UNIT-I

Accounting for Share Capital and Debentures: Issue, forfeiture and reissue of forfeited shares - concept & process of book building - Issue of rights and bonus shares - Buyback of shares - Redemption of preference shares Issue and Redemption of Debentures

Introduction

Two major limitations of sole-proprietorship concerns and partnership firms are : (i) inadequacy of funds, and (ii) unlimited liability. To overcome these limitations, one of the most convenient form of organisation that grew with expansion of business requiring huge funds is the joint stock company form of organisation. In India, joint stock companies are governed by the provisions of the Companies Act, 1956.

Meaning of the Company

A joint stock company is a voluntary association of persons formed for the purpose of some business for profit with common capital, divisable into transferable shares and possessing a corporate legal entity and a common seal. It is created by a process of law and can be put to an end only by a process of law. It is a legal person and is something different from its members. It is, therefore, capable of acting in its own name. But as it has no physical existence, it must act through its agents and all the contracts entered into by its agents must be under the seal of the company. The members as such do not carry on the business of the company. A group of personswho individully called the directors and collectively form the Board of Directors are appointed. The company acts through the Board of Directors or subordinates appointed by the Board for the purpose.

Share capital of a company is divided into parts and each part is called a share. Every person who takes up a share or shares of a company becomes its member and continues to be a member so long as he holds even a single share. He is called a shareholder and is a part-owner of the company. But a person can be both a shareholder and the creditor of the same company and at the same time.

KINDS OF COMPANIES

From the point of view of *formation*, the companies are of three kinds:

(i) Chartered Companies: Those companies which are incorporated under a special charter by the king or sovereign such as East India Company. Such companies are rarely formed now-a-days as trading companies.

(ii) Statutory Companies: These companies are formed by a special Act of the Legislatures or Parliament, e.g., the Reserve Bank of India, Damodar Valley Corporation, etc.

(iii) Registered Companies: Such companies which are incorporated under the Companies Act, 1956 or were registered under the previous Companies Act.

From the point of view of *liability* there are three kinds of companies:

(i) Limited Companies: In case of such companies, the liability of each member is limited to the extent of a face value of shares held by him. Suppose Vishal takes a share of Rs. 100, he remains liable to the extent of that amount. As soon as that amount is paid, he is no more liable.

(ii) Guarantee Companies: The liability of the member of such a company is limited to the amount he has undertaken to contribute to the assets of the company in the event of its wound up. This guaranteed amount is limited by fixed sum which is specified in the memorandum. Chambers of commerce, trade associations and sportsclubs are usually guarantee concerns. The object of such companies is not to make profit and distribute dividend.

(iii) Unlimited Companies: They are nothing but large partnerships registred under the Companies Act and the members just like partners have unlimited liablity and both their share of contribution as well as their private property are at stake when the company is to be wound up. Such companies are rare these days.

From the point of view of *public investment* company may be of two kinds:

(i) Private Companies: A private company means a company which by its articles (a) restrict the right to transfer its shares, if any (b) Limits the number of members to fifty, excluding past or present employees of the company who are the members of the company and (c) Prohibits any invitation to the public to subscribe for any shares in or debentures of the company

(ii) Public Companies: Public companies are those companies which are not private companies. All the three restrictions are not imposed on such companies.

Books of Accounts: Section 209 of the companies Act, 1956 requires that every company is required to keep at its registered office books of account. These books are to be maintained in such a way so as to disclose (i) the sums of money received and expended by the company and the matter in respect of which the receipt and expenditure has taken place. (ii) All sales and purchases of goods of the company. (iii) All assets and liabilities of the company. In case a company is engaged in production, processing, manufacturing or mining activities, it has also to maintain cost accounting records relating to utilization of material or labour or other items of cost as may be required by the Central Government.

Statutory Books: Statutory books are those which a limited company is under statutory obligation to maintain at its registred office for maintaining a record of its activities in order to safeguard the interest of the shareholders and creditors. The following is the list of such books:

(i) Register of investments not held in company's name.
(ii) Refister of fixed deposits.
(iii) Register of mortgage charges.
(iv) Register of members.
(v) Index of members where the number is more than 50 unless the register of member itself affords an index.
(vi) Register of debentureholders.
(vii) Index of debenture holders where their number is more than 50 unless the register of debentureholders itself affords an index.
(viii) Foreign register of member's and debenture holders and their duplicates.
(ix) Minuts books containing minutes of proceeding of general meeting and Board Meetings.
(x) Register of contracts with companies and firms in which directors are interested directly or indirectly.
(xi) Register of directors, managing directors, manager and secretary.
(xii) Register of directors' shareholdings.
(xiii) Register of loans, guarantees etc. to or investments in shares and debentures of the companies in the same group under the same management.
(xiv) Register of renewed and duplicate certificates.
(xv) Copy of every instrument creating any charge requiring registration.

ISSUE OF SHARES

The capital of the companycan be divided into different units with definite value called shares. Holders of these shares are called shareholders or members of the company. There are two types of shares which a company may issue, i.e., (1) Preference Shares and (2) Equity Shares.

1. **Preference Shares:** Shares which enjoy the preferential right as to dividend and repayment of capital in the event of winding up of the company over the equity shares are called preference shares. These shares will get fixed rate of dividend. Preference shares may be:
   (a) Cumulative Preference Shares
   (b) Non-cumulative Preference Shares
   (c) Redeemable Preference Shares
   (d) Irredeemable Preference Shares
   (e) Convertible Preference Shares
   (f) Non-convertable Preference Shares
   (g) Participating Preference Shares
   (h) Non-participating Preference Shares
2. **Equity Shares:** Equity shares will get dividend and repayment of capital after meeting the claims of preference shareholders. There will be no fixed rate of dividend to be paid to the equity shareholders and this rate may vary from year to year. This rate of dividend is determined by directors and in case of large profits, it may even be more than the rate attached to preference shares. Such shareholders may go without any dividend if no profit is made.

Terms of Issue

The terms on which shares are to be issued by the company are given in the prospectus. Shares can be issued either at par or at a premium or at a discount. Shares are said to be issued at par when a shareholder is required to pay the face value of the shares to the company. For example, when shares of Rs. 10 are issued at Rs. 10, these are said to be issued at face value. Shares are said to be issued at premium when a shareholder is required to pay more than the face value to the company. For example, is shares of Rs. 10 are issued at Rs. 12, then shares are said to be issued at a premium. Shares are said to be issued at discount when the shareholder is required to pay less amount than the face value of the share to the company. When the shares of Rs. 10 are issued at Rs. 8, the shares are said to be issued at a discount.

The issue price of shares can be received in one instalment or it can be spread over different instalments. The amount when received in different instalments may be paid on application, allotment or in different calls. The amount which is received on application is called the application money and the amount which becomes due on allotment is called allotment money. Rest of the amount may be called in different calls according to the requirements and needs of the company. If it is called in more than one instalment, the first instalment is called as first call, second instalment as the second call and the last instalment as the final call. For example, if a company issued 1,50,000 equity shares of Rs. 10 each in January, Rs. 10 may be called as under:

Jan. 5 Rs. 2 with application known as application money.
Feb. 9 Rs. 3 on allotting the shares known as attotment money.
May 16 Rs. 1.50 in the first instalment known as first call.
July. 27 Rs. 1.50 in second instalment known as second call.
Sept. 11 Rs. 2.00 in last instalment known as final call.

Journal Entries for Issue of Shares:

	Journals		**Dr.**	**Cr.**
1.	On receipt of application money: Bank Account Dr. To Share Application Account (Being the application money on ...shares @ Rs. ......per share)		Rs. Xxx	Rs. xxx
2.	On allotment of Shares: (a)Application money on allotted shares is transfered to share capital account: Share Application Account Dr. To Share Capital Account (Being the application money transfered to Share Capital Account)		xxx	xxx
	(b) Those applicants who could not be allotted any share, their money will be returned: Share Applicatio Account Dr. To Bank Account (Being the application money of shares returned)		xxx	xxx
3.	On the allotment of shares, all allotment money becomes due to the company:			

	Share Allotment Account Dr. To Share Capital Account (Being the share allotment money on ..... shares @ Rs. ...... per share as per resolution dated ....)		Xxx	xxx
4.	On receipt of allotment money: Bank Account Dr. To Share Allotment Account (Being the receipt of share allotment money)		xxx	xxx
5.	On making the first call due from the shareholdewrs: Share first Call Account Dr. To Share Capital Acccount (Being the first call money due on ... shares @ Rs. ....per share as per resolution of the directors dated ...)		xxx	xxx
6.	On receipt of the first call money: Bank Account Dr. To Share First Call Account (Being the receipt of share first call money)		xxx	xxx

Note: Similar entries will be passed for second call, third and final call, if any.

Illustration 1. Vishal Ltd., issued a prospectus inviting applications for 1,00,000 Equity Shares of Rs. 10 each, payable as to Rs. 2 with application, Rs. 3 on allotment and the balance on first and final call. Applications were received for 80,000 shares only. All the applications were accepted in full. The call was also made in the due course of time. All moneys were duly received. Journalise all the abovementioned transactions including cash transactions.

Solution:

Journal

			Dr.	Cr.
1.	Bank Account Dr. To Equity Share Application A/C (Being the receipt of application money on 80,000 equity shares @ Rs. 2 per share)		Rs. 1,60,000	Rs. 1,60,000

2.	Equity Share Application Account Dr. Equity Share Allotment Account Dr. To Equity Share Capital Account (Being capitalisation of application money @ Rs. 2 per share and allotment money due @ Rs. 3 per share on 80,000 equity shares alloted)		1,60,000 2,40,000	 4,00,000
3.	Bank Account Dr. To Equity Share Allotment Account (Being the receipt of allotment money on 80,000 equity shares @ Rs. 3 per share)		2,40,000	 2,40,000
4.	Equity Share First and Final Call Account Dr. To Equity Share Capital Account (Being the first and final call due on 80,000 equity shares @ Rs. 5 per share)		4,00,000	 4,00,000
5.	Bank Account Dr. To Equity Share First and final Call Account (Being the receipt of first and final call on 80,000 equity shares @ Rs. 5 per share)		4,00,000	 4,00,000

Issue of Shares for Purchase of Assets:

If the shares have been allotted to any person or firm from whom the company has purchased any assets, the following entry will be passed:

Asset Account Dr. xxx
To Share Capital Account xxx
(Being ..... shares allotted...... in consideration of purchase of assets for the company)

Issue of Shares at a Premium:

A company may issue shares at a premium, i.e., at a value greater than its face value. The power to issue shares at a premium need not be given in the Articles of Association. Premium so received shall be credited to a seperate account called Securities Premium Account. However, according to guidelines issued by the SEBI, a new company set up the entrepreneurs without a track record can issue capital to public only at par. A new company has been defined by SEBI as one which has completed 12 months of commercial operations and its audited operative results are not available. But where a new company is being set up by the existing companies with a five year track record of consistant profitability, it will be free to price its issue provided:

(i) The participation of the promoting companies is not less than 50% of the equity of the new company.

(ii) The issue price is made applicable to all new investors uniformly; and

(iii) The prospectus or offer document contains justification for issue price.

Section 78 of the Companies Act, 1956 gives the purpose for which securities premium account may be applied by the company. These are:

(i) For the issue of fully paid bonus shares to the members of the company;

(ii) for writting off preliminery expenses of the company;

(iii) For writting off the expenses of the commission paid or discount allowed on any issue of shares or debentures of the company; and

(iv) For providing premium payable on the redemption of any redeemable preference shares or debentures of the company.

Journal Entries:

	Journal		**Dr.**	**Cr.**
(a)	If the premium is paid with application money: (i)Bank Account Dr. To Share Application Account (Being share application money along with premium received)		Rs. xxx	Rs. xxx
	(ii) Share Application Account Dr. To Share Capital Account To Securities Ptemium Account (Being share application transfered to share capital and securities premium account)		xxx	 xxx xxx
(b)	If the securities premium is received alongwith the allotment: (i)Share Allotment Account Dr. To Share Capital Account		 xxx	 xxx

	To Securities Premium Account (Being the allotment money and securities premium money due on ....shares)			xxx
	(ii) Bank Account Dr. To Share Allotment Account (Being the receipt of allotment money along with securities premium account)		xxx	xxx

Issue of Shares at a Discount:

A company can issue shares at a discount, i.e., value less than the face value subject to the following conditions:

(i) The issue of shares at a discount is authorised by a resolution by the company in the general meeting and sanctioned by the Central Government.

(ii) The resolution must specify the maximum rate of discount which should not exceed10% of the nominal value of shares or such higher percentage as the Central Government may permit.

(iii) One year must have been elapsed since the date at which the company was allowed to commence business.

(iv) Issue must take place within two months after the date of the sanction by the court or within such extended time as the court may allow.

(v) Every prospectus relating to the issue of shares and every balance sheet after the issue of shares shall contain particulars of the discount allowed and so much of the discount as has not been written off.

Journal Entry:

1.	**The following journal entry is passed on the issue of the shares at a discount at the time of allotment:** Share AllotmentAccount Dr. Discount on the Issue of Shares Account Dr. To Share Capital Account		Rs. xxx xxx	Rs. xxx

Calls in Arrears and Calls in Advance:

If any amount has been called by the company either as allotment or call money and a shareholder has not paid that money, this is known as calls in arrears. On shuc calls in arrears, if the company directors want and there is a provision in the Articles of Association, the company can charge interest @ 5% for the period for which such amount remained in arrear from the shareholder.

Similarly, if any calls has been made but while paying that call, some shareholders has paid the amount of the rest of calls also, then such amount will be called as calls in advance and will be credited to a separate account known as calls in advance account by passing the following entry.

1.	Bank Account Dr. To Calls in Advance Account			xxx	 xxx

Calls in Advance Account is shown on the liabilities side of the Balance Sheet separately from the paid up capital. Generally interest is paid on such calls according to the provisions of the Articles of Association but such rate should not exceed 6% per annum. Calls in advance are not entitled for any dividend declared by the company.

Illustration 2. On 1st March, 2008, ABC Ltd., makes an issue of 20,000 equity shares of Rs. 10 each payable as below:

On application Rs. 2; On allotment Rs. 3 and the first and final call Rs. 6 (three months after allotment).

Applications were received for 26,000 shares and Directors made allotment in full to the applicants demanding ten or more shares and returned money to the applicants for 6,000 shares. One shareholder who was allotted 40 shares paid first and final call with allotment money and another shareholder who was alloted 60 shares did not pay allotment money on his shares, but which he paid with the first and final call. Directors have decided to charge and allow interest, as the case may be, on calls in arrears and calls in advance respectively according to the provisions of Table A. Give the necessary journal entries in the books of the company.

Solution

JOURNAL ENTRIES

2008			Rs.	Rs.
Mar. 1	Bank Account Dr. To Share Application Account (Being application money received on 26,000 shares @ Rs. 2 per share)		52,000	52,000
Mar. 1	Share Application Account Dr. To Share Capital Account To Bank Account Being application money of 20,000 shares transfered to share capital account and application money of 6,000 shares refunded)		52,000	40,000 12,000
,,	Share Allotment Account Dr. To Share Capital Account To Securities Premium Account (Being allotment money and securities premium due on 20,000 shares @ Rs. 3 per share)		60,000	40,000 20,000
,,	Bank Account Dr. To Share Allotment Account To Calls in Advance Account (Being the receipt of allotment money @ Rs 3 on 19,940 shares and advance call money on 40 shares @ Rs. 6 each)		60,060	59,820 240
June. 1	Share First and Final Call Account Dr. To Share Capital Account (Being the amount due in respect of first and final call on 20,000 shares @ Rs. 6 per share)		1,20,000	1,20,000
June. 1	BankAccount Dr. To Share First and Final Call Account To Share Allotment Account (Being the amount received on account of first and final call on 19,960 shares @ Rs. 6 and calls		1,19,940	1,19,760 180

	in arrears on allotment)			
June. 1	Calls in Advance Account Dr. To share First & Final Call Account (Being adjustment of calls in advance against the first and final call)		240	240
June. 1	Interest on Calls in Advance Account Dr. To Bank Account (Being interest paid on calls in advance i.e., on Rs. 240 for 3 monts @ 6% p.a)		3.60	3.60
June. 1	Bank Account Dr. To Interest on Calls in Arrears Account (Being receipt of interest on calls in arrears, i.e., Rs. 180 for 3 months @ 5% p.a)		2.25	2.25

Forfeiture of Shares:

When a shareholder fails to pay calls, the company, if empowered by its articles, may forfit the shares. If a shareholder has not paid any call on the day fixed for payment thereof and fails to pay it even after his allotment is drawn to it by the secreatary by registred notice, the Board of Directors pass a resolution to the effect that such shares be forfited. Shares once forfited becomes the property of the company and may be sold on suchterms as directors think fit. Upon forfiture, the original shareholder ceases to be a member and his name must be removed from the register of members.

Journal Entries

The following entry is passed at the time of forfeiture of shares.

Share Capital Account Dr.	(with the called amount on such shares as capital)
Securities Premium Account Dr.	(if not received)
To Share Capital Account	(with amount which becomes due but not paid)
To Discount on Issue of Shares Account	(if shares are issued at discount)
To Shares Forfited Account	(with the amount already received on such shares)

Surrender of Shares: After the allotment of shares, sometimes a shareholder is not able to pay the further calls and returns his shares to the companyfor cancellation. Such voluntary return of shares to the company by the shareholder himself is called surrender of shares. Surrender of shares has no separate accounting treatment but it will be like that of forfiture of shares. The same entries (as are passed in case of forfeiture of shares) will be passed in case of surrender of shares.

Reissue of Forfeited Shares:

Forfeited shares may be reissued by the company directors for any amount but if such shares are issued at a discount then the amount of discount should not exceed the actual amount received on forfeited shares plus original discount on reissued shares, if any. The purchaser of forfeited reissued shares is liable for payment of all future calls duly made by the company.

The following journal entry on such reissue is passed:

Bank Account	Dr.	(amount received on such reissue)
Discount on Issue of Shares Account	Dr.	(with original rate of discount if the shares originally were issued at discount)
Shares Forfited Account	Dr.	(loss on reissue of shares)
To Share Capital Account		(with face value of shares)
To Securities Premium Account		(if shares are reissued at premium)

After reissue of all forfited shares if there is no balance in shares forfited account, then there will be no capital profit. But where there is profit on the reissue of forfeited shares (i.e., shares forfeited account is showing credit balance after reissue of all forfeited shares) then such profit should be treated as capital profit and will be transferred to capital reserve by passing the following entry:

1.	Shares Forfeited Account	Dr.		xxx	
	To Capital Reserve Account				xxx

Illustration 3: A shareholder was holding 500 equity shares of Rs. 10 each of a company issued at 10% discount. He paid Rs. 2 on application, Rs. 3 on allotment but could not pay the first call of Rs. 3 per share and his shares were forfeited by the directors. The shares were reissued subsequently at a price of Rs. 7 per share. Give the necessary journal entries.

Solution

JOURNAL ENTRIES

			Rs.	Rs.
1.	Equity Share Capital Account Dr.		4,500	
	To Equity Share First Call Account			1,500
	To Discount on Issue of Shares Account			500
	To Shares Forfeited Account			2,500
	(Being forfeiture of 500 equity shares of Rs. 10 each Rs. 9 per share called issued at a discount of 10% for non-payment of first call of Rs. 3 per share; Rs. 5 per share paid forfited)			
2.	Bank Account Dr.		3,500	
	Discount on Issue of Shares Account Dr.		500	
	Shares Forfeited Dr.		500	
	To Equity Share Capital Account			4,500
	(Being reissue of 500 forfeited shares @ Rs. 7 per share credited as Rs. 9 per share paid-up)			
3.	Shares Forfeited Account Dr.		2,000	
	To Capital Reserve			2,000
	(Being profit on reissue of forfeited shares transferred to capital reserve account)			

Illustration 4: A holds 200 equity shares of Rs. 10 each on which he paid Re. 1 per swhare as application money. B holds 300 equity shares of Rs. 10 each on which he has paid Re. 1 and Rs. 3 per share as applicaation and allotment money respectively.

C holds 500 equity shares of Rs. 10 each on which he has paid Re. 1 on application, Rs. 3 on allotment and Rs. 2 on first call.

They all fail to pay their arrears and the second call of rs. 2 per share and the directors, thereafter , forfeited the shares. All these shares were reissued subsequently @ Rs. 11 per share as fully paid. Give the necessary journal entries.

Solution

JOURNAL ENTRIES

			Rs.	Rs.

1.	Equity Share Capital Account Dr. To Equity Share Allotment Account To Equity Share First Call Account To Equity Share Second Call Account To Shares Forfeited Account (Being forfeiture of shares of A,B & C)		8,000	 600 1,000 2,000 4,400
2.	Bank Account Dr. To Equity Share Capital Account To Securities Premium Account (Being reissue of 1,000 forfeited shares of Rs. 10 each at Rs. 11 per share credited as fully paid-up)		11,000	 10.000 1,000
3.	Shares Forfeited Account Dr. To Capital Reserve Account (Being balance of shares forfeited account taking as capital profit transferred to Capital Reserve Account)		4,400	 4,400

Forfiture of Shares when there is Over-subscription and Pro-rata Allotment

It has already been stated that in case of companies of repute, there is possibility of over-subscription. Some applications are rejected altogether and others are allotted on pro-rata basis. When allotted shares on pro-rata basis are forfeited, the problem arises about the amount to be forfeited. In such cases, the following procedure may be adopted:

(a) Calculate the total number of shares applied for on the basis of allotted shares.

(b) Calculate the total amount received on application by multiplying the number of shares with application money. This is the amount which is to be forfeited on default.

(c) Deduct the amount due on application on alloted shares and calculate balance, i.e., money received in advance and to be adjusted on allotment.

(d) Calculate the amount due on allotment on such shares and deduct the amount already received as advance on application. This gives the amount in arrear on allotment and is credited to Share Allotment Account at the time of forfeiture of shares.

Illustration 5: X Ltd., issued for public subscription 20,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share payable as under:

Rs. 2 per share on application; Rs. 5 per share (including premium) on allotment; Rs. 2 per share on first call; Rs. 3 per share on final call.

Applications for 30,000 shares were received. Allotment was made pro-rata to the applicants for 24,000 shares, the remaining applications being rejected. Money overpaid on application was utilised towards sums due on allotment.

Shri Balaji to whom 800 shares were allotted failed to pay the allotment money, first and second call money abs Shri Murugan of whom 1,000 shares were allotted failed to pay the last two calls.

All these forfeited shares were reissued to Shri Vinod as fully paid-up at Rs. 8 per share.

Give the necessary journal entries to recoed the above transactions.

Solution **In the books of X Limited**

JOURNAL

			Rs.	Rs.
1.	Bank Account Dr. To Equity Share ApplicationAccount (Being the application money received on 30,000 equity shares @ Rs. 2 per share)		60,000	 60,000
2.	Equity Share Application Account Dr. To Share Capital Account To Equity Share Allotment Account To Bank Account (Being application money transferred to share capital account, share allotment account and the balance refunded to the applicants)		60,000	 40,000 8,000 12,000
3.	Equity Share Allotment Account Dr. To Share Capital Account To Securities Premium Account (Being the allotment money due on 20,000 equity shares @ Rs. 5 per share including premium)		1,00,000	 60,000 40,000
4.	Bank Account (1) Dr. To Equity Share Allotment account		88,320	 88,320

	(Being the share allotment money received)			
5.	Equity Share First Call Account Dr. To Share Capital Account (Being the share first call money due on 20,000 equity shares @ Rs. 2 per share)		40,000	 40,000
6.	Bank Account Dr. To Equity Share First Call Account (Being the receipt of share first call money)		36,400	 36,400
7.	Equity Share Final Call Account Dr. To Share Capital Account (Being the share final call money due on 20,000 equity shares @ Rs. 3 per share)		60,000	 60,000
8.	Bank Account Dr. To Equity Share Final Call Account (Being the receipt of share final call money)		54,600	 54,600
9.	Equity Share Capital Account Dr. Share Premium Account Dr. To Equity Share Allotment Account To Equity Share First Call Account To Equity Share Final Call Account To Share Forfeited Account (Being the forfeiture of 1,800 shares for the non-payment of allotment on 800 shares and first and final call money on 1,800 equity shares)		18,000 1,600	 3,680 3,600 5,400 6,920
10.	Bank Account Dr. Share Forfeited Account Dr. To Equity Share Capital Account (Being the reissue of the forfeited shares as fully paid up @ Rs. 8 per share)		14,400 3,600	 18,000
11.	Share Forfeited Account Dr. To Capital Reserve Account		3,320	 3,320

	(Being the profit on reissue of forfeited shares transferred to Capital Reserve Account)			

Working Note: **Rs.**

(1) Calculation of amount received on allotment

Amount due on allotment		1,00,000
Less: Already received		8,000

		92,000
Less: Amount not received on 800 shares		
Shares Allotted to Shri Balaji 800		
If alloted 5shares applied 6		
If alloted 800 shares applied 960		
Surplus money on application (160 X 2) =	320	
Amount of allotment due = 800 X 5 =	4,000	
Less: Already received	320	
	----------	3,680

		88,320

Illustration 6: On 1st March, 2009 Bama Co Ltd., issued 25,000 10% preference shares of Rs. 25 each payable as to Rs. 4 with application, Rs. 6 on allotment and the balance in two equql calls of Rs. 7.50 per share. Subscription list (which was opened on 6th March, 2009) totalled 51,0000 shares. The Board of Directors rejected one application for 1,000 swhares and alloted shares on the remaining applications on pro-rata basis on 1st April, 2009.First calls was made three after allotment where as the second call was made four months after the first call. All moneys were duly received. In each case, a 14 days notice was served.

Pass journal entries, prepare Cash Book and show Ledger accounts.

Solution:

Dr. **Cash Book (Bank Columns only)** **Cr.**

2009		Rs.	2009		Rs.
Mar.6	To 10% Preference Shares Applications & Allotment Account (application money on 51,000 10% preference shares @ RS. 4 per share)	2,04,000		By 10% Preference Share Application Account (refund of application money on 1,000 preference shares @ Rs. 4 per share)	4,000
April 1-14	To 10% Preference Shares allotmrnt Account	50,000		By Balance c/d	6,25,000
July 1-14	To 10% Preference Shares First call account	1,87,500			
Nov 1-14	To 10% Preference Shares Second and Final call	1,87,500			
		6,29,000			6,29.000

Journal **Dr.** **Cr.**

2009			Rs.	Rs.
Apr. 1	10% Preference Share Application & Allotment A/c Dr. To 10% Preference Capital Account (Being application money @ Rs. 4 per share and allotment money @ Rs. 6 per share credited to 10% Preference Capital Account On allotment of 25,000 shares as per Directors resolution)		2,50,000	2,50,000
July.1	10% Preference Shares First Call Account Dr. To 10% Preference Share Capital Account (Being first call money due on 25,000 10% preference shares @ Rs. 7.50 per share, as per Directors resolution)		1,87,500	1.87,500
Nov. 1	10% Preference Share Second and Final Call A/c Dr. To 10% Preference share Capital Account (Being second and final call money due on 25,000 10% preference shares @ Rs. 7.50 per share as per Board of Directors resolution)		1,87,500	1,87,500

Working Notes:

Share Applied for	Shares Alloted	Application money received	Application money	Appropriation towards Allotment money	Refund
		Rs.	Rs.	Rs.	Rs.
1,000	--	4,000	--	--	4,000
50,000	25,000	2,00,000	1,00,000	1,00,000	--
51,000	25,000	2,04,000	1,00,000	1,00,000	4,000

	Rs.
Total allotment money on 25,000 10% Preference shares @ Rs. 6 per share	1,50,000
Less: Amount of application money appropriate towards allotment money	1,00,000

Balance received after allotment	50,000

Ledger

Dr. 10% Preference Share Application & Allotment Account Cr.

2009		Rs.	2009		Rs.
Apr. 1	To 10% Preference Share Capital account	2,50,000	Mar.6	By Bank Account	2,04,000
	To Bank Account	4,000	April 1-14	By Bank Account	50,000
		2,54,000			2,54,000

10% Preference Share first Call Account

2009		Rs.	2009		Rs.
July 1	To 10% Preference Share capital Account	1,87,500	July 1-14	By Bank Account	1,87,500

10% Preference Share Second and Final Call Account

2009		Rs.	2009		Rs.
Nov.1	To 10% Preference Share Capital Account	1,87,500	Nov. 1-14	By Bank Account	1,87,500

10% Preference Share Capital Account

		Rs.	2009		Rs.
			Apr.1	By 10% Preference Share Application & Allotment Account	2,50,000
	To Balance c/d	6,25,000	July 1	By 10% Preference Share First Call Account	1,87,500
			Nov. 1	By 10% Preference Share Second & Final Call Account	1,87,500
		6,25,000			6,25,000
				By Balance b/d	6,25,000

REDEMPTION OF PREFERENCE SHARES:

Under section 100 of the Companies Act, a company is not allowed to return to its shareholders the share money without the permission of the Court. But permission of the court is not necessary, if the refund is to be made to the preference shareholders.

When the capital is raised by issuing redeemable preference shares, it is to be paid back by the company to such shareholders after the expiory of stipulated period whether the companyis to be wound up or not. The amount of such shares will be paid back within ten years of their issue either out of the profits or proceeds of the issue of fresh shares. The following important provisions regarding redemption of preference shares are given under section 80 of the Companies Act.

(1) Such shares cannot be redeemed unless they are fully paid up. In other words partly paid up shares cannot be redeemed. This provision is made in order to protect the interest of the creditors.

(2) Such shares can be redeemed either out of profits which would be available for dividend or out of the proceeds of a fresh issue of shares made with the object of redemption. These shares cannot be redeemed out of the proceeds of fresh issue of debentures or out of the sale proceeds of any property of the company as it will lead to erosion of available security to the creditors. Capital profits such as shares forfeited account, development rebate account, capital redemption reserve account, securities premium account,profit prior to incorporation and capital reserve are not available for dividend. If shares are to be redeemed at premium, then such premium must be provided either out of the acumulated profits of the company or out of the company's securities premium account. The word 'proceeds' implies the amount received excluding the amount of securities premium if the shares are issued at premium but the net amount if the shares are issued either at a par or at a discount. This clause is inserted in order to protect the interest of the creditors.

(3) When shares are redeemed out of profits available for distribution for dividend, a sum equql to the nominal amount of the shares so redeemed must be transferred out of profits to a reserve account to be called ' Capital Redemption Reserve Account'. This provision is made in order to immobilise profits from being used for any other purpose such as distribution of dividend, redemption of debentures, etc.

(4) Capital Redemption Reserve Account can be used for issuing fully paid bonus shares to the shareholders. This account cannot be reduced except in accordance with the sanction of the court relating to reduction of share capital.

(5) Redemption of preference shares should not be regarded as a reduction of the authorised capital of the company and as such the reduced shares should remain part of the authorised capital and must be shown in the Balance Sheet.

Procedure for Solving Problems: The following procedure for solving problems is suggested:

1.First of all see whether the redeemable preference shares are fully paid up or partly paid up. If partly paid up, make the following journal entries for making partly paid up as fully paid up.

(a)	Preference Shares Final Call Account Dr. To Preference Share Capital Account		xxx	 xxx
(b)	Bank Account Dr. To Preference Shares Final Call Account		xxx	 xxx

2. Pass entry for the total amount due to preference shareholders including the face value of preference shares and the premium to be paid on redemption of preference shares . The entry is:

	Redeemable Preference Share Capital Account Dr. Premium on Redemption Account Dr. To Preference Shareholders Account or Preference Shares Redemption Account		xxx xxx	 xxx

3.Make entry for issue of equity sharesw either with premium or without premium in order to provide amount for the purpose of redemption of preference shares by fresh issue.

	Bank Account Dr. Discount on Issue of Shares Account Dr. To Equity Share Capital Account To Securities Premium Account		xxx xxx	 xxx xxx

4.Provide premium to be paid on redemption of preference shares out of securities premium account (from fresh issue or existing balance) or profit and loss account or general reserve etc. by passing the following entry:

	Securities Premium Account or			

	Profit and Loss Account or General Reserve Account Dr. To Premium on Redemption Account		xxx	xxx

5.Appropriate amount from profit and loss account or general reserve or any other reserve (available for dividend) to meet the deficiency of the amount required for redemption of preference shares (or if redemption is to be made out of profits only) by passing the following entry:

	Profit and Loss Account or General Reserve etc. Dr. To Capital Redemption Reserve Accoint		xxx	xxx

6.If liquid assets are not available for making payment to preference shareholders on redemption then current assets may be sold by the company or bank overdraft may be arranged.

	Bank Account Dr. Profit and Loss Account (loss on sale of assets) Dr. To Current Assets A/C or Bank Loan A/C To Profit and Loss A/C (profit on sale of assets)		xxx xxx	xxx xxx

7.Payment will be made to the preference shareholders by passing the following entry:

	Preference Shareholders Account (Or) Preference Share Redemption Account Dr. To Bank Account		xxx	xxx

8.If redemption of preference shares is made by conversion of some other shares, then the following entry will be passed:

	Preference Share Capital Account Dr. To New Share Capital Account		xxx	xxx

9.Sometimes capital redemption reserve account is utilised for issuing fully paid bonus shares. In such a case the following entries will be passed:

(1)	**When decision is taken to issue bonus shares:** Capital Redemption Reserve Account (Or) Any other Reserve (Specifically mentioned in the question) To Bouus to Equity Shareholders Account		xxx	xxx
(2)	**When issue of bonus shares is made:** Bonus to Equity Shareholders Account Dr. Equity Share Capital Account		xxx	xxx

10. When right issue is made to the shareholders after redemption of preference shares and issue of bonus shares, then the number of such right shares is calculated after taking into consideration the recent issue of bonus shares. Entries for issue of rights shares will be made on the same lines as are made for issue of equity shares in the ordinary course.

Illustration 1: A company has 40,000 10% redeemable preference shares of Rs. 100 each, fully paid. The company decides to redeem the shares on December 31, 2009 at a premium of 5 per cent. The company makes the following issues : -

(a) 10,000 equity shares of Rs. 100 each at a premium of 10 per cent.
(b) 10,000 12% debentures of Rs. 100 each.

The issue was fully subscribed and all the amounts were received. The redemption was duly carried out. The company has sufficient profits. Give journal entries.

Solution: **Journal** **Dr.** **Cr.**

2009			Rs.	Rs.
Dec. 31	Bank Account Dr.		11,00,000	
	To Equity Share Capital account			10,00,000
	To Share Premium Account			1,00,000
	(Being the allotment of 10,000 shares of Rs.100 each at a premium of Rs. 10 each.)			
Dec. 31	Bank Account Dr.		10,00,000	
	To 12% Debentures Account			10,00,000
	(Being allotment of 10,000 12% debentures of Rs. 100 each)			
Dec. 31	Profit and Loss Account Dr.		1,00,000	
	Share Premium Account Dr.		1,00,000	
	To Premium on Redemption of Preference Shares Account			2,00,000
	(Being the provision of premium of 5% payable on redemption of 40,000 redeemable preference shares of Rs. 100 each)			
Dec. 31	Profit and Loss Account Dr.		30,00,000	
	To Capital Redemption Reserve Account			30,00,000
	(Being the amount transferred to Capital Redemption Reserve Account – the amount uncovered by the face value of the shares issued)			
Dec. 31	10% Redeemable Preference Share Capital Account Dr.		40,00,000	
	Premium on Redemption of Preference shares Account Dr.		2,00,000	
	To Bank Account			42,00,000

Illustration 2: The following is the summarised Balance Sheet of Reliance Limited:

Liabilities	Rs.	Assets	Rs.

Paid up Share Capital		Bank	90,000
Equity Shares:		Other Assets	8,10,000
50,000 shares of Rs. 10 each	5,00,000		
10% Redeemable Pref.Shares			
1,000 shares of Rs. 100			
Each fully called 1,00,000			
Less: Calls in arrear 1,000	99,000		
(On 50 shares @ Rs. 20 each)			
Reserves and Surplus:			
General Reserve	1,00,000		
Dev. Rebate Reserve	50,000		
Other Liabilities	1,51,000		
	9,00,000		9,00,000

The Redeemable Preference Shares were redeemed on the following basis;

(1) Further 4,500 equity shares were issued at a premium of 10 per cent;

(2) Expenses for fresh issue os shares – Rs. 5,000;

(3) Of the 50 preference shares, holders for 40 shares paid the call before the date of redemption. The balance 10 shares were forfeited for non payment of calls before redemption. The forfeited shares were reissued as fully paid on receipt of Rs. 500 before redemption;

(4) Preference shares were redeemed at a premium of 10 per cent, and securities premium amount was utilised on full for the purpose.

Show journal entries including those relating to cash and the summarised Balance Sheet after redemption showing rough workings.

Solution: Journal Entries Dr. Cr.

			Rs.	Rs.
	Bank Account Dr.		49,500	
	To Equity Share Capital Account			45,000
	To Securities Premium Account			4,500
	(Being the issue of 4,500 equity shares at a			

	premium of 10%)			
	Shares Issue Expenses Account Dr. To Bank Account (Being the expenses on the issue of shares)		5,000	 5,000
	Bank Account Dr. To Preference Shares Call in Arrears A/C (Being the receipt of calls in arrears on 40 preference shares @ Rs. 20 each)		800	 800
	Redeemable Preference Share Capital A/c Dr. To Preference Shares Calls in Arrear A/c To Shares Forfeited Account (Being the furfeiture of 10 preference shares for non payment of final call of Rs. 20 each)		1,000	 200 800
	Bank Account Dr. Shares Forfeited Account Dr. To Redeemable Preference Share Capital To Capital Reserve Account (Being the reissue of redeemable preference shares on payment of Rs. 500 and the profit transferred to Capital Reserve Account)		500 800	 1,000 300
	Securities Premium Account Dr. General Reserve Account Dr. To Premium on Redemption Account (Being premium on redemption provided out of past accumulated profits & securities premium out of fresh issue)		4,500 5,500	 10,000
	General Reserve Account Dr. To Capital Redemption Reserve A/C (Being the transfer of Rs. 55,000, the amount of shares redeemed out of profit, to Capital Redemption Reserve Account)		55,000	 55,000

	Redeemable Preference Share Capital A/C Dr. Premium on Redemption Account Dr. To Preference Shareholders Account (Being the amount due to redeemable preference shareholders on redemption)		1,00,000 10,000	 1,10,000
	Preference Shareholders Account Dr. To Bank Account (Being amount paid on redemption of 1,000 Redeemable Preference Shares)		1,10,000	 1,10,000

BALANCE SHEET OF RELIANCE LIMITED. (after redemption)

Liabilities	Rs	Assets	Rs.
Share Capital:		Fixed Assets:	
54,500 equity shares of Rs.		Other assets	8,10,000
10 each fully paid.	5,45,000	Current Assets	
Reserves and Surplus:		Cash at Bank (see note)	25,800
Capital Reserve	300	Misc. Expenses & Losses	
Capital Redemption Reserve	55,000	Share issue expenses	5,000
General Reserve	39,000		
Dev. Rebate Reserve	50,000		
Current Liabilities:			
Other Liabilities	1,51,000		
	8,40,800		8,40,800

Note: Calculation of Cash at Bank :

CASH AT BANK ACCOUNT

	Rs		Rs
To Balance b/d	90,000	By Share Issue Expenses	5,000
To Share Capital	45,000	By Preference Shareholders	1,10,000

To Securities Premium To Pref. Shares Calls in Arrears To Red Pref. Share Capital	4,500 800 500	By Balance c/d	25,800
	1,40,800		1,40,800

Illustration 3: Tata Limited has the following balances as on 31 – 03 – 2006:

Liabilities	Rs.	Assets	Rs.
Share Capital :			
Issued, Subscribed and fully paid up		Fixed Assets Current Assets	22,00,000 8,00,000
10,000 Equity Shares of Rs. 100 each	10,00,000		
5,000 Preference Shares of Rs. 100 each	5,00,000		
Capital Reserve	1,00,000		
Securities Premium A/C	1,00,000		
General Reserve	2,00,000		
Profit and Loss A/c	1,00,000		
Current Liabilities	10,00,000		
	30,00,000		30,00,000

The preference shares are to be redeemed at 10% premium. Fresh issue of equity shares is to be made to the extent it is required under the Companies Act for the purpose of this redemption. The shortfall in funds for the purpose of the redemption after utilising the proceeds of the fresh issue is to be met by taking a bank loan. Show journal entries.

DEBENTURES

A debenture may be defined as an acknowledgement (mostly under seal of the company) of a debt or loan raised by a company. Just as share capital of a company is divided in a large number of parts, each part being called a share, a loan raised by a company may be divided in a large number of parts, each part being called a debenture. Debentures are serially numbered.

Debenture is a creditorship security; company has to pay interest to debentureholders at the agreed rate. It is used to prefix ‘Debentures’ with the annual rate of interest. Thus, if interest at 10% per annum has to be paid on certain debentures, these debentures will be called 10% Debentures.

Distinction between Debentures and Shares: The following are the points of distinction between debentures and shares:

1. **Creditorship Security V. Ownership Security:** Whereas a debenture is creditorship security, a share is an ownersip security. It means that a debentureholder is a creditor of the company, while the shareholder is a part-owner of the company. It is the fundamental distinction between a debenture and a share.
2. **Certainty of return:** A debentureholder is certain of return on his investment. The company has to pay interest on debentures at the fixed rate agreed upon at the time of issue even if it sufferss beavy losses. A shareholder cannot get dividend if the company does not earn profits. As a matter of fact, even when a company earns a profit, its Directors may decide to plough back the profits and not declare a dividend. Thus, there is no certainty of return on investment in shares.
3. **Order of repayment on winding up:** In case of winding up of a company, the amount of debentures will be repaid before any amount is paid to shareholders to return share capital.
4. **Restrections on issue at a discount:** There are no restrections on issue of debentures at a discount, but there are legal conditions which have to be fulfilled to issue shares at a discount.
5. **Mortgage:** There can be mortgage debentures. It means that assets of the company can be mortgaged in favour of debentureholders by way of security. But there can be no mortgage shares.
6. **Convertibility:** Debentures which can be converted into shares at the option of debentureholders can be issued. But shares convertible into debentures cannot be issued.

Issue of Debentures. Debentures are issued in the same manner in which shares are issued. The company issues a prospectus inviting applications along with a sum of money called application money. After Scrutiny, the Board of Directors makes allotment of debentures. If the entire sum of money has not been asked for along with applications another sum of money called, allotment money may be asked for. Subsequently there may be a few calls even. But mostly, the entire amount is received on application or on application and allotmrent.

According to SEBI (Securities and Exchange Board of India) guidelines, issue of fully convertible debentures having a conversion period of more than 36 months is not permissible unless conversion is optional with "put" and "call" option.

Entries for issue of debentures are similar to those passed for issue of shares, only the names of the accounts are changed. There are Debenture Application Account, Debenture Allotment Account, Debenture First Call Account, Debenture Second Call Account and Debenture Third and Final Call Account etc. Instead of crediting Share Capital Account, Debentures Account is credited.

Journal Entries **Dr.** **Cr.**

1.	When applications are received, the entry is: Bank Account Dr. To Debenture Application Account	Rs. xxx	Rs. xxx
2.	On allotment, the application money on debentures alloted is transferred to Debentures Account: Debenture Application Account Dr. To Debentures Account	xxx	 xxx
3.	The amount on application which are rejected will be refunded: Debentures Application Account Dr. To Bank Account	xxx	 xxx
4.	Surplus application money on partiallu accepted applications will be transferred to Debenture Allotment Account: Debenture Application Account Dr. To Debenture Allotment Account	xxx	 xxx
5.	The amount due on allotment: Debenture Allotment Account Dr. To Debentures Account	xxx	 xxx
6.	On receipt of the allotment money: Bank Account Dr.	xxx	

	To Debenture Allotment Account		xxx
7.	The amount due on first call: Debenture First Call Account Dr. To Debentures Account	xxx	xxx
8.	On receipt of the first call money: Bank Account Dr. To Debenture First Call Account	xxx	xxx
9.	The amount due on second and final call: Debenture Second and Final Call Account Dr. To Debentures Account	xxx	xxx
10.	On receipt of the second and final call money: Bank Account Dr. To Debenture Second and Final Call Account	xxx	xxx

Illustration 7. J. S Ltd. issued 10.000 12% Debentures of Rs. 100 each, payable as to Rs. 20 on application and the balance on allotment. Applications were received for 15,000 debentures out of which applications for 9,000 were allotted fully, applications for 400 were allotted 100 debentures and the remaining rejected. All sums due were received. Journalise. Also show the Balance Sheet.

Solution:

J S Ltd.'s Journal

			Dr. Rs.	Cr. Rs.
1.	Bank Account Dr. To 12% Debenture Application Account (Being the amount received as application money on 15,000 debentures @ Rs. 20 each)		3,00,000	3,00,000
2.	12% Debenture Application Account Dr. 12% Debenture allotment Account Dr. To 12% Debentures Account (Being application money @ Rs. 20 per debenture and allotment money @ Rs. 80 per		2,00,000 8,00,000	10,00,000

	debenture credited to 12% Debentures Account in respect of 10,000 debentures allotted as per Directors resolution)			
3.	12% Debentures Application Account Dr. To 12% Debentures Allotment Account To Bank Account (Being transfer of requisite amount from debentures applications account to debentures allotment account and refund made to unsuccessful applicants)		1,00,000	 60,000 40,000
4.	Bank Account Dr. To 12% Debentures Allotment Account (Being the amount received against Debenture Allotment Account)		7,40,000	 7,40,000

Balance Sheet of J S Ltd.

Liabilities	Rs.	Assets	Rs.
12% Debentures	10,00,000	Bank	10,00,000

Premium on Issue of Debentures and Discount on Issue of Debentures:

Premium on issue of Debentures account and Discount in issue of Debentures Account take place of Share Premium Account and Discount on issue of Shares Account respectively. Like shares, debentures may be issued at par, at a premium or at a discount. But the law does not lay down any maximum limit for discount on issue of debentures. The sanction of the Company Law Board is also not needed.

Illustration 8 : Give journal entries in the books of a purchasing company:

(a) A company purchased assets of Rs. 3,50,000 and took over the liabilities of Rs. 30,000. It agreed to pay the purchase price, Rs. 3,30,000, by issuing debentures of Rs. 100 each at a premium of 10%.

(b) A company Purchased assets of Rs. 3,60,000 and took over liabilities of Rs. 35,000. It agreed to pay the purchase price, Rs. 3,34,950, by issuing debentures of Rs. 100 each at a premium of 10% and Rs. 65 by cash. The debentures of the same company are quoted in the market at Rs. 130.

(c) A company purchased assets of Rs. 3,80,000 and took over the liabilities of Rs. 30,000 at an agreed value of Rs. 3,33,000. The company issued debentures at 10% discount in full satisfaction of the purchase price.

Solution:

JOURNAL **Dr.** **Cr.**

			Rs.	Rs.
(a)	Sundry Assets Account Dr. Goodwill Account (Balance Figure) Dr. To Liabilities Account To Vendors Account (Being the purchase of assets and liabilities by purchasing company)		3,50,000 10,000	 30,000 3,30,000
	Vendor Account Dr. To Debentures Account To Premium on Issue of Debentures A/c (Being issue of debentures at a premium of 10%)		3,30,000	 3,00,000 30,000
(b)	Sundry Assets Account Dr. Goodwill Account Dr. To Sundry Liabilities Account To Vendors Account (Being the purchase of assets and liabilities by the purchasing company)		3,60,000 10,015	 3,35,015 35,000
	Vendors Account Dr. To Debentures Account To Premium on Issue of Debentures A/c To Cash Account		3,35,015	 3,04,500 30,450 65
(c)	Sundry Assets Account Dr.		3,80,000	

	To Sundry Liablities Account To Vendors Account To Capital Reserve account (Being the take over of assets and liabilities)			30,000 3,33,000 17,000
	Vendors Account Dr. Discount on Issue of Debentures Account Dr. To Debentures Account (Being the payment of purchase consideration be issuing debentures at a discount of 10%)		3,33,000 37,000	 3,70,000

If the whole amount of debentures is to be called by the company either on application or in different calls, then the entries will be passed in the books of the company on the same lines as was done in case of issue of shares.

REDEMPTION OF DEBENTURES

Meaning of Debentures

A company for its extention and development may require to raise funds without increasing its share capital. The company may invite the public by open declaration to lend money for a fixed period at a declared rate to be paid on such money. Debentures is an instrument in writing given by a company acknowledging the liability for the total amount received as a result of issue of debentures and agreeing thereby to pay the money raised after the expiry of the stipulated period at a certain rate of interest per annum The Company Act defines debentures as ‘debenture includes debenture stock, bonds or any other securities of a company, whether constituting a charge on the assets of the company or not.’

Difference between Debenture and Debenture Stock

The following are the difference between a debenture and a debenture stock:

(1) Debenture need not be fully paid whereas debenture stock must be fully paid.

(2) Debenture can be transferred wholly whereas debenture stock can be transferred in fractions also.

(3) Debentures are identified by their distinct numbers whereas no such distinct numbers are in case of debenture stock.

Stages of Debentures:

(I) Issue of Debentures

(II) Redemption of Debentures.

Debentures may be redeemed in one of the following three ways:-

(1) **In one lot:** All the debentures may be redeemed in one lot at the end of a specified period of time or even before the expiry of the specified period of time by serving a notice to debenture holders.

(2) **In instalments by draw of lots:** The debentures may be redeemed in instalments. For example one-tehth of the total debentures may be redeemed every year for ten years by draw of lots. Lot will have to be drawn every year to determine which particular debentures have to be redeemed in that particular year.

(3) **By purchase of debentures in the open market:** A company may reserve the right to buy its debentures in the open market. If the company cancels the debentures so purchased, it will amount to redemption of these debentures.

When debentures are issued with certain conditions at which redemption can be made, there are five cases which are given as follows:

Case	Conditions of Issue	Conditions of Redemption
1.	Issued at par	Repayable at par
2.	Issued at Premium	Repayable at par
3.	Issued at discount	Repayable at par
4.	Issued at par	Repayable at premium
5.	Issued at discount	Repayable at premium

The journal entries to be passed at the time of issue and redemption of debentures in the five cases are given below:

I.	When debentures are issued at par and repayable at per: (a) On issue of debentures: Bank Account Dr. To Debentures Account		Rs. xxx	Rs. xxx
	(b) On redemption of debentures:			

	Debentures Account Dr. To Bank Account		xxx	 xxx
II.	When debentures are issued at premium and repayable at par: (a) On issue of debentures: Bank Account Dr. To Debentures Account To Premiun on Issue of Debentures A/C		 xxx	 xxx xxx
	(b) On redemption of debentures: Debentures Account Dr. To Bank Account		 xxx	 xxx
III.	When debentures are issued at discount and repayable at par: (a) On issue of debentures: Bank Account Dr. Discount on Issue of Debentures A/C Dr. To Debentures Account		 xxx xxx	 xxx
	(b) On redemption of debentures: Debentures Account Dr. To Bank Account		 xxx	 xxx
IV.	When debentures are issued at par and repayable at premium: (a) On issue of debentures: Bank Account Dr. Loss on the issue of Debentures Account Dr. To Debentures Account To Premium on Redemption of Debentures		 xxx xxx	 xxx xxx
	(b) On redemption of debentures: Debentures Account Dr. Premium on the redemption of debentures Dr To Bank Account		 xxx xxx	 xxx

V.	When debentures are issued at a discount but repayable at a premium: (a) On issue of debentures: Bank Account Dr. Loss on the Issue od Debentures Account Dr. To Debentures Account To Premium on Issue of Debentures A/C		 xxx xxx	 xxx xxx
	(b) On redemption of debentures: Debentures Account Dr. Premium on Redemption of Debentures A/c Dr. To Bank account		 xxx xxx	 xxx

Sources of Finance for Redemption of Debentures:

(1) Redemption out of Profits:

When debentures are redeemed out of profits, profits of the company are utisised for the purpose of redemption withholding the same for dividend. In such a case the following journal entries will be passed.

1.	Entry for amount paid on redemption: Debentures Account Dr. To Bank Account		Rs. xxx	Rs. xxx
2.	Entry for transfer of profit: Profit and Loss Appropriation Account Dr. To Debenture Redemption Reserve Account		 xxx	 xxx
3.	When balance of D.R.R A/c is not required for redemption and is transferred to General Reserve Account: Debenture Redemption Reserve Account Dr. To General Reserve Account		 xxx	 xxx

(2) Redemption out of capital:

If debentures are redeemed out of capital, no amount of divisible profit is kept aside for redeeming debentures. Profits are not utilised for redemption of debentures and may go to the shareholders by way of dividends. Redemption out of capital reduces the liquidity resources acailable to the company. Therefore, a company may adopt this method only when it has sufficient surplus funds.

According to the guidelines issued by SEBI, a company has to create Debenture Redemption Reserve equivalent to 50% of the amount of debentures issued before redemption of debentures commences. Thus, according to this provision redemption of debentures wholly out of capital is now not possible. However, creation of Debenture Redemption Reserve is not required in the following cases:

1. Debentures with a maturity of 18 months or less.

2. Fully convertable debentures. In case of partly convertable debentures, Debenture Redemption Reserve is to be created for the non-convertable part in the same way as applicable for fylly non-convertable debentures.

	When debentures are redeemed out of capital the following entry is made: Debentures Account Dr. To Bank Account		Rs. xxx	Rs. xxx
	Sometimes instead of passing one entry given above, the following two entries are passed: (a) Debentures Account Dr. To Debentureholders (c) Debentureholders Account Dr. To Bank Account		 xxx xxx	 xxx xxx

3. **Redemption by conversion**:

Sometimes the debentureholders of a company are given the option to convert their debentures into the shares or new debentures within a stipulated period. Such option is exercised by the debentureholders only when they are very sure about the progress of the company. The new shares or debentures can be issued either at par or at a premium or at a discount. The following entry will be made:

			Rs.	Rs.
	Old Debentures Account Dr.		xxx	
	Discount on the Issue of Shares/Debentures A/C Dr.		xxx	xxx
	To New Share Capital / Debentures Account			xxx
	To Premium on Issue of shares/Debentures Account			

Illustration 4: On July 1, 2006 X Ltd. gave notice of its intention to redeem its outstanding Rs. 4,00,000 4 ½ % Debenture Stock on January 1, 2007 at 102 per cent and offered the holders the following options:

(1) To apply the redemption money to subscribe for:

(a) 6^ Cumulative Preference Shares of Rs. 20 eaxh at Rs. 22.50 per share accepted by the holders of Rs.1,71,000 stock, or

(b) 6% Debenture stock of Rs. 96 accepted by the holders of Rs. 1,44,000 stock, or

(2) To have their holdings redeemed for cash if neither of the options under (1) was accepted. You are required to show the journal entries necessary to record the redemption and allotments under (1) and (2) and to state the amount of cash required to satisfy the option.

Solution: **JOURNAL** **Dr.** **Cr.**

			Rs.	Rs.
	4 ½ % Debentures Account Dr. Premium on Redemption of Debentures Account Dr. To Debentureholders Account (Being redemption of debentures of Rs. 4,00,000 at 102 per cent)		4,00,000 8,000	 4,08,000
(1)(a)	Debentureholders Account Dr. To 6% Cumulative Preference Share Capital A/c To Securities Premium Account (Being debentureholders of Rs. 1,71,000 (Redemption value Rs. 1,74,420) accepted Cum. Pref. Shares of Rs. 20 each at 22.50 per share)		1,74,420	 1,55,040 19,380

(b)	Debentureholders Account Dr. Discount on Issue of Debentures Account Dr. To 6% Debentures Account (being debentureholders of Rs. 1,44,000 (redemption value Rs. 1,46,880) issued new 6% Debentures at Rs. 96)		1,46,880 6,120	 1,53,000
	Debentureholders Account Dr. To Bank Account (Being Debentureholders of Rs. 85,000 (redemption value Rs. 86,700) paid in cash)		86,700	 86,700
(2)	Total amount required for Redemption is Rs. 4,08,000, i.e., (4,00,000 X 102/100)			

UNIT-II

Introduction

A limited company must prepare every year the Profit and Loss Account and the Balance Sheet. Section 209 makes it compulsory for a company to keep certain books of account. Section 210 governs the preparation of the final accounts. The important portions of this section read as follows: -

(1) At every annual general meeting of the company held in pursuance of section 166, the Board of Directors of the company shall lay before the company –
   (a) The balance sheet as at the end of the period specified in sub-section (3); and
   (b) A profit and loss account for the period

(2) In case of a company not carrying on business for profit, an income and expenditure account shall be laid before the company at its annual general meeting instead of profit and loss account, and all references to 'profit and loss account', 'profit' and 'loss' in this section and elsewhere in this Act, shall be construed, in relation to such a company, as references respectively to the 'income and expenditure account', 'the excess of income over expenditure' and 'the excess of expenditure over income'.

(3) The profit and loss account shall relate –
   (a) In the case of the first annual general meeting of the company, to the period beginning with the incorporation of the company and ending with a day which shall not precede the day of the meeting by more than nine months; and
   (b) In the case of any subsequent annual general meeting of the company, to the period beginning with the day immediately after the period for which the account was last submitted and ending with a day which shall not precede the day of the meeting by more than six months, or in case where an extension of time has granted for holding the meeting under the second provision to sub-section (1) of section 166, by more than six months and the extension so granted.

(4) The period to which the account aforesaid relates is referred in this Act as a 'financial year', and it may be less or more than a calendar year, but it shall not exceed fifteen months:

Legal Position Regarding Final Accounts of Companies

Section 210 to 220 of the Companies Act, 1956 deal with the legal position relating to the final accounts of joint stock companies. A brief mention of these legal provisions is given below:

Section 210. It deals with the preparation and presentation of the final accounts of a joint stock company.

Section 211. It deals with form of contents of the Balance Sheet and Profit and Loss Account.

Section 212. It deals with the disclosure of certain particulars in the Balance Sheet of a holding company in respect of its subsidiaries.

Section 213. It makes provision for extension of the financial year of the holding company and subsidiary.

Section 214. It makes provisions regarding rights of holding company's representatives and members to inspect books of accounts kept by any of its subsidiaries.

Section 215. As per this section, the Balance Sheet and Profit and Loss Account of a company shall be authenticated, (i.e., signed) on behalf of the Board of Directors by its manager or secretary, if any, and by not less than two directors of the company, one of whom shall be a managing director, where there is one.

Section 216. As per this section, the Profit and Loss Account shall be treated as an annexure to the Balance Sheet and the auditors' report as an enclosure thereto.

Section 217. The report of the Board of Directors shall be attached to every Balance Sheet laid before the shareholders in general meeting.

Section 218. It provides for penalty for improper issue, circulation or publication of Balance Sheet or Profit and Loss Account.

Section 219. It deals with the right of the member to copies of Balance Sheet and Profit and Loss Account, auditors' report and every other document required by law to be annexed or attached to the Balance Sheet, which is to be presented in the general meeting.

Section 220. According to this section, three copies of Balance Sheet and Profit and Loss Account be filed with the Registrar within 30 days after the annual general meeting.

Preparation and Presentation of the Final Accounts:

In respect of preparation and presentation of the final accounts the requirements of Section 210 of the Companies Act are quoted below:

(1) At every annual general meeting of a company in pursuance of section 166, the Board of Directors of the company shall lay before the company :

(a) A balance sheet as at the end of the period specified in sub-section (3); and (b) a profit and loss account for that period.

(2) In case of a company not carrying on business for profits, an income and expenditure account shall be laid before the company at its annual general meeting instead of profit and loss account and all references to "profit and loss account", "profit" and "loss" in this and elsewhere in this Act shall be construed, in relatin to such a company as refrences respectively to the "income and expenditure account", "the excess of income over expenditure" and "the excess of expenditure over income".

(3) The profit and loss account shall relate :

(a) In the case of the first annual general meeting of the company to the period beginning with the incorporation of the company and ending with a day which shall not precede the day of the meeting by more than nine months: and

(b) In the case of any subsequent annual general meeting of the company, to the period beginning with the day immediately after the period for which the account was last submitted and ending with a day which shall not precede the day of the meeting by more than six months or in case where an extension of time has been granted for holding the meeting under the second provision to sub-section (1) of section 166, by more than six months and the extension so granted.

(4) The period to which the account aforesaid relates is referred to in this Act as a financial year and it may be less or more than a calendar year, but it shall not exceed fifteen months.

Provided that it may extend to eighteen months where special permission has been granted in that behalf by the registrar.

(5) If any person, being a director of a company, failure to take all reasonable steps to comply with the provisions of this section, he shall, in respect of each offence, be

punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees or with both:

Provided that in case of any proceedings against a person in respect of an offence under this section, it shall be a defence to prove that a competent and realible person was charged with the duty of seeing that the provision of this section were complied with and was in a position to discharge that duty.

Provided further that no person shall be sentenced to imprisonment for any such offence unless it was committed wilfully.

(6) If any person, not being a director of the company, having been charged by the Board of Directors with the duty of seeing that the provisions of this section be complied with, makes default in doing so, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees or with both:

Provided that no person be sentenced to imprisonment for any such offence unless it was committed wilfully.

Form and Contents of Profit and Loss Account:

SCHEDULE VI, PART II

Form of Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To Opening Stock	xxx	By Sales xxx	
To Purchases		Less: Sales Returns xxx	xxx
Less: Purchas Returns	xxx	By Closing Stock	
To Freight and Carriage	xxx		
To Wages	xxx		
To Coal & Coke	xxx		
To Gross Profit c/d	xxx		
	xxx		
	xxx		xxx
	xxx	By Gross Profit b/d	xxx
To Salaries	xxx	By Interest Received	xxx
To Rent	xxx	By Rent Received	xxx

To Discount	xxx	By Discount	xxx
To Commission	xxx	By Commission	xxx
To Advertisment	xxx	By Profit on sale of Assets	xxx
To General Expenses			
To Directors' Fees			
To Bad Debts			
To Loss on sale of assets			
To Depreciation			
To Preliminary Expenses			
To Provision for Income Tax			
To Net Profit c/d			
	xxx		xxx

PROFIT AND LOSS APPROPRIATION ACCOUNT OF............ CO. LTD.

(as on 31 March, 20…...........)

	Rs.		Rs.
To Transfer to Reserves	Xxx	By Last year's Balance b/d	Xxx
To Income Tax for previous year not provided for	Xxx	By Net Profit for the year b/d	Xxx
		By Amount withdrawn from General Reserve or any other reserve	Xxx
To Interim Dividend	Xxx		
To Proposed dividend	Xxx	By Provision such as Income Tax provision no longer required	Xxx
To Surplus (Balance figure) carried to Balance Sheet	Xxx		
	xxx		**xxx**

SCHEDUL VI, PART I

(SECTION 211)

FORM OF BALANCE SHEET

A. HORIZONTAL FORM

Balance Sheet of ….. (here enter the name of the company)

As on .... (here enter the date as at which the balance sheet is made out)

Figures for the previous year Rs. (1)	Liabilities (2)	Figures for the current year Rs. (3)	Figures for the previous year Rs. (4)	Assets (5)	Figures for the current year Rs. (6)
	Share Capital: **Authorized** … shares of Rs. ….each **Issued**: …. Shares of Rs. …. Each **Subscribed:** …. Shares of Rs. ....each. **Less: Calls Unpaid**: (i) By Directors (ii) By others **Add:** Forfeited Shares **Reserves and Surplus:** 1.Capital Reserve 2.Capital Redemption Reserve 3.Share premium A/c 4. Other Reserves 5. Surplus			**Fixed Assets:** **(**a)Goodwill (b)Land (c) Buildings (d) Leaseholds (e) Railway sidings (f) Plant and machinery (g) Furniture and Fittings (h) Development of Property (i) Patents, trade marks and designs (j) Livestock (k) Vehicles etc., **Investments:** 1. Investment in	

	6. Proposed additions to Reserve 7. Sinking funds **Secured Loans:** 1.Debentures 2.Loans and advances from Banks 3.Loans and advances from subsidiaries 4. Other loans and advances **Unsecured Loans:** 1Fixed Deposits 2.Loans and advances from subsidiaries 3. Short term Loans and Advances 4. Other loans and advances **Current Liabilities and Provisions:** **A. Current Liabilities** 1.Acceptances 2.Sundry Creditors 3.Subsidiary Companies 4. Advance payments 5. Unclaimed dividends 6. Other Liabilities 7. Interest accrued but not due on loans			Government or trust securities 2. Investments in shares, debentures and bonds 3. Immovable properties 4. Investments in the capital of partnership firms **Current assets, Loans and Advances:** **(A)Current Assets** 1. Interest accrued on investments 2. Stores and Spare Parts 3. Loose tools 4. stock in Trade 5. Work in progress 6. Sundry Debtors 7. Cash in hand and at bank **(B) Loans and Advances:** 8. Advances and loans to subsidiaries 9. Advances and loans to partnership 10. Bills of	

	B. Provisions 1.Provision for Taxation 2.Proposed Dividend 3.For Contingencies 4.For proposed fund scheme 5.For insurance, pension and similar staff benefit schemes 6.For Provident Fund scheme 7. Other Provisions			Exchange 11. Balances with customs, port trust etc., **Miscellaneous Expenditure:** 1.Preliminary Expenses 2.discount on issue of Shares 3. Underwriting Commission 4. Development Expenditure **Profit and Loss Account**	

VERTICAL FORM OF BALANCE SHEET

Vertical form of Balance sheet inserted as Part B of Part I of Schedule VI to the Companies Act, 1956 by GSRNo.220 (E) dated 12 – 03 – 1979 is as follows:

B. VERTICAL FORM

Name of the Company ……………….

Balance Sheet as at ……………….

(1)	Schedule No. (2)	Figures as at the end of current financial year (3)	Figures as at the end of previous financial year (4)
I. SOURCES OF FUNDS			
(1) Shareholders' Funds:			
(a) Capital			
(b) Reserves and Surplus			
(2) Loan funds:			
(a) Secured Loans			
(b) Unsecured Loans			
II. APPLICATION OF FUNDS			
(1) Fixed assets:			
(a) Gross block			
(b) Less Depreciation			
(c) Net block			
(d)Capital work-in-progress			
(2) Investments			
(3) Current Assets, Loans and Advances:			
(a) Inventories			
(b) Sundry Debtors			
(c) Cash and bank balance			
(d) Other current assets			
(e) Loans and advances			

Less: Current liabilities and Provisions (a) Liabilities (b) Provisions **Net Current Assets** (1) (a) Miscellaneous Expenditure to the extent Not written off or Adjusted (c) Profit and Loss Account **Total**			

Illustration 1 : Prepare a Balance Sheet in Vertical form as at 31st March, 2010 from the following informarion of Goodwill Company Limited as required under Part I B of Schedule VI of the Companies Act, 1956 :

	Rs.
Term loan	10,00,000
Sundry Creditors	11,45,000
Advances	3,72,000
Cash and Bank Balances	2,75,000
Staff Advances	55,000
Provision for Taxation	1,70,000
Securities Premium	4,75,000
Loose tools	50,000
Investments	2,25,200
Loss for the year	3,00,000
Sundry Debtors	12,25,000
Miscellaneous Expenses	58,000
Loans from debtors	2,00,000
Provision for doubtful debts	20,200
Stores	4,00,000

Fixed assets (WDV)	51,50,000
Finished goods	7,50,000
General Reserve	20,50,000
Capital work – in – progress	2,00,000

Additional Information:

(1) Share capital consists of :

(a) 3,000 Equity Shares of Rs. 100 each fully paid up.

(b) 10,000 – 10% Redeemable Preference Shares of Rs. 100 each fully paid up.

(2) Term loans are secured

(3) Depreciation on assets Rs. 5,00,000

(4) Schedule need not be given. However, groupings should form part of the answer.

Solution :

Goodwill Company Limited

BALANCE SHEET

As on 31st March, 2010

		As on 31-3-10	As on 31-3-10
Sources of Funds			
1. Shareholders' Funds :			
(a) Share Capital		13,00,000	
(b) Reserves and Surplus		25,25,000	38,25,000
2. Loans Funds :			
(a) Secured Loans		10,00,000	
(b) Unsecured Loans		Nil	10,00,000
3. Suspense Account (Balancing figure)			27,00,000
			75,25,000
Application of Funds			
1.Fixed Assets:			
(a) Gross Block		56,50,000	

(b) Less : Depreciation		5,00,000	
(c) Net Block		51,50,000	
(d) Capital work-in-progress		2,00,000	53,50,000
			2,25,200
2. Investments			
3. Current Assets, Loans & Advances			
(a) Inventories		12,00,000	
(b) Sundry Debtors		12,04,800	
(c) Cash and Bank Balances		2,75,000	
(d) Loans and Advances		4,27,000	
		31,06,800	
Less : Current Liabilities & Provisions :			
(a) Current Liabilities	13,45,000	15,15,000	
(b) Provisions	1,70,000		15,91,800
4. Miscellaneous Expenditure :		3,00,000	
(a) Profit and Loss Account		58,000	
(b) Miscellaneous Expenses			3,58,000
			75,25,000

Working Notes : Rs.

1. Share Capital:

3,000 Equity Shares of Rs. 100 each	3,00,000
10,000 – 10% Redeemable Preference Shares of Rs. 100 each	10,00,000
	13,00,000

2. Reserves and Surplus:	
Securities Premium	4,75,000
General Reserve	20,50,000

	25,25,000

3.Fixed assets:	
Fixed Assets at WDV	51,50,000
Add : Depreciation	5,00,000

	56,50,000

4.Inventories:	
Finished Goods	7,50,000
Stores	4,00,000
Loose Tools	50,000

	12,00,000

5.Sundry Debtors:	12,25,000
Less : Provision for Doubtful Debts	20,200

	12,04,800

6.Loans and Advances:	
Advances	3,72,000
Staff Advances	55,000

	4,27,000

7.Current Liabilities :

Sundry Creditors	11,45,000
Loans from Debtors	2,00,000

	13,45,000

Illustration 2: The Arun Manufacturing Company Limited was registred with a nominal capital of Rs. 60,00,000 in Equity Shares of Rs. 10 each. The following is the list of balances extracted from its books on 31st March 2009 :

	Rs.
Calls-in-arrear	75,000
Premises	30,00,000
Plant and Machinery	33,00,000
Interim dividend paid on 1st November, 2008	3,92,500
Stock, 1st April, 2008	7,50,000
Fixtures	72,000
Sundry Debtors	8,70,000
Goodwill	2,50,000
Cash in hand	7,500
Cash at Bank	3,99,000
Purchases	18,50,000
Preliminary Expenses	50,000
Wages	8,48,650
General Expenses	68,350
Freight and Carriage	1,31,150
Salaries	1,45,000
Directors' Fees	57,250
Bad Debts	21,100
Debenture interest paid	1,80,000
Share Capital	40,00,000

12% Debentures	30,00,000
Profit and Loss Account (Credit Balance)	2,62,500
Bills Payable	3,70,000
Sundry Creditors	4,00,000
Sales	41,50,000
General Reserve	2,50,000
Bad debts Provision 1st April, 2008	35,000

Prepare Trading and Profit and Loss Account and Balance Sheet in proper form after making the following adjustments:

(a) Depriciate Plant and Machinery by 15%.
(b) Write off Rs. 5,000 from Preliminary Expenses.
(c) Provide for half year's debenture interest due.
(d) Leave Bad and Doubtful Debts Provision at 5% on Sundry Debtors.
(e) Provide for Income Tax @ 50%.
(f) Stock on 31st March, 2009 was Rs. 9,50,000.

Trading and Profit and Loss Account of Arun Manufacturing Company Limited

As on 31st March, 2009

	Rs.		Rs.
To Opening Stock	7,50,000	By Sales	41,50,000
To Purchases	18,50,000	By Closing Stock	9,50,000
To Wages	8,48,650		
To Freight and Carriage	1,31,150		
To Gross Profit c/d	15,20,200		
	51,00,000		51,00,000
To Salaries	1,45,000	By Gross Profit b/d	15,20,200
To General Expenses	68,350		
To Directors' Fees	57,250		

To Bad debts 21,100			
Add: New Provision 43,500			

64,600			
Less: Old Provision 35,000	29,600		

To Debenture interest			
paid 1,80,000			
Add: Outstanding 1,80,000	3,60,000		

To Depreciation on Plant and Machinery	4,95,000		
To Preliminary Expenses	5,000		
To Provision for Income Tax	1,80,000		
To Net Profit c/d	1,80,000		
	15,20,200		15,20,200
	3,92,500		2,62,500
To Interim Dividend		By Balance b/d	1,80,000
To Profit Transferred to Balance Sheet	50,000	By Net Profit b/d	
	4,42,500		4,42,500

Balance Sheet of Arun Manufacturing Company Limited

As on 31st March, 2009

Liabilities	Rs.	Assets	Rs.
Share Capital :		Fixed Assets:	
Authorised Capital :		Goodwill	2,50,000
6,00,000 Equity Shares of Rs. 10		Premises	30,00,000
Per share	60,00,000	Plant & Machinery 33,00,000	
Issued Capital :		Less: Depreciation 4,95,000	28,05,000
4,00,000 Equity Shares of Rs.10		--------------	
per share	40,00,000	Fixtures	72,000
Subscribed & Paid up Capital:		**Investments:**	Nil
4,00,000 Equity Shares		**Current Assets, Loans and**	
Of Rs. 10 per share 40,00,000		**Advances :**	
Less: Calls in arrears 75,000	39,25,000	**A.Current Assets:**	
-------------		Cash in hand	7,500
Reserves and Surplus:		Cash at Bank	3,99,000
General Reserve	2,50,000	Sundry Debtors 8,70,000	
Profit and Loss account	50,000	Less: Provision for	
Secured Loans:		Doubtful Debts 43,500	8,26,500
12% Debentures 30,00,000		-----------	
Add: Interest due 1,80,000	31,80,000	Stock	9,50,000
-------------		**B.Loans and Advances:**	Nil
Unsecured Loans:	Nil		
Current Liabilities &		**Miscellaneous Expenditure:**	
Provisions:		Preliminary Expenses 50,000	
A. Current Liabilities:		Less: Written Off 5,000	45,000
Sundry Creditors	4,00,000	---------	
Bills Payable	3,70,000		
B.Provisions:		**Profit and Loss Account:**	Nil
Provision for Income Tax	1,80,000		
	83,55,000		**83,55,000**

Illustration 3 : From the following particulars furnished by **M/S VISHAL LIMITED.,** prepare the Balance Sheet as at 31st March, 2008, as required by Part I Schedule VI of the Companies Act.

Particulars		**Dr. Rs.**	**Cr. Rs.**
Equity Share Capital (Rs. 10 each, fully paid up)			10,00,000
Calls in Arrears		1,000	
Land		2,00,000	
Buildings		3,50,000	
Plant and Machinery		5,25,000	
Furniture		50,000	
General Reserve			2,10,000
Loan from State Financial Corporation			1,50,000
Stock :			
Finished Goods	2,00,000		
Raw Materials	50,000	2,50,000	

-			68,000
Provision for Taxation		2,00,000	
Sundry Debtors		42,700	
Advances			60,000
Proposed Dividend			1,00,000
Profit and loss Account		30,000	
Cash Balance		2,47,000	
Cash at Bank		13,000	
Preliminary Expenses			1,21,000
Loans (Unsecured)			2,00,000
Sundry Creditors (for Goods and Expenses)			
		19,09,000	19,09,000

The following additional information is also provided : -

(a) Miscellaneous Expenses included Rs. 5,000 audit fees and Rs. 700 for out of pocket expenses paid to the auditors.

(b) 2,000 Equity Shares were issued for consideration other than cash.

(c) Debtors of Rs. 52,000 are due for more than six months.

(d) The cost of assets :

Buildings	Rs. 4,00,000
Plant and Machinery	Rs. 7,00,000
Furniture	Rs. 62,500

(e) The balance of Rs. 1,50,000 in the Loan from State Finance Corporation is inclusive of Rs. 7,500 for interest accrued but not due. The loan is secured by hypothication of the Plant and Machinery.

(f) Balance at Bank includes Rs. 2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.

(g) Bills receivable for Rs. 2,75,000 maturing on 30th June, 2008, have been discounted.

(h) The company had contract for the erection of machinery at Rs. 1,50,000 which is still incomplete.

Solution:

BALANCE SHEET OF M/S VISHAL LIMITED

As on 31st March, 2008

Liabilities	Rs.	Assets	Rs.
Share Capital :		**Fixed Assets :**	
Authorised :	?	Land at cost	2,00,000
Issued and Subscribed :		Buildings, at cost 4,00,000	
1,00,000 Equity Shares of Rs. 10 Each (of the above shares, 2,000 equity shares are allotted as fully paid up pursuant to a contract without payment being received in cash)	10,00,000	Less: Depreciation 50,000	3,50,000

		Plant & Machinery 7,00,000	
		Less: Depreciation 1,75,000	5,25,000

		Furniture at cost 62,500	
Less; Calls-in-arrear	1,000	Less: Depreciation 12,500	50,000
	9,99,000	----------	
Reserves and Surplus :		**Investments :**	Nil
General Reserve	2,10,000	**Current Assets, Loans and Advances :**	
Profit and Loss Account	1,00,000		
Secured Loans :		**A. Current Assets:**	
Loan from State		Stock:	
Financial Corporation 1,42,500		Finished goods 2,00,000	

Add: Interest accrued 7,500 ------------	1,50,000	Raw materials 50,000 ----------	2,50,000
Unsecured Loans :	1,21,000	Sundry Debtors	
Current Liabilities and Provisions :		(a) Debtors outstanding For more than six Months 52,000	
A. Current Liabilities :			
Sundry Creditors for goods and Expenses	2,00,000	(b) Other Debtors 1,48,000 -----------	2,00,000
B. Provisions :		Cash Balance	30,000
Provision for Tax	68,000	Cash at Bank :	
Proposed Dividend	60,000	(a) Scheduled Banks 2,45,000	
Contingent Liabilities not Provided for:		(b) Others 2,000 -----------	2,47,000
1. Bills receivable for Rs. 2,75,000 maturing on 30th June, 2008 have been discounted.		**B. Loans and Advances:**	
		Advances	42,700
2. The company had contract for the erection of machinery at Rs. 1,50,000 which is still incomplete.		**Miscellaneous Expenditure :**	
		Preliminary Expenses	13,300
	19,08,000		19,08,000

Illustration 5 : The following is the balance sheet of Sri Kannan Department Stores Ltd., as at 31st March, 2009 :

Particulars	Rs.	Rs.
Stock, 1st April, 2008	7,50,000	
Purchases Returns		1,00,000
Purchases and Sales	24,50,000	34,00,000
Wages	3,00,000	
Discount		30,000

Carriage Inward	9,500	
Furniture and Fittings	1,70,000	
Salaries	75,000	
Rent	40,000	
Sundry Expenses	70,500	
Profit and Loss Appropriation Account, 31st March, 2008		1,50,000
Dividend paid for 2007 – 08		
Share Capital	90,000	
Debtors and Creditors		10,00,000
Plant and Machinery	2,75,000	1,75,000
Cash at Bank	2,90,000	
General Reserve	4,62,000	
Patents and Trade Mark	48,000	1,55,000
Bills Receivable and Bills Payable	50,000	70,000
	50,80,000	50,80,000

Prepare Trading Account, Profit and Loss Account, and Profit and Loss Appropriation Account for the year ended 31st March, 2009 and Balance Sheet at that date. Take into consideration the following adjustments:

(a) Stock on 31st March, 2009 was valued at Rs. 8,80,000.
(b) Make a provision for income tax @ 50%.
(c) Depreciate Plant and Machinery @ 15%, Furniture and Fittings @ 10% and Patents and Trade marks @ 5%.
(d) On 31st March, 2009, outstanding rent amounted to Rs. 8,000 while outstanding salaries totalled Rs. 9,000.
(e) The Board Directors propose a dividend @ 15% per annum for the year ended 31st March, 2009 after the minimum transfer to General Reserve as required by law.
(f) Make a provision for doubtful debts amounting to Rs. 5,100.
(g) Provide fo managerial remuneration @ 10% of the net profits before tax.

Solution

Trading and Profit & Loss Account of Sri Kannan Department Stores Ltd.

As on 31st March, 2009

Dr. **Cr.**

		Rs.		Rs.
To Stock, 1st April,2008		7,50,000	By Sales	34,00,000
To Purchases	24,50,000		By Stock, 31st March, 2009	8,80,000
Less: Returns	1,00,000			
	-------------	23,50,000		
To Wages		3,00,000		
To Carriage Inward		9,500		
To Gross Profit c/d		**8,70,500**		
		42,80,000		42,80,000
To Salaries	75,000		**By Gross Profit b/d**	**8,70,500**
Add: Outstanding	9,000	84,000	Ny Discount	30,000

To Rent	40,000			
Add: Outstanding	8,000	48,000		

To Sundry Expenses		70,500		
To Provision for Doubtful Debts		5,100		
To Depreciation On:				
Plant & Machinery @ 15%		43,500		
Furniture & Fittings @ 10%		17,000		
Patents & Trade Mark @ 5%		2,400		
To Outstanding Managerial Remuneration @ 10% of net Profit before tax		63,000		
To Provision for Income Tax		2,83,500		
To Net Profit c/d		**2,83,500**		

	9,00,500		9,00,500
			1,50,000
To Dividend paid for 2007 – 08	90,000	By Balance b/d	2,83,500
To Transfer to General Reserve 5% of Net Profit	14,180	By Net Profit for the year b/d	
To Proposed Dividend @ 15%	1,50,000		
To Balance carried to Balance sheet	**1,79,320**		
	4,33,500		4,33,500

Balance Sheet of Sri Kannan Department store Ltd.

As on 31st March, 2009

Liabilities	Rs.	Assets	Rs.
Share Capital		**Fixed Assets**	
Authorised	?	Plant & Machinery 2,90,000	
Issued & Subscribed	10,00,000	Less: Depreciation 43,500	2,46,500
Reserves and Surplus		-----------	
General Reserve		Furniture & Fittings	
Balance as on 1st		1,70,000	1,53,000
April, 2008 1,55,000		Less: Depreciation 17,000	
Add: Aditions		-----------	
Made during the		Patents & Trade Mark 48,000	45,600
Year 14,180	1,69,180	Less: Depreciation 2,400	
--------------		-----------	Nil
Profit & Loss Account	1,79,320	**Investments**	
Current Liabilities and		**Current Assets, Loans and**	
Provisions:		**Advances**	
(A).Current Liabilities		**(A)Current Assets**	8,80,000
Acceptances	70,000	Stock	
Creditors	1,75,000	Debtors 2,75,000	

Outstanding Rent	8,000	Less: Provision	2,69,900
Outstanding Salaries	9,000	For doubtful Debts 5,100	
Outstanding Managerial		------------	4,62,000
Remuneration	63,000	-	
(B).Provisions		Cash at Bank	50,000
Provision for Taxation	2,83,500	**(B)Loans and Advances**	Nil
Proposed Dividend	1,50,000	Bills of Exchange	Nil
		Miscellaneous Expenditure	
		Profit and Loss Account	
	21,07,000		21,07,000

Valuation of Goodwill

Goodwill is the name, fame or reputation earned in business by the company or any form of the business over a period of time. Acquiring goodwill makes the business to attract more and more customers and with passage of time it ultimately results in increase of profits generally. Thus, goodwill fetches some extra salable value to a prosperous business over and above the intrinsic value of net assets. In fact, it is very easy to describe goodwill but very difficult to define. Despite the above limitation there are some very good definitions given below. In the words of 'Spicer and Regler" goodwill may be said to be that element arising from the reputation, connection or other advantages possessed by a business, which enables on the capital represented by the net tangible assets employed in the business.

According to J O Magee 'The capacity of a business to earn profit is basically what is meant by the term goodwill'.

As per Dr. Cannings 'Goodwill is the present value of the firm's anticipated excess earnings'.

According to A V Adamson, 'Just as cement binds together the bricks and other building material into walls, similarly goodwill binds together or unites the other assets and aspects of the business into cohesive whole'.

According to the Institute of Chartered Accountants of India, goodwill is 'an intangible asset arising from business connections or trade name or reputation of an enterprise'.

Nature of Goodwill

Goodwill consists of the advantages a business has in connection with its customers, employees and outside parties with whom it has to contact. That is why it was defined as the probability that the old customers will revert back. Goodwill has been said to be an attractive force which brings in customers. Thus, to determine the nature of goodwill in a particular case, it is necessary to consider the type of business and the type of customers which such a business is inherently likely to attract as well as the particular circumstances of each case. Goodwill of a business is an aggregation of the strength of management, product central policies and attitude toward competition.

Features of Goodwill:

(1) Goodwill may have positive value or negative value. It is positive when the value of business is more than the value of its net identifiable assets and negative when the value of the business is less than the value of its net identifiable assets.

(2) The value of goodwill has no relation to the amount invested and costs incurred in order to build it.

(3) The value of goodwill fluctuates from time to time due to changing circumstances which are internal and external to business.

(4) It is not possible to separately evaluate each of the intangible factors contributing to goodwill.

(5) Goodwill may be purchased or inherent in the business. When a business concern is purchased and the purchase consideration is in excess of the fair value of the identifiable net assets acquired, such excess is recorded as goodwill. However, goodwill is recorded only when an amalgamation is in the nature of purchase and

is not a merger, pooling of interests method is followed and goodwill is not recorded.

(6) An objective valuation of goodwill is difficult. Being subjective it differs from estimate to estimate.

Sources of Goodwill: The following are the main sources which generally give rise to goodwill.

(i) The location of the business e.g., a retail shop located in a busy market centre.

(ii) The reputation of the articles sold arising from the high standard or quality of the goods themselves.

(iii) Possession of trademarks patents or copyrights.

(iv) Possession of advantageous contracts or complete or partial monopoly.

(v) The personality and reputation of the owner or management, arising through his/its skill and influence, as in the case of a professional man. For example, a Chartered Accountant.

(vi) Any special advantage like government legislative or other enjoyed by the firm, e.g., inclusion in the list of approved suppliers to Government, Municipal Corporation or C.P.W.D. etc.

(vii) Development of the business and shopping facilities with the changing conditions of the market e.g., provision for the visitor's rest room.

METHODS FOR VALUING THEGOODWILL

It is not very easy to value and account for goodwill unless there is a particular method accepted by all. However there are five methods for valuing goodwill depending upon the situation.

I. Arbitrary Statement

II. Average Profit Method

III. Super Profit Method

IV. Capitalization Method

ARBITRARY STATEMENT

The valuation of goodwill is arrived at by making a valuation by one of the parties i.e., vendor or purchaser to which the other agrees. The parties may together estimate the value to be placed on the goodwill or an independent party may be called in to give his option as to the value, it being left to the parties to decide whether they will accept or reject the valuation.

This method can be used only when information relating to earning capacity is available. If this information is not available because of non-availability of the profit immediately prior to sale or if the profits are abnormal or unreliable then such data cannot be used as a guide to further profits. Similarly information relating to earning capacity may not be available if the business being acquired may be converted into one of a different nature from that existing prior to date of purchase as in the case of a retail shop dealing in garments is purchased with a vied to converting it to a pharmacy. Consideration should also be given to the question of trading advantages (e.g. quotas) made available to the purchaser by the vendor and licences to import goods up to authorized values. There are really no inter obtainable from the accounting data as to the valuation of such benefits passed on to the purchaser and their worth remain a matter of assessment to be agreed upon by the parties.

AVERAGE PROFIT METHOD

In general all businesses aim for profit and are expected to grow in the future. The buyer of business is also interested to know the present earnings, whether the business will maintain the same profit in the future and if there is scope to increase profit in the future also. If it is not, then the buyer will not pay for goodwill as it would mean purchasing a loss making company. Goodwill is paid for obtaining a future advantage. However, the future is uncertain and is usually estimated on the basis of past. Therefore, in a business what profits are likely to accrue in the future depends upon its average performance in the past and hence the average profits. Therefore, while valuing the goodwill, the buyer always takes the assurance of future, maintainable profits in his mind. Ultimately it results in the earning capacity of the business. Earning capacity of the business depends upon the following factors:

(a) **Nature of Goods.** Profits depend upon nature of goods. If business deals in articles of daily use, profits are likely to be constant. More than constant profits, the more is the goodwill or vice versa.

(b) **Monopolised Business.** A monopolized business will have more goodwill as compared to a business in which many rivals can enter the business.

(c) Trade Name.

(d) **Risk Involved.** Greater the risks involved higher are the profits.

(e) Favorable Location and Site.

(f) Possession of Trademarks, Patents and Copyrights.

(g) Access to Suppliers.

(h) **Capital Required.** If two business units earn the same profits with different amounts of capital, the business unit with lesser amount of capital requirements will enjoy more goodwill.

The profit earned by the company may be subscribed to certain adjustments like abnormal loss, abnormal gain, recurring and non recurring income and expenses.

Simple Average Profit.

Illustration 1: The following particulars are available in respect of business carried on by Mr. Vishal

Profits earned : 2005 – Rs. 6,00,000
2006 – Rs. 4,80,000
2007 – Rs. 5,70,000

You are required to calculate the value of goodwill on the basis of 2 years purchase of average profit of last 3 years.

Solution :

(i) Average Profits $= \dfrac{6,00,000 + 4,80,000 + 5,70,000}{3} = 5,50,000$

(i) Goodwill is based on the number of years purchase on average profit =

Average Profit X Number of years of Purchase

= 5,50,000 X 2 = Rs. 11,00,000

Illustration 2 : From the following calculate the value of goodwill on the basis of 5 years purchase of the average profits of the preceding 7 years:

2003	Profit Rs.	80,000
2004	Profit Rs.	90,000
2005	Profit Rs.	1,10,000
2006	Loss Rs.	50,000
2007	Profit Rs.	1,00,000
2008	Loss Rs.	60,000
2009	Profit Rs.	85,000

Solution :

Year	**Profit or Loss**
2003	(+) 80,000
2004	(+) 90,000
2005	(+) 1,10,000
2006	(-) 50,000
2007	(+) 1,00,000
2008	(-) 60,000
2009	(+) 85,000
Total Profit	(+) 3,55,000

$$\text{Average Profits} = \frac{\text{Total profits after reducing loss}}{\text{Total No. of years including loss}}$$

$$= \frac{3,55,000}{7} = \text{Rs. } 50,714.2857$$

Rounded off to Rs. 50714

Goodwill is based on Number of years of purchase of Average Profit =

Average Profit X Number of years of purchase

50,714 X 5 = Rs. 2,53,570

Illustration 3 : Gurukalam and Co. decided to purchase a business for Rs. 24,00,000. Its profits for the last four years were 2005 – Rs. 6,00,000; 2006 – Rs. 7,50,000; 2007 – Rs. 7,20,000 and 2008 – Rs. 6,90,000. The owner of the business was personally managing it. A manager to replace him has to be paid Rs. 90,000 p.a.

Calculate the value of goodwill if it is valued on the basis of three year's purchase of the average net profit for the last four years.

Solution :

$$\text{Average Profits} = \frac{6,00,000 + 7,50,000 + 7,20,000 + 6,90,000}{4} = 6,90,000$$

Average Profit	Rs. 6,90,000
Less: Manager salary paid	Rs. 90,000
Average future maintainable profit	Rs. 6,00,000

Goodwill is based on number of years of average profit =

Average profit X Number of years of purchase

= 6,00,000 X 3 = Rs. 18,00,000

Illustration 4 : The following information is presented for five years ending 31st March, 2010.

Year ending 31st March	Profit After Tax	Taxation	Transfer to Reserve	Director's Remuneration
2006	6,00,000	2,16,000	1,20,000	48,000
2007	6,60,000	2,40,000	1,44,000	54,000
2008	5,76,000	1,80,000	96,000	54,000
2009	7,80,000	3,00,000	1,80,000	60,000
2010	8,64,000	4,20,000	1,80,000	72,000

Fixed assets revalued and same showed an appreciation of Rs. 60,00,000 (depreciation to be provided for @ 10 per cent). The company has 8 per cent preference share capital of Rs. 12,00,000. The current rate of taxation may be taken @ 50 per cent. Calculate the value of goodwill on the basis of four year's purchase of the last five years average profits.

Solution : Calculation of future average maintainable profits.

Year	Profit after Tax	Taxation	Director's Remuneration	Profits before Tax and Director's Remuneration
2006	6,00,000	2,16,000	48,000	8,64,000
2007	6,60,000	2,40,000	54,000	9,54,000
2008	5,76,000	1,80,000	54,000	8,10,000
2009	7,80,000	3,00,000	60,000	11,40,000
2010	8,64,000	4,20,000	72,000	13,56,000
Total Profit				51,24,000

$$\text{Average Profit} = \frac{\text{Total Profit}}{\text{No. of Years}} = \frac{51,24,000}{5} = 10,24,800$$

	Rs.	Rs.
Profit		10,24,800
Less: Common adjustment		
(a) Depreciation @ 10% on 60,00,000	6,00,000	
(b) Director's Remuneration	72,000	
	6,72,000	
Profit before Tax	3,52,800	
Less: Income Tax @ 50%	1,76,400	
Profit after Tax	1,76,400	
Less: Preference Dividend @ 8% on Rs. 12,00,000	96,000	
Future Average Maintainable Profit		80,400

Goodwill is based on number of years of average profit =

Average profit X Number of years of purchase

80,400 X 4 = Rs. 3,21,600

Note: Director's remuneration has been taken as Rs. 72,000 because hereafter it would not be less than this amount in the future.

III. SUPER PROFIT METHOD

Goodwill, no matter how determined, represents a valuation of future earnings. As per the first definition of goodwill, it presents the value of firm's anticipated 'excess' earnings. If there are no anticipated excess earnings over normal earnings, there can be no goodwill. Thus goodwill is paid by the buyer only if the business that is being purchased is earning profits in excess of normal rate of earnings. So the excess of average profit over normal profit is known as super profit.

Defined in another way, super profit is the excess of profit which can be expected in future years over and above what is necessary for paying a fair return on capital employed, considering the risk involved in that class of business and fair managerial remuneration.

It is such excess profit that is referred to as super profit and represents the difference between the average profit earned by the business and the normal profit based on the normal rate of return for representative firms in the industry. Hence, this method of valuing goodwill will require the following information :

(1) A normal rate of return for representative firm in the industry;

(2) The fair value of capital employed; and

(3) The estimated future earning of the firm, i.e., average of the profits earned in the past three or four years. Each has been discussed below :

(A) Normal Rate of Return. The normal earning is that rate of earning which investors in general expect on their investments in a particular type of industry. This rate of earning differs from industry to industry. The normal rate of earnings is required to be adjusted in the light of certain circumstances such as :

(1) **Higher bank rate.** Any increase in the bank rate increases the expectation of investors and they start hoping higher rate of return.

(2) **General boom.** When there is a boom in industry the investors start expecting More and normal rate of return is to be increased.

(3) **Risk attached to the investment.** The more the risk, more is the rate of return. Risk may also be due to high amount of borrowing made by the business or nature of business.

(4) **Period of investment**. The longer the period of investment, higher is the rate of return.

(B) Capital Employed. The capital invested in the business brings return as in terms of profit. If there is more capital employed one can expect more return since the profit of a firm can be justified in terms of capital employed only

		Rs.
Assets (other than goodwill and deferred expenditures like Preliminary expenses, discount, etc.) at market value		XXX
Less:	Liabilities due to outside parties (i.e., creditors, bills payable, debentures, taxation, outstanding bills, etc.) at revised values, if any	XXX

Capital Employed		XXX

Calculation of Super profit. Super profit is a simple difference between average profit and normal profit. Suppose Rs. 5,00,000 is the average profit and normal profit is Rs. 2,80,000. So Super profit = Average profit minus Normal profit = Rs. 2,20,000.

Illustration 5 : The following particulars are available in respect of the business carried on by a trader :

(1) Profits earned :

2007 Rs. 5,00,000; 2007 Rs. 6,00,000; 2008 Rs. 5,50,000

(2) Normal rate of profit	10%
(3) Capital Employed	Rs. 30,00,000
(4) Present value of an annuity of one rupee for five years at 10%	Rs. 3.78

(5) The profits included non-recurring profits on an average basis of Rs. 40,000 out of which it was deemed that even non-recurring profits had a tendency of appearing at the rate of Rs. 10,000 p.a.

You are required to calculate goodwill : (a) as per five years purchase of super profits, (b) as per capitalization of super profit method, and (c) as per annuity method.

Solution :

Calculation of Average profit :	Rs.
Profits : 2007	5,00,000
2008	6,00,000
2009	5,50,000
	16,50,000
Average Profits (16,50,000 / 3)	5,50,000
Less: Non-recurring profit	40,000
	5,10,000
Add: Non-recurring profit having tendency of Recurring profit	10,000
Average Expected Profits	5,20,000

Calculation of Super Profit:	Rs.
Average Expected Profits	5,20,000
Less: 10% Normal Profit on Rs. 30,00,000 Capital Employed	3,00,000
Super Profit	2,20,000

(a) Goodwill as per five years purchase of Super Profit (2,20,000 X 5) 11,00,000

(b) Goodwill as per capitalization of Super Profit method

$$2,20,000 \times \frac{100}{10} = 22,00,000$$

(c) Goodwill as per Annuity Method (2,20,000 X 3.78) 8,31,600

IV CAPITALIZATION METHOD

The following are the main steps to be taken in computing goodwill by this method:

(a) Ascertain the average net profit which it is expected will be earned in future;
(b) Capitalise this net profit at the rate which is considered a suitable return on capital invested in a business of the type under consideration;
(c) Find the value of the net tangible assets used in the business, i.e., assets less outside liabilities; and
(d) Deduct the net tangible assets as per (c) from the capitalised profit obtained in (b) and the difference is goodwill.

VALUATION OF SHARES

Illustration : On 31st March, 2007, the Balance Sheet of a Limited Company disclosed the following position :

Liabilities	Rs.	Assets	Rs.
Issued Capital in Rs. 10		Fixed Assets	5,00,000
Shares	4,00,000	Goodwill	40,000
Reserves	90,000	Current Assets	2,00,000
Profit & Loss Account	20,000		
5% Debentures	1,00,000		
Current Liabilities	1,30,000		
	7,40,000		7,40,000

On 31st March, 2007 the fixed assets were independently valued at Rs. 3,50,000 and goodwill at Rs. 50,000. The net profits for the three years were :

2005 Rs. 51,600; 2006 Rs. 52,000; 2007 Rs. 51,650.

Of which 20% was placed to reserve this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%.

Compute, the value of the company's shares by (a) the assets method, and (b) the yield method.

Solution :

(a) **Value of Shares according to the Assets Method:**

		Rs.
Market value of Fixed Assets		3,50,000
Goodwill (as per valuation)		50,000
Current Assets		2,00,000
Total Value of Assets		6,00,000
Less : Liabilities : 5% Debentures	1,00,000	
Current Liabilities	1,30,000	
		2,30,000
Net Assets		3,70,000

$$\text{Intrinsic Value per share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs. } 3,70,000}{40,000} = \text{Rs. } 9.25.$$

(b) Value of Shares according to Yield Method :

1. **Calculation of Average Expected Future Profits :**

		Rs.
Profits :	2005	51,600
	2006	52,000
	2007	51,650
	Total Profits for three years	1,55,250
	Average Profits (1,55,250 / 3)	51,750
Less : 20% transferred to reserves (51,750 X 20/100)		10,350
	Average Profits after Reserves	41,400

2. **Calculation of Expected Return :**

$$\text{Expected Return} = \frac{\text{Expected Profits}}{\text{Equity Capital}} \; 100$$

$$= \frac{41,400}{4,00,000} \times 100 = 10.35\%$$

3. **Calculation of Yield Value of Share :**

$$\frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{Paid up Value of share}$$

$$= \frac{10.35}{10} \; 10$$

= Rs. 10.35.

Illustration : The following particulars are available in relation to Akshaya Ltd. :

(1) Capital : 450 6% preference shares of Rs. 100 each fully paid ; and 4,500 equity shares of Rs. 10 each fully paid.

(2) External liabilities : Rs. 7,500.

(3) Reserves and surplus : Rs. 3,500

(4) The average expected profit (after taxation) earned by the company : Rs. 8,500

(5) The normal profit earned on the market value of equity shares (fully paid) of the same time of companies is 95.

(6) 10% of the profits after tax each year is transferred to reserves.

Calculate the intrinsic value per equity share and the value per equity share according to dividend yield basis. Assume that out of total assets worth Rs. 350 are fictitious.

Solution :

Calculation of Intrinsic Value per Equity Shares		Rs.
Preference Share Capital		45,000
Equity Share Capital		45,000
Reserves and Surplus		3,500
External Liabilities		7,500

Gross Assets (Equal to total liabilities)		1,01,000
Less : Fictitious Assets	Rs. 350	
External Liabilities	Rs.7,500	
	-------------	7,850

Assets available for Shareholders		93,150
Less : Preference Share Capital		45,000

Assets available for Equity Shareholders		48,150

Number of Equity Shares		4,500

Therefore, Intrinsic Value per Equity Share $= \dfrac{\text{Rs. } 48{,}150}{4{,}500} = \text{Rs. } 10.70$

Calculation of value per Equity Share on Dividend Yield Basis	Rs.
Average Expected Profit (after tax)	8,500
Less : Transfer to Reserve 10%	850
	7,650
Less : Preference Share Dividend @ 6% on Rs. 45,000	2,700
Expected Profit for Equity Shareholders	4,950

$$\text{Expected Rate of Dividend} = \frac{\text{Expected Profit}}{\text{Equity Share Capital}} \times 100$$

$$= \frac{\text{Rs. } 4{,}950}{\text{Rs. } 45{,}000} \times 100 = 11\%$$

$$\text{Value per Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Profit}} \times \text{Paid up Value of share}$$

$$= \frac{11\%}{9\%} \times \text{Rs. } 10 \quad = \text{Rs. } 12.22$$

UNIT – III

SYLLABUS

Merger and Acquiistion of companies:- Meaning of amalgamation of Acquisition- types of amalgamation-amalgamation in the nature of purchase-mehtods of purchase consideration-calculation of purchase considferation(Indian accounting standard 103)- Net assets method-net payment method-accounting for amalgamation(problems on both the methods)-entries of ledger accounts in the books of transfer company and transferee company-preparation of new balance sheet-(vertical form)

Accounting for Amalgamation, Absorption and External Reconstruction

Introduction

Sometimes companies carrying on similar business combine with each other to obtain the economies of large scale production or to avoid the disastrous results of cut throat competition. It is being done by Amalgamation and Absorption. The term amalgamation is used when two or more companies carrying on similar business go into liquidation and a new company is formed to take over their business. The term absorption is also used when an existing company takes over the business of one or more existing companies. These concepts have been modified by the Accounting Standard 14 (AS – 14) – "Accounting for Amalgamation", issued by the Institute of Chartered Accountants of India. This standard is applicable in respect of accounting periods commencing on or after 1st April, 1995 and is mandatory in nature. This standard specifies the procedure of accounting for amalgamation and the treatment of any resultant goodwill or reserve.

Purchase Consideration

Purchase consideration is the amount which is paid by the purchasing (transferee) company for the purchase of the business of the vendor (transferor) company. The purchasing company agrees to pay certain sum of payments to the vendor company called purchase consideration. While determining the amount of purchase consideration special care should be given to the valuation of assets and liabilities of the vendor (transferor) company. The calculation of purchase consideration is very important and may be calculated in the following ways:

(1) **Lump Sum Method.** When the transferee company agrees to pay a fixed sum to the transferor company, it is called a lump sum payment of purchase consideration. For example, if A Ltd., purchases the business of B Ltd., and agrees to pay Rs. 50,00,000 in all, it is an example of lump sum payment.

(2) **Net Worth (or Net Assets) Method.** According to this method, the purchase consideration is calculated by calculating the net worth of the assets taken over by the transferee company. The net worth is arrived at by adding the agreed value of assets taken over by the transferee company minus agreed value of liabilities to be assumed by the transferee company. While calculating purchase consideration under this method the following points merit attention:

(a) The term 'Assets' will always include cash in hand and cash at bank unless otherwise specified but shall not include fictitious assets as preliminary expenses, discount on the issue of shares or debentures, underwriting commission, debit balance of Profit & Loss Account, etc.

(b) If the particular asset is not taken over by the transferee company, it should not be included in the purchase consideration.

(c) The term 'Liabilities' will mean all liabilities to third parties (i.e., excluding company and shareholders).

(d) The term ‘trade liabilities’ will include trade creditors and bills payable. It will exclude other liabilities to third party as bank overdraft, debentures, outstanding expenses, tax liability etc.

(e) If a fund or portion of a fund denotes liability to third parties, the sum must be included in the liability as staff provident fund, workmen’s’ savings bank account, workmen’s’ profit profit sharing fund, workmen’s’ compensation fund (up to the amount of claim, if any).

(f) The ‘term liability’ will not include past accumulated profits or reserves such as general reserve, dividend equalisation fund, reserve fund, sinking fund, capital reserve, securities premium account, capital redemption reserve account, profit and loss account etc., as these are payable to shareholders and not to third parties.

(g) The term ‘business’ will always mean both the assets and the liabilities.

(h) If any liability is not taken over by the transferee company, the same should not be included in the purchase consideration.

(i) Goodwill (being an intangible asset) value agreed to be paid by the transferee company is added in the purchase consideration.

(j) The consideration for the amalgamation should include any non-cash element at fair value. In case of issue of securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up. Where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

(k) Where the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and a reasonable estimate of the amount can be made. In all other cases, the adjustment should be recognised as soon as the amount is determinable [see Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date].

(l) Treatment of Reserves Specified in a Scheme of Amalgamation. Where the scheme of amalgamation sanctioned under a statute prescribes the treatment to be given to the reserves of the transferor company after amalgamation, the same shoot be followed.

Net worth or net assets method of purchase consideration may be made clear by the following example :

BALANCE SHEET OF KARPAGAM CO. LTD.
As at 31st March, 2005

Liabilities	Rs.	Assets	Rs.
Share Capital		Goodwill	2,80,000
60,000 Equity Shares of	6,00,000	Land and Buildings	1,60,000
Rs.10	1,00,000	Plant and Machinery	2,80,000
5% Debentures	60,000	Stock	1,60,000
Sundry Creditors	40,000	Debtors	80,000
General Reserve	2,00,000	Cash	20,000
Profit and Loss account		Preliminary Expenses	20,000
	10,00,000		**10,00,000**

Suppose (i) Company **Providence Ltd.,** takes over the business of Company Karpagam Ltd.,; (ii) The value agreed for various assets is : Land and Buildings Rs. 2,50,000, Plant and Machinery Rs. 2,40,000, Goodwill Rs, 2,20,000, Stock Rs. 1,30,000 and

Debtors Rs. 80,000; Providence Company does not take over cash but agrees to assume the liability of Sundry Creditors at Rs. 50,000.

The calculation of purchase consideration will be as follows :

Value of assets taken over by Providence Company Ltd., :	**Rs.**
Land and Buildings	2,50,000
Plant and Machinery	2,40,000
Goodwill	2,20,000
Stock	1,30,000
Debtors	80,000

	9, 20,000
Less : Sundry Creditors taken over by Providence Co. Ltd.	50,000

Purchase Consideration	**8,70,000**
	------------

(3) **Net Payment Method.** Under this method purchase consideration is calculated by adding the various payments in the form of shares, securities, cash etc. made by the transferee company. No amount of liabilities is deducted even if these are assumed by the purchasing company. Thus purchase consideration is the total of all the payments whether in shares, securities or cash. Suppose, in the example given above Providence Ltd., agrees to give for every 10 shares in Karpagam Ltd., 15 shares of Rs10 each, Rs.8 paid up; Providence Ltd., also agrees to pay Rs 1,50,000 cash to discharge the creditors.

The Purchase Consideration will be calculated as under :

Shareholders of Karpagam Ltd. will get :

$$60,000 \times \frac{15}{10} = 90,000 \text{ shares of Rs. 10 each, Rs. 8 paid up} \quad 7,20,000$$

Cash paid to discharge creditors	1,50,000
Purchase Consideration	**8,70,000**

(4) **Shares Exchange Method.** Under this method purchase consideration is required to be calculated on the basis of intrinsic value of shares. The intrinsic value of a share is calculated by dividing the net assets available for equity shareholders by the number of equity shares. This value determines the ratio of exchange of the shares between the transferee and transferor companies. In some cases the agreed values of the shares of both the companies are given. In that case the purchase consideration is calculated with reference to the value of shares of two companies involved. Suppose X Ltd. and Y Ltd. are two companies carrying on business in the same line of activity. Their capital is Rs. 60,00,000 and Rs. 20,00,000 (value of each share , Rs. 100). The two companies decided to amalgamate in XY Ltd. If each share of X Ltd. and Y Ltd. is valued at Rs. 150 and Rs. 250 respectively for the purpose of amalgamation, then purchase consideration will be as under :

	X Ltd. Rs.	Y Ltd. Rs.
60,000 shares of Rs. 150 each	90,00,000	---
20,000 shares of Rs. 250 each	---	50,00,000

Note : While issuing shares to individual shareholders of the selling company, these may be in fractions. A company cannot issue shares in fractions but it can issue fractional certificates or coupons or pay cash for the fractions.

RECONSTRUCTION

It means reconstruction of a company's financial structure. It may take place either with or without the liquidation of the company.

Internal Reconstruction: This is generally resorted to by a company which is being reorganized internally. A scheme of re-organization is prepared in which all parties sacrifice. The sacrifices are made in this order – equity shareholders, preference shareholders, unsecured creditors and partially secured creditors. Under this scheme the existing company continues in its legal entity from and can take advantage of carry forward and set off of the past losses.

AMALGAMATION AND EXTERNAL RECONSTRUCTION

ACCOUNTING ENTRIES IN THE BOOKS OF THE TRANSFEROR COMPANY:

The books of the transferor company being wound up will be closed in the same way as the books of a partnership firm being dissolved. The following entries are made:

(1) For transferring assets taken over by the transferee company

Realisation Account

To Various Assets (individually at book value)

Note. Assets which are not taken over by the purchasing company as cash, bank balance will not be transferred to Realisation Accounts. Fictitious assets like preliminary expensses, discount or commission or expenses on issue of shares or debentures, debit balance of profit and loss account are not to be transferred to realisation account. Assets on which some provision has been made are to be transferred to realisation account at their gross figures and provisions has been made should be transferred along with liabilities.

(2) For transferring liabilities taken over by the transferee company

Various Liabilities (Individually) Dr. (at book value)

To Realisation Account

Note. Only those liabilities are to be transferred which have been assumed by the transferee company. Accumulated profits like credit balance of profit and loss account, general reserve, dividend equalisation reserve, sinking fund, capital reserve are not transferred to realisation account. If there is any fund which partially represents liability and partially undistributed profit, then that portion which represents liability should be transferred to to realisation account. Trade liabilities include sundry creditors and bills payable but not outstanding bills.

(3) For purchase consideration

Transferee Company's Account Dr.

To Realisation Account

(4) For receiving purchase consideration from the transferee company

Bank Account Dr.

Shares in Transferee Company A/c Dr.

To Transferee Company a/c

(5) For assets sold by the transferor company not taken over by the transferee company

Bank Account Dr.

Realisation A/c (if loss on sale of assets) Dr.

To Assets Account

To Realisation A/c (if profit on sale of assets)

(6) For liquidation expenses

(a) If the expenses are to be met by the transferor company

Realisation Account Dr.

To Bank Account

(b) If the expenses are to be met by the transferee company, there are two alternatives:

First Alternative – no entry.

Second Alternative – the following two entries will be passed:

(i) Transferee Co.'s A/c Dr.

To Bank Account

(ii) Bank Account Dr.

To Transferee Co.'s A/c

(c) If liquidation expenses are included in the purchase consideration and not paid separately by the purchasing company

Realisation Account Dr.

To Bank Account

(7) For liabilities not taken over by the transferee company when paid by the transferor company

Various Liabilities A/c Dr.

Realisation A/c (if excess payment is made) Dr.

To Bank Account

Or Shares in Transferee co. A/c

To Realisation A/c (if less payment is made)

(8) For Closing Realisation Account

(a) If Profit

Realisation A/c Dr.

To Equity shareholders A/c

(b) If Loss

Equity Shareholders A/c Dr.

To Realisation A/c

(9) For transferring Preference Share Capital

Preference Share Capital A/c Dr.

To Preference Shareholders A/c

Note. If arrears of dividend are to be paid to preference shareholders, then such excess amount should be debited to realisation account and credit to Preference Shareholders Account. If the preference shareholders have agreed to get less than the amount of capital, then reverse entry is to be passed.

(10) For transferring equity share capital and accumulated profit:

Equity Share Capital A/c Dr.

General Reserve A/c Dr.

Debenture Redemption Reserve A/c Dr.

Dividend Equalisation Reserve A/c Dr.

Share Premium A/c Dr.

Profit and Loss A/c Dr.

Accident Compensation Fund Dr

Share Forfeited A/c Dr.

Profit Prior to Incorporation A/c Dr.

Any Other Reserve or Fund A/c Dr.

To Equity Shareholders A/c

(11) For transferring accumulated loss and expenses not written off

Equity Shareholders A/c Dr.

To Profit and Loss A/c

To Discount or Expenses on issue of shares or debentures

To Preliminary Expenses

To Underwriting Commission

(12) For paying shareholders

Preference Shareholders A/c Dr.

Equity Shareholders A/c Dr.

To Bank or Shares in transferee company

ACCOUNTING ENTRIES IN THE BOOKS OF THE TRANSFEREE COMPANY

(1) On amalgamation of business

Business Purchase Account Dr. (with the amount of

To Liquidators of Transfereor Co purchase consideration)

(2) For recording assets and liabilities taken over

Sundry Assets (Individually) Account Dr. (with book value)

To Sundry Liabilities A/C (Individually) (with book value)

To Reserve Account (with book value)

To Business Purchase Account (with book value)

The difference between debits and credits is adjusted in the reserves of the transferee company.

Note. As per AS – 14, the balance of the Profit and Loss A/C of the transferor company is transferred to General Reserve. If any.

Instead of passing two entries one combined entry can be passed :

Sundry Assets Account Dr.

To Sundry Liablities

To Profit and Loss Account

To Reserve Account

To Liquidators of the Transfereor Co. A/C

The difference between the above mentioned debits and credits is adjusted against the reserve in the books of transferee company.

(3) For making payment to the liquidator of the transferor company.

Liquidator of the Transferor Co. A/C Dr.

To Bank / Share Capital / Securities Premium (if any)

(4) If liquidation expenses are paid by the transferee company

Profit and Loss Account Dr.

To Bank Account

(5) For the formation expenses of the transferee company

Preliminary Expenses Account Dr.

To Bank Account

Illustration 1 : On 31st March, 2008, White Ltd. was absorbed by Black Ltd., the later taking over all the assets and liabilities of the former at book values. The consideration for the business was fixed at Rs. 40,00,000 to be discharged by the transfree company in the form of its fully paid equity shares of Rs. 10 each, to be distributed among the shareholders of the transferor company, each shareholder getting two shares for every share held in the transferor company. The balance sheet of the two companies as on 31st March, 2008 stood as under :

Liabilities	White Ltd.	Black Ltd.	Assets	White Ltd.	BlackLtd.
Share Capital : Authorised Issued & Subscribed Equity Shares of Rs. 10 each General Reserve Profit & Loss A/C Workmen's Compensation Fund Sundry Creditors Staff Provident Fund Provision for Taxation					

Example-1

1. A company having 500000 8% preference shares of Rs10 each decides to consolidate the shares into shares of Rs100 each .the required journal entry is as follows

8% preference share capital (Rs. 10)A/c Dr	50,00,000	
To 8% preference share capital (Rs100) A/c		50,00,000

Example 2

2.conversion of stock into shares

A company decides to convert its Rs10 equity shares capital of Rs8,00,000 into stock.

The following is the journal entry to be passed

Equity capital A/c Dr 8,00,000

To equity capital stock A/c 8,00,000

Example 3

3. Refunding surplus capital which is found to be in excess of the needs of the company

A company whose paid up capital includes 10,000 shares equity shares of Rs100 each fully paid decides to return Rs.20 per share to the members , thus reducing each shres to Rs. 802 each. Fully paid.

Particulars	Debit	Credit
Equity share capital (Rs.100) A/c Dr	10,00,000	
To equity share capital (Rs.80) A/c		8,00,000
To sundry shareholders A/cc		2,00,000
Sundry shareholders A/c Dr	2,00,000	
To bank A/c		2,00,000

Example 4

Cancelling or writing off lost of capital, not represented by assets

5,000 equity shares of Rs. 10 each are reduced to fully paid shares of Rs.6 each .

Particulars	Debit	Credit
Equity share capital (Rs10)A/c Dr	50,000	
To equity share capital (Rs6) A/c		30,000
To capital reduction A/cc		20,000

Example 5

When there is appreciation in the value of any of the assets

On the date of capital reduction a company finds that its buildings have appreciated by Rs.40,000 and the value of stock has gone up by Rs.30,000

Particulars	Debit	Credit
Buildings A/c	40,000	
Stock A/c	30,000	
To capital reduction A/c		70,000

Example 6

when debenture holders or creditors make some sacrifice as a part of capital reduction scheme

As per the capital reduction scheme adopted by a company 5,000 7% debenture of Rs.100 each are to be reduced to Rs80each and trade creditors have agreed to reduce their claims by Rs.50,000

Particulars	Debit	Credit
7% debentures A/c Dr	1,00,000	
Creditors A/c	50,000	
To capital reduction A/c		1,50,000

Example 7

X co ltd has the following shares as a part of its share capital

- 10,000 *% preferences shares of Rs.100 each fully paid
- 50,000 equity shares of Rs.5 each fully paid

- 20,000 equity shares of Rs. 10 each . Rs. 8 called up and paid up
- The company has decided to alter the share capital of Rs.10 each.
- To sub divide the preference share in to shares of Rs.10h.
- To consolidate the equity shares of Rs. 5 each in to shares of Rs.10 each

To convert the partly paid up equity shares in to fully paid up shares of Rs8 each with necessary legal sanctions.

Journal the following

Particulars	Debit	Credit
Preference share capital (Rs100 each) A/c Dr To preference shares capital (Rs10) A/c	10,00,000	 10,00,000
Equity share capital (Rs 5)A/ c Dr To equity shares capital (Rs10) A/c	2,50,000	 2,50,000
Equity share capital (partly paid)A/c Equity share capital (fully paid) A/c	1,60,000	 1,60,000

Example 8

(Surplus in Capital Reduction Account)

ABC Ltd passed resolution and got court permission for the reduction of its share capital by Rs.5,00,000 for the purpose mentioned as under:

- To write off the debit balance of P& L a/c of Rs.2,10,000
- To reduce the value of plant and machinery by Rs.90,000 and goodwill by Rs.40,000
- To reduce the value of investments by Rs.80,000

The reduction was made by converting 50,000 preference shares of Rs.20 each fully paid to the same number of preference shares of Rs15 each fully paid and by converting

50,000 equity shares of Rs.20 each on which Rs.15 is paid up into 50,000 equity shares of Rs.10 each fully paid up.

Particulars	Debit	credit
Preference share capital A/c(Rs20) Dr	10,00,000	
To preference share capital A/c		7,50,000
To capital reduction A/c		2,50,000
Equity share capital A/c (partly paid)	7,50,000	
A/c Dr		5,00,000
To equity share capital (fully		2,50,000
paid) A/c		
To capital reduction A/c		
Capital reduction A/c D r	5,00,000	
To profit and loss A/c		2,10,000
To plant and machinery A/c		90,000
To good will A/c		40,000
To investment A/c		80,000
To capital reserves A/c (bal figure)		80,000

Example 9

Following a series of losses. XYZ co Ltd resolved to reduce its capital to 50,000 fully paid Rs.5 shares and to eliminate share premium account. The company's balance sheet prior to implementation of the scheme was:

Liabilities	Amount	Assets	Amount
Share capital :		Good will	1,00,000
50000 fully paid shares of RS10	5,00,000		

each			
Securities premium A/c	50,000	Land and building s	1,62,000
Creditors	62000	Plant and machinery	2,07,000
Bank overdraft	73,000	Stock	92,000
		Debtors	74,000
		Profit and loss a/c	50,000
	6,85,000		**6,85,000**

It was resolved to apply the sum available under the scheme:

- To write off the good will account
- to write off the debit balance of the profit and loss account
- To reduce the book values of the assets by the following amounts:
- ✓ Land and buildings Rs.42,000
- ✓ Plant and machinery Rs.67,000
- ✓ Stock Rs.33,600

To provide a bad debts reserve of 10 % of the book value of debtors

Show the journal entries to give effect to the scheme and prepare the revised balance sheet after its implementation.

Particulars	Debit	Credit
Share capital A/c Dr To capital reduction A/c	2,50,000	 2,50,000
Securities premium A/c Dr To capital reduction A/c	50,000	 50,000
Capital reduction A/c Dr To good will A/c	3,00,000	 1,00,000

To profit and loss A/c		50,000
To land and building A/c		42,000
To stock A/c		33,600
To provision for bad debts A/c		7,400
To plant and machinery A/c		67,000

Balance sheet of XYZ ltd as on

Liabilities	Amount	Assets	Amount
Share capital : 50,000 fully paid shares of Rs.5 each	2,50,000	Land and buildings	1,20,000
Creditors	62,000	Plant and machinery	1,40,000
Bank overdraft	73,000	Stock	58,400
		Debtors 74,000 (LESS) provision for debts 7,400	56600
	3,85,000		**3,85,000**

Amalgamation in the nature of purchase

Amalgamation – lump sum method of purchase

1. Raman Ltd and Sivan Ltd have a agreed to amalgamate .A new company Siva ram Ltd has been formed to take over the running concern as on 31.12.1993 the following balance sheets show the position of the companies amalgamation

Liabilities	Raman Ltd	Sivan Ltd	Assets	Raman Ltd	Sivan Ltd
Share capital	20,000	50,000	Good will	-	6,000

Rs10 each					
General reserve	16,000	-	Furniture	8,000	12,000
Capital reserve	-	4,000	Stock	16,000	8,000
P& L a/c	4,000	-	Sundry debtors	10,000	17,000
Creditors	10,000	6,000	Cash at bank	12,000	7,000
Loan from bank	10,000	16,000	P & L a/c	-	6,000

Siva ram Ltd took over all the assets and liabilities of both the transferor companies at book values except cash at bank , creditors and the good will of Sivan ltd which was considered worthless .

The purchase consideration was agreed at Rs.60,000 for Raman Ltd and Rs.40,000 for Sivan Ltd fully paid equity shares of Rs.10 each were issued settle the purchase price for both the companies

Cash at bank of both companies was exactly sufficient to settle their creditors at 10% discount and pay the liquidation expenses .

You are required to give important ledger in the books of transferor companies and the journal entries and balance sheet in the book of transferee company.

Solution:

Books of Raman Ltd (transferor company)

Realisation account

Particulars	Amount	Particulars	Amount
To plant	14,000	By loan from bank	10,000
To furniture	8,000	By Siva ram Ltd	60,000
To stock	16,000	By creditors (10,000*10/100)	1,000
To sundry debtors	10,000		
To bank (exp)12,000-9,000	3,000		
To share holders (profit)	20,000		
	71,000		**71,000**

Bank account

Particulars	Amount	Particulars	Amount
To balance b/d	12,000	By creditors(10,000-1,000)	9,000
		By realisation (expenses)	3,000
	12,000		**12,000**

Shareholders A/c

Particulars	Amount	Particulars	Amount
To shares in Siva ram ltd	60,000	By share capital A/c	20,000
		By general reserve A/c	16,000

		By P& L a/c	4,000
		By realisation a/c	20,000
	60,000		**60,000**

Books of Sivan Ltd (transferor company)

Realisation account

Particulars	Amount	Particulars	Amount
To plant	20000	By loan from bank	16000
To furniture	12000	By Siva ram ltd	40000
To stock	8000	By creditors(6000*10/100)	600
To sundry debtors	17000	By shareholders (loss)	2000
To bank (expenses) (7000-5400)	1600		
	58,600		**58,600**

Bank account

Particulars	Amount	Particulars	Amount
To balance b/d	7,000	By creditors(6000-600)	5,400
		By realisation (expenses)	1,600
	7,000		**7,000**

Shareholders A/c

Particulars	Amount	Particulars	Amount
To P & L A/c	6,000	By share capital A/c	50,000
To realisation	2,000	By capital reserve A/c	4,000
To good will	6,000		

To share in Siva ram Ltd	40,000		
	54,000		**54,000**

Note: since good will of Sivan Ltd is considered worthless there is no need to transfer it to realisation account. Like any other loss it is transferred to shareholders directly.

Books of siva ram Ltd (transferee company)

Particulars	Debit	Credit
Business purchase A./c Dr	1,00,000	
To Raman Ltd A/c		60,000
To Sivan Ltd A/c		40,000
Plant A/c Dr	34,000	
Furniture A/c Dr	20,000	
Stock A/c Dr	24,000	
Sundry debtors A/c Dr	27,000	
Good will A/c Dr	21,000	
To business purchase A/c		1,00,000
To loan from bank		26,000
Liquidator of Raman Ltd A/c	60,000	
Liquidator Sivan Ltd A/c	40,000	
TO share capital A/c		1,00,000

Liabilities	Amount	Assets	Amount
Capital : 10000 shares of Rs.10 each	1,00,000	Fixed assets: Goodwill	21,000
Loan from bank	26,000	Plant	34,000

		Furniture	20,000
		Current assets: Stock Sundry debtors	 24,000 27,000
	1,26,000		**1,26,000**

Absorption –Net payment method

1. The following is the balance sheet of X Ltd as on 31.3.1996

Liabilities	Amount	Assets	Amount
Share capital : 2,00,000 shares of Rs.10each	20,00,000	Land and building	10,00,000
General reserve	2,50,000	Plant and machinery	15,00,000
Dividend equalisation reserve	2,00,000	Furniture	25,000
Profit and loss a/c	51,000	Stock	6,00,000
12 % debenture	10,00,000	Work in progress	3,00,000
Sundry creditors	3,00,000	Sundry debtors	2,50,000
		Cash at bank	1,26,000
	38,01,000		**38,01,000**

The company was absorbed by A Ltd on the above date. The consideration for the absorption is the discharge of the debentures at a premium of 5%taking over the liability in respect of sundry creditors and a payment of Rs7 in cash and one share of Rs.5 in A Ltd at the market value of Rs.8 per share for every share in X Ltd . The cost of liquidation of Rs.15,000 is to be met by the purchasing company. pass journal entries in the books of A Ltd

Statement showing purchase consideration

Particulars	Cash	Shares	Total
for shareholders:			
CASH 2,00,000*7	14,00,000		14,00,000
Shares in A Ltd 2,00,000*1*8		16,00,000	16,00,000
Purchase consideration	**14,00,000**	**16,00,000**	**30,00,000**

Note: As per As-14 Purchase price should include payment to shareholders alone .So debenture have to be shown as taken over by A Ltd and then settled .Cost of liquidation paid by purchasing Co should be shown as reimbursement.

Books of X ltd (transferor company)

Journal entries

Particulars	Debit	credit
Realisation A/c Dr	38,01,000	
To sundry assets		38,01,000
Sundry creditors A/c Dr	3,00,000	
12 % debenture A/c	10,00,000	
To realisation A/c		13,00,000
A Ltd A/c Dr	30,00,000	
To realisation A/c		30,00,000
Bank A/c Dr	14,00,000	
Share in A ltd Dr	16,00,000	
To A ltd A/c		30,00,000
A Ltd A/c Dr	15,000	
To bank A/c		15,000
Bank A/c Dr	15,000	

To A ltd A/c		15,000
Share capital A/c Dr General reserve A/c Dr Dividend equalisation reserve A/c Dr Profit and loss A/c Dr To share holders A/c	20,00,000 2,50,000 2,00,000 51,000	 25,01,000
Realisation A/c Dr To shareholders A/c	4,99,000	 4,99,000
Shareholders A/c Dr To bank A/c To shares in A ltd	30,00,000	 14,00,000 16,00,000

External construction : Net payment method

The book of S ltd contained the following balance as on May 31.1994

Particulars	Debit	Credit
Equity share capital (Rs10 Each) Creditors	-	12,00,000 14,00,000
Patents and trade marks Plant and machinery Stock Debtors Cash Preliminary expenses Profit and loss a/c	12,00,000 4,00,000 *3,00,000* *5,00,000* *12,500* *72,500* *1,15,000*	
	26,00,000	**26,00,000**

The patents and trade marks are considerably over valued . the company is also not in a position to raise any further capital. The following scheme of reconstruction has therefore been framed.

The company will go into voluntary liquidation. A new company S.S Ltd will be formed with an authorised capital of Rs.20,00,000 to take over the assets.

Liability will be discharged by the new company to the creditors by payment of 25 paise in a rupee in cash and 50 paise in a rupee by issue of 9% debenture

1,20,000 shares of Rs.10 each (Rs.5 per share paid) will be issued to the shareholders of S ltd the balance Rs.5 per share to be paid on allotment

Expenses of liquidation amounting to Rs.17,500 will be paid by S.S Ltd the scheme was approved by all concerned. You are required to

Close the ledger of S ltd

Give entries to open the book of S ltd

Prepare the opening balance sheet of S.S Ltd

Books of 'S' Ltd (transferor company)

Realisation A/c

Particulars	Amount	Particulars	Amount
To patents and trade marks	12,00,000	By S.S Ltd	6,00,000
To plant and machinery	4,00,000	By creditors	14,00,000
To stock	3,00,000	By share holders (loss)	4,12,500
To debtors	5,00,000		
To cash	12,500		
	24,12,500		**24,12,500**

Creditors A/c

Particulars	Amount	Particulars	Amount
To realisation A/c (transfer)	14,00,000	By balanced b/d	14,00,000
	14,00,000		14,00,000

S.S Ltd A/c

Particulars	Amount	Particulars	Amount
To realisation a/c	6,00,000	By shares in S.S.Ltd	6,00,000
	6,00,000		**6,00,000**

Bank A/c

Particulars	Amount	Particulars	Amount
To S.S Ltd(expenses)	17,500	By S.S Ltd (expenses)17500	17,500
	17,500		**17500**

Share holders A/c

Particulars	Amount	Particulars	Amount
To preliminary expenses	72,500	By share capital A/c	1,200,000
To profit and loss a/c	1,15,000		
To realisation A/c	4,12,500		
To shares in S.S ltd	6,00,000		
	12,00,000		**12,00,000**

Share in S.S Ltd A/c

Particulars	Amount	Particulars	Amount
To S Ltd A/c	6,00,000	By shareholders A/c	6,00,000
	6,00,000		**6,00,000**

Books of S.S Ltd (transferee company)

Particulars	Debit	Credit
Business purchase A/c Dr	6,00,000	
To Liquidator of s ltd A/c		6,00,000
Patents and trade marks A/c Dr	12,00,000	
Machinery A/c Dr	4,00,000	
Stock A/c Dr	3,00,000	
Debtors A/c Dr	5,00,000	
Cash A/c Dr	12,500	
To business purchase A/c		6,00,000
To creditors (14,00,000*75/100)		10,50,000
To capital reserve A/c		7,,62,500
Capital reserve A/c Dr	7,62,500	
To bank (expenses)		17,500
To patents and trade marks A/c		7,45,000
Liquidators of S.S Ltd A/c Dr	6,00,000	
To equity share capital A/c (Rs5Paid)		6,00,000
Bank A/C Dr	6,00,000	
To equity share capital A/c		6,00,000
Creditors A/c Dr	10,50,000	
To bank A/c		3,50,000
To 9% debenture A/c		7,00,000

Balance sheet of S.S Ltd as on 31st may 1994

Liabilities	Amount	Assets	Amount
Share capital :authorised 2,00,000 shares of Rs.10each	20,00,000	Patents and trade marks(12,00,000-7,45,000)	4,55,000
Issued and paid up capital 120000 shares of Rs10each fully paid	12,00,000	Plant and machinery	4,00,000
9% debentures	7,00,000	Stock	3,00,000
		Debtors	5,00,000
		Cash	12,500
		Bank (600000-367500)	2,32,500
	19,00,000		**19,00,000**

Inter company holdings

Inter company Owings and unrealized profit in stock also

Following are the balance sheets of two companies W Ltd and Z ltd as at march 31 1999

Liabilities	W Ltd	Z Ltd	Assets	W Ltd	Z Ltd
Equity shares of Rs100 each	500000	300000	Sundry assets	750000	350000
Reserves	100000	60000	1000 shares in W ltd at cost	-	100000
Creditors	150000	90000			
	750000	**450000**		**750000**	**450000**

W ltd was to absorb Z Ltd agreeing that the shares of both the companies are worth Rs120 each . the purchase consideration was to be discharged in the form of fully paid shares.

A sum of Rs20000 is owed by W ltd to Z Ltd .also included in the stock of W Ltd is RS30000 goods supplied by Z Ltd .also included in the stock at cost plus 20%.

Give entries in the books of both the companies and balance sheet in the books of W ltd

Solution:

In the books "Z Ltd (transferor company)

Particulars	Debit	Credit
Realization A/c Dr To sundry assets	3,50,000	 3,50,000
Creditors A/c Dr To realization A/c	90,000	 90,000
W Ltd A/c Dr To Realization A/c	2,40,000	 2,,40,000
Shares in W ltd A/c Dr To W Ltd A/c	2,40,000	 2,40,000
Shares in W Ltd A/c Dr To realizations A/c	20,000	 20,000
Share capital A/c Dr Reserve A/c Dr To shareholders A/c	3,00,000 60,000	 3,60,000
Share holders account A/c Dr To share In W ltd	3,60,000	 3,60,000

Investment in shares of W Ltd should be re -valued on the same basis as agreed value for the shares for the purpose of absorption so 1000 *120-100000=Rs20000 is the profit on the investment made in W Ltd 's shares by Z Ltd

Working note 1

Realisation A/c

Particulars	Amount	Particulars	Amount
To sundry assets	3,50,000	By creditors	90,000
		by W Ltd	2,40,000
		By shares in W Ltd A/c (profit on revaluation of investment in shares)	20,000
	3,50,000		**3,50,000**

Working note 2

Shares in W ltd account A/c

Particulars	Amount	Particulars	Amount
To balance b/d	1,,00,000	By shareholders	3,60,000
To realisation A/c (1000*120-100000)	20,000		
To W ltd	2,40,000		
	3,60,000		**3,60,000**

Working note 3

Shares holders A/c

Particulars	Amount	Particulars	Amount
To shares in W ltd	3,60,000	By share capital a/c	3,00,000

		By reserves	60,000
	3,60,000		**3,60,000**

Working note 4

Purchase consideration

Total value of Z LTd shares 3,00,000/100 *120 3,60,000

No of shares to be issued by W ltd on the basis of agreed value of its own shares

At Rs120 each

3,00,000/120 = 3,000 shares

Less: Shares already held by Z Ltd 1,000shares

Fresh shares to be issued by W ltd to Z Ltd 2,000 shares

Purchase consideration =2,000 *120 = Rs.2,40,000

In the books of W Ltd (transferee company)

Particulars	Debit	Credit
Business purchase A/c Dr To liquidator of Z Ltd	2,40,000	 2,40,000
Sundry assets A/c Dr To creditors To business purchase A/c To capital reserve A/c	3,50,000	 90,000 2,40,000 20,000
Liquidator of Z Ltd A/c Dr To share capital A/c (2000 *100) To securities premium A/c (2000 *20)	2,40,000	 2,00,000 40000
Creditors A/c Dr To sundry Assets a/c	20000	 20000
Capital Reserve A/c Dr	5000	

To sundry assets A/c		5000

Balance sheet of W Ltd (after amalgamation)

Liabilities	Amount	Assets	Amount
Share capital: 7000 shares of Rs100 each)of above 2000 shares are issued for consideration other than cash)	7,00,000	Sundry assets: (750000+350000) 11,00,000 Less: Mutual owing 20,000 10,80,000 Less: unrealised profit 5,000 in stock	10,75,000
	1,00,000		
Capital reserve (20000-5000)	15,000		
Securities premium	40,000		
Creditors (150000+90000) 240000 Less: Mutual owing 20000	2,20,000		
	10,75,000		**10,75,000**

UNIT – III

POSSIBLE QUESTIONS

PART A (1 mark)

(Online examinations)

PART B (2 Marks)

1. What is Amalgamation?

2. Explain 'Capital Reduction'.

3. Mention various types of Amalgamation.

4. What do you understand by the term Capital Profits?

5. List out the methods for computing Purchase Consideration.

PART B (2 Marks)

1. M Ltd. And N Ltd. Agreed to amalgamate on the basis of the following Balance Sheet as on 31-3-1997.

Liabilities	M Ltd. Rs.	N Ltd. Rs.	Assets	M Ltd. Rs.	N Ltd. Rs.
Share capital Rs.25 each	75,000	50,000	Goodwill	30,000	-
P&L A/C	7,500	2,500	Fixed assets	31,500	38,800
Creditors	3,500	3,500	Stock	15,000	12,000
Depreciation fund	-	2,500	Debtors	8,000	5,200
			Bank	1,500	2,500

TOTAL	**86,000**	**58,500**	**TOTAL**	**86,000**	**58,500**

The assets and liabilities are to be taken over by a new company formed called 'P Ltd', at book values. P Ltd's capital is Rs. 2,00,000 divided into 10,000 equity shares of Rs.10 each and 10,000 9% preference shares of Rs.10 each.

P Ltd. Issued the equity shares equally to the vendor companies and preference shares were issued for any balance of purchase price.

Pass journal entries in the books of P Ltd. And prepare its balance sheet.

2. The following scheme of reconstruction has been approved for Divya Ltd
   (A) The shareholders to receive in lieu of their present holding of 60,000 shares of Rs.10 each fully paid the following.
      (I) Fully paid new equity shares equal to 1/3rd of their holding
      (II) 8% preference shares fully paid, to the extent of 1/5th of the above new equity shares
      (III) Rs.60,000 8% secured debentures
   (B) The debenture holders' total claim of Rs.75,000 to be reduced to Rs.25,000. This will be satisfied by the issue of 2,5000 8% preference shares of Rs.10 each fully paid
   (C) An issue of 50,000 6% first debentures was made and allotted, payment for the same having been received in cash.
   (D) The goodwill which stood an Rs.3,00,000 was written down to Rs.50,000. Plant & Machinery which stood at Rs.1,00,000 was written down to Rs.75,000
   (E) The freehold premises which stood at Rs.1,75,000 was written down by Rs.75,000

Give Journal entries in the books of Divya Ltd. for the above Reconstruction.

3. Raman Ltd., and Sivam Ltd., have agreed to amalgamate. A new Company, Sivaraman Ltd., has been formed to take over the running concern as on 31.12.2005. The following

Balance Sheets show the position of the companies amalgamating

Liabilities	**Raman Ltd. Rs.**	**Sivam Ltd. Rs.**	**Assets**	**Raman Ltd. Rs.**	**Sivam Ltd. Rs.**
Share Capital Rs. 10 each	20,000	50,000	Goodwill	-	6,000
General Reserve	16,000	-	Plant	14,000	20,000
Capital Reserve	-	4,000	Furniture	8,000	12,000
P& L A/c	4,000	-	Stock	16,000	8,000
Loan from Bank	10,000	6,000	Sundry Debtors	10,000	17,000
Creditors	10,000	6,000	Cash at bank	12,000	7,000
			P & L A/c	-	6,000
	60,000	**46,000**		**60,000**	**46,000**

Sivaram Ltd. Took over all the assets and liabilities of both the transferor companies at book values except cash at bank, creditors and the goodwill of Sivan Ltd. which was considered worthless.

The Purchase Consideration was agreed at Rs. 60,000 for Raman Ltd., and Rs. 40,000 for Sivan Ltd., Fully paid Equity Shares of Rs. 10 each were issued to settle the purchase price for both the companies.

Cash at bank of both the companies was exactly sufficient to settle their creditors at 10 % discount and pay the liquidation expenses.

You are required to give important ledger accounts to close the books of the transferor companies and the Journal and Balance Sheet in the books of the transferee company, assuming that the amalgamation is in the nature of Purchase.

4. The summarised Balance Sheet of Ambrose Co. Ltd., as at 31st December, 2008 was as follows :

Liabilities	Amount Rs.	Assets	Amount Rs.
Authorised & Issued Capital : 2,00,000 Equity Shares of Rs. 10 each Fully Paid	20,00,000	Land and Buildings	15,00,000
10,000, 6 % Cumulative Preference Shares of Rs. 100 each fully paid	10,00,000	Plant and Machinery	10,00,000
Bank Overdraft	7,00,000	Goodwill	2,00,000
Sundry Creditors	5,00,000	Patents and Trade Marks	1,00,000
(Note : the Cumulative Preference dividend is in arrear for three years)		Stock	4,00,000
		Sundry Debtors	3,00,000
		Preliminary Expenses	1,00,000
		Profit and Loss A/c	6,00,000
	42,00,000		**42,00,000**

A Scheme of Capital reduction was approved on the following terms:

(i) The Preference Shareholders agreed that their Shares be reduced to fully paid Shares of Rs. 50 each and to accept Equity Shares of Rs. 5 each fully paid in lieu of Dividend Arrears

(ii) The Equity Shareholders agree that their shares be reduced to a fully paid value of Rs. 5 each

(iii) The Authorised Capital of the company is to remain at Rs. 30,00,000 divided into 4,00,000 Equity Shares of Rs. 5 each and 20,000, 6 % Cumulative Preference Shares of Rs. 50 each

(iv) All the Intangible and Fictitious Assets are to be eliminated and Bad Debts of Rs. 50,000 and absolute stock of Rs. 80,000 are to be written off.
Give the necessary Journal Entries to record the Capital Reduction and draw up the revised Balance Sheet.

5. Following a series of losses, XYZ Co. Ltd., resolved to reduce its Capital to 50,000 fully paid Rs. 5 shares and to eliminate Share Premium Account. The companies Balance Sheet prior to implementation of the Scheme was :

Liabilities	Amount Rs.	Assets	Amount Rs.
Share Capital; 50,000 Fully paid Shares of Rs. 10 each	5,00,000	Goodwill	1,00,000
Securities Premium A/c	50,000	Land and Buildings	1,62,000
Creditors	62,000	Plant and Machinery	2,07,000
Bank Overdraft	73,000	Stock	92,000
		Sundry Debtors	74,000
		Profit and Loss A/c	50,000
	6,85,000		**6,85,000**

It was resolved to apply the sum available under the Scheme:

(i) To write off the Goodwill Account

(ii) To write off the debit balances of the Profit and Loss Account

(iii) To reduce the Book values of the Assets by the following Accounts :

Land and Building - Rs. 42,000

Plant and Machinery - Rs. 67,000

Stock - Rs. 33,600

(iv) To provide a bad debts reserve of 10 % of the Book value of Debtors

Show the Journal entries to give effect to the scheme and prepare the revised Balance Sheet after its implementation

6. The following are the balance sheets of Sindhu Ltd., and Bindhu Ltd., as on 31-3-2000

Liabilities	Sindhu Ltd Rs.	Bindhu Ltd Rs.	Assets	Sindhu Ltd Rs.	Bindhu Ltd Rs.
Equity share capital (Rs. 10 each)	5,00,000	3,00,000	Fixed Assets	8,00,000	3,50,000
8% Pref. Share capital (Rs.100 each)	2,00,000	1,00,000	Current Assets	4,00,000	2,50,000
General Reserve	1,00,000	50,000			
P&L A/C	50,000	30,000			
12 % Debentures of Rs. 100 each	50,000	20,000			
Current Liabilities	3,00,000	1,00,000			
	12,00,000	**6,00,000**		**12,00,000**	**6,00,000**

Sindhu Ltd., agreed to acquire Bindhu Ltd., on the following terms :

(i) 11 % Preference Shares will be issued to discharge the Preference Shares in Bindhu Ltd., at 25 % Premium

(ii) Cash of Rs. 2 per Share will be paid and one Equity Shares in Sindhu Ltd., will be issued at agreed value of Rs. 13 per share for every Equity Shares in Bindhu Ltd.

(iii) Bindhu Ltd., 's Debentures are to be paid off in cash

Give Journal Entries in the books of Sindhu Ltd., and prepare its Balance Sheet, if Amalgamation is in the Nature of Merger.

UNIT- V

Banking:

Section 5 of Banking Regulation Act defines Banking as "the accepting, for the purpose of lending or investment, of deposit of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise.

Features of banking company:

- The borrowing,raising,or taking up of money.
- The lending or advancing of money either upon or without security.
- The granting and issuing of letters of credit,travellerscheques and circular notes.
- The buying and selling of bullion.
- The buying and selling of foreign exchange including foreign bank notes.
- Contracting for public and private loans negotiating and issuing the same.
- Undertaking and executing trust.
- The acquisition, constructing, maintenance and alternation of any building or works necessary or convenient for the purpose of the company.
- Carrying on and transacting every kind of guarantee and indemnity business.
- The collecting and transmitting of money and securities.
- Undertaking the administration of estates as executor, trustee or otherwise
- No banking company can carry on business in India unless its subscribed capital is not less than one- half of the authorized capital and its paid up capital is not less than one – half of subs.capital.
- A banking company cannot create any charge upon its uncalled capital.
- Every banking co.shalltransfer a sum equal to 25% of profits to statutory reserve.
- A bank can open a branch only at the permission or reserve bank

Accounting System:

The accounting system of a banking company is different from that of a trading or manufacturing company. A bank has a large number of customers whose acc are to be maintained in such a way so that these should be kept upto date.

Features of Banking Accounting System:

- Entries in the personal ledgers are made directly from vouchers.
- From such entries in personal acc each day summary sheets in total are prepared.
- The general ledger's trial balance is extracted and agreed every day.
- A trial balance of detailed personal ledger is prepared periodically and get agreed with general ledger.
- Two vouchers are prepared for every transaction not involving cash- debit and credit voucher.

Revised Formats
THE THIRD SCHEDULE
(See Section 29)
Form A
FORM OF BALANCE SHEET

Balance Sheet of ———————————— (here enter the name of the Banking Company)

Balance Sheet as on 31st March (Year)

(000's omitted)

CAPITAL & LIABILITIES	Schedule	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
Capital	1		
Reserve & Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
TOTAL			
ASSETS			
Cash and Balances with Reserve Bank of India	6		
Balance with banks and money at call and short notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
TOTAL			
Contingent Liabilities			
Bills for collection	12		

Schedule 1 — Capital

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. **FOR NATIONALISED BANKS**		
Capital (Fully owned by Central Government)		

Contd.

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
II. **FOR BANKS INCORPORATED OUTSIDE INDIA**		
Capital		
(i) (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head)		
(ii) Amount of deposit kept with the RBI under Section 11(2) of the Banking Regulation Act, 1949		
TOTAL		

III. **FOR OTHER BANKS**

Authorised Capital	(……shares of Rs.	each)
Issued Capital	(……shares of Rs.	each)
Subscribed Capital	(……shares of Rs.	each)
Called-up Capital	(……shares of Rs.	each)
Less: Calls Unpaid		
Add: Forfeited Shares		

Schedule 2 – Reserves and Surplus

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. ***Statutory Reserves***		
Opening Balance		
Additions during the year		
Deductions during the year		
II. ***Capital Reserves***		
Opening Balance		
Additions during the year		
Deductions during the year		
III. ***Securities Premium***		
Opening Balance		
Additions during the year		
Deductions during the year		
IV. ***Revenue and other Reserves***		
Opening Balance		
Additions during the year		
Deductions during the year		
V. ***Balance in Profit and Loss Account***		
TOTAL		
(I, II, III, IV and V)		

Schedule 3 — Deposits

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
A. I. Demand Deposits		
(i) From Banks		
(ii) From Others		
II. Savings Bank Deposits		
III. Term Deposits		
(i) From Banks		
(ii) From Others		
TOTAL		
(I, II and III)		
B. (i) Deposits of branches in India		
(ii) Deposits of branches outside India		
TOTAL		

Schedule 4 — Borrowings

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. **Borrowing in India**		
(i) Reserve Bank of India		
(ii) Other Banks		
(iii) Other Institutions and Agencies		
II. **Borrowings outside India**		
TOTAL (I and II)		
Secured borrowings in I & II above –		

Schedule 5 — Other Liabilities and Provisions

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. Bills Payable		
II. Inter-office adjustments (net)		
III. Interest Accrued		
IV. Others (including provisions)		
TOTAL		

Schedule 6 — Cash and Balances with Reserve Bank of India

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. Cash in Hand (including foreign currency notes)		
II. Balances with Reserve Bank of India		
(i) In Current Account		
(ii) In Other Accounts		
TOTAL (I & II)		

Schedule 7 — Balances with Banks and Money at Call & Short Notice

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. **In India**		
(i) Balances with banks		
(a) in Current Accounts		
(b) in Other Deposit Accounts		
(ii) Money at call and short notice		
(a) with Banks		
(b) with other Institutions		
TOTAL (I & II)		
II. **Outside India**		
(i) in Current Accounts		
(ii) in other Deposit Accounts		
(iii) Money at call and short notice		
TOTAL		
GRAND TOTAL (I & II)		

Schedule 8 — Investments

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. **Investments in India in**		
(i) Government Securities		
(ii) Other approved securities		
(iii) Shares		
(iv) Debentures and Bonds		
(v) Subsidiaries and/or Joint Ventures		
(vi) Others (to be specified)		
TOTAL		

Contd.

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
II. **Investments outside India**		
(i) Government Securities (Including local authorities)		
(ii) Subsidiaries and/or Joint Ventures abroad		
(iii) Other investments (to be specified)		
TOTAL		
GRAND TOTAL (I & II)		

Schedule 9 — Advances

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
A. (i) Bills purchased and discounted		
(ii) Cash Credits, Overdrafts and Loans payable on demand		
(iii) Term Loans		
TOTAL		
B. (i) Secured by tangible assets		
(ii) Covered by Bank/Government Guarantees		
(iii) Unsecured		
TOTAL		
C. I. **Advances in India**		
(i) Priority Sectors		
(ii) Public Sector		
(iii) Banks		
(iv) Others		
TOTAL		
II. **Advances outside India**		
(i) Due from Banks		
(ii) Due from others		
(a) Bills purchased and discounted		
(b) Syndicated Loans		
(c) Others		
TOTAL		
GRAND TOTAL (C. I & II)		

Schedule 10 — Fixed Assets

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. **Premises**		
At cost as on 31st March of the preceding year		
Additions during the year		
Deductions during the year		
Depreciation to date		
II. **Other Fixed Assets** (including Furniture and Fixtures)		
At cost as on 31st March of the preceding year		
Additions during the year		
Deductions during the year		
Depreciation to date		
TOTAL (I & II)		

Schedule 11 — Other Assets

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. Inter-office Adjustments (net)		
II. Interest Accrued		

Contd.

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
III. Tax paid in advance/Tax deducted at source		
IV. Stationery and Stamps		
V. Non-banking assets acquired in satisfaction of claims		
VI. Others @		
TOTAL		

@ In case there is any unadjusted balance of loss the same may be shown under this item with appropriate footnote.

Schedule 12 — Contingent Liabilities

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. Claims against the bank not acknowledged as debts		
II. Liability for partially paid investments		
III. Liability on account of outstanding forward exchange contracts		
IV. Guarantees given on behalf of constituents		
(a) In India		
(b) Outside India		
V. Acceptances, endorsements and other obligations		
VI. Other items for which the bank is contingently liable		
TOTAL		

REVISED FORMAT FOR PROFIT AND LOSS ACCOUNT

Form 'B'

Form of Profit & Loss Account for the year ended 31st March—

('000 omitted)

	Schedule No.	Year ended 31.3.— (Current Year)	Year ended 31.3.— (Previous Year)
I. INCOME			
Interest earned	13		
Other income	14		
TOTAL			
II. EXPENDITURE			
Interest expended	15		
Opening expenses	16		
Provisions and Contingencies			
TOTAL			
III. PROFIT/LOSS			
Net profit/loss (–) for the year			
Profit/Loss (–) brought forward			
TOTAL			
IV. APPROPRIATIONS			
Transfer to Statutory Reserves			
Transfer to other Reserves			
Transfer to Government/Proposed Dividends			
Balance carried over to Balance Sheet			
TOTAL			

Schedule 13 — Interest Earned

	Year ended 31.3.— (Current Year)	Year ended 31.3.— (Previous Year)
I. Interest/Discount on advances/bills		
II. Income on investments		
III. Interest on balances with Reserve Bank of India and other inter-bank funds		
IV. Others		
TOTAL		

Schedule 14 — Other Income

		Year ended 31.3.— (Current Year)	Year ended 31.3.— (Previous Year)
I.	Commission, Exchange and Brokerage		
II.	Profit on sale of investments		
	Less : Loss on sale of investments		
III.	Profit on revaluation of investments		
	Less : Loss on revaluation of investments		
IV.	Profit on sale of land, building and other assets		
	Less : Loss on sale of land, building and other assets		
V.	Profit on exchange transactions		
	Less : Loss on exchange transactions		
VI.	Income earned by way of dividends etc. from subsidiaries/companies and/or joint ventures abroad/in India		
VII.	Miscellaneous Income		
TOTAL			

Note: Under items II to V—Loss figures may be shown in brackets.

Schedule 15 — Interest Expended

		Year ended 31.3.— (Current Year)	Year ended 31.3.— (Previous Year)
I.	Interest on deposits		
II.	Interest on Reserve Bank of India/inter-bank borrowings		
III.	Others		
TOTAL			

Schedule 16 — Operating Expenses

		Year ended 31.3.— (Current Year)	Year ended 31.3.— (Previous Year)
I.	Payments to and provisions for employees		
II.	Rent, Taxes and Lighting		
III.	Printing and Stationery		
IV.	Advertisement and Publicity		
V.	Depreciation on Bank's property		
VI.	Directors' fees, allowances and expenses		
VII.	Auditor's fees and expenses (including branch auditors)		
VIII.	Law Charges		
IX.	Postages, Telegrams, Telephones, etc.		
X.	Repair and Maintenance		
XI.	Insurance		
XII.	Other expenditure		
TOTAL			

Share Capital:

It has always been stated that the subscribed share capital of a banking company should not be less than one-half of its authorized capital. Similarly, its paid-up share capital should not be less than one-half of its subscribed capital.

Contingency Accounts:

These accounts are maintained in order to meet any known contingencies, e.g., provision for taxation, provision for bad and doubtful debt, etc. These accounts also include any unadjusted suspense accounts. The amounts are usually merged with Current Accounts. As a result, the reader/analyst does not know their existence separately.

Bills Payable:

These include unpaid bank drafts, telegraphic transfers, circular note or cash order. In order to remit money from one place to another by a customer, service rendered by a bank in this respect is to grant bank drafts and telegraphic transfers against a nominal charge.

These drafts and telegraphic transfers etc. are paid to the holders by the issuing bank's branches who reimburse the money. Naturally, any such draft issued by a bank but which remains unpaid at the date of the Balance Sheet is treated as a liability of the issuing bank.

Bills for Collection:

These include drafts and hundies drawn by a creditor on his debtor, and the same is lodged with the bank for collection against documents already attached. These are numbered by the bank serially and all information about them is recorded in a book known as Bills for Collection Register. Until they are actually collected they are not recorded in any other account.

After collection — the entry will be:

Cash A/c	Dr.	Full amount received
To Customer A/c		Balancing figure
" Commission A/c		Bank's Commission

These bills, at the time of preparing Final A/c, are shown on both sides of the Balance Sheet. It will be recorded on the Assets side since the bank will get the payment in due course and also on the Liabilities side since it will have to be accounted for to customers.

These items appear as:

On Liabilities side — Bills for collection, being Bills Received as per contra.

On Assets side — Bills Receivable, being Bills for Collection as per contra.

Acceptance, Endorsements and other obligations:

It is a liability of a bank in respect of bills accepted or endorsed on behalf of its customers including letter of credit issued and guarantees given. A security is usually required for this purpose and a commission is charged by the bank. The customers are liable to pay to the bank for full payment of the bills plus any loss or expenses that may be incurred.

As a result, this item will appear in both sides of the Balance Sheet in the following manner:

On Liabilities side:

Acceptance, Endorsements and other obligations as per contra.

On Assets side:

Constituent's liabilities for acceptance, Endorsements, and other obligations as per contra.

Branch Adjustments:

A banking company may have different branches in different places. As a result, some transactions may take place between the head office of the bank and its branches. Head office passes necessary entries after receiving the periodical statements from the branches.

In the absence of such information, some entries remains unadjusted in the head office books at the time of preparing the final accounts. Therefore, such entries are recorded in the Balance Sheet under the head 'Branch Adjustments'. It may appear on either side of the Balance Sheet depending on the Debit or Credit Balance.

Unexpired Discounts, or Rebates on Bills Discounted:
If a bank discounts a bill or purchases a hundi etc. it receives discount for the full period which is credited to Discount Account. But the point is that the bank is not entitled to take credit for any greater amount of such discount than what has actually been earned to the Balance Sheet date.

As a result, such discounts are apportioned between the current year and the next year and the amount which is carried forward is shown in the Balance Sheet under the head 'Unexpired Discount' or 'Rebate on Bills Discounted'.

Money at Call and Short Notice:
It includes:
(i) Inter-bank call money and
(ii) Call money at short notice.

These are actually inter-bank transactions. Under this head, money is borrowed by one bank from another for a period of 3 days to 31 days and, naturally, the bank having surplus money advances such loans to the bank having short supply of money. These transactions are transacted with the help of brokers who charge brokerage usually @½% from both the banks. The rate of interest, of course, fluctuates every day, depending on the demand and supply of money.

Advances:
It includes the following (if advances are made by Indian banks):
(i) Loans,
(ii) Cash Credit,
(iii) Overdrafts, and
(iv) Bills discounted and purchased.

Loans:

A loan is an advance of money made with or without security. A certain amount is advanced for a stipulated period at an agreed rate of interest in a loan account. The rate of interest is lower than rate of interest of cash credit.

Most of the business houses prefer to use cash credit although the rate of interest is higher since the same is most convenient to them.”

Cash Credit:

It is an arrangement made between the bank and its customer so that the former allows the latter to borrow money up to a certain limit. It is not always necessary that the money should immediately be withdrawn. It is usually sanctioned on hypothecation or pledge of stock.

Overdraft:

If a customer requires funds for a short period and he has a current account in a bank, he may be allowed to overdraw his current account with or within a certain limit fixed by the banking authorities.

The rate of interest is generally higher than the rate of interest of Cash Credit. It is advantageous on behalf of the customer since he is to pay interest only on the amount that has already been taken.

BANK BALANCE SHEET VS COMPANY BALANCE SHEET

	BANK BALANCE SHEET	COMPANY BALANCE SHEET
Definition	Prepared as per the mandate by the Regulatory Authority	Prepared as per the Regulations of International Accounting Standards Board
Objective	To reflect the trade-off between bank's profit and risk	Reflects the financial position of the organization to the stakeholders
Scope	Limited since it is applicable only to banks	Boarder since it is applicable to all sorts of companies
Equation	Assets = liabilities + shareholders' equity (bank's assets and liabilities are much different from any regular company)	Assets = liabilities + shareholders' equity
Complexity	Preparation of balance sheet for a bank is more complex since bank needs to calculate the "net loans",	Preparation of company balance sheet is much simpler
Time consumption	Bank's balance sheets need a lot of time to prepare	Company's balance sheet does not take a lot of time to prepare
Key concepts	Loans, short term investments and allowances for losses on loans.	Assets, liabilities and shareholders equity.
Mentionable elements	Bank balance sheet mentions reference through 'schdules'.	Company's balance sheet mentions its reference via notes.
Type of balance	In bank balance sheet, the type of balance is average balance	In company balance sheet, the type of balance is ending balance.

Problem:1

From the following particulars, prepare a Profit and Loss Account of New Bank Ltd. For the year ended 31.12.2006

Particulars	Amount Rs.(in'000)	Particulars	Amount Rs.(in'000)
Interest on Loans	260	Interest on Cash Credits	225
Interest on Fixed Deposits	280	Rent and Taxes	20
Rebate on Bills Discounted	50	Interest on Overdrafts	56
Commission Charged to Customers	9	Directors and Auditors Fees	4
Establishment Expenses	56	Interest on Savings Bank Accounts	70
Discount on Bills Discounted	200	Postage and Telegrams	2
Interest on Current Accounts	45	Sundry Charges	2
Printing and Advertisements	3		

Solution:

New Bank Ltd
Profit and Loss Account for the year ended 31.12.96

	Schedule No.	Year ended 31.12.96 (Current Year) Rs.(in '000)	Year ended 31.12.95 (Previous Year) Rs.(in '000)
I. Income			
Interest Earned	13	741	
Other Income	14	9	

Total		750	
II. Expenditure		-------------	
Interest Expended	15	395	
Operating Expenses	16	87	
Provisions and Contingencies		-------------	
Total		482	
III. Profit/Loss:		------------	
Net Profit for the year (I – II)		268	
Profit b/f		-	
Total		268	
IV. Appropriations:		---------	

Prepared by K.Kavitha, SampathKumar and R.Jayalakshmi, Asst Prof, ~~Dept of~~ Commerce, KAHE

Transfer to statutory reserve (25% of 268)		67	
Transfer to other reserves		-	
Transfer to Government/proposed dividend		-	
Balance c/f to balance sheet		201	

		268	

Note: Transfer to statutory reserve is now increased to 25% of Net Profit from the earlier 20%.

Working notes:

Schedule 13: Interest earned	Rs. (in'000)
Interest on loans	260
Discount on bills discounted	200
Interest on cash credits	225
Interest on overdrafts	56
Total	741

Note: Rebate on bill is the closing rebate and it will be shown in schedule 5 in balance sheet

Schedule 14: Other Income	Rs. (in'000)
Commission charged to customers	9
Total	9

Schedule 15: Interest expended	Rs. (in'000)
Interest on fixed deposit	280
Interest on current accounts	45
Interest on savings bank account	75
Total	395

Schedule 16: Operating expenses	Rs. (in'000)
Establishment expenses	56
Printing and Advertisement	3
Rent and rates	20
Director's and auditor's fees	4
Postage and telegram	2
Sundry charges	2
Total	87

Provisions and Contingencies	Rs.
Provisions and Contingencies	Nil
Total	Nil

Problem:2

From the following information relating to Lakshmi Bank Ltd., prepare the Profit and Loss A/c for the year ended 31st December, 2007.

Particulars	Amount Rs.	Particulars	Amount Rs.
Rent Received	72,000	Salaries and Allowances	2,18,800
Exchange and Commission	32,800	Postage	5,600
Interest on Fixed Deposits	11,00,000	Sundry Charges	4,000
Interest on Savings Bank A/cs	2,72,000	Director's & Auditors fees	16,800
Interest on Overdrafts	2,16,000	Printing	8,000
Discount on Bills Discounted	7,80,000	Law Charges	3,600
Interested on Current Accounts	1,68,000	Locker Rent	1,400
Interest on Cash Credits	8,92,000	Transfer Fees	2,800
Depreciation on bank property	20,000	Interest on Loans	10,36,000

Solution:

The Lakshmi Bank Ltd

Profit and Loss Account for the year ended 31.12.1987

	Schedule No.	Year ended 31.12.1987 Rs.
I. Income		
Interest Earned	13	29,24,000
Other Income	14	1,09,000
Total		30,33,000
II. Expenditure		
Interest Expended	15	15,40,000
Operating Expenses	16	2,76,800
Provisions and Contingencies		----
Total		18,16,800
III. Profit/Loss:		
Net Profit for the year (I – II)		12,16,200
Profit b/f		----

Total		12,16,200
IV. Appropriations: Transfer to statutory reserve (25% of 268) Transfer to other reserves Transfer to Government/proposed dividend Balance c/f to balance sheet		 3,04,050 ---- ----- 9,12,150
		12,16,200

Note: Transfer to statutory reserve has been increased to 25% recently.

Working notes:

Schedule 13: Interest earned	Rs.
Interest on overdrafts	2,16,000
Discount on bills discounted	7,80,000
Interest on cash credits	8,92,000
Interest on loans	10,36,000
Total	29,24,000

Schedule 14: Other Income	Rs.
Locker rent	1,400
Transfer fee	2,800
Exchange and commission	32,800
Rent	72,000
Total	1,09,000

Schedule 15: Interest expended	Rs.
Interest on fixed deposits	11,00,000
Interest on savings bank account	2,72,000
Interest on current accounts	1,68,000
Total	15,40,000

Schedule 16: Operating expenses	Rs. (in'000)
Depreciation on bank property	20,000
Salaries and allowances	2,18,000
Postage	5,600
Sundry charges	4,000
Director's and auditor's fees	16,800
Printing	8,000
Law charges	3,600
Total	2,76,800

Particulars	Amount Rs.(in'000)	Particulars	Amount Rs.(in'000)
Share Capital Issued and Subscribed	4,000	Reserve Fund (u/sec 17)	6,200
Fixed Deposits	42,600	Savings Bank Deposits	19,000
Current Accounts	23,200	Money at Call and Short Notice	1,800
Investments	25,000	Profit and Loss A/c (Cr.) 1st Jan 2016	1,350
Dividend for 2015	400	Premises	2,950
Cash in Hand	380	Cash with RBI	10,000
Cash with Other Banks	6,000	Bills discounted and Purchased	3,800
Loans, Cash Credits and Overdrafts	51,000	Bills Payable	70
Unclaimed Dividends	60	Rebate on Bills Discounted	50
Short Loans (Borrowings from other Banks)	4,750	Furniture	1,164
Other Assets	336	Net Profit for 2016	1,550