the price band is specified). A copy of the draft prospectus is filed with SEBI and distributed to institutional buyers by lead merchant bankers acting as book runners. Institutional investors specify the price as well as the quantity of shares they want to buy. The book runner, after receiving the above information, determines the price to be offered to the public.

(3) Other methods of buyback are:

➤Pursuant to the terms of an employee share scheme, employee share purchases are purchases of shares for the benefit held by current or former employees of the company, including salaried directors.

➤Odd-lot purchase - Purchase by listed companies of small parcels of shares which are not marketable on the stock exchange. An odd lot here, where the lot of securities of a public company, whose shares are listed on a recognized stock exchange, is smaller than the marketable lot as may be specified by the stock exchange.

➤A selective buy-back is a buy-back that does not fall into any other category, such as the purchase of shares of a particular member.

Further share issue after buy back:

Each buy-back shall be completed within twelve months from the date of passing of the special resolution or board resolution. A company which has bought back any security cannot issue securities of the same type by way of public issue, rights issue for a period of six months from the date of buy back.

Filing of return with regulator:

Company, after completing the buy-back filing with the Registrar and the Securities and Exchange Board of India, shall within thirty days of such completion of return in Form 4C containing such particulars relating to the buy-back. No return shall be filed with the Securities and Exchange Board of India by an unlisted company.

Prohibition on buy back:

The Company shall not directly or indirectly purchase its own shares or other specified securities.

(a) by any subsidiary including its own subsidiaries; Or

(b) by any investment company or group of investment companies.

2.14 Escrow Accounts

On or before the Company opens the Offer deposits into the escrow account, by way of security for the performance of his obligations under the sections and such amount as specified in the by-laws,

(1) Escrow amount shall be payable as follows:

(a) If consideration payable is not more than ₹100 core, then the 25% of consideration if not
(b) If consideration payable exceeds 100 cores, then the 25% up to 100 cores and 19% thereafter.

(2) Escrow account specified in sub-regulations shall include

(a) Cash deposited in a Scheduled Commercial Bank or;
(b) Bank Guarantee in favor of Merchant Banker; Or
(c) Deposit of acceptable securities with appropriate margin with dealer banker, Or
(d) (a), (b) and a combination of (c) above.

(3) While opening an account, the merchant banker shall authorize the bank to instruct the bank to issue a banker's cheque or demand draft for the amount standing to the bank's credit. Where the escrow account is deposited with a scheduled commercial bank called Escrow Account as provided in the sections.

(4) Where the escrow account carries a bank guarantee, Such bank guarantee shall be in favor of the merchant banker and shall be valid for thirty days from the closing of the offer.

(5) If securities are included in the escrow account, the Merchant Banker shall be authorized to realize the value of such Escrow Account by sale or otherwise and if there is any shortfall in the recovery of the value of the securities, the Merchant Banker shall be liable to meet any such loss.

(6) If the escrow account includes bank guarantees or sanctioned securities, then it shall not be returned until all obligations under the sections are fulfilled by the merchant banker.

(7) Where the escrow account includes a bank guarantee or deposit of approved securities, then the company should also deposit at least one percent of the total consideration payable in cash, and by way of security for its fulfillment as a obligations by the Company under the sections.

(8) On payment of consideration to all shareholders accepting the offer and after completing all formalities of buy-back, amount in Escrow, Guarantees and Securities, if any, then the company will be released.

(9) In the interest of the shareholders, the Board may confiscate the Escrow account in case of non-compliance by the company with its obligations under the sections.

(10) Amount forfeited under sub-regulation, those who have accepted the offer and the balance, the distributor will be used for it.

2.15 Penalty

If a company defaults in complying with the provisions, the company or any officer of the company who is in default shall be punished with imprisonment for a term which may extend to two years or with fine which may extend to fifty thousand rupees or with fine as per the offenses under Section 621A of the Companies Act.

2.16 Accounting Treatment of Buy-back of Share

1. For purchase of shares: (a) When shares are purchased at face value: Equity share capital A/c Dr. To bank a/c	------ ------
(b) When shares are bought at a premium (more than the principal value): Equity share capital A/c Dr. share premium / General Reserve A/c Dr. To bank a/c	----- ----- -----
(c) When shares are bought at a discount (less than the principal value): Equity share capital A/c Dr. To bank a/c To capital redemption reserve a/c	----- ----- -----
2. For provision of capital redemption reserve: Share premium a/c Dr. General Reserve a/c Dr. Profit and loss a/c Dr. To capital redemption reserve a/c	----- ----- ----- -----

Illustration -1 Ankit Ltd. decides to purchase its own 50,000 equity shares of Rs.10 each. The company had a balance of Rs.10,00,000 in its general Reserve and Bank balance of Rs.8,00,000. In order to buy back the shares, the company issued 20,000, 9% redeemable preference shares of Rs.10 each, which were fully subscribed and paid up. The company bought all the shares at Rs.15 Per Share. Make entries in the books of the company.

Solution:

Date	Particulars	L.F	Debit (Amount)	Credit (Amount)
1	Bank A/c Dr. To 9% Red. Pref. Share Capital A/c (Issue of 9% 20,000 redeemable pref. shares of Rs.10 each for buy-back of equity shares)		2,00,000	 2,00,000
2	Equity Share Capital A/c Dr. General Reserve A/c Dr. To Equity Shareholders A/c (For implementing decision to buy-back 50,000 equity shares)		5,00,000 2,50,000	 7,50,000
3	Equity Shareholders A/c Dr. To Bank A/c (Payment made for buy-back of equity shares)		7,50,000	 7,50,000

4	General Reserve A/c Dr. To Capital Redemption Reserve A/c (The amount equal to nominal value of shares purchased out of general reserve (5,00,000 – 2,00,000 issue) transferred to Cap. Red. Reserve A/c)		3,00,000	3,00,000

Illustration -2 Ankita Ltd. decides to purchase its own 100,000 equity shares of Rs.10 each. The company had a balance of Rs.10,00,000 in its general Reserve and Bank balance of Rs.10,00,000. In order to buy back the shares, the company issued 30,000, 10% redeemable preference shares of Rs.10 each, which were fully subscribed and paid up. The company bought all the shares at Rs.15 Per Share. Make entries in the books of the company.

Solution:

Date	Particulars	L.F	Debit (Amount)	Credit (Amount)
1	Bank A/c Dr. To 10% Red. Pref. Share Capital A/c (Issue of 10% 30,000 redeemable pref. shares of Rs.10 each for buy-back of equity shares)		3,00,000	3,00,000
2	Equity Share Capital A/c Dr. General Reserve A/c Dr. To Equity Shareholders A/c (For implementing decision to buy-back 100,000 equity shares)		10,00,000 5,00,000	15,00,000
3	Equity Shareholders A/c Dr. To Bank A/c (Payment made for buy-back of equity shares)		15,00,000	15,00,000
4	General Reserve A/c Dr. To Capital Redemption Reserve A/c (The amount equal to nominal value of shares purchased out of general reserve (10,00,000 – 3,00,000 issue) transferred to Cap. Red. Reserve A/c)		7,00,000	7,00,000

2.17 Conclusion:

A buy back is a method by which a company pays back its investors and buys back its own shares. Once the buyback is completed, the shares of the company that are bought back are not retained by the company but are extinguished if the face value becomes too diluted or if the company has a higher amount of face. It reserves or if the promoters of the company want to acquire more controlling percentage within the company. When the stock is normally operational.

❖ **Exercises:**

1. Explain the Meaning and definition of Buy-back of share.
2. Explain the Reasons for Buy-back of share.
3. Explain the Objectives of Buy-back of share
4. Explain the Advantages and Disadvantages of Buy-back of share
5. Explain the Laws or recognizing of Buy back of share
6. Explain the Conditions of Buy back of share
7. Explain the Disclosure (disclose / advertise) of buy-back of shares
8. Explain the Process of Buy back of share
9. Explain the Solvency declaration of a companies
10. Explain the Register of Buy back of share.
11. Explain the Change in share capital.
12. Explain the Methods of Buyback
13. Explain the Escrow accounts.
14. Write a short note on Penalty.
15. Explain the Accounting treatment of Buy back of share.

1. from the Balance sheet of Arpita Ltd. as on 31-03-2022 is as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital: 2,00,000 Equity shares of Rs.10 each	20,00,000	Fixed Assets	15,00,000
General Reserve	10,00,000	Debtors	5,00,000
Securities Premium	5,00,000	Stock	12,00,000
Profit & Loss A/c	2,00,000	Bank Balance	10,00,000
Creditors	5,00,000		
	42,00,000		**42,00,000**

The company wants to buy-back its 60,000 equity shares. For this purpose, it issues 10% 20,000 redeemable preference shares of Rs. 10 each, which are fully subscribed and paid-up. The company buys-back the shares at Rs.14 per share. Pass the necessary journal entries and prepare Balance sheet after buy-back.

[Ans: Amount required for buy-back Rs.8,40,000 of which Rs.2,40,000 is the premium. This should be debited to Securities Premium A/c. Bank balance Rs.3,60,000; Total of the new B/s Rs. 35,60,000; Transfer Rs.4,00,000 from General Reserve to Capital Redemption Res. A/c.]

2. from the Balance sheet of Aashish Ltd. as on 31-03-2023 is as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital: 2,00,000 Equity shares of Rs.10 each	20,00,000	Fixed Assets	15,00,000
General Reserve	10,00,000	Debtors	10,00,000
Securities Premium	5,00,000	Stock	7,00,000
Profit & Loss A/c	2,00,000	Bank Balance	10,00,000
Creditors	5,00,000		
	42,00,000		**42,00,000**

The company wants to buy-back its 30,000 equity shares. For this purpose, it issues 10% 15,000 redeemable preference shares of Rs. 10 each, which are fully subscribed and paid-up. The company buys-back the shares at Rs.12 per share. Pass the necessary journal entries and prepare Balance sheet after buy-back.

[Ans: Amount required for buy-back Rs. 3,60,000 of which Rs.60,000 is the premium. This should be debited to Securities Premium A/c. Bank balance Rs.7,90,000; Total of the new B/s Rs. 39,90,000; Transfer Rs.1,50,000 from General Reserve to Capital Redemption Res. A/c.]

UNIT-3 ALTERATION OF SHARE CAPITAL-I

3.1 Introduction

3.2 Meaning of Alteration of Share Capital

3.3 Alteration in the Form of Share Capital

- **Illustrations**
- **Exercise**

3.1 Introduction

The authorized capital of a company is mentioned in its Memorandum of Association. The company issues share during its life time within the limits of its authorized capital. However, it is not compulsory for the company to retain its authorized capital to its original limit only. If necessary,

1. The company is entitled to increase its authorized capital subject fulfilling certain conditions.
2. Secondly, it can alter form of its share capital, i.e. it can convert its shares into stock or stock into shares.
3. Thirdly, it is entitled to return a part of its paid-up capital if it feels that it is an excess of its requirements.
4. If the company has accumulated large losses, it can reduce its share capital to wipe off losses. Of course, the last two changes can be made subject to the permission of the court only. In fact, taking into consideration the effects of changes in the capital on the interest of various parties, the Companies Act has laid down different conditions for alternation of its share capital.

3.2 Meaning of Alteration of Share Capital:

A company can alter its share capital, as per Indian Companies Act, 2013 under section 61 on certain conditions. The following are the modes of alteration of share capital of the company allowed by the Companies Act:

(A) Increase of Share Capital: When the company needs raising the money, new shares are issued to increase the paid-up capital. In this way its share capital is increased. Sometimes if a company has accumulated profits and has good reserves, it issues bonus shares to the shareholders. Thus, share capital can be increased in two ways:

1. By issuing New Shares

2. By issuing Bonus Shares

(B) Changing the form of share capital

1. Consideration of shares i.e. converting present shares of small value in to shares of high value.

2. Sub-division of shares i.e. converting the shares of high value into shares of small value.

3. Conversion of shares into stock and vice-versa.

4. Diminution of the share's capital through the cancellation of shares not taken up.

(C) **Reduction of shares capital:**

For the alternation of shares under Section 94, the following points should be noted:

1. The company which desires to alter its capital must be a company limited by shares.

2. The articles of the company must authorize such alteration.

3. These alternations must be made by the company in the General Meeting and an ordinary resolution is sufficient to make alteration.

4. The company is required to file a notice of such a change with the Registrar within 30 days of the passing of the resolution.

3.3 Alteration in the Form of Share Capital:

The company can change the form of capital in any one of the following ways:

1. Consolidate its shares into shares of larger amount.

2. Sub-divide its shares of smaller amount.

3. Convert its shares into stock or stock into shares.

1. Consolidation of Shares:

In consolidation, a specified number of shares are combined into one new share; in such a way that nominal value of new share is equal to the aggregate of shares so consolidated. The company has the power to consolidate shares of small denomination into shares of higher denomination. In the case of party paid consolidation of shares must be the same as it was before consolidation.e.g. 10,000 shares of each Rs. 10, Rs. 8 per share paid up are consolidated into 1,000 shares of Rs. 100 each, Rs. 80 per share paid up i.e. 80% of the nominal value should be paid-up in case of consolidation of shares.

Suppose 40,000 equity shares of Rs. 10 each are consolidated into 4,000 equity shares of Rs. 100 each, the entry will be as under:

Equity Share Capital Account (Rs. 10)	Dr.	4,00,000	
To Equity share capital A/c			4,00,000

2. Sub-division of shares:

The company, if authorized by its articles, may sub-divide its shares of bigger denomination into shares of smaller denomination. The company may do so to give a chance of purchasing company's shares to investors of middle class. When the shares to be sub-divided are not fully paid-up, the amount unpaid on each reduced shares must be same as it was before the sub-division. The charges regarding the sub-division of shares should be recorded in the registrar of members and necessary accounting entry should be passed.e.g. 2,000 shares of Rs. 100 each and sub-divided into 20,000 shares of Rs. 10 each.

Share Capital Account (Rs. 100)	Dr.	2,00,000	
To Share capital A/c(Rs. 10)			2,00,000

3. Conversion of Shares into Stock:

The conversion of fully paid-up shares into stock will be affected by resolution of the company in the general meeting, if Articles authorize such conversion. Stock is simply a set of shares put together, and is, therefore, transferable in sum of any amount. While a share is transferable as a whole, it cannot be split into parts.

When the shares are converted into stock the Register of Members will show the amount of stock held by each member instead of the number of shares held. On conversion of shares into stock, entry would be:

Equity Share Capital A/c.	Dr.	-	
To Equity Stock A/c.			-

Note: While converting shares into stock, if the value of the stock is more or less than the value of shares, then the difference will be transferred to either discount or Premium on issue of Stock Account.

Illustration:1

Give the Journal Entries:

1. The share capital of Raha Limited was divided into 10,000 shares of Rs. 50 each. The company decided to partition the equity shares into 2 equity shares of Rs. 10 each and 3 preference shares of Rs. 10 each.

2. Mahi Pharmaceutical Limited decided to issue equity stock of Rs. 60 in exchange for 5 equity shares of Rs. 10 each.

3. Ragini Company Limited decided to issue equity stock of Rs. 95 in exchange for 10 equity shares of Rs. 10 each.

Solution:

Entry in the books of the company

Date.	Particulars	Dr.	Cr.
	Equity Share Capital A/c (10,000 shares @ ₹50) Dr.	5,00,000	
	To Equity Share Capital A/c (20,000 shares @ ₹10)		2,00,000
	To Preference Share Capital A/c (30,000 shares @ ₹10)		3,00,000
	Equity Share Capital A/c Dr.	50	
	Discount on stock A/c Dr.	10	
	To Equity stock		60
	Equity Share Capital A/c (10 shares @ Rs. 10 each) Dr.	100	
	To Equity stock		95
	To Stock on premium		5

Illustration:2 Roshan Co. Ltd. with a share Capital of 10,000 Equity shares of Rs. 100 each fully paid carries out by, proper resolution, a sub-division into shares of Rs. 10 each. Show the necessary journal entry to give effect to the above resolution.

Solution:

Books of Roshan Co. Ltd Journal Entries

Date.	Particulars	Dr.	Cr.
	Bank A/c Dr.	10,00,000	
	To Share Capital		10,00,000
	Equity Share Capital A/c Dr.	10,00,000	
	To Share Capital		10,00,000

Illustration:3 A Company has the following Share Capital:

(i) 10,000 Equity Shares of Rs. 10 each, Rs. 5 Paid-up;

(ii)1,000 Preference Shares of Rs. 100 each, Rs. 50 paid-up.

The company decides that all shares are to be consolidated or sub-divided into shares of Rs. 50 each.

You are required to pass necessary Journal entries.

Solution:

Journal Entries

Date.	Particulars	Dr.	Cr.
	Equity Share Capital (Rs. 10) A/c Dr. To Equity Share Capital (50) A/c (Being consolidation of 10,000 equity shares of Rs. 10 each, Rs. 5 paid-up into 2,000 equity shares of Rs. 50 each, Rs. 25 paid-up)	50,000	 50,000
	Preference Share Capital (Rs.100 A/c) Dr. To preference share capital (Rs.50) A/c (Being sub-division of 1,000 shares of Rs. 100 each, Rs. 50 paid up into 2,000 shares of Rs. 50 each, Rs. 25 paid-up)	50,000	 50,000

Illustration:4 A company has the following share capital:

10,000 Equity shares of Rs. 10 each, Rs. 5 paid up.

The company makes a final call of Rs. 5 per share and passes a resolution to convert the share capital into stock of an equivalent amount.

Later on the company decides to reconvert the stock into fully paid equity shares of Rs. 10 each. You are required to pass necessary journal entries in the books of the company.

Solution:

Journal Entries

Date.	Particulars	Dr.	Cr.
	Equity shares final call A/c Dr. To Equity share capital A/c (Being final call of Rs. 5 per share on 10,000 equity shares was made)	50,000	 50,000

	Bank A/c Dr. To Equity share Final call A/c (Being the amount of final call recd. On equity shares)	50,000	 50,000
	Equity shares capital A/c Dr. To Equity Stock A/c (Being conversion of fully paid up 10,000 shares of Rs. 10 each into stock of Rs. 1,00,000)	1,00,000	 1,00,000
	Equity stock A/c Dr. To Equity share Capital A/c (Being reconversion of Rs. 10,00,000 equity stock into 10,000 fully paid-up equity shares of Rs. 10 each)	1,00,000	 1,00,000

Illustration:5 Rima Ltd., has an issued capital of Rs. 4,00,000 in 4,000 shares of Rs. 100 each on which Rs. 70 per share has been called up. The company now decides to reduce the share capital to shares of Rs. 70 each fully paid by cancelling the uncalled amount of Rs. 30 per share. Show journal entry.

Solution:

Books of Rima Co. Ltd Journal Entries

Date.	Particulars	Dr.	Cr.
	Bank A/c (4000x70 fully paid) Dr. To share capital A/c	2,80,000	 2,80,000
	Share Capital A/c (4000x70 fully paid) Dr. To share Capital A/c	2,80,000	 2,80,000

❖ **Exercise**

➢ **Multiple choice questions:**

1. **What is meant by the alteration of share capital?**

A. Issuing new shares to existing shareholders
B. Changing the structure of a company's authorized capital
C. Paying dividends to shareholders
D. Creating debentures for raising funds

Answer: B

2. Under which section of the Companies Act, 2013, can a company alter its share capital?

A. Section 61
B. Section 62
C. Section 53
D. Section 69

Answer: A

3. Which of the following is NOT a method of altering share capital?

A. Increasing the authorized share capital
B. Reducing the share capital
C. Issuing debentures
D. Consolidating or dividing shares

Answer: C

4. What is the minimum requirement for a company to alter its share capital?

A. Board resolution
B. Approval of shareholders in a general meeting
C. Approval of the Registrar of Companies
D. Approval of SEBI

Answer: B

5. When a company increases its authorized share capital, it must amend its:

A. Articles of Association
B. Memorandum of Association
C. Both Articles and Memorandum of Association
D. Shareholders' agreement

Answer: B

➢ **Answer the following Questions**

1. What is the alteration of share capital?

2. Why would a company alter its share capital?

3. What are the methods of altering share capital?

4. What is procedure for increasing share capital?

➢ **Give the appropriate journal entry.**

1. Piyush Co. Ltd. its converted 10,000 equity shares of Rs. 10 each into equity stock of Rs. 1,02,000.

2. Kaya Kalp Ayurvedic Company Ltd. 70,000 fully paid-up equity shares of Rs. 100 are registered by deposit. The company has been divided into 6 equity shares of Rs. 10 each and 4 preference shares of Rs. 10each.

3. Pharma Limited converted 100 equity shares pf Rs. 10 each into equity stock of Rs. 850.

4. 10,000 equity shares of a company are divided into one share of Rs.100 each and one share of Rs. 10 each.

5. A company converts 5,000 equity shares into equity stock. The original price of an equity share is Rs.100.

   (1) At a price of Rs. 102 per share

   (2) Apply in both the above situations at a price of Rs. 98 per share.

6. A company has a paid-up share capital of Rs. 12,80,000 divided into 1,00,000 equity shares of Rs. 10 each, Rs. 8 per share paid up. The company decides to reduce the paid-up capital to Rs. 6 per share paid up by paying off the necessary amount. Give the appropriate journal entry.

UNIT-4 ALTERATION OF SHARE CAPITAL -II

4.1 Introduction

4.2 Provision Regarding Issue of Right Shares

4.3 Bonus Shares

4.4 Reasons for issue of Bonus Shares

4.5 Sources of Bonus Shares

4.6 Fractional Bonus Shares

4.7 Accounting Entries for Issue of Bonus Shares

4.8 Illustrations

❖ **Exercise**

4.1 Introduction

A company can increase its share capital within the limits of authorizes capital at any time without getting sanctioned from either its shareholders or from the central government. If the company has exhausted its authorized capital, it can increase its Authorized Capital, if it requires additional funds for its business. A company can also increase its share capital by issuing bonus shares, in which case, it does not get additional finances, but is able to retain the accumulated profits permanently with itself. In short, a company can increase its shares capital in the following ways:

(1) By issuing additional shares (2) By issuing bonus shares

(1) Issue of Further Shares:

When the company has not issued shares to the extent of its authorized capital, it can issue further shares and increase in its share capital. This does not require the consent of even shareholders, because the authorized capital is not fully issued. The directions can take decisions regarding further issue.

But when the authorized capital has been fully issued and the company wants to issue more shares, it will have to increase its authorized share capital. For this purpose, the company must be authorized by its articles and consent of shareholders must be obtained in the general meeting.

(2) Bonus shares:

Sometimes, the company gives shares to its shareholders out of its accumulated profits, and the shareholders are not required to pay anything, such shares are called bonus shares. This is an additional benefit to the shareholder of the company, in addition to the dividend. Further discussion about bonus shares is done later on this chapter.

4.2 Provision Regarding Issue of Right Shares

When the company makes further issue of shares, it is compulsory for it to offer them to existing shareholders in proportion to their present holding. As the present shareholders have got these shares, they are called Right Shares.

The provisions regarding issue of right shares are contained in Section 62 of the Companies Act,2013.

(1) Such further shares shall be offered to equity shareholders of the company, in proportion to the capital paid up on those shares.

(2) The offer shall be made by notice specifying the number of shares offered and the time within which the offer should be accepted.

(3) The offer should give a time limit of not less than 15 days and not more than 30 days from the date of the offer.

(4) Unless the articles provide otherwise, the offer shall also include a right to renounce the shares offered to him in favor of any other person. The notice should contain a statement of this right.

(5) After expiry of the time specified in the notice, or on the receipt of earlier intimation from the person that he declines to accept the shares offered to him, the Board of Directors may dispose them of in such manner as they think most beneficial to the company.

4.3 Bonus Shares

It is prudent policy on the part of the company not to distribute its entire profit as dividend to shareholders but to transfer a portion of such profit to reserve to meet unknown contingency and to strengthen the financial position of company. When the amount so transferred to various reserve accumulate and forms a substantial amount, then generally, the company would like to give the benefit of such profit to the shareholders. However, many companies do not like to distribute it by way of cash dividend, as it is likely to affect adversely the working capital of the company. If the company wants to utilize the amount of reserve for the expansion of the business, the company may distribute it in form of shares without payment being made by the existing equity shareholders. The shares so issued are known as “Bonus Shares”. Thus, by issuing bonus shares the reserve is capitalized and the accumulated profit is utilized for the expansion of the business. This is known as ‘ploughing back of profit.’

4.4 Reasons for issue of Bonus Shares

(1) When the company has large accumulated reserves, whether capital or revenue and it wants to capitalize these reserves for making it a permanent capital of the company.

(2) When the company, though has reserves, is not in position to pay cash bonus because it may disturb the cash position.

(3) Where the value of fixed assets far exceeds the value of capital, to make the capital to show a value on par with the value of the assets.

(4) When the higher rates of dividend payment are not advisable because shareholders may demand at least the same rate or even more in the future which the company may not be in a position to pay.

(5) When the market value exceeds the face value of shares, to make the value on par with each other.

4.5 Sources of Bonus Shares

A company can issue the Bonus Shares out of the following:

(1) Credit balance of Profit and Loss A/c

(2) General Reserve or any other reserve which is an appropriation of the profit

(3) Balance of Debenture Redemption Fund or Sinking fund after the debenture is redeemed

(4) Capital Redemption Reserve A/c

(5) Share Premium A/c

(6) Capital Profits and Reserves such as profit prior to incorporation, profit on acquisition of business, profit on sale of fixed assets etc.

Capital Redemption Reserve Account and Share Premium Account can be applied only for issuing fully paid-up bonus shares, i.e. it cannot be used towards making partly paid shares fully paid-up.

We have discussed the method of issuing bonus shares to give the benefit of accumulated profit to the shareholders of the company. Another method of giving such a benefit to shareholders is to make their partly paid shares fully paid.

4.6 Fractional Bonus Shares

Bonus shares are issued by company in proportion to their existing shareholding. Many times, a full share cannot be allotted to a shareholder. E.g. a company issues one bonus shares for four shares held. A shareholder holding 10 shares will get 2 full shares and one half the shares. This is a fractional share. It is also called bonus coupon.

The fractional share can be disposed of in any one of the following ways:

(1) The sum is paid in cash to the shareholders.

(2) The company may issue fractional share to the shareholders with the instruction that he should either get the remaining fractional share to make it a full share, within a simulated time limit or he must dispose of his fractional share within that time limit.

(3) The fractional shares are all handed over to the trustee of shareholders, who will sell them in the market and after deducting the expenses, will distribute the amount among the shareholders in proportion to their entitlement. (This method is now used by most of the companies and bonus coupons for fractional shares are not issued.)

4.7 Accounting Entries for Issue of Bonus Shares

(1) Payment of bonus shares from available sources:

Profit and Loss A/c Dr.

General Reserve A/c Dr.

Capital Redemption Reserve A/c Dr.

Share Premium A/c Dr.

To Bonus to shareholders A/c

(2) When bonus is to be utilized for issuing fully shares:

Bonus to shareholder's A/c Dr.

To share capital A/c

To Share Premium A/c (If issued at premium)

(3) Bonus is to be utilized for making partly paid shares fully paid-up:

- Profit and Loss A/c Dr.

  General Res. A/c Dr.

  Cap. Res. A/c Dr.

  To bonus to shareholders A/c

- Share final call A/c Dr.

  To Equity Share Cap. A/c

- Bonus to shareholders A/c Dr.

  To Share final call A/c

4.8 Illustrations

(1) The issued share capital of Bindiya Ltd. Consists of 60,000 Equity shares of Rs. 10 each. On 31-3-24, it had Rs. 5,00,000 to the credit to General Reserve and Rs. 3,00,000 to the credit of P&L Account. The Company decided to issue bonus shares at the rate of 1 share for every 3 shares held and decided to utilized the General reserve up to Rs. 1,50,000 and the balance out of Profit and Loss Account. Assuming that the above schemes has been accepted, give necessary Journal Entries in the books of the company.

(2)

Journal Entries in the books of Bindiya Ltd.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1	General reserve A/c Dr. P & L A/c Dr. To Bonus to Shareholders A/c (Being provision made to issue 1 share for every three shares held to the shareholders)		1,50,000 50,000	 2,00,000
2	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (Being 20,000 bonus shares issued to shareholders)		2,00,000	 2,00,000

(3) The XYZ co. Ltd has the following items in its balance sheet as on 31-3-24:

	Rs.
Subscribed Equity Share Capital	1,00,000
(Shares of Rs. 10 each, Rs. 8 paid up)	
General Reserve	1,50,000
P & L A/c (credit)	2,00,000

The company decided:

(1) To convert partly paid equity Shares into fully paid shares

(2) To issue bonus shares at Rs.10 each at a premium of 25% on the basis of 1 equity Share for every two equity shares held.

Write Journal Entries in the books of the company.

Journal Entries in the books of Bindiya Ltd.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1	General reserve A/c Dr. To Bonus to shareholders A/c (Being General Reserve capitalized for Bonus to be paid to shareholders)		1,03,125	 1,03,125

2	Share Final Call A/c Dr. To Equity Share Capital A/c (Being a call of ₹ 2 made on 25,000 shares)		25,000	 25,000
3	Bonus to Shareholders A/c Dr. To Share Final Call A/c (Being bonus utilized in paying call on shares)		25,000	 25,000
4	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c To Security Premium A/c (Being issue of 5,000 shares of ₹ 10 each at a premium of ₹ 2.5 per share as bonus)		78,125	 62,500 15,625

(3) Issued and Paid up capital of a company consists of 20,000 equity shares of Rs. 10 each, Rs. 8 per share called up and paid up.

Following balances appeared in the Balance Sheet of the company on 31-3-24:

	Rs.
Capital reserve	20,000
General reserve	30,000
Profit and Loss A/C (credit)	10,000
Capital Redemption Reserve	1,00,000
Provident Fund	2,00,000

The Directors of the company decided to issue bonus as under:

(i) Bonus to make partly paid up equity shares fully paid up.

(j) Issue fully paid up equity shares as bonus in the ratio of 2:1 (1 Share as bonus against 2 shares held)

Pass Journal Entries in the books of the company.

[Guj. Uni., F.Y., Nov. 2013]

Journal Entries in the books of Company

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1	Capital Redemption Reserve A/c Dr. General Reserve A/c Dr. Profit & Loss A/c Dr.		1,00,000 30,000 10,000	- - -

	To Bonus to Shareholders A/c (Being Reserves & Profit capitalized for Bonus to be paid to shareholders)			1,40,000
2	Share Final Call A/c Dr. To Equity Share Capital A/c (Being a call of ₹ 2 made on 20,000 shares)		40,000 -	- 40,000
3	Bonus to Shareholders A/c Dr. To Share Final A/c (Being bonus utilized in paying call on shares)		40,000 -	- 40,000
4	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (Being issue of 10,000 shares of ₹ 10 each as bonus)		1,00,000 -	- 1,00,000

(4) Following are the balances of Dhanvi Ltd:

Particulars	Rs.
2,000 Equity Shares of Rs. 10 each, Rs. 8 Paid Up	16,000
General reserve	4,000
Capital Redemption reserve	16,000
Securities Premium	2,000
Profit from the revaluation of fixed assets	2,000

(1) It was resolved in the annual general meeting of the company to make their partly paid shares as fully paid shares from free reserves.

(2) After making it fully paid up, company issues 1 share as right Share against 5 shares held by the shareholders, each of Rs. 10 at Rs. 12. All the shareholders have exercised their right.

(3) After such right issue, company is using all usable reserves for declaring fully paid up bonus shares of Rs. 10 each.

Pass required entries for the above transactions.

[Guj. Uni., F.Y., Nov. 2016]

Journal Entries in the books of Aarti Ltd.

Date	Particulars	L.F.	Debit(Rs.)	Credit(Rs.)
1	General Reserve A/c Dr. To Bonus to Shareholders A/c (Being General Reserve capitalized for Bonus)		4,000	 4,000

2	Share Final Call A/c Dr. To Equity Share Capital A/c (Being a call of ₹ 2 made on 2,000 shares)		4,000	 4,000
3	Bonus to Shareholders A/c Dr. To Share Final Call A/c (Being bonus is utilized for paying call on shares)		4,000	 4,000
4	Bank A/c Dr. To Share Capital A/c To Security Premium A/c (Being issue of right shares at ₹ 12 in the ratio of 5:1)		4,800	 4,000 800
5	Capital redemption Reserve A/c Dr. Security Premium A/c (2,000 + 800) Dr. To Equity Share Capital A/c (Being issue of 1,880 new shares of ₹ 10 each using all usable reserves as bonus)		16,000 2,800	 18,800

[5] The Balance Sheet of Mansi Co. Ltd. as on 31-3-24.

Particulars	**Note**	**Rs.**
I. Equity and Liabilities:		
(1) Shareholders' Funds:		
(a) Share Capital:		8,00,000
80,000 Equity Shares of Rs. 10 each		
(b) Reserves and Surplus:		
General Reserve		3,60,000
Profit and Loss A/c		3,00,000
(2) **Non-Current Liabilities**:		
(a) Long Term Borrowings: 12% Debentures		2,00,000
Total		**16,60,000**
II. **Assets**		
(1) Non-Current Assets:		
(a) Fixed Assets		8,00,000
(2) Current Assets:		

(a) Inventories: Stock			2,00,000
(b) Trade Receivables: Debtors			2,60,000
(c) Cash and Cash Equivalents:			
Cash and Bank Balance			4,00,000
Total			**16,60,000**

It was resolved at Annual General Meeting:

(1) To pay dividend of 8%.

(2) To Issue one bonus share for every four shares held.

(3) To repay the debentures at a premium of 3%.

Pass the necessary Journal Entries and prepare new Balance sheet.

[Guj. Uni., F.Y., Nov. 2012]

Journal Entries in the books of Mansi Co. Ltd

Date	**Particulars**	**L.F.**	**Debit (Rs.)**	**Credit (Rs.)**
1	General Reserve A/c Dr. To Equity Dividend A/c (8,00,000 * 8%) (Being provision made for Equity Dividend)		64,000	 64,000
2	Equity Dividend A/c Dr. To Bank A/c (Being paid 8% dividend to Equity Shareholders)		64,000	 64,000
3	General Reserve A/c Dr. To Bonus to Shareholders A/c (Being provision is made for issue of 4:1 bonus)		2,00,000	 2,00,000
4	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (Being issue of 20,000 shares of ₹ 10 each as bonus)		2,00,000	 2,00,000
5	12% Debentures A/c Dr. Debenture Red. Premium A/c Dr. To Bank A/c (Being Debentures are redeemed at 3% premium)		2,00,000 6,000	 2,06,000

6	Profit & Loss A/c Dr. To Debenture Redemption Premium A/c (Being debenture red. premium written off to P & L A/c)		6,000	6,000

Balance Sheet of Mansi Co. Ltd. as on 31-03-2019

Particulars	Note	Amount (Rs.)
I. Equities and Liabilities:		
(1) Shareholder's Funds:		
(a) Share Capital:		
1,00,000 Equity Shares of Rs. 10 each		10,00,000
(b) Reserves and Surplus:		
General reserves (3,60,000 – 64,000 -2,00,000)		96,000
Profit and Loss A/c (3,00,000 – 6,000)		2,94,000
Total		**13,90,000**
II. Assets:		
(1) Non-Current Assets:		
(a) Fixed Assets		8,00,000
(2) Current Assets:		
(a) Inventories		2,00,000
(b) Trade Receivables: Debtors		2,60,000
(c) Cash and Cash Equivalents:		
Cash and Bank Balance		
(4,00,000 -64,000 – 2,06,000)		1,30,000
Total		**13,90,000**

❖ **Exercise**

- **Answer the following Questions:**

  (1) Explain the Provision Regarding Issue of Right Shares.

  (2) Discuss the Reasons for issue of Bonus Shares.

- **Short Notes**:

  (1) Bonus Share

(2) Fractional Bonus Share

(3) Sources of Bonus Share

- **Examples**:

1. The balance sheet of X Co. ltd. As on 31-3-2024 was as follow:

Particulars	Note No.	Rs.
I. Equities and Liabilities:		
(1) Shareholder's Fund:		
(a) Share capital:		4,00,000
4,000 Equity shares of Rs. 100 each		
(b) Reserves and Surplus:		
Share premium 80,000		
Reserve fund 2,00,000		
Profit and loss A/c 1,50,000		4,30,000
(2) Current Liabilities:		
(a) Trade Payable: Sundry Creditors		70,000
Total		**9,00,000**
II. Assets		
(1) Non-Current Assets		9,00,000
Total		**9,00,000**

The company decided to issue Bonus shares at the rate of 3 shares for every 4 shares and for this purpose, it was decided to utilized total amount for Share Premium; Rs. 1,20,000 out of Reserve Fund and the balance out of Profit and Loss A/c.

You are required to pass journal entries to give effect to the above and prepare the amended Balance Sheet.

2. The issued share capital of A-one Plastics Ltd. consists of 10,000 equity shares of Rs. 100 each, Rs. 80 paid up. It has Rs. 3, 00,000 in the reserve fund. The Directors recommended to capitalize the reserve of Rs. 2,00,000 and utilize the amount in making partly paid shares fully paid up.

Assuming the scheme is accepted, give journal entries.

3. All Well Co. Ltd. has an authorized capital of Rs. 80, 00,000 divided in equity shares of Rs. 100 each. The issued capital of the company was Rs. 48, 00,000 divided into shares of Rs. 100 each. Rs. 80 per share called and paid.

A sum of Rs. 27, 60,000 was capitalized out of Reserve Fund and out of the amount so capitalized, the directors were authorized to-

(a) Declare a Bonus Dividend to make shares a fully paid.

(b) To issue 12,000 new equity shares of Rs. 100 each at premium of Rs. 50 per share on the basis of one equity shares for every four equity shares held.
Assuming that the resolution was given effect to, you are requested to pass necessary journal entries in the books of the company.

4. The Balance Sheet of Apollo Co. Ltd. as at 31-3-2024 was as under:

Particulars	**Note No.**	**Rs.**
I. Equities and Liabilities:		
(1) Shareholder's Fund:		
(a) Share capital:		
Authorized Capital: 6,00,000		
issued: 40,000 shares of Rs. 10 each		4,00,000
(b) Reserves and Surplus:		
Profit and loss A/c		2,40,000
(2) Non-Current Liabilities:		
(a) Long-term Borrowing:		
5% Debenture		2,60,000
(3) Current Liabilities:		
(a) Trade Payable: Creditors		1,40,000
Total		**10,40,000**
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
(i) Tangible Assets:		
Freehold Properties		2,00,000
(2) Current Assets:		
(a) Inventories		2,40,000
(b) Trade Receivables: Debtors		2,00,000
(c) Cash and Cash equivalent:		
Cash and Bank balance		4,00,000
Total		**10,40,000**

At the Annual meeting, it was agreed

(1) To pay a dividend in cash of 10% free of tax (Rate of deduction of Income-tax is 20%)

(2) To issue one bonus share for every four old shares held.

(3) To give existing shareholders the option to purchase one share of Rs. 10 each at Rs. 15 per share, for every four shares held prior to the bonus distribution. All the shareholders exercised their option.

(4) To repay the debentures at a premium of 3%.

Give the necessary journal entries and give the Balance Sheet after transactions are completed.

5. The following balances are taken from the balance sheet of X Co. Ltd. as at 31-3-2024.

(1) Paid up Share capital	Rs.50,00,000
(2) General Reserve	Rs.40,00,000
(3) Capital Reserve	Rs.22,00,000
(4) Average Profit of last three years	Rs.25,00,000

Calculate the amount of bonus shares that the company can issue on the basis of 10 residual Reserve Test (2) Dividend Test.

6. The Balance Sheet of Firm Festival Ltd. as at 31-3-24 read as under:

Particulars	**Note No.**	**Rs.**
I. Equities and Liabilities:		
(1) Shareholder's Fund		
(a) Share capital:		
Authorized capital: 30,000		
issued: 2,000 shares of Rs. 10 each		20,000
(b) Reserves and Surplus:		
Profit and loss A/c		14,000
(2) Non-Current Liabilities:		
(a) Long-term Borrowing:		
6% Debenture		12,000
(3) Current Liabilities:		
(a) Trade Payable: Creditors		6,000
Total		**52,000**

II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
(i) Tangible Assets:		
Freehold Properties		10,000
(2) Current Assets:		
(a) Inventories		12,000
(b) Trade Receivables: Debtors		8,000
(c) Cash and Cash equivalent:		
Cash and Bank balance		
		22,000
Total		**52,000**

At the annual meeting it was agreed:

(1) To pay a dividend in cash of 10% free of tax (Income tax at 20%).

(2) To issue one bonus shares for every four old shares held.

(3) To give existing shareholders the option to purchase one share of Rs. 10 at Rs. 12.50 per share for every four shares held prior to the bonus distribution. All the shareholders took up their option.

(4) To repay the Debentures at a premium of 3%.

Give the necessary journal entries and give the Balance Sheet after the transactions are completed.

7. Dattatreya Co. Ltd. declare bonus out of its general reserve to convert its party paid shares into fully paid shares. Afterwards three fully paid equity shares were used to distribute as bonus in exchange for five shares from share premium and capital reserve.

The balances on 31-12-24 are as under:

Equity share capital (each share of Rs. 100, paid up to the extent of Rs. 75)	6,00,000
General reserve	2,50,000
Capital Reserve	3,30,000
Share Premium	1,50,000

Write necessary journal entries in the books of Dattatreya Company regarding bonus shares.

8. The following was the Balance Sheet of HIV Co. Ltd. as on 31-12-24.

Particulars	**Note No.**	**Rs.**
I. Equities and Liabilities:		
(1) Shareholder's Fund:		
(a) Share capital:		
Equity shares of Rs. 10fully paid		3,00,000
(b) Reserves and Surplus:		
General Reserve		2,88,000
Profit and loss A/c		22,000
(2) Current Liabilities:		70,000
Total		**6,80,000**
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
(i) Tangible Assets:		
Freehold Properties		5,40,000
(2) Current Assets:		
(a) Inventories		1,30,000
(b) Cash and Cash equivalent:		
Cash and Bank balance		10,000
Total		**6,80,000**

On 1-1-25 the company decided to issue bonus shares on the basis of two fully paid equity shares of Rs. 10 each for every five equity shares held. After the issue of Bonus shares the company issued new equity shares as Right shares on the capital as enhanced by issue of bonus shares at the rate of two new equity shares of Rs. 10 each at 20% premium, for every five equity shares held, which were fully paid up.

From the above particulars pass the necessary journal entries in the books of the company and prepare new balance sheet immediately thereafter.

BBA
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BLOCK: 2

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UNIT-5 REDEMPTION OF PREFERENCE SHARES

5.1 Introduction

5.2 Provisions of Companies Act, 2013

5.3 Accounting Treatment of Redemption of Preference Shares (Redemption of Fully Paid-Up Shares / Redemption of Partly Called Up Preference Shares / Redemption of Fully Called but Partly Paid-Up Preference Shares)

5.4 Illustrations

❖ **Exercise**

5.1 Introduction

Generally, a company is not allowed to purchase its own shares. If it does so, it amounts to reduction of share capital which is not permitted unless certain conditions are fulfilled. They are:

(1) A special resolution must be passed in general meetings and

(2) Sanction from the court must be obtained. But the Companies Act has provided for an exception to this rule and accordingly a company can issue Redeemable Preference Shares. Money received on these shares can be returned by the company in future.

Redeemable Preference Share are a hybrid form of shares and debentures and incorporates features of both. It resembles debentures more than preference Shares. However, from legal point of view, it is treated as share. The provisions relating to Redeemable Preference Shares are set out in Section 55 of the Companies Act. The conditions laid down are such that the share capital can be returned and yet the interest of creditors is not adversely affected.

5.2 Provisions of Companies Act, 2013

The conditions in Section 55 of the act and are summarized below:

1. A company limited by shares can issue redeemable preference shares subjected to provisions of Sec.55 of the Act. Such an issue must also be authorized by the Articles of the Association (AOA).

2. With the effect from 1st march, 1997 a company cannot issue irredeemable preference shares or shares which can be redeemed beyond a period of 20 years.

3. A company is permitted to carry out redemption from only two sources.

(a) Profit of the company which would otherwise be available for dividend.

(b) Proceeds of fresh issue of shares made for the purpose of redemption.

The section rules out any other source such as issue of debentures, borrowing from banks and other financial institutions for carrying out redemption.

4. Where shares are redeemed from out of profits otherwise available for dividend, a sum equal to nominal value of the shares redeemed must be transferred to a reserve account. Such a reserve account is styled as "Capital Redemption Reserve A/c".
5. Only fully paid preference shares are to be redeemed. If partly paid shares are to be redeemed, call must be made first and then redemption must be carried out.
6. Redemption may be at par or at premium according to the terms of issue. If redemption is at premium, such a premium must be met out of profit or the balance in "Security premium A/c".
7. Capital Redemption Reserve A/c is available only for the purpose of issue of bonus shares. This reserve must be kept intact unless otherwise sanctioned by the court.
8. Redemption of redeemable preference shares does not result in reduction of authorized capital of the company. To the extent reduction has taken place, company can issue further shares, as if those shares had never been issue.
9. If new shares are issued for the purpose of redemption, it will not amount to increase in capital.
10. Subject to the provision of this section, redemption must be carried out in accordance with the terms provided in Articles of the company.

Important Notes:

1. If the shares are not fully paid a call must be made and shares must be made fully paid. Then only such shares can be redeemed.

2. If such shares are redeemed out of the profits available for dividend, then an amount equal to the nominal value of shares must be transferred from profits to Capital redemption Reserve A/c.

3. If they are to be redeemed out of the fresh issue of shares, then entries for fresh issue must be made.

4. If they are to be redeemed at a premium, the amount of the premium must be debited to either Share premium A/c or to profit and loss A/c.

5.3 Accounting Treatment of Redemption of Preference Shares (Redemption of Fully Paid-Up Shares / Redemption of Partly Called Up Preference Shares / Redemption of Fully Called but Partly Paid-Up Preference Shares)

The following accounting entries will have to be made in the books of the company for redemption of preference shares.

Step-1: Issue of Shares:

If there is fresh issue of share capital for the purpose of redemption then make following journal entries for it:

1	Bank A/c Dr. To Share capital A/c
2	Bank A/c Dr. Discount A/c Dr. To Share capital A/c
3	Bank A/c Dr. To Share capital A/c To Share premium A/c

Step-2: Redemption of Preference Shares:

This redemption can be done either at par or at a premium for that make an entry as follows:

1	**When redemption at par:** Red. Pre. Shares Cap. A/c Dr. To Red. Pre. S. H. A/c
2	**When redemption at premium:** Red. Pre. Shares Cap. A/c Dr. Pre. On Red. Of Pre. Sh. A/c Dr. To Red. Pre. S. H. A/c

Step-3: Call Money Due:

This redemption can be done but before it if preference shares are not fully paid-up it should be first fully paid-up and then after it can be redeemed.

1	Red. Pre. Sh. Call A/c Dr. To Red. Pre. Sh. Cap. A/c
2	Bank A/c Dr. To Red. Pre. Sh. Call A/c

Step-4: Provision for the Redemption Preference Shares out of profits:

If the proceeds of fresh issue of shares are less than the amount of shares redeemed, the amount equal to the difference must be transferred from different reserves to Capital Redemption Reserve A/c.

1	Profit and Loss A/c Dr. Or General reserve A/c Dr. To Cap. Red. Res. A/c

Note: Red. Pre. Shares redeemed = Fresh issue of share capital + Cap. Redemption res. A/c

Step-5: Transfer Premium on Redemption A/c:

Transfer premium on redemption of preference shares to either profit and loss A/c or any Reserve A/c or premium A/c.

1	Share Premium A/c Dr. To Pre. On Red. Of PS. A/c

Step-6: Paid to Preference Shareholders:

1	Pre. Shareholders A/c Dr. To Bank A/c

Step-7: Declaration of Bonus Shares:

If Bonus Shares are issued out of capital redemption reserve A/c, the following journal entries are made:

1	Cap. Red. Res. A/c Dr. To Bonus to S.H. A/c
2	Bonus to S.H. A/c Dr. To Share Cap. A/c

Illustration:1 Raj Co. Ltd. had 5,000, 8% redeemable preference shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of Rs. 10 each fully paid up at par. You are required to pass necessary journal entries including cash transactions in the books of the company.

Solution:

In the Books of Raj Co. Ltd.

Journal Entries

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
	Bank a/c Dr. To Equity Share Capital a/c (Being the issue of 50,000 Equity shares of Rs. 10 each at par for the purpose of redemption of preference shares)	5,00,000	 5,00,000
	8% Redeemable Preference Share Capital A/c Dr. To preference shareholders A/c (Being the amount payable on redemption of preference shareholders Account)	5,00,000	 5,00,000
	Preference shareholders A/c Dr. To Bank A/c (Being the amount paid on redemption of preference shares)	5,00,000	 5,00,000

Illustration:2 A company decided to redeem 2,000 Redeemable preference shares of Rs. 100 each at a premium of 5%. For the purpose, it issued 2,000 Equity shares of Rs. 100 each at a premium of 10%. All were subscribed and full amount was received. Give Journal entries.

Journal Entries

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
1.	Redeemable pref. share Capital A/c Dr. Premium on Red. Of Preference shares A/c Dr. To preference shareholders A/c (preference shares to be redeemed at a premium of 5%)	2,00,000 10,000	 2,10,000

	Bank a/c Dr. To Equity Share Capital A/c To share premium A/c (2,000 equity shares of Rs. 100 each issued at a premium of 10% in order to provide for redemption of preference shares)	2,20,000	 2,00,000 20,000
	Share premium A/c Dr. To premium on redemption of pref. shares A/c (share premium utilized in writing of redemption premium)	10,000	 10,000
	Preference shareholders A/c Dr. To Bank A/c (Being the amount paid on redemption of preference shares)	2,10,000	 2,10,000

Illustration:3 Mehta construction Co. Ltd. decided to redeem their preference shares as on 31st March,2021 on which date the position was as under.

Mehta construction Co. Ltd.

Balance sheet as at 31 March,2021

	Particulars	**As at 31st March, 2021**
A	**Equity and Liabilities**	**Rs.**
1.	Shareholder's Funds	
	(a) Share Capital	
	Issued Subscribed & Paid-up Capital:	
	8,000 Equity shares of Rs.100 each	8,00,000
	16,000 Redeemable preference shares of Rs.50 each, Rs.25 paid up	4,00,000
	2,000 Redeemable preference shares of Rs.100 each fully paid	2,00,000
	(b) Reserve and surplus	
	Securities Premium Account	20,000
	Capital Redemption Reserve	1,80,000
	Dividend Equalisation Reserve	2,20,000
	(c) Money Received against share warrants	-
		18,20,000

2.	Share Application Money Pending Allotment	-
3.	Non-current Liabilities	-
4.	**Current Liabilities**	
	(a) Short-term Borrowings	-
	(b) Trade Payables	1,80,000
B	**Total**	**20,00,000**
1.	**Assets**	
2.	Non-current Assets	-
	Current Assets	
	(a) Current investments	-
	(b) Inventories	-
	(c) Trade Receivables	-
	(d) Cash and Cash Equivalents	2,80,000
	(e) Short-term Loans and Advances	-
	(a) Other Current Assets	17,20,000
	Total (1) + (2)	**20,00,000**

The redemption of partly paid up shares was to be at a premium of 5 per cent. The Capital Redemption Reserve appearing in the balance sheet is the reserve brought into being as a result of a redemption which took place in 2000. To enable the redemption to be carried out the company decides to issue, after carrying out the necessary formalities required under law, sufficient number of new equity shares at a discount of 10 per cent. The redemption is duly carried out. Show journals entries relating to the redemption and new issue and also the balance sheet after redemption. Ignore the question of dividend up to the date of redemption.

Solution:

Mehta Construction Co. Ltd

Journal

Sr. No.	Particulars	Dr. Rs.	Cr. Rs.
(1)	Preference Share Capital A/c (fully paid) Dr. Premium on redemption of pref. shares A/c Dr. To Sundry preference shareholders A/c (Being amount due to preference shareholders on redemption, including premium at 5%)	4,00,000 20,000	 4,20,000
(2)	Dividend Equalisation Reserve Dr. To Capital redemption reserve A/c (Being transfer to the latter account as required by law, to the extent the redemption has been from distributable profits)	2,20,000	 2,20,000
(3)	Bank A/c Dr. Discount on Issue of share A/c Dr.	1,80,000 20,000	

	To Equity share Capital A/c (Being issue of new equity shares @ 10 per cent discount for the purpose of redemption of preference shares to the extent required)		2,00,000
(4)	Sundry preference shareholders A/c Dr. To Bank (Being payment made to preference shareholders)	4,20,000	 4,20,000
(5)	Securities Premium A/c Dr. To Premium on redemption of preference shares (Being writing off premium on redemption of preference shares from share premium)	20,000	 20,000

Mehta Construction Ltd.
Balance sheet as at 31st March, 2021
(summarised balance sheet after redemption)

	Particulars	Rs.
A	**Equity and Liabilities**	
1.	Shareholder's Funds	
	(a) Share Capital	
	Issued Capital: 10,000 Equity shares of Rs.100 each	10,00,000
	2,000 Redeemable preference shares of Rs.100 each	2,00,000
	(b) Reserve and Surplus	
	Capital Redemption Reserve	4,00,000
	Discount on Issue of Shares	(20,000)
	(c) Money Received against share warrants	-
		15,80,000
2.	Share Application Money Pending allotment	**-**
3.	Non-current Liabilities	**-**
4.	Current Liabilities	
	(a) Short-term Borrowings	**-**
	(b) Trade Payables	**1,80,000**
	Total (1) + (2) + (3) + (4)	**17,60,000**
B	**Assets**	
1.	Non-current Assets	**-**
2.	Current Assets	
	(a) Current Investments	**-**
	(b) Inventories	**-**
	(c) Trade Receivables	**-**
	(d) Cash and Cash Equivalents	40,000
	(e) Short-term Loans and Advances	-
	(f) Other current Assets	17,20,000
	Total (1) + (2)	**17,60,000**

Illustration:4 Roshan Co. Ltd. has an authorized equity capital of Rs. 40 lakhs divided into shares of 100 each. The paid-up capital was Rs. 25,00,000. Besides this, the company had 9% Redeemable Cumulative Preference Shares of 10 each for Rs. 5,00,000. Balances on other accounts were-Share Premium, 18,000, Profit and Loss Account 1,44,000 and General Reserve ₹ 6,80,000 Included in Sundry Assets were investments of the face value of 60,000 carried in the books at a cost of ₹ 68,000.

The company decided to redeem the Cumulative Preference Shares at 10% premium, partly by the issue of equity shares of the face value of ₹ 2,40,000 at a premium of 10%. Investments were sold at 105% of their face value. All preference shareholders were paid off except 3 holders holding 500 shares.

After redemption of the Cumulative Preference Shares, fully paid bonus shares were issued in the ratio of 1: 4.

Give the necessary journal entries bearing in mind that the Directors wanted a minimum reduction in free reserves, while effecting the above transactions. Working should form part of your answer.

Roshan Co. Ltd.

Journal Entries

Date	**Particulars**	**Dr. Rs.**	**Cr. Rs.**
	Bank A/c Dr. To Equity share Capital A/c To share premium A/c (Issue and allotment of 2,400 Equity shares of Rs. 100 each fully paid at a premium of 10%)	2,64,000	 2,40,000 24,000
	Bank A/c Dr. Profit and Loss A/c Dr. To Investment A/c (Investments of Rs. 60,000 face value sold at 105 against the cost of Rs. 68,000; loss on sale debited to profit and loss A/c)	63,000 5,000	 68,000
	Share Premium A/c Dr. To premium payable on redemption of pref. shares (Premium payable on redemption of preference shares @ 10% charged to share premium account)	50,000	 50,000
	General Reserve A/c Dr. To Capital redemption reserve (Amount transferred to capital redemption reserve to provide for redemption of pref. shares: Shares redeemed, face value 5,00,000 Face value of new shares issued 2,40,000 2,60,000	2,60,000	 2,60,000
	9% Redeemable cum. Preference share capital A/c Dr. Premium payable on redemption A/c Dr. To preference shares redemption Alc	5,00,000 50,000	 5,50,000

	(Amount payable on redemption transferred to preference share redemption A/c)		
	Preference shares redemption A/c Dr. To Bank A/c (Amount paid to preference shareholder holding 24,750 shares including premium payable on redemption) Capital Redemption Reserve A/c Dr. Share premium Dr. General Reserve Dr. To Bonus to equity shareholders A/c (Decision to issue bonus shares in the ratio of 1:4 to 27,400 shareholders out of capital redemption reserve, share premium A/c and the balance out of general reserve)	5,44,500 2,60,000 10,000 4,15,000	 5,44,500 6,85,000
	Bonus to equity shareholders A/c Dr. To Equity share capital A/c (Issue of the bonus shares to the equity shareholders)	6,85,000	 6,85,000

Illustration:5 Extract of ledger balances of Kalpana Ltd. as on 31st March, 2015 includes the following:

Particulars	**Rs.**
2,000, 12% preference shares of Rs. 100 each, fully paid	2,00,000
Surplus	40,000
Securities Premium	12,000

Under the terms of issue, the preference shares are redeemable on 31st March, 2015 at a premium of 10%. The directors desire to make a minimum fresh issue of equity shares of Rs. 10 each at a premium of 5% for redemption purpose.

You are required to ascertain the amount of fresh issue to be made and pass necessary journal entries in the books of the company. [CS Executive, June 2016]

Solution:

No. of shares to be issued

Suppose x number of shares are to be issued

20,000+20,000=40,000+12,000+10x+5% of 10x

2,20,000=52,000+10x+0.5x

10.5x=1,68,000

Therefore x = 1,68,000/10.5 = 16,000

No. of shares to be issued = 16,000

Particulars	**Dr. (Rs.)**	**Cr. (Rs.)**
Pref. share Capital A/c Dr. Premium on redemption A/c Dr. To preference shareholders A/c (Being premium redemption of ,2000 preference shares at premium of 10%)	2,00,000 20,000	 2,20,000
Bank A/c Dr. To Equity share capital A/c To Securities premium A/c (Being issue of 16,000 shares of Rs. 10 each at a premium of 10% for the purpose of redemption of preference shares)	1,68,000	 1,60,000 8,000
Securities premium A/c Dr. To premium on redemption (Being utilization of security premium balance for writing of premium on redemption)	20,000	 20,000
Profit and Loss A/c Dr. To capital redemption reserve A/c	40,000	 40,000
Preference shares holder's A/c Dr. To Bank A/c	2,20,000	 2,20,000

❖ **Exercise**

1. 30,000, 9% Redeemable preference shares of Rs. 100 each of Info Customer care Ltd. repayable at a premium of 12% are now due for redemption. The company has accumulated reserves the amount of which is much excess the sum required for redemption. In addition, there is a large balance lying securities premium account which is available for payment of premium on redemption.
   Show the journal entries in the books of the company to give effect to above.

   (Ans. Amount transferred to capital redemption reserve Rs. 15,00,000)

2. A company issued Rs. 1,80,000 Redeemable Preference shares at par on 1st janauary,1990 redeemable at the option of the company on or after 31st December, 1994 in Whole or in part. The following redemptions were made out of profits:
   On 30th June,1997 Rs. 60,000
   On 30th June,1998 , Rs. 40,000
   In December,1998, the company issued equity shares of the face value of Rs. 60,000 at a premium of 2% and on 31st December in the same year it redeemed the balance of preference shares.
   Pass the necessary journal entries to record the transactions. (Guj. Uni. B.com)

3. Redeemable preference share capital of Nihar Company Limited is Rs. 3,00,000 which decided to redeem it at a premium of 10%. On the same date, the company's balance sheet showed share premium of Rs. 9,500 and profit and loss account (credit balance) Rs. 1,40,000. For the purpose of redemption, necessary Equity shares of Rs. 100 each were issued at 5% discount. The necessary amount for redeeming the preference shares was obtained partly from the balance of profit and partly from issue of shares.

   Pass necessary entries in the books of Nihar company Ltd. (South Guj. Uni. S.Y. April,1983)

4. Z Ltd. has the following balance sheet as on 31 March, 2018.

Z Ltd.

Balance Sheet as at 31st March,2018

	Particulars	**As at 31st March, 2021**
A	**Equity and Liabilities**	**Rs.**
1.	Shareholder's Funds	
	(a) Share Capital	
	Issued Subscribed & Paid-up Capital:	
	20,000 Equity shares of Rs.100 each	20,00,000
	10,000 preference shares of Rs. 100 each	10,00,000
	(b) Reserve and Surplus	
	Capital Reserve	2,00,000
	Securities Premium A/c	2,00,000
	General Reserve A/c	4,00,000
	Profit and Loss Account	2,00,000
		40,00,000
2.	Share Application Money Pending Allotment	-
3.	Non-current Liabilities	-
4.	Current Liabilities	
	(a) Short-term Borrowings	-
	(b) Trade Payables	-
	(c) Other current Liabilities	20,00,000
	(d) Short-term Provisions:	-
		20,00,000
	Total (1) +(2) +(3) +(4)	**60,00,000**

B	**Assets**	
1.	Non-current Assets	
	(a) Fixed Assets	
	Tangible Assets	44,00,000
		44,00,000
2.	Current Assets	
	(a) Current investments	-
	(b) Inventories	-
	(c) Trade Receivables	-
	(d) Cash and Cash Equivalents	-
	(e) Short-term Loans and Advances	-
	(f) Other Current Assets	16,00,000
		16,00,000
	Total (1) + (2)	**60,00,000**

Preference shares are to be redeemed at 10% premium. Fresh issue of equity shares is to be made to the extent required under the companies act for the purpose of this redemption. The shortfall in funds for the purpose of the redemption after utilizing the proceeds of the fresh issue are to be met by taking a bank loan. Subsequently show journal entries.

(**Ans. Amount transferred to capital redemption Reserve Rs. 6,00,000)**

UNIT-6 ACCOUNTING FOR DEBENTURES

6.1 Introduction and Meaning

6.2 Types of Debentures

6.3 Procedure of Issuing Debentures

6.4 Writing off Loss on Issue of Debentures

6.5 Redemption of Debentures

6.6 Different terms of Issue and Redemption of Debentures

6.7 Debentures Issued as Collateral Security

6.8 Debenture Redemption Fund

6.9 Accounting Entries

❖ Exercise

6.1 Introduction and Meaning

Debentures are an instrument by which the company can borrow money from the public or others. A joint stock company can borrow money from the member of the public in a peculiar way. The word debenture is used to signify the acknowledgement of a debt, given under the seal of the company, and containing a contract for the repayment of the principal sum at specified date and for the payment of interest at a fixed rate percent until the principal sum is repaid. In case, it requires money for a considerably long period, it can either issue shares or debentures. Shares will entail a permanent burden of paying dividend, whereas debentures cab be repaid in future. Hence a company would issue debentures if it feels that it would be able to return the money and does not want to undertake a permanent burden of dividend by issuing shares.

It must be very clearly understood that debentures and shares are basically different. Shares signify the ownership of the company whereas debentures acknowledge the debt of the company to the debenture-holder. The latter is a creditor of the company. Dividend is to be paid to shareholders only if there are profits and directors think it proper to distribute dividend. Whereas the interest paid to debenture-holder does not depend on profits. It has to be paid irrespective of profits.

As per section 2(30) “a debenture includes debenture stock, bonds and other securities of a company whether constituting a charge on the assets of the company or not”

6.2 Types of Debentures

A company may issue various kinds of debentures with different rights as given below:

A. **From the point of view of Security:**

1. **Simple or Naked Debentures:** These are debentures which do not carry any charge on the assets of the company. The holders of such debentures are not given any security as to the payment of interest and repayment of capital. The debentures are treated as unsecured creditors.

2. **Mortgage Debentures:** Debentures which are secured by a mortgage or charge on the whole or a part of the assets of the company are known as mortgage debentures. The charge may be either a fixed charge or a floating charge.

B. **From the point of view of Redemption:**

1. **Redeemable Debentures:** Redeemable debentures provide for the payment of the principal amount on the expiry of a certain period. In time, the debentures may be redeemed by the company or demand by the holders or at the direction of the company. The date of redemption may be stated in the terms of issue.

2. **Mortgage Debentures:** In the case of irredeemable or perpetual debentures, the company does not give any undertaking of repaying the money borrowed by issuing debentures, after a fixed time or within a fixed period during the continuance of business by the company. These debentures are retained as a part of the permanent capital structure of the company. Company may repay debentures at any time it may choose to do so, but the creditors cannot compel the company to repay them at certain time.

C. **From the point of view of Convertibility:**

1. **Convertible Debentures:** These are debentures which are wholly or partly convertible into shares of the company as per the terms of their issue.

2. **Non-convertible Debentures:** Debentures not convertible into shares of the company are termed as non-convertible debentures.

D. **From the point of view of Transferability:**

1. **Registered Debentures:** Registered debentures are made out in the names of specific persons, who are registered as a debenture-holder in the books of the company. They are transferable in the same way as shares or in accordance with the conditions endorsed on their back. The payment of interest and repayment of principal is made to those whose names have been registered with the company and recorded in the Register of Debentureholders.

2. **Bearer Debentures:** Bearer debentures are treated as negotiable instruments and are transferable by mere delivery. The names of the holders of such debentures are not required to be registered in the register of Debentureholders.

6.3 Procedure of Issuing Debentures

The Directors are empowered to borrow money on behalf of company; they decide to issue debentures by passing a resolution in board meeting. The resolution contains details about the amount of Debentures, Terms of Debentures and Rate of Interest etc. if the total amount of debentures along with other borrowings exceeds the total of paid up capital and reserves of the company, the sanction of shareholders meeting is required.

Debentures are issued, like shares, by the company issuing a prospectus whereby the public is invited to apply for its debentures. The debentures may be issued at a par or with premium or at a discount. There is no restriction as regards the maximum amount of discount that can be allowed while issuing the debentures. Trustees for Debenture-holders are appointed by a trust deed to protect the interest of debenture holders.

Debentures applications are received direct by the bank along with cheque. The secretary prepares application and allotment sheets after the subscription list is closed. On the basis of these lists, the directors pass a resolution for allotment of debentures. Finally, the secretary would inform the applicants about the allotment of debentures to them. Debenture holders may be asked to pay the whole amount along with the application or to pay the sum in instalment.

A. **Issue Debentures at Par:** When company goes for diversified capital structure, they issued shares as well as debentures also. The institute has so many opportunities to issue debentures like at par, at premium and at discount. In the case of new company generally they preferred at par issue only.

Illustration 1: A company issued 1,000, 12% Debentures of Rs. 100 each at a par. The amount was payable as follows: on application Rs. 30; on allotment Rs. 20; on call Rs.50. All debentures were allotted and the all sums due were received. Give journal entries.

Sol: Working

Deb. Amt. –	1000 Deb. * 100 F.V. =	100000 Rs.
On Application –	1000 Deb. * 30 Rs. =	30000 Rs.
On Allotment –	1000 Deb. * 20 Rs. =	20000 Rs.
On Final Call -	1000 Deb. * 50 Rs. =	50000 Rs.

Journal Entries

Date	Particulars	L.F.	Debit	Credit
1	Bank A/c. Dr. To Debenture App. A/c.		30,000	 30,000
2	Debenture App. A/c. Dr. To 12% Debenture A/c.		30,000	 30,000

3	Debenture Allot. A/c. Dr. To 12% Debenture A/c.		20,000	 20,000
4	Bank A/c. Dr. To Debenture Allot. A/c.		20,000	 20,000
5	Debenture Final Call A/c. Dr. To 12% Debenture A/c.		50,000	 50,000
6	Bank A/c. Dr. To Debenture Final Call A/c.		50,000	 50,000

B. Issue Debenture at Premium: There are no restrictions on the price at which debentures can be issued. Prosperous companies may issue debentures at a price higher that the nominal value, when it is said to have been issued at a premium. The amount of premium is credited to 'debenture premium account'.

Illustration 2: X Ltd. issued 5,000 debentures of Rs. 100 each at a premium of 10% repayable at par after 10 years. The amount was payable as under:

On application 20%
On allotment 30% [including premium]

And the remaining amount with the call. Assuming that al the debentures were applied for and allotted and call the moneys due were received, draft journal entries.

Sol: Working

Deb. Amt. – 5000 Deb. * 100 F.V. = 5,00,000 Rs.

On Application – 5000 Deb. * 20 Rs. = 1,00,000 Rs.

On Allotment – 5000 Deb. * 20 Rs. = 1,00,000 Rs. Deb. Amt.

5000 Deb. * 10 Rs. = 50,000 Rs. Pre. Amt.

On Final Call – 5000 Deb. * 60 Rs. = 3,00,000 Rs.

Journal Entries

Date	Particulars	L.F.	Debit	Credit
1	Bank A/c. Dr. To Debenture App. A/c.		1,00,000	 1,00,000
2	Debenture App. A/c. Dr. To Debenture A/c.		1,00,000	 1,00,000
3	Debenture Allot. A/c. Dr. To Debenture A/c. To Debenture Pre. A/c.		1,50,000	 1,00,000 50,000
4	Bank A/c. Dr. To Debenture Allot. A/c.		1,50,000	 1,50,000
5	Debenture Final Call A/c. Dr.		3,00,000	

	To Debenture A/c.			3,00,000
6	Bank A/c. Dr. To Debenture Final Call A/c.		3,00,000	 3,00,000

C. Issue Debenture at Discount: Subject to restrictions in company's articles, a company can issue debenture at a price which is less than its nominal value. In such a case, it is said to have been issued at a discount. There are no restrictions on the maximum-rate of discount. The amount of discount is transferred to 'Discount on Debentures Account.' The face value of debenture issued is credited to Debentures Account.

Illustration 3: X Ltd. issued 1000 12% Debentures of Rs. 100 each at Rs. 95. The amount was payable as follows: on application Rs. 20; on allotment Rs. 50; on call Rs. 25.

Sol: Working

Deb. Amt. – 1000 Deb. * 100 F.V. = 1,00,000 Rs.

On Application – 1000 Deb. * 20 Rs. = 20,000 Rs.

1000 Deb. * 5 Rs. = 5,000 Rs. Dis. Amt.

On Allotment – 1000 Deb. * 50 Rs. = 50,000 Rs. Deb. Amt.

On Final Call – 1000 Deb. * 25 Rs. = 25,000 Rs.

Journal Entries

Date	Particulars	L.F.	Debit	Credit
1	Bank A/c Dr. To Debenture Application A/c.		20,000	 20,000
2	Debenture Application A/c Dr. Debenture Discount A/c Dr. To Debenture A/c		20,000 5,000	 25,000
3	Debenture Allotment A/c Dr. To Debenture A/c		50,000	 50,000
4	Bank A/c Dr. To Debenture Allotment A/c		50,000	 50,000
5	Debenture Final Call A/c Dr. To Debenture A/c		25,000	 25,000
6	Bank A/c Dr. To Debenture Final Call A/c		25,000	 25,000

D. Issued for Consideration other than Cash: In this case, debentures are issued for consideration other than cash. Examples are allotment of debentures for assets purchased or technical services received. There is no receipt of cash in these transactions for the allotment of debentures. The following are the accounting entries:

1. **On acquisition of assets:**

Assets A/c (with value of assets) Dr.

To vendors (with purchase price)

Note: In case the value of assets is more than the purchase price, the balance is credited to Capital Reserve. In a Reverse Case i.e. where the purchase price is more than the value of assets purchased, the balance is debited to Goodwill Account.

2. **On Allotment of Debentures:**

Vendors A/c Dr.

To Debentures A/c

Note: In case debentures are issued at discount, the "debenture Discount Account' will be debited with the amount of discount allowed. In case issued of debentures is at premium, the 'Debenture Premium Account 'will be credited with the amount of premium.

6.4 Writing off Loss on Issue of Debentures

When debentures are issued at discount, it is prudent to write off the loss during the life of debentures. The loss on issue of debentures (e.g. discount on issue of debentures or Premium payable on redemption etc.) appears on the 'Assets side' of the Balance Sheet. However, it is a fictitious asset which must be written off as soon as possible. As the company gets the benefit of debentures over a number of years, it is spread over few years and is gradually written off as follows:

- ❖ If the debentures are to be redeemed after a definite period the discount must be written off equally over that period.
- ❖ If debentures are redeemed partially every year, then the discount must be written off during the period in proportion to amounts outstanding at the end of each year before redemption.
- ❖ It the debentures are irredeemable, then the discount must be written off within the reasonable period.

The debit balance of 'Debenture Discount Account' will appear in the Balance sheet of the assets side till it is completely written off. It is to be noted that writing off loss on issue of debentures is not a legal necessity. However, sound financial principles require that such loss should be written off as soon as possible but, in any case, before the debentures are completely redeemed.

The loss cab be written off from any capital profit (including securities premium) or revenue profit. The entry for writing off the loss will be as follow:

Capital Reserve/P & L A/c Dr.

To Loss (Discount) on issue of debentures A/c

6.5 Redemption of Debentures

Debenture is a liability of the company and is to be repaid sooner or later to the debenture holders. Generally, it is redeemed in the form of cash. However, the company may not have sufficient cash at the time of maturity of debentures, then in that case company may give an option of accepting new debentures in place of old ones. In case of convertible Debentures, the debenture holders are given the option of accepting shares in place of debentures. Generally, the terms on which the debentures are to be redeemed are given in the prospectus. Debentures may be redeemed by any one of the following methods.

Methods of redeeming debentures

- **Payment on a <u>Specified Date</u>**
  1. Sinking Fund/ Debenture Redemption Fund
  2. Insurance policy/
- **Purchase in the open Market**
- **Repayment by Instalments**
- **Buy-back Method**

➢ **Repayment on a Specified Date:**

Debentures may be redeemed as a lump sum on a specified date mentioned under the terms of issue. The amount to be paid may be the face value of the debentures or at a premium according to the terms of the issue.

➢ **Purchase in the open Market:**

The company may purchase the debentures in the open market. The law does not prohibit the company from doing so. The purchased debentures may be cancelled immediately or retained by the company as investment and subsequently the company, as its choice, may reissue the debentures or cancel them.

➢ **Repayment by Installments:**

Under this method, a certain portion of the debentures are redeemed periodically. Some of the debentures may be redeemed by annual drawings every year according to the terms of issue. The actual serial numbers of debentures to be redeemed every year are determined in advance or they may be fixed every year by drawings lots.

- **Buy-back Method:**

Sometimes the company while issuing debentures makes a stipulation that after completion of one year from the date of issue of debentures every year debentures of certain amount will be bought back by the company if the debenture holder wants to return the debentures and that the nominal value of debentures will be paid to Debentureholders.

6.6 Different Terms of Issue and Redemption of Debentures

Accounting aspects of issue of debentures may be studied from two different angles.

1) From the angle of Price:

A. Issued at Par

B. Issued at Premium

C. Issued at Discount

2) From the angle of Redemption:

A. Redeemed at Par

B. Redeemed at Premium

C. Redeemed at Discount

The following combinations result if we combine the angle of Price and the angle of Redemption:

- Issued at Par and Redeemable at Par / Premium / Discount
- Issued at Discount and Redeemable at Par / Premium
- Issued at Premium and Redeemable at Par / Premium

Now, we discussed for the above three combinations are given

1. Issued at Par and Redeemable at Par / Premium / Discount:

- **Issued at par & Repayable at Par:** This is totally normal type of procedure, if company issued debenture at par and redeemed also at par. In case of company does not feel to give any pull to investors they offered this type of proposal. In this case entry would be:

A. On issue of Debentures:

Bank A/c Dr.

To Debentures A/c

B. On Payment:

Debentures A/c Dr.

To Bank A/c

❖ **Issued at Par & Repayable at Discount:** In this case company takes more money from investors and paid less at the time of redemption. It may be noted that discount receivable on redemption should be recorded only on redemption of debentures and not on issue of debentures. This is as per the accounting convention of conservatism according to which expected losses are to be taken into account but not expected profits. In this case entry would be:

A. On issue of Debentures:

Bank A/c Dr.

To Debentures A/c

B. On Payment:

Debentures A/c Dr.

To Bank A/c

To Profit on redemption of Debentures

❖ **Issued at Par & Repayable at Premium:** A company may sometimes issue debentures on the condition that it will pay something more than the face value of the debentures, when it will return money. It will redeem the debentures at a premium. The premium to be paid by the company is redemption premium and is a loss to the company; and it is debited to 'Loss on Issue of debentures A/c.' The same amount is, at the same time, liability to be paid in addition to the value of debentures and as such it is credited to 'Premium on redemption of Debenture A/c.' The entry would be:

A. On issue of Debentures:

Bank A/c Dr. (amt. received on Deb. Issued at par)

Loss on Issue of Deb. A/c Dr. (Loss of Red. Premium)

To Debentures A/c (Face value of Deb.)

To Prem. on Red. of Deb. A/c (Liability of red. Pre.)

B. On Payment:

Debentures A/c. Dr.

Premium on Red. of Deb. A/c. Dr.

To Bank A/c.

Illustration 4: ABB Ltd. issued 60,000 debentures of Rs. 100 each on 31-12-19 at a discount of 10% redeemable at a premium of 5%. The company redeemed the debentures on 31-12-24.

Give journal entries in the books of the company for both of the year.

Solution: **Working**

Deb. Amt. – 60,000 Deb. * 100 F.V. = 60,00,000 Rs.

Discount Amt. – 100 Rs. F.V. * 10% = 10 Rs. * 60,000 = 6,00,000 Rs.

Redemption Pre. – 100 Rs. * 5% = 5 Rs. **,** 60,000 * 5 Rs.= 3,00,000 Rs.

Redemption Amt. – 105 Rs. * 60,000 Deb. = 63,00,000 Rs.

Journal Entries

Date	**Particulars**	**L.F.**	**Debit**	**Credit**
31-12-19	Bank A/c. Dr. Deb Dis. A/c. Dr. Loss on Issue of Deb. A/c. Dr. To Debenture A/c. To Prem. on Red. of Deb. A/c.		54,00,000 6,00,000 3,00,000	 60,00,000 3,00,000
31-12-24	Debenture A/c. Dr. Prem. On Red. Of Deb. A/c. Dr. To Debenture holder A/c.		60,00,000 3,00,000	 63,00,000
31-12-24	Debenture holder A/c. Dr. To Bank A/c.		63,00,000	 63,00,000

2. Issued at Discount and Redeemable at Par / Premium / Discount:

❖ **Issued at Discount & Repayable at Par:** A company some times issued debentures at Discount to attract major part of investors and redeemed at par. In this case company get less amount at the time of issue and paid full amount of face value of the debentures. The entry would be:

a. On issue of Debentures:

Bank A/c. Dr.

Discount on issue of Debentures A/c. Dr.

To Debentures A/c.

b. On Payment:

Debentures A/c. Dr.

To Bank A/c.

❖ **Issued at Discount & Repayable at Discount:** The company choose this proposal rarely only because it is never pull up to the investors invest in this instrument. A company offered discount at the time of issue and at the time of redemption also offered discount which will be same discount or less then previous discount. In this case entry would be:

A. On issue of Debentures:

Bank A/c. Dr.
Discount on issue of Debentures A/c. Dr.
To Debentures A/c.

B. On Payment:

Debentures A/c. Dr.
To Bank A/c.
To Profit on redemption of Debentures

❖ **Issued at Discount & Repayable at Premium:** A company may have to issue debentures at a discount and also offer a redemption premium, when either the money market is much depressed or the company does not enjoy any prestige among investors. The company will have to bear two-fold losses; one, in the form of discount and the other in the form of redemption premium. Both these losses are losses of capital nature and must be written off over a number of years. The entry for this type of debenture under the circumstances would be:

A. On issue of Debentures:

Bank A/c. Dr. (amt. received on Deb. Issued at par)

Discount on Deb. A/c. Dr. (Amt. of Discount)

Loss on Issue of Deb. A/c. Dr. (Loss of Red. Premium)

To Debentures A/c. (Face value of Deb.)

To Prem. on Red. of Deb. A/c. (Liability of red. Pre.)

B. On Payment:

Debentures A/c. Dr.

Premium on Red. of Deb. A/c. Dr.

To Bank A/c.

Illustration 5: XYZ Ltd. Issued 2,000 10% debenture at 100 each at a discount of 5% redeemable at a premium of 10% after 10 years. Give Journal Entries for the issue and redemption of debentures.

Date	**Particulars**	**L.F.**	**Debit**	**Credit**
(1) When Debentures are issued:				
	Bank A/c Dr. Discount on Debenture A/c Dr. Loss on Issue of Debenture A/c Dr. To 10% Debenture A/c To Premium on Redemption of Debenture A/c (Issue of 2,000 debentures at a discount of 5% repayable at a premium of 10%)		1,90,000 10,000 20,000	 2,00,000 20,000
(2) When Debentures are redeemed:				
	10% Debenture A/c Dr. Premium on Redemption of Debenture A/c Dr. To Debenture holders A/c (Amount due on 2,000 debentures of Rs. 100 each at a premium of 10%) Debenture holder A/c Dr. To Bank A/c (Amount paid on the redemption of debentures)		2,00,000 20,000 2,20,000	 2,20,000 2,20,000

3. **Issued at Premium and Redeemable at Par / Premium:**

- **Issued at Premium & Repayable at Par:** If company have good image in the market then they will be issued debenture at premium. But at the time of redemption debenture redeem at par, in such circumstances investor may suffer loss. The entry would be:

  a. On issue of Debentures:
  Bank A/c. Dr.
  To Debentures A/c.
  To Premium on issue of debenture A/c.

  b. On Payment:
  Debentures A/c. Dr.
  To Bank A/c.

- **Issued at Premium & Repayable at Discount:** The Company offered this type of plan hardly ever for the reason that investors are not friendly with plan. In this case company issued debentures at premium and at the time of redemption, it will be redeemed at discount. The debenture holder suffers two-fold losses. In this case entry would be:

A. On issue of Debentures:

Bank A/c. Dr.
To Debentures A/c.
To Premium on issue of debenture A/c.

B. On Payment:

Debentures A/c. Dr.
To Bank A/c.
To Profit on redemption of Debentures

❖ **Issued at Premium & Repayable at Premium:** In case of company's goodwill is very good in the market, they can go for issued debenture at premium and same this debenture also redeemed at premium. There is not necessary premium amount is same for issued and redemption. The entry would be:

A. On issue of Debentures:

Bank A/c. Dr.

Loss on issue of debentures A/c. Dr.

To Debentures A/c.

To Premium on issue of debentures A/c.

To Premium on redemption of debentures A/c.

B. On Payment:

Debentures A/c. Dr.

Premium on redemption of debentures A/c. Dr.

To Bank A/c.

6.7 Debentures Issued as Collateral Security:

When a company takes a loan, say, from a Bank, it offers additional security against the loan in the form of debentures. Such securities will supplement the tangible security given, if any. The understanding is that if the company repays the loan with interest, the bank will return the debentures to the company which will then cancel them.

If the company fails to repay the loan on the stipulated rate, then the debentures given as collateral security to the bank will become live debentures and the banker assumes all the rights of the debenture holder.

When the debentures are issued as collateral security, the company makes no entry in its books. This fact will be shown in the inner column of the Balance Sheet under the heading Debentures by way of information. But the Bank's loan will be shown as a liability in the Balance Sheet.

There are two ways of dealing with such debentures in the accounts of the company.

1. No entry, whatsoever, is made in the books of the company. A note is given in the Balance Sheet regarding depositing of the debentures as collateral security. For example, if A Ltd. obtains a loan of Rs. 30,000 from its bankers giving debentures of Rs. 40,000 as collateral security, the Balance sheet will appear as follows:

Liabilities	Amt.	Assets	Amt.
Debentures (in addition, Deb. Rs.40,000 have been issued as collateral security) Bank Loan (secured by the issued of Deb. For Rs.40,000 as collateral security)	--- 30,000		

2. The transaction may be recorded in the books of the company by the following entry;

Debenture suspense A/c.
To Debentures (Collateral Security) A/c.

Liabilities	Amt.	Assets	Amt.
Debentures (in addition, Deb. Rs.40,000 have been issued as collateral security) **(as per contra entry)** Bank Loan (secured by the issued of Deb. For Rs.40,000 as collateral security)	40,000 30,000	Miscellaneous Exp and Losses: Deb. Suspense A/c. **(as per contra entry)**	40,000

'Debenture Suspense A/c.' is shown in the asset side and the Debentures are shown in the liability side of the balance sheet.

When the company repays the loan with interest the bank will return the debentures to the company which will then cancel them by passing the following entry.

Debenture (Collateral Security) A/c.	Dr.	40,000	
To Debentures Suspense A/c.			40,000

In case the company fails to pay the loan, the debentures issued as collateral security will become active. The following journal entry will be passed:

Bank loan A/c.	Dr.	30,000	
Loss on issue of Deb. A/c.	Dr.	10,000	
To Debenture A/c.			40,000

6.8 Debenture Redemption Fund

When the debentures are to be redeemed, the company has to arrange a large amount of cash for payment. The heavy outflow of cash may affect the company's working capital and carry out the redemption from the profit, the company can set apart a portion of its profit for the purpose of redemption by adopting the following course of action. A definite sum will be appropriated for a stipulated period from the profits and credited to a newly opened account called the Debenture Redemption Fund Account or the Sinking Fund Account. Investments will be made outside the business in good securities will be made outside the business in good securities equivalent to the amount credited in the Sinking Fund Account. The interests received on the investments are also credited to the Sinking Fund Account till the debentures are redeemed. During the year of redemption, the investments are sale in the market and the proceeds are utilised for payment to the Debentureholders; the profit or loss on sale of such investments being transferred to the sinking fund account.

The amount to be appropriated every year from the profit will be determined by considering the total amount to be redeemed, the number of years for which the appropriation is to be made and the expected rate of interest earnings on the amount to be invested.

SEBI has made it obligatory for all companies raising resources through debentures to create a Debenture redemption Reserve equivalent to 50% of the amount of debenture issue before the company starts to redeem the debentures. In the case of partly convertible debentures, debenture redemption reserve has to be created in respect of non-convertible portion of debenture issue on the same lines as applicable for fully non-convertible debenture issue.

6.9 Accounting Entries

At The End of the 1st Year:

1. **When annual Instalments to be invested:**

   Profit & Loss Appropriation A/c. Dr.
   To DRF A/c. / To Sinking Fund A/c.

2. **When the actual amount is invested:**

   Sinking Fund Investment A/c. Dr.
   To Bank A/c.

In the Subsequent Years: (except during the year of redemption)

1. **When the interest on investments received:**

   Bank A/c. Dr.
   To Int. on Sinking Fund Investment A/c.

2. **For transfer of interest to Sinking Fund A/c.**

Int. on Sinking Fund Investment A/c. Dr.
To Sinking Fund A/c.

3. **For appropriating the annual instalments to be invested:**

Profit & Loss Appropriation A/c. Dr.
To DRF A/c. / To Sinking Fund A/c.

4. **For investing the total amount including the interest received:**

Sinking Fund Investment A/c. Dr.
To Bank A/c.

Note: During the year of redemption, the first three entries for the interest received and appropriation will be passed. But the investments will not be made and on the contrary the investments already made will be realised. Therefore, in addition to the above three entries, the following entries are to be passed.

1. **On the sale of investments:**

Bank A/c. Dr.
To Sinking Fund Investments A/c.

2. **For transferring the profit on sale of investments, if any:**

Sinking Fund Investment A/c. Dr.
To Sinking Fund A/c.

3. **For Transferring the loss on sale of investments:**

Sinking Fund A/c. Dr.
To Sinking Fund Investment A/c.

4. **Any balance in the S.F. A/c. will be transferred to the Gen. Res. A/c.:**

Sinking Fund A/c. Dr.
To General Reserve A/c.

5. **For Redemption:**

Debenture A/c. Dr.
To Debenture Holder A/c.

6. **For the payment to the Debentureholders:**

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

Illustration 6: In 1985 a limited company issued 4,000 12% Debentures of Rs. 100 each. Interest was payable half-yearly on 30th June and 31st December every year., and they were repayable at par on 31st December, 2005. The Company reserved the right of giving due notice, to redeem them on any date after 31st December, 1998 at Rs. 105. On 31st December, 1998 the Debenture Redemption Fund was showing a balance of Rs. 2,17,000 and the same amount stood invested outside the business. The directors gave notice to repay the debentures on 30th June, 1999 in accordance with the terms of issue, and at the same time offered the holders of debentures the right, instead of payment in cash, to receive one new 14% Debentures of Rs. 100 each and Rs. 7 in cash for each existing debenture.

Debenture-holders holding 2,800 debentures accepted the offer and the rest were paid out in cash. This Cash was provided by the company partly out of current funds and partly by the sale of a part of the Sinking Fund Investments which realized Rs. 1,17,400 their book value being Rs. 1,02,000.

Set out the Ledger Accounts affected by the above transactions ignoring interest payments.

[Sau. Uni., S.Y., April, 1995]

Solution:

Sinking Fund Account

		Rs.			Rs.
30-6-99	To prem. on Red. of debentures A/c	20,000	1-1-99	By Balance b/c.	2,17,000
“	To General Reserve A/c	2,12,400	30-6-99	By Deb. Red. Investment A/c (Profit)	15,400
		2,32,400			2,32,400

Sinking Fund Investment Account

		Rs.			Rs.
1-1-99	To Balance b/d	2,17,000	30-6-99	By Bank A/c	1,17,400
30-6-99	To Sinking Fund A/c (Profit)	15,400	31-12-99	By Balance c/d	1,15,000
		2,32,400			2,32,400
1-1-2000	To Balance b/d	1,15,000			

12% Debentures Account

		Rs.			Rs.
30-6-99	To Debenture-holders A/c	4,00,000	1-1-99	By Balance b/d	4,00,000
		4,00,000			4,00,000

Debenture-holders Account

		Rs.			Rs.
30-6-99	To Bank A/c (1,200 * Rs. 105)	1,26,000	30-6-99	By 12% Deb. A/c	4,00,000
"	To Bank A/c (2,800 * Rs.7)	19,600	"	By Prem. on red. of Deb. A/c	20,000
"	To 14% New Debenture A/c (2,800 *98)	2,74,400			
		4,20,000			4,20,000

General Reserve Account

		Rs.			Rs.
31-12-99	To balance c/d	4,00,000	30-6-99	By sinking fund A/c	2,12,400
			"	By Profit and Loss A/c	1,87,600
		4,00,000			4,00,000

Illustration 7: Krisha Textiles Ltd. issued 10% Debentures of Rs. 100 each on the following terms:

(1) 50,000 debentures at Rs. 95 each.
(2) 18,000 Debentures of Rs. 100 each against purchase of machinery of Rs. 20,00,000.
(3) 14,000 Debentures of Rs. 100 each as collateral security against a bank Loan of Rs. 10,00,000.

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

Journal Entries in the books of Krisha textiles Ltd.

Date	particulars	L.F.	Debit (Rs.)	Credit (Rs.)
(1)	Bank Account (50,000 Deb. × ₹ 95) Dr. To Debenture Application & Allotment A/c (Being 40,000 debentures were issued at ₹ 95 per debenture)		47,50,000	47,50,000

2	Debenture Application & Allotment A/c Dr. Discount on Debentures A/c Dr. To 9% Debentures A/c (Being Debentures were allotted)		47,50,000 2,50,000	 50,00,000
(2)	Machinery A/c Dr. To 9% Debentures A/c (18,000 debenture * Rs. 100) To Security Premium Account (Being 9,000 debentures were issued against purchase of machinery)		20,00,000	 18,00,000 2,00,000
(3)	Debenture Suspense A/c Dr. To 9% Debenture A/c (Being 14,000 debentures were issued as collateral security against Bank Loan)		14,00,000	 14,00,000

Illustration 8: (a) The following were the balances in the books of a Company as on 1st January, 1995.

12% Debenture Rs. 3,00,000

Debenture redemption Fund Rs. 2,25,000

8% D.R.F.Investments Rs. 2,25,000

Company transfers Rs. 25,000 every year to Debenture Redemption Fund account. After receiving interest on investments, company sold out the said investments at 20% profit on 31-12-95 and Debentures amounting to Rs. 2,40,000 were redeemed at 10% premium.

Write Journal entries in the books of the company on 31-12-95 and also Prepare Ledger Accounts.

(b) Rakhi Limited has given the following options to debentures holders for redemption of its 12% 10,000 Debentures of Rs. 100 each at 5% premium.

Options	Exercised by the holders of
1 10% Pref. Shares of Rs. 100 each, Rs. 80 Paid up, at Rs. 120/-	5,000 Debentures
2 15% New Debentures of Rs. 100 each at 5% discount	3,800 Debentures
3 Payment in Cash	1,200 Debentures

Pass necessary entries for redemption of debentures in the books of Rakhi Limited.

[Guj. Uni., S.Y., April, 1999]

Solutions:

12% Debentures Account

		Rs.			
31-12-95	To Debenture holders A/c	2,40,000	1-1-95	By Bal b/d	3,00,000
	To Bal. c/d	60,000			
		3,00,000			3,00,000

Debenture-Holders Account

		Rs.			Rs.
31-12-95	To bank A/c	2,64,000	31-12-95	By Debenture A/c	2,40,000
			"	By Premium on Redemption of Debenture A/c	24,000
		2,64,000			2,64,000

Premium on Redemption of Debentures Account

		Rs.			Rs.
31-12-95	To Debenture holders A/c	24,000	31-12-95	By Debenture Red. Fund A/c	24,000
		24,000			24,000

Debenture redemption Fund Account

		Rs.			Rs.
31-12-95	To Premium on Redemption of Debentures A/c	24,000	1-1-95	By bal. b/d	2,25,000
			31-12-95	By P & L App. A/c	25,000
"	To General Reserve A/c – Transfer	2,40,000	"	By Bank A/c – Int. Rec. on D.R.F. Investments	18,000
"	To Bal. c/d	49,000			

			"	By Debenture Redemption Fund Investments - Profit	45,000
		3,13.000			3,13,000

Debenture Redemption Fund Investments Account

		Rs.			Rs.
1-1-95	To Bal. b/d	2,25,000	31-12-95	By Bank A/c	2,70,000
31-12-95	To Debenture redemption Fund A/c - Profit	45,000			
		2,70,000			2,70,000

Journal Entries in the books of Co.

			Rs.	Rs.
31-12-95	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Fund A/c (Amt. set aside out of profit for redemption of debentures)		25,000	25,000
"	Bank A/c Dr. To Debenture Redemption Fund A/c (Int. received on D. R. Fund Investments at 8% on Rs. 2,25,000 for 1 year)		18,000	18,000
"	Bank A/c Dr. To Debenture Redemption Fund Investments A/c (Sale Proceed of Deb. Red. Fund Investments)		2,70,000	2,70,000
"	Debenture A/c Dr. Debenture Redemption Premium A/c Dr. To Debenture-holders A/c (Amount payable on redemption of debentures)		2,40,000 24,000	2,64,000

"	Debenture-holders A/c Dr. To Bank A/c (Amount of debenture paid with premium)		2,64,000	 2,64,000
"	Debenture Redemption Fund Investment A/c Dr. To Debenture Redemption Fund A/c (Profit on sale of investments transferred to Deb. Red. Fund A/c)		45,000	 45,000
"	Debenture Redemption Fund A/c Dr. To Debenture Redemption Premium A/c (Debenture Redemption Premium A/c transferred to Debenture Redemption Fund A/c)		24,000	 24,000
"	Debenture Redemption Fund A/c Dr. To General Reserve A/c (The balance of Deb. Redemption Fund transferred to General Reserve after redeeming debentures)		2,40,000	 2,40,000

(B) Calculation of amount paid to debenture holders by different considerations:

(1) 10% Pref. Shares:

Amount Payable = 5,000 * 105 = Rs. 5,25,000

Rs. Amount Payable Pref. Shares

120 = 1

5,25,000 = ?

5,25,000 * 1/120 = 4,375 Shares

(i) 4,375 Pref. Shares * Rs. 80 = Rs. 3,50,000

(ii) 4,375 Pref. Shares * Rs. 40 premium = Rs. 1,75,000

= Rs. 5,25,000

(2) 15% New Debentures:

Amount payable 3,800 * Rs. 105 = Rs. 3,99,000

Rs. Amount payable	New Debenture
95	1
3,99,000	?

3,99,000 * 1/95 = 4,200

(i) Nominal Value of 4,200 Debentures * Rs. 100 = 4,20,000

(ii) Less: Discount on 4,200 Debentures (4,200 * 5) = 21,000

Rs. 3,99,000

(3) In Cash:

Amount payable 1,200 * Rs. 105 = Rs. 1,26,000

Total Amount payable = 10,000 * 105 =Rs. 10,50,000

Pref.Shares	5,25,000	
New debentures	3,99,000	
Cash	1,26,000	=Rs. 10,50,000

Journal Entries would be as follows:

			Rs.	Rs.
(1)	12% Debenture A/c Dr. Premium on Redemption of Debenture A/c Dr. To Debenture-holders A/c (The amount payable on 10,000 10% debentures of Rs. 100 each at a premium of 5%)		10,00,000 50,000	10,50,000
(2)	Debenture holders A/c Dr. To 10% Pref. Share Capital A/c To Share Premium A/c (Redemption of 5,000 debentures by issue of 4,375 Pref. Shares of Rs. 100 each, Rs. 80 paid up at a premium of Rs. 40 each)		5,25,000	3,50,000 1,75,000
(3)	Debenture Holders A/c Dr. Discount on Debenture A/c Dr.		3,99,000 21,000	

	To 15% Debenture A/c (Redemption of 38,000 debentures of Rs. 100 each by issue of new 15% debentures of Rs. 100 each at a discount of 5%)			4,20,000
(4)	Debenture-holders A/c Dr. To Bank A/c (Redemption of 1,200 debentures of Rs. 105 cash by payments of cash)		1,26,000	 1,26,000

❖ **Exercise**

- **LONG QUESTIONS:**

(1) Explain Types of Debentures in detail

(2) Explain the process for issuing Debenture.

(3) Write a Note on Writing Off Loss on Issue of Debentures.

(4) Discuss the methods of Redeeming Debentures.

(5) Explain Debentures Issued as Collateral Security

- **PRACTICAL PROBLEMS**

1. A Ltd. issued 1,000 12% debentures of Rs. 100 each, payable as Rs. 30 on application and the balance on allotment. Applications were received for 2,000 debentures out of which applications for 800 were allotted fully, applications for 600 debentures were allotted 200 debentures and the remaining were rejected. All sums due were received. Journalized it and show the balance sheet.

2. ABB Ltd. issued 60,000 debentures of Rs. 100 each on 31-12-19 at a discount of 10% redeemable at a premium of 5%. The company redeemed the debentures on 31-12-24. Give journal entries in the books of the company for both of the year.

3. On 1-1-2023 ACC Ltd. issued 5,000 12% Debentures of Rs. 100 each at par but redeemable at Rs. 110 on 1-1-2024. Give journal entries for issue and redemption of Debenture.

4. A company issued 10% debentures of Rs. 2,00,000 on 1st April, 2023 at a discount of 5%, repayable in annual instalment of Rs. 50,000 each on 31st March every year. Prepare debenture discount account for all these year. The financial year of the company ends on 31st March every year.

5. A Ltd. issued 10,000, 14% debentures of Rs. 100 each at a discount of 6%. The debentures have to be redeemed at the rate of Rs. 1,00,000 each year commencing with the end of the 5^{th} year. State the amount of discount to be written off for the first five years.

6. A company issued debentures of Rs. 60,000 on 1-4-23. These debentures are repayable in three equal instalments of Rs. 20,000 each on 31^{st} March every year. Calculate the amount of discount to be written off each year when the total discount on issue is Rs. 3,000. The financial year of the company ends on 31^{st} December every year.

7. Zee Ltd. issued 5,000 15% Debentures of Rs. 100 each at a discount of 6% on 1^{st} July, 2024 repayable by five equal annual drawing of Rs. 1,00,000 each. The company closes its accounts on 31^{st} March each year. Prepare Debenture Discount Account for the duration of the Debentures.

8. The following three alternatives have been given to redeem 5,000, 8% debentures of Rs. 100 each at 5% premium.
(1) Payment in cash.
(2)10% redeemable preference shares to be issued at Rs. 120 (face value Rs. 100).
(3) 9% new debentures of Rs. 100 each at Rs. 90.
Holders of 2,000 Debentures accepted preference shares; 1,800 holders accepted 9% new debentures and the remaining holders demanded cash.
Pass entries for the redemption of debentures.

9. The Bharti Shipyard Ltd. felt that its owned founds are not enough for expansion of business and so far, raising borrowed funds, it issued 10%, 15,000 debentures of Rs. 100 each, having a mortgage on fixed assets, on following terms:

(1) Debentures will be issued at 10% discount.
(2) Debentures can be redeemed at any time after 10 years.
(3) Debentures will be redeemed at 20% premium.
(4) Debentures will be redeemed for any of the following options:

Options:

- Equity shares of Rs. 10 each to be issued at a premium of Rs. 2

OR

- 10% Pref. shares of Rs. 100 each to be issued at a premium of 20%.

OR

- 25% new debentures of Rs. 100 each to be issued at 10% discount.

OR

- To pay cash.

The applications for requests (offers) for redemption of debentures were as follows:

(1) Holders of 6,000 debentures were accepted equity shares.

(2) Holders of 3,000 debentures accepted new debentures.

(3) Holders of 1,000 debentures accepted cash.

(4) Holders of 5,000 debentures accepted pref. shares.

Write journal entries for issue and redemption of debentures in the books of the company.

10. On 1-1-2019, Virasat Ltd. issued 12,000, fifteen years debentures of Rs. 100 each having a coupon rate of 10% p.a. It was clarified at the time of the issue that the company could redeem these debentures by giving six moths notice any time after five years at a premium of 4% either by:

(1) Payment in cash.

OR

(2) Allotment of 10% preference shares of Rs. 100 each at Rs. 130 per share.

OR

(3) 11% new debentures of Rs. 100 each a Rs. 96 per debenture.

On 1-4-2024, the company gave a notice to its debenture holders to redeem the debentures on 1-10-2024.

Holders of 4,800 debentures accepted the offer of preference shares; holders of 5,760 debentures accepted the offer of 11% new debentures and the remaining accepted cash on 1-10-2024.

Pass necessary journal entries at the time of redemption and also show your calculations as a part of the answer.

11. On 1-1-2019, Vishwakarma Ltd. issued 30,000, 12% debentures of Rs. 100 each for 5 years on condition that the debentures could be redeemed by the company at a premium of 5% by giving 6 months notice at any time after five years, either by payment of cash or by allotment of shares and other debentures according to the option of the debenture holders.

Necessary notice was given on 1-1-2024 informing the debenture- holders about the company's intention to redeem debenture on 1-7-2024 either by payment in cash or by allotment of 11%. Preference shares of Rs. 100 each at Rs. 105 or by issuing 10% debentures of Rs. 100 each at Rs. 90.

Holders of 6,000 debentures accepted the offer of 10% debentures, holders of 15,000 debentures accepted 11% preference shares and the rest claimed cash.

Pass necessary journal entries for the redemption of debentures.

12. X Co. Ltd. issues the following debentures:

1) 1,000, 12% debentures of Rs. 100 each at par, redeemable at a premium of 5% after 5 years.
2) 500, 14% debentures of Rs. 100 each at a premium of 10% payable at par after 5 years.
3) 500, 10% debentures of Rs. 100 each at a discount of 10% but repayable at premium of 5% after 10 years.

4) 300 debentures of Rs. 100 each as collateral security to a creditor who advanced a loan of Rs. 25,000 to the company.

13. Solve following problems:

1. A company issued 8,000 12% debentures of Rs. 100 each at a discount of 5%, to be redeemed at a premium of 5%. Give journal entries.
2. A company issued 10,000, 10% debentures of Rs. 100 each at par to be redeemed at a premium of 5% after ten years. Give journal entries.
3. On 1-4-2024 VSNL Ltd. issued 10,000 debentures of Rs. 100 each at a discount of 6% repayable by annual drawing of Rs. 2,00,000. Show the discount account in the ledger for the period of duration of the debentures and pass necessary journal entries.

14. Bharat Ltd. issued 3,000, 15% debentures of Rs. 100 each at Rs. 110 payable as under:

On application	Rs. 25
On allotment	Rs. 35 [including premium]
On first and final call	Rs. 50

The debentures were fully subscribed and moneys were dully received. Show the cash book and journal entries and prepare balance sheet.

15. On january1, 2022 ABC Ltd. issued 1,000, 12% debentures of Rs. 100 each at Rs. 95. The terms of issue provided that beginning with, 2023 Rs. 20,000 of debentures should be redeemed, either by drawings at par or by purchase in the open market every year. The company wrote off Rs. 1,000 from the discount on deb.'s every year in 2023 the debentures to be redeemed were repaid at the end of the year by drawings on december31, 2024 the Co. purchased for cancellation 200 debentures at the ruling price of Rs. 95 the expenses being Rs. 100. Interest is payable yearly. Give journal entries in the books of ABC Ltd. show the Balance sheet.

16. On January 1, 2021 CI Ltd. 1,000, 6% debentures of Rs. 100 each repayable at the end of the end of four years at a premium of 10%. It has been decided to institute a sinking fund for the purpose the investments being excepted to realize, 5% net Sinking fund tables show that Rs. 0.232012 invested annually amounts to Rs.1 at 5% in four years. Investments were made in multiplies of hundreds only.

On December 31, 2024 the balance at the bank was Rs. 40,000 and the investments realised Rs. 82,000. The debentures were paid off. Give entries and show ledger accounts except for debenture interest.

17. Bhanu Co. issues 14% Debentures of Rs. 1,35,000 on 1-1-20 with a condition that they should be redeemed by setting aside at the end of every year Rs. 30,000 out of profits, investing the amount in 10% Govt. Securities. The interest received at the end of the year should be invested in the same securities.

Securities were sold off on 30-6-24 for Rs. 1,40,000 and the debentures were paid off.

Prepare debenture Redemption Account and Debenture Redemption Fund Investment Account up to 31-12-24.

18. Messrs Bio-chem Ltd. issued 6% Debentures for Rs. 2,00,000 of Rs. 100 each at par, which are repayable at the end of 5 years at a premium of 5%. In terms of the Trust deed, a sinking fund was to be created for the purpose of accumulating sufficient funds for the purpose. Investments were made yielding 5% interest received at the end of each year. All investments including re-investment of interest received were made at the end of the year.

You are required to show, for 5 years, the

(i) Sinking Fund Account and

(ii) Sinking Fund Investment Account

19. The following are the balances as on 31-3-24 extracted from the books of Minaxi Ltd.

12% Debentures	4,00,000
Debenture Redemption Fund	3,00,000
Debenture Redemption Fund Investments	3,00,000
Interest on Deb. Red. Fund Investments	30,000
Discount on Debentures	40,000

On the above date, the investments worth Rs. 2,50,000 were sold at a loss of 10% to redeem 50% debentures at 10% premium.

The company transfers Rs. 50,000 every year to debenture redemption fund account. The company has also purchased 8% central Government loan of Rs. 50,000 at 2% premium.

Prepare following accounts in the books of the Company:

(i) 12% Debentures Account

(ii) Debenture Redemption Fund Account.

(iii) Debenture Redemption Fund Investments Account

(iv) Discount on Debentures Account

20. The following balances were extracted from the books of Dharti Limited as on 31st March, 2024.

12% Debentures		5,00,000
Debenture Redemption Fund		3,80,000
Debenture Redemption Fund Investments		
9% Gujarat Government loan	2,00,000	
(Purchased at face value)		
10% Central Government Loan	1,80,000	3,80,000

(Face value Rs. 1,90,000)

Interest received on above Investments	37,000
Discount on issue of Debentures	50,000

On 31-3-2024 Debenture Redemption fund investments were sold as under:

(i) 9% Gujarat Government Loan at the rate of Rs. 95.

(ii) 10% Central Government Loan at the rat of Rs. 104.

On 1st April, 2024 the Debentures of Rs. 3,00,000 were redeemed at a premium of 5% and on the same day 10% National Defense Bonds of Rs. 1,00,000 were purchased at a premium of 3%.

The amount of Rs. 50,000 is transferred every year to the debenture Redemption Fund. The interest on Debentures had been paid up to 31st March, 2024.

Accounting year of the Company ends on 31st March every year. From the above particulars, pass necessary journal entries in the books of the company and prepare "Debenture Redemption Fund Account" and "Debenture redemption Fund Investment Account".

UNIT-7 FINAL ACCOUNTS OF COMPANY -1

7.1 Introduction

7.2 General instructions for Preparation of Final Account as per the Companies Act, 2013

7.3 Format of Profit & Loss Account and the Balance Sheet of a company as per the requirements of Schedule III of the Companies Act, 2013.

7.4 Adjustments

7.5 Final Account: Important Points

❖ **Exercise**

7.1 Introduction

The Basic rules for preparing a Company's Final Accounts – viz. Balance sheet and profit & loss Account remain the same as in case of Sole-Traders or Partnership Firm.

Every company likes to measure the performance of its business operations in terms of profit or loss. It also likes to know the value of its assets and liabilities on the closing date of accounting period. Final accounts, these days known as financial statements are divided into two parts, i.e. income statements and position statements.

The term income statement traditionally known as profit & loss account is divided in three parts in case of companies.

1. First part - Trading Account

2. Second part - Profit & Loss Account

3. Third part - Profit & Loss Appropriation Account

Trading Account shows Gross profit & Loss while profit & Loss account shows the Net profit or Net loss of the company Profit & loss Account shows the appropriation of profit between dividend Reserve and funds. In case of manufacturing companies, manufacturing account is prepared to ascertain cost of production before Trading and profit & loss account.

Every company must prepare Balance Sheet of the company shall give true and fair view of the state of affairs of the company as at the end of financial year and shall be made as per format given in schedule-III part-I. The profit & Loss Account should be made as per format given in schedule III Part-II.

As per 2013 Companies Act:

1. According to Section 128, makes it compulsory for companies to keep certain books of accounts, like profit & loss A/c. and Balance sheet.
2. According to Section 129, governs the preparation of Final Accounts for companies.
3. According to section 129, requires the balance Sheet and profit & Loss A/c. to be set up in the prescribed form. Balance sheet of the companies must present true and fair view of the state of affairs.

7.2 General instructions for Preparation of Final Account as per the Companies Act 2013

The following items are special for a company and their treatment in the final accounts.

1. The Company Final Accounts must be in the form prescribed by Companies Act, 2013. Items in Balance Sheet must be in the same order.
2. The headings of Final Accounts must indicate name of the company. It should also state: "Balance Sheet as at ………" and "Profit and Loss A/c. for the year ended………"
3. Company Law requires certain disclosures in the Final Accounts. They must be shown in the Balance Sheet and Profit and Loss Account. To illustrate:
   - Calls in Arrears must be deducted form called up share capital showing separately calls in Arrears from directors and others. [If the Trail Balance shows only the paid-up capital and the calls in arrear is given in the information, the amount is first added to the paid up capital to show the called-up capital and then deducted again so that the net amount, i.e. the paid-up capital is shown in the outer column.]
   - Shares issued to vendors for consideration other than cash and shares issued as bonus shares should be disclosed in balance Sheet.
   - Market value of investments, if any, should be shown.
   - Where loans are secured, the assets hypothecated, mortgaged or charged should be shown in balance Sheet.
   - Debtors exceeding 6 months should be shown separately.
   - Remuneration to Auditors should indicate Amount paid for Audit fees and other work (taxation work etc.) separately in Profit and Loss Account.
   - Cash at Bank should indicate Balance with Scheduled Bank and Balance with other banks distinctively.

4. There are two items which are not to be taken in Balance Sheet total.

(a) Authorised Capital

(b) Contingent Liabilities.

Amount of Authorised Capital should be underlined to ensure that it is excluded from total and contingent Liabilities should be shown by way of foot note below the Balance sheet total.

5. Dividend:

- **Interim Dividend:** This represents the dividend for a period of six months paid by the company before the preparation of the final A/c. This item appears in the trail Balance and is shown on the debit side of the Profit & Loss Appropriation A/c.

- **Final Dividend appearing in the Trail Balance:** This represents the dividend paid for the previous year and is shown on the debit side of the Profit & Loss Appropriation A/c.

- **Final Dividend proposed for the current year:** This item appears in the adjustment and represents the dividend proposed but not paid hence this shown on the debit side of the Profit & Loss Appropriation A/c. and on the liability side of the balance sheet under the heading ‘provisions.

  Profit and Loss Appropriation Account Dr.

  To proposed dividend Account

- **Unclaimed Dividend:** This is a credit item in the Trail Balance and is shown on the liability side of the balance Sheet under the heading ‘Current Liability’.

- **Preference Share Dividend:** Preference share dividend is always paid prior to any payment of dividend to equity shareholders. But preference shareholders can claim dividend only out of profits and unlike interest on debentures, it cannot be paid when there is no profit. If equity shareholders are not paid any dividend on preference share capital remains unpaid, it appears as a contingent liability outside the balance sheet.

6. Dividend/ Interest received:

This is an income for the company on the investments made by it in the shares/Debentures of some other company. This item appears in the trail balance and is shown on the credit side of the Profit & Loss Account. If the amount given is a net amount after deducting tax at source of the Income Tax Act, the amount should be grossed up and the gross amount shown in Profit & Loss Account and tax deducted at source is shown on the asset side of the Balance Sheet.

7. **Interest paid on Debentures:**

The gross amount of interest paid on debenture will be debited to the Profit & Loss Account and the tax deducted at source is shown on the liability side of the balance Sheet under the heading tax Payable.

8. **Discount and Cost of Issue of Debentures:**

The discount on shares or Debentures written off in the current year is shown on the debit side of the Profit & Loss Account and the unwritten off portion is shown on the asset side of the Balance Sheet under the heading 'Miscellaneous expenses.

9. **Share forfeited Account:**

This appears as a credit item in the Trail Balance and is shown on the liability side of the Balance Sheet by adding it to the paid-up capital.

10. **Share Premium Account** shown on the liability side under the heading 'Reserves & Surplus'.

11. **Income Tax limit for Depreciation:**

Depreciation on various Fixed Assets will be charged in the books at a rate deemed fit by the company, but if it exceeds the deprecation allowable as per tax rules, the excess deprecation charged will be added back to the book profit for calculating:

(a) The managerial remuneration payable as a percentage of Profit and

(b) Provision for Taxation for the current year.

E.g. If a company has Fixed Asset of Rs. 2,00,000 and profit after depreciation at 5% p.a. is Rs. 80,000 and the income tax limit for deprecation is Rs. 8000, calculate (i) 5% of the Net Profit as commission to the manager and (ii) Tax Provision at 50%.

Solution:

Net Profit after depreciation		80,000 Rs.
Less: Manger's Commission:		
Net profit as per books	80,000 Rs.	
Add: Excess dep. Written off		
(Rs. 10,000 – Rs. 8,000)	2,000 Rs.	
	82,000 Rs.	

Commission: (82,000 * 5%)		4,100 Rs.
		75,900 Rs.
Less: Provision for Income Tax:		
Profit as calculate above	82,000 Rs.	
Less: Manager's Commission	4,100 Rs.	
	77,900 Rs.	
Provision for Tax = 77,900 * 50%		38,950 Rs.
	Net profit as per P & L A/c.	36,950 Rs.

12. Income Tax:

- **Tax deducted at source:** As per sections 193 & 194 of the Income tax Act 1961, tax is to be deducted at source form interest on securities and dividends before they are paid. (e.g.: If the gross dividend is Rs. 5000 and tax is deducted at source at the rate of 23%, the investor receives only a net Rs. 3850. the tax deducted at source, Rs. 1150 appears as a debit item in the Trial Balance. This will be adjusted against the tax payable for the current year.)

- **Advance Payment of Tax:** This is an Advance Tax paid in respect of the current year income and will appear as a debit item in the Trail Balance. This is also adjusted against the Tax Payable.

- **Provision for tax for the Current Year:** This is given in the adjustment and is debited to the Profit & Loss Account and also shown in the Balance Sheet on the liability side under the heading current liabilities and provisions.

- **Credit Balance in the 'Provision for tax' column appearing in the Trail Balance:** This represents the provision made in the previous year and the Income Tax paid in respect of the previous year should be adjusted against this provision and the excess provision if any, is credited to the Profit & Loss Appropriation Account. If the credit balance in the 'Provision for Tax' column appearing in the rail Balance is after the payment of tax, it means only excess provision, and it is credited to the Profit & Loss Appropriation Account.

- **Debit Balance in the 'Provision for Tax' column appearing in the Trail Balance:** If the provision for tax shows a debit balance, it means that the old provision is insufficient and the debit balance is shown in the debit side of the Profit & Loss Appropriation Account.

13. Deferred Revenue expenditure written off:

There are certain expenses which are of revenue nature, but its benefit is likely to be available to a company for a considerably long time. Such expense is usually not written off to Profit & Loss Account in the year in which it is incurred but it is temporarily capitalized and is spread over a number of years.

To the extent they are not written off they are shown on Asset side of the Balance Sheet under the heading of 'Miscellaneous Expenses'. Every year, proportionate amount of such deferred expenditure is written off and is debited to profit and Loss account.

e.g.: preliminary Expenses, Discount Allowed on issue of Shares & Debentures, Underwriting Commission, Brokerage on shares, Advertisement campaign on large scale etc.

14. Pre-incorporation Expenses:

Pre-incorporation expenses denote expenses incurred by the promoters for the purpose of the company before its incorporation.

- Preliminary analysis of the conceived idea.
- Detailed investigation in terms of technical feasibility and commercial viability to establish the soundness of the proposition.
- Preparation of 'Project Report' or 'Feasibility Report' and its verification through independent appraisal authority
- Organiation of funds, Property and managerial ability and assembling of other business elements.

These expenses should be properly capitalized and shown in the Balance Sheet under the heading 'Miscellaneous Expenditure'. There is no legal requirement to write-off these expenses to Profit & Loss Account within any specified period of time nor is there any rigid accounting convention in regard to this matter.

15. Bonus Shares:

- **Cash Bonus:** The term cash bonus stands for extra dividend paid by the company. Cash bonus is paid by the company when it has large accumulated profit as well as cash to pay dividend. Before making any cash payment, directors should make sure that it will not affect adversely their working capital requirements and future plans of capitalization. Cash bonus, inherently, implies that it may not be repeated in the future. Entries for cash bonus are the same as done for dividend.
- **Bonus Shares:** Bonus shares are issued by a company when it wants to pay dividend by issuing shares. Bonus shares are declared when company has sufficient profit to declare.

7.3 Format of Profit & Loss Account and the Balance Sheet of a company as per the requirements of Schedule III of the Companies Act,2013.

PROFORMA OF BALANCE SHEET: (HORIZONTAL FORM- As per Companies Act-1956)

SCHEDULE VI, PART – I
(See section 211)

Balance Sheet of _____________ (Here enter the name of the company) **as at** _____________
(Here enter the date at which the balance sheet is made out)

LIABILITIES		AMT. (figures for the current year)	ASSETS		AMT. (figures for the current year)
I. SHARE CAPTIAL:			**I. FIXED ASSETS:**		
AUTHORISED CAPITAL:			1. Goodwill	---	
Eq. Shares of Rs.___ each	----		2. Land & Building	---	
Pf. Shares of Rs. ___ each	----	-----	3. Leasehold property	---	
			4. Plant & Machinery	---	
ISSUED CAPITAL:			5. Furniture & Fittings	---	
Eq. Shares of Rs.___ each	----		6. Railway sidings	---	
Pf. Shares of Rs. ___ each	----		7. Development of Property	---	
CALLED UP CAPITAL:			8. Patents, Trade-Marks, Designs	---	
Eq. Shares of Rs.___ each	----				
Pf. Shares of Rs. ___ each	----		9. Livestock	---	
			10. Vehicles	---	
PAID UP CAPITAL:			11. Tools	---	
Eq. Shares of Rs.___ each			**(Assets are shown less**		
Less: unpaid calls			**Depreciation or Original**		
Add: Forfeited amt.	-----		**Cost)**		-------
Pf. Shares of Rs. ___ each	-----	-----			
			II. INVESTMENTS:		
II. RESERVES & SURPLUS:			1. Investments in Government Securities	---	
1. General Reserve Add: Cu. Year Provision	----		2. Investments in Shares, Debentures or Bonds.	---	
2. Share Premium	----		3. Investment in the capital of partnership firm.	---	
3. Capital Redemption Res.	----				
4. Capital Reserve	----				
5. Deb. Sin. Fund Add. Int. on S. F. Add. Inst. Of S.F.	----		4. Debenture Sinking Fund	---	
			5. Other Investments	---	
6. Surplus (Bal. in P & L A/c.)			6. Immovable Properties.	---	-------
7. Investment Allowance Fu.	----				
8. Dividend Equalisation Fu.	----		**III. CURRENT**		
9. Export profit Reserve	----		**ASSETS, LOANS AND**		

10. Proposed Add. To Res.	----		**ADVANCES:**		
11. Other Reserve	----		**(A) CURRENT**		
	----	----	**ASSETS:**	---	
III. SECURED LOANS:			1. Int. Accrued on Invest.	---	
1. Debentures			2. Stores & spares	---	
2. Loans & Advances from	----		3. Stock in Trade	---	
bank			4. Work-in-Progress		
3. Loans & Advances from	----		5. Debtors		
subsidiaries			1. Debts o/s for a		
4. Other Loans & Advances	----		period of exceeding six	---	
(security against charges on)	----	----	months		
			2. Other Debts -----		
IV. UNSECURED LOANS:			Less: B.D. -----	---	
1. Fixed Deposits			Less: NBDR -----	---	
2. Loans & Advances from			7. Cash Balance		
subsidiaries	----		8. Bank balance (with		
3. Public Deposits			Scheduled Bank &	---	
4. Short term Loans & Adv.	----		Others Bank)	---	-------
(from Bank & Others)	----		9. Telephone Deposit		
5. Director's Loan			**(B) LOANS &**		
	----		**ADVANCE**		
V. CURRENT LIABILITES	----	----	1. Advances and Loans to	---	
AND PROVISIONS:			subsidiaries		
(A) CURRENT			2. Advances and Loans to		
LIABILITES:			Partnership Firms in		
1. Sundry Creditors			which the Company or		
2. Bills Payable/Acceptances	----		any of its Subsidiaries	---	
3. Bank Overdraft	----		is a partner.	---	
4. Unclaimed Dividends	----		3. Bills of exchange		
5. Adv. Payment received	----		4. Advances recoverable		
6. Int. accrued but not due on	----		in cash or in kind (e.g.		
Loans	----		pre-paid taxes,	---	
7. Outstanding Expenses			Insurance etc.)		
8. Other Liabilities	----		5. Balances with customs		
(B) PROVISIONS:	----		Port trust etc. (where		
9. Provision for Taxation	----	----	payable on demand)	---	-------
10. Proposed Dividends					
11. Provident Fund Scheme	----		**IV. MISCELLANEOUS**		
12. Pension and staff benefit	----		**EXPENSES:**		
Scheme	----		**(PRELIMINARY EXP.)**		
13. Other Provisions			1. Preliminary Expenses	---	
	----		2. Discount on the issue		
A foot-note to the Balance	----	----	of Shares or		
Sheet may be added to show			Debentures	---	
separately—			3. Advertisement		
1. Claims against the company			Suspense Account	---	

not acknowledged as debts. 2. Uncalled liability on shares partly paid. 3. Arrears of fixed cumulative dividends. 4. Estimated amount of contracts remaining to be executed on capital account and not provided for. 5. Other money for which the company is contingently liable.		---------	4. Comm. or Brokerage on underwriting or subscription of Shares or Debentures 5. Interest paid out of Capital during Const. 6. Development expenditure not adjusted **<u>V. PROFIT & LOSS A/C.</u>** Balance of Loss	--- --- ---	------- ------ -----------

PROFORMA OF BALANCE SHEET: (VERTICAL FORM- As per Companies Act, 2013)

SCHEDULE VI, PART – I

(See section 641 (1))

Balance Sheet of ______________ (Here enter the name of the company) **as at ______________**

(Here enter the date at which the balance sheet is made out)

Particulars	Schedule No.	Figures as at the end of current fin. Year.	Figures as at the end of previous fin. Year.
<u>I. EQUITY AND LIABILITIES:</u>			
1. **Shareholders Funds:**			
(a) Capital			
(b) Reserves and Surplus			
(C) Money Received against Shares Warrants			
2. Share Application Money Pending Allotment			
3. Non-Current Liabilities			
(a) Long-term Borrowings			
(b) Deferred Tax Liabilities			
(c) Other Long-Term Liabilities			
(d) Long-term Provisions			
4. Current Liabilities			
(a) Short-term Borrowings			
(b) Trade Payables			
(c) Other Current Liabilities			
(d) Short-term Provisions			

TOTAL:			
<u>II. ASSETS:</u>			
Non-Current Assets			
1. (a) Fixed Assets:			
(i) Tangible Assets			
(ii) Intangible Assets			
(iii) Capital Work-in-Progress			
(iv) Intangible Assets Under Development			
(b) Non - Current Investments			
(c) Deferred Tax Assets (Net)			
(d) Long-term Loans and Advances			
(e) Other Non-Current Assets			
2. Current Assets			
(1) (a) Current Investments			
(b) Inventories			
(c) Trade Receivables			
(d) Cash and Cash Equivalents			
(e) Short-term Loans and Advances			
(f) Other Current Assets			
TOTAL:			

PROFORMA OF PROFIT & LOSS ACCOUNT (As per Companies Act 1956)

SCHEDULE VI, PART – II

1ST PART: TRADING / MANUFACTURING A/C.

Profit & Loss Account of ______________ (Here enter the name of the company) **for the year ended ______________** (Here enter the date at which the profit & loss a/c. is made out)

Particulars	Amt.	Particulars	Amt.
To Op. Stock (Raw Material, Work-in-Progress, Finished Goods)	---	By Sales	
To Purchases		Less: Sales Return	---
Less: Purchase Return	---	By Closing Stock (Raw Material, Work-in-Progress, Finished Goods)	---
To Wages	---	By Goods goes out by other reasons	---
To Manufacturing Expenses	---		
To Carriage Inward	---		
To Freight & Insurance	---		
To Fuel & Power	---		
To Gross Profit	---		
	---------		--------

2nd PART: PROFIT & LOSS ACCOUNT:

Particulars	Amt.	Particulars	Amt.
To Gross Loss	---	By Gross Profit	---
To Salary	---	By Sundry Income	---
To Rent & taxes	---	By Interest on Investment	---
To Depreciation	---	By Other income	---
To Office Expenses	---	By Discount Received (TB) -----	
To Insurance Premium	---	By CDR (Adj.) -----	
To Stationery & Printing	---	-----	
To Postage	---	By CDR (TB) -----	---
To B.D. (TB) -----		By Bad debts recovery	---
To B.D. (Adj.) -----		By Profit on sale of Assets	---
TO BDR (Adj.) -----		By BDR (excess provision written	
-----		back)	---
To BDR (TB) -----	---	By Net Loss (Transferred to P & L	
To Discount Allowed (Tb) -----		Appropriation A/c.)	---
To DDR (Adj.) -----			

To DDR (TB) -----	---		
To Interest on Loan	---		
To interest on Debentures	---		
To Loss on Sale of Assets	---		
To Carriage Outward	---		
To Advertisement Expenses	---		
To Delivery Van Expenses	---		
To packaging Expenses	---		
To Salesmen's Commission	---		
To Contribution of Provident Fund			
To Tax Provision	---		
To directors Fees	---		
To Amt. paid to Auditors:	---		
For Audit Fees -----			
For Other Services -----			
To Other Expenses	---		
To Preliminary Expenses written off	---		
To Repair & Renewals			
To General charges	---		
To Underwriting Commission	---		
Written Off	---		
To Net Profit transferred to P & L			
Appropriation A/c.	---		

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3rd PART: PROFIT & LOSS APPROPRIATION ACCOUNT:

Particulars	Amt.	Particulars	Amt.
To Balance b/d. (if Loss)	---	By Balance b/d (if Profit)	---
To Net Profit	---	By Net Loss	---
To Dividend	---	By Transfer from Reserve	---
To Provision for General Res.	---	By Balance C/d.	---
To Debenture Redemption Res.	---		
To Other Reserve (As per Adj.)	---		
To Interim dividend	---		
To Proposed Dividend	---		
To Balance c/d.	---		
	---------		--------

PROFORMA OF PROFIT & LOSS ACCOUNT (As per Companies Act 2013)

SCHEDULE III, PART – II
STATEMENT OF PROFIT AND LOSS

Profit & Loss Account of ______________ (Here enter the name of the company) **for the year ended ______________** (Here enter the date at which the profit & loss a/c. is made out)

Particulars	Schedule No.	Figures as at the end of current fin. Year.	Figures as at the end of previous fin. Year.
I. Revenue from operations			
II. Other Income			
III. Total Revenue (I + II)			
IV. Expenses:			
Cost of Materials Consumed			
Purchases of Stock-in Trade			
Changes in Inventories of Finished Goods			
Work in progress and stock-in-trade			
Employee Benefits Expenses			
Finance Costs			
Depreciation and Amortization Expense			
Other Expenses			
Total Expenses			
V. Profit before Exceptional and Extraordinary Items and Tax (III-IV)			
VI. Exceptional items			
VII. Profit before Extraordinary items and tax(V-VI)			
VIII. Extraordinary Items			
IX. Profit before Tax (VII-VIII)			
X. Tax Expenses:			

(1) Current Tax (2) Deferred Tax XI. Profit (Loss) for the period from continuing operations (IX-X) XII. Profit (Loss) from discontinuing operations XIII. Tax expenses of discontinuing operations XIV. Profit (Loss) from discontinuing operations (after tax) (XII-XIII) XV. Profit (Loss) for the period (XI +XIV) XVI. Earnings per Equity Shares: (1) Basic (2) Diluted			

7.4 Adjustments

Adjustments should be given two effects in Final Accounts.

1. Closing Stock:
1. In p & L A/c. – 1st Part Credit side
2. In Balance Sheet Asset side as Current Assets

2. O/s. Expense:
1. In P & L A/c. – 2nd Part Add in respective expenses
2. In Balance sheet Liabilities side as a Current Liabilities

3. Pre-paid Exp.:
1. In P & L A/c. – 2nd Part Sub. from the respective Income
2. In Balance sheet Assets side as a Loans & Advances

4. O/s Income:
1. In P & L A/c. – 2nd Part Add into the respective Income
2. In Balance sheet Assets side as Current Assets

5. Pre-received Income:
1. In P & L A/c. – 2nd Part Sub. from the respective Income
2. In Balance sheet Liabilities side as Current Liabilities

6. Depreciation:
1. In P & L A/c. – 2nd Part Debit side
2. In Balance sheet sub. from respective Fixed Assets

7. Bad Debt reserve:
1. In P & L A/c. – 2nd Part Debit side (in the format of B.D.)
2. In Balance sheet sub. from Sundry Debtors

8. Transfer to G.R.:
1. In P & L A/c. – 3rd Part Debit side
2. In Balance sheet Liability side Add. to G.R. under the heading Reserves & Surplus

9. Proposed Final Div.:
1. In P & L A/c. – 3rd Part Debit side
2. In Balance sheet Liability side Add. under the heading Provisions

10. O/s. Debenture Int.:	1. In P & L A/c. – 2nd Part Debit side 2. In Balance sheet Liability side under the heading Secured Loan
11. Provision for Tax:	1. In P & L A/c. – 2nd Part Debit side 2. In Balance sheet Liability side under the heading Provision
12. Write off --% of Pr. Exp.:	1. In P & L A/c. – 2nd Part Debit side 2. In Balance sheet Assets side Sub. form Miscellaneous Expense
13. Provision for DRF:	1. In P & L A/c. – 3rd Part Debit side 2. In Balance sheet Liability side Add. in DRF under the heading Reserves & Surplus
14. Authorised Capital:	1. Only one effect on Balance sheet Liabilities side under the heading of Capital.
15. Credit Sales:	1. In p & L A/c. – 1st Part Credit side Add. in sales 2. In Balance Sheet Asset Side Add. in Debtors under the heading Current Assets
16. Credit Purchase:	1. In p & L A/c. – 1st Part Debit side Add. in Purchase 2. In Balance Sheet Liabilities Side Add. in Creditors under the heading Current Liability
17. Bills Discounted but not matured:	1. In Balance Sheet Add. in BOD on Liability Side **or** Sub. from Bank Balance on Asset side 2. In Balance Sheet Add. in Debtors under the heading Current Assets

7.5 Final Account: Important Points

1. While solving any company's Final Account example, remember two Rules:

1.) All Debit Balances are either Assets or Expenses

All Credit Balances are either Liabilities or Income

2.) Figures of Trial Balance will have only one effect in Final Accounts.

2. While reading an example, especially information below Trial Balance you should be able to identify.

Which is an "Adjustment" requiring two effects and which is an "additional information" for disclosure in Final Accounts, and also careful about Hidden Adjustment. (Such as 6% debentures, 10% Investment)

3. Proposed Dividend should always be calculated on called up capital before adding/deducting items as per below:

   - Preference Shares have priority in dividends over equity shares.
   - Dividend is an Appropriation of profit and hence it comes in 3rd Part.
   - Interim dividend is paid in the middle of the year and hence it comes in Trial Balance.
   - Proposed dividend is always an appropriation adjustment requiring two effects.
   - Proposed dividend does not become liability until declared by shareholders in AGM. Hence it should be shown in 'Provision'.
   - Unclaimed dividend comes under the head current liability.

4. Interest O/s. on debentures should be added to debentures. Care should be taken about hidden adjustment in respect of Interest on Debentures. Interest accrued but not due should shown as current liabilities.

5. Investments can have three values:

   - Face Value: For calculation of interest
   - Cost of Purchase Price: To be taken in B/s total
   - Market Value: For disclosure only

6. You should exercise great care about twin items in Trail Balance and should give correct treatment. (1) Discount (2) Purchase & Sales (3) Debtors & Creditors (4) Bills Receivable & Bills Payable (5) Bank & Cash (6) Provident Fund & Contribution to Provident Fund

7. Depreciation for the year should be calculated on (1) Original Cost, if Straight Line Method is asked (2) Written Down value, if Reducing Balance Method is asked.

   Remember:

   - Original Cost – Accumulated Depreciation – Written Down Value
   - If accumulated Depreciation or Depreciation Fund is **given** in Trial Balance the value of Assets is always consider as an Original Cost.
   - If Depreciation Fund is **not** given in Trial Balance the value of asset is always consider as **WDV**.
   - Depreciation on newly purchased Asset should be calculated on proportionate basis according to period of usage.

- If value of Asset in Trial Balance is its written down value, then original cost can always be calculated if information is given about depreciation Fund. Also, depreciation Fund or Accumulated Depreciation up to end of last year can be calculated if original cost is given.

- Depreciation in Trial Balance (debit side) is Current Year's Depreciation. It means adjustment entry has already been passed and therefore only one effect should be given. It should be debited to P/L A/c. like any other expense.

8. If there is Advance Income Tax paid and Provision for Taxation for same Assessment Year only net figure should be shown.

9. If Tax liability of any past year is determined and provision for taxation is either excess or short it should be adjusted in 3rd part only.

10. Any income or interest received on investment made from specific fund should be credited to fund and not to P & L A/c.

11. If there is an uncertain liability which may or may not materialise it should be disclosed by way of footnote below the B/s. They are called "Contingent Liabilities".

12. If security is given Bank Overdraft should be treated as secured loan otherwise current Liabilities.

❖ Exercise

• State whether each of the following statement is 'True' or 'False'.

1. No Dividend can be paid on calls in advance. **True**

2. Managerial Remuneration is to be calculated before providing for taxation. **True**

3. Any dividend remaining unclaimed after three years from the date on which it became due can be transferred to capital reserve. **False**

4. Issue of bonus shares is not permissible unless the existing partly paid -up shares are made fully paid-up. **True**

5. In the final accounts of a joint-stock company, provision for income-tax for the current year is shown as a charge against revenue and not as an appropriation of profits. **True**

• Answer the following Questions:

1. Prepare a statement of profit and Loss account of a company as per the revised Schedule III of the Companies Act, 2013.

2. Prepare a statement of Balance Sheet of a company as per the revised Schedule III of the Companies Act, 2013.

- **Write a Short notes on:**
    1. **1.** Dividend
    2. **2.** Bonus shares
    3. 3. Pre-incorporation Expenses

UNIT-8	FINAL ACCOUNTS OF COMPANY-2

8.1 Introduction

8.2 Illustrations

❖ **Exercise**

8. 1 Introduction:
In previous chapter, we have learnt theory aspects of Company Final Account as per Companies Act, 2013. In this chapter, we are going to study example i.e. how to prepare final accounts of the company from the trial balances and balances at the end of the year.

8.2 Illustrations:
Illustration -1: The following balances were recorded in the books of Nikita Co. Ltd. on 31-3-24:

Debit Balance	**Rs.**	**Credit Balance**	**Rs.**
Income Tax	70,000	Reserve for Bad debts	7,500
Calls-in arrears (Equity Shares)	25,000	Debenture Redemption Fund	50,000
Cash and Bank balance	27,000	Income from Investment	23,750
Land & Building	4,25,000	Public Deposit	36,500
Opening Stock	83,250	Loan from Bank of India	63,500
Provident Fund Contribution	6,250	Profit & Loss A/c	13,750
Plant & Machinery	2,87,500	Creditors	60,000
Furniture	80,000	Bills Payables	22,500
Investments	4,14,250	Sales	6,50,000
Loose Tools	30,000	5% Debentures(mortgage)	1,25,000
Postage and Telegram	10,000	Provident Fund	32,500
Stationary Expenses	6,250	Capital Reserve	1,37,500
Rent and Taxes	50,000	Securities Premium	42,250
Salary	1,42,500	Share Forfeiture A/c	11,250
Director's Fees	8,750	General Reserve	2,25,000
Debtors	1,65,000	7.5% Pref. Share Capital	2,50,000
Preliminary Expenses	15,000	Equity Share Capital	5,00,000
Productive Wages	88,000		
Debenture Redemption Fund Investments	50,000		
Purchases	2,66,250		
	22,50,000		**22,50,000**

You are required to prepare Profit & Loss Statement and the Balance Sheet (as per Schedule III) on that date after taking into account the following additional information:

(1) The Stock on 31-3-24 was Rs. 2,38,500.
(2) Provide 5% reserve for bad debts on Debtors.
(3) Prepaid rent amounted to Rs. 5,000.

(4) Provide depreciation on Plant & Machinery at 2%, on Furniture at 5% and on Land & Building at 4%.
(5) The authorized capital of the company amount to Rs. 12,50,000.
(6) The directors of the company recommended 7.5% dividend on preference share capital and 10% on Equity Share Capital.
(7) Transfer Rs. 50,000 to General Reserve.
(8) Outstanding Expenses:

Productive Wages	Rs. 6,250
Salaries	Rs. 7,500
Rates and Taxes	Rs. 3,750

(9) Provision for Dividend distribution tax is to be made at 20% on proposed dividend.

[Guj. Uni., F.Y., Nov. 2014]

Solution:

Balance Sheet of Nikita Co. Ltd.
As on 31st March 2024

Particulars	Note	Rs.
I. Equities and Liabilities:		
(1) Shareholders' Funds:		
(a) Share Capital	1	7,36,250
(b) Reserves and Surplus	2	5,04,750
(2) Non-Current Liabilities:		
(a) Long Term Borrowing	3	2,25,000
(b) Long term provisions:		
Provident fund		32,500
(3) Current Liabilities:		
(a) Trade Payables	4	82,500
(b) Other Current Liabilities	5	23,750
(c) Short Term Provision	6	82,500
Total:		**16,87,250**
II. Assets:		
(1) **Non-Current Assets:**		
(a) Fixed Assets: Tangible Assets	7	7,65,750
(b) Non-Current Investments	8	4,64,250
(2) Current Assets:		
(a) Investments	9	2,68,500
(b) Trade Receivables		
Debtors (1,65,000 – 8,250 B.D.R.)		1,56,750
(c) Cash and Cash Equivalents:		
Cash and Bank Balance		27,000
(d) Other Current Assets: Prepaid Rent		5,000
Total:		**16,87,250**

Profit and Loss Statement of Nikita Co. Ltd.

For the year ended on 31st March, 2024.

Particulars	Note	Rs.
I. Revenue From Operations – Sales		6,50,000
II. Other Income: Income From Investments		23,750
III. Total revenue: (I +II)		**6,73,250**
IV. Expenses:		
(A) Purchases		2,66,250
(B) Changes in value of stock (83,250 – 2,38,500)	**10**	(1,55,250)
(C) Employee Benefit Expenses		1,56,250
(D) Finance Cost: Deb. Interest		6,250
(E) Depreciation	**11**	26,750
(F) Other Expenses	**12**	2,53,750
Total Expenses		**5,54,000**
V. Profit for the period (III – IV)		**1,19,750**

Notes to Accounts:

Note 1: Share Capital

Particulars			**Rs.**
Authorized Capital:			12,50,000
Issued, Subscribed Capital and Paid-Up Capital:			
Pref. Share Capital			2,50,000
Equity Share Capital	5,00,000		
Less: Calls in arrears	25,000		
	4,75,000		
Add: Forfeiture A/c	11,250		4,86,250
		Total:	**7,36,250**

Note 2: Reserves & Surplus:

Particulars			**Rs.**
Capital Reserve			1,37,500
Debenture redemption Fund			50,000
General Reserve: Opening Balance		2,25,000	
Add: Current year's appropriation		50,000	2,75,000
Securities Premium			41,250
Surplus: Balance in Statement of Profit and Loss:			
Opening balance (Last year's surplus)		13,750	
Add: Surplus as per current year's Statement of Profit & Loss		1,19,750	
		1,35,500	
Less: Provisions & Appropriations:			
Equity Dividend	50,000		

Preference Dividend	18,750		
Dividend Distribution Tax	13,750		
Transfer to General Reserve	50,000	1,32,500	1,000
		Total	**5,04,750**

Note 3: Long Term Borrowings

Particulars	**Rs.**
5% Mortgage Debentures	1,25,000
Public Deposits	36,500
Loan from Bank of India	63,500
Total	**2,25,000**

Note 4: Trade Payables

Particulars	**Rs.**
Creditors	60,000
Bills Payables	22,500
Total	**82,500**

Note 5: Other Current Liabilities

Particulars	**Rs.**
Interest due on debentures	6,250
Outstanding productive wages	6,250
Outstanding salaries	7,500
Outstanding rates and taxes	3,750
Total	**23,750**

Note 6: Short Term Provisions

Particulars	**Rs.**
Preference Dividend (2,50,000 x 7.5%)	18,750
Equity Dividend (5,00,000 x 10%)	50,000
Dividend Distribution Tax (50,000 + 18,750 = 68,750 x 20%)	13,750
Total	**82,500**

Note 7: Fixed Assets: Tangible Assets

Assets	**Opening Balance**			**Less:**	**Net**
	Op. bal.	**Add. (Ded.)**	**Cl. Bal.**	**Depreciation**	**Assets**
Land & Building	4,25,000	-	4,25,000	17,000	4,08,000
Plant & Machinery	2,87,500	-	2,87,500	5,750	2,81,750
Furniture	80,000	-	80,000	4,000	76,000
Total	**7,92,500**	**-**	**7,92,500**	**26,750**	**7,65,750**

Note 8: Non-Current Investments:

Particulars		**Rs.**
Investments		4,14,250
Debentures Redemption Fund Investments		50,000
Total		**4,64,250**

Note 9: Inventories

Particulars		**Rs.**
Closing Stock		2,38,500
Loose Tools		30,000
Total		**2,68,500**

Note 10: Employee Benefit Expenses

Particulars		**Rs.**
Salaries	1,42,500	
+ Outstanding	7,500	1,50,000
Provident Fund Contribution		6,250
Total		**1,56,250**

Note 11: Depreciation and Amortization Expenses

Particulars		**Rs.**
Dep. On Land & Building (4,25,000 x 4%)		17,000
Dep. On Plant & Machinery (2,87,500 x 2%)		5,750
Dep. On Furniture (80,000 x 5%)		4,000
Total		**26,750**

Note 12: Other Expenses

Particulars		**Rs.**
Productive wages	88,000	
+ Outstanding	6,250	94,250
Rent and Rates	50,000	
+ Outstanding	3,750	
	53,750	
- Prepaid	5,000	48,750
Postage and Telegram		10,000
Stationary Expenses		6,250
Income Tax		70,000
Directors' Fees		8,750
Preliminary Expenses written off		15,000
Bad debt reserves (8,250 – 7,500)		750
Total		**2,53,750**

Illustration-2: The Following is the Trial Balance of Anisha Co. Ltd. as on 31-3-2024:

Particulars	**Debit (Rs.)**	**Credit (Rs.)**
Debenture Redemption fund and its investments	50,000	50,000
10% Debentures	-	1,25,000
Share capital and calls in arrears	25,000	7,50,000
Capital Reserve	-	1,37,500
General Reserve	-	2,25,000
Share Premium	-	52,500
Provident Fund and Provident Fund Contribution	6,250	32,500
Debtors-Creditors	1,65,000	82,500
Production Expenses	88,000	-
Preliminary Expenses	15,000	-
Investments	4,14,250	-
Furniture	80,000	-
Plant-Machinery	2,87,500	-
Land and Building	4,25,000	-
Purchases and Sales	2,67,000	6,50,000
Opening Stock	82,500	-
Profit and Loss A/c (1-4-2023)	-	13,750
Goodwill	30,000	-
Salaries	1,42,500	-
Rent, rates and Taxes	50,000	-
Directors' fees	8,750	-
Bas Debt Reserve	-	7,500
Public Deposits	-	36,500
Advance income tax	70,000	-
Cash-Bank and Bank Loan	27,000	63,500
Postage-Telegram	16,250	-
Income from Investments	-	23,750
	22,50,000	**22,50,000**

Prepare Final Accounts in Vertical Form from the following information:

(1) The Authorized Capital of the company amounts to Rs. 25,00,000 of Rs. 10 each.
(2) Transfer Rs. 62,500 to general Reserve
(3) Provide Provision for taxation for Rs. 35,000.
(4) Stock on 31-3-2024 was Rs. 2,50,000.
(5) Provide 5% reserve for bad debts on debtors.
(6) Outstanding Expenses:

Production Expenses	Rs. 6,250
Salaries	Rs. 7,500
Rent-rates	Rs. 3,750

(7) Provide rent amounted to Rs. 12,500.
(8) Provide Depreciation on Plant and Machinery at 10% and on Furniture at 12%.

(9) The Directors of the company recommended 10% dividend on share capital.
(10) Write off Preliminary expenses.
(11) Ignore corporate dividend tax.

[Sau. Uni, S.Y., Nov. 2016]

Solution:

Balance sheet of Anisha Ltd. as on 31st March, 2024

Particulars	Note	Rs.
I. Equities and Liabilities:		
(1) Shareholders' Funds:		
(a) Share Capital	1	7,25,000
(b) Reserves and Surplus	2	5,59,650
(2) Non-Current Liabilities:		
(a) Long Term Borrowing	3	2,25,000
(b) Long term provisions:		
Provident fund		32,500
(3) Current Liabilities:		
(a) Trade Payables: Creditors		82,500
(b) Other Current Liabilities	4	30,000
(c) Short Term Provision	5	1,10,000
Total:		**17,64,650**
II. Assets:		
(1) Non-Current Assets:		
(a) Fixed Assets:		
(i) Tangible Assets	6	7,54,150
(ii) Intangible Assets: Goodwill		30,000
(b) Non-Current Investments	7	4,64,250
(2) Current Assets:		
(a) Inventories		2,50,000
(b) Trade Receivables		
Debtors (1,65,000 – 8,250)		1,56,750
(c) Cash and Cash Equivalents:		
Cash and Bank Balance		27,000
(d) Other Current Assets:	8	82,500
Total:		**17,64,650**

Profit and Loss Statement of Nikita Co. Ltd.
For the year ended on 31st March, 2024.

Particulars	Note	Rs.
I. Revenue From Operations – Sales		6,50,000
II. Other Income: Income From Investments		23,750
III. Total revenue: (I +II)		**6,73,250**
IV. Expenses:		
(G) Purchases		2,67,000
(H) Changes in value of stock (82,500 – 2,50,000)		(1,67,500)

(I) Employee Benefit Expenses	**9**	1,56,250
(J) Finance Cost: Deb. Interest		12,500
(K) Depreciation	**10**	38,350
(L) Other Expenses	**11**	1,76,250
Total Expenses		**4,82,850**
V. Profit before tax (III – IV)		1,90,900
VI. - Provision for income tax		35,000
Profit for the period		**1,55,900**

Notes to Accounts:

Note 1: Share Capital

Particulars			**Rs.**
Authorized Capital:			
2,50,000 Equity Shares of Rs. 10 each			25,00,000
Issued, Subscribed Capital and Paid-Up Capital:			
Equity Share Capital	7,50,000		
Less: Calls in arrears	25,000		7,25,000
		Total	**7,25,000**

Note 2: Reserves & Surplus:

Particulars			**Rs.**
Capital Reserve			1,37,500
Debenture redemption Fund			50,000
General Reserve: Opening Balance		2,25,000	
Add: Current year's appropriation		62,500	2,87,000
Securities Premium			52,500
Surplus: Balance in Statement of Profit and Loss:			
Opening balance (Last year's surplus)		13,750	
Add: Surplus as per current year's Statement of Profit & Loss		1,55,900	
		1,69,650	
Less: Provisions & Appropriations:			
Equity Dividend	75,000		
Transfer to General Reserve	62,500	1,37,500	32,150
		Total	**5,59,650**

Note 3: Long Term Borrowings

Particulars		**Rs.**
10% Debentures		1,25,000
Public Deposits		36,500
Bank Loan		63,500
	Total	**2,25,000**

Note 4: Other Current Liabilities

Particulars	Rs.
Outstanding Expenses:	
productive wages	6,250
salaries	7,500
rates and taxes	3,750
Outstanding Interest on debentures	12,500
Total	**30,000**

Note 5: Short Term Provisions

Particulars	Rs.
Proposed Dividend	75,000
Provision for Taxation	35,000
Total	**1,10,000**

Note 6: Fixed Assets: Tangible Assets

Assets	Opening Balance			Less:	Net
	Op. bal.	**Add. (Ded.)**	**Cl. Bal.**	**Depreciation**	**Assets**
Land & Building	4,25,000	-	4,25,000	-	4,25,000
Plant & Machinery	2,87,500	-	2,87,500	28,750	2,58,750
Furniture	80,000	-	80,000	9,600	70,400
Total	**7,92,500**	**-**	**7,92,500**	**38,350**	**7,54,750**

Note 7: Non-Current Investments:

Particulars	Rs.
Investments	4,14,250
Debentures Redemption Fund Investments	50,000
Total	**4,64,250**

Note 8: Other Current Assets

Particulars	Rs.
Prepaid Rent	12,500
Income Tax paid in advance	70,000
Total	**82,500**

Note 9: Employee Benefit Expenses

Particulars		Rs.
Salaries	1,42,500	
+ Outstanding	7,500	1,50,000
Provident Fund Contribution		6,250
Total		**1,56,250**

Note 10: Depreciation and Amortization Expenses

Particulars	Rs.
Dep. On Plant & Machinery	28,750
Dep. On Furniture	9,600
Total	**38,350**

Note 11: Other Expenses

Particulars		Rs.
Productive wages	88,000	
+ Outstanding	6,250	94,250
Rent and Rates	50,000	
+ Outstanding	3,750	
	53,750	
- Prepaid rent	12,500	41,250
Directors' Fees		8,750
Postage and Telegram		16,250
Bad debt reserves (8,250 – 7,500)		750
Preliminary Expenses written off		15,000
Total		**1,76,250**

Illustration – 3: The following is the Trial Balance of X Auto Parts Manufacturing Co. Ltd. as on 31-3-2024.

Particulars	Debit (Rs.)	Credit (Rs.)
Stock (1-4-2023)	1,86,420	-
Purchase and Sales	7,18,210	11,69,900
Returns	12,680	9,850
Manufacturing Wages	1,09,740	-
Sundry Manufacturing Expense	19,240	-
Carriage Inwards	4,910	-
18% Bank Loan (Secured)	-	50,000
Interest on Bank Loan	4,500	-
Office Salaries and Expenses	17,870	-
Auditor's Expense	8,600	-
Directors' Remuneration	26,250	-
Preliminary Expenses	6,000	-
Freehold Premises	1,64,210	-
Plant & Machinery	1,28,400	-
Furniture	5,000	-
Loose Tools	12,500	-
Debtors and Creditors	1,05,400	62,220
Cash on hand	19,530	-
Cash in Bank	96,860	-
Advance Payment of Tax	84,290	-

Profit and Loss A/c (1-4-2023)	-	38,640
Share Capital	-	4,00,000
	17,30,610	**17,30,610**

Prepare company's final accounts after taking into consideration the following adjustments:

(1) On 31st march, 2024, Outstanding manufacturing wages and outstanding office salaries stood at Rs. 1,890 and Rs. 1,200 respectively. On the same date, the stock was valued at Rs. 1,24,840 and loose tools at Rs. 10,000.

(2) Provide for accrued interest on bank loan for 6 months.

(3) Depreciation on Plant and machinery is to be provided at 15% and on Furniture at 10%.

(4) Write off preliminary expenses.

(5) Make a provision for income tax at 50%.

(6) The directors recommended a dividend at 15% for the year ending on 31st March, 2024 after statutory transfer to General Reserve at 5%.

(7) Provide for Corporate Dividend tax at 20%.

[Sau. Uni., S.Y., Jan. 2021]

Solution:

Balance Sheet of X Auto Parts Manufacturing Co. Ltd. as on 31-3-2024

Particulars	Note	Rs.
I. Equities and Liabilities:		
(1) Shareholders' Funds:		
(a) Share Capital	1	4,00,000
(b) Reserves and Surplus		46,800
(2) Non-Current Liabilities:		
(a) Long Term Borrowing:		
18% Mortgage Loan		50,000
(3) Current Liabilities:		
(a) Trade Payables: Creditors		62,220
(b) Other Current Liabilities	2	7,590
(c) Short Term Provision	3	1,52,160
Total:		**7,18,770**
II. Assets:		
(1) Non-Current Assets:		
(a) Fixed Assets:		
(i) Tangible Assets	4	2,77,850
(2) Current Assets:		
(a) Inventories: Stock in Trade	5	1,34,840
(b) Trade Receivables:		
Debtors		1,05,400

(c) Cash and Cash Equivalents:	6	
Cash and Bank Balance		1,16,390
(d) Other Current Assets:		
Advance Payment of Tax		84,290
Total:		**7,18,770**

Profit and Loss Statement of X Auto Parts Co. Ltd.

For the year ended on 31st March, 2024.

Particulars	Note	Rs.
I. Revenue From Operations – Sales (11,69,900- 12,680)		11,57,220
II. Other Income:		-
III. Total revenue: (I +II)		11,57,220
IV. Expenses:		
(M) Purchases (7,18,210 – 9,850)		7,08,360
(N) Changes in Inventories		61,580
(O) Employee Benefit Exp (1,86,420 – 1,24,840)	**7**	45,320
(P) Finance Cost: Interest on bank Loan (4,500 + 4,500)		9,000
(Q) Depreciation	**8**	22,260
(R) Other Expenses	**9**	1,50,380
Total Expenses		9,96,900
V. Profit before tax (III – IV)		1,60,320
- Provision for income tax (50%)		80,160
Profit for the period		**80,160**

Notes to Accounts:

Note 1: Reserves & Surplus:

Particulars			**Rs.**
General Reserve: Current year's appropriation (80,160 x 5%)			4,008
Surplus: Balance in Statement of Profit and Loss:			
Opening balance (Last year's surplus)		38,640	
Add: Surplus as per current year's Statement of Profit & Loss		80,160	
		1,18,800	
Less: Provisions & Appropriations:			
Equity Dividend	60,000		
Transfer to General Reserve	4,008		
Corporate Dividend tax	12,000	76,008	42,792
		Total	**46,800**

Note 2: Other Current Liabilities

Particulars	**Rs.**
Outstanding Manufacturing Expenses	1,890

Outstanding Office Salary	1,200
Outstanding Interest on Bank Loan for 6 Months (50,000 x 18% x 6/12)	4,500
Total	**7,590**

Note 3: Short Term Provisions

Particulars	**Rs.**
Equity Dividend (4,00,000 x 15%)	60,000
Corporate Dividend Tax (60,000 x20%)	12,000
Provision for Taxation	80,160
Total	**1,52,160**

Note 4: Fixed Assets: Tangible Assets,

Assets	**Opening Balance**			**Less:**	**Net**
	Op. bal.	**Add. (Ded.)**	**Cl. Bal.**	**Depreciation**	**Assets**
Freehold Premises	1,64,210	-	1,64,210	-	1,64,210
Plant & Machinery	1,28,400	-	1,28,400	19,260	1,09,140
Furniture	5,000	-	5,000	500	4,500
Total	**2,97,610**	**-**	**2,97,610**	**19,760**	**2,77,850**

Note 5: Inventories:

Particulars	**Rs.**
Stock in Trade	1,24,840
Loose Tools	10,000
Total	**1,34,840**

Note 6 : Cash and Cash Equivalent

Particulars	**Rs.**
Cash on Hand	19,530
Cash at Bank	96,860
Total	**1,16,390**

Note 7: Employee Benefit Expenses

Particulars		**Rs.**
Salaries	17,870	
+ Outstanding	1,200	19,070
Director's Remuneration		26,250
Total		**45,320**

Note 8: Depreciation and Amortization Expenses

Particulars	Rs.
Dep. On Plant & Machinery	19,260
Dep. On Furniture	500
Loose Tools written off (12,500 – 10,000)	2,500
Total	**22,260**

Note 9: Other Expenses

Particulars		Rs.
Manufacturing wages	1,09,740	
+ Outstanding	1,890	1,11,630
Sundry Manufacturing Expenses		19,240
Carriage Inwards		4,910
Preliminary Expenses written off		6,000
Auditor's Fees		8,600
Total		**1,50,380**

❖ **Exercise:**

1. Prepare Balance Sheet of Shri Rajshree Ltd. in the form prescribed under scheduled III of the Companies Act, 2013 from the Balance Sheet given below:

Balance Sheet as on 31st March, 2024

LIABILITIES	AMOUNT	ASSETS		AMOUNT
Forfeiture of shares	900	Loan		1,200
Provision for Bonus	1,500	Deposits		2,100
Provident fund	1,500	Stores		7,500
Pension Fund	1,500	Cash balance		3,600
Superannuation Fund	1,500	Prepaid Expenses		2,400
Income tax reserve	3,000	Building[trading]		3,09,000
Creditors	26,100	Building[non-trading]		15,000
Dena Bank [H.P. A/c.]	3,000	Discount on debentures		1,500
Outstanding interest on		Profit and loss A/c		16,500
debentures	4,500	Accrued interest on		
Paid-up capital:		Investment		300
3,000 equity shares of		Stock		60,000
Rs. 100 each Share	3,00,000	Debtors	51,000	
premium	22,500	- B.D.R.	2,400	48,600
General Reserve Fund	15,000	Calls in Arrears		300
Dividend Equalization Fund	15,000	Land		36,000
Depreciation Fund	30,000	Furniture		9,000
Debenture Redemption Fund		Tools		3,000
Capital Profit	6,000	Goodwill		30,000
Debentures	15,000	Machinery		48,000
Bills payable	1,50,000	National Saving Certificate		6,000
	3,000			
	6,00,000			**6,00,000**

Note: Company Issued 750 equity shares of Rs. 100 each as bonus shares on 31-3-2024.

2. The authorized Capital of Anamika Co. Ltd. is Rs. 7,50,000 consisting of 3,000, 6% Cumulative Preference Shares of Rs. 100 each. The following is the Trial Balance drawn up 31 December, 2024:

Particulars	**Debit Rs.**	**Credit Rs.**
Paid up Capital:		
3,000, 6% Cum. Pre. Shares	-	3,00,000
3,000, equity shares (Rs. 75 per share called up)	-	2,25,000
Goodwill	1,00,000	-
5% first mortgage debentures (secured on freehold prop.)	-	2,10,000
Trade debtors	1,67,500	-
Trade creditors	-	1,25,520
Freehold properties at cost	3,90,000	-
Stock on 1st January, 2024	2,41,500	-
General reserve	-	82,725
Salaries	1,03,500	-
Profit and loss Account	-	58,500
Reserve for taxation	-	8,800
Delivery expenses	1,02,000	-
Rent and rates	38,250	-
General expenses	21,000	-
Furniture at cost	75,000	-
Sales	-	9,18,600
Purchase	4,76,500	-
Bills receivable	6,000	-
Freight and carriage inward	3,750	-
Investment- 600 shares of Rs. 100 each in Sunil Ltd.	60,000	-
Debenture interest (half year to 30th june,2024)	5,250	-
Final dividend for 2023	20,250	-
Preference dividend for [half year to 30th June, 2024]	9,000	-
Balance at bank in Current A/c	97,500	-
Cash in hand	14,145	-
Share forfeited A/c	-	2,000
	19,31,145	**19,31,145**

(A) The value of stock on December 31, 2024 was Rs. 2,15,000.

(B) Depreciation on freehold properties is to be provided at 2½% and on furniture at 6%.

(C) The directors propose to pay the second half year's dividend on preference shares and 10% dividend on equity shares.

(D) Shares were forfeited on non-payment of Rs. 35 per share.

You are required to prepare Profit and Loss A/c and Balance Sheet of the Ambica Co. Ltd as per Companies Act, 2013.

3. The Authorized Capital of Raju Ltd. is Rs. 50,00,000 divided into 30,000 equity shares of Rs. 100 each and 1,00,000, 6% cumulative pre. Shares of Rs. 20 each. The company has issued 20,000 equity shares and 40,000 preference shares. 75% amount was called up and paid up on both these types of shares.

The following are the balance extracted from the books of the company as on 31St march, 2024:

Particulars	**Rs.**
Share premium	1,30,000
Cash on hand	1,685
Patents	89,660
Land	9,20,000
Goodwill	4,61,700
Interest and dividend on investment	54,550
Machinery	5,41,900
Debtors	2,53,800
Adjusted purchase	4,07,730
Bills receivable	83,400
Return inwards	2,100
Discount [debit balance]	365
Debenture redemption fund	5,85,750
Sales	4,96,290
Employees provident fund	1,09,320
7½% Mortgage debentures [to be redeemed on 31-3-2028]	9,00,000
Shares of Rupa Ltd. [8,000 shares of Rs. 80 each, Rs. 50 per share paid up]	4,00,000
Wages	54,700
Commission	8,580
Furniture	99,680
Office expenses	1,00,530
Director’s fees	14,700
Interest on debentures	54,000
Motor-car	40,000
Depreciation on motor-car	3,200
Provident fund contribution	12,985
Stock [31-3-24]	1,59,565
Preliminary expenses	47,600
Bad debt reserve	9,430
General reserve	15,880
Fixed deposits	3,00,000
Creditors	1,77,760
Discount on issue of debentures	26,000
Debenture redemption fund investment	5,85,000
Advance against construction of buildings	5,10,100

You are required to prepare the final accounts of the company for the year ended 31st march, 2024 according to the requirements of the companies act, 2013 after taking into account the following additional informations:

(1) Additional reserve for bad debt is to be created on debtors at 2%.

(2) Write off one-fourth of preliminary expenses.

(3) The item of interests and dividend on investment includes Rs. 20,850, being the amount of interest received on debenture redemption fund investment.

(4) Provide depreciation on machinery at 10%; on Patents a 20% and on furniture at 5%.

The amount of depreciation on motor-car is to be made equal to 10%.

4. The following is the Trial Balance of Aarti Ltd. as on 31st December, 2024:

Particulars	**Rs.**	**Rs.**
Land and building	1,50,000	-
Furniture	10,000	-
Leasehold Premises [Lease to expire on 31st Dec. 2010]	75,000	-
Sundry debtors and Sundry Creditors	1,20,000	43,200
Shares in Subsidiary Company [160 Eq. Shares of Rs.100 each Rs. 50 per share paid up]	8,000	-
Called up capital	-	3,00,000
Purchase and sales	3,15,000	4,83,500
Bills Receivable and Bills Payable	35,500	4,400
Advance Against Purchase of goods	8,900	-
Profit and loss A/c	1,22,490	-
Overdraft from bank [secured against land and buildings]	-	1,60,000
Opening stock	40,580	-
5% debentures	-	60,000
Depreciation Fund [31-12-24]	-	30,500
Debentures sinking fund investments	37,500	-
Depreciation on land and building	3,000	-
Depreciation on furniture	500	-
Debenture redemption fund	-	37,500
Interest on debenture redemption fund investments	-	1,200
Wages	50,250	-
Manufacturing expenses	27,570	-
Freight, duty etc.	10,560	-
Interest on debentures	1,500	-
Prepaid insurance	1,200	-
Salaries	28,500	-
Discount on issue of debentures	2,000	-
General expenses	19,850	-
Insurance	6,800	-
6% Government loan	45,000	-

Interest on Government loan	-	1,350
Goodwill	4,000	
Shares transfer fees	-	250
Unclaimed dividend	-	1,800
	11,23,700	**11,23,700**

The capital of the company is as under:

(1) 5%, 750 Preference Shares of Rs. 100 each.

(2) 3,000 Equity Shares of Rs. 100 each allotted and called up to Rs. 75 per share.

You are required to prepare the final accounts of the company in forms required under the companies' act 2013, after taking into consideration the following points:

(a) Closing stock Rs. 51,900[This includes defective stock which requires estimated repairing charges of Rs. 1,080]

(b) Bills discounted but not matured Rs. 6,500.

(c) Credit sales worth Rs. 1,500 were left unrecorded in the books of accounts.

(d) Provide 2½% on debtors for doubtful debts reserve.

(e) Of the debtors write off Rs. 1,500 for bad debt.

(f) Anand, the manager is to be paid commission at 10% of net profits, if any.

(g) The debtors include Rs. 21,500 outstanding for more than six months.

5. The inexperienced accountant of Krish Trading Co. Ltd. has prepared the following The Balance sheet with errors, as at 31-3-24:

Name of Accounts	**L.F.**	**Dr. Bal. Rs.**	**Cr. Bal. Rs.**
Share Capital: Equity shares of Rs. 10 each, fully paid		-	56,200
Forfeited Shares Account		2,500	-
Balance due to bank		-	25,900
Creditors		-	38,000
Cash on hand		500	-
Sales		-	1,20,000
Stock on 1-4-23		30,000	-
Purchase		80,000	-
Carriage inward		2,200	-
Carriage outward		-	1,600
Discount allowed to customers		-	1,500
Discount allowed by creditors		4,000	-
Rates and insurance as per ledger 2,800			

+ Paid in advance	200		3,000	-
Share transfer fees			10	-
Advertising as per ledger	5,600			
+ Accrued at 31-3-24	1,000		4,600	-
Wages			10,000	-
Profit and loss A/c [1-4-23]			-	25,000
Building [1-4-23]	80,000			
+ Extension during the year	10,000		70,000	-
Bad debt reserve [1-4-23]			-	1,200
Debtors			35,000	-
Plant [1-4-23]	12,400			
- 5% depreciation	620		11,780	-
Petty expenses			400	-
Telephone and printing			5,810	-
Stock at 31-3-24			28,000	-
Bills payable			10,000	-
Preliminary expenses			5,000	-
			3,02,800	**2,69,400**

(a) The authorised capital is 10,000 equity shares of Rs. 10 each of which 6,120 shares were issued. The final call of Rs.5 on 500 shares were not paid and these shares were forfeited.

(b) Write off Rs. 1,500 for a bad debt which is included in debtors.

(c) Create a bad debt reserve @ 5% on debtors.

(d) The company has declared a dividend of 10%.

From the above information, prepare Trading A/c, profit and loss A/c, Profit and loss Appropriation A/c for the year ending 31-3-24 and balance sheet as on that date.

6. The authorised capital of The Patel Steam Navigation Co. Ltd. consists of 7,00,000 shares of Rs. 10 each, of which, 1,50,000 shares have been subscribed. The accountant of the company has prepared the following trial balance as on 31st march, 2024 and owing to his inability to find out the difference, he seeks your assistance.

On carrying out the necessary examination of the accounts you find the interest accrued on investment is taken into the trial balance from the statement prepared and no entry is made in the books; you also find that the balance of profit and loss account, viz. Rs. 10,000 [Rs. 90,000 profit per last balance sheet less Rs. 80,000 appropriations thereof brought forward from last year is omitted and you find certain other obvious errors in copying down the balances in the trial balance.

After giving effect to the necessary corrections, you are required to prepare the balance sheet and profit and loss account as required by the Companies Act, 2013.

Particulars	Debit Rs.	Credit Rs.
Subscribed capital	-	6,00,000
Calls in arrears	-	7,000
Calls in advance	5,00,000	-
Book Debts [of which Rs. 20,000 are doubtful and of which Rs. 10,000 are more than 6 months old]	50,410	-
Steamers, barges etc.	4,00,000	-
Furniture and fittings	4,700	-
Unexpired insurance	27,000	-
Customs deposit	1,023	-
Investment at cost	4,00,000	-
Interest accrued on the above	12,800	-
Forfeited shares Account	9,350	-
Cash with bankers in Fixed Deposit	6,00,000	-
Cash with bankers on Current Accounts	1,91,000	-
Cash in hand	10,217	-
Voyage Receipts	-	3,90,000
Voyage expenses	2,10,000	-
Interest	-	20,000
Transfer fees	-	1,500
Expenses of management	1,30,000	-
Depreciation	25,000	-
Reserve fund	-	1,50,000
Dividend equalization reserve	-	25,000
Provision for doubtful debts	-	16,000
Unpaid dividends	-	1,20,000
Liabilities for goods supplied	-	9,500
Liabilities for expenses	-	1,55,000
Other liabilities	-	50,000
	25,71,500	**15,44,000**

Note: Depreciation written off to date on "Steamers, Barges etc." and on "Furniture and Fittings" is Rs. 2,00,000 and Rs. 3,000 respectively.

7. Paridhi Mills Ltd. as an Authorised Capital of 10,000 Equity Shares of Rs. 100 each and 2,000 Equity Shares of Rs. 100 each have been issued for subscription. The following are the balance as on 30th June, 2024:

Particulars	Debit Rs.	Credit Rs.
Opening stock	68,400	-
General Reserve	-	40,000
Building	1,20,000	-
Machinery	44,820	-
Furniture	29,000	-
Debtors and Creditors	92,000	29,560

Preliminary expenses	8,400	-
Bad debt and Bad Debt Reserve	3,600	3,000
Bank	28,600	-
Purchase and sale	1,66,500	3,61,080
Wages	71,400	-
Discount	600	1,640
Office salary	12,000	-
Share capital [Rs.90 per share paid up]	-	1,80,000
Tax paid and Outstanding exp.	16,400	6,500
Stationery and printing	14,400	-
Prepaid taxes	1,500	-
Provision for depreciation	-	55,200
Profit and Loss A/c	-	9,140
Unsecured loan	-	14,000
Depreciation	13,500	-
Interim dividend	9,000	-
	7,00,120	**7,00,120**

Write off preliminary expenses and Rs. 2,000 Bad Debts and keep the reserve for Bad debts of 5% on Sundry Debtors. Interest on loan at 5% remains outstanding. The Closing Stock amounts to Rs. 60,000. Provision for depreciation includes provision to date in respect of Building Rs. 20,000; Machinery Rs. 28,000 and Furniture Rs. 7,200.

The directors desire to propose the following appropriations.

(1) Declaration of final dividend at 10% on the paid up share capital.
(2) Provision for taxation Rs. 20,000.
(3) General Reserve Rs. 4,000.

You are required to prepare the company's Final Accounts for the year ended on 30th June, 2024. [S.U. April – 1997]

8. Following is the Trial Balance as on 31-3-2024of Y Ltd.

Particulars	**Debit Rs.('000)**	**Particulars**	**Credit Rs.('000)**
Cash on hand	50	Equity shares fully called up	5,400
Cash at bank	800	10% debentures	6,000
Debtors	200	General reserve	450
Bills Receivable	450	P & L A/c	270
Purchase	5,250	Bad Debt reserve	30
Sales return	50	Creditors	280
Wages	180	Bills Payable	560
Salary	320	Sales	7,550
Carriage Inwards	45	Purchase return	36
6% investment	800	Interest on investment	24
Land and building	6,500		
Furniture	350		
Plant - -Machinery	2,000		

Interest on debentures	300		
Calls in arrears	400		
Bad debts	20		
Goodwill	500		
Director fees	120		
Preliminary expenses	80		
General expenses	70		
Opening Stock	2,000		
Interim dividend	115		
	20,600		**20,600**

(1) Closing Stock Rs. 18,00,000.
(2) Depreciate Plant & Machinery at 10%, Furniture at 15% and Land & Building at 2%.
(3) Write off preliminary expenses 25%.
(4) Dividend on equity shares at 5% to be provided.
(5) Tax provision of Rs. 40,000 to be provided.
(6) An amount of Rs. 1,00,000 to be transferred to General Reserve account.
(7) Reserve for Bad debt to be maintained at 10% on debtors.

Prepare Company's Final Accounts as per Companies act, 2013.

9. Trial balance of Anjali Ltd. as on 31-3- 24 was as under:

Trial Balance

Particulars	**Debit Rs.**	**Credit Rs.**
10%, 5,000 Per Share of Rs. 100 each	-	5,00,000
Profit on Foreign exchange	-	19,00,000
Creditors and debtors	2,50,000	12,00,000
Bills payable and Bills Receivable	1,30,000	1,60,000
Cash and Bank	40,000	1,90,000
Bad Debt and Bad Debt Reserve	10,000	25,000
Purchase and sales	16,00,000	48,00,000
Goods return	50,000	40,000
Wages	9,00,000	-
Preliminary expenses	1,10,000	-
Rent paid and Outstanding rent	1,10,000	10,000
20,000 equity shares of Rs. 100 each	-	20,00,000
14% debentures and interest on debentures	70,000	20,00,000
Opening stock	1,00,000	-
Plant – Machinery	20,00,000	-
Furniture	15,00,000	-
Administrative expenses	3,70,000	-
Depreciation on Plant-Machinery	2,00,000	-
Share investment	11,35,500	-
Vehicles	12,00,000	-
Profit & Loss A/c [1-4-23]	-	6,39,500
Share premium	-	3,30,000

G.S.F.C. Mortgage loan	-	40,00,000
Building after depreciation [1-4-23]	80,19,000	-
	1,77,94,500	**1,77,94,500**

(1) Closing stock valuation at sales price Rs. 4,00,000 and sales price (maintained cost + 25% profit).

(2) Building purchased on 1-4-20 and depreciation on building 10% p.a. by reducing balance system from 1-4-23 dep. Method changed and depreciation is calculated on cost price.

(3) Provide 10% dep. On Vehicles and Vehicles purchased on 6-11-23.

(4) On 1-4-23 debentures Rs. 10,00,000 converts into equity shares capital but is not recorded

(5) Provide 5% depreciation on furniture, Rs. 40,000 furniture purchased on 1-7-23 wrongly recorded in purchase.

(6) Write off 40% of preliminary expenses.

(7) 25% of Net Profit is to be transferred to General Reserve a/c.

(8) Proposed dividend 25% on equity shares.

Prepare Co.'s Final Accounts as per Companies Act, 2013.

10. Trial Balance on 31-3-24 of Manisha Ltd. was as under:

Trial Balance

Particulars	Debit Rs.	Particulars	Credit Rs.
Goodwill	1,50,000	Paid up Shares capital	10,00,000
Land and Building	6,00,000	15% debentures	4,00,000
Plant-Machinery	9,00,000	General reserve	2,50,000
Furniture	2,50,000	Profit & Loss A/c [1-4-23]	4,20,000
Opening stock	2,20,000		
Salary	1,50,000	Sales	30,00,000
Purchase	20,50,000	Tax provision [1-4-23]	2,50,000
Debtors	3,00,000	Creditors	3,60,000
Tax paid [for last year]	2,20,000	Provident Fund	1,20,000
Dividend paid	2,50,000	Share premium	2,00,000
Wages	2,10,000		
Commission	2,000		
Cash- Bank	4,50,000		
Audit fee	10,000		
Provident fund contribution	10,000		
Directors fee	15,000		
Interest on debentures	30,000		
Office expenses	40,000		
Bills Receivable	20,000		
Carriage inward	10,000		
Carriage outward	7,000		

Bad Debt Custom Rent- taxes Postage and telecom	6,000 60,000 15,000 25,000		
	60,00,000		**60,00,000**

(1) Authorized share capital 5,00,000 equity share of Rs. 10 each.

(2) Provide depreciation 5% on Land & Building, 10% on Plant & Machinery and 10% on Furniture.

(3) Closing stock valued at Rs. 5,50,000.

(4) Provide 5% Bad Debt Reserve on debtors.

(5) Provide tax provision 50% of Net Profit.

(6) Board of directors decided and proposed 30% dividend.

Prepare Company's Final Accounts as per Companies Act, 2013.

11. The Balance from ledger account is as on 31-3-24 was as under:

Paid up share capital	15,00,000
14% debenture	5,00,000
Share premium	2,50,000
Goodwill	9,37,000
Land & Building	12,00,000
Plant & Machinery	15,00,000
General Reserve	6,00,000
Audit fees	12,000
Directors' fees	18,000
Debentures Interest	35,000
Custom	1,25,000
Bills Receivable	1,20,000
Bills Payable	1,50,000
Postage and telegram	50,000
P & L A/c [1-4-23]	5,75,000
Furniture	3,00,000
Opening stock	4,80,000
Salary	1,53,000
Wages	2,30,000
Cash balance	2,50,000
Bank Overdraft	4,50,000
Purchase	41,55,000
Sales	61,95,000
Carriage inward	10,000
Carriage outward	15,000
Provident Fund	1,50,000
Patent and Trademark	2,40,000
Copyright	2,00,000

Office expenses	50,000
Tools	60,000
Unpaid dividend	20,000
Insurance premium	12,000
Debtors	4,50,000
Creditors	3,20,000
Stationery and printing	80,000
Bad debts	30,000
Bad Debt Reserve	5,000
Provident Fund contribution	30,000

(1) Closing stock Rs. 8,05,000.

(2) Provide depreciation 10% on Land & Building, 15% on Furniture, 20% on Plant & Machinery, 25% on Tools.

(3) Write off Rs. 10,000 as Bad Debt and provide 5% Bad Debt Reserve on debtors

(4) 2,00,000 is to be transferred to General Reserve a/c.

(5) Proposed dividend 40% on share capital.

(6) Provide tax provision 57.5% on Net profit.

BBA
SEMESTER-2 CORE
CORPORATE ACCOUNTING
BLOCK: 3

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UNIT-9 VALUATION OF GOODWILL

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9.2 Meaning

9.3 Features of Goodwill

9.4 Need for Valuation of Goodwill

9.5 Factors affecting value of Goodwill

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9.1 Introduction

Goodwill refers to a measure of the capacity of a business to earn above normal profits. It represents the advantages a business has in connection with its customers, employees, and outside potties with whom it comes in contact. Benefits and advantage of a good name, reputation, and connection of a business is also known as goodwill. It is the attractive force which bring the customers. It is the one thing which is wipe out old complaints and establishes new business. It is an intangible but a real asset.

9.2 Meaning

Goodwill is defined as, "the present value of a firm's anticipated excess earning." when a man pays for Goodwill, he pays for something which puts him in a position of being able to do by his own unaided efforts.

Goodwill is thus the extra saleable value attached to a prosperous business beyond the intrinsic value of net assets. in other words of spleen and piglet "Goodwill may be said to be that element arising from the reputation, connation or other advantages possessed by a business which enables it to earn greater profits than the return normally to be expected on the capital represented by the net tangible assets employed in the business."

9.3 Features of Goodwill

1) Goodwill may be positive value or negative value. It's positive when the value of business is more than the value of its net separable assets and negative when the value of its net separable assets.
2) It is not possible to separately value each of the intangible factors contributing to goodwill.
3) The value of goodwill has no relation to the amount invested and costs incurred in order to build it.
4) The value of goodwill fluctuates from time to time due to changing circumstances which are internal and external to business.

5) There can be no objective valuation of goodwill. It is subjective and it differs from estimator to estimator.

9.4 Need for Valuation of Goodwill

There are various circumstances when it may be necessary to value goodwill. Some of the circumstances are:

1) **In the case of individuals**: when proprietor or a partner dies, Goodwill has to be valued for purposes of estate duty, death duty etc.
2) **In case of a partnership**:
   - ❖ When a new partner is admitted into firm.
   - ❖ When a partner retires or dies.
   - ❖ When the firm is dissolved and business is sold.
   - ❖ When the profit sharing ratio of partners is changed.
   - ❖ When two or more firms amalgamate.
3) **In case of a company**:
   - ❖ When two or more companions amalgamate.
   - ❖ When one company absorbs another company or one company wants to acquire controlling interest in another company.
4) **In the case of a sole trader concern**: It is valued at the time of selling the business to decide the purchase consideration.
5) When the government or a local authority requisitions the business premises for public purposes.

9.5 Factors Affecting Value of Goodwill

- Quality of the management team
- Market shares for the product
- Productivity levels of the workers
- Research and development efforts
- Effecting advertising to establish brand popularity
- Good industrial relations
- Training and development programmers for works supervisors and executives at various levels
- Valuation factors and proximity to markets.
- Effective tax planning
- Patents & trade marks
- Customers' favorable attitude and customer satisfaction.

- The profit position over years.
- Technical collaborations with established companies

9.6 Methods of Valuation of Goodwill

There are many methods of calculating goodwill.

1. Arbitrary assessment
2. Goodwill based on total turnover
3. goodwill based on over age annual profit
4. Goodwill based on super profit
5. Annuity method
6. Capital employed

Generally goodwill valuation is based on such methods are as follows.

- ❖ Simple profit methods
- ❖ Capitalization of average profit method
- ❖ Super profit method

[A] Simple profit methods:

Under this method goodwill is exp. To be a purchase of certain number of year based on the overage of a given period it's in to steps.

- ❖ Calculation of overage profit taking into collection the profit of the preceding three or year's profits.

- ❖ Multiply the overage profits as per (1) by the number of year's purchase of profit which goodwill represents, according to the.

Why average profits? : Goodwill is paid for obtaining an advantage. However the future is uncertain is usually estimated on the basis of past. In a business what profits are likely to acc. the future depends upon its average per in the post and hence the average profit.

1. **A certain number of year's purchase of profit method:** It is a very simple method to goodwill is to taken a certain number of years purchase of post profits. An average profit of the past three to five years is ascertained and it is multiplied by a certain number. The following guidelines may be useful in determining as to how many years purchase should be selected.

- ❖ Generally, the number of years that a new business would take to establish itself would be taken as the number of years' purchase.

- ❖ The goodwill of professional persons is taken at one or two years purchase.
- ❖ When the profits of the business are slowly declining, only one or two years purchase is considered but when the profit is progressively increasing three to five years purchase is taken.
- ❖ While ascertaining average profits, non-trading income or expenditure and items of exceptional nature are not included.

2. A certain number of years purchase of Weighted Average Profit Method:

If the profits of the past few years are continuously increasing, it is better to take a weighted average of the profits. When it was continuously increasing in past so it can be assumed that it will continue to increase in future also. Hence more importance should be given to the last years' profit and less importance should be given to earlier years' profits.

[B] Capitalization of Average Profits Method:

Under this method adjusted future maintainable profits are capitalized applying normal rate of return to arrive at the normal capital employed. Goodwill is taken as the difference between the normal capital employed and the actual capital employed. The following steps are taken to value goodwill under this method:

I. **Average Profit (estimating the maintainable profit):** the expected future profit is estimated. If any changes are expected in future in the profit being earned, such changes are taken into consideration.

II. **Determining the actual Capital Employed:** Now the amount of Net Assets is found out (only Tangible Assets). Tangible assets mean such assets which can be seen and touched and which can fetch price in the market, if sold. It does not include intangible asset like goodwill. This net assets is the capital employed in business.

III. **Expected Return:** The expected rate of return on capital employed is ascertained in the type of business in which the firm is engaged. On the basis of this rate of return the estimated profit is to be capitalized. If an investor wants to invest his money in this type of business, then the rate of return that he expects to earn is called expected rate of return.

IV. **Goodwill:** the excess of the capitalized value over the net assets is the value of goodwill.

Goodwill = Capitalized Value – Net Assets

[C] Super profit method:

In the first method that it takes into account only average profits for the purpose of assessing goodwill. However, a purchaser of business would be prepared to pay for goodwill only if he is able to earn more than average profit. That is goodwill attaches to that business which earns an extra profit. This extra profit is called super profit.

Super profit is the excess of the annual average profit of business over the normal profit, i.e. over what an investor would expect in the class of business, account being taken of the fair remuneration for managing the business.

e.g. in a firm the average capital invested is Rs. 1,00,000 and the expected rate of return in this class of business is 15%. The firm earns the annual average profit of Rs. 20,000, and then the super profit is:

Annual average profit	20,000
Less: Normal profit (as per 15% expected rate of return on Rs. 100,000)	15,000
Super Profit	5,000

If the goodwill is to be valued at 5 years' purchase of super profits, then value of goodwill will be:

Goodwill= 5,000 x 5 years = Rs. 25,000

When value of goodwill find out on the basis of super profit following steps should be taken:

I. **Capital Employed:** It is equal to net assets of the business i.e. total assets (except intangible assets like goodwill) less total liabilities.

Capital Employed = Total Assets – Total liabilities

- **Value of fixed assets:** For the purpose of ascertaining capital employed the values of fixed assets to be considered should be the current market values, as the profits are expressed in terms of current price. If there is a depreciation fund balance against a particular fixed assets, but the market value of the asset is more than the depreciated value then the market value is taken into account.

- **Non-trading Investment:** when find out net assets, non-trading investments should not be included. Non-trading investments are simply investments of extra funds of business. But trade investments must be included. E.g. sinking fund investment, P.F. investment in shares of subsidiary co. etc.

(If the investments are necessary to carry on business, it is called trade investments. If the type of investment is not given, it may be treated as non-trading investments.)

- ❖ **Fictitious Assets:** fictitious assets are not to be added. (e.g., preliminary exp., Debenture discount, underwriting commission, Adv. Suspense A/c. is the adv. Exp. Pre-paid then it must be included)

- ❖ **Accumulated profit:** while deducting liabilities from total assets, it must be remembered that credit balances. Which are only accumulated profits should not be deducted (e.g. reserve fund, workers comp fund, investment fluctuation fund, P & L A/c.-credit) but the following funds are liabilities and so they must be deducted: provision fund, workers profit sharing fund etc.

- ❖ **Debentures:** debentures should include or not. According to one option of goodwill is to be calculated from shareholders view point, then the amount of debenture should be deducted. But some accountants include debenture in capital employed and debentures are not deducted as a liability. But we will consider shareholders viewpoint and debenture will be deducted as a liability.

- ❖ **Preference share capital and dividend:** generally goodwill of a company is ascertained from the view-point of equity shareholders in so far as the preference share get only fixed dividend even in case of large profits. Hence preference capital is generally deducted from the capital employed in which case; the preference dividend is also deducted from the average profits.

II. Expected Rate of Return:

Super profit is ascertained by comparing actual profit with expected return. This expected return is the normal profit that an average firm in the same class of business can earn with the same amount of capital. It is the normal return which an investor would expect looking to the risk involved in that class of business.

(Sometimes, the expected rate of return is indirectly given in the example. e.g. the shares of a company having a paid up value of Rs. 100 is quoted in the market at Rs. 200 and the company paying dividend at 20% then the normal rate of return may be taken at 10%.)

However the following factors should be considered while determining the expected rate of return:

- ❖ **High bank rate:** Increase in bank rate increase expectation of the investors and they expect higher profit.

- **General Prosperity:** If there is condition of prosperity in the market then the investor expects higher return.

- **Investment time:** If the time of investment is more. If investment is for a long period of time then the rate of expected return is more.

- **Proportion of Risk:** Business which borrows more money or in which risk in more, then naturally, the expected rate would be more. When there is more risk there is higher expectation.

- **Expected rate of return = rate of return on investment without risk + additional return according to degree of risk**

- **ROROI (without risk) = Govt. security or Int. on govt. sec., long term bank deposits.**

III. Annual Average Profit/ Future maintainable profit:

The annual average profit has to be ascertained for the purpose of arriving at super profit. It is the average profit of the last three to five years.

- It is not enough to take only last one year's profit but past three to five years profits are averaged so that they may include all possible seasonal changes and fluctuations.

- Those expenses which were charged against profits in the past but which are not likely to recur in future must be added back to the profits. (e.g., the seller of business was paying rent of premises but the purchaser owns the premises, then the purchaser will not pay rent and the rent should be added to the profit. Similarly, allowance must be made for the expense which are likely to be incurred or increased in future.- managerial remuneration)

- If any unusual extra-ordinary expense or incomes have been included in the past, then it must be written back. (e.g. loss due to fire, if it had been debited to profit of some past year it must be added back to the profit to get normal profit similar treatment should be given to some unusual income – govt. subsidy received once only)

- If in the past some non-recurring expenses or incomes have been considered for arriving at profit or loss it must be reversed to get normal profit. (e.g., if any amount realized on sale of machinery is credited to profit and loss account it must be deducted from profit. If contribution to any political party has been debited to P&L A/c. it must be added back to profit)

- ❖ If any mistake had been committed in past while calculating P & L its effects must be removed. (e.g., purchase price of a machine had been debited to P & L A/c. then it must be added back to profit)
- ❖ If closing stock is valued at a higher figure then the difference should be deducted from profit of that year. The opening stock of next year is shown at a higher figure, which has reduced the profit so the profit of the next year should be increased by that amount)
- ❖ If the investment has not been included in the capital employed then interest on such investments should also be excluded from the profits.
- ❖ If during any past year, there were unusual circumstances prevailing (e.g., long strike) and profit is considerably less or there is a loss, then profit or loss of that year should not be considered for calculating average profit.
- ❖ Provision should be made for possible future taxation liability.
- ❖ As the goodwill is valued from the view-point of equity shareholders, the preference dividend should be deducted from the average profit.

IV. Valuation of Goodwill:

Super profit is obtained by deducting the expected future profits from the average net profits of the firm. The super profit so ascertained is then multiplied by the number of years which a new firm would take to earn that much profit.

Super Profit = Average profit – Expected profit

Goodwill = Super profit x No. of years purchase

- **Illustrations:**

Illustration – 1: From the following information of ABC enterprise calculate goodwill based on 3 years purchase price of simple average profit:

Year:	2017	2018	2019	2020	2021
Profit:	1,50,000	2,00,000	1,80,000	1,75,000	1,90,000

Ans:

YEAR	PROFIT (Rs.)
2017	1,50,000
2018	2,00,000
2019	1,80,000
2020	1,75,000
2021	1,90,000
	8,95,000

Average Profit = Total Profit / No. of years
= 8,95,000 / 5
= 1,79,000 Rs.
Goodwill = Average profit x No. of years purchase price
= 1,79,000 x 3 years
= 5,37,000 Rs.

Illustration – 2: Calculate the value of goodwill as on 1st January, 2023 on the basis of 3 years purchases of the Average profits for the last 5 years profits. The profits & losses for the years were:

Year:	2018	2019	2020	2021	2022
Profit:	92,000	70,000	(Loss- 40,000)	55,000	90,000

Ans:

YEAR	PROFIT (Rs.)
2018	92,000
2019	70,000
2020	(40,000)
2021	55,000
2022	90,000
	2,67,000

Average Profit = Total Profit / No. of years
= 2,67,000 / 5
= 53,400 Rs.
Goodwill = Average profit x No. of years purchase price
= 53,400 x 3 years
= 1,60,200 Rs.

Illustration – 3: Profits of a partnership firm for the last 5 years were Rs. 30,000; Rs. 40,000; Rs. 50,000; Rs. 60,000 and Rs. 70,000. In this case, calculate the weighted average profit as well as goodwill of the firm, based on 3 years purchase price of the weighted average.

Ans:

PROFIT (Rs.)(X)	Weight(W)	Weighted profit (WX)
30,000	1	30,000
40,000	2	80,000
50,000	3	1,50,000
60,000	4	2,40,000
70,000	5	3,50,000
Total	15	8,50,000

Weighted Average Profit = Weighted Profit / total weight
= 8,50,000 / 15
= 56,667 Rs.

Goodwill = weighted Average profit x No. of years purchase price
= 53,400 x 3 years
= 1,60,200 Rs.

CAPITALISATION METHOD:

Steps:-

(1) Find out Average Net Profit

(2) Capitalize Profit at Expected rate of return(Find out capitalized value of profit)

(3) Net assets = Assets – Liability

(4) Goodwill = Capitalization of Net Profit – Net Assets

Illustration – 4: The following is the balance sheet of Kamal Ltd. As on 31-3-2023 and the Sanjay Ltd. Intends to Purchase its Business.

Particulars	Note	Rs.
I. Equity & Liabilities		
(a) Shareholder's Funds:		
Share capital 1000 equity shares of Rs.100 each		1,00,000
(b) Non-Current Liabilities:		
(c) Current Liabilities:		
Trade Payable: Creditors		50,000
Other Current Liabilities		20,000
Total		**1,70,000**
II. Assets		
(a) Non-Current Assets: Fixed Assets		80,000
(b) Current Assets:		
Trade Receivables: Debtors		30,000
Inventories: Stock		40,000
Cash & Cash Equivalents: Cash Balance		5,000
Bank Balance		15,000
Total		**1,70,000**

Profits of the Company for the last 5 years have been as follows: Rs.10,000, Rs.12,000, Rs.11,000, Rs.14,000 and Rs.13,000.

The managing director of the company who was working in the honorary capacity now will have to be paid an annual salary of Rs.3,000 on the other hand, the rent at Rs.4,000 P.A. which had been by Kamal Ltd. will not be charged in future, since Sanjay Ltd. Owns its own premises. It was considered that a reasonable return on capital invested for the type of business was 10%. Calculate the value of goodwill by capitalization of average profits method.

Ans.:

Total Profit of last five years = 10,000 + 12,000 + 11,000 + 14,000 + 13,000
= Rs. 60,000

Step – 1: Average Profit = Total Profit / No. of years

= Rs. 60,000 / 5 years
= Rs. 12,000

Average Profit	Rs. 12,000
+ Rent which will not be charged	Rs. 4,000
- Salary to managing director	Rs. 3,000
Adjusted Average Profit	Rs. 13,000

Step – 2: Capitalize Profit at Expected Rate of Return
= Adjusted Average Profit / Expected Rate of Return
= Rs. 13,000 / 10%
= Rs. 1,30,000

Step – 3: Net Assets = Total Assets – Total Liabilities
= Rs. 1,70,000 – Rs. 70,000
= Rs. 1,00,000

Step – 4: Goodwill = Capitalized Profit – Net Assets
= Rs. 1,30,000 – Rs. 1,00,000
= Rs. 30,000

SUPER PROFIT METHOD:
Steps:-

(1) Find out Capital Employed = Total Assets – Total Liabilities
(2) Calculate Expected Profit = Capital Employed / Expected Rate of Return
(3) Calculate the Average Net Profit (Future Maintainable Profit)
(4) Super Profit = Future Maintainable Profit – Expected Profit
(5) Goodwill = Super Profit x No. of purchasing years

Illustration – 5:
The following is the Balance sheet of Vikash Co. Ltd. as on 31-3-2023.

Particulars	Note	Rs.
I. Equity and Liabilities:		
(a) Shareholder's Funds:		
Share capital :		
Equity Shares of Rs.10 each, Fully paid up		1,60,000
10% Pref. Shares of Rs.10 each, Fully Paid		40,000
Reserves & Surplus		48,000
(b) Non-Current Liabilities:		
Long-Term Borrowings: 15% Debentures of Rs.100 each		80,000
Long-Term Provisions: Workers Profit Sharing Fund		6,000
Provident Fund		10,000
(c) Current Liabilities:		
Trade Payables: Creditors		32,000
Bills Payable		12,000
Short-Term Provisions: Provision For Taxation		12,000

Total		**4,00,000**
II. Assets: (a) Non-Current Assets: (i) Fixed Assets: Intangible Assets: Goodwill Tangible Assets: Building 1,48,000 -Dep. 32,000 Machinery 1,48,000 -Dep. 28,000 Furniture 12,000 -Dep. 2,000 (ii) Non-Current Assets: Shares in Subsidiary Co. 10% Investments (Face Value 30000 Int. is tax free) (b) Current Assets: Trade Receivables: Debtors 48,400 -BDR 2,000 Bills Receivable Inventories: Stock Cash and Cash Equivalents: Cash & Bank Other Current Assets: Prepaid Expenses Discount on Debentures		 11,200 1,16,000 1,20,000 10,000 10,000 24,000 46,400 20,000 32,800 8,000 800 800
Total		**4,00,000**

You are required to compute the value of the goodwill of the company, at 4 years purchase of its profits, taking into account, the following particulars:

1) The present market value of the building and machinery is ascertained at Rs.1,80,000 and Rs.104000 respectively and the remaining assets are to be taken at their book values.

2) The market price of the Shares of the company, Doing similar business and giving dividing at 20%, is twice its paid up value.

3) The profit of the company before providing for Tax at 50% for the last 4 years are as under: Profit (Rs.):70,400, 76,800, 73,600 and 80,000

Ans.:

Step – 1: Capital Employed = Total Assets – Total Liabilities

Total Assets	Rs.
Building	1,80,000
Machinery	1,04,000
Furniture (Less: Depreciation)	10,000
Investments – Shares in Sub. Co.	10,000
Debtors (Less: Bad Debt Reserve)	46,400
Bills Receivable	20,000

Stock		32,800
Cash & Bank		8,000
Prepaid Expenses		800
Total		4,12,000
Less: Total Liabilities:		
15% Debentures	80,000	
Workers' Profit Sharing Fund	6,000	
Provident Fund	10,000	
Creditors	32,000	
Bills Payable	12,000	
Provision for Taxation	12,000	1,52,000
Net Assets		2,60,000
Less: Preference Share Capital		40,000
Capital Employed		2,20,000

Step – 2: Expected Profit = Capital Employed x Expected Rate of Return
= Rs. 2,20,000 x 10%
= Rs. 22,000

Step – 3: Future Maintainable Profit:

Total Profit of last four years = 70,400 + 76,800 + 73,600 + 80,000
= Rs. 3,00,800

Average Profit = Total Profit / No. of years
= Rs. 300,800 / 4 years
= Rs. 75,200

Average Profit	Rs. 75,200
Less: Interest on Investments (30,000 x 10%)	Rs. 3,000
	Rs. 72,200
Less: Taxation (50%)	Rs. 36,100
Profit After Tax	Rs. 36,100
Less: Preference Dividend (40,000 x 10%)	Rs. 4,000
Future Maintainable Profit	Rs. 32,100

Step – 4: Super Profit = Future Maintainable Profit – Expected Profit
= Rs. 32,100 – Rs. 22,000
= Rs. 10,100

Step – 5: Goodwill = Super Profit x No. of Purchasing Years'
= Rs. 10,100 x 4 years
= Rs. 40,400

Illustration – 6: The following is the balance sheet of Samarth Ltd. as on 31-3-2023.

Particulars			Note	Rs.
I. Equity and Liabilities:				
(a) Shareholders' Funds:				
Share Capital: 2000 10% Preference Shares of Rs.100 each				2,00,000
80,000 equity Shares of Rs.10 Each				8,00,000
General Reserve				3,00,000
Profit & Loss A/c: Balance of 2021-`22	1,60,000			
Profit for 2022-`23	8,60,000			10,20,000
(b) Non-Current Liabilities:				---
(c) Current Liabilities:				
Trade Payable: Creditors				70,000
Short-Term Provisions: Depreciation Fund:				
Building		40,000		
Investment		70,000		1,10,000
Total				**25,00,000**
II. Assets:				
(a) Non-Current Assets:				
Fixed Assets:				
Tangible Assets: Building				2,60,000
Furniture				20,000
Non-Current Investments: 5% Gov. Securities				7,60,000
(Face Value 8,00,000 Int. is Tax Free)				
Other Non-Current Assets: Preliminary Expense				10,000
(b) Current Assets:				
Inventories: Stock at market value				9,00,000
Trade Receivables: Debtors	5,00,000			
-BDR	40,000			4,60,000
Bills Receivables				20,000
Cash & Cash Equivalents: Cash & Bank Balance				70,000
Total				**25,00,000**

You are required to compute the value of goodwill of the company at 3 years purchase of its super profit taking into account the following particulars:

1) The building is now worth Rs.4,50,000
2) Companies doing similar business so a profit earning capacity of 20% on market value of their shares.
3) The profits for the past 3 years have shown an increase of Rs.60,000 annually.
4) Profit for 2022-2023 shown above is before tax, assume tax at 50%.
5) For computation of average profit, weights, to be used are 1, 2 and 3 respectively.

Ans.:

Step – 1: Capital Employed = Total Assets – Total Liabilities

Total Assets		Rs.
Building		4,50,000
Furniture		20,000
Stock		9,00,000
Debtors		4,60,000
Bills Receivables		20,000
Cash & Bank Balance		70,000
Total		19,20,000
Less: Total Liabilities		
Creditors	70,000	
Provision for Taxation	4,30,000	5,00,000
(50% of current year's profit)		
Net Assets		14,20,000
Less: Preference Share Capital		2,00,000
Capital Employed		12,20,000

Step – 2: Expected Profit = Capital Employed x Expected Rate of Return
= Rs. 12,20,000 x 20%
= Rs. 2,44,000

Step – 3: Future Maintainable Profit:

As the profit of the company of last three years is increasing by Rs. 60,000 each year and the profit of 2022-'23 is Rs. 8,60,000.

The profit for 2021-'22 will be = Rs. 8,60,000 – Rs. 60,000 = Rs. 8,00,000
The profit for 2020-'21 will be = Rs. 8,00,000 – Rs. 60,000 = Rs. 7,40,000

Average Profit:

Year	Profit (X)	Weight (W)	Weighted Profit (WX)
2020-'21	7,40,000	1	7,40,000
2021-'22	8,00,000	2	16,00,000
2022-'23	8,60,000	3	25,80,000
		6	49,20,000

Weighted Average Profit = Weighted Profit / Total Weights
= Rs. 49,20,000 / 6
= Rs. 8,20,000

Weighted Average Profit	Rs. 8,20,000
Less: Interest on Investments (8,00,000 x 5%)	Rs. 40,000
	Rs. 7,80,000

Less: Taxes (50%)	Rs. 3,90,000
Profit After Tax	Rs. 3,90,000
Less: Preference Dividend (2,00,000 x 10%)	Rs. 20,000
Future Maintainable Profit	Rs. 3,70,000

Step – 4: Super Profit = Future Maintainable Profit – Expected Profit
= Rs. 3,70,000 – Rs. 2,44,000
= Rs. 1,26,000

Step – 5: Goodwill = Super Profit x No. of Purchasing Years'
= Rs. 1,26,000 x 3 years
= Rs. 3,78,000

❖ Exercises:

Q-1. Explain the Meaning and Features of Goodwill.

Q-2. When need for valuation of Goodwill arises?

Q-3. Which factors are affecting the value of Goodwill?

Q-4. Explain the methods of Valuation of Goodwill.

Q-5. X, Y and Z are partners sharing profits and losses in the ratio of 2 : 2 : 1. It was provided in the partnership agreement that on the retirement of a partner, goodwill should be calculated on the basis of four years' purchase of the average net profits for the preceding seven years. Z retires on 31st March, 2023. Calculate the amount of goodwill. Net profits for the past seven years were as under:

Rs. 10,000; Rs. 12,500; Rs. 22,500; Rs. 20,000; Rs. 10,000; Rs. 25,000; Rs. 22,500.

[Ans.: Goodwill Rs. 70,000, Average Profit Rs. 17,500]

Q-6. A Company purchased the business of a partnership firm and agreed to give for goodwill, an amount equal to three years' purchase of weighted average profit of the last four years. The profit for last four years were as follows:

2020: Rs. 15,400; 2021: Rs. 20,000; 2022: Rs. 21,200; 2023: Rs. 25,200.

The weights to be given to the profits are 1, 2, 3 and 4 respectively. Compute the value of Goodwill.

[Ans.: Goodwill Rs. 65,940, Weighted Average Profit Rs. 21,980]

Q-7. The sheet of Neha Ltd. was under balance sheet as on 31st March, 2023.

Particulars	Rs.
I. Equity and Liabilities	
(a) Shareholders' Funds:	
Share Capital: Paid up capital	50,000
Reserve & Surplus: Profit & loss	11,330
(b) Non-Current Liabilities:	---
(c) Current Liabilities:	
Short-Term Borrowings: Bank Overdraft	11,670
Trade Payable: Sundry Creditors	18,100
Short-Term Provisions: Provisions for Taxation	3,900
Total	**95,000**
II. Assets	
(a) Non-Current Assets:	
Fixed Assets:	
Tangible Assets: Land & Building At cost	22,000
Plant & Equipment less Depreciation	20,000
Intangible Assets: Goodwill at cost	5,000
(b) Current Assets:	
Trade Receivables: Sundry Debtors	18,000
Inventories: Stock	30,000
Total	**95,000**

The company commenced business on 1st April, 2018 with a paid up capital of Rs.50000. Profit earned before providing for taxation, have been as followed:

2018-2019	2019-2020	2020-2021	2021-2022	2022-2023
Rs. 8,100	Rs. 8,800	Rs. 10,300	Rs. 11,600	Rs. 13,000

Income tax may be assumed at 25% dividend have been distributed from the profit of the first two years at the rate of 10% and from those of the next two years at the rate of 15% on the paid up Capital.

Calculate the value of goodwill by capitalization of net profit Calculate average profit by the weighted average, weight to be given is 1 to 5. Expected rate of return is 12.5%.

[Ans.: Goodwill Rs. 10,870]

Q-8. The following is the balance sheet of Dhara Ltd. as on 31-3-2023. Akshay Ltd. Wants to purchase its business.

Particulars	Rs.
I. Equity and Liabilities	
(a) Shareholders' Funds:	
Share capital : 15000 Equity Shares of Rs.10 each	1,50,000
(b) Non-Current Liabilities:	
Long-Term Provisions: Provident Fund	10,000

(c) Current Liabilities:	
Trade Payables: Creditors	30,000
Bills Payable	10,000
Total	**2,00,000**
II. Assets	
(a) Non-Current Assets:	
Fixed Assets:	
Tangible Assets: Land & Building	1,00,000
Plant & Machinery	30,000
(b) Current Assets:	
Trade Receivables: Debtors	20,000
Bills Receivable	10,000
Inventories: Stock	30,000
Cash and Cash Equivalents: Cash & Bank	10,000
Total	**2,00,000**

The profits of company for the last 5 years are Rs.24,000, Rs.20,000, Rs.32,000, Rs.24,000 and Rs.30,000 Respectively. Manager of the company Shri Chandra was giving honorary service, but now a salary of Rs.5,000 per annum will have to be paid to him. Dhara Ltd. Pays RS.4,000 for office rent, which Akshay Ltd. will not be required to pay.
The expected rate of return in this type of business is 10%
Calculate goodwill on the basis of capitalization of average profit method.

[Ans.: Goodwill Rs. 1,00,000, Average Profit after adjustments Rs. 25,000, Capitalized profit @ 10% Rs. 2,50,000, Net Assets Rs. 1,50,000]

Q-9. The following is the Balance Sheet of Sanket Ltd. as on 31-3-2023.

Particulars	Rs.
I. Equity and Liabilities:	
(a) Shareholders' Fund:	
(i) Share Capital: Equity Shares of Rs.10 each, Fully paid up	2,50,000
10% Pref. Shares of Rs.10 each, Fully Paid	2,30,000
(ii) Reserve & Surplus: General Reserve	80,000
Profit & Loss A/c	40,000
(b) Non-Current Liabilities:	
(i) Long-Term Borrowings: 12% Debentures of Rs.100 each	2,50,000
(ii) Long-Term Provisions: Provident Fund	40,000
(d) Current Liabilities:	
(i) Trade Payable: Creditors	1,94,000
Bills Payable	8,000
(ii) Other Current Liabilities: Outstanding Expenses	3,000
Total	**10,95,000**
II. Assets	
(a) Non-Current Assets:	

(i) Fixed Assets:			
Tangible Assets: Land & Building	2,02,000		
-Dep.	10,000		1,92,000
Machinery	3,46,000		
-Dep.	58,000		2,88,000
Furniture	20,000		
-Dep.	5,000		15,000
Intangible Assets: Goodwill			15,000
(ii) Non-Current Investments: 10% Inv. against Provident Fund			40,000
10% Debentures of Priyam Ltd.			90,000
(Face Value 100000 Int. is taxable)			
(iii) Other Non-Current Assets: Preliminary Expenses			3,000
(b) Current Assets:			
(i) Trade Receivables: Debtors	2,40,000		
-BDR	14,000		2,26,000
Bills Receivables			44,000
(ii) Inventories: Stock			1,52,000
(iii) Cash and Cash Equivalents: Cash & Bank			24,000
(iv) Other Current Assets: Prepaid Expenses			6,000
Total			**10,95,000**

Additional Information:-

1) The present market value of land and building and Machinery are Rs.2,88,000 and Rs.2,16,000 respectively, while remaining assets are to be taken at their book values
2) The expected rate of return on capital employed in this type of business is considered to be 15%.
3) The Profit of the company, after deducting tax at 50% for the last 3 years and appropriate weights to be used are as under:

Year	Profit	Weight
1	80,200	1
2	84,400	2
3	98,800	3

From the above particulars you are required to calculate the value of the goodwill of the company on the basis of 4 years purchases of its super profits, calculated on weighted average profit of the last 3 years.

[Ans.: Capital Employed Rs. 2,86,000, Expected Profit Rs. 42,900, Future Maintainable Profit Rs. 62,900, Super Profit Rs. 20,000, Goodwill Rs. 80,000]

Q-10: The following is the Balance Sheet of Shyam Ltd. as on 31-3-2023.

Particulars	**Rs.**
I. Equity and Liabilities:	
(a) Shareholders' Funds	
(i) Share Capital: Equity Share Capital of Rs. 10 each, fully paid up	3,00,000
10% Pref. Share Capital of Rs. 100 each, fully paid up	2,50,000
(ii) Reserve & Surplus: General Reserve	90,000
Profit & Loss A/c: Balance as on 1-4-'22 4,000	
Profit for 2022-'23 (before 50% tax) 2,40,000	2,40,000
(b) Non-Current Liabilities:	
(i) Long-Term Borrowings: 12% Debentures	2,80,000
(ii) Long Term Provisions: Provident Fund	45,000
(c) Current Liabilities:	
(i) Trade Payables: Creditors	1,70,000
Bills Payable	16,000
Total	**14,00,000**
II. Assets:	
(a) Non-Current Assets:	
(i) Fixed Assets:	
Tangible Assets: Land and Building	2,30,000
Machinery	4,40,000
Intangible Assets: Goodwill	15,000
(ii) Non-Current Investments:	
Investment against provident fund	45,000
12% Debentures of Ram Ltd.	85,000
(Face Value Rs. 80,000, and interest is taxable)	
(iii) Other Non-Current Assets: Preliminary Expenses	4,000
(b) Current Assets:	
(i) Inventories: Stock	2,30,000
(ii) Trade Receivables: Debtors	2,70,000
Bills Receivable	50,000
(iii) Cash and Cash Equivalents: Cash & Bank	24,000
(iv) Other Current Assets: Prepaid Expenses	7,000
Total	**14,00,000**

Additional Information:

(1) The present market value of Land & Building is Rs. 3,42,500, while the remaining assets, are to be taken at their book value.

(2) The expected rate of return on capital in the class of business done by Shyam Ltd. is 12%.

(3) The profits of the company, before tax at 50% for the past three years are as under:
2019-'20: Rs. 1,80,000, 2020-'21: Rs. 1,90,000, 2021-'22: Rs. 2,10,000.
From the above particulars, you are required to compute the value of goodwill of the company on the basis of four years' purchase of its super profits, calculated on weighted average profit of the last four years. The appropriate weights to be used are:
2019-'20: 1, 2020-'21: 2, 2021-'22: 3 and 2022-'23: 4.

[Ans.: Goodwill Rs. 60,000, Capital Employed Rs. 5,22,500, Expected Profit Rs. 62,700, Future Maintainable Profit Rs. 77,700, Super Profit Rs. 15,000]

Q-11: The following is the Balance Sheet of Jay Ltd. as on 31-3-2023.

Particulars		Rs.
I. Equity and Liabilities:		
(a) Shareholders' Funds		
(i) Share Capital: Equity Share Capital		7,00,000
10% Cum. Pref. Share Capital		3,00,000
(ii) Reserve & Surplus: General Reserve		5,00,000
Workmen's Compensation Fund		20,000
(b) Non-Current Liabilities:		
(i) Long-Term Borrowings: 15% Debentures		4,00,000
(ii) Long Term Provisions: Workmen's Profit Sharing Fund		70,000
(c) Current Liabilities:		
(i) Trade Payables: Creditors		1,50,000
Bills Payable		50,000
(ii) Short-Term Provisions: Provision for Taxation		2,00,000
Depreciation fund: Building	50,000	
Machinery	1,00,000	1,50,000
(iii) Other Current Liabilities: Outstanding Expenses		10,000
Total		25,50,000
II. Assets:		
(c) Non-Current Assets:		
(i) Fixed Assets:		
Tangible Assets: Building		7,00,000
Machinery		8,00,000
Intangible Assets: Goodwill		1,00,000
(ii) Non-Current Investments:		
10% Taxable Investments (Face Value Rs. 1,00,000)		1,20,000
Shares in Subsidiary Co.		1,00,000
(iii) Other Non-Current Assets: Advertisement Suspense A/c		1,50,000
(d) Current Assets:		

(i) Inventories: Stock		2,80,000
(ii) Trade Receivables: Debtors	2,00,000	
- B.D.R.	10,000	1,90,000
(iii) Cash and Cash Equivalents: Cash & Bank		80,000
(iv) Other Current Assets: Prepaid Expenses		30,000
Total		14,00,000

Additional Information:

(1) The present market value of the building is Rs. 9,00,000 while the remaining assets are to be taken at their book values.

(2) The expected rate of return on capital employed is 10%.

(3) Income-tax assessment upto the last year is completed and there remains no liability for that. The provision for taxation, equal to 50% of profit, is created for this year.

(4) The profit of the company before tax for last three years is increasing every year by Rs.90,000.

[Ans.: Goodwill Rs. 75,000; Capital Employed Rs. 11,00,000; Expected Profit Rs. 1,10,000; Future Maintainable Profit Rs. 1,35,000; Super Profit Rs. 25,000]

UNIT-10 VALUATION OF SHARES

10.1 Introduction

10.2 Need for Valuation of Shares

10.3 Factors Affecting Value of Shares

10.4 Methods of Valuation of Shares

10.4.1 Intrinsic Value Method

10.4.2 Yield Method

10.4.3 Fair Value Method

- **Illustrations**
- **Exercises**

10.1 Introduction

Valuation of shares is the most complex accounting problem. It involves the use of financial and accounting data but much depends on the valuation based on purely quantitative data. Thus share valuation is an intricate exercise involving accounting as well as non-accounting data. Objective and subjective considerations and a resolution of the conflicting interests of the parties involved in it. Valuation is also closely linked to the purpose of valuation.

Generally the shares of public companies are quoted on recognized stock exchange and there is no difficulty in fixing the values of such shares. But the price quoted on stock exchange are many times not enough for certain purpose because they are influenced by a number of external factors like govt. policy, political situation, international trade policy etc. over which the company has no control.

Further there is no market price of the shares as in the case of a private limited company, or a proprietorship as the shares of such companies are not quoted in the market or where for certain reasons the market price does not reflect the true value of the shares.

10.2 Need For Valuation of Shares

The following are the particulars where it becomes necessary to value the shares.

1) Sale of share by one person to another
2) Mangers acquisition and capital restructurings
3) Purchase and sale of shares in private companions and other unquoted shares
4) Transfer of share in an Indian company by a non-resident.
5) Valuation for tax-purpose e.g. gift tax wealth
6) When shares are pledged as collateral for a loan.
7) Determine the amount payable to dissent shareholder under selection 494 of the companies

8) Compensating shareholders when the undertaking is nationalized.
9) Conversion of shares of one class into another
10) Valuation of shares held by an investment companies.

10.3 Factors Affecting Value of Shares

The factors that affect the valuation of shares are largely the same that affect the valuation of goodwill. Generally shares are valuation on the basis of field and the factors that affect the field are broadly divided into two category. (A) Internal factors (B) external factor. Which are beyond the control of the company:

A. <u>Internal factors:</u>

The factors which are eighth the control of the company are as under:

1. **Economically situation**: The stronger the financial position of the company the higher the price that an investor would be prepared to pay. While valuing shares recoups liquidity of capital market value of assets are continues.

2. **Earning capacity:** The earning capacity is perhaps the most important factor affecting the valuation of shares. The shares of a company with stable earnings. Would naturally command higher value of shares.

3. **Goodwill:** The strong financial position & the stability of earning enhance the prestige and goodwill which will add to the value of net assets. The raises the intrinsic value as well as market value of shares.

4. **Unfavorable ratios:** If the financial ratios of the company like current ratio, proprietary ratio, gearing ratio, debt-equity ratio etc. are unfavorable, then the investor are not prepared to invest in the shares of such companies.

5. **Capital employed:** As compared to the expected rate of return if the capital employed is more or less that affects the share valuation of the company.

B. **External Factors**: The factors affecting the value of shares over which the company has no control can be enumerated as below.

1. **Nature of business:** Businesses involving higher risks are not much favored by investors except speculators. Hence, the value of shares of a company engaged in risky business would be lower as genuine investors are less attracted towards such companies.

2. **Quantum of savings:** The total amount of savings available in the county and the willingness of the people to invest their saving determine the demand for shares. In advanced countries the people are prepared to invest their savings in corporate securities and the value of shares remain high.

3. **Government policy:** The government policies towards industries affect the value of shares. The value of shares will remain low when there is a threat of nationalization, positive of high taxes changes in export import policy etc.

4. **Political Condition:** If there is political stability in the country and only one party remains in control then the value of shares will be more but if there is political instability, the value of share does not increase under such condition.

5. **Return on shares of other companies:** The return of shares of the other companies during similar type of business plays important part in deciding the value of shares of our companies.
   The valuation of shares calls for deep understanding knowledge and practical commonsense of the business because some external factors affect valuation and management have control over such factors.

10.4 Methods of Valuation of Shares

There are two accepted and widely used method of valuing shares:

- ❖ Net assets valuation method or asset backing method or intrinsic value method or break-up value method.
- ❖ Yield method or earning capacity valuation method.

10.4.1 Net Assets Method (Intrinsic Value Method)

This method measures the value of the net assets of the company against each share. This is ascertained by taking the value of the company's assets, subtracting the amount of the liabilities, preference shareholder claims and divided the remaining amount among the equity shareholders according to their individual right. Net assets value may be expressed by the following formula:

$$\text{Net assets value of a share} = \frac{\text{Net value of assets} - \text{liabilities} - \text{pref.shareholders' claims}}{\text{No of Eq.Shares}}$$

Valuation of shares according to this method becomes necessary when a company wants to purchase or absorb another company or when shares of a company are to be acquired in a large number to obtain controlling interest in it or when the company is taken into liquidation, the yield is not an important factor and net assets have to be ascertained. In such cases shares have to be valued by net assets method.

The following point should be carefully studied in connection with net assets method:

1) **Goodwill:** It is generally valued and added to the total assets while ascertaining net assets. If the b/w appears in the balance sheet but is worthless it should not be included. Conversely even when goodwill does not opera in the books the goodwill should be valued and included in the total assets if the business has acquired prestige. Generally b/w is there is a clear instruction to find out b/w then it should be found out and added to the total assets.

2) **Fictitious Assets:** It is operating on the assets side should be excluded from total assets as they are only debit balances and will not fetch anything e.g. preliminary expenses, debenture discount P & L A/c.

3) **Accumulated profit:** It is operating on the liability side. Should not be deducted from total assets for the purpose of ascertaining net assets e.g. General reserve, P & L A/c, Deb. Red. Fund.

4) **Liability:** The liabilities to be deducted from total assets include the following:
   - All long term as well as short liabilities including interest there on if any.
   - Provision for taxation.
   - The liabilities for which no provision has been made but which are to be paid.
   - Previous year's adjustments which will reduced the profit.
   - Preference capital, preference dividend and proposed preference dividend.

5) **Realizable values:** The assets should be valued at their realizable value and not at their book value. If however the realizable value are not given then the book value may be taken as realizable values.

6) **Depreciation:** The depreciation on assets whose market values are into in excess of their book value should not be taken into assent.

[e.g. the book value of buildings is Rs. 100000 and the deprecation fund for building stand at Rs. 40000 then the present book value of building is Rs 6000. If the market value of building is given as Rs. 125000 then this value only should be included in the assets instead of Rs. 60000]

7) **Preference shares:** The following point must be considered when Preference share capital is given.

   - The preference shares get priority in respect of dividend and retune of capital in winding up over the equity shares the preference share capital must be deducted from the total net assets.
   - It must be noted that if the rate of dividend on pertinence share capital is more than the normal return expected then the value of preference share capital will be increased proportionately.

e.g. If the total assets of a company are worth Rs. 150000 and its liabilities are Rs. 60000 its net assets would be Rs. 90000 suppose the company has issued 3000 6% preference shares of Rs. 10 each and 1000 Equity shares of Rs.10 each, then the value of Equity share will be computed as.

(1) Net Assets = assets – liabilities

	= 150000 – 6000	= 90000
Less	Preference share capital	= 30000
	Amount available to Equity shareholder	= 60000

$$\text{Value of equity share} = \frac{6000}{1000} = \text{Rs. } 60$$

But in the case of normal return on preference shares is 6% only. However, if the preference shares carry 9% dividend then the value of preference shares will be,

$$= \frac{\text{Rs. } 10 \text{ (F.Y.) X } 9 \text{ (dividend allowed)}}{6 \text{ (normal return)}}$$

= Rs. 15

In such case not only paid up amount of preference share will be deducted but also the amount to be deducted more than face value.

Amount to be deducted = 3000 (no of p.s.) x Rs. 15

= Rs. 45000

$$\text{Value of Equity share} = \frac{45000}{1000}$$

= Rs. 45

(2) If the preference shares are preferred as to repay the capital and arrears of preference dividend are payable in winding up then both the preference share capital and the arrears of such dividend must be deducted from net assets and the remaining amount only must be divided by the number of equity shares.

(3) If the pref. shares have no preferential right as to return of capital but rank equally with equity shares then the total assets would be divided by the total shares of both types. For example in the above illustration the net assets of Rs. 90000 would be divided among 3000 pref. shares and 1000 equity shares.

$$= \frac{90000}{4000}$$

= Rs. 22.5 value of each share

8) **Non-trading investment:** while finding out value of share value of non-trading investments should also be added because here we just think that if the business is closed down and all assets are sold, what amount will be realized. Similarly interest on non-trading investment should not be dividend in fixed.

10.4.2 Yield Valuation Method:

This method takes into account the earnings available for distribution for valuating shares. The value so calculated is generally now as "Market Value". When an investor thinks of purchasing shares of a company he is interested in the income that he will receive from his invest meets. Hence the shares are generally valued on the basis of yield. This method is known as "Yield Valuation Method' 'or' Earning Capacity Valuation Method.'
Under this method the following steps are essential for building out the value of shares.

1) **Future maintainable profit:** The profit of the company which the company is expected to earn and maintain in future should be ascertained, the average net profit of the last three to five years should be adopted as the basis. While calculating normal average profit abnormal years should be avoided certain adjustments must be made in

the average profit. So arrived at in order to get the ‘future maintainable profit’.

(A) Non-recurring items should be excluded e.g. if rent of premises was paid in the past but not the company owns its own premises, then the rent should not be charged to profits.

(B) Income tax must be provided out of the profit. In case the rate of income tax is not given, it should not be assumed. Need to be 50% of net profits if the profits of the past years are given after providing for taxes then no such adjustment be made.

(C) If allocation to reserves is essentials every year, then the normal percentage must be deducted out of profits for such reserves because the net profit cannot be regarded as distributive unless that allocation is made.

(D) If the value of equity share is to be ascertained and the company has issued preference shares then the dividend on such preference shares should be deducted from the average profit.

2) **Expected rate of return:** The expected rate of return on capital infused that on investor expects from the business of the type in which the company is engaged must be ascertained.

3) **Value of shares:** The ration of average maintainable profits and the normal rate of return give the value of shares when multiplied by the paid up value of share.

1. Rate of Dividend= $\frac{\text{Avg.profit for dividend}}{\text{Eq.share capital}}$ X 100

2. Value of Eq. Share = $\frac{\text{Dividend rate}}{\text{Exp.Rate of return}}$ X 100

10.4.3 Fair Value Method:-

The fair value of a share may be taken to mean the average of the intrinsic value nosed on net assets and market value based on yield method.

This value is fair in circumstances when the net profit of the company is small and at the same time its net assets are substantial. In such a case there will be a market difference between the values. Computed under the two methods and a compromise is affected by ascertaining the mean of these two values which is known as ‘Fair

$$\text{Fair value of Share} = \frac{\text{Intrinsic value + market value Share}}{2}$$

- **Illustrations:**

Illustration – 1: Ascertain the intrinsic value of Equity Share of A Co. Ltd. from the information provided below:

Particulars	Note	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital: 1,00,000 10% Preference Shares of Rs. 10 each		10,00,000
1,00,000 Equity Shares of Rs. 10 each		10,00,000
(b) Reserve & Surplus: Reserves		4,00,000
(2) Non-Current Liabilities:		
(a) Long-Term Borrowings: 10% Debentures		4,00,000
(3) Current Liabilities:		
(a) Trade Payables: Creditors		95,000
(b) Short Term Provisions: Depreciation Fund:		
Land & Building 50,000		
Plant & Machinery 50,000		1,00,000
Total		29,95,000
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets: Land & Building (M.V. Rs. 1400000)		13,50,000
Plant & Machinery		12,50,000
Furniture		10,000
Intangible Assets: Goodwill		50,000
(b) Non-Current Investments: Shares in Sub. Co.		1,50,000
10% Debentures in Other Co.		40,000
(2) Current Assets:		
(a) Inventories: Stock		80,000
(b) Trade Receivables: Debtors		60,000
(c) Cash and Cash Equivalents: Cash & Bank Balance		5,000
Total		29,95,000

Goodwill of the company is to be taken at three times the super profits. The company's average annual profit (after deducting tax @ 50%) are Rs. 273000. Expected rate of return on equity capital employed is 10%.

Solution:

Step – 1: Capital Employed = Total Assets – Total Liabilities

Total Assets	Rs.
Land & Building (Market Value)	14,00,000
Plant & Machinery (Less: Depreciation)	12,00,000
Furniture	10,000
Investments in Shares of Subsidiary Co.	1,50,000
Stock	80,000

Debtors		60,000
Cash & Bank Balance		5,000
Total		29,05,000
Less: Total Liabilities:		
10% Debentures	4,00,000	
Creditors	95,000	4,95,000
Net Assets		24,10,000
Less: Preference Share Capital		10,00,000
Capital Employed		14,10,000

Step – 2: Expected Profit = Capital Employed x Expected Rate of Return
= Rs. 14,10,000 x 10%
= Rs. 1,41,000

Step – 3: Future Maintainable Profit:

Average Profit (After Tax)	Rs. 2,73,000
Less: Interest on Investments (after tax)	Rs. 2,000
	Rs. 2,71,000
Less: Preference Dividend (10,00,000 x 10%)	Rs. 1,00,000
Future Maintainable Profit	Rs. 1,71,000

Step – 4: Super Profit = Future Maintainable Profit – Expected Profit
= Rs. 1,71,000 – Rs. 1,41,000
= Rs. 30,000

Step – 5: Goodwill = Super Profit x No. of Purchasing Years'
= Rs. 30,000 x 3 years
= Rs. 90,000

- **Intrinsic Value:**

Step – 1: Net Assets = Total Assets – Total Liabilities

	Rs.
Capital Employed for the purpose of Goodwill	14,10,000
Add: Goodwill	90,000
Add: Non-Trading Investments	40,000
Net Assets for Eq. Shareholders	15,40,000

Step – 2: Intrinsic Value of Share = $\frac{\text{Net Assets}}{\text{No.of Equity Shares}}$

$$= \frac{15,40,000}{1,00,000}$$

= Rs. 15.40

Illustration – 2: The paid up capital of Ananya Ltd. consists of 5,000 Equity Shares of Rs. 100 each, fully paid. The normal average profit (after tax) of the company is Rs.

100000. It is the practice of the company to transfer Rs. 20000 out of the profit to General Reserve. The normal return applicable to the particular type of business is 10%. Calculate the Market (Yield) Value of Share.

Solution:

- **Market (Yield) Value:**

Step – 1: Profit for Equity Shareholders:

Average Profit (After tax)	1,00,000
Less: 50% Tax	20,000
Profit for Equity Shareholders'	80,000

Step – 2: Rate of Dividend = $\frac{Profit\ for\ Equity\ Shareholders'}{Paid\ up\ Equity\ Capital} X\ 100$

$= \frac{80,000}{5,00,000} X\ 100$

= 16%

Step – 3: Market Value = $\frac{Rate\ of\ Dividend}{Expected\ Rate\ of\ Return} X Paid\ up\ capital$

$= \frac{16}{10} X\ 100$

= Rs. 160

Illustration – 3: The following is the balance Sheet of Samarth Ltd. as on 31-3-2023:

Particulars	Note	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital: 40000 10% Preference Shares of Rs.10 each		4,00,000
40000 Equity Shares of Rs.10 each		4,00,000
(b) Reserves & Surplus: Reserves		1,28,000
Profit & Loss A/c		32,000
(2) Non-Current Liabilities:		
(a) Long-Term Borrowings: 15% Debentures		1,60,000
(b) Long-Term Provisions: Provident Fund		40,000
(3) Current Liabilities:		
(a) Trade Payables: Creditors		32,000
Bills Payable		14,000
Total		12,06,000
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets: Land & Building 5,40,000		

-Dep.	20,000		5,20,000
Machinery	5,00,000		
-Dep.	20,000		4,80,000
Furniture	25,600		
-Dep.	1,000		24,000
Intangible Assets: Goodwill			30,400
(b) Non-Current Investments:			
10% Investment against Provident Fund			40,000
12% Debentures of Spandan Ltd.			45,600
(Face value Rs.48000 and interest is taxable)			
(2) Current Assets:			
(a) Inventories: Stock			32,000
(b) Trade Receivables: Debtors	24,000		
-B. D. Res.	1,600		22,400
(c) Cash and Cash Equivalents: Cash & Bank			11,600
Total			12,06,000

Additional Information:-

(1) The present market value of land and building is Rs.569600.
(2) The company's average annual profit (before deducting Tax at 50%) is Rs.224000
(3) The expected rate of return on capital employed in this type of business is considered to be 10%.
(4) The value of the Goodwill of the company has been ascertained at Rs.60800.

From the above particulars, ascertain the fair value of Equity Share of the company.

Solution: [A] Intrinsic Value:

Step – 1: Net Assets = Total Assets – Total Liabilities

Total Assets		Rs.
Land and Building		5,69,600
Machinery (Less: Depreciation)		4,80,000
Furniture (Less: Depreciation)		24,000
Goodwill		60,800
Investment against Provident Fund		40,000
12% Debentures of Spandan Ltd.		45,600
Stock		32,000
Debtors (Less: Bad Debt Reserve)		22,400
Cash and Bank		11,600
Total		12,86,000
Less: Total Liabilities:		
Debentures	1,60,000	
Provident Fund	40,000	
Creditors	32,000	
Bills Payable	14,000	2,46,000

Net Assets	10,40,000
Less: Preference Share Capital	4,00,000
Net Assets for Eq. Shareholders	6,40,000

Step – 2: Intrinsic Value of Share = $\frac{\text{Net Assets}}{\text{No.of Equity Shares}}$

$= \frac{6,40,000}{40,000}$

= Rs. 16

[B] Market Value:

Step – 1: Profit for Equity Shareholders:

Average Profit (Before tax)	2,24,000
Less: 50% Tax	1,12,000
	1,12,000
Less: Preference Dividend (4,00,000 x 10%)	40,000
Profit for Equity Shareholders'	72,000

Step – 2: Rate of Dividend = $\frac{Profit\ for\ Equity\ Shareholders'}{Paid\ up\ Equity\ Capital} X\ 100$

$= \frac{72,000}{4,00,000} X\ 100$

= 18%

Step – 3: Market Value = $\frac{Rate\ of\ Dividend}{Expected\ Rate\ of\ Return} X Paid\ up\ capital$

$= \frac{18}{10} X\ 10$

= Rs. 18

[C] Fair Value:

Fair Value = $\frac{Intrinsic\ Value + Market\ Value}{2}$

$= \frac{16+18}{2}$

= Rs. 17

Illustration – 4: The Balance Sheet of Vishal Ltd. as on 31-3-2023 was as under:

Particulars	Note	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital:		
20000 'A' Eq. Shares of Rs.10 each fully paid up		2,00,000
20000 'B' Eq. Shares of Rs.10 each, Rs.8 per share paid-up		1,60,000
10000 'C' Eq. Shares of Rs.10 each, Rs.6 per share paid-up		60,000
(b) Reserve & Surplus: General Reserve		70,000
Profit & Loss A/c		30,000
(2) Current Liabilities:		
(a) Short-Term Borrowings: Bank Overdraft		15,000
(b) Trade Payables: Creditors		50,000
(c) Other Current Liabilities: Liabilities for expenses		10,000
(d) Short-Term Provisions: Dep. Fund:-Building 5,000		
Machinery 20,000		25,000
Total		6,20,000
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets: Building		80,000
Machinery		1,00,000
Intangible Assets: Goodwill		65,000
(b) Other Non-Current Assets: Preliminary Expenses		4,500
(2) Current Assets:		
(a) Inventories: Stock		2,00,000
(b) Trade Receivables: Debtors		1,50,000
(c) Cash and Cash Equivalents: Cash Balance		18,000
(d) Other Current Assets: Prepaid Insurance		2,500
Total		6,20,000

Find the value of the company's each type of Equity Shares By (1) Net Assets method and (2) Yield Method, taking into account the following:

(1) Goodwill of the company has been valued at Rs.80,000.
(2) Debtors are considered good except for Rs.10,000.
(3) Normal Expected Return on capital employed is 10%.
(4) The net profits of the company, for the last 3 years were as following
    2020-2021 Rs.1,00,000; 2021-2022 Rs.130000; 2022-2023 Rs.1,20,500
(5) Building has been valued at Rs.1,00,000.
(6) There is a claim amounting to Rs.25500 and it has to be paid according to the settlement agreed upon.

Solution:

[A] Net Assets Method:

Step – 1: Net Assets = Total Assets – Total Liabilities

Total Assets		Rs.
Building		1,00,000
Machinery (Less: Depreciation)		80,000
Goodwill		80,000
Stock		2,00,000
Debtors (Less: Bad Debt Reserve)		1,40,000
Cash		18,000
Prepaid Insurance		2,500
Total		6,20,500
Less: Total Liabilities:		
Bank Overdraft	15,000	
Creditors	50,000	
Liabilities for Unpaid Expenses	10,000	
Amount of Claim	25,500	1,00,500
		5,20,000
Add: Unpaid Calls: 20,000 Shares x Rs. 2	40,000	
10,000 Shares x Rs. 4	40,000	80,000
Net Assets		6,00,000

Step – 2: Intrinsic Value of Fully paid Share = $\frac{\text{Net Assets}}{\text{No.of Equity Shares}}$

$$= \frac{6,00,000}{50,000}$$

= Rs. 12

Thus, the Intrinsic Value of 'A' Equity Share is Rs. 12.
Intrinsic Value of 'B' Equity Share Rs. 12 less Rs. 2 unpaid = Rs. 10.
Intrinsic Value of 'C' Equity Share Rs. 4 unpaid = Rs. 8.

[B] Yield Method:

Step – 1: Profit for Equity Shareholders:

Total Profits			
2020-2021		1,00,000	
2021-2022		1,30,000	
2022-2023	1,20,500		
Less: B.D.R.	10,000		
Claim	25,500	85,000	3,15,000
÷ Number of Years			3
Average Profit			1,05,000
Less: Transfer to General Reserve (20%)			21,000
Profit for Equity Shareholders'			84,000

Step – 2: Rate of Dividend = $\frac{Profit\ for\ Equity\ Shareholders}{Paid\ up\ Equity\ Capital} X\ 100$

$= \frac{84,000}{4,20,000} X\ 100$

= 20%

Step – 3: Market Value of 'A' = $\frac{Rate\ of\ Dividend}{Expected\ Rate\ of\ Return} XPaid\ up\ capital$

$= \frac{20}{10} X\ 10$

= Rs. 20

Market Value of 'B' = $\frac{Rate\ of\ Dividend}{Expected\ Rate\ of\ Return} XPaid\ up\ capital$

$= \frac{20}{10} X\ 8$

= Rs. 16

Market Value of 'C' = $\frac{Rate\ of\ Dividend}{Expected\ Rate\ of\ Return} XPaid\ up\ capital$

$= \frac{20}{10} X\ 6$

= Rs. 12

❖ Exercises:

Q-1: Explain the need for valuation of shares.
Q-2: Which factors are affecting the value of shares?
Q-3: Explain the methods of valuation of shares.
Q-4: From the following information, ascertain the value of equity shares under the 'Net assets' Method:

Balance Sheet as at 31-3-2023

Particulars	Note	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital:		
1000 10% preference shares of Rs.100 each		1,00,000
1000 Equity Shares of Rs.100 Each		1,00,000
(2) Current Liabilities:		
(a) Trade Payables: Creditors		2,00,000

Total		**4,00,000**
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets: Sundry Assets		3,80,000
Intangible Assets: Goodwill		10,000
(b) Other Non-Current Assets: Preliminary Expenses		10,000
Total		**4,00,000**

Sundry assets including Goodwill were valued at Rs.510000. There was an unrecorded liability of Rs.10000.

[Ans.: Value of Equity Share Rs. 200; Net Assets Rs. 2,00,000]

Q-5: The balance Sheet of the Kumar Manufacturing Ltd. is given below.

Particulars	**Note**	**Rs.**
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital: 8800 Shares of Rs.250 each Fully paid		22,00,000
(b) Reserve & Surplus: Reserve Fund		8,24,000
Profit & Loss A/c		36,12,000
(2) Non-Current Liabilities:		
(a) Long-Term Provisions: Workmen's Saving A/c		2,27,000
Provident Fund		54,000
(3) Current Liabilities:		
(a) Trade Payables: Creditors		38,86,000
(b) Short-Term Provisions: Depreciation Fund		4,63,000
Total		**1,12,66,000**
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets: Land at cost		2,21,000
Building at cost		11,73,000
Machinery at cost		20,58,000
Furniture at cost		5,000
(b) Non-Current Investments: Investment (at Market value)		17,00,000
(c) Other Non-Current Assets: Debenture Charges		25,000
(2) Current Assets:		
(a) Inventories: Stock in trade (at market value)		26,00,000
(b) Trade Receivables: Book Debts		3,35,000
(c) Cash and Cash Equivalents: Cash & Other balance		31,49,000
Total		**1,12,66,000**

Depreciation fund is in excess by Rs.54000 then the amount of actual depreciation.

[Ans.: Intrinsic value Rs. 757.39; Net Assets Rs. 66,65,000 ÷ 8,800 Shares]

Q-6: The annual average Profits of Komal Co. is Rs.100000, while its capital employed is Rs.300000. The rate of taxation is 55% and the expected rate of return is 10% Find out the market price of 3750 Equity Shares of Rs.100 (paid up Rs.80).
[Ans.: Market value of share Rs. 120; Rate of dividend 15%; Average profit after tax Rs. 45,000]

Q-7: The Balance Sheet of Jaya Ltd. on 31-3-2023 was as follows.

Particulars	**Note**	**Rs.**
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital: 30000 Equity Shares of Rs.10 Each		3,00,000
(b) Reserve & Surplus: General Reserve		1,50,000
Profit & Loss A/c		1,25,000
(2) Non-Current Liabilities:		
(a) Long-Term Borrowings: 5% Debentures		1,00,000
(b) Long-Term Provisions: Workmen's Saving Fund		1,00,000
Workmen's Profit Sharing Fund		75,000
(3) Current Liabilities:		
(a) Trade Payables: Creditors		5,00,000
Total		**13,50,000**
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets: Land & Building		2,00,000
Intangible Assets: Goodwill		1,00,000
(b) Non-Current Investments: Investment at cost		2,75,000
(Market value Rs.240000)		
(2) Current Assets:		
(a) Inventories: Stock		4,00,000
(b) Trade Receivables: Debtors		3,00,000
(c) Cash and Cash Equivalents: Cash Balance		75,000
Total		**13,50,000**

On 31st March 2023 the stock was valued at Rs.350000 and Goodwill at Rs.75000.

The Net Profits for 3 years were 2020-2021 Rs.95000, 2021-2022 Rs.65000, 2022-2023 Rs.110000 of which 20% was placed to reserve. This proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 12%

Find the value of company's Share by net assets method and yield method.
[Ans.: Value of share by Net Assets Method Rs. 15.50 (Net Assets Rs. 4,65,000 ÷ 30,000 shares); Value of share by Yield Basis Rs. 20 (Average Profit Rs. 72,000; Rate of dividend 24% on capital of Rs. 3,00,000)]

Q-8: Balance Sheet of a Company is under:

Particulars	Note	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital: Equity Share Capital each of Rs.100		2,00,000
8% Preference Share Capital		1,00,000
(2) Current Liabilities:		
(a) Trade Payables: Creditors		25,000
Bills Payable		25,000
Total		**3,50,000**
II. Assets		
(1) Non-Current Assets: Fixed Assets		2,50,000
(2) Current Assets		1,00,000
Total		**3,50,000**

(1) Market value of Fixed Assets is 10% more and that of Current Assets is 5% less.

(2) Average Profit of last 5 years is Rs.42000 Expected rate of return is 10%. Evaluate Goodwill on the basis on 3 years purchase of super profit and find out value of equity Shares as per intrinsic value method and value as per yield method.

[Ans.: Capital Employed Rs. 2,20,000, Expected Profit Rs. 22,000, Average Profit Rs. 34,000, Super Profit Rs. 12,000, Goodwill Rs. 36,000. Intrinsic value of equity share Rs. 128 (2,56,000 ÷ 20,000 shares), Rate of dividend on Equity Shares 17%, Market Value of shares Rs. 170]

Q-9: From the following information relating to Paresh Ltd., you are required to work out the value per equity Share:

Balance Sheet as at 31-3-2023

Particulars	Note	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital: 10000 Shares of Rs.10 each fully paid		1,00,000
(b) Reserve & Surplus: General Reserve		50,000
Profit & Loss A/c		30,000
(2) Non-Current Liabilities:		
(a) Long-Term Borrowings: Loans		1,10,000
(3) Current Liabilities		10,000
Total		**3,00,000**
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets		1,10,000
Intangible Assets: Goodwill		20,000
(b) Other Non-Current Assets: Preliminary Expenses		10,000
(2) Current Assets		1,60,000
Total		**3,00,000**

Other Information:

The Company's net profit & Loss for the Preceding five years before providing for taxation were:

31-3-2023	31-3-2022	31-3-2021	31-3-2020	31-3-2019
Profit	Loss	Loss	Profit	Profit
60,000	40,000	20,000	1,00,000	30,000

The rate of taxation may be taken at 55%. The expected rate of return may be taken at 10%.

[Ans.: Value of share Rs. 11.70, Average Profit Rs. 11,700; Rate of dividend 11.70%]
(Note: We have taken into account losses of two years as per Income Tax Act, because loss can be carried forward and can be deducted from profit upto next 8 years)

Q-10: The Share capital of a company is as follows:

	Rs.
(1) 10000 A equity Shares, Rs.100 each fully paid	10,00,000
(2) 10000 B equity Shares, of Rs.100 each Rs.60 paid	6,00,000
(3) 10000 C equity Shares, of Rs.100 each, Rs.50 paid	5,00,000
Paid up Capital	21,00,000
(4) General Reserve	6,00,000
(5) Creditors	3,00,000
Total	30,00,000

The after Tax average Profit of the company is estimated to be Rs.2,00,000. The expected rate of return in such type of Business is 10%.

Find out the value of Shares by-

(1) Intrinsic Value Method
(2) Yield Method.

[Ans.: Intrinsic Value of 'A' share Rs. 120, 'B' share Rs. 80, 'C' share Rs. 70;
Yield Value of 'A' share Rs. 95.20, 'B' share Rs. 57.12, 'C' share Rs. 47.60]

Q-11: From the following balance Sheet as on 31-3-2023 and additional particulars of the Aneri Co. Ltd., calculate the value of the goodwill of its business and the intrinsic value of Shares there after:

Particulars	**Note**	**Rs.**
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital: 9% Pref. Shares Of Rs.100 Each		10,00,000
Equity Shares Of Rs.100 each fully paid		10,00,000
Equity Shares Of Rs.100 each, Rs.50 paid-up		10,00,000
(b) Reserve & Surplus: General Reserves		6,00,000
(2) Non-Current Liabilities:		
(a) Long-Term Borrowings: 12% Debentures		10,00,000

(b) Long-Term Provisions: Provident Fund		25,000
(3) Current Liabilities:		
(a) Trade Payables: Creditors		75,000
(b) Short Term Provisions: Provision For Taxation		4,00,000
Proposed Dividend: Equity		2,10,000
Preference		90,000
Total		**54,00,000**
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets: Land & Building		20,00,000
Machinery		20,00,000
Furniture		2,00,000
Intangible Assets: Goodwill		1,80,000
(b) Non-Current Investments: 10% Government Securities		2,00,000
(c) Other Non-Current Assets: Preliminary Expenses		20,000
(2) Current Assets:		
(a) Inventories: Stock		2,00,000
(b) Trade Receivables: Debtors		4,00,000
(c) Cash and Cash Equivalents: Bank Balance		1,50,000
Cash Balance		50,000
Total		**54,00,000**

Additional Information:-

(1) Book value of Land & Building is 50% more than market value. Land & building is to be valued at their market value, while the value of other assets is considered to be their book value.
(2) Income-Tax assessment up to the 2021-2022 is completed and there remains no liability for that. The provision for taxation, equity to 50% of profit, is crested for this year.
(3) The profit of the company before tax for last 3 years is increasing every year by Rs.120000
(4) Value of Goodwill is to be calculated at 2 years' Purchase of Super Profit.
(5) The market Price of Shares of the company, doing Similar Business and giving dividend at 30% is 3 times of its paid up value.

[Ans.: Capital Employed Rs. 44,10,000; Expected profit Rs. 4,41,000; Average profit Rs. 2,60,000; Super Profit Rs. – 1,81,000; Goodwill = NIL (As there is no super profit, there can be no goodwill). Intrinsic value of fully paid share Rs. 187, partly paid share Rs. 137 (Net Assets Rs. 56,10,000 ÷ 30,000 shares)]

Q-12: The Balance Sheet of Bindra Ltd. as on 31-3-2023 is given below:

Particulars	Note	Rs.
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital: 10% Cum. Red. Pref. Shares of Rs. 10 each		5,00,000

Equity Shares of Rs. 10 each, Rs. 8 paid up		8,00,000
(b) Reserve & Surplus: General Reserve		6,00,000
(2) Non-Current Liabilities:		
(a) Long-Term Borrowings: 12% Debentures		5,00,000
(3) Current Liabilities:		
(a) Trade Payables: Creditors		4,00,000
Total		**28,00,000**
II. Assets		
(1) Non-Current Assets:		
(a) Fixed Assets:		
Tangible Assets: Land and Building		5,00,000
Plant and Machinery		12,00,000
Furniture		1,50,000
(b) Other Non-Current Assets: Preliminary Expenses		1,00,000
(2) Current Assets:		
(a) Inventories: Stock		4,00,000
(b) Trade Receivables: Debtors		2,00,000
Bills Receivable		1,00,000
(c) Cash and Cash Equivalents: Bank Balance		1,50,000
Total		**28,00,000**

Additional Information:

(1) The present value of the assets of the company is to be taken as double.
(2) The goodwill of the company is to be valued at three times the average super profit of last three years.
(3) Average profits of last three years after deducting tax at 50% is Rs. 6,00,000.
(4) For the last three years, the company has been transferring 25% of the profit after taxes every year to its General Reserve Account.
(5) The expected rate of return in the Company's line of business is 10%. From the above information, find out the fair value of the equity shares of the company.

[Ans.: Capital Employed Rs. 35,50,000; Expected Profit Rs. 3,55,000; Average Profit Rs. 5,50,000; Super Profit Rs. 1,95,000; Goodwill Rs. 5,85,000; Intrinsic Value of Share Rs. 41.35 (Net Assets Rs. 41,35,000 ÷ 100,000 shares); Market Value of Share Rs. 40, Rate of Dividend 50%; Fair Value of Share Rs. 40.675]

UNIT-11 UNDERWRITING COMMISSION

11.1 Introduction and Meaning

11.2 Classification of Applications

11.3 Types of Underwriting Contract

11.4 Sub Underwriting Contract

11.5 Statement of Liability of Underwriters (No Firm Underwriting)

11.6 Accounting Entries Relating to Underwriting of Shares

- **Exercises**

11.1 Introduction and Meaning

A public company has to collect certain amount of minimum share capital to get the certificate to commence business, after it has obtained a certificate of incorporation. This minimum amount is called "Minimum Subscription". The amount of minimum subscription is determined by the directors. If the company does not get the minimum subscription, it has to return the share application money and the company cannot start business. Now the situation is that as per notification issued by the finance Ministry and also as per SEBI Guidelines issued in 2000, the company should receive share application up to 90% of the whole issue. If subscription is not received to the extent of 90% of the shares issued, the application money has to be returned. In order to avoid uncertainty of getting required subscription, the company enters into an underwriting of getting required subscription, the company enters into an underwriting agreement, by which the underwriters guarantee to buy unsubscribed shares.

"Underwriting is an agreement entered into by the company with the underwriters, by which underwriters agree that, in the event of the public not taking up the whole of the issue, they will, for an agreed commission, take up such part of the shares as the public has not applied for."

Underwriting commission the consideration payable to the underwriters for underwriting the issue of shares or debentures of a company is called underwriting commission. Such a commission is paid at a specified rate on the issue price of the whole of the shares or debentures underwritten whether or not the underwriters are called upon to take up any shares or debentures. Thus, the underwriters are paid for the risk they bear in the placing of shares before the public. Underwriting commission may be in addition to brokerage.

Payment of Underwriting Commission Section 40 (6) of the Companies Act, 2013:

A copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration. Thus, the Underwriting Commission is limited to 5% of issue price in case of shares and 2.5% in case of debentures. The rates of commission given above are maximum rates. The company is free to negotiate lower rates with underwriters.

The persons who underwrite the issue are known as underwriters. In case of large issues two or more persons or institutions jointly underwrite the issue. Each of them will underwrite a specified amount.

- The underwriters undertake a great deal of risk and so they get commission from the company. The rate of underwriting commission is determined according to the bargaining capacity of the company, subject to the maximum percentage laid down by the companies act.

- The underwriters make a detailed study of the financial position of the company, the demand of the industry, the market condition etc. before entering into such an agreement.

- When they are required to take up certain number of shares, they apply to subscribe for such shares and a resolution is passed in the meeting of Board of directors for sanctioning it.

- There is a difference between underwriting commission and brokerage. In underwriting, the underwriters guarantee that they would take up those shares which are not subscribed by the public. But the brokers simply help the company by persuading the public to apply for shares. They do not give any guarantee. Their remuneration is known as brokerage.

11.2 Classification of Applications

When the issue is underwritten by two or more underwriters, then to determine the liability of underwriters, applications received are classified into two groups:

(1) Marked Applications and (2) Unmarked Applications.

Marked Applications are those applications which bear the name, stamp, and code number of the underwriter. In case, issue is not fully subscribed, marked applications will be taken into consideration to determine underwriters' liability. Sometimes, when quantity of applications is too large (issue being the mega issue) underwriters get their name, code no. etc. printed on the applications.

The applications which are not marked are unmarked applications. In these applications form there is no name, code no. or stamp of any underwriter. These types of applications form are blank i.e., without name and stamp of underwriter and are received directly form the public by the company.

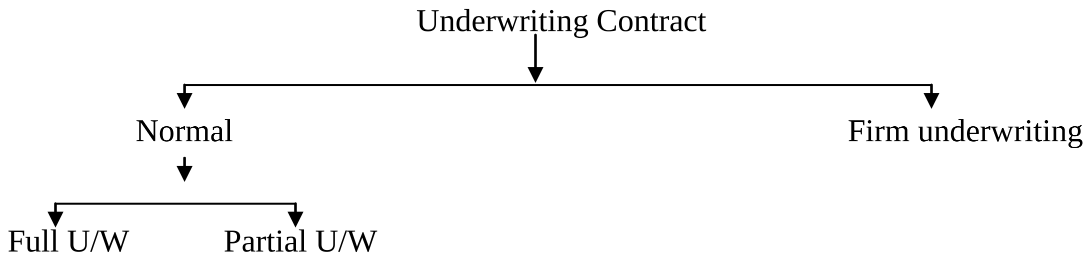
Unmarked applications are divided amongst underwriters in ratio of gross liability.

There will be no use of this distinction, if whole issue is underwritten by only one underwriter.

When the whole issue is fully subscribed by the public, the classification of marked and unmarked applications becomes immaterial.

11.3 Types of Underwriting Contract

Underwriting contract or Agreement can be following types.



A) Normal underwriting can be divided into two categories

(i) Full or whole underwriting and
(ii) Partial underwriting

(i) Full or whole underwriting: In this type of contract underwriters fully underwrite the public issue assuring the company that if shares or debentures offered to public is not fully subscribed the unsold portion of the issue will be purchased by the underwriters. If the issue is fully subscribed then there will be no liability on part of underwriter to take up any share. Underwriters' liability can be determined by following way:

Shares offered to public less shares subscribed by public = unsubscribed shares to be taken up by underwriters.

If there are more than one underwriter giving the guarantee, then to decide the liability of each underwriter, statement showing liability should be prepared?

(ii) Partial underwriting: When a part of the whole issue is underwritten by underwriters than it is called partial underwriting. For example, if a company made public issue of 1, 00,000 shares but underwriting contract is for 60,000 shares only then it is partial underwriting. For balance of shares, company is liable for selling the shares. Underwriting commission will be calculated on the amount of shares underwritten only.

In case of partial underwriting the company is treated as having underwritten the remaining shares. Benefit of unmarked applications is given to company and no credit is given to underwritten the remaining shares. Benefit of unmarked applications is given to company and no credit is given to company and no credit is given to underwriter for unmarked applications.

B) Firm underwriting: When the underwriter agrees to take up a specified number of shares irrespective of the results of the public response to the issue the agreement is known as Firm underwriting. Company is bound to allot the specified number of shares to the underwriters for which they have given firm guarantee.

Total liability of the underwriter in the case of firm underwriting will be:
Net liability as per underwriting contract plus no. of shares under firm underwriting = Total Liability of u/w.

11.4 Sub Underwriting Contract

Sometimes the underwriter enters into a contract with another underwriter to reduce his liability. This contract is known as sub-underwriting to reduce his liability. This contract is between main underwriter and sub underwriter. So, company has no concern with this matter.

In sub-underwriting contract, the sub-underwriters accept to underwrite certain portion of the issue and in consideration he gets sub-underwriting commission as decided with underwriter. Most probably this rate always remains lower than the rate of commission agreed with the company. This company to sub-underwriter is paid by the underwriter.

The main responsibility of sub-underwriter is to share the liability of underwriter when underwriter has to purchase, shares at the time public issue not fully subscribed. Sub underwriter will purchase the shares in proportion of liability he has undertaken.

No entry or transaction is recorded in books of company regarding this contract. Sub underwriter cannot ask commission from company. This contract is entirely between underwriter and company is unknown party to this.

When an issue is underwritten by more than one underwriter i.e. a case of Joint Underwriting, a difficulty may arise in deciding the basis on which unmarked applications should be allocated among different underwriters. The allocation between the underwriters can be done by any one of the two methods:

1. To be allocated in the ratio of gross liability.
2. To be allocated in the ratio of liability as calculated (in step 3) after reducing marked applications from gross liability.
3. Total Applications Received = Total Un-Marked Applications + Total Marked Applications

11.5 Statement of Liability of Underwriters (No Firm Underwriting)

Step	Particulars	Basis	A	B	C	Total
1	Gross liability (As Underwritten)	Agreed Ratio	xxx	xxx	xxx	xxx
2	Less: Marked Application	Actual	xxx	xxx	xxx	xxx
3	Balance	(1 – 2)	xxx	xxx	xxx	xxx

4	Less: Un Marked Application	GL / (3)	xxx	xxx	xxx	xxx
5	Net Liability	(3 – 4)	xxx	xxx	xxx	xxx

11.6 Accounting Entries Relating to Underwriting of Shares

1. If shares or debentures are issued at par
   Underwriter's Account Dr
   To share capital A/c
   (with nominal value of shares allotted to him)

2. If shares or debentures are issued at premium
   Underwriter's Account Dr
   To share capital A/c
   To Shares premium A/c
   (with the capital amount and premium allotted to underwriter)

3. If shares or debentures are issued at discount
   Underwriter's Account Dr
   Discount on issue of shares A/c Dr
   To share capital Account
   (with shares are issued at discount i.e. Net price with discount)

4. When underwriting commission due to underwriter
   Commission (shares) Dr
   To Underwriter Account
   (with the commission on shares)

5. If the final balance due from underwriter to the company
   Bank Account Dr
   To underwriter Account
   (with the final balance received from underwriter)

6. If the final balance is due from the company to the underwriter
   Underwriter's Account Dr
   To Bank Account
   (with the amount paid in cash)

Illustration - 1:

Tara Ltd decided to issue 1,00,000 equity shares. The whole issue was underwritten by 3 Underwriters S 40%, H 30% and I 30%. Applications for 80,000 shares were received in all out of which applications for 20,000 shares had the stamp of S, those for 10,000 shares had the stamp of H, and 20,000 shares had the stamp of I. The remaining applications did not bear any stamp. Calculate the liability of underwriters.

Solution:

Total Applications Received = Total Un Marked Applications + Total Marked Applications

Total Un-Marked Applications = Total Applications Received – Total Marked Applications

Total Un-Marked Applications = 80,000 – (20,000 + 10,000 + 20,000)
Total Un-Marked Applications = 80,000 – 50,000
Note: Total Un-Marked Applications = 30,000 Shares

Since the question does not mention about how to allocate the un-marked applications among the underwriters, mention the same as assumption i.e., allocating un marked application in the ratio of gross liability should be preferred. Un-marked applications to be allocated in the ratio of Gross Liability

Statement of Liability of Underwriters (No. Of Shares)

Step	Particulars	Basis	S	H	I	Total
1	Gross liability (As Underwritten)	4:3:3	40,000	30,000	30,000	1,00,000
2	Less: Marked Application	Actual	(20,000)	(10,000)	(20,000)	(50,000)
3	Balance	(1 – 2)	20.000	20.000	10,000	50,000
4	Less: Un Marked Application	Gross Liability (4:3:3)	(12,000)	(9,000)	(9,000)	(30,000)
5	**Net Liability**	**(3 – 4)**	**8,000**	**11,000**	**1,000**	**20,000**

Illustration- 2:

S Ltd decided to issue 50,00,000 Equity shares of Rs 10 each. The whole issue was underwritten by X, Y and Z as below:

X: 15,00,000 Shares
Y: 25,00,000 Shares
Z: 10,00,000 Shares

Applications were received for 48,50,000 shares, of which the marked applications were as follows:

X: 12,00,000 Shares
Y: 25,00,000 Shares
Z: 8,50,000 Shares

Calculate the number of shares to be taken up by the underwriter's, unmarked applications are to be distributed amongst the underwriters in the ratio of their gross liability.

Solution:

Total Applications Received = Total Unmarked Applications + Total Marked Applications

Total Un Marked Applications = Total Applications Received – Total Marked Applications

Total Un Marked Applications = 48,50,000 – (12,00,000 + 25,00,000 + 8,50,000)
Total Un Marked Applications = 48,50,000 – 45,50,000
Total Un Marked Applications = 3,00,000 Shares

Statement of Liability of Underwriters

Step	Particulars	Basis	X	Y	Z	Total
1	Gross liability (As Underwritten)	3:5:2	15,00,000	25,00,000	10,00,000	50,00,000
2	Less: Marked Application	Actual	(12,00,000)	(25,00,000)	(8,50,000)	(45,50,000)
3	Balance	(1 – 2)	3,00.000	0	1,50,000	4,50,000
4	Less: Un Marked Application	3:5:2	(90,000)	(1,50,000)	(60,000)	(3,00,000)
5	Balance	(3 – 4)	2,10,000	(1,50,000)	90,000	1,50,000
6	Less: Surplus of B adjusted	3:2	(90,000)	1,50,000	(60,000)	0
7	**Net Liability**	**(5 – 6)**	**1,20,000**	**0**	**30,000**	**1,50,000**

Illustration-3:

A Ltd decided to issue 1,00,000 equity shares. The whole issue was underwritten by 5 underwriters as follows - X: 25%, Y: 15%, W: 10%, P: 30% and Z: 20%. Applications bearing stamp of underwriters, X: 13,750, Y: 10,250, W: 9,250, P; 8,250, Z: 8,500 were received. 30,000 Shares did not bear mark of any underwriter. Find the liability of individual underwriters. Unmarked applications are to be distributed amongst the underwriters in the ratio of their liability.

Solution:

Total Applications Received = Total Unmarked Applications + Total Marked Applications

Total Applications Received = 30,000 + (13,750 + 10,250 + 8,250 + 9,250 + 8,500)

Total Applications Received = 30,000 + 50,000
Total Applications Received = 80,000

Statement of Liability of Underwriters

Step	Particulars	Basis	X	Y	W	P	Z	Total
1	Gross liability (As Underwritten)	5:3:2:6:4	25,000	15,000	10,000	30,000	20,000	1,00,000
2	Less: Marked Application	Actual	(13,750)	(10,250)	(9,250)	(8,250)	(8,500)	(50,000)
3	Balance	(1 – 2)	11,250	4,750	750	21,750	11,500	50,000
4	Less: Unmarked App.	5:3:2:6:4	(7,500)	(4,500)	(3,000)	(9,000)	(6,000)	(30,000)
5	Balance	(3 – 4)	3,750	250	(2,250)	12,750	5,500	20,000
6	Less: Surplus of C adjusted	5:3:6:4	(675)	(375)	2,250	(750)	(250)	0
7	Balance	(5 – 6)	3,125	(125)	0	12,000	5,000	20,000
8	Less: Surplus of B adjusted	5:6:4	(42)	125	0	(50)	(33)	0
9	**Net Liability**	**(7 – 8)**	**3,083**	**0**	**0**	**11,950**	**4,967**	**20,000**

Illustration: - 4

X Company issued applications 36,000 of equity shares of 100 each. The issue was fully underwritten by A, B and C equally. Applications were received for 32,000 shares out of which marked applications were as follows.

A: 12,000
B: 8,000
C: 6,000
Determine liability of A, B and C and pass journal entries commission 5%

Solution:

Calculations of unmarked applications.
Total Applications Received 32,000
Less: Marked Applications 26,000
6,000

Particulars	A	B	C
Gross liability	12,000	12,000	12,000
Less: Unmarked applications	2,000	2,000	2,000
(Gross Liability Ratio 1:1:1)			
	10,000	10,000	10,000
Less Marked Applications	12,000	8,000	6,000

	(2,000)	2,000	4,000
Surplus of A distributed to B, C in gross Liability (1:1)	2,000	1,000	1,000
Net Liability	-	1,000	3,000

Calculations of Commission:

X – 12000 × 100 = 12,00,000 × 5% = 60,000
Y – 12000 × 100 = 12,00,000 × 5% = 60,000
Z – 12000 × 100 = 12,00,000 × 5% = 60,000

Journal

Bank Account Dr 32,00,000
To Equity share capital 32,00,000

(Being allotment of 32,000 shares at 100 per share)

Y's Account (1000 × 100) Dr 1,00,000
Z's Account (3000 × 100) Dr 3,00,000
To Equity share capital Account 4,00,000
(Being unsubscribed shares taken by Underwriters)

Underwriting Commission A/c Dr. 1,80,000

To X's Account 60,000
To Y's Account 60,000
To Z's Account 60,000
(Being U. Commission due to underwriters at 5% on issue price of shares)

X's Account Dr. 60,000
To Bank Account
(Being amount paid on final settlement)

Bank Account 2,80,000
To Y's Account (1,00,000-60,000) 40,000
To Z's Account (3,00,000-60,000) 2,40,000
(Being final balance due to from Y and Z and received in cash on final settlement)

❖ **Exercises**

1. The Maheshwari Ltd. issued 50,000 shares of Rs. 10 each. M/s. Dharampal and sons entered into an underwriting agreement for underwriting the whole of the issue at a commission of 4% on shares. Applications were received for 46,000 shares from the public and remaining shares were taken up by the underwriters. Cash was received on all the shares. Pass journal entries in the books of the company.

2. A Ltd. issued 1,00,000 shares of Rs. 10 each of 1-7-2022. Chamanlal and sons entered into an underwriting agreement for the subscription of whole of the public issue at a commission of 5% on shares. The public subscribed for 96,000 shares and rest had to be taken up by the underwriter, out of which 3,000 shares were sold at Rs. 9 per share. These shares were subsequently quoted in the market at Rs. 8 per share on 31-12-2022. Prepare underwriting account in the books of Chamanlal and sons.

3. A company issuing 10,000 shares of Rs. 10 each at par, enters into an agreement of underwriting these shares with A and B in the ratio of 3: 2. Applications for 6,000 shares were received from public inclusive of marked applications of A 4,000 shares and B 1,000 shares and for the rest of 1,000 shares applications were received by the company directly.

4. A Ltd. issued a prospectus inviting applications for 8,00,000 equity shares of Rs. 10 each at a premium of 10 per cent.
The whole issue was fully underwritten by Abhijeet, Kalpesh, Sagar and Ramesh as follows:

Abhijeet	3,20,000 shares	Sagar	1,60,000 shares
Kalpesh	2,40,000 shares	Ramesh	80,000 shares

Applications were received for 7,00,000 shares of which marked applications were as follows:

Abhijeet	3,40,000 shares	Sagar	1,70,000 shares
Kalpesh	1,60,000 shares	Ramesh	10,000 shares

It was agreed that underwriters be paid commission at 5% on the issue price.
From the above information, find out the liabilities of individual underwriters and give necessary journal entries in the books of the company.

5. Samson Ltd. issued 90,000 shares each of Rs. 10. Following three underwriters have taken responsibility as under:

Paresh: 45,000 shares, Parag: 4,500 shares; Pravin 15,000 shares.

They have also agreed for fixed underwriting for following shares:

Paresh: 7,500 shares, Parag: 4,500; Pravin: 4,500 shares.

The company received applications for 60,000 shares which does not include fixed underwriting. Out of these, marked applications were as under for 45,000 shares.

Paresh: 18,000 shares, Parag: 15,000 shares; Pravin: 12,000 shares.

(1) fix the liability of each underwriter. No credit is given for fixed underwriting.
(2) Give journal entries in the books of Samson Ltd.
(3) 5% commission is to be paid to underwriters. **(Sau. Uni. T.Y. - April. 2006)**

6. Golmaal Ltd. makes a public issue of 1,50,000 shares of Rs. 10 each at the premium of 10%. Underwriters Mr. Aan, Ban and Shan underwrite whole issue on equal basis. Company received total applications for 1,40,000 shares. Particulars regarding applications received are as under:

Underwriter	Applications regarding firm u/w	Marked applications	Total
Aan	5,000	40,000	45,000

Ban Shan Unmarked applications	5,000 3,000 -	45,000 34,000 -	50,000 37,000 8,000
	13,000	1,19,000	1,40,000

The underwriters settled their accounts. You are required to prepare:

(1) A statement showing the liability of the underwriters.
(2) Journalise the above transactions in the books of Golmaal ltd.

7. Anand Co. ltd offers to Public 1,50,000 equity shares of Rs.100 each at par. Application money is Rs. 60 per share and at the time of allotment Rs. 40. A, B and C underwrite the whole issue in equal proportion and will be paid 5% commission for this. Applications for 1,40,000 shares were received details of which are as under:

Under Writer	Applications for firm underwriting	Marked Applications	Total
A	5,000	40,000	45,000
B	5,000	46,000	51,000
C	3,000	34,000	37,000
Unmarked Applications			7,000
Total Applications recd. For shares			1,40,000

It is decided to credit unmarked applications to A and C in equal proportion Anand Ltd. allotted the shares to public and received allotment money also. All the transactions with underwriters are also settled.

1) Prepare statement showing liability of underwriters.
2) Pass journal entries in books of Anand Ltd.

8. Kena ltd. made public issue of 5,00,000 equity shares of Rs. 10 each at the premium of Rs.2 per share. Entire issue was underwritten as below:

Chintan	1,50,000 shares
Shashavat	1,25,000 shares
Nilesh	1,25,000 shares
Shailesh	1,00,000 shares

In addition, they have also given firm underwriting for Rs. 12,000, Zero 8,000 and 28,000 shares respectively. At the time of determining liability, this firm underwriting is given as credit.

Applications, except applications for firm underwriting, received were for 30000, Nilesh 20000 and Shailesh 500000 shares. Application money is decided Rs. 12 per share including Rs.2 premium per share. Underwriters are entitled for commission at 4%. Determine the liability of underwriters and pass journal entries in books of the company.

UNIT-12	CAPITAL REDUCTION

12.1 Introduction

12.2 Meaning of Capital Reduction

12.3 Objectives of Capital Reduction

12.4 Types / Methods of Capital Reduction

12.5 Legal Framework (Under the Indian Companies Act, 2013)

12.6 Impact of Capital Reduction

12.7 Accounting Treatment

12.8 Journal Entries for Capital Reduction

12.9 Pro-forma of Capital Reduction Account

- **Illustrations**
- **Exercises**

12.1 Introduction

Capital reduction is a process undertaken by companies to restructure their share capital. It is often implemented to adjust a company's financial position and eliminate losses, overvalued assets, or excess capital that is not being utilized effectively. This process is highly regulated under corporate laws, such as the **Companies Act, 2013** in India, to ensure the protection of shareholders' and creditors' interests.

Capital reduction typically involves reducing the face value of shares, cancelling unpaid share capital, or writing off accumulated losses. This helps a company realign its capital structure, improve financial ratios, and prepare for future growth.

12.2 Meaning of Capital Reduction

Capital Reduction refers to the process of decreasing a company's share capital, either to eliminate financial losses or to distribute surplus funds back to shareholders. It is a legal procedure that alters the share capital structure without impacting the operational aspects of the business.
The reduction may involve:

1. **Reducing the Face Value of Shares:** For example, reducing shares with a face value of ₹10 to ₹5 each.
2. **Cancelling Unpaid Share Capital:** Eliminating the liability of unpaid amounts on shares.
3. **Writing off Accumulated Losses:** Adjusting the share capital to eliminate past losses reflected in the balance sheet.

Capital reduction is governed by **Sections 66** of the Companies Act, 2013 in India and requires approval from shareholders, the National Company Law Tribunal (NCLT), and adherence to prescribed legal formalities.

12.3 Objectives of Capital Reduction

- **Eliminate Accumulated Losses:** To remove past losses from the balance sheet and enable the declaration of dividends.
- **Restructure Capital:** To optimize the capital structure and reduce excess or idle share capital.
- **Improve Financial Health:** To enhance the company's net worth by writing off fictitious assets or unrealized expenses.
- **Return Surplus to Shareholders:** To repay shareholders for excess funds that the company does not require.

12.4 Types / Methods of Capital Reduction

1. Reduction in the Face Value of Shares

This involves reducing the nominal (or face) value of the shares while keeping the number of shares unchanged. The reduction in the face value lowers the paid-up share capital of the company. This method is commonly used to adjust the capital structure or eliminate fictitious assets like accumulated losses or goodwill.

Example:

A company with 1,00,000 equity shares of ₹10 each (₹10,00,000 total capital) reduces the face value of shares to ₹5 each. The new share capital will be ₹5,00,000, and the reduction of ₹5,00,000 can be used to eliminate accumulated losses.

Journal Entry:

Equity Share Capital A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000

2. Cancellation of Unpaid Share Capital

This involves cancelling the portion of share capital that is unpaid by shareholders. For example, if shares are partly paid (e.g., ₹6 paid on shares with a face value of ₹10), the company may cancel the unpaid portion (₹4 per share). This method reduces the liability of shareholders for calls on unpaid shares.

Example:

A company with 1,00,000 shares of ₹10 each, where ₹6 per share is paid up, cancels the unpaid ₹4 per share. The total reduction is ₹4,00,000.

Journal Entry:

Equity Share Capital A/c	Dr.	4,00,000	
To Capital Reduction A/c			4,00,000

3. Writing Off Accumulated Losses

This type of capital reduction involves using the reduced capital amount to eliminate accumulated losses or fictitious assets in the balance sheet. This helps the company clean up its financial statements and improve its ability to declare dividends in the future.

Example:

A company with accumulated losses of ₹8,00,000 reduces its share capital from ₹10,00,000 to ₹2,00,000. The amount written off (₹8,00,000) is used to eliminate losses.

Journal Entry:

Equity Share Capital A/c	Dr.	8,00,000	
To Profit & Loss A/c			8,00,000

12.5 Legal Framework (Under the Indian Companies Act, 2013)

- Governed by **Section 66 of the Companies Act, 2013**.
- Requires approval by a **special resolution** passed by shareholders.
- Requires confirmation by the **National Company Law Tribunal (NCLT)**.
- Creditors' consent may be required to ensure their interests are protected.
- Filing necessary documents with the Registrar of Companies (ROC).

12.6 Impact of Capital Reduction

- **On Shareholders:** Face value or the number of shares may reduce, but the overall value of their investment remains the same.
- **On Creditors:** Creditors' claims remain unaffected unless the reduction impacts their security.
- **On Company:** Financial statements are realigned, enabling better performance and financial transparency.

12.7 Accounting Treatment:

Steps for Accounting Treatment

1. **Pass Journal Entries for Reduction**

   Depending on the method of capital reduction, entries are passed to:

   - Reduce the paid-up share capital.
   - Adjust or write off losses or fictitious assets.
   - Return surplus capital to shareholders.

2. **Adjust the Balance Sheet**

   After passing journal entries, the balance sheet is updated to reflect the new capital structure.

3. **Close the Capital Reduction Account**

   The Capital Reduction Account is closed by transferring the amounts to the appropriate accounts (e.g., Profit & Loss Account, Reserves, or Asset Accounts).

12.8 Journal Entries for Capital Reduction

1. Reduction of Paid-Up Share Capital

If the face value of shares is reduced, the reduction is recorded as follows:

Equity Share Capital A/c   Dr.

To Capital Reduction A/c

2. Writing 0ff Accumulated Losses

The amount in the Capital Reduction Account is used to eliminate accumulated losses in the Profit & Loss Account.

Capital Reduction A/c   Dr.

To Profit & Loss A/c

3. Writing off Fictitious or Overvalued Assets

The Capital Reduction Account can also be used to write off fictitious assets (e.g., preliminary expenses, goodwill) or overvalued assets.

Capital Reduction A/c   Dr.

To Asset A/c

4. Cancellation of Unpaid Share Capital

When unpaid share capital is cancelled, the entry reflects the reduction in liability.

Equity Share Capital A/c   Dr.

To Capital Reduction A/c

5. Return of Surplus Capital to Shareholders

If the company returns surplus funds to shareholders, the following entry is passed:

Equity Share Capital A/c   Dr.

To Bank A/c

6. Transfer to Capital Reserve (If Applicable)

If the capital reduction results in surplus (e.g., after writing off losses or fictitious assets), the remaining amount is transferred to the **Capital Reserve Account**.

Capital Reduction A/c   Dr.

To Capital Reserve A/c

12.9 Pro-forma of Capital Reduction Account

Capital Reduction Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Profit & Loss A/c(Debit balance)	--	By Pref. Share Capital A/c	--
To Intangible Assets A/c (Goodwill etc.)	--	By Equity Share Capital A/c	--
To Fictitious Assets A/c (Preliminary expenses; Debentures Discount A/c etc.)	--	By Securities Premium A/c	--
To Current Assets A/c (Stock etc.)	--	By Outstanding Debentures Interest A/c	--
To Fixed Assets A/c (Land-building, Plant Machinery etc.)	--	By Creditors A/c (Amount waived)	--
To Preference Dividend A/c	--	By General Reserve A/c	--
To Capital Reserve A/c (Difference)	**?**	By Profit & Loss A/c (If Credit balance)	--
	--		--

❖ Illustrations:

Illustration – 1: The balance sheet of Sanjay Ltd. as on 31st March, 2023 was as under:

Particulars	Notes	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholder's Funds:		
(a) Share Capital :		
10,000 Equity Shares of Rs.100 each fully paid-up		10,00,000
15,000 7% Pref. Shares of Rs.100 each fully paid-up		15,00,000
(b) Reserves & Surplus : Profit & Loss A/c (Dr.)		(2,30,000)
(2) Current Liabilities:		
(a) Trade Payable : Creditors		60,000

(b) Other Current Liabilities : Bank Overdraft		40,000
Total		**23,70,000**
II. Assets:		
(1) Non-Current Assets :		
(a) Fixed Assets:		
(i) Tangible Assets:		
Leasehold Buildings		2,61,600
Plant and Machinery		84,400
(ii) Intangible assets : Patents		17,00,000
(b) Other Non-Current Assets:		
Discount on Debentures		36,000
Preliminary Expenses		24,000
(2) Current Assets:		
(a) Inventories : Stock		1,10,000
(b) Trade Receivable : Debtors		1,53,000
(c) Cash and Cash Equivalents : Cash Balance		1,000
Total		**23,70,000**

Due to heavy losses, the scheme of reduction of capital is accepted and as a result the following capital reduction fund account is created:

Capital Reduction Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Profit & Loss	2,30,000	By Equity Share Capital A/c	7,50,000
To Preliminary expenses	24,000	By Pref. Share Capital A/c	7,50,000
To Discount on Debentures	36,000		
To Leasehold Property	61,600		
To Stock	30,000		
To Plant Machinery	16,880		
To Bad Debts Reserve	30,600		
To Patents	10,00,000		
To Capital Reserve	70,920		
	15,00,000		**15,00,000**

Pass necessary Journal entries in the books of the company and also prepare balance sheet after capital reduction.

Solution:

Journal Entries in the books of Sanjay Ltd.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1	Equity Share Capital A/c Dr.		7,50,000	
	Pref. Share Capital A/c Dr.		7,50,000	
	To Capital Reduction A/c			15,00,000
	(Being Equity Share Capital and Pref. Share Capital reduced as per scheme of Capital Reduction)			
2	Capital Reduction A/c Dr.		12,90,000	
	To Profit & Loss A/c			2,30,000
	To Preliminary Expenses A/c			24,000
	To Discount on Debentures A/c			36,000
	To Patents A/c			10,00,000
	(Being Capital Reduction A/c is utilized for writing off Fictitious and Intangible Assets)			
3	Capital Reduction A/c Dr.		1,08,480	
	To Leasehold Property A/c			61,600
	To Stock A/c			30,000
	To Plant & Machinery A/c			16,880
	(Being Capital Reduction is utilized to writing off Fixed assets as per scheme of capital reduction)			
4	Capital Reduction A/c Dr.		30,600	
	To Bad Debt Reserve A/c			30,600
	(Being Bad debts reserve written off as per scheme of capital reduction)			
5	Capital Reduction A/c Dr.		70,920	
	To Capital Reserve A/c			70,920
	(Being balance of Capital Reduction A/c transferred to Capital Reserve A/c)			

Sanjay Ltd. (and reduced)

Balance Sheet as on 31-3-2023

Particulars		Notes	Amount
I. EQUITY AND LIABILITIES:			
(1) Shareholders' Funds:			
(a) Share Capital:			
Equity Share Capital (10,00,000 - 7,50,000)			2,50,000
7% Pref. Share Capital (15,00,000 - 7,50,000)			7,50,000
(b) Reserves & Surplus:			
Profit & Loss A/c (-2,30,000 + 2,30,000)			---
Capital Reserve			70,920
(2) Current Liabilities:			
(a) Trade Payables: Creditors			60,000
(b) Other Current Liabilities: Bank Overdraft			40,000
TOTAL			**11,70,920**
II. ASSETS:			
(1) Non-Current Assets:			
(a) Fixed Assets:			
(i) Tangible Assets			
Leasehold Buildings (2,61,600 - 61,600)			2,00,000
Plant & Machinery (84,400 - 16,880)			67,520
(ii) Intangible Assets			
Patents (17,00,000 - 10,00,000)			7,00,000
(b) Other Non-Current Assets:			
Discount on Debentures (36,000 - 36,000)			---
Preliminary Expenses (24,000 - 24,000)			---
(2) Current Assets:			
(a) Inventories: Stock (1,10,000 - 30,000)			80,000
(b) Trade Receivables: Debtors	1,53,000		
Less: Bad debt reserve	30,600		1,22,400
(c) Cash and Cash Equivalents: Cash Balance			1,000
TOTAL			**11,70,920**

Illustration – 2: The balance sheet of Akshat Co. Ltd. as on 31-3-2023 is as follows:

Particulars	Notes	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholder's Funds:		
(a) Share Capital :		
75,000 Equity Shares of Rs.10 each		7,50,000
4,000 6% Cum. Pref. Shares of Rs.100 each		4,00,000
(b) Profit & Loss A/c (Dr.)		(4,35,000)
(2) Non-Current Liabilities:		
(a) Long Term Borrowings:		
6% Secured Debentures		3,75,000
Director's Loan		1,00,000
(3) Current Liabilities:		
(a) Trade Payables : Creditors		3,00,000
(b) Other Current Liabilities:		
Accrued Interest on Debentures		22,500
Bank Overdraft		1,95,000
Total		**17,07,500**
II. Assets:		
(1) Non-Current Assets :		
(a) Fixed Assets:		
(i) Tangible Assets:		
Freehold Property		4,25,000
Plant		50,000
(ii) Intangible assets :		
Goodwill		1,30,000
Patents		37,500
(b) Non-Current Investments		55,000
(c) Other Non-Current Assets :		
Preliminary Expenses		1,00,000
(2) Current Assets:		
(a) Inventories : Stock		4,25,000
(b) Trade Receivable : Debtors		4,85,000
Total		**17,07,500**

The Tribunal approved a scheme of re-organisation to take effect on 1st April, 2023 whereby-

(1) The 6% Cumulative Preference shares to be written down to Rs.75 each and equity shares to Rs.2 each.

(2) Of the Cumulative preference shares dividends which are in arrears for 4 years, 3/4 to be waived and equity shares of Rs.2 each to be allotted for the remaining.

(3) Accrued interest on Debentures to be paid in cash.

(4) Debenture holders agreed to take over freehold property, book value of Rs.1,00,000 at a valuation of Rs.1,20,000 in part payment of their holding and to provide additional cash of Rs.1,30,000 secured by a floating charge on company's assets at an interest rate 8% annually.

(5) Patents, goodwill and preliminary expenses to be written off.
(6) Stock to be written off by Rs.65,000.
(7) Amount of Rs.68,500 of be provided for bad debt.
(8) Remaining freehold property to be re-valued at Rs.3,87,500.
(9) Trade Investments be sold for Rs.1,40,000.
(10) Directors to accept settlement of their loan as to 90% thereof by allotment of equity shares of Rs.2 each and as to 5% in cash, the balance 5% being waived.
(11) There were capital commitments totalling Rs.2,50,000. These contracts, are to be cancelled on payments of 5% of the contract price as a penalty.

You are required to show journal entries relating to the above transactions (Including cash transactions) and prepare the Balance Sheet of the company after completion of the scheme.

Solution:

Journal Entries in the books of Akshat Co. Ltd.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1	6% Cum. Pref. Share Capital A/c Dr. Equity Share Capital A/c Dr. To Capital Reduction A/c (Being Equity Share Capital and Pref. Share Capital reduced as per scheme of Capital Reduction)		1,00,000 6,00,000	 7,00,000
2	Capital Reduction A/c Dr. To Preference Dividend A/c (Being Provision for Pref. Dividend is made)		24,000	 24,000
3	Preference Dividend A/c Dr. To Equity Share Capital A/c		24,000	 24,000

	(Being preference dividend is paid by allotting equity shares of ₹ 2 each)			
4	Outstanding Debenture Interest A/c Dr. To Cash A/c (Being o/s debenture interest is paid in cash)		22,500	 22,500
5	6% Secured Debenture A/c Dr. To Freehold Property A/c To Capital Reduction A/c To Cash/Bank A/c (Being debenture holders agree to collect freehold property and cash)		2,50,000	 1,00,000 20,000 1,30,000
6	Capital Reduction A/c Dr. To Goodwill A/c To Patents A/c To Preliminary Expenses A/c (Being intangible and fictitious assets written off)		2,67,500	 1,30,000 37,500 1,00,000
7	Capital Reduction A/c Dr. To Stock A/c (Being stock is w/o under scheme of capital reduction)		65,000	 65,000
8	Capital Reduction A/c Dr. To Bad debt reserve A/c (Being bad debt reserve is to be provided)		68,500	 68,500
9	Freehold property A/c Dr. To Capital Reduction A/c (Being on revaluation value of freehold property increased)		62,500	 62,500
10	Cash/Bank A/c Dr. To Trade Investment A/c To Capital Reduction A/c (Being Trade Investment to be sold by profit and it is credited to capital reduction)		1,40,000	 55,000 85,000
11	Director’s Loan A/c Dr.		1,00,000	

	To Equity Share Capital A/c To Cash/Bank A/c To Capital Reduction A/c (Being directors accept equity shares for 90%, cash for 5% and remaining 5% waived of their loan)			90,000 5,000 5,000
12	Capital Reduction A/c Dr. To Cash/Bank A/c (Being penalty at 5% are levied on contract price for cancelling contract)		12,500	 12,500
13	Capital Reduction A/c Dr. To Profit & Loss A/c (Being accumulated loss is to be written off under the scheme of capital reduction)		4,35,000	 4,35,000

Capital Reduction Account

Particulars	Rs.	Particulars	Rs.
To Pref. Dividend A/c (Rs. 96,000 x ¼)	24,000	By 6% Pref. Share Capital A/c (4,000 shares x Rs. 25)	1,00,000
To Patents A/c	37,500	By Equity Share Capital A/c (75,000 shares x Rs. 8)	6,00,000
To Goodwill A/c	1,30,000	By Profit on Freehold Property	20,000
To Preliminary Expenses A/c	1,00,000	By Freehold Property A/c (3,87,500 – 3,25,000)	62,500
To Stock A/c (w/o)	65,000	By Profit on Investment (1,40,000 – 55,000)	85,000
To Bad Debt Reserve A/c	68,500	By Director's Loan (waived)	5,000
To Penalty on Contract (2,50,000 x 5%)	12,500		
To Profit & Loss A/c (w/o)	4,35,000		
	8,72,500		**8,72,500**

Akshat Co. Ltd. (and reduced)

Balance Sheet as on 31-3-2023

Particulars	Notes	Amount
I. EQUITY AND LIABILITIES:		
(1) Shareholders' Funds:		
(a) Share Capital:		
Equity Share Capital		264,000
(7,50,000 - 6,00,000 + 24,000 + 90,000)		
6% Cum. Pref. Share Capital (4,00,000 - 1,00,000)		300,000
(b) Reserves & Surplus:		
Profit & Loss A/c (-4,35,000 + 4,35,000)		---
(2) Non-Current Liabilities:		
(a) Long Term Borrowings:		
8% Secured Debentures (3,75,000 - 2,50,000)		125,000
(3) Current Liabilities:		
(a) Trade Payables: Creditors		300,000
(b) Other Current Liabilities: Bank Overdraft		225,000
(-195,000 - 22,500 - 130,000 + 140,000 - 5,000 - 12,500)		
TOTAL		**1,214,000**
II.ASSETS:		
(1) Non-Current Assets:		
(a) Fixed Assets:		
(i) Tangible Assets		
Freehold Property (425,000 - 100,000 + 62,500)		387,500
Plant		50,000
(ii) Intangible Assets		
Goodwill (1,30,000 - 1,30,000)		---
Patents (37,500 - 37,500)		---
(b) Other Non-Current Investments (55,000 - 55,000)		---
(c) Other Non-Current Assets:		---
Preliminary Expenses (1,00,000 - 1,00,000)		---
(2) Current Assets:		

(a) Inventories: Stock (4,25,000 - 65,000)			360,000
(b) Trade Receivables: Debtors	485,000		
Less: Bad debt reserve	68,500		416,500
TOTAL			**1,214,000**

Illustration – 3: The balance sheet of Haresh Ltd. as on 31-3-2023 was as follows:

Particulars	Notes	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholder's Funds:		
(a) Share Capital :		
Equity Shares of Rs.100 each fully paid		4,48,000
9% Pref. Shares of Rs.100 each		2,24,000
(b) Reserve and Surplus : General Reserve		15,680
(2) Non-Current Liabilities:		
(a) Long Term Borrowings:		
10% Debentures		2,24,000
Director's Loan		89,600
(3) Current Liabilities:		
(c) Trade Payables : Creditors		1,12,000
(d) Other Current Liabilities:		
Accrued Int. on Debentures		22,400
Bank Overdraft		53,760
Total		**11,89,440**
II. Assets:		
(1) Non-Current Assets :		
(a) Fixed Assets:		
(i) Tangible Assets:		
Freehold Property		2,24,000
Plant & Machinery		3,02,400
(iii) Intangible Assets :		
Goodwill		56,000
Patents		56,000
Copy Right		15,680

(d) Non-Current Investments		1,12,000
(e) Other Non-Current Assets :		
Preliminary Expenses		20,000
Advt. Suspense A/c		92,000
(c) Current Assets:		
(c) Inventories : Stock		2,01,600
(d) Trade Receivable : Debtors		1,09,760
Total		**11,89,440**

The scheme of capital reduction sanctioned by the Tribunal is as under:

(1) Equity shares are to be written down by Rs.80 each.

(2) Preference shares are to be written down to Rs.60 each.

(3) The Debenture holders agreed to have their accrued interest paid in cash and to take over freehold property, having a book value of Rs.1,12,000 at a valuation of Rs.1,56,800 in part payment of amount due to them.

(4) The Directors accept settlement of their loan as to 80% of thereof by allotment of Equity Shares, 10% in cash and the balance being waived.

(5) The remaining amount is to be utilized in writing down Plant and Stock in the proportion to their book values.

(6) All invisible and intangible assets are to be written off.

You are required to show the Journal Entries and prepare Balance Sheet after Capital Reduction.

Solution:

Journal Entries in the books of Haresh Ltd.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1	Equity Share Capital A/c Dr.		3,58,400	
	9% Pref. Share Capital A/c Dr.		89,600	
	To Capital Reduction A/c			4,48,000
	(Being Equity Share Capital and Pref. Share Capital reduced as per scheme of Capital Reduction)			
2	O/s Debenture Interest A/c Dr.		22,400	
	To Cash/Bank A/c			22,400
	(Being O/s Debenture interest paid in cash)			

3	10% Debenture A/c Dr.		1,56,800	
	To Freehold Property A/c			1,12,000
	To Capital Reduction A/c			44,800
	(Being debenture holders agree to collect freehold Property)			
4	Director's Loan A/c Dr.		89,600	
	To Equity Share Capital A/c			71,680
	To Cash/Bank A/c			8,960
	To Capital Reduction A/c			8,960
	(Being directors accept equity shares for 80%, cash for 10% and remaining 10% waived of their loan)			
5	Capital Reduction A/c Dr.		2,39,680	
	To Goodwill A/c			56,000
	To Patents A/c			56,000
	To Copy Right A/c			15,680
	To Preliminary Expenses A/c			20,000
	To Advertisement Suspense A/c			92,000
	(Being all fictitious and intangible assets are written off under the scheme of capital reduction)			
6	Capital Reduction A/c Dr.		2,62,080	
	To Plant & Machinery A/c			1,57,248
	To Stock A/c			1,04,832
	(Being balance is utilized in writing down P&M and Stock)			

Capital Reduction Account

Particulars	Rs.	Particulars	Rs.
To Goodwill A/c	56,000	By Equity Share Capital A/c (4,480 shares x Rs, 80)	3,58,400
To Patents A/c	56,000	By 9% Pref. Share Capital A/c (2,240 shares x Rs. 40)	89,600
To Copy Right A/c	15,680	By Profit on Freehold	44,800

		Property (1,56,800 – 1,12,000)	
To Preliminary Expenses A/c	20,000	By Director's Loan (waived)	8,960
To Advertisement Suspense A/c	92,000		
To Plant & Machinery A/c (Diff. 2,62,080 x 3/5)	1,57,248		
To Stock A/c (Diff. 2,62,080 x 2/5)	1,04,832		
	5,01,760		**5,01,760**

Haresh Ltd. (and reduced)

Balance Sheet as on 31-3-2023

Particulars	Notes	Amount
I. EQUITY AND LIABILITIES:		
(1) Shareholders' Funds:		
(a) Share Capital:		
Equity Share Capital		161,280
(4,48,000 - 3,58,400 + 71,680)		
9% Pref. Share Capital (2,24,000 - 89,600)		134,400
(b) Reserves & Surplus:		
General Reserve		15,680
(2) Non-Current Liabilities:		
(a) Long Term Borrowings:		
10% Debentures (2,24,000 - 1,56,800)		67,200
(2) Current Liabilities:		
(a) Trade Payables: Creditors		112,000
(b) Other Current Liabilities: Bank Overdraft		85,120
(-53,760 - 22,400 - 8,960)		
TOTAL		**575,680**
II. ASSETS:		
(1) Non-Current Assets:		
(a) Fixed Assets:		
(i) Tangible Assets		

Freehold Property (2,24,000 - 1,12,000)		112,000
Plant & Machinery (3,02,400 - 1,57,248)		145,152
(b) Other Non-Current Investments		112,000
(2) Current Assets:		
(a) Inventories: Stock (2,01,600 - 1,04,832)		96,768
(b) Trade Receivables: Debtors		109,760
TOTAL		**575,680**

❖ **Exercises:**

- **Theoretical Questions:**

  Q-1: Explain the meaning of capital reduction.

  Q-2: What are the objectives of capital reduction?

  Q-3: Explain the types / methods of capital reduction.

  Q-4: What is the legal framework in India for capital reduction?

  Q-5: Explain the impact of capital reduction.

  Q-6: Explain the accounting treatment for capital reduction.

  Q-7: Write journal entries for capital reduction.

  Q-8: Give the pro-forma of capital reduction account.

- **Practical Questions:**

Q-1: The balance sheet of Vikas Co. Ltd. as on 31-3-2023 is as under:

Particulars	Notes	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholder's Funds:		
(a) Share Capital :		
Equity Shares of Rs.10 each fully paid		18,00,000
9% Pref. Shares of Rs.100 each fully paid		12,00,000
(c) Reserves & Surplus :		
Workers Accident Compensation Fund		4,00,000
Profit & Loss A/c (Dr.)		(8,26,000)
(2) Non-Current Liabilities:		
(a) Long Term Borrowings: 8% Debentures		8,00,000
(3) Current Liabilities:		
(a) Trade Payable : Creditors		3,36,000
(b) Other Current Liabilities :		

Unpaid interest on debentures		64,000
Total		**37,74,000**
II. Assets:		
(1) Non-Current Assets :		
(a) Fixed Assets:		
(i) Tangible Assets:		
Land & Buildings		9,60,000
Plant and Machinery		9,74,000
(ii) Intangible assets :		
Goodwill		6,00,000
Patents		3,20,000
(b) Other Non-Current Assets:		
Preliminary Expenses		1,20,000
(2) Current Assets:		
(a) Inventories : Stock		4,00,000
(b) Trade Receivable : Debtors		3,20,000
(c) Cash and Cash Equivalents : Bank Balance		80,000
Total		**37,74,000**

The scheme of capital reduction approved was as under:

(1) Preference Shares and Equity Shares are to be reduced by Rs.20 and Rs.8 per share respectively.

(2) Preference dividend is unpaid for two years, the preference shareholders agreed to waive 3/5 of the dividend and remaining paid for cash.

(3) The debenture holders forego their unpaid interest and for part payment of debentures they took over machineries of Rs.4,00,000 for Rs.3,20,000.

(4) All the intangible and fictitious assets are to be written off, and debtors and creditors are to be written off by Rs.40,000 and Rs.80,000 respectively.

(5) Land and building are to be shown at market value. The book value of Land and building is 75% of the market value.

From the above information you are required to pass necessary journal entries and prepare balance sheet thereafter.

[Ans.: Amount credited to Capital Reduction Rs. 25,44,000 (Pref. Share Capital Rs. 2,40,000 + Equity Share Capital Rs. 14,40,000 + Unpaid Interest on Debentures Rs. 64,000 + Creditors Rs. 80,000 + Land & Building Rs. 3,20,000 + Workmen Accident

Compensation Fund Rs. 4,0,000). Utilization Rs. 20,72,400 (Pref. Dividend Rs. 86,400 + Loss on Plant Rs. 80,000 + Goodwill Rs. 6,00,000 + Patents Rs. 3,20,000 + Preliminary Expenses Rs. 1,20,000 + Debtors Rs. 40,000 + Profit & Loss A/c Rs. 8,26,000) Balance Rs. 4,71,600 transferred to Capital Reserve A/c; Total of B/S Rs. 25,34,000]

Q-2: The balance sheet of Sanket Ltd. as on 31-3-2023 is as follows:

Particulars	Notes	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholder's Funds:		
(a) Share Capital :		
Equity Shares of Rs.10 each		7,00,000
10% Pref. Shares of Rs.100 each		2,00,000
(b) Reserves & Surplus : Profit & Loss A/c (Dr.)		(2,10,000)
(2) Non-Current Liabilities:		
(a) Long Term Borrowings: 15% Debentures		2,00,000
(3) Current Liabilities:		
(a) Trade Payable :		
Creditors		75,000
Bills Payable		12,500
(b) Other Current Liabilities :		
Outstanding interest on debentures		22,500
(c) Short Term Provision : Taxation Provision		50,000
Total		**10,50,000**
II. Assets:		
(1) Non-Current Assets :		
(a) Fixed Assets:		
(i) Tangible Assets:		
Land & Buildings		4,00,000
Machinery		1,30,000
(ii) Intangible assets : Goodwill		70,000
(b) Non-Current Investments		40,000
(c) Other Non-Current Assets:		
Preliminary Expenses		35,000
(2) Current Assets:		

(a) Inventories : Stock (b) Trade Receivable : Debtors (c) Cash and Cash Equivalents : Bank Balance		1,95,000 60,000 1,20,000
Total		**10,50,000**

Contingent Liability: Claim against the Company Rs.60,000.

The following scheme of Capital redemption was approved:

1) Preference Shares to be reduced up to Rs.80 per share.
2) Equity Shares to be reduced by Rs.6 per Share.
3) The debenture holders agreed to forego 50% of their outstanding interest and remaining interest amount was paid.
4) Debenture holders agreed to accept a piece of land worth Rs.1,50,000 at Rs.2,00,000 as full payment.
5) The remaining land and building were valued at Rs.2,51,750.
6) Rs.47,000 were realized for investments.
7) Reconstruction expenses amounted to Rs.25,000.
8) It was decided that company had to pay the pending claim.
9) Intangible and fictitious assets are to be written off.
10) The remaining amount is to be utilized in writing down Machinery and Stock in proportion of their book values.

Write journal entries in the books of the company and prepare Capital Reduction A/c.

[Ans.: Amount credited to Capital Reduction Rs. 5,30,000 (Pref. Share Capital Rs. 40,000 + Equity Share Capital Rs. 4,20,000 + O/s Debenture Interest Rs. 11,250 + Profit on Land Rs. 50,000 + Land & Building A/c Rs. 1,750 + Profit on Investments Rs. 7,000). Utilization Rs. 4,00,000 (Reconstruction Expenses Rs. 25,000 + Claim Rs. 60,000 + Goodwill Rs. 70,000 + Preliminary Expenses Rs. 35,000 + Profit & Loss A/c Rs. 2,10,000). Rs. 1,30,000 would be available for writing of Machinery and Stock in the ratio of 2 : 3 (Machinery Rs. 52,000 and Stock Rs. 78,000)]

Q-3: The balance sheet of Ankit Ltd. as on 31-3-2023 is as follows:

Particulars	Notes	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholder's Funds: (a) Share Capital : Equity Shares of Rs.10 each, fully paid		 24,00,000

6% Cumulative Preference Shares of Rs.100 each, fully paid		6,00,000
(2) Non-Current Liabilities:		
(a) Long Term Borrowings: 15% Debentures		6,40,000
(3) Current Liabilities:		
(a) Trade Payable :		
Creditors		7,02,400
(b) Other Current Liabilities :		
Outstanding interest on debentures		57,600
Total		**44,00,000**
II. Assets:		
(1) Non-Current Assets :		
(a) Fixed Assets:		
(i) Tangible Assets:		
Land & Building		12,00,000
Plant & Machinery		4,00,000
(ii) Intangible assets : Goodwill		3,00,000
Trade Mark		1,60,000
(b) Non-Current Investments: Investments		2,40,000
(c) Other Non-Current Assets:		
Preliminary Expenses		1,20,000
Discount on Debentures		1,00,000
Profit and Loss Account		6,00,000
(2) Current Assets:		
(a) Inventories : Stock		6,00,000
(b) Trade Receivable : Debtors		6,80,000
Total		**44,00,000**

The following scheme of Capital redemption was approved:

(1) Preference shares are to be reduced by Rs.30 per share.

(2) Equity shares are to be reduced up to Rs. 5.

(3) Debenture-holders agreed to waive their outstanding interest.

(4) Land and building is revalued at Rs. 15,00,000.

(5) Investments are sold for Rs. 3,20,000.

(6) Dividend on preference shares for the last three years is not declared and paid. Preference shareholders agreed to waive half of their arrears of dividend and for the remaining amount they agreed to accept equity shares.

(7) Intangible and fictitious assets are to be written off.

(8) Reconstruction expenses amounted to Rs. 33,600.

(9) The balance of the capital reduction account is to be utilized in writing off plant and stock in the proportion of their book values.

Pass necessary journal entries to record the above transactions in the books of the company and prepare the balance sheet of the company after completion of the scheme.

[Ans.: Amount credited to Capital Reduction Rs. 18,17,600 (Pref. Share Capital Rs. 1,80,000 + Equity Share Capital Rs. 12,00,000 + Debenture Interest Rs. 57,600 + Land & Building Rs. 3,00,000 + Investments Rs. 80,000). Utilization Rs. 13,67,600 (Dividend Rs. 54,000 + Reconstruction Expenses Rs. 33,600 + Goodwill Rs. 3,00,000 + Trade Mark Rs. 1,60,000 + Preliminary Expenses Rs. 1,20,000 + Debenture Discount Rs. 1,00,000 + P & L A/c Rs. 6,00,000). Rs. 4,50,000 would be available for writing off value of Plant and Stock in the ratio of 2 : 3 (Plant Rs. 1,80,000 + Stock Rs. 2,70,000). Total of B/S Rs. 30,16,400]

- **Multiple Choice Questions (With correct answer):**

1. What is the primary purpose of capital reduction?

a) To increase the share capital of a company

b) To reorganize the company's capital structure

c) To pay dividends to shareholders

d) To issue new shares

Answer: b) To reorganize the company's capital structure

2. Which section of the Companies Act (in most jurisdictions) generally governs the reduction of share capital?

a) Section 100

b) Section 52

c) Section 66

d) Section 12

Answer: c) Section 66

(*Note: Verify based on the jurisdiction-specific Companies Act.*)

3. Which of the following is NOT a reason for capital reduction?
   a) To write off accumulated losses
   b) To return excess capital to shareholders
   c) To issue bonus shares
   d) To restructure liabilities
   Answer: c) To issue bonus shares

4. What is the court's primary concern in approving a scheme of capital reduction?
   a) The impact on share prices
   b) The availability of reserves
   c) The protection of creditors' interests
   d) The compliance with tax regulations
   Answer: c) The protection of creditors' interests

5. In a capital reduction, which of the following typically occurs?
   a) An increase in the nominal value of shares
   b) A reduction in the number of issued shares
   c) An increase in the number of shareholders
   d) Conversion of equity into debt
   Answer: b) A reduction in the number of issued shares

6. What is required from creditors for a company to reduce its capital?
   a) Their approval must always be obtained
   b) Creditors have no rights in the process
   c) Creditors must confirm they are unaffected or paid off
   d) The company must pay dividends to creditors
   Answer: c) Creditors must confirm they are unaffected or paid off

7. Which account is generally adjusted to offset accumulated losses during capital reduction?
   a) Capital reserve account
   b) General reserve account
   c) Share capital account
   d) Profit and loss account
   Answer: c) Share capital account

8. Capital reduction requires approval from which of the following entities?

a) Shareholders only

b) Creditors only

c) Regulatory authorities and the court

d) Shareholders, creditors, and the court

Answer: d) Shareholders, creditors, and the court

9. What is the effect of capital reduction on a company's net worth?

a) It increases the net worth

b) It decreases the net worth

c) It has no impact on the net worth

d) It depends on the purpose of the reduction

Answer: d) It depends on the purpose of the reduction

10. What happens to the paid-up capital in a capital reduction process?

a) It always remains unchanged

b) It is reduced to adjust losses or liabilities

c) It increases through a fresh issue of shares

d) It is converted into reserves

Answer: b) It is reduced to adjust losses or liabilities

UNIT-13	LIQUIDATOR'S ACCOUNT

13.1 Introduction

13.2 Modes of Winding Up

13.3 Disbursement by the Liquidator

13.4 Format of Liquidator's Account

13.5 Some Important Points and Hints

❖ **Exercise**

13.1 Introduction

A company has no physical existence and cannot die a natural death. It is a creation of law and its corporate life can come to an end by process of law only. It can be wound up under the provisions of companies Act. Liquidation of a company suggests winding up the business of the company, disposing off its assets, paying off all its liabilities and surplus, if any, being returned to its shareholders. It must be made clear at the outset that liquidation of company does not mean that the company is insolvent. Even financially sound and affluent company may be taken into liquidation. Secondly, when a company is taken into liquidation, it does not always mean that its business is closed down. It may be wound up for the purpose of reconstruction and amalgamation too.

13.2 Modes of Winding Up

The winding up of a company may be either:

(a) Compulsory winding up by the court.

(b) Voluntary winding up by members or by creditors.

(c) Winding up subject to the supervision of the court.

13.3 Disbursement by the Liquidator

The liquidator is appointed to dispose off the assets of the company and to pay off its debts. The disbursements are to be made by the liquidator in the following order:

(1) The full amount to fully secured creditors. The partly secured creditors to the extent of their securities. The balance of partly secured creditors to the extent not paid off will be added to the unsecured creditors.

(2) Liquidation expenses which include:

1. Legal charges; and
2. Liquidator's remuneration.

(3) Preferential creditors. (as per list given in Para (3) below)

(4) Creditors who have a floating (general) charge over the assets of the company such as Debenture- holders.

(5) Unsecured creditors.

(6) Preference shareholders.

(7) Equity shareholders.

Let us see each item in detail.

[1] Fully secured Creditors:

Those creditors to whom specific assets are pledged, whose realizable value is equal to, or more than the amount of debt are fully secured creditors. If the creditors themselves realize the assets pledged and recover their dues, then no amount will appear as a receipt. But in case, if the assets are realized more than the amount of debt, the surplus is handed over to the liquidator. Such surplus is handed over to the liquidator. Such surplus will be shown as a receipt in the liquidator's final statement.

However, if the secured creditor hands over the security to the liquidator for realizing, the letter will show the amount realized as a receipt, the amount due to the secured creditor will be paid in full out of the amount realized. This would appear as the first item on payment side of the liquidator's statement of Account.

[2] Liquidation Expenses:

Before any amount is paid to creditors, the liquidation expenses including liquidators' remuneration are to be paid first. These expenses include legal charges, charges of auctioneers and valuers, cost of notice in newspapers and gazettes etc.

[3] Preferential Creditors:

Those creditors are preferential to whom their dues are to be paid in full before anything is paid to unsecured creditors. According to Section 53, the following liabilities of the company are preferential and shall be paid in priority to all other debts:

1. All revenues, taxes, cesses, and rates due from company to the Central or State Government or to a Local Authority and having become due and payable within the 12 months next before the commencement of winding up.

2. All wages or salary of any employee in respect of services rendered to the company and due for a period not exceed in 4 months within the 12 months next before the commencement of winding up. This amount should not exceed thousand rupees in cash of any employee or Rs. 20000.

(NOTE: Salary or Remuneration Payable to Director or Managing director or any person who is in position to take decision about the company, should not be considered as preferential.)

3. All accrued holiday remuneration (Leave Salary) payable to any employee on the termination of his employment before or due to winding up.

4. Contributions payable by the company, payable during the 12 months next before the winding up, for any employee under Employee's State Insurance Act or any other law for the time being in force.

5. All amount due in respect of compensation under Workmen's Compensation Act.

6. All sums due to any employee from a provident fund, Pension fund, Gratuity fund or any other fund for Welfare of employee, maintained by the company.

7. Expenses of any investigation of Company's affairs by inspectors under section 219 of the Act, so far as they are payable by the company.

[4] Creditors having Floating Charge:

These creditors have a floating charge over all assets of the Company, but no charge on any specific asset. They rank only after preferential creditors have been paid in full. If assets are not sufficient to pay preferential creditors in full, the creditors with floating charge do not get anything. If no information is given debentureholders should be assumed having floating charge.

[5] Unsecured Creditors:

Any surplus left after the meeting the claims of all other creditors mentioned above, will be utilised in meeting claims of unsecured creditors. They will include (a) Ordinary trade creditors, (b) bills payable, (c) unpaid expenses, (d) excess of claims of party secured creditors over the value of securities, (e) unclaimed dividend etc. However, unclaimed dividend will be paid only after all third-party liabilities are met in full.

[6] Preference Shareholders:

According to companies Act, the Preference shares carry preferential right in respect of dividend as well as repayment of capital. Hence, they are to be paid in full before anything is returned to equity shareholders. The claim of preference shareholders in respect of capital and preference dividend due must be first met in full. If the surplus in the hands of liquidator is not sufficient than call should be made on equity shares, if they are partly paid. However, preference shareholders have no right to participate in surplus unless it specifically provided in the articles.

After payment of all Capitals and dividends any surplus remains it should be paid to equity shareholders only. If, however, Preference shares and participating then they will also be entitled to share in such surplus.

[7] Equity Shareholders:

If any surplus is left after the meeting the claims of preference shareholders, the entire surplus is returned to equity shareholders. If the amount so left exceeds the paid-up equity share capital, the surplus is distributed among equity share holders only. Preference shareholders have no right to share in such surplus, unless it is specially provided in the articles.

13.4 Format of Liquidator's Account:

Format of liquidator's account is given below

LIQUIDATOR'S ACCOUNT

Receipt	Estimated Value Rs.	Value Realised Rs.	Payments	Amount Rs.
Cash on hand Cash at bank Assets realised: Bills receivable Trade debtors Loans and advances Stock-in trade Freehold properties Plant & Machinery Furniture and fittings Investments *Surplus from securities Call from contributories On shares @ -- per Share			Secured Creditors** Liquidation expenses **Liquidator's Remuneration**. % on Rs. realized % on Rs. disturbed **Preferential creditors** Debenture holders ---- + interest*** ---**Unsecured creditors**---- Add: Shortfall in security payable to secured creditors --- Return to contributories Preference shares holders Equity shareholders on – Shares @ Rs. – per share.	

1. (*) Only if security is realized by creditors directly.
2. (**) Only if the securities pledged to them are realised by liquidator. Amount paid will be amount realised or amount due whichever is less.
3. (***) Up to date of repayment if company is solvent, otherwise it should be paid up to date liquidation only.

- **Receipts of Liquidator:**

Generally, the receipts of liquidator consist of following items:-

1. Amount realized from sale of assets.
2. Amount of compensation recovered from officers of company for misfeasance or beach of duty.

3. Amount of calls received from contributories (Shareholders).

13.5 Some Important Points and Hints

[1] Creditors Having Fixed Charge (Secured Creditors)

A. Creditors may directly realize the security pledged or mortgage to them. There can be three alternatives:

1) Value realised > amount due to secured creditor. In such, cash excess money realised will be shown on receipt side as “Surplus from Security”.

2) Value realised = Amount due to secured creditors.

3) Value realised < Amount due to secured creditor. The difference (i.e., shortfall) in value of security should be added to” Unsecured Creditors”.

B. Secured creditors do not sell security but the assets pledged to them are sold by Liquidator. Amount received will be shown on receipt side. Amount paid will be shown as first item in payment side even before liquidation expenses.

❖ **Remember:**

- Creditors having fixed charge will be paid amount due to them or security realised whichever is less.
- If their security realised less than amount due, they are called partly secured creditors and balance unpaid must be added to unsecured creditors.
- If they realised more money, then must return the surplus money to liquidator.
- If assets are Hypothecated, Pledged or Mortgaged to secured creditors having fixed charged it should be assumed that they have realised the assets directly by themselves and no remuneration should be paid to Liquidator. If, however it is clearly state in the example that liquidator has realised these assets then the instructions given in the example should be followed.

[2] Debentures:

❖ Debentures should be assumed to have a floating charge if nothing is maintained regarding the security held by Debenture holders.

❖ Interest on debentures should be paid till the date of repayment if the company is solvent.

❖ Solvent means company is able to pay all liabilities in full. If, however the company is insolvent and is not able to meet all liabilities interest should be paid up to date of winding up only.

[3] Liquidator’s Remuneration:

When liquidator’s remuneration is a certain percentage on the amount paid to unsecured creditors, it is calculated on actual amount paid to unsecured creditors including preferential creditors. Calculation of liquidator’s remuneration present no problem, if unsecured creditors are paid in full. Suppose, unsecured creditors are Rs. 70,000 and liquidators' remuneration is fixed at 3% on amount paid to unsecured creditors. If the liquidator is able to discharge the debt in full, his remuneration will be computed as under:

Rs. 70,000 *3/100 = Rs. 2,100,

However, the calculation becomes difficult if the money left in hands of the liquidator is not sufficient to pay unsecured creditors in full. In the above illustration, suppose the liquidator has only Rs. 61,800 left with him, then he will not be able to pay the unsecured creditors in full. Secondly, he will recover remuneration out of his surplus before he makes payment to creditors. He will get Rs. 3 if Rs. 100 is paid to unsecured creditors i.e., he should have Rs. 103 of which he will get Rs. 3 and will pay Rs. 100 to unsecured creditors. Hence, his remuneration is 3/103 of the amount left him.

Rs. 61,800 x 3/103 = Rs. 1,800

Thus, he will get Rs. 1,800 as his remuneration remaining Rs. 60,000 will be paid to unsecured creditors.

Remember:

Preferential creditors should be added to unsecured creditors for calculating Liquidator's remuneration. If, however, example clearly gives instruction to exclude them, the instruction given in the example should be followed.

[4] Preference Dividend:

If the dividend on cumulative preference shares in arrears when the company is wound up, the question arises whether such arrears are to be paid before any repayment of equity capital. The following points are noteworthy:

1) If such dividend has been declared before winding up, it has to be paid, as the dividend once declared is treated as a liability of the company and should be paid along with preference capital.

2) When example does not specify anything assume that preference shares are cumulative.

3) Arrears of Cumulative Preference Dividend.

(a) If specified in the articles of company order of payment should be:

- ❖ Preference Share Capital.
- ❖ Arrears of Cumulative preference Dividend.
- ❖ Equity Share Capital.

(b) If articles do not specify about such payment, then order should be:

- ❖ Preference Share Capital
- ❖ Equity Share Capital
- ❖ Arrears of Cumulative Preference Dividend.

In other words, arrears of Cumulative Preference Dividend (not declared) if not stated otherwise in the Articles of the Company should be paid out of surplus (if any) remaining after refunds of Equity Capital. If example does specify anything assumption should be made and not should be written off.

[5] Calls of Equity Shares:

1) If cash is not sufficient to pay preference shareholders call must be made on equity shares and just sufficient money be raised to pay off preference shareholders.

2) If there are more than one category of equity share with different paid-up values, call must be made in such a way that:

   Loss per share is equal for all categories of equity shares

and

   No amount is refunded to those shareholders who pay calls

   Loss per share can be arrived at as follows:-

   Paid up capital – Surplus / Number of shares

or

   Loss per share = Paid up capital + Deficit / Numbers of shares

The above formula should be applied only if all equity shares have same face value. If, however the face (nominal) values of equity shares are different, percentage deficiency may be calculated.

In above formula surplus means cash left with liquidator after paying preference shareholders

If there are calls in arrears, it should be assumed that they are received.

If there are calls in advance and call is required to be made amount received should be reduced to the extent of calls already received in advance.

If there are calls in advance and no further call is to be made the amount of calls in advance should be refunded after unsecured creditors but before returning capital.

Illustration: 1

The following particulars relate to a limited company which has gone into voluntary liquidation. Prepare the liquidator's final account allowing for his remuneration at 2% on the amount realised and 2% on the amount distributed among unsecured creditors other than preferential creditors.

	Rs
Preferential creditors	10,000
Unsecured creditors	32,000
Debentures	10,000

The assets realized the following sums:	
Building	20,000
Machinery	18,650
Furniture	1,000
The Liquidation expenses amount to Rs.100	

Solution:

Liquidator's Account

Receipts	**Rs**	**Payments**	**Rs**
Building	20,000	By Liquidation expenses	1,000
Machinery	18,650	Liquidators Remuneration	
Furniture	1,000	2% on amount realised 39650 x 2/100 = 793	
		2% on amount paid to unsecured creditors* 350	1,143
		Debenture holders	10,000
		Preferential creditors	10,000
		Unsecured creditors**	17,507
	39,650		**39,650**

Calculation of amount paid to unsecured creditors:

Amount available to unsecured creditors:		
Total Receipts		39,650
Less: Payments Liquidation expenses	1,000	
Liquidators Remuneration amount realized	793	
Debenture holder-paid	10,000	
Preferential creditors-pai	10,000	21,793
Amount available to unsecured creditors		17,857

Calculation of Liquidators remuneration 2% on amount distributedamong unsecured creditor:

Commission = Amount Available x 2/102

17857 x 2 /102 = 350

Amount paid to unsecured creditors 17857 – 350 = 17507

Illustration: 2

Kannan Ltd was liquidated o 31-12-2021.

Balance sheet as on 31-12-2021

Liabilities	Rs.
Share capital	1,00,000
8% Debenture	1,00,000
Mortgage Loan (Secured loan on Building)	50,000
Sundry Creditors	80,000
	3,30,000
Assets	**Rs.**
Land and Building	60,000
Plant and Machinery	60,000
Stock	60,000
Debtors	70,000
Cash in hand	5,000
Profit and Loss a/c	75,000
	3,30,000

Assets realised as follows:

a) Land and Building Rs.55,000
b) Stock Rs.20,000
c) Plant & Machinery Rs.25,000
d) Half of the debtors were bad and the balance realised 60% book value.
e) Liquidator was entitled to a commission of 3% on amount realised other than cash and 2% on the amount paid to unsecured creditors.
f) Preferential creditors amount to Rs.10000 (included in sundry creditors)
g) Liquidation expenses amount to Rs.970. Prepare liquidator's final statement of account.

Solution:

Liquidator's Accounts

Receipts	Rs.	Payments	Rs.
To cash in hand	5,000	By secured creditors (mortgage Loan)	50,000

To assets realised:		Liquidation expenses	970
Land & Building	55,000	Liquidator‟s Remuneration	
Stock	20,000	3% on amount realised. except cash 12600 x3 /100=	3,780
Plant & Machinery	25,000	Amount paid to debenture holders Balanced available amount	71,250
Debtors realised	21,000		
	1,26,000		1,26,000

Note: 1) Debtors Realised: Debtors	70,000
Less: 50% Bad	35,000
Balance 60% realised 35000 x 60 /100 = 21000 *	35,000

Illustration: 3

The following particulars relate to a company which has gone into liquidation. You are required to prepare the liquidator's final statement of account allowing for his remuneration of 3% as amounts paid to unsecured creditor other than preferential creditors.

Preferential creditors	Rs.12,000
Unsecured creditors	Rs.40,000
Debentures	Rs.14,000

Assets realised Rs.40000 liquidation expenses amounted Rs.4,000

Solution :

Liquidator's account

Receipts	Rs.	Payments	Rs.
Assets realized	40,000	Liquidation expenses	4,000
		Liquidator's Remuneration 3% amount paid to unsecured creditors	291
		Debentures	14,000
		Preferential creditors	12,000
		Unsecured creditors	9,709
	40,000		40,000

1) Calculation of Commission Payable to Liquidator Commission = Amountavailable x 3/103

Amount available:

Total Receipts		40,000
Less: Payment's liquidation expenses	4,000	
Debentures	14,000	
Preferential creditors	12,000	30,000
		10,000

10000x3/103=291

ii) Amount pay able to unsecured creditors

Amount available	10,000
Less: Commission	291
	9,709

Illustration 4:

Shri A.B. Govindan is appointed liquidator of a company in liquidation on 1st July, 2022 and the following balances are extracted from the books on that date.

Particulars	Rs	Particulars	Rs
Capital:		Machinery	30,000
8,000 shares of Rs 10 each	80,000	Leasehold Properties	40,000
Debentures Bank	50,000	Stock-in-trade	1,000
Overdraft Liabilities for	18,000	Book Debts	60,000
Purchases Provision for	20,000	Investments	6,000
Bad Debts	10,000	Calls in Arrear	5,000
		Cash in hand	1,000
		Profit and Loss Account	35,000
	1,78,000		**1,78,000**

Prepare a statement of affairs to be submitted to the meeting of the creditors.

The Machinery is valued at Rs 60,000, the Leasehold Properties at Rs 73,000, Investments at Rs 4,000, Stock-in-trade at Rs 2,000; bad debts are Rs 2,000, doubtful debts are Rs 4,000 estimated to realise Rs 2,000. The Bank Overdraft is secured by deposit of title deeds of Leasehold Properties. Preferential creditors for taxes and wages are Rs 1,000. Telephone rent owing is Rs 80.

Solution:

Statement of Affairs of A.B. Govindan as at July 1, 2022

Assets not specifically pledged (as per List 'A')

Cash in hand	1,000
Trade Debtors	56,000
Calls in Arrear	5,000
(Marketable) Investments	4,000
Stock	2,000
Machinery	60,000
	1,28,000

Assets specifically pledged (as per List 'B')

	Estimated Realizable value Rs	Due to secured creditors Rs	Deficiency ranking as unsecured Rs	Surplus carried to last column Rs
Leasehold Properties	73,000	18,000	–	55,000
	73,000	18,000	–	55,000

Estimated surplus from assets specifically pledged	55,000
Estimated total assets available for preferential creditors, Debenture holders secured by a floating charge, and unsecured creditors (carried forward)	1,83,000
Summary of Gross Assets	**Rs**
Gross realisable value of assets specifically pledged	73,000
Other Assets	1,28,000
Gross Assets	**2,01,000**

	Rs
Estimated total assets available for preferential creditors,	
debenture holders secured by a floating charge, and unsecured creditors (brought forward) 1,83,000	
Gross Liabilities	(Rs)
Liabilities Secured creditors (as per List 'B') to the extent to which claims are estimated to be covered by assets specifically pledge	18,000

1000	Preferential creditors (as per List 'C')		1,000
	Estimated balance of assets available for debenture holders		1,82,000
	Secured by a floating charge and unsecured creditors.		
50,000	Debenture holders secured by a floating charge (as per List 'D')		50,000
	Estimated surplus as regards debenture holders		1,32,000
20,080	Unsecured creditors (as per List 'E')	Rs	
	Liabilities for purchases	20,000	
	Telephone rent outstanding	80	20,080
89,080	Estimated surplus as regards creditors being the Difference between Gross Assets and Gross Liabilities		
			1,11,920

❖ **Exercises**

1. Explain the Modes of Winding Up.
2. What is Disbursement by the Liquidator?
3. Explain the Format of Liquidator's Account.

Practical questions

1. India Co. Ltd. was taken into voluntary liquidation on 30- 9-2023. On this date, its total liabilities amounted to Rs. 1,60,000 which included the following:

- Income-tax for the assessment year 2020-21; 2021-22 and 2022-23 has been Rs. 5,000; Rs. 3,000 and Rs. 4,000 respectively which is still not paid. The assessment is completed each year by 31st July.

- 6 months' salaries for 4 clerks amounting to Rs. 3,600 @ Rs. 150 per month for each clerk.
- Two months' salaries of Managing Director Rs.3,000.
- Provident fund dues of two employees for the last ten years Rs. 10,000.
- A director has advanced Rs.3,000 to the Company for paying last two-month salary to some of the employees.

From the above information find out preferential creditors and unsecured creditors of the company.

2. Lal Limited went into voluntary liquidation on 30th September, 2020. Their total liabilities amounted to Rs. 121850. The following items were included in the above amount. Classify the Preferential and other types of Creditors.

(1) Local Taxes due and payable: On 1^{st} Oct., 2019 Rs.750 and On 1^{st} April, 2020 Rs. 850 = 1,600

(2) Trade Creditors = 25,750

(3) Managing Director's Salary for last 6 months = 21,000

(4) Last three months' salaries of five clerks at Rs. 1,500 per month = 7,500

(5) Provident Fund of 3 employees who had served for 10 years = 22,500

(6) Employees' State Insurance Premium for 9 months up to 30^{th} September, 2020 = 6,000

(7) Accrued holiday remuneration of employees whose services were terminated at Rs. 3,000 for 2 year = 12,000

(8) Sales-tax due on 30th Sept., 2019 Rs.2500 and due for the current year to date Rs.3,000= 5,500

(9) The amount due to government for income-tax for the assessment years 2017-18, 2018-19, 2019-20 were Rs.5,000; Rs.7,000 and Rs. 8,000 respectively.

(Assessments of every year have been completed before 31st July.) = 20,000

Total Liabilities Rs 1,36,850

3. The position of TCS Ltd. was as under on 31- 12- 2020 when it was taken into voluntary liquidation.

Share capital: 5000 Equity shares of Rs. 100 each 5,00,000

1000 Preference shares of Rs. 100 each	1,00,000
Fully secured creditors (securities realised Rs. 2,40,000)	2,10,000
3 months' salaries (of 6 clerks)	7,000
Income-tax and local rates	35,000
Unsecured creditors	8,34,000
Debentures having floating charge	15,00,000
Liquidation expenses	25,000
Liquidators' remuneration	50,000

Assets realised Rs. 28,11,000 including the securities in the hands of fully secured creditors, Income-tax included Rs. 5000 assessed on 31-12-19.

Prepare Liquidator's Final Statement of Accounts.

4. The Giri Limited went into voluntary liquidation. Its assets realised Rs. 3,50,000 excluding amount realised by sale of securities held by the secured creditors. The following was the position:

Share capital - 1,000 shares of Rs. 100 each fully paid	=	1,00,000
Secured creditors (Securities realised Rs. 40000)	=	35,000
Unsecured creditors	=	1,40,000
Preferential Creditors	=	6,000
Debentures having a floating charge on assets	=	2,50,000
Liquidation expenses	=	5,000
Liquidator's remuneration	=	7,500

Prepare the Liquidator's Final Statement of Account.

5. Maruti Ltd. went into voluntary liquidation on 31st December 2020, The Balance sheet as on that date was as under:

LIABILITIES	AMOUNT
Share capital:	
1000, 7% preference shares of Rs. 100 each	1,00,000
1000 'X equity shares of Rs. 100 each (Rs. 80 paid up)	80,000
700 'B' equity shares of Rs. 100 each (Rs. 60 paid up)	42,000
800 'C' equity shares of Rs, 100 each (Rs. 40 paid up)	32,000
5% Mortgage debentures	20,000
Outstanding Interest on debentures	1,000
Creditors	1,35,000
	4,10,000

ASSETS	AMOUNT
Land-Building	1,12,000
Machinery	74,000
Investments	68,000
Stock	15,000
Debtors	36,000
Cash and Bank Balance	27,500
Profit and Loss A/c	70,000
Preliminary expenses	7,500
	4,10,000

Assets realized: Land - Building- Rs. 84,400, Machinery Rs. 36,000, Stock Rs. 9,100, and Debtors Rs. 28,500.

Creditors include preferential creditors Rs. 5,000. Investments were mortgaged with creditors of Rs. 65,000 who realised Rs. 71,000 of the same. The excess was given to liquidator. Creditors of Rs. 25,000 were paid up 3% less and creditors of Rs. 10,000 were paid 35% less. Remaining creditors were paid fully.

Debenture holders were paid on 30-6-2021 Liquidation expenses were Rs. 6,895. Liquidator is entitled to a remuneration of 3% on the assets realised by him and 2% on the amount distributed to unsecured creditors other than preferential creditors.

Prepare final statement of Liquidator. Show necessary calculations.

(Sau. Uni. Exam: 2006)

6. Manish Ltd. went into a voluntary liquidation on 31-12-22. The Balance Sheet as on that date was as Linder:

LIABILITES	AMOUNT
6,000 Equity Shares of Rs. 100 each	6,00,000
12% Debentures	1,00,000
Outstanding interest on Debentures	12,000
Loan Secured by charge on Investments	50,000
Sundry Creditors	1,80,000
Provident Fund	18,000
	9,60,000
ASSETS	**AMOUNT**
Goodwill	65,000
Land & Building	3,50,000
Machinery	1,55,000
Investments	70,000
Stock	75,000
Debtors	72,000
Cash & Bank Balance	12,100
Advertisement Suspense A/c	12,900
Profit and Loss A/c	1,48,000
	9,60,000

Considering the following information, prepare Liquidator's Final Statement of Receipts and Payments:

1. Assets were realised Land & Building Rs. 4,20,000; Machinery Rs. 1,10,000; Stock Rs. 55,000 and Debtors Rs. 45,000. Creditors of the Loan have sold the Investment for Rs. 75,000 and the additional amount was returned to the liquidator.

2. Sundry creditors include the following: (i) 3 months' salaries (of 5 clerks) Rs. 7500.

   (ii) Income-tax and local rates Rs. 35,000 (Inc-tax included Rs. 5,000 assessed on 31-8-21)

3. The Debenture holders were paid off on 31-3-22.
4. Liquidation expenses amounted to Rs. 10,000.
5. The liquidator is entitled to remuneration at 2% on the amount realised on assets by him and 2% on amount distributed to shareholders.

7. B Ltd. went into voluntary liquidation on 31-12-22. The Balance Sheet of Bajaj Ltd. as on 31-12-22 was as follows:

LIABILITES	**AMOUNT**
5,000 Equity Shares of Rs. 100 each Rs. 60 per share paid up	3,00,000
5,000 Equity Shares of Rs.100 each Rs.40 per share paid up	2,00,000
1,500 12% Pref. Shares of Rs.100 each	1,50,000
8% Debentures (Having a floating Charge on all assets)	2,00,000
Interest Outstanding on Debentures (Also secured as above)	16,000
Creditors	2,34,000
	11,00,000
ASSETS	**AMOUNT**
Land & Buildings	2,00,000
Plant & Machinery	2,75,000
Patents	85,000
Stock at cost	1,25,000
Sundry Debtors	2,30,000
Cash & Bank	25,000
Profit & Loss A/c	1,60,000
	11,00,000

The dividend on preference shares are in arrears for two years. The arrears are payable on liquidation as per the Articles of the company. Creditors include preferential creditors of Rs. 20,000 and a loan for Rs. 1,50,000 secured by a mortgage on Land & Buildings.

Land & Buildings	2,20,000
Plant & Machinery	2,00,000
Debtors	2,05,000
Patents	50,000
Stocks	1,00,000

The expenses of liquidation amounted to Rs. 15,070. The liquidator is entitled to a commission of 3 % on all assets realised (except Cash and Bank) and a commission of 2 % on amount distributed among unsecured creditors. All payments were made on 30th June 2023.
Prepare the Liquidator's Final Statement of Receipts and Payments.

8. The balance sheet of Unitech Ltd. as on 31st March, 2022 was as under:

LIABILITES	**AMOUNT**
Paid up Capital:	
1,000 6% Pref. shares of Rs. 100 each	1,00,000
2,000 Equity shares of Rs. 100 each fully paid	2,00,000
3,000 Equity shares of Rs. 100 each Rs.50 Paid	1,50,000
Secured Loan:	
6% Debentures (Floating charge on all assets)	1,00,000
Other Loan:	
Mortgage on Land & Building	1,00,000
Current Liabilities:	
Sundry creditors	90,000
Income Tax	10,000
	7,50,000
ASSETS	**AMOUNT**
Fixed Assets:	
Land and Building	2,00,000
Plant and Machinery	2,20,000
Current Assets:	
Stock	1,00,000
Debtors	1,00,000
Cash & Bank	30,000
Profit & Loss Account	1,00,000
	7,50,000

The company went into voluntary liquidation on 1st April, 2022.

- The preference dividend was in arrears for three years.
- The arrears are payable on liquidation.
- The asset realised as follows:
  Land and Building Rs. 2,40,000; Plant & Machinery Rs. 1,80,000; Stock Rs. 70,000 and Debtors Rs. 60,000.
- The liquidation expenses amounted to Rs, 8,000.
- The liquidation entitled to a commission at 2% on all assets realised and 3% on amount distributed to unsecured creditors.

All payments were made on 30th September, 2022.
Prepare the liquidator's final statement of receipts and payments.

9. The liquidator of "Ankit Company Ltd." has (after paying preference share holders) cash on hand Rs. 6,72,000.

The equity share capital structure of company is as follows:

Type of equity shares	**No. of equity shares**	**Face value of per equity share Rs.**	**Paid up of per equity shares Rs.**
A	8,000	100	75
B	6,000	75	60
C	4,000	50	35
D	20,000	10	5

With necessary calculations prepare liquidator's receipt payment statement.

(Sau. Uni. Exam: - 2007)

UNIT-14 RECENT DEVELOPMENTS IN ACCOUNTING

14.1 Introduction

14.2 Introduction of Human Resources Accounting

14.3 Definition of HRA

14.4 Objectives of HRA

14.5 Advantages of HRA

14.6 Valuation Methods of HRA

14.7 Introduction of Inflation Accounting

14.8 Meaning and Definition of Inflation Accounting

14.9 Methods to Show Effects of Inflation in Accounts

14.10 Introduction of Social Responsibility Accounting

14.11 Meaning of Social Responsibility Accounting

14.12 Objectives of Social Responsibility Accounting (SRA)

14.13 Key Components of Social Responsibility Accounting (SRA)

14.14 Benefits of Social Responsibility Accounting (SRA)

14.15 Challenges of Social Responsibility Accounting (SRA)

❖ **Exercises**

14.1 Introduction

There are three major recent developments in accounting as Human Resources Accounting (HRA), Inflation Accounting, and Social Cost Accounting. All such recent development in accounting is discussed below:

14.2 Introduction of Human Resources Accounting

Organizational structure, strategy, technology and physical assets cannot guarantee sustainable competitive advantage for an organization in an era of globally competitive business environment in which not only companies but entire product categories can disappear overnight. This is because of the fact that the competitors can duplicate all of the traditional benchmarks of success.

However, it is not possible to clone the quality of human resources. Human resources can provide an enterprise a sustainable competitive advantage through the creation of super quality intellectual assets.

It is widely recognized that human resources are no lesser important than other productive resources. However, the recognition of importance of people in organization as productive resources by the accountants is a recent origin.

It was in 1960's, the behavioural scientists attacked the conventional accounting practice for its failure to value the human resources of the organization along with other productive resources and pointed out that this was a serious handicap for effective management. As a consequence, valuation of human resources has received widespread recognition. In the course of time a number of accounting models have been developed to value and report human resources of an organization. In the management terminology this is called Human Resource Accounting (HRA).

Human resources have certain distinct characteristics from other physical assets, like personality, self control, devotion, quality, skill, talents, loyalty, and initiative. An organization's basic need of present time is to improve productivity that can be improved by the human force. Hence to encourage, it is necessary to take progressive decisions for them. Advocates of HRA stresses on the importance of the human element in organizations and the failure of conventional accounting in dealing with it as an asset. In its simplest from HRA involves the identification of the costs of recruitment, training, and maintenance of an entity's human assets.

The basic premise underlying the theory of HRA are as follows:

- People are valuable resources of an enterprise.
- The usefulness of manpower as an organizational resource is determined by the way in which it is managed.
- Information on investment and value of human resources is useful for decision making in the enterprise.

14.3 Definition of HRA

HRA is the systematic recording of the transactions relating to the value of human resources.

- American Accounting Association, "HRA is a process of identifying and measuring data about human resources and communicating this information to interested parties."

- Woodruff defines HRA as "an attempt to identify and report investments made in human resources of an organization that are presently not accounted for in conventional system that tells the management what changes over time are accruing to human resources of the business"

According to the above definitions, the requirements of HRA are as follows:

- Valuation of human resources.
- Recording of human resources as per accounting principles.
- Disclosure of human resource information in the financial statements.

HRA is the measurement of cost value of people for organization. HRA is the systematic recording of the transactions relating the value of human resources. The importance of people in the organization as productive resource was ignored by the management, but nowadays it has received increasing attention and widespread interest in developing the system of HRA.

Basic Premises of HRA:

The basic premises underlying the theory of HRA are:

- People are valuable resources of an enterprise.
- The usefulness of manpower as an organizational resource is determined by the ay in which it is managed and
- Information on investment and value of human resource is useful for decision making in the enterprise.

14.4 Objectives of HRA

HRA helps in developing financial assessments for the people within the organization. However, the specific objectives of HRA may be outlined as under:

- ❖ To assist the management in taking suitable decisions regarding investment on human resources.
- ❖ To provided information to all people concerned regarding the earning potential of human resources of the organization.
- ❖ To assess the efficiency of human resources in obtaining productivity and profitability, and
- ❖ To provide comparative information regarding costs and benefits associated with investment in human assets.
- ❖ To help the persons interested in the organization to know whether the human resources are giving a return equivalent to their worth or not
- ❖ To help in development of management principles by clarifying the financial consequences of various practices.
- ❖ To know whether the human resources have been properly utilized and allocated.
- ❖ To measure the costs incurred on human resources by firms.
- ❖ To evaluate the return on investment on human capital.
- ❖ To communicate the organization and the public at large about the worth of human resources of an organization.

It is an attempt to identify and report investments made in the human resources of the organization that are not presently accounted for under 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. Ina nutshell HRA involves:

(a) Measurement and valuation of human resources and

(b) Communicating the information so generated for internal and external decision-makers.

14.5 Advantages of HRA

1. It provides quantitative information about the value of human capital which is very helpful to mangers for taking decisions. For investors also this is vital information for rating the investments.

2. In the absence of HRA the management may not realize the negative effects of certain programs aimed at improving profits in the short run. Such programs may result in decreased value of human assets due to fall in the productivity levels, high labour turnover, and low morale etc.

3. It helps management to judge the adequacy or otherwise of the resources and go in for further recruitment, if necessary.

4. HRA recognizes the importance of an individual and thus promotes the intellectual and social growth thereby facilitating the achievement of economic goals of the organization as well.

5. As stated at the outset, the success of an organization very much depends on the build up of quality workforce at all levels.

6. Management is very much facilitated in its planning and control functions relating to areas like labour turnover, low productivity, performance evaluation and even capital budgeting.

14.6 Valuation Methods of HRA

In measuring the value of human resources, it is difficult to comply with the generally accepted accounting principles. There are two approaches to valuation one based on cost and other is to measure the economic value of the resource a based-on capitalization of earnings. Some of these methods are critically discussed below:

1. **Acquisition (historical) cost:** Under this method the costs of acquisition, namely, the costs incurred in recruitment, hiring and induction of employees, are taken into account. The process involves capitalization of historic costs. The cost so capitalized has to be written off over a period of time for which the employee remains with the firm. If for some reason the employee leaves the organization prematurely, the unamortized cost remaining in the books has to be written off against the profit and loss account of the particular year. This method is simple to understand by all concerned. It is also easy to implement. Other methods of valuing may create behavioral problems. Historic cost method does not create any such problems. The most important drawback of this system is that historic costs are not relevant for decision-making and are useless.

2. **Replacement cost:** While in the case of acquisition cost past costs are considered, under this approach one takes into account how much it costs to replace a firm's existing resources and thus represents a current value approach. So, this is a

method of adjusting historic costs to the current market conditions. This exercise may be redundant unless the management desires to replace its present resources.

Replacement costs can be positional or personal. Positional replacement costs are typical in nature and relate to the position, but not the individual who occupies it. Position replacement cost typically comprises (i) acquisition and learning costs, and (ii) separation costs. Personal replacement costs are referring to the sacrifice to be incurred to replace a person today with a substitute capable of providing an equivalent set of services in all the positions that the former might occupy. The concept of personal replacement cost is akin to the concept of economic value discussed later.

3. **Opportunity Cost Model:** An interesting method advocated by Hekimian and Jones, called opportunity cost method, is that divisional heads may bid for the services to various people whose services they may require and then include the bid price in the investment base.

   This model of HRA seeks to measure the value of human resources on the basis of economic concept of opportunity cost. This model was proposed by Hekimian and Jones to overcome the limitations of replacement cost model. This model is also known as 'Competitive Bidding Model'.

   It attempts to estimate the value of human resources by establishing an internal labour market in an organization through the process of competitive bidding. Under this model, all managers of profit centers are encouraged to bid for any scarce employee they want. This is largely artificial method involving the concept of the competitive bidding process.

4. **Lev and Schwartz Model (Economic valuation Methods):** Based upon the economic concept of value, this model was suggested by Baruch Lev and Schwartz. This model is popularly known as 'Present value of future earning model'. The model is a salary-based model. It is based on certain assumptions. One of the most important assumptions is that the employee will not leave the organization till retirement. According to them, the value of human capital embodied in a person of age 'X' is the present value of his remaining earnings from employment.

   The model of HRA given by Lev and Schwartz ignored the possibility of death prior to retirement age. The model given by them cab be considered as an improvement over the cost models as it seeks to value the human resources of an organization on the basis of the economic value of employees of total organization.

5. **Hermanson's Models:** Hermanson has suggested two models for the measurement of human resources: (i) Unpurchased Goodwill Model and (ii) Adjusted Discounted Future Wages Model.

   (i) Unpurchased Goodwill Model: This model is argued that super normal profits in a firm are the indicators of presence of human resources. The model requires computation of the ratio of net income after taxes (EAT) to total assets of each firm. This in turn is compared with the ratio for the industry as a whole. The value of human resources of a firm is then measured with the help of differential rates.

(ii) Adjusted Discounted Future Wages Model: This model uses compensation as a surrogate measure of a person's value to the firm. Compensation means the present value of future stream of wages and salaries to employees of the firm. The discounted future wages stream is adjusted by an 'efficiency ratio' which is weighted average of the ratio of the return on investment of the given firm to all the firms in the economy for a specified period, usually the current year and the preceding four years.

6. **Jaggi and Lau Model:** The model suggested by Jaggi and Lau is based on valuation of groups rather than individuals. A group implies homogeneous employees who may or may not belong to the same department or division. It might be difficult to predict an individual's expected service tenure in the organization or at a particular level or position, but on a group basis it is easier to ascertain the percentage of people in a particular group likely either to leave the firm during each of the forthcoming period, or to be promoted to higher levels.

14.7 Introduction of Inflation Accounting

Inflation is a state in which purchasing power of money goes down or conversely there is more money in circulation than is justified by goods and services. The effect of inflation is that prices of assets go up and the accounts prepared on the basis of conventional accounting system present very distorted figures to the users of accounts.

Accountants prepare Profit and Loss Account and Balance Sheet at historical costs. Profit is the difference between revenue and costs. Revenue reflects the current value whereas costs represent current as well as historical costs.

Thus, the profit is overstated and profit of different periods becomes incomparable. Since the business activity is measured in terms of money and the value of money is fluctuating due to inflation, any measurement with fluctuating scale is unreliable and would distort the true financial position of the organization.

Inflation Accounting devised to show the effect of changing cost and prices of affairs of a company during the course of relative accounting periods. It is also known as Account for price level changes.

Accounting that takes into account this price level changes, is popularly known as Inflation Accounting and it is a method devised to show the effect of changing cost and prices on the affairs of the company during the course of relative accounting period.

14.8 Meaning and Definition of Inflation Accounting

In the seven decades of nineteen century prices have increased at a much faster annual rate in comparison with second post-war period. In many countries, including India, the price rise was 15% per annum, as compared with a rate of 5% in the same period. Thus, the need to bring out the impact of inflation on financial position of a business is increasingly felt in view of the fact that the accounts are prepared on the basis of historical cost only. "There is no general agreement regarding the term "inflation accounting", although the description has most frequently been adopted in past for those accounting systems which make some allowance for the effects of changing prices on historical cost of business assets. In short, feasibility of accounting for price level changes is termed as inflation accounting.

The accountants are recording business transactions in terms of monetary units e.g., rupees or dollars or pounds. When the transactions are recorded in money terms, there is an implied assumption that the value of money will remain stable but the value of money has been fluctuating quite violently in almost all parts of the world. The instability of measuring rod of the accountant had distorted both the revenue statement and balance sheet.

Thus, if the effects of price level changes, particularly rising prices, are not taken into consideration, then it will have following effects on financial statements:

1. Profit and loss account will show more profit than the actual profit because depreciation provision is inadequate and the closing stocks are progressively valued at higher price due to inflation.

2. As profit & loss account shows more and illusory profits than the true profit, more amount of income-tax and dividend would be paid. Thus, more funds would be required to pay income tax, bonus, dividend etc.

3. Balance sheet will not exhibit the true state of affairs of business because fixed assets are shown at the historical cost while current assets are shown at current cost.

14.9 Methods to Show Effects of Inflation in Accounts

The following methods are used to recognize the effects of changing price level on financial statements:

1. **Putting Note in Accounts:** Accountants still believe that the accounts must be prepared on the historical cost basis. As the English Institute has said "Historical cost should continue to be the basis on which annual accounts should be prepared." If accounts are prepared on the basis of changing price level, they would become complicated and the shareholders, for whom they are primarily prepared, would not be able to understand them. Besides, it amounts to giving up the traditional belief that the value of rupee remains stable. Hence, they contend that the accounts should be prepared on the historical cost basis only. But a note

should be appended to them, showing the effects of changing price level in accounts presented.

This method is defective in the sense that no changes are made in the accounts and hence profit shown by accounts is in excess of the true profit, as depreciation is charged on old values. Secondly when the old assets are to be discarded, the accumulated amount of depreciation would not be sufficient for its replacement.

2. **Replacement Reserve Method:** As we have just seen above, the depreciation calculated on historical cost of an asset would not be enough to replace the old asset when it is discarded, because depreciation was calculated on the old values of assets. Hence, it is suggested that an additional amount necessary for the purpose of replacement over the actual depreciation charged should be transferred to a separate 'Replacement Reserve Account' every year. The replacement cost is estimated and the additional amount required for replacement is transferred from profit to the Replacement reserve. Again, here it must be emphasized that the accounts are prepared only on historical cost basis and no changes are incorporated in them for making adjustments due to changing price level. Only a special replacement Reserve in created.

3. **Partial change method:** Another method for adjustment of accounts on the basis of changing price level is to make partial changes in accounts. Fixed assets are generally written-up and stock is valued on the basis of LIFO method. (i) In some countries businesses have been permitted for taxation purposes to link-up fixed assets in accordance with a legally established index. Thereafter depreciation is charged on the written-up amounts. (ii) when stock and issue of materials are priced on LIFO method, the sales revenue are charged with latest purchase price of the goods sold, which resembles the current price of goods.

4. **Current Purchasing Power Accounting (CPP):** Under this method, all items in the financial statements are restated in terms of constant unit of money, i.e., in terms of the same general purchasing power by using an appropriate multiplier. This method takes into account the changes in the general purchasing power of money and ignores the actual use or fall in the price of the given item. Profit, under this method, would be the increase in the value of net assets over a period, valued in terms of current purchasing power.

   The basic objective of CPP is to adjust the historical values recorded in the books for various items for changes in the general price level, by converting monetary units, say Rupees reflecting various amounts of purchasing power on different dates into a common measuring unit, where such unit reflects a uniform amount of purchasing power for all measurements.

   The steps involved in this accounting process are:

   - The financial statement namely Balance sheet and Profit and Loss Account would be prepared on historical cost basis, as usual.

- A difference is made between monetary and non-monetary items recorded in the accounts.

- Monetary items shall be continued to be stated in the accounts at their recorded values as they represent current values.

- The balance sheet shall be restated, where the non-monetary items shall be shown at their current purchasing power.

- The profit and loss calculation shall be amended so as to take into account the current purchasing power op opening and closing inventory and adjustment for depreciation.

5. **Current Cost Accounting (CCA):** This method recognizes the changes in the prices of individual assets irrespective of the quantum and direction of change in the general price level. Under this method, assets are valued at current cost. Current cost in the cost at which the assets can be replaced as on a date. Profit is the excess of income at current values over expenditure at current values.

   Replacement cost is the estimated cost of acquiring new asset of the same productive capacity at current prices adjusted for estimated depreciation since acquisition is based on such replacement value.

   Net realizable value is the estimated realizable value of the asset on sale in the ordinary course of business less estimated cost of disposal.

   The following are the important features of the CCA method:

   - Fixed assets and inventories are both to be shown in the balance sheet at their value to the business and not, in the former case, at historical cost less market price.

   - Depreciation is to be computed on the current value of various assets to provide a more realistic measure of the resources consumed during the accounting period;

   - The cost of goods sold during the year has to be ascertained on the basis of prices prevailing date of consumption and not at the date of purchase;

   - The higher cost of maintaining monetary working capital at the same level must be computed and charged to revenue as an item of cost

14.10 Introduction of Social Responsibility Accounting

In recent times, it is now believed that the responsibility of business manager is not only to earn the maximum profits for its owners, but they owe some responsibility to the society also. Willingly or unwillingly, the concept has been accepted by modern business managers. As one author has put is management being increasingly held responsible not only for the efficiency of operations, as expressed in profitability, but also for what is done about an endless number of “social problems”. Reporting about the steps taken by management to fulfill its social responsibility and the effects of these measures on society may be termed as ‘social responsibility accounting’. It has widened the scope of conventional accounting.

14.11 Meaning of Social Responsibility Accounting

Social Responsibility Accounting (SRA) is a branch of accounting that deals with the measurement, reporting, and auditing of an organization's social and environmental impacts. SRA is also known as sustainability accounting, corporate social responsibility (CSR) reporting, or environmental, social, and governance (ESG) reporting.

14.12 Objectives of Social Responsibility Accounting (SRA)

1. It provides stakeholders with information about an organization's social and environmental impacts, which helps them make informed decisions.

2. It helps organizations identify areas for improvement and make informed decisions about their social and environmental impacts.

3. It promotes transparency and accountability in an organization's social and environmental practices, which helps build trust with stakeholders.

14.13 Key Components of Social Responsibility Accounting (SRA)

1. Social Auditing: A systematic process of evaluating an organization's social performance. Social auditing involves assessing an organization's social impacts, such as labor practices, human rights, and community engagement.

2. Environmental Accounting: The measurement and reporting of an organization's environmental impacts. Environmental accounting involves assessing an organization's environmental impacts, such as greenhouse gas emissions, water usage, and waste management.

3. Stakeholder Engagement: The process of involving stakeholders in an organization's decision-making processes. Stakeholder engagement involves communicating with stakeholders, such as employees, customers, suppliers, and communities, to understand their needs and concerns.

4. Sustainability Reporting: The preparation and publication of reports on an organization's social, environmental, and economic performance. Sustainability reporting involves reporting on an organization's progress towards its sustainability goals and objectives.

14.14 Benefits of Social Responsibility Accounting (SRA)

1. Improved reputation and brand image: SRA helps organizations demonstrate their commitment to social and environmental responsibility, which can improve their reputation and brand image.

2. Enhanced stakeholder trust and loyalty: SRA helps organizations build trust with stakeholders by providing them with information about their social and environmental performance.

3. Better risk management and compliance: SRA helps organizations identify and manage social and environmental risks, which can help them comply with regulations and avoid reputational damage.

4. Increased efficiency and cost savings: SRA can help organizations identify areas for improvement and implement cost-saving measures.

5. Improved decision-making and strategic planning: SRA provides organizations with information about their social and environmental performance, which can help them make informed decisions and develop strategic plans.

14.15 Challenges of Social Responsibility Accounting (SRA)

1. Lack of standardized reporting frameworks: There is no single, universally accepted framework for SRA reporting, which can make it difficult for organizations to know what to report and how to report it.

2. Limited availability of data and metrics: SRA requires organizations to collect and report data on their social and environmental performance, which can be time-consuming and expensive.

3. Difficulty in measuring and quantifying social and environmental impacts: SRA requires organizations to measure and quantify their social and environmental impacts, which can be difficult to do.

4. Resistance to change and lack of buy-in from stakeholders: SRA requires organizations to make changes to their operations and reporting practices, which can be difficult to implement and may require significant cultural and behavioral changes.

5. Limited resources and budget constraints: SRA requires organizations to invest time, money, and resources in collecting and reporting data on their social and environmental performance, which can be a challenge for organizations with limited resources and budget constraints.

- **Exercises:**

- **MCQs:**

1. What is Human Resource Accounting (HRA)?

A) A method of accounting that values human resources as assets
B) A method of accounting that expenses human resources as costs
C) A method of accounting that ignores human resources
D) A method of accounting that only values physical assets
Answer: A) A method of accounting that values human resources as assets

2. What is the main objective of Human Resource Accounting?

A) To provide financial information to stakeholders
B) To provide non-financial information to stakeholders
C) To value human resources as assets
D) To expense human resources as costs
Answer: C) To value human resources as assets

3. Which of the following methods is used to value human resources in Human Resource Accounting?

A) Historical cost method
B) Present value method
C) Cost-benefit method
D) All of the above
Answer: D) All of the above

4. Which of the following is a benefit of Human Resource Accounting?

A) It helps to identify the cost of human resources
B) It helps to value human resources as assets
C) It helps to improve human resource management
D) All of the above
Answer: D) All of the above

5. What is inflation accounting?

A) A method of accounting that adjusts financial statements for changes in the general price level
B) A method of accounting that ignores changes in the general price level
C) A method of accounting that adjusts financial statements for changes in specific prices
D) A method of accounting that adjusts financial statements for changes in foreign exchange rates
Answer: A) A method of accounting that adjusts financial statements for changes in the general price level

6. Which of the following is a method of inflation accounting?

A) Current Cost Accounting (CCA)
B) Current Purchasing Power (CPP) Accounting
C) Constant Dollar Accounting
D) All of the above
Answer: D) All of the above

7. Which of the following is a limitation of inflation accounting?

A) It is difficult to determine the correct rate of inflation
B) It is difficult to adjust financial statements for changes in the general price level
C) It ignores changes in specific prices
D) All of the above
Answer: D) All of the above

8. What is the difference between Current Cost Accounting (CCA) and Current Purchasing Power (CPP) Accounting?

A) CCA adjusts financial statements for changes in specific prices, while CPP adjusts financial statements for changes in the general price level
B) CCA adjusts financial statements for changes in the general price level, while CPP adjusts financial statements for changes in specific prices
C) CCA is used for financial reporting, while CPP is used for tax purposes
D) CCA is used for tax purposes, while CPP is used for financial reporting
Answer: A) CCA adjusts financial statements for changes in specific prices, while CPP adjusts financial statements for changes in the general price level

9. What is Social Responsibility Accounting (SRA)?

A) A method of accounting that focuses on the financial performance of a company
B) A method of accounting that focuses on the social and environmental impacts of a company
C) A method of accounting that focuses on the economic performance of a company
D) A method of accounting that focuses on the governance of a company
Answer: B) A method of accounting that focuses on the social and environmental impacts of a company

10. What is the main objective of Social Responsibility Accounting?

A) To provide financial information to stakeholders
B) To provide information on the social and environmental impacts of a company
C) To improve the financial performance of a company
D) To reduce the social and environmental impacts of a company
Answer: B) To provide information on the social and environmental impacts of a company

11. Which of the following is a benefit of Social Responsibility Accounting?

A) It helps companies to reduce their social and environmental impacts
B) It helps companies to improve their financial performance
C) It provides stakeholders with information on the social and environmental impacts of a company
D) All of the above

Answer: D) All of the above

- **Theoretical Questions:**

Q-1 What is Human Resources Accounting?
Q-2 Explain the Definition of HRA.
Q-3 Explain the Objectives of HRA.
Q-4 Explain the Advantages of HRA.
Q-5 Explain the Valuation Methods of HRA.
Q-6 What is Inflation Accounting?
Q-7 Explain the Meaning and Definition of Inflation Accounting.
Q-8 Explain the Methods to Show Effects of Inflation
Q-9 What is Social Responsibility Accounting?
Q-10 Explain the Meaning of Social Responsibility Accounting
Q-11 Explain the Objectives of Social Responsibility Accounting (SRA).
Q-12 Explain the Key Components of Social Responsibility Accounting (SRA).
Q-13 Explain the Benefits of Social Responsibility Accounting (SRA).
Q-14 Explain the Challenges of Social Responsibility Accounting (SRA).

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સ્વાધ્યાયઃ પરમં તપઃ
સ્વાધ્યાયઃ પરમં તપઃ
સ્વાધ્યાયઃ પરમં તપઃ

શિક્ષણ, સંસ્કૃતિ, સદ્‌ભાવ, દિવ્યબોધનું ધામ
ડૉ. બાબાસાહેબ આંબેડકર ઓપન યુનિવર્સિટી નામ;
સૌને સૌની પાંખ મળે, ને સૌને સૌનું આભ,
દશે દિશામાં સ્મિત વહે હો દશે દિશે શુભ-લાભ.

અભણ રહી અજ્ઞાનના શાને, અંધકારને પીવો ?
કહે બુદ્ધ આંબેડકર કહે, તું થા તારો દીવો;
શારદીય અજવાળા પહોંચ્યાં ગુર્જર ગામે ગામ
ધ્રુવ તારકની જેમ ઝળહળે એકલવ્યની શાન.

સરસ્વતીના મયૂર તમારે ફળિયે આવી ગહેકે
અંધકારને હડસેલીને ઉજાસના ફૂલ મહેંકે;
બંધન નહીં કો સ્થાન સમયના જવું ન ઘરથી દૂર
ઘર આવી મા હરે શારદા દૈન્ય તિમિરના પૂર.

સંસ્કારોની સુગંધ મહેંકે, મન મંદિરને ધામે
સુખની ટપાલ પહોંચે સૌને પોતાને સરનામે;
સમાજ કેરે દરિયે હાંકી શિક્ષણ કેરું વહાણ,
આવો કરીયે આપણ સૌ
ભવ્ય રાષ્ટ્ર નિર્માણ...
દિવ્ય રાષ્ટ્ર નિર્માણ...
ભવ્ય રાષ્ટ્ર નિર્માણ

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