ਜਗਤ ਗੁਰੂ ਨਾਨਕ ਦੇਵ
ਪੰਜਾਬ ਸਟੇਟ ਓਪਨ ਯੂਨੀਵਰਸਿਟੀ
ਪਟਿਆਲਾ

The Motto of Our University
(SEWA)

SKILL ENHANCEMENT
EMPLOYABILITY
WISDOM
ACCESSIBILITY

JAGAT GURU NANAK DEV
PUNJAB STATE OPEN UNIVERSITY, PATIALA

(Established by Act No. 19 of 2019 of the Legislature of State of Punjab)

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SEMESTER-III

BCB32302T
CORPORATE ACCOUNTING

Head Quarter: C/28, The Lower Mall, Patiala-147001
Website: www.psou.ac.in

The Study Material has been prepared exclusively under the guidance of Jagat Guru Nanak Dev Punjab State Open University, Patiala, as per the syllabi prepared by Committee of Experts and approved by the Academic Council.

COURSE COORDINATOR AND EDITOR:

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PREFACE

Jagat Guru Nanak Dev Punjab State Open University, Patiala was established in December 2019 by Act 19 of the Legislature of State of Punjab. It is the first and only Open University of the State, entrusted with the responsibility of making higher education accessible to all, especially to those sections of society who do not have the means, time or opportunity to pursue regular education.

In keeping with the nature of an Open University, this University provides a flexible education system to suit every need. The time given to complete a programme is double the duration of a regular mode programme. Well-designed study material has been prepared in consultation with experts in their respective fields.

The University offers programmes which have been designed to provide relevant, skill-based and employability-enhancing education. The study material provided in this booklet is self-instructional, with self-assessment exercises, and recommendations for further readings. The syllabus has been divided in sections, and provided as units for simplification.

The University has a network of 10 Learner Support Centres/Study Centres, to enable students to make use of reading facilities, and for curriculum-based counselling and practicals. We, at the University, welcome you to be a part of this instituition of knowledge.

Prof. G.S. Batra
Dean Academic Affairs

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(CORE COURSE (CC)
SEMESTER III
(BCB32302T): CORPORATE ACCOUNTING

MAX. MARKS: 100
EXTERNAL: 70
INTERNAL: 30
PASS: 35%

Objectives: **Credits: 6**

To enable the students to acquire the basic knowledge of the corporate accounting and to learn the techniques of preparing the financial statements.

INSTRUCTIONS FOR THE CANDIDATES:

Candidates are required to attempt any two questions each from the sections A and B of the question paper and any ten short questions from Section C. They have to attempt questions only at one place and only once. Second or subsequent attempts, unless the earlier ones have been crossed out, shall not be evaluated.

Section A

Accounting for Share Capital & Debentures **:** Issue, forfeiture and reissue of forfeited shares: concept & process of book building; Issue of rights and bonus shares; Buy back of shares; Redemption of preference shares; Issue and Redemption of Debentures.

Final Accounts **:** Preparation of profit and loss account and balance sheet of corporate entities, excluding calculation of managerial remuneration, Disposal of company profits.

Valuation of Goodwill and Valuation of Shares **:** Concepts and calculation: simple problem only

Section B

Amalgamation of Companies **:** Concepts and accounting treatment as per Accounting Standard: 14 (ICAI) (excluding intercompany holdings). Internal reconstruction: concepts and accounting treatment excluding scheme of reconstruction.

Accounts of Holding Companies/Parent Companies **:** Preparation of consolidated balance sheet with one subsidiary company; Relevant provisions of Accounting Standard: 21 (ICAI).

Accounts of Banking Companies **:** Difference between balance sheet of banking and non-banking companies; Prudential norms; Asset structure of a commercial bank; Non-performing assets (NPA)

Note:

1. The relevant Indian Accounting Standards in line with the IFRS for all the above topics should be covered.
2. Any revision of relevant Indian Accounting Standard would become applicable Immediately.

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SEMESTER: III

BCDB32302T: CORPORATE ACCOUNTING

COURSE COORDINATOR AND EDITOR: DR. POOJA AGGARWAL

SECTION A

UNIT NO.	UNIT NAME
UNIT 1	ACCOUNTING FOR SHARE CAPITAL
UNIT 2	BOOK BUILDING, RIGHT ISSUE, BONUS SHARE AND BUY BACK OF SHARES
UNIT 3	ACCOUNTING FOR REDEMPTION OF PREFERENCE SHARES
UNIT 4	ACCOUNTING FOR DEBENTURES: ISSUE AND REDEMPTION OF DEBENTURES
UNIT 5	FINAL ACCOUNTS
UNIT 6	VALUATION OF GOODWILL AND SHARES

SECTION B

UNIT NO.	UNIT NAME
UNIT 7	AMALGAMATION: ACCOUNTING STANDARD
UNIT 8	ACCOUNTING FOR AMALGAMATION
UNIT 9	INTERNAL RECONSTRUCTION
UNIT 10	ACCOUNTING FOR HOLDING COMPANIES: PREPARATION OF CONSOLIDATED BALANCE WITH ONE SUBSIDIARY COMPANY
UNIT 11	ACCOUNTS OF HOLDING COMPANIES: RELEVANT PROVISIONS OF ACCOUNTING STANDARD 21/IND AS 110
UNIT 12	ACCOUNTS FOR BANKING COMPANY

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SEMESTER III
COURSE: CORPORATE ACCOUNTING

UNIT-I: ACCOUNTING FOR SHARE CAPITAL

STRUCTURE

1.0 OBJECTIVES

After going through this unit, you will be able to:

- Understand the basic nature of a Company, Shares and Share Capital and their classification;

- Explain the accounting treatment of shares issued at par and at premium including over subscription and pro-rata treatment;
- Outline the accounting for forfeiture of shares and reissue of forfeited shares under varying situations;
- Know the way to report the shares in financial statements.

1.1 INTRODUCTION

In earlier days, sole-proprietorship form of business organization was found as the most popular form of organization. But due to inadequate capital, lack of effective management and continuity of such business, it gave birth to the concept of partnership form of business organization. But both of these forms of organization were suffering from the common problems like inadequacy of capital, uncertain continuity, unlimited liability of the owners as well as partners. These problems created a chance for the formation of joint stock company in India which are to be registered as per the practices of Indian Companies Act, 2013 or any other previous act.

1.2 MEANING AND DEFINITION OF COMPANY

Any organization which is registered or incorporated under Indian Companies Act, 2013 or any other previous companies act is known as a Company. Here, a group of persons voluntarily associated with each other for some profitable motive. The total capital required by the company for its operation is divided into smaller equal units called Share. Any person who purchases such shares is called a shareholder who is the ultimate owner of the company. A company is recognized as an artificial person and it has a separate legal identity in the business world. The continuity of the company is not affected by the death or insolvency of any member. As company has a separate legal entity, it can enter into any kind of dealings as well as agreement with other party regarding purchase, sale of goods, commodity, assets etc. It can sue others and can be sued by law. As there are many shareholders existing in a company, the management is not vested in their hands. So, the Board of Directors play an important role in the management of the company.

"Company means a company incorporated under this act or any previous companies' law". Section 2(20) of the Companies Act, 2013.

1.3 FEATURES OF COMPANY

i. **Voluntary Association:** It must be incorporated under Indian Companies Act, 2013 or any previous companies act. A company is an artificial person where the people voluntarily associated with each other to earn profit**.**

ii. **Indefinite Continuity:** A company can continue for an indefinite period till it is wound up. The members may join or leave the organization frequently but this will not affect the operation of the company.

iii. **Separation of Ownership & Management:** The management of the company lies in the hands of board of directors, managers but not in the hands of owner. Hence, management & ownership are separated from each other.

iv. **Transferability of Membership:** The membership of the shareholders can be transferred easily to other party in case of public limited company but not in private company.

v. **Number of Members:** The minimum number of members is required is 2 to start the private company and its membership cannot exceed 200. But in case of public limited company the minimum number of members required is 7 and the maximum number is unlimited.

vi. **Limited Liability:** The liability of the shareholders is limited to the value of the shares that they hold. If any unpaid balance is there then the shareholders are supposed to pay that unpaid balance at the time of winding up of the company.

vii. **Common Seal:** It is recognized as an official signature for an artificial body which indicates the authentication of the documents prepared and signed by the company. Without common seal the company cannot enter into any kind of agreement with any party.

1.4 CLASSIFICATION OF COMPANY

On the basis of Incorporation: Chartered Company, Statutory Company and Registered Company.

On the basis of Liability: Companies Limited by Shares, Companies Limited by Guarantee and Unlimited Company.

On the basis of Control: Government Company, Holding Company, Subsidiary Company and Foreign Company.

On the basis of Number of Members: Private Company, Public Company and One Person Company (OPC).

1.5 MEANING OF SHARES

The total amount of capital is divided into smaller denominations of equal parts are called shares. Share is a source of arranging funds for the company by which a company can raise finance from the public as well as from other sources as owned capital.

1.6 TYPES OF SHARES

According to the section 43 of the Indian Companies Act 2013 share is divided into two types:

(i) Preference Shares and
(ii) Equity Shares

Preference Share:

Preference shares are those shares which carry some preferential rights over Equity shares. Such preferences are that the preference shares will receive dividend first out of the profits of the company before it is distributed among equity shares at a fixed rate and repayment of capital at the time of liquidation of the company. Preference shareholders don't have voting rights at the time of taking important decisions.

Equity Share:

Equity shares are those shares which have no preferential rights like preference shares regarding receiving of dividend as well as repayment of capital. But equity shareholders are the real owners of the company. Equity shareholders earn no fixed rate of dividend out of the profits of the company, but have voting rights as well as participate in the management of the company.

1.7 MEANING OF SHARE CAPITAL

Share capital means the capital arranged by the company by issue of Equity shares and Preference Shares.

1.8 CLASSIFICATION OF SHARE CAPITAL

(i) Authorized Capital
(ii) Issued Capital
(iii) Subscribed Capital
(iv) Called up Capital
(v) Paid up Capital
(vi) Reserve Capital

Authorized Capital:

It is the maximum amount of capital that a company can raise by issue of shares during its life time. It must be mentioned in the Memorandum of Association at the time of registration of the company. If the company desires to issue extra shares, then the authorized limit should be extended by passing a special resolution in the board meeting. It is otherwise called as Nominal Capital or Registered Capital.

Issued Capital:

It is that part of authorized capital of the company that the company can issue to the general public for subscription. All the authorized capital are not issued by the company at a time, rather they will be issued as per the capital need of the company. It should be kept in mind that the issued capital cannot exceed the authorized capital of the company.

Subscribed Capital:

It is that part of issued capital which has been subscribed by the public. The company should receive minimum 90% of the share out of total issued capital for raising funds for the company.

Called up Capital:

It is that part of nominal value of shares which has been asked by the company to be paid by the public. It says how much capital has been called by the company till date from the public.

Paid up Capital:

It is that part of called up capital which has been received by the company or the shareholders have paid. It is the actual capital of the company, which is to be added to the total capital. The portion of called up capital which is not received by the company is called unpaid capital or Calls-in-Arrear.

Reserve Capital:

It is the part of authorized capital, which can be called only at the time of winding up of the company as passed by the special resolution. It is available only for the preferential creditors of the company at the time of liquidation of the company. Conversion of such capital into ordinary capital is not possible without the permission of the court.

1.9 MEANING OF ISSUE OF SHARES

Issue of share is a process in which the company obtains owned capital from its shareholders. Shares are issued by the company through different process like book building, private placement, IPO etc. In the current digitization era, the shares are issued through the online process. Some part of the subscribed capital will be issued by the company to the general public through the public advertisement process. At the same time the company also provides prospectus which contains the details about the organization, which guide the public to know about the company and helps them in taking decisions regarding investment in shares.

1.10 TYPES OF ISSUE OF SHARES

The shares of a company can be issued in different condition such as

(i) Issue of shares at par,
(ii) Issue of shares at premium and
(iii) Issue of shares at discount, which are discussed as follows

Issue of shares at par:

When shares are issued at face value or at nominal value, this is called issue of shares at par. Here the market value or issue price is equal to the nominal value of the share.

Issue of shares at premium:

When the issue price of share is more than the nominal value of share, this is called issue of shares at premium. For example - If the issue price of share is ₹12 against the nominal value of ₹ 10, then company will receive Rs 2 as premium amount.

Issue of share at discount:

When the issue price of shares is less than the nominal value of the share, is called issue of share at discount. But as per section 53 of companies Act, 2013 issue of shares at discount is not permissible.

The nominal value of share can be collected by the company either at one time or by several installments. Such phases of installments are known as application, allotment and call.

Application stage:

After going through the prospectus, the public can be able to know about the company and its future prospective. Now they may take interest to purchase the shares of the company through the prescribed application form and fees. The application money should be fixed at minimum amount of 25% if the issue price as per SEBI guideline. But section 39 of companies Act, 2013 suggested the minimum application money to be fixed at 5% of nominal value. Such application money to be deposited by the public in prescribed scheduled bank as mentioned in the prospectus. The money received in application will be transferred to share capital account during allotment.

Allotment of shares:

After collection of application money, it is to be sent to the company along with the list of applicants for future processing by the concerned bank. In this stage the applications are scrutinized by the company and the director will select and finalize the applications, to whom allotment will be made. Here the selected applicants will be informed through the allotment letter and a letter of regret is sent to the rejected applicants. The application money of rejected applicants will be refunded to them within a stipulated time period. If the organization makes any delay for refund of money, then the company will pay the due amount along with interest rate of 15%. The allotted shareholders are required to pay allotment money asked by the company.

Call stage:

After collection of allotment money, the company asks the call money due from the shareholders as per provisions of articles of association. In the absence of Articles of Association, the company will follow the companies Act, 2013. The call money may be collected by the company in one call or in more than one call.

1.11 ACCOUNTING ENTRIES FOR ISSUE OF SHARES

(i) When the application money is received

Bank A/C Dr

To share application A/C

(Being the application money on---shares @ Rs- per share is received)

(ii) When shares are scrutinized for allotment process

Share application A/C Dr

To share capital A/C

To Bank A/C (if any shares were rejected)

(Being application money in transferred to share capital a/c and application money of rejected shares were refunded)

(iii) When the allotment money is due

Share allotment A/C Dr

To share capital A/C

(Being allotment money on – shares @ Rs—is due)

(iv) When allotment money is received

Bank A/C Dr

To share allotment A/C

(Being allotment money is received)

(v) When call money is due from shareholders

Share call A/C Dr

To share capital A/C

(Being call money is due on—shares @ Rs---each)

(vi) When call money is received

Bank A/C Dr

To share call A/C

(Being call money is received)

Illustration 1

ABC Ltd. Registered with an authorized capital of Rs 50,00,000 divided into equity shares of Rs 10 each payable on application Rs 3, on allotment Rs 5 and balance on call. The company has issued 1,00,000 equity shares for public subscription. The public have subscribed for 90,000 shares. All the money due were received in time. Pass necessary journal entries.

Solution:

Date	Particular	LF	Dr (₹)	Cr (₹)
	Bank A/C Dr		2,70,000	
	To share application A/C			2,70,000
	(Being application money on 90,000 shares @ Rs 3 each were received)			
			2,70,000	
	Share Application A/C Dr			2,70,000
	To share capital A/C			
	(Being application money is transferred to share capital account)			
			4,50,000	

	Share allotment A/C Dr To share capital A/C (Being allotment money is due on 90,000 shares @ ₹ 5 each)		4,50,000	4,50,000 4,50,000
	Bank A/C Dr To share allotment A/C (Being allotment money is received)		1,80,000	1,80,000
	Share call A/C Dr To share capital A/C (Being call money is due on 90,000 shares @ ₹ 2 each)		1,80,000	1,80,000
	Bank A/C Dr To share call A/C (Being call money is received)			

1.12 FORMAT OF COMPANY'S BALANCE SHEET SHOWING SHARE CAPITAL

Particulars	Notes No	₹
Equity and Liabilities		
Shareholder's Funds		
Share Capital	1	xxx
Reserves and surplus	2	xxx
Total		xxx

Notes to Accounts

1. Share Capital		
Authorized capital		
Equity share capital (--------shares @ ₹ ---- each)		×××
Preference share capital (------shares @ ₹ ---each		×××
		xxx
Issued capital		
Equity share (-------shares @ ₹ ------each)		×××
Preference share (-----shares @ ₹ --- each)		×××
		xxx
Subscribed and paid-up capital		
Fully paid up		
-----Equity share of ₹---each	xxx	
-----preference share of ₹---- each	xxx	xxx
Not fully paid up		
--------Equity share of ₹ ---- each	×××	
Less – Calls in Arrears	×××	
		xxx
-------preference share of Rs----- each	×××	
Less ---- calls in Arrear	×××	xxx
Add ----share forfeiture Account		xxx
Amount to be shown is the Balance sheet		xxx
2. Reserves and Surplus		
Securities premium Reserve	xxx	
Capital Reserve	xxx	

Issue of shares and collection of Amount in lumpsum

(i) When shares are issued and money received

Bank A/C Dr

To Share Application and Allotment A/C

(Being application and allotment money is received)

(ii) When shares are allotted and money is capitalized

Share Application and Allotment A/C Dr

To share capital A/C (with nominal value)

(Being shares were allotted are money transferred to share capital account)

1.13 ACCOUNTING TREATMENT FOR ISSUE OF SHARE AT PREMIUM

When the shares are issued at premium, the premium amount can be received by the company either in application stage or in allotment stage or in call stage. In case any information is missing regarding the stages where premium money will be received, then there it is assumed that securities premium will be collected in allotment stage.

(a) When allotment money is due

Share allotment A/C Dr

To share capital A/C

To securities premium reserve A/C

(b) When allotment money is received

Bank A/C Dr

To share allotment A/C

Illustration 2

MN Ltd. Issued 20,000 equity share of Rs 10 each at a premium of Rs 1 payable on application Rs 3, on allotment Rs 5 including premium, Rs 2 on 1st call and balance on 2nd and final call. The money on all shares were duly received in time. Pass necessary journal entries and also Show shareholders' fund in the balance sheet of the company.

Solution:

Date	Particulars	LF	Dr (₹)	Cr (₹)
	Bank A/C Dr To Share Application A/C (Being application money of 20,000 shares @ Rs 3 per share were received)		60,000	 60,000
	Share Application A/C Dr To Share Capital A/C (Being application money is transferred to share capital account)		60,000	 60,000
	Share Allotment A/C Dr To share capital A/C To securities premium reserve A/c (Being allotment money is due)		10,000	 80,000 20,000
	Bank A/C Dr To Share Allotment A/C (Being allotment money is received)		10,000	 10,000
	Share 1st call A/C Dr To Share Capital A/C (Being 1st call money of 20,000 shares @ Rs 2 per share is due)		40,000	 40,000

	Share 2nd & Final Call A/C Dr To Share Capital A/C (Being final call of Rs 1 on 20,000 shares is due)		20,000	20,000
	Bank A/c Dr To share 1st call A/c (Being first call money received)		40,000	40,000
	Bank A/C Dr To Share 2nd & Final call A/C (Being final call money is received)		20,000	20,000

Particulars	Note No	₹
1. Equity and liabilities		
Shareholders' funds		
(a) Share capital	1	2,00,000
(b) Reserve surplus	2	20,000
		2,20,000

Notes to Account

1. Share capital	
Authorized capital	-----------
Issued capital	-----------
Subscribed and paid-up capital	
Fully paid up	2,00,000
(20,000 equity shares @ Rs. 10 each)	
2. Reserve & surplus	
Securities premium reserve	20, 000

1.14 APPLICATION OF SECURITIES PREMIUM RESERVE

As prescribed in section 52 of the companies Act, 2013 the use of securities premium reserve can be done for following purposes:

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

(ii) To write off preliminary expenses of the company.

(iii) To write off the expenses of, or the commission paid or discount allowed on any issue of shares or debentures of the company.
(iv) Can be used as premium payable on the redemption of any redeemable preference shares or debentures of the company.
(v) For using in case of buy back of shares.

1.15 OVER SUBSCRIPTION OF SHARES

When the number of shares subscribed by the public are more than the issued number of shares, is called as oversubscription of shares. In this situation the company can allot maximum up to the issued number of shares. In this case shares can be allotted in the following process.

(i) Excess application may be rejected
(ii) Some portion of application may be rejected and some may be allotted proportionately.
(iii) All application may be allotted on pro rata basis.
(iv) Some applications are rejected, some are allotted in full and some are allotted on pro rata basis.

Illustration 3

Sunshine Ltd. Invited application for 1,00,000 equity shares of Rs. 50 each at a premium of 20% payable on application Rs 20, on allotment Rs 30 (20+10) and Rs 10 on call. Applications are received for 1,50,000 shares, of which company has rejected 50,000 shares. Pass necessary journal entries.

Solution:

Bank A/C	Dr		30,00,000	
To share application A/C				30,00,000
(Being application money is received on 1,50,000shares @ 20 each)				
Share application A/C	Dr		30,00,000	
To share capital A/C				20,00,000
To Bank A/C				10,00,000
(Being application money is capitalized)				
Share allotment A/C	Dr		30,00,000	
To share capital A/C				20,00,000
To securities premium reserve A/C				10,00,000
(Being allotment money is due)				

Bank A/C Dr To share allotment A/C (Being allotment money is received)		30,00,000	30,00,000
Share call A/c Dr To share capital A/C (Being call money is due)		10,00,000	10,00,000
Bank A/C Dr To share call A/C (Being call money is received)		10,00,000	10,00,000

1.16 PRO-RATA ALLOTMENTS OF SHARES IN CASE OF OVER SUBSCRIPTION

In case of pro rata allotment of shares, the excess applications are not rejected, rather they are allotted on proportionate basis. In this case the excess application money will be adjusted towards sum due on allotment and call. If the question remains silent about the treatment of excess application money, then it will be adjusted in allotment stage only, and surplus if any will be refunded to the shareholders.

Illustration 4

Raghav Ltd. was registered with an authorized capital of Rs 50,00,000 divided into equity share of Rs 50 each. The company has issued 20,000 equity shares @ 20% premium payable on application Rs 15, on allotment Rs 35 including premium and Rs 10 on call. Public applied for 35,000 shares. 5000 shares were rejected and their money refunded. Remaining applicants were allotted on pro rata basis. All money were received in due time. Pass necessary journal entry.

Solution:

Bank A/C Dr To share application A/C (Being application money received for 35,000 shares @15 each)		5,25,000	5,25,000
Share application A/C Dr To share capital A/C To share allotment A/C To Bank A/C (Being application money of 20,000 share are capitalized and excess application money transferred to share allotment A/c)		5,25,000	3,00,000 1,50,000 75,000

Share allotment A/C Dr To share capital A/C To Securities premium reserve A/C (Being allotment money is due along with premium amount)		7,00,000	5,00,000 2,00,000
Bank A/C Dr To share allotment A/C (Being allotment money is received)		5,50,000	5,50,000
Share call A/C Dr To share capital A/C (Being call money is due on 20,000 shares @ Rs 10 each)		2,00,000	2,00,000
Bank A/C Dr To share call A/C (Being call money is received)		2,00,00	2,00,000

1.17 CALLS IN ARREARS

When a shareholder fails to pay allotment or call money to the company, is called calls-in-arrear. As per the provision of Articles of Association the company can charge interest @ 10% p.a. for the period for which such amount remained in arrear from the shareholders. Such unpaid amount may or may not be transferred to calls-in-arrear account.

Journal entry for call in Arrear

Calls-in-Arrear A/C Dr

To Share Allotment/Call A/C

1.18 CALLS IN ADVANCE

Sometimes some shareholders may pay the rest of call money in advance along with either in allotment or in first call. The amount received by the company in such way is called calls in advance. As per the provisions of Articles of Association the company can allow interest @ 12% p.a. to the shareholders. It is shown on the liability side of Balance sheet under the main-head current liability and sub-head other current liabilities.

Journal entry for Calls-in-Advance

Bank A/C Dr

To calls in advance A/C

1.19 ISSUE OF SHARES FOR CONSIDERATION OTHER THAN

Sometimes a company purchases some assets against which cash is not paid out, rather the company issue some shares to the seller/vendor as purchase consideration, is known as issue of shares for consideration other than cash. The following journal entries are to be passed: -

(a) On purchases of business

Sundry assets A/C Dr (Individually at agreed value)
Goodwill A/C Dr
To sundry liabilities A/C (Individually at agreed value)
To vendor A/C (with purchases consideration)
To capital reserve A/C

- If the amount of sundry liabilities and purchases consideration is more than sundry assets, then the difference figure will be debited to Goodwill account.
- If the amount of sundry assets is more than the sundry liabilities and purchases consideration, then the difference figure will be credited to Capital Reserve Account.

(b) On issue of share to the vendors

Vendors A/C Dr (Amount of purchases consideration)
To share capital A/C (Nominal value of share)
To securities premium reserve A/C (If issued at premium)

While passing this journal entries, it is required to know, how many shares are to be issued to the vendors against purchases consideration. This number of shares can be calculated with the help of following formula: -

$$\frac{\text{Amount of purchases consideration}}{\text{Issue price of a share}} = \text{shares}$$

Illustration 5

MN Ltd. Issued 10,000 equity shares of Rs 100 each at per payable on application Rs 30, on allotment Rs 50 and on call Rs 20. All the shares were subscribed. Allotment was made to all the shares and all money received expect the allotment & call money on 400 shares, which is transferred to calls-in-Arrear Account. Pass necessary journal entries.

Solution:

Date	Particulars	LF	Dr (₹)	Cr (₹)
	Bank A/C Dr To share application A/C (Being application money on 10,000 equity share @ Rs 30 each were received)		3,00,000	 3,00,000
	Share application A/C Dr To share capital A/C (Being application money is capitalized)		3,00,000	 3,00,000

	Share allotment A/C Dr To share capital A/C (Being allotment money is due)		5,00,000	5,00,000
	Bank A/C Dr Calls in Arrear A/C Dr To share allotment A/C (Being allotment money is received)		4,80,000 20,000	5,00,000
	Share call A/C Dr To share capital A/C (Being call money is due)		2,00,000	2,00,000
	Bank A/C Dr Calls in Arrear A/C Dr To share call A/C (Being call money is received)		1,92,000 8,000	2,00,000

Illustration 6

Prasun textile Ltd. Issued 2,00,000 equity shares of Rs 10 each at a premium of Rs 2 per share payable on application Rs 3, on allotment Rs 6 including premium and balance on call. Public applied for 1,90,000 shares. All shareholders paid their due amount in right time expect one shareholder holding 5,000 shares failed to pay call money only, where as another shareholder holding 10,000 shares paid the call money in advance along with allotment. Pass necessary journal entries.

Solution:

Date	Particulars	LF	Dr (₹)	Cr (₹)
	Bank A/C Dr To share application A/C (Being application money on 1,90,000 shares @ Rs 3 per share were received)		5,70,000	5,70,000
	Share application A/C Dr To share capital A/C (Being application money capitalized)		5,70,000	5,70,000
	Share allotment A/C Dr To share capital A/C To securities premium reserve A/C (Being allotment money on 1,90,000 shares were due)		11,40,000	7,60,000 3,80,000
	Bank A/C Dr To share allotment A/C		11,70,000	11,40,000

	To calls in advance A/C (Being allotment money received along with advance for 10,000 shares)			30,000
	Share call A/C Dr To share capital A/C (Being call money is due)		5,70,000	 5,70,000
	Bank A/C Dr Calls in Arrear A/C Dr Calls in Advance A/C Dr To share call A/C (Being call money is received except on 5,000 shares and advance money received is adjusted)		5,25,000 15,000 30,000	 5,70,000

1.20 FORFEITURE OF SHARES

When any shareholder fails to pay the money called by the company, then that is called calls-in-Arrear. Even after the reminder if any shareholder does not play the unpaid amount, then the company has the right to forfeit the shares, subject to it must be allowed in Articles of Association. Forfeiture of shares means cancellation or rejection of membership of the shareholders.

Journal entry for Forfeiture of Shares

Share capital A/C	Dr	(up to the called-up face value of share)
Securities premium reserve A/C	Dr	(If premium money not received)
To unpaid calls A/C		(Amount not received)
To share forfeiture A/C		(Amount received)

If Calls-in-Arrear Account is maintained

Share capital A/C	Dr	(Up to called up face value of share)
Securities Premium Reserve A/C	Dr	(If premium reserve money not received)
To Calls-in-Arrear A/C		(Amount not received)
To Share Forfeiture A/C		(Amount received)

1.21 REISSUE OF FORFEITED SHARES

The shares which are forfeited/ cancelled, may be reissued by the directors of the company. In this case the shares may be reissued either at par or at premium or at discount. When the shares are reissued at a discount, then the discounted amount will be adjusted out of shares forfeiture account. Balance left in share forfeiture account will be transferred to Capital Reserve Account.

Following journal entry will be passed on such reissued of shares—

Bank A/C	Dr	(Amount received on reissued)
Share forfeiture A/C	Dr	(For Shortage/Discounted amount)

To Share Capital A/C (face called up value of shares)
To Securities Premium Reserve A/C (If shares are reissued at premium)

Illustration 7

Vijay Ltd invited the public to subscribe for 1,00,000 shares of Rs 10 each at a premium of Rs. 2 per share payable on application Rs 3, on allotment Rs 6 (including premium) and balance on call. Applications were received for 1,20,000 shares, of which 20,000 shares were rejected and their money refunded. All money were duly received expect the call money on 5,000 shares. These shares were subsequently forfeited and reissued at Rs 8 per share fully paid up. Pass necessary journal entries.

Solution:

Bank A/C	Dr		3,60,000	
To share application A/C				3,60,000
(Being application money on 1,20,000 shares were received)				
Share application A/C	Dr		3,60,000	
To Share Capital A/C				3,00,000
To Bank A/C				60,000
(Being application money transferred to share capital account and 20,000 shares were rejected and their money refunded)				
Share allotment A/C	Dr		6,00,000	
To share capital A/C				4,00,000
To securities premium reserve A/C				2,00,000
(Being allotment money is due)				
Bank A/C	Dr		6,00,000	
To share allotment A/C				6,00,000
(Being allotment money is received)				
Share call A/C	Dr		3,00,000	
To share capital A/C				3,00,000
(Being call money is due on 10,000 shares @ 3 each)				
Bank A/C	Dr		2,85,000	
Calls-in-Arrear A/C	Dr		15,000	
To share call A/C				3,00,000
(Being call money is received and calls-in-Arrear account is opened for 5,000 shares)				
Share capital A/C	Dr		50,000	
To calls-in-Arrear A/C				15,000
To Share forfeiture A/C				35,000
(Being 5,000 shares were forfeited)				

Bank A/C Dr Share forfeiture A/C Dr To share capital A/C (Being 5,000 shares were reissued at Rs 8 per share as fully paid up)		40,000 10,000	 50,000
Share forfeited A/C Dr To capital reserve A/C (Being balance of share forfeiture amount transferred to capital reserve)		25,000	 25,000

1.22 PRO-RATA ALLOTMENT OF SHARES

In case of over subscription of shares, it is not possible to allot all shares to all the applicants, because the company can't allot excess share over issued number of shares. In this situation the company may follow any of the following alternatives:

(i) Excess application may be rejected and shares may be allotted to the remaining applicants in full.

(ii) Shares may be allotted to all the applicants on pro-rata basis.

(iii) Some applications may be rejected, some applications may be allotted in full and remaining applicants may be allotted on pro-rata basis.

Pro-rata allotment means allotment of available shares on proportionate basis to the applicants. In this case the excess money received in application stage will be adjusted towards the sum due on call after adjustment of allotment money, if it is mentioned in the question. Otherwise, the excess application money after adjustment of allotment will be refunded to shareholders.

Illustration 8

Bikram Ltd. issued 1,00,000 equity shares of ₹ 50 each payable as under:

On application	₹ 10 per share;
On allotment	₹ 15 per share;
On first call	₹ 15 per share;
On second and final call	₹ 10 per share;

Applications were received for 4,00,000 shares on 1st January, 2021 and allotment was made on first February, 2021.

Pass journal entries for issue of shares under each of the following cases:

(a) Allotted 1,00,000 shares in full to selected applicants and the application for the remaining 3,00,000 shares were rejected.

(b) Pro rata allotment of 25 per cent of the shares applied to every applicant; to apply the balance of application money towards amount due on allotment; and to refund the balance amount.

(c) Reject applications for 2,00,000 shares, accept full applications for 80,000 shares and make a pro rata allotment of 20,000 shares to remaining applicants. Excess application money to be adjusted towards allotment and call.

Solution:

(a)

Date	Particulars	LF.	Dr. (₹)	Cr. (₹)
2021 Jan. 1	Bank A/c Dr To Equity shares applications A/c (Application money received for 4,00,000 shares @ ₹ 10 per share)		40,00,000	 40,00,000
Feb. 1	Equity shares application A/c Dr To Equity share capital A/c To Bank A/c (Application money adjusted and surplus refunded)		40,00,000	 10,00,000 30,00,000
Feb. 1	Equity shares allotment A/c Dr To equity share capital A/c (Allotment money due on 1,00,000 shares @ ₹ 15 per share)		15,00,000	 15,00,000
	Bank A/c Dr To equity share allotment A/c (Allotment money received)		15,00,000	 15,00,000
	Equity shares first call A/c Dr To equity share capital A/c (First call money due on 1,00,000 shares @ ₹ 15 per share)		15,00,000	 15,00,000
	Bank A/c Dr To equity shares first call A/c (First call money received)		15,00,000	 15,00,000
	Equity shares second and final call A/c Dr To equity share capital A/c (Second and final call money due on 1,00,000 shares @ ₹ 10 per share)		10,00,000	 10,00,000
	Bank A/c Dr To equity shares second and final call A/c (Second and final call money received)		10,00,000	 10,00,000

(b)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)

2021 Jan. 1	Bank A/c Dr To equity share Application A/c (Application money received for 4,00,000 shares @ 10 per share)		40,00,000	40,00,000
Feb. 1	Equity Shares Application A/c Dr To Equity share capital A/c (1,00,000×₹ 10) To Equity shares Allotment A/c (1,00,000×₹ 15) To Bank A/c (₹ 40,00,000 - ₹ 25,00,000) (Application and allotment money adjusted and surplus refunded)		40,00,000	10,00,000 15,00,000 15,00,000
Feb. 1	Equity shares allotment A/c Dr To Equity share capital A/c (Allotment money due on 1,00,000 shares @ ₹ 15 per share)		15,00,000	15,00,000
	Equity shares First call A/c Dr To Equity Share Capital A/c (First call money due on 1,00,000 shares @ ₹ 15per share)		15,00,000	15,00,000
	Bank A/c Dr To equity shares first call A/c (First call money received)		15,00,000	15,00,000
	Equity shares second and final call A/c Dr To Equity Share Capital A/c (Second and final call money due on 1,00,000 shares @ ₹ 10 per share)		10,00,000	10,00,000
	Bank A/c Dr To Equity Shares Second and Final call A/c (Second and final call money received)		10,00,000	10,00,000

(c)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)

2021 Jan. 1	Bank A/c Dr To shares application A/c (Application money received on 4,00,000 shares @ ₹ 10 per share)		40,00,000	 40,00,000
Feb. 1	Equity shares application A/c Dr To equity share capital A/c (1,00,000× ₹ 10) To equity shares allotment A/c (20,000× ₹ 15) To calls- in-advance A/c (20,000× ₹ 25) To Bank A/c (WN) (Application money adjusted and surplus refunded)		40,00,000	 10,00,000 3,00,000 5,00,000 22,00,000
Feb. 1	Equity shares allotment A/c Dr To equity share capital A/c (Allotment money due on 1,00,000 shares @ ₹ 15 per share)		15,00,000	 15,00,000
	Bank A/c Dr To equity shares Allotment A/c (Allotment money received)		12,00,000	 12,00,000
	Equity shares first call A/c Dr To equity share capital A/c (First call money due on 1,00,000 shares @ 15 per share)		15,00,000	 15,00,000
	Bank A/c Dr Calls-in-advance A/c Dr To equity shares first call A/c (Calls-in-advance adjusted and the balance first call money received)		12,00,000 3,00,000	 15,00,000
	Equity shares second and final call A/c Dr To equity share capital A/c (Final call money due on 1,00,000 shares @ ₹ 10 per share)		10,00,000	 10,00,000
	Bank A/c Dr Calls-in-advance A/c Dr To equity shares second final call A/c (Calls-in-advance adjusted and the balance second and final call money received)		8,00,000 2,00,000	 10,00,000

Illustration 9

Alfa Co. Ltd. Issued 50,000 Equity Shares of ₹ 10 each at a premium of ₹ 2 per share payable as follow:

₹ 3 on application, ₹ 4 on allotment (including premium), ₹ 2 on first call and ₹ 3 on final call. Applications were received for 65 Equity Shares. Application for 40,000 Equity Shares were accepted in full; 10,000 Equity shares were allotted to applicants of 20,000 equity shares and applications for 5,000 equity shares were rejected. The amounts due were dully received accept the first call on 1,000 Equity shares and final call on 1,500 Equity shares.

Pass entrees in the case book and journal of the company also so capital in the balance sheet.

Solution:

In the Books of Alfa Co. Ltd

CASH BOOK (BANK COLUMN ONLY)

Date	Particulars	₹	Date	Particulars	₹
	To Shares Application A/c	1,95,000		By Shares Application A/c	15,000
	To shares Allotment A/c	1,70,000		By Balance c/d	5,93,500
	To Shares First Call A/c	98,000			
	To Shares Second and Final call A/c	1,45,000			
		6,08,500			6,08,500

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Shares Application A/c Dr			
	To share capital A/c		1,50,000	
	(Application money on 50,000 shares transferred to share capital account)			1,50,000
	Share application A/c Dr		30,000	
	[(20,000×₹3)-(10,000×₹3)			30,000
	To share allotment A/c			
	(Surplus application money on partially accepted application transferred to shares allotment account)			
	Shares Allotment A/c Dr		2,00,000	
	To share capital A/c			1,00,000
	To securities premium reserve A/c			1,00,000
	(Amount due on allotment: ₹ 2 on 50,000 shares for capital and ₹ 2 on 50,000 shares for premium)			

	Shares first call A/c Dr To share capital A/c (Amount due on first call @ ₹ 2 per share on 50,000 shares)		1,00,000	1,00,000
	Calls-in-Arrear A/c Dr To shares first call A/c (Call money not received transferred to call-in-arrear account)		2,000	2,000
	Shares second and final call A/c Dr To share capital A/c (Second and final call due on 50,000 shares)		1,50,000	1,50,000
	Calls-in-Arrear A/c Dr To shares second and final call A/c (Call money not received transferred to calls-in-arrear account)		4,500	4,500

BALANCE SHEET

As at……

Particulars	Note No	₹
EQUITY AND LIABITIES		
Shareholders' Fund		
Share capital	1	4,93,500

Note to Accounts

Share capital		₹
Authorized capital		
…Equity shares of ₹ 10 each		…
Issued capital		
50,000 Equity shares of ₹ 10 each		5,00,000
Subscribed capital		
Subscribed and fully paid-up		
48,500 Equity shares of ₹ 10 each		4,85,000
Subscribed but not fully paid-up		
1,500 Equity Shares of ₹ 10 each	15,000	
Less: Calls-in-arrear [(1,000×₹2)+(1,500×₹3)]	6,500	8,500
		4,93,500

Illustration 10

Sipra Ltd. Invited application for issuing 2,00,000 equity shares of ₹10 each at a premium of ₹ 20 per share. The amount was payable as follows:

On application-- ₹ 2 per share,

On allotment -- ₹13 per share (Including ₹ 10 premium),
On first call -- ₹ 7 per share (Including ₹ 5 premium), and
On final call -- ₹ 8 per share (Including ₹ 5 premium).

Application for 1,80,000 shares were received. Shares were allotted to all the applicants. Yogesh, a shareholder holding 5,000 shares paid his entire share money along with the allotment money. Ramesh, a holder of 7,000 shares failed to pay the allotment money along with the first call money. Mahesh, holding 2,000 shares din not pay the final call. Mahesh's shares were forfeited immediately after the final call. Out of the forfeited shares, 1,500 shares were reissued at ₹ 8 per share fully paid up. Pass necessary journal entries.

Solution:

In the Books of Sipra Ltd.

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr.		3,60,000	
	To equity shares application A/c			3,60,000
	(Application money received for 1,80,000 shares)			
	Equity shares application A/c Dr.		3,60,000	
	To equity share capital A/c			3,60,000
	(Application money transferred)			
	Equity shares allotment A/c Dr.		23,40,000	
	To equity share capital A/c			5,40,000
	To securities premium reserve A/c			18,00,000
	(Allotment money due)			
	Bank A/c Dr.		23,24,000	
	To equity share allotment A/c			22,49,000
	To Calls-in-Advance A/c			75,000
	Or			
	Bank A/c Dr.		23,24,000	
	Calls-in-Arrear A/c Dr.		91,000	
	To equity shares allotment A/c			23,24,000
	To calls-in-advance A/c			75,000
	(Allotment money received except on 7,000 shares and calls-in-advance received)			
	Equity shares first call A/c Dr.		12,60,000	
	To equity shares capital A/c			3,60,000
	To securities premium reserve A/c			9,00,000
	(Shares first call due)			
	Bank A/c Dr.		13,16,000	
	Calls-in-advance A/c Dr.		35,000	

	To equity shares first call A/c			12,60,000
	To equity shares allotment A/c			91,000
	Or			
	Bank A/c Dr.		13,16,000	
	Calls-in-advance A/c Dr.		35,000	
	To equity shares first call A/c			12,60,000
	To calls-in-arrears A/c			91,000
	(First call money received along with calls-in-arrears and calls-in-advance adjusted)			
	Equity shares second and final call A/c Dr.		14,40,000	
	To equity share capital A/c			5,40,000
	To securities premium reserve A/c			9,00,000
	(Second and final call money due)			
	Bank A/c Dr.		13,84,000	
	Calls-in-advance A/c Dr.		40,000	
	To equity shares second and final call A/c			14,24,000
	Or			
	Bank A/c Dr.		13,84,000	
	Calls-in-arrears A/c Dr.		16,000	
	Calls-in-advance A/c Dr.		40,000	
	To equity shares second and final call A/c			14,40,000
	(Second call money received except on 2,000 shares and calls-in-advance adjusted)			
	Equity share capital A/c Dr.		20,000	
	Securities premium reserve A/c Dr.		10,000	
	To equity shares second and final call A/c			16,000
	To forfeited shares A/c			14,000
	Or			
	Equity share capital A/c Dr.		20,000	
	Securities premium reserve A/c Dr.		10,000	
	To-calls-in-arrears A/c			16,000
	To forfeited shares A/c			14,000
	(2,000 shares forfeited)			
	Bank A/c Dr.		12,000	
	Forfeited shares A/c Dr.		3,000	
	To equity shares capital A/c			15,000
	(1,500 shares out of forfeited shares reissued)			
	Forfeited shares A/c Dr.		7,500	
	To capital reserve A/c			7,500
	(Balance remaining in forfeited shares Account for 1,500			

	shares transferred to capital reserve account)			

Illustration 11

'ABC Ltd.' Invited applications for issuing 1,00,000 shares of ₹ 10 each at a premium of ₹ 2 per share. The amount was payable as follow:

On application – ₹ 3 per share (Including premium ₹ 1),

On allotment -- ₹ 4 per share (Including premium ₹ 1),

On first call -- ₹ 3 per share, and

On second and final call – balance amount.

Applications for 1,90,000 shares were received. Allotment was made to the applicants as sollows:

Category	No. of shares applied	No. of shares allotted
I	50,000	40,000
II	1,00,000	60,000

Remaining applications were rejected.

Rajat, a shareholder belonging to Category I who had applied for 2,500 shares, failed to pay the amount due on allotment and first call. His shares were immediately forfeited.

Reema, a shareholder belonging to Category II who was holding 3,000 shares failed to pay the first call and second call money. Her shares were also forfeited. Afterward 4,000 shares were reissued @ ₹ 8 per share fully paid up. These including all the forfeited shares of Reema. Pass necessary journal entries for the above transaction in the books of 'KLN Ltd.

Solution:

In the Books of KLN Ltd.

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr		5,70,000	
	To equity shares application A/c			5,70,000
	(Application money received for 1,90,000 shares @ ₹ 3 per share)			
	Equity shares application A/c Dr		5,70,000	
	To equity share capital A/c			2,00,000
	To securities premium reserve A/c			1,00,000
	To equity share allotment A/c			1,50,000
	To Bank A/c (40,000×₹3)			1,20,000
	(Application money transferred to equity share capital, equity share allotment and the balance refunded)			
	Equity shares allotment A/c Dr		4,00,000	
	To equity share capital A/c			3,00,000
	To securities premium reserve A/c			1,00,000
	(Allotment money due)			
	Bank A/c Dr		2,43,500	
	To equity shares allotment A/c			2,43,500
	(Allotment money received expect on 2,000 shares)			
	Equity shares first call A/c Dr		3,00,000	
	To equity share capital A/c			3,00,000
	(First call money due)			
	Bank A/c Dr		2,85,000	
	To equity shares first call A/c			2,85,000
	(first call money received expect on 5,000 shares)			
	Equity share capital A/c Dr		16,000	
	Securities premium reserve A/c Dr		2,000	
	To forfeited shares A/c			5,500
	To equity shares allotment A/c			6,500
	To equity shares first call A/c			6,000
	(2,000 shares of Rajat forfeited for non - payment of allotment and first call money)			
	Equity shares second and final call A/c Dr		1,96,000	
	To equity share capital A/c			1,96,000
	(Second and final call due on 98,000 shares)			
	Bank A/c Dr		1,90,000	
	To equity shares second and final call A/c			1,90,000
	(Second and final call money received except on 3,000 shares)			
	Equity share capital A/c Dr		30,000	

	To forfeited shares A/c To equity shares first call A/c To equity shares second and final call A/c (3,000 shares of Reema forfeited for non-payment of both the calls)			15,000 9,000 6,000
	Bank A/c Dr Forfeited shares A/c Dr To equity share capital A/c (3,000 shares of Reema and 1,000 shares of Rajat reissued)		32,000 8,000	 40,000
	Forfeited shares A/c Dr To capital reserve A/c (Gain on reissue transferred to capital reserve) (WN 2)		9,750	 9,750

1.23 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House, New Delhi.
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co., New Delhi.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication, New Delhi.
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

1.24 TERMINAL QUESTIONS/EXERCISES

Objective type questions

1. State whether the following statements are **True** or **False:**

(i) Issued share capital can be more than the authorized share capital.

(ii) Company’s shares are generally transferable.

(iii) Shares can be issued to public at a discount.

(iv) Securities premium reserve is shown is the assets part of the balance sheet.

(v) Pro rata allotment is made in the event shares are undersubscribed.

[Ans: (i) False; (ii) True; (iii) False; (iv) False; (v) False.]

2. Fill-in-the blanks with appropriate words:

(i) Shares are allotted on pro rata basis in the case of -----------------.

(ii) Gain (profit) on reissue of forfeited shares is transferred to----------------.

(iii) A company may issue shares for------------- against purchases of assets.

(iv) Preference shareholders have the preferential right to receive------------over Equity shares.

(v) When shares are forfeited, share capital accounts debited by------------ --.

[Ans: (i) Oversubscription; (ii) Capital reserve (iii) Consideration other than cash; (iv) dividend; (v) Called-up amount.]

Very short Answer type questions

1. Give the definition of share.
2. What is meant by ‘preference shares?
3. What is meant by Authorized Capital?
4. What is meant by subscribed capital?
5. Differentiate between ‘called-up share capital’ paid-up share capital;
6. What is meant by reserve capital?
7. What is mean by undersubscription of shares?
8. Give the meaning of calls-in-arrear.
9. What is calls-in-advance?
10. Give the meaning of forfeiture of shares.

1. Prakash Ltd. Invited applications for 1,00,000 shares of ₹ 10 each payable as follows:
   ₹ 2 on application, ₹ 3 on allotment, ₹ 2 on first call and the balance on final call.
   All the shares are applied and allotted. All the money was duly received.
   You are required to journalise these transactions.
2. Bombay Cotton Ltd. Invited applications for 5,000 shares of ₹ 100 each payable ₹ 30 on application, ₹ 40 on allotment and balance on first and final call. Applications were received for 60,00 shares. Applications were accepted for 5,000 shares and remaining applications were rejected. All call were made and received except first and final call on 100 shares.
   Pass the journal entries in the books of Bombay Cotton Ltd.
3. Sriram Ltd. Purchased machinery costing ₹ 17,00,000 from Manik Ltd. Sriram Ltd. paid 20% of the amount by cheque and for the balance amount issued equity shares of ₹ 100 each at premium of 25 per share.
   Pass necessary journal entries for the above transactions in the books of Sriram Ltd. Show your working notes clearly.
   [Ans:10,880 Equity Shares to be issued.]
4. MN Ltd. company with a registered capital of ₹ 5,00,000 in shares of ₹ 10 each issued 20,000 shares payable ₹ 2 on application, ₹ 4 on allotment, ₹ 2 on first call and ₹ 2 on final call. All the money payable on allotment was duly received but on the first call being made, one shareholder paid the entire balance on his holding of 300 shares and five shareholders with a total holding of

1,000 shares failed to pay their dues on the first call. These shares were forfeited for non-payment on first call money. Final call was made and all the money due was received. Later on, forfeited shares were reissued @ ₹ 6 per share as fully paid-up.

Record the above on the company's journal and prepare the Balance Sheet.

[Ans: Capital reserve--₹ 2,000; Balance Sheet total--₹ 2,02,000.]

5. Paroma Ltd. was formed on first April, 2010 with an Authorized capital of ₹ 2,00,000, divided into 2,000 equity shares of ₹ 100 each. 1,000 shares were issued as fully paid to the vendors of building for payment of the purchase consideration. The remaining 1,000 shares were offered for public subscription at a premium of ₹ 5 per share payable as:

On application	₹ 10 per share,
On allotment	₹ 25 per share (including premium),
On first call	₹ 40 per share,
On final call	₹ 30 per share,

Applications were received for 900 shares which were duly allotted and the allotment money was received in full. At the time of the first call, a shareholder who had 100 shares failed to pay the first call money and his shares were forfeited. These shares were reissued @ ₹ 60 per share, ₹ 70 per share paid-up. Final call has not been made.

You are required to

(i) Pass necessary journal entries to record the above transactions and

(ii) show how share capital would appear in the Balance Sheet of the company.

[Ans: capital reserve ---- ₹ 2,000 Balance Sheet total --- ₹ 1,69,500.]

6. Alfa Ltd. Invited applications for issuing 75,000 equity shares of ₹ 10 each. The amount was payable as follows:

On application and allotment ---------------------------₹ 4 per share,

On first call..₹ 3 per share,

On second and final call ---------------------------------balance.

Applications for 1,00,000 shares were received. Shares were allotted to all the applicants on pro rata basis and excess money received with applicants was transferred towards some due on first call. Vibha who was allotted 750 shares failed to pay the first call. Her shares were immediately forfeited. Afterwards the second call was made. The amount due on second call was also received expect on 1,000 shares applied by Monika. Her shares were also forfeited. All the forfeited shares were reissued to Mohit for ₹ 9,000 as fully paid-up.

Pass necessary journal entries in the Books of Alfa Ltd. For the above transactions.

[Ans: capital reserve ₹ 3,250.]

7. Strong Ltd. Invited applications for issuing 1,20,000 equity shares of ₹ 10 each at a premium of ₹ 2 per share. The amount was payable as follows:

On application ------------------------- ₹ 2 per share,

On allotment ---------------------------₹ 5 per share (including premium),

On first and final call ---------------- balance.

Applications for 1,50,000 shares were received. Shares were allotted to all the applicants on pro rata basis. Excess money received on applications was adjusted towards sums due on allotment. All calls were made. Manav who had applied for 3,000 shares failed to pay the amount due on allotment and first and final call. Madhav who was allotted 2,400 shares failed to pay the first and final call. Shares of both Manav and Madhav were forfeited. The forfeited shares were reissued at ₹ 9 per share as fully paid-up.

Pass necessary journal entries for the above transactions in the books of Strong Ltd.

[Ans: capital reserve ₹ 13,200.]

8. XYZ Ltd. Is registered with an Authorised capital of ₹ 2,00,000 divided into 2,000 shares of ₹ 100 each of which, 1,000 shares were offered for public subscription at a premium of ₹ 5 per share, payable as:

   On application ----------------------- ₹ 10 per share

   On allotment ------------------------- ₹ 25 per share (including premium),

   On first call --------------------------- ₹ 40 per share,

   On final call -------------------------- ₹ 30 per share.

   Applications were received for 1,800 shares, for which applications for 300 shares were rejected outright; the rest of the applications were allotted 1,000 shares on pro rata basis. Excess application money was transferred to allotment.

   All the money was duly received except from Surindar, holder of 100 shares, who failed to pay allotment and first call money. His shares were later forfeited and reissued to Shakti at ₹ 60 per share ₹ 70 paid-up. Final call has not been made.

   Pass necessary journal entries and prepare cash book in the books of XYZ Limited.

   [Ans: capital reserve ₹ 500.]

9. Cosmo Ltd. Issued a prospectus inviting application for 50,000 equity shares of ₹ 10 each, payable ₹ 5 as per application (including ₹ 2 as premium), ₹4 as per allotment and the balance towards first and final call.

   Applications were received for 65,000 shares. Application money received on 5,000 shares was refunded which letter of regret and allotments were made on pro rata basis to the applicants of 60,000 shares. Money overpaid on applications including premium was adjusted on account of sums due on allotment.

   Mr. Sharma to whom 700 shares were allotted failed to pay the allotment money and his shares were forfeited by the directors on his subsequent failure to pay the call money.

   All the forfeited shares were subsequent sold to Mr. Jain credited as fully paid-up for ₹ 9 per share.

   You are required to set out the journal entries and the relevant entries in the cash book.

   [Ans: capital reserve ₹ 2,100.]

B. COM

SEMESTER III
COURSE: CORPORATE ACCOUNTING

UNIT-2: BOOK BUILDING, RIGHT ISSUE, BONUS ISSUE AND BUY BACK OF SHARES

STRUCTURE

2.0 . Objectives

2.1 . Book Building

- **2.1.1 Meaning of Book Building**
- **2.1.2 Book Building vs. Fixed Price Method**
- **2.1.3 Process of the Book Building**
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- **2.2.1 Meaning of Right Issue or Pre-emptive Right**
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2.4 Meaning of Buy back of Share

- **2.4.1 Meaning of Buyback of Shares**
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- **2.4.3 Reason for Buyback**
- **2.4.4 Regulations for Buyback of Shares in Indian Scenario**
- **2.4.5 Proportionate Buyback**
- **2.4.6 Advantages of Buyback of Shares**

2.0 OBJECTIVES

After going through this unit, you should be able to:

- Know the concept and process of Book Building
- Understand the meaning of Right Issue and its valuation technique
- Explain the concept of Bonus Shares along with its accounting treatment
- Determine the Provisions of the Companies Act Regarding Issue of Bonus Shares
- State the concept, objectives and reasons of buyback of shares
- Understand the Accounting treatment for Buyback of shares

2.1 BOOK BUILDING

2.1.1 Meaning of Book Building

Book Building may be defined as a process used by companies to raise capital through Public Offerings-both Initial Public Offering (IPO) and Follow on Public Offers (FPOs) for price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional investors as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process. The objective of book building is to arrive at fair pricing of the issue which is supposed to emerge out of offers given by various large investors like mutual funds and institutional investors. This process of fair pricing of issue of shares is determined at a date close to the date of the opening of public offer.

2.1.2 Book Building vs. Fixed Price Method:

The main difference between the book building method and the fixed price method is that in the *book building method*, the issue price is not decided initially. The investors have to bid for the shares within the price range given. The issue price is fixed on the basis of demand and supply of the shares.

On the other hand, in the *fixed price method*, the price is decided right at the start. Investors cannot choose the price. They have to buy the shares at the price decided by the company. In the book building method, the demand is known every day during the offer period, but in fixed price method, the demand is known only after the issue closes.

2.1.3 Process of the Book Building

a) The Issuer who is planning an offer nominates lead merchant banker(s) as 'book runners'.
b) The Issuer specifies the number of securities to be issued and the price band for the bids.
c) The Issuer also appoints syndicate members with whom orders are to be placed by the investors.
d) The syndicate members put the orders into an 'electronic book'. This process is called 'bidding' and is similar to open auction.
e) The book normally remains open for a period of 5 days.
f) Bids have to be entered within the specified price band.
g) Bids can be revised by the bidders before the book closes.
h) On the close of the book building period, the book runners evaluate the bids on the basis of the demand at various price levels.
i) The book runners and the Issuer decide the final price at which the securities shall be issued.
j) Generally, the number of shares is fixed; the issue size gets frozen based on the final price per share.
k) Allocation of securities is made to the successful bidders. The rest bidders get refund orders.

2.1.4 Advantages of Book Building Process

Following are the main advantages of book building process:

a) It allows for price and demand discovery.
b) The cost of issue is much less than other traditional methods of raising capital.
c) The time taken for completing the entire process is much less than that of normal public issue.
d) The demand for shares in book building is known before the issue closes. In fact, if there is no demand, the issue may be deferred and can be rescheduled after having realised the temper of the market.

2.2 ISSUE OF RIGHT SHARES

2.2.1 Meaning of Rights Issue or Pre-emptive Right

Right Issue means to offer shares to the existing shareholders of the company in proportion to their existing shareholding in the company for the purpose of raising fresh capital for the company. In other words, it is "pre-emptive right" that a shareholder has in a company in preference to an outsider. With these rights the shareholders of the company can purchase new shares at a discounted rate to the market price.

2.2.2 Advantages of Rights Issue

Following are the advantages of right issue:

a) Control of the company is retained in the hands of the existing shareholders.

b) The existing shareholders do not suffer on account of dilution in the value of their holdings if fresh shares are offered to them because value of the shares is likely to fall with fresh issue.
c) The expenses to be incurred, if shares are offered to the general public, are avoided.
d) Image of the company is bettered when right issues are made from time to time.
e) There is more certainty of getting capital when fresh issue of shares is made to the existing shareholders instead of to the general public.
f) Directors cannot misuse the opportunity of issuing new shares to their friends and relatives at lower prices and at the same time retaining more control in their hands.\

2.2.3 Valuation of Rights

Usually, a company offers right issue at a price which is lower than the market price of the shares so. That existing (i.e., old) shareholders may get the monetary benefit of being associated with the company for a long time. Existing shareholders who have been offered right shares and do not want to purchase these offered shares may *renounce* their right shares in favour of some other persons within the specified period as mentioned earlier. In such a case, the existing shareholders can make a profit by selling his right to such other person because generally the right shares are offered to the existing shareholders at a price lower than the market price of the shares. The right to purchase more shares is valuable if the market price of the shares is more than the issue price. An existing shareholder may sell his right with or without selling his existing shareholding. The price of right may, therefore, be either cum-right price or ex-right price. *Cum-right price* gives the purchaser, besides the ownership of the shares already held, the right to apply for new shares offered by the company whereas *ex-right price* gives the purchaser only the ownership of the existing shares held by the seller and not the right to apply for additional shares offered by the company.

This right can be valued in terms of money as below:

(a) Calculate the market value of shares which an existing shareholder is required to have in order to get fresh shares.
b) Add to the above price paid for the fresh shares.
c) Find out the average price of existing shares and fresh shares.
d) The average price of the share should be deducted from the market price and the difference thus ascertained is value of right.

The value of the right can also be calculated by applying the following formula:

$$R = \frac{M - N}{N + 1}$$

Where, R = Value of one right share

M = Cum-right market price of a share

S = Subscription price or issue price for a new share

N = Number of old shares required to purchase one right share

Illustration 1

A company is planning to raise funds by making rights issue of equity shares to finance its expansion. The existing equity share capital of the company is 50,00,000. The market value of its share is 42. The company offers to its shareholders the right to buy 2 shares at 11 each for every 5 shares held. You are required to calculate:

(i) Theoretical market price after rights issue; (ii) the value of right; and (iii) percentage increase in share capital.

Solution:

Market value of 5 shares already held by a shareholder @ Rs. 42	= Rs. 210
Add: Amount to be paid by him for acquiring 2 more shares @ 11 per share	= Rs. 22
Total price of 7 shares after rights issue	= Rs. 232
Therefore, theoretical market price of one share $(i.e., \frac{232}{7})$	= Rs. 33.14

i) Value of Right = Market Price - Theoretical Market Price
= Rs. 42 – Rs. 33.14. = Rs. 8.86
Or

Value of right can be calculated by applying the formula as given below

$$R = \frac{M - N}{N + 1} = \frac{42 - 11}{2.5 + 1} = 8.86$$

(N = 5 existing shares required for getting 2 right shares. Therefore for getting 1 share, existing shares required 2.5)

ii) Percentage increase in share capital

Present capital	50,00,000
Rights Issue Rs. 50,00,000 x $\frac{2}{5}$	20,00,000
% Increase in Share Capital $(\frac{20,00,000}{50,00,000} \times 100)$	40%

2.3 BONUS SHARES OR CAPITALISATION OF PROFITS

2.3.1 Meaning of Bonus Share

Whenever any company desires to mobilise any portion of its accumulated profits, the company may issue bonus shares to its existing shareholders. It means issue of shares without any payment from its existing shareholders. Therefore, issue of bonus shares amounts to payment of dividend in kind i.e. in the form of shares issued without any cash payment from the accumulated reserves of the company. Renunciation of the right of bonus shares is not allowed.

Thus, capitalisation of profits (issue of bonus shares) may be done in two ways:

i) By converting the partly paid shares into fully paid.
ii) By issuing fully paid bonus shares to existing shareholders free of cost.

2.3.2 Provisions of the Companies Act Regarding Issue of Bonus Shares

According to Section 52 of the Companies Act, 2013, the securities premium may be applied in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares. Section 55 provides that the Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares. As per Section 63 of the Companies Act, 2013, a company may issue fully paid-up bonus shares to its members in any manner, out of-

i) its free reserves
ii) the Securities Premium Account; or
iii) the Capital Redemption Reserve Account

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

2.3.3 Free Reserves that can be used for Issue of Bonus Shares

a) Surplus Account.
b) General reserve.
c) Dividend equalisation reserve.
d) Capital reserve arising from profit on sale of fixed assets received in cash.
e) Balance in debenture redemption reserve after redemption of debentures.
f) Capital Redemption Reserve Account created at the time of redemption of redeemable preference shares out of the profits.
g) Securities Premium Account collected in cash only.

It may be remembered that both the above accounts (Item nos. 6 & 7) can be utilised only for issuing fully paid bonus shares and not for making partly paid shares fully paid shares.

Reserves (i.e., Not Free Reserves) Not Available for Issue of Bonus Shares

a) Capital reserve arising due to revaluation of assets.
b) Securities Premium arising on issue of shares on amalgamation or take over

c) Investment allowance reserve/Development rebate reserve before expiry of 4 years of creation.
d) Balance in Debenture Redemption Reserve Account before redemption takes place.
e) Surplus arising from a change in the method of charging depreciation.

2.3.4 Advantages of Issue of Bonus Shares

Issue of bonus shares benefits the company as well as the shareholders in the following manner:

a) It enhances the goodwill and creditworthiness of the company as the profit is permanently ploughed back into the organization.
b) There is no need for investors to pay any tax on receiving bonus shares.
c) No requirement of cash regarding payment made to equity shareholders because dividend paid in the form of equity shares will not affect cash and liquidity.
d) As accumulated reserves can be used for the purchase of fixed assets or other technologies so it facilitates the opportunities regarding the growth and expansion of the company.
e) When the company declares dividend in the future, the investors will receive higher dividend as now they hold more number of shares in the company due to bonus shares.

2.3.5 Disadvantages of Issue of Bonus Shares

a) Increase in shares capital does not mean increase in the amount of profit, though the rate of dividend also decreases when bonus is paid by the company in the form of shares.
b) Sometimes issue of bonus shares increases the opportunities regarding the speculation as far as the price of shares is concerned.
c) More shares given by the company in lieu of bonus basically decreases the market price of the shares due to more supply of shares in the market.

2.3.6 Accounting Treatment for issue of Bonus Shares

(A) If the bonus is utilised by making existing partly paid shares fully paid shares, the

1)	Surplus Account	Dr.
	or General Reserve Account	Dr.
	or Capital Profit Account	Dr.
	To Bonus to Shareholders Account	
	(Being amount transferred for bonus payable to shareholders)	
2)	Share Final Call Account	Dr.
	To Share Capital Account	
	(Being final call due on shares)	
3)	Bonus to Shareholders Account	Dr.
	To Share Final Call Account	

(Being bonus to shareholders utilised to make the final call paid-up)

(B) If the payment of bonus is made by issue of free fully paid bonus shares, the following journal entries will be recorded

(1) Surplus Account Dr.
or General Reserve Account Dr.
or Capital Redemption Reserve Account Dr.
or Securities Premium Account Dr.
or Capital Reserve Account Dr.
or Any Other Reserve Account Dr.
To Bonus to Shareholders Account
(Being amount transferred for issue of bonus shares)

(2) Bonus to Shareholders Account Dr.
To Share Capital Account
To Securities Premium Account (if bonus shares are issued at a premium)
(Being issue of bonus shares)

From the entries given above, it is clear that issue of bonus shares represents the addition to share capital of the company, but shareholders' fund remains unchanged because reserves are decreased by a corresponding amount.

Illustration 2

(Bonus Shares with minimum reduction in free reserves)

Following items appear in the Trial Balance of Tara Ltd. as on 31st March, 2020.

Particulars	Amount
4,500 Equity Shares of 100 each	4,50,000
Capital Reserve (Including Rs. 40,000 being profit on sale of Plant)	90,000
Securities Premium Account	40,000
Capital Redemption Reserve	30,000
General Reserve	1,05,000
Surplus Account (Cr. Balance)	65,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. Pass necessary Journal Entries in the books of Tara Ltd.

Solution:

JOURNAL ENTRIES

			Rs.	Rs.
	Capital Redemption Reserve A/c Securities Premium A/c Capital Reserve (Realised in cash) A/c General Reserve A/c To Bonus to Shareholders (Being issue of 1 , 500 bonus shares of Rs. 100 each by utilization of various Reserves)		30,000 40,000 40,000 40,000	 1,50,000
	Bonus to Shareholders A/c To Equity Share Capital A/c Being Capitalisation of Profit)		1,50,000	 1,50,000

Illustration 3

Mahima construction Ltd. has accumulated large profits in the Reserve Account and the Board of Directors decide to utilise it to make the capital properly representative of the financial position. The paid-up capital of company is Rs. 8,00,000 consisting of Rs. 50,000 equity shares of Rs. 10 each fully paid and 50,000 equity shares of Rs. 10 each, Rs. 6 per share paid up.

The Directors decided to issue one fully paid-up bonus share at a premium of Rs. 5 for every fully paid share held and to make the partly paid shares fully paid. At the date of allotment of the bonus shares the market value of the above share stands at Rs. 24.

Assuming that the scheme is accepted and that all legal formalities are gone through, pass necessary Journal Entries.

Solution:

JOURNAL ENTRIES

			Dr.	Cr.
	Reserve A/c Dr. To Bonus to Shareholders A/c (Being amount transferred from Reserve Account for payment of bonus to shareholders)		9,50,000	 9,50,000

	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Being final call due on 50,000 partly paid shares @ Rs. 4 per share)		2,00,000	2,00,000
	Bonus to Shareholders A/c Dr. To Equity Share Final Call A/c (Being bonus to shareholders utilized to make the final call paid up)		2,00,000	2,00,000
	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being bonus to shareholders applied towards issue of 50,000 bonus shares of Rs.10 each at a premium of Rs. 5 per share to fully paid equity shareholders in the ratio of 1 bonus share for every one fully paid share held)		7,50,000	5,00,000 2,50,000

Illustration 4

Mukul Ltd. has Rs. 11,20,000 in Equity Share Capital consisting of Rs.80,000 shares of Rs. 10 each fully paid and 40,000 shares of 10 each, of which Rs. 8 paid per share paid. It has Rs. 40,000 in Capital Reserve, Rs. 90,000 in Securities Premium Reserve Account, Rs. 1,40,000 in Capital Redemption Reserve Account and Rs. 3,00,000 in General Reserve.

By way of bonus dividend the partly paid up shares are converted into fully paid up shares and the holders of fully paid up shares are also allotted fully paid up bonus Shares in the same ratio.

Securities Premium Account includes a premium of Rs. 50,000 for shares issued to vendors pursuant to a scheme of absorption.

Pass Journal Entries showing separately the two types of bonus issues as mentioned above with the minimum reduction in free reserves.

SOLUTIONS:

In the Books of Mukul Ltd.

JOURNAL ENTRIES

			Rs.	Rs.

	General Reserve Account Dr. To Bonus to Shareholders Account (Being bonus dividend payable for making 40,000 shares of Rs.10 each, Rs. 8 paid up as fully paid up)		80,000	 80,000
	Share Final Call Account Dr. To Equity Share Capital Account (Being the final call due on 40,000 equity shares @ Rs. 2 per share as per Board's resolution)		80,000	 80,000
	Bonus to Shareholders Account Dr. To Share Final Call Account (Being bonus utilised towards payment of final call on 40,000 shares)		80,000	 80,000
	Securities Premium Account Dr. Capital Redemption Reserve Account Dr. General Reserve Account Dr. To Bonus to Shareholders Account (Being bonus dividend payable to holders of fully Paid shares in the ratio of 1 : 4 as paid to holders of partly paid shares)		40,000 1,40,000 20,000	 2,00,000
	Bonus to Shareholders Account Dr. To Equity Share Capital Account (Being issue of 20,000 bonus shares to be distributed in the ratio of 1 bonus share for every 4 shares held)		2,00,000	 2,00,000

Notes: (1) General Reserve has been utilised for making partly paid shares as fully paid shares because Securities Premium Account and Capital Redemption Reserve Account cannot be utilised for making partly paid shares as fully paid.

(2) Capital profits can be distributed as dividend if they are realised in cash. Capital Reserve has not been utilised as it is not known whether it is realised in cash or not.

(3) Securities premium of Rs. 50,000 for hares issued to vendors not realised in cash has not been used for issue of bonus shares.

2.4 BUY BACK OF SHARES

2.4.1 Meaning of Buy back of Shares

When a company wants to buy its own stock from the shareholders, it is known as buy back of shares. Buy back is a method of cancellation of share capital which leads to a reduction in the share capital of a company.

2.4.2 Objectives of Buy back

i) To increase the EPS of the shares purchased back, assuming that there will be no reduction in the earnings of the company.
ii) To increase the promoters' holdings in the company.
iii) Increase the market price of the share as the buyback price is higher than the market price.
iv) To make the investors aware about the financial strength and prospects of the company.
v) To aid the company in distributing its surplus cash among the investors.
vi) To modify the capital structure.

2.4.3 Reasons for Buy back

i) To shrink equity base thereby injecting much needed flexibility;
ii) To prevent hostile take-over bids;
iii) To return surplus cash to shareholders;
iv) In increasing the underlying share value;
v) To support the share price during periods of temporary weakness;
vi) To achieve or maintain a target capital structure;

2.4.4 Regulations for Buyback of Shares in Indian Scenario

According to Section 68 of the Companies Act, 2013, a company may purchase its own shares or other specified securities out of:

i) Its free reserves (Le. reserves which are free for distribution as dividend); or
ii) The securities premium account ; or
iii) The proceeds of the issue of any shares or other specified securities.

2.4.5 Proportionate Buyback

In case the number of securities tendered for buyback is more than the number of securities to be bought back, the number of securities to be bought back from each member shall be determined by the following formula:

$$\text{Acceptance tendered by a member} \times \frac{\text{Number of securities to be bought back}}{\text{Total acceptance tendered}}$$

2.4.6 Advantages of Buyback of Shares

Following are the main advantages of buyback of shares:

1) Companies with huge amount of free reserves are open to employ funds to acquire shares through buyback process.
2) Buyback of shares assists a company to reduce its unused and excessive share capital which provides more benefits to the shareholders.
3) Buyback of shares results in lower capital base, which improves post-buyback EPS and boosts the price-earnings ratio as well as the dividend yield.
4) Buyback of shares is allowed under Section 68 if the liquidity position of the company is decent. The defaulter companies are not allowed to engage in buyback and hence it gives a reality check about the companies' liquidity position.
5) Buyback delivers appreciation of capital to investors which may otherwise be not available.
6) Buyback signalizes to the market that shares are undervalued.
7) Buyback of shares assist the promoters to formulate an effective defense strategy against hostile takeover bids.

2.4.7 Disadvantages of Buyback of Shares

Following are the main disadvantages of buyback of shares

i) The buybacks indicate under valuation of companies stock. The companies plough back some of the outstanding shares thereby creating a shortage of shares in the market.
ii) Companies opt for buybacks when they can't find better options to deploy their surplus cash which implies that there is a few or no scope for further expansion.
iii) It could divert the funds of the organization from productive investment opportunities.
iv) It might encourage unscrupulous promoters to use the money of the company to increase their own stakes at lower prices.

2.4.8 Accounting Entries on Buyback of shares

Following entries may be required to record buyback of shares:

a) When investments are sold for buyback of own shares

Bank A/c	Dr.
Surplus A/c	Dr. (for loss on sale of investment)
To Investment A/c	
To Capital Reserve A/c (for profit on sale of non-trade investments)	
To Surplus A/c (for profit on sale of trade investments)	

b) For issue of debentures or other specified securities (excluding shares of the kind to be bought back) for buyback purpose :

Bank A/c	Dr.
To Debentures/Other Specified Security A/c	

To Securities Premium A/c (if any)

c) For cancellation of shares bought back

Equity Share Capital A/c Dr. (with Nominal Value)

Free Reserves/Securities Premium A/c Dr. (with Premium payable)

To Shareholders A/c (Actual cost of buyback shares)

d) For making the payment of buyback shares

Shareholders A/c Dr.

To Bank A/c

Alternative to (c) and (d) entries

e) For cancellation of shares bought back

i. Equity Share Capital A/c Dr.

Buyback Premium A/c Dr.

To Shares Buyback A/c

ii. For adjustment of buyback premium

Securities Premium A/c Dr.

General Reserve A/c Dr.

To Buyback Premium A/c

iii. For making payment of buyback shares

Shares Buyback A/c Dr.

To Bank A/c

(e) For transfer of nominal value of shares bought back out of free reserves

Free Reserves A/c Dr.

To Capital Redemption Reserve A/c

(f) For expenses incurred in buyback of shares

Buyback Expenses A/c Dr. (with the amount)

To Bank A/c

(g) For transfer of buyback of expenses Surplus

A/c Dr.

To Buyback Expenses A/c

Illustration 5

Kalinga Ltd. decides to buyback 10% of Rs. 100 crores paid up equity capital. The face value per equity share is Rs. 10 but the market price per share is Rs. 15. Following steps were taken for buyback of shares: (i) To issue 14% debentures of Rs. 100 each at par for face value of Rs. 10 crores, (ii) To utilize general reserve, to sell investments of Rs. 7 crores for Rs. 8 crores, to buy back the shares at the market price, to immediately cancel the shares bought back. Journalize the transactions.

Solution:

JOURNAL ENTRIES

(In crores)

			Rs.	Rs.
	Bank A/c Dr.		10	
	To 14% Debentures A/c			10
	(Being issue of 14% debentures at par for buyback of shares)			
	Bank A/c Dr.		8	
	To Investments A/c			7
	To Surplus A/c			1
	(Being sale of investments and profit on sale transferred to Surplus A/c)			
	Equity Share Capital A/c Dr.		10	
	General Reserve A/c Dr.		5	
	To Shareholders A/c			15
	(Being cancellation of bought back shares of nominal value of Rs.10 crores and general reserve utilised for premium)			
	Shareholders A/c Dr.		15	
	To Bank A/c			15
	(being amount payable on buyback of shares paid to shareholders)			

ILLUSTRATION 6.

Following figures have been extracted from the books of Konark Ltd. as on 31-3-2020.

Authorized Capital:

50,00,000 Equity Shares of Rs. 10 each	5,00,00,000

Issued and Subscribed Capital:

50,00,000 Equity Shares of Rs. 10 each, fully paid-up	5,00,00,000

Reserves & Surplus:

General Reserve Rs. 80,00,000; Surplus A/c Rs. 20,00,000; Capital Reserves Rs. 30,00,000; Securities Premium Account Rs. 15,00,000; 14% Debentures Rs. 50,00,000; Cash and Bank Balance Rs. 1,00,00,000.

The company decided to buy back 25% of the paid up equity share capital at face value. It was also decided to issue further 14% debentures of Rs. 50,00,000 at par for the purpose of buyback. Pass necessary Journal Entries.

Solution:

JOURNAL ENTRIES

			Dr Rs.	Cr Rs.
	Bank A/c Dr. To 14% Debentures A/c (Being issue of debentures of Rs. 50,00,000 at par for the purpose of buyback of shares)		50,00,000	50,00,000
	Equity Share Capital A/c Dr. To Shareholders A/c (Being cancellation of 25% of paid up capital on account of 25% shares bought back)		1,25,00,000	1,25,00,000
	General Reserve Dr. To Capital Redemption Reserve A/c (Being transfer of general reserve to Capital Redemption Reserve A/c, Rs. 1,25,00,000 - Rs. 50,00,000)		75,00,000	75,00,000
	Shareholders A/c Dr. To Bank A/c (Being payment made for shares bought back)		1,25,00,000	1,25,00,000

ILLUSTRATION 7.

Sunshine Ltd. had authorized capital of Rs. 20 crores of Rs. 100 each equity shares and an issued and subscribed capital of Rs. 10 crores. The company decided to buyback 25% of its share capital direct from its shareholders at Rs. 75 per shares. The company had issued Rs. 2 crores, 10% preference shares two months back for the purpose of buyback, the balances in the following accounts were:

Securities Premium A/c	Rs. 10,00,000
General Reserve A/c	Rs. 80,00,000

Record the transactions in the books of the company in accordance with the provisions of the Act.

Solution:

JOURNAL

			Rs.	Rs.
(i)	Securities Premium A/c Dr.		10,00,000	
	General Reserve A/c Dr.		40,00,000	
	To Capital Redemption Reserve A/c			(1) 50,00,000
	(Being transfer of Rs. 10,00,000 from Securities Premium Account and Rs. 40,00,000 from General Reserve to Capital Redemption Reserve Account)			
(ii)	Equity Share Capital A/c Dr.		2,50,00,000	
	To Capital Reserve A/c			62,50,00
	To Equity Shareholders A/c			1,87,50,000
	(Being amount payable to the Equity Shareholders on buyback of 2,50,000 equity shares of 100 each at f 75 per share)			
(iii)	Equity Shareholders A/c Dr.		1,87,50,000	
	To Bank A/c			1,87,50,000
	(Being payment made to equity shareholders for buyback of shares)			

Working Note (1) `

Total nominal value of equity shares bought back 2,50 00,000

Less: Issue of 10% preference shares for the purpose of	
Buyback of shares 2 months back	2,500,000
Amount to be transferred to capital redemption reserve	50,00,000

2.5 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House, New Delhi.
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co., New Delhi.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication, New Delhi.
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

2.6 TERMINAL QUESTIONS/EXERCISES

Objective Type

Fill in the Blanks

1) When an existing company makes subsequent issue of shares to the existing shareholders, it is called____________shares.
2) The offer of right shares to existing shareholders will be made by giving a notice of at least of__________________days.
3) Section 62 as regards issue of right share will not apply to_______________companies.
4) Usually, a company offers rights issue at a price which is_______then the market price of the shares.
5) A company may issue fully paid up______to its members out of its free reserves.
6) The buyback of shares should not exceed_______________________% of the paid up capital and free reserves of the company.
7) For the purpose of buyback, the shares and securities should be listed at the _______________

8) Buyback offer should remain open for a minimum of 15 days and maximum of___________days.

Answers.

1. Right; 2. 15; 3. Private; 4. Lower; 5. Bonus share; 6. 25%; 7. Stock Exchange; 8. 30 days.

Very Short Answer Type

1) What are right shares?
2) State the advantages of issuing right shares.
3) Is any amount paid by a shareholder on issue of bonus shares to him ?
4) Give a list of reserves which are not available for issue of bonus shares.
5) Give a list of the circumstances which warrant the issue of bonus shares.
6) What do you understand by Buyback of Shares?
7) Mention the sources where from buyback of shares can be made.

Long Answer Type

1. What do you mean by rights issue? State the relevant provisions of the Companies Act regarding rights issue in the case of a public company. How is the value of the right computed?
2. What do you mean by bonus shares? What are the various sources from which these are issued?
3. What do you mean by buy back of shares? State the conditions to be fulfilled for buyback of shares.
4. Discuss the advantages and disadvantages of buy back of shares.
5. What is Book building? Discuss different process of book building.

Practical Problems

1. Southern Ltd. decides to increase its existing share capital by making a right issue to the existing shareholders in proportion of one new share for every 4 shares held. The company declared a dividend of Rs. 20 share. On the declaration of dividend and recommendation of the right, the shares are quoted at a price of Rs. 240 cum-dividend and cum-right. The company offers, under right issue, a share of 100 each at a premium of 20. Calculate the value of the right.

   Ans. Rs. 20
2. The nominal value of the equity shares of a company is Rs. 10 and the current market price is Rs. 40. The company issues right shares at the rate of 1 equity share for every 2 existing shares held, the right shares being issued at a premium of 10%.

   From the above, calculate the value of the right.

   Ans. Rs. 9.67

3. ABC Company Ltd. has decided to issue rights shares to its existing shareholders in proportion to one share for every five shares held at a premium of Rs. 50 for a nominal value of Rs. 100 per share. Calculate the market value of the right if the market value of the share at the time of announcement of rights issue by the company is Rs. 250.

   Ans. Rs.16.67

4. A company has accumulated large profits in the Reserve Account and the directors decide to utilise a part of this in order to make the capital properly representative of the financial position. The paid-up share capital is Rs. 10,00,000 consisting of 90,000 Equity shares of 10 each fully paid and 20,000 Equity shares (face value Rs. 10 each) Rs. 5 per share paid up. The directors decide to issue one bonus share at a premium of Rs. 10 for every fully paid share held and to make the partly paid shares fully paid. At the date of the allotment of bonus shares the market value of the Equity share stands at Rs. 33.
   Give necessary Journal Entries in respect of the above transactions.

Ans. [Bonus to Shareholders ` 19,00,000].

5. A company with an issued and subscribed capital of Rs. 10,00,000 in 1,00,000 shares of face issue Rs. 10 each, of which Rs. 8 per share is paid up. It has accumulated a Reserve of Rs. 3,00,000. Out of this Reserve Rs. 2,00,000 is intended to be utilised in declaring a bonus at the rate of 25% on the paid-up capital so that the shares may become fully paid. Show the necessary Journal Entries.

Ans. [Bonus to Shareholders Rs. 2,00,000]

6. MN Ltd. decides to buyback 25% of its Rs. 4 crores paid up equity capital. The face value per equity share is Rs. 10 whereas the market price is Rs. 25. MN Ltd. takes the following steps for buyback of its shares:

a) To issue 14% debentures of Rs. 100 each at par for face value of 1 crore at par.
b) To utilise general reserve to the extent required.
c) To sell investments of Rs. 50,00,000 for Rs. 52,00,000.
d) To buy back the shares at the market price.

Journalise the above transactions.

7. Following figures have been extracted from the books of Metals Product Ltd. as on 31-3-2020. Paid up Capital 9,00,000 Equity Shares of Rs. 10 each Rs. 90,00,000; General Reserve Rs. 15,00,000; Surplus A/c Rs. 5,00,000; Securities Premium A/c Rs. 3,00,000; 14% Debentures Rs. 10,00,000; Bank Balance Rs. 20,00,000.
   The company decided to buyback 25% of the paid-up equity share capital at face value. It was also decided to issue further 14% debentures of RS. 10,00,000 at par for the purpose of buyback of shares.
   Journalise the above transactions relating to buyback of shares.

8. Following are the balances of different assets and liabilities of Excellent Ltd. as on 31-03-2020.

   30,000 Equity Shares of Rs. 10 each Rs. 3,00,000; Free Reserves Rs. 4,50,000; Securities Premium Account Rs. 1,50,000; Debentures Rs. 6,25,000; Creditors Rs. 2,75,000; Fixed Assets Rs. 9,00,000; Stock Rs. 2,00,000, Debtors Rs. 1,50,000 and Bank Balance Rs. 5,50,000.

   On the above date shares are bought back by the company to the extent possible, at a premium of Rs. 40 per share. Pass Journal Entries.

   Ans. Number of shares to be bought back = 3,750.

9. KGF Ltd. had issued capital of Rs. 1,00,00,000 of Rs. 10 per equity shares. The balance in the Securities Premium Account was Rs. 1,00,000 and general reserves Rs. 15,00,000. The company decided to buyback 20% of its share capital directly from its shareholders at Rs. 8 per share. The company had issued Rs. 5,00,000, 10% preference shares two months back for the purpose of buyback.

   Pass necessary journal entries.

   Ans. Transfer to Capital Redemption Reserve Account Rs. 15,00,000.

B. COM

SEMESTER III
COURSE: CORPORATE ACCOUNTING

UNIT-3 ACCOUNTNG FOR REDEMPTION OF PREFERENCE SHARES

STRUCTURE

3.0 OBJECTIVES

After going through this unit, you should be able to:

- Know the meaning of Redemption of Preference Shares
- Identify the conditions for a valid Redemption
- State the Sources and Restricted Sources for creation Capital Redemption Reserve Account
- Understand the Accounting treatment for Redemption of Preference Shares

3.1 MEANING OF REDEMPTION OF PREFERENCE SHARES

Redemption of capital means refund of capital, which is raised from the shareholders. This redemption is not permissible without the permission of the court as prescribed by the section 66 of Companies Act, 2013. But when the capital has been arranged by the company by issue of redeemable preference shares, then it can be refunded to the shareholders after the expiry of the stipulated time period.

(i) Redemption of preference share means refund of share money to the preference shareholders.
(ii) A company cannot issue irredeemable preference shares.
(iii) Maximum redemption period of preference share capital is 20 years.

(iv) In case of infrastructural company, it can issue preference shares more than 20 years but not beyond 30 years. But company must redeem at least 10% of share in each year from 21st year or earlier.

3.2 CONDITIONS UNDER SECTION 55 FOR A VALID REDEMPTION

(i) For the purpose of redemption, preference shares must have to be fully paid up. If there are partly paid up or partly called up preference share in the company then it is necessary to make them fully paid-up shares before redemption.

(ii) Redeemable preference share can be redeemed out of profit of the company which are available for dividend or out of proceeds of fresh issue of equity or preference share. Company can also use both the sources for the redemption of preference shares.

(iii) When the shares are redeemed out of profits (available for dividend), then such amount of nominal value of the share redeemed must be transfer to a separate account called Capital Redemption Reserve (CRR) account. It is an appropriation of profit which is made to restrict the use of that amount of profit for any other purposes. However, CRR can be utilised for the issue of fully paid bonus shares to the shareholders.

(iv) The redemption of preference shares by a company shall not be taken as reduction of authorised capital.

(v) The amount of premium payable on redemption of preference shares will be adjusted out of Securities Premium Account or out of profits available or General Reserve.

(vi) Preference shares must be redeemed within one month of the issue of new shares of the company.

(vii) An information copy must be sent to the ROC of the company within 30 days of the redemption.

(viii) The preference shares cannot be redeemed by fresh issue of debentures.

3.3 SOURCES USED TO CREATE CAPITAL REDEMPTION RESERVE

(Free reserves / Profits available for dividend)

(i) Surplus A/C
(ii) General reserve
(iii) Reserve fund
(iv) Dividend equalisation fund
(v) Workmen compensation fund
(vi) Contingency reserve
(vii) Workmen accident fund
(viii) Voluntary debenture redemption fund

3.4 RESTRICTED SOURCES FOR CREATION OF CAPITAL REDEMPTION RESERVE ACCOUNT

(i) Securities Premium Account
(ii) Share Forfeiture Account

(iii) Capital Reserve
(iv) Development Rebate Reserve
(v) Profits Prior to Incorporation

When the shares are redeemed out of profits then it is better to use the balance in the Statement of P/L Account before use of any other free reserves.

When the shares are redeemed partly from fresh issue and partly out of profit.

(a) If number of shares for fresh issue is given

Nominal value of redeemable preference share capital	×××
Less - Nominal value of capital out of fresh issue	×××
Balance out of profit (to CRR)	×××

(b) If the number of shares for fresh issue is not given.

Nominal value of redeemable preference capital =	×××
Less - Divisible profit available for redemption	×××
Balance for fresh issue	×××

$$\text{No. Of shares to be issued} = \frac{\text{Balance for fresh issue}}{\text{Face value of a new share}}$$

If existing securities premium in the Balance Sheet plus premium for fresh issue is sufficient to cover fully the premium on redemption account, then the above-mentioned alternatives will be applied, otherwise following method will be applied.

Nominal values of redeemable preference capital	×××
Add - Premium on redemption	×××
	×××
Less - Divisible profit available for redemption	×××
Less - Existing Securities Premium A/C	×××
Balance for fresh issue	×××

$$\text{No. of shares to be issued} = \frac{\text{Balance for fresh issue}}{\text{Issue price of new share}}$$

3.5 JOURNAL ENTRIES FOR THE REDEMPTION OF PREFERENCE SHARES

(i) When the partly paid-up shares are converted in to fully paid up for redemption purpose.

(a) Final call is due:

% Redeemable Preference Share Final Call A/C Dr
    To % Redeemable Preference Share Capital A/C

(b) Final call money received:

Bank A/C Dr
    To % Redemption preference share final call A\C

(ii) Sale of investment for providing cash on redemption

Bank A/C Dr

Surplus A/C Dr (If Loss)

To investment A/C

To surplus A/C (If Profit)

(iii) When the fresh issue of Equity Share is made for redemption.

At par

Bank A/C Dr

To Equity Share Capital A\C

At premium

Bank A/C Dr

To Equity Share Capital A/C

To Securities Premium A/C

(iv) When free reserves and profit are used for redemption of capital

Surplus A/C Dr

General Reserve A/C Dr

To Capital Redemption Reserve A/C

(v) When Premium on redemption A/C is closed:

Securities Premium A/C Dr

Surplus from Statement of P/L A/C Dr

Revenue Reserve A/C Dr

To Premium on Redemption A/C

(vi) For the total amount due for redemption.

Redeemable preference share capital A/C Dr

Premium on Redemption A/C Dr

To Redeemable Preference Shareholders A/C

(vii) When payment is made.

Redeemable Preference Shareholders A/C Dr

To bank A/C

Note - If there are untraceable preference shareholders. Then final payment will be not made to them. They are shown in the balance sheet under the head current liabilities.

Illustration 1

i) Issues at par 40,000 Redeemable Preference shares of 10 each redeemable at premium of 10% per share.

ii) Redeems 20,000 of the Redeemable Preference shares out of surplus of the company.

iii) 30,000 equity shares of Rs. 10 each were issued at par and out of the proceeds redeems the balance of the redeemable preference shares.

Journalise these transactions.

Solution:

JOURNAL ENTRIES

(i)	Bank A/c Dr To Redeemable Preference Share Capital A/c (Being amount received on issue of 40,000 redeemable preference shares)		4,00,000	4,00,000
(ii)	Redeemable Preference Share Capital A/c Dr Premium on Redemption A/c Dr To Redeemable Preference Shareholders A/c (Being transfer of amount due to redeemable preference shareholders)		2,00,000 20,000	2,20,000
	Surplus A/c Dr To Premium on Redemption A/c To Capital Redemption Reserve A/c (Being premium provided out of Surplus Account and reserve created as required in Section 55 of the Companies Act, 2013)		2,20,000	20,000 2,00,000
	Redeemable Preference Shareholders A/c Dr To Bank A/c (Being the payment made to redeemable preference shareholders on redemption)		2,20,000	2,20,000
(iii)	Redeemable Preference Share Capital A/c Dr Premium on Redemption A/c Dr To Redeemable Preference Shareholders A/c (Amount due on redemption transferred to		2,00,000 20,000	2,20,000

	redeemable preference shareholders account)			
	Bank A/c Dr To Equity Share Capital A/c (Being the issue of equity shares for redemption of preference shares)		3,00,000	3,00,000
	Surplus A/c Dr To Premium on Redemption A/c (Premium provided out of Surplus Account for redemption of preference shares)		20,000	20,000
	Redeemable Preference Shareholders A/c Dr To Bank A/c (Amount paid on redemption of preference shares)		2,20,000	2,20,000

Illustration 2. (Where number of shares of fresh issue is not given).

Sunlight Ltd. has an issued Share Capital of 650, 7% Redeemable Preference Shares of Rs.100 each and 4,500 Equity Shares of Rs. 50 each. The Preference Shares are redeemable at premium of 7.5 % on April 1, 2020.

The Company's Balance Sheet as on 31st March, 2020 was as follows:

I. Equity and Liabilities	
(1) Shareholders' Funds	
(a) Share Capital:	
4,500 Equity Shares of Rs. 50 each fully paid	2,25,000
650 7% Redeemable Preference Shares of Rs. 100 each fully paid	65000
(b) Reserves and Surplus : Surplus Account	48,000
(2) Current Liabilities	
Sundry Creditors	56,500
Total	3,94,500
II. Assets	
(1) Non-current Assets	
(a) Fixed Assets	3,45,000
(b) Investments	18,500
(2) Current Assets	
Balance at Bank	31,000
Total	3,94,500

For the redemption of Preference Shares, the Company decided to sell all the investments for Rs. 16,000; and to finance part of the redemption from company's funds, subject to leaving a minimum balance of 12,000 in the surplus Account. The company also desires to issue sufficient Equity Shares of 50 each at a premium of Rs. 13 per share to raise the balance of funds required.

You are required to prepare the necessary Journal entries to record the above transactions and the Balance Sheet as on completion.

Solution:

Journal Entries in the books of Exchange Ltd.

			₹	₹
	Bank A/c Dr. Surplus A/c Dr. To investment A/c (Being the investment sold at ₹ 16,000 and loss debited to surplus Account)		16,000 2,500	 18,500
	7% Red. Preference share capital A/c Dr. Premium on redemption A/c Dr. To preference shareholders A/c (Being the amount payable on redemption of 650 preference shares transferred to preference shareholders A/c)		65,000 4,875	 69,875
	Bank A/c Dr. To equity share application & allotment A/c (Being the application money received on 650 Equity shares of ₹ 50 each at a premium of ₹ 13 per share)		39,690	 39,690
	Equity shares application & allotment A/c Dr. To equity share capital A/c To securities premium A/c (Being the allotment of 650 equity shares of 50 each at a premium of ₹ 13 per share vide board resolution dated……)		39,690	 31,500 8,190
	Surplus Account Dr. To capital redemption reserve A/c (Being the amount transferred out of surplus A/c equal to nominal value of shares redemption otherwise than out of proceed of fresh issue)		33,500	 33,500
	Securities premium A/c Dr. To premium on redemption A/c		4,875	 4,875

	(Being the premium payable on redemption of preference shares charge to securities premium Account)			
	Preference shareholders A/c Dr.		69,875	
	To Bank A/c			69,875
	(Being the payment made on redemption of preference shares at a premium of 7 ½%)			

BALANCE SHEET OF EXCHANGE LTD.

As on 1st April, 2020

	Note No.	₹
I. Equity and liabilities		
(1) Shareholders' funds		
(a) Share capital	A	2,56,500
(b) Reserves and Surplus	B	48,815
shareholders' fund		3,05,315
(2) Non-current liabilities		------
(3) Current liabilities:		
Trade receivables: Sundry creditors		56,500
Total equity and liabilities (1) + (2) + (3)		3,61,815
II. Assets		
(1) Non- current Assets:		
Fixed Assets		3,45,000
(2) Current Assets:		
Cash and cash equivalents: cash at Bank		16,815
Total Assets		3,61,815

Notes to Accounts

	₹
A. Share capital	
5,130 equity shares of ₹ 50 each fully paid	2,56,000
B. Reserves and Surplus	
Capital redemption reserves account	33,500
Securities premium account	3,315
Surplus account	12,000
	48,815

Working Notes:

(1) Calculation of Number of Equity Shares to be Issued	**₹**	**₹**
Balance in surplus account		48,000
Less: Loss on sale of investment	2,500	
Amount to be retained as balance	12,000	14,500
Amount available for transfer to capital redemption reserve A/c		33,500
Nominal value of equity shares to be issued (₹ 65,000 - ₹ 33,500)		31,500

No. of equity shares = 31,500/ ₹ 50 = 630 shares.

ILLUSTRATION 3. (Where forfeiture and reissue of shares is to be done before redemption of preference shares).

Following is the Balance Sheet of Moon Ltd. as at 31st March, 2019

I. Equity and Liabilities		`
(1) Shareholders' Funds		
(a) Share Capital:		
i) Equity Shares Capital (fully paid)		18,00,000
ii) 9% Redeemable Preference Shares of Rs.100		
each fully called	1,80,000	
Less: Calls-in-arrears	<u>2,000</u>	1,78,000
(b) Reserves and Surplus:		
Revenue Reserve		13,50,000
(2) Current Liabilities		
a) Creditors		4,50,000
b) Provisions		2,22,000
Total		40,00,000
II. Assets		
(1) Non-current Assets		
(a) Fixed Assets		27,00,000
(b) Investments		2,00,000
(2) Current Assets		11,00,000
Total		40,00,000

100 preference shares on which the last call of 20 was not paid, were forfeited by the Board of Directors on 30th April, 2019

The Directors redeemed the remaining preference shares at a premium of 10% on 30th sept., 2019. For this purpose, 10,000 Equity shares of Rs.10 each were issued at a premium of 10% and were fully paid up within 30th July, 2019. Current assets before the company closes its accounts on 31st march every year.

Pass necessary journal entries on redemption of preference shares.

Solution:

JOURNAL ENTRIES

Date	Particulars		Dr.₹	Cr.₹
2019 April 30	9% Redeemable preference share capital A/c Dr. To calls in arrear A/c To forfeited shares A/c (Being forfeiture of 100 preference shares of ₹ 10 each for non-payment of final call of ₹ 20)		10,000	 2,000 8,000
July 30	Bank A/c Dr. To equity share capital A/c To securities premium A/c (Being issue of 10,000 equity shares of ₹ 10 each at a premium of 10% for a redeeming preference shares as per boards' resolution No…….. Dated… ....)		1,10,000	 1,00,000 10,000
Sept. 30	9% Redeemable preference share capital A/c Dr. Premium on redemption of preference shares A/c Dr. To preference shareholders A/c (Being amount due to preference shareholders on redemption of 1,700 preference shares of ₹ 100 each at a premium of 10%)		1,70,000 17,000	 1,87,000
Sep. 30	Securities premium A/c Dr. Revenue reserve A/c Dr. To premium on redemption of preference shares A/c (Being premium on redemption of preference		10,000 7,000	 17,000

	shares provided out of securities premium A/c and revenue reserve A/c)			
Sep. 30	Revenue reserve A/c Dr.		70,000	
	To capital redemption reserve A/c			70,000
	(Being transfer of requisite amount of revenue reserve A/c to capital redemption reserve A/c for redemption of preference shares)			
Sep. 30	Forfeited shares A/c Dr.		8,000	
	To capital reserve A/c			8,000
	(Being balance of forfeited shares A/c transferred to capital reserve A/c)			
Sep. 30	Preference shareholders A/c Dr.		1,87,000	
	To Bank A/c			1,87,000
	(Being payment of amount due to preference shareholders)			

Illustration 4. (Where some preference shareholders are not traceable).

Following is the information taken from the books of King Ltd. as on 30th September, 2020:

I. Equity and Liabilities	
Shareholders' Funds	
Share Capital:	
Issue and Paid-up Capital:	
8% Redeemable Preference Shares of Rs.100 each full paid	56,000
Equity Shares of Rs. 10 each fully paid	1,68,000
Reserves and Surplus:	
Securities Premium Account	7,000
Surplus Account	61,000
Current Liabilities:	
Creditors	28,000

Total	3,20,000
II. Assets	
Non-current Assets	2,00,000
(a) Fixed Assets	1,20,000
(b) Current Assets	
Total	3,20,000

The preference shares were redeemed on 10th October, 2020 at a premium of 10 per cent. No trace could be found of the holders of 12 preference shares.

You are required to give the Journal Entries in the books of the company and draw up the resultant Balance Sheet in a summarised form.

Solution: JOURNAL ENTRIES

2019 Oct.10	8% Redeemable preference share capital A/c Dr. Premium on redemption of pref. shares A/c Dr. To preference shareholders A/c (Being amount payable on redemption of preference shares transferred to preference shareholders account)		56,000 5,600	₹ 61,600
Oct.10	Securities premium Account Dr. To premium on redemption of preference shares Account. (Being premium on redemption provided out of securities premium Account)		5,600	5,600
Oct.10	Surplus Account Dr. To capital redemption reserve Account (Being amount equal to the nominal value of preference shares redeemed transferred to capital redemption reserve Account as required by law)		56,000	56,000
Oct.10	Preference shareholders Account Dr. To Bank Account (Being payment made to redeemable preference shareholders holding 548 shares (560 – 12) @ ₹ 110 per share)		60,280	60,280

BALANCE SHEET OF CARDAMOM LTD.

As at 10th October, 2020

		Note No.	₹
I. Equity and liabilities			
(1) Shareholders' funds			
Share capital		A	1,68,000
Reserve and surplus		B	62,400
Total			2,30,400
(2) Non-current liabilities			Nil
(3) Current liabilities			
Trade payable (Creditors)			28,000
Amount due to preference shareholders (For holders of 12 shares of ₹ 100 each @ ₹ 110 on redemption of their shares who were not traceable)			1,320
Total			29,320
Total equity and liabilities (1) + (2) + (3)			2,59,720
ii. Assets			₹
(1) Non-current assets			
Fixed assets	₹		2,00,000
(2) Current assets	1,20,000		
Less: cash paid on redemption of preference shares	60,280		
			59,720
Total assets (1) + (2)			2,59,720

Accompanying notes to the balance sheet

Share capital

	₹
Issued, subscribed and paid-up capital:	
16,800 equity shares of ₹ 10 each fully paid-up	1,68,000

Reserve and surplus

		₹
Capital redemption reserve account		56,000
(Capital on redemption of 5,600 pref. shares of ₹ 10 each out of surplus A/c	₹	
Securities premium account	7,000	
Less: premium utilised for premium payable	5,600	
On redemption of pref. shares		1,400
Surplus account as at 30-9-2020	61,000	
Less: account transferred to capital redemption reserve A/c for	56,000	
Redemption of pref. shares		5,000
		62,400

3.6 USE OF ALGEBRAIC EQUATION FOR FINDING OUT THE FACE VALUE OF SHARES TO BE ISSUED FOR REDEMPTION OF PREFERENCE SHARES

Sometimes it is required to calculate the minimum number of shares to be issued for redemption of preference shares which could not otherwise be redeemed. The use of algebraic equation (as given below) may be useful for finding out the minimum face value of shares to be issued. The equation is to be applied only when the given amount of premium in the Securities Premium A/c in the Balance Sheet plus the amount of premium to be obtained from the fresh issue of shares is not sufficient to pay the premium on redemption of preference shares. It is because Securities Premium A/c given in the Balance Sheet cannot be used for reducing the face value of shares. It can be used for providing premium on redemption of preference shares.

When fresh issue is to be made at a premium

$$\begin{array}{l}\text{Redeemable Preference} \\ \text{Share Capital} \\ + \text{Premium on Redemption}\end{array} = \begin{array}{l}\text{[Balance in Securities Premium Account} \\ \text{in the Balance Sheet]} + \text{[Revenue Profits} \\ \text{available for redemption]} + \text{[N]} + \text{[N x} \\ \text{\% Rate of Premium on Fresh Issue]}\end{array}$$

Here N = Face Value of fresh issue of shares for redemption of preference shares

Illustration 5. Balance Sheet taken from the books of a company is as follow:

I. Equity and Liabilities	`
(1) Shareholders' Funds	
Share Capital:	
i) 80,000 Equity Shares of 10 each fully paid	8,00,000
ii) 12% Redeemable Preference Shares of	
Rs.100 each, 80 per share called up and paid up	4,00,000
Reserves and Surplus:	
i) Securities Premium Account	15,000
ii) Surplus Account	74,995
(2) Current Liabilities	1,15,235
Total	14,05,230
II. Assets	
(1) Non-current Assets	
(a) Fixed Assets	9,75,000
(b) Investments	50,000
(2) Current Assets	3,80,230
Total	14,05,230

The Redeemable Preference Shares are to be redeemed at a premium of 10%. The Directors wish that only the minimum number of fresh equity shares of Rs. 10 each at a premium of 5% be issued to provide for redemption of such preference shares as could not otherwise be redeemed.

You are required to give the Journal Entries in the books of company.

Solution:

JOURNAL ENTRIES

			₹	₹
	12% Red. Pref. share final call A/c Dr.			
	To Red. Pref. share capital A/c		1,00,000	
	(Being final call of ₹ 20 each on 5,000			1,00,000

	preference shares to make them fully paid up for making them eligible for redemption)			
	Bank A/c Dr. To 12% Redeemable pref. share final call A/c (Being amount received against pref. share final call)		1,00,000	1,00,000
	12% Redeemable pref. share capital A/c Dr. Premium of Redemption of pref. shares A/c Dr. To Redeemable pref. shareholders A/c (Being amount payable on redemption of 5,000 preference shares of ₹ 100 each at 10% premium)		5,00,000 50.000	5,50,000
	Bank A/c Dr. To equity share capital A/c To securities premium A/c (Being issue of 43,810 equity shares of ₹ 10 each at a premium of 5%)		4,60,000	4,38,100 21,905
	Securities premium A/c Dr. Surplus A/c Dr. To premium on Redemption of pref. shares A/c (Being premium payable on redemption of preference shares provided)		36,905 13095	50,000
	Surplus A/c Dr. To capital redemption reserve A/c (Being provision created out of surplus account of redemption of preference shares as required by section 55 of the companies Act, 2013)		61,900	61,900
	Redeemable pref. shareholders A/c Dr. To Bank A/c (Being payment of amount due to preference shareholders on account on redemption)		5,50,000	5,50,000

Illustration 6. The following balances are appearing in the Book of Sky Ltd. on 31.03.2020.

Redeemable Preference Share Capital (Shares of 10 each)	2,00,000
Calls-in-Arrear	2,000
General Reserve	1,00,000
Share Premium Account	5,000

The preference shares are fully called up and due for redemption at a premium of 10%. Calls-in-arrear are in respect of final call at the rate of Rs. 4 per share and these shares are held by Mr. Rohit whose whereabouts are not known.

The Board of Directors decided that 50% of the General Reserve is to be utilised for the purpose of redemption of redeemable preference share capital and to meet the further requirement of funds, further 14,500 numbers of equity shares of 10 each were issued at a premium of 20%. The redemption of preference shares was duly carried out and subsequently the company utilised the balance of Capital Redemption Reserve Account to issue equity shares at 10 each as bonus to shareholders.

You are required to show necessary Journal Entries in the Books of Sky Ltd.

Solution:

Books of all Xerox Ltd.

JOURNAL ENTRIES

			₹	₹
	Redeemable pref. share capital A/c Dr. Premium on redemption A/c Dr. To redeemable pref. shareholders A/c (Being 19,500 fully paid redeemable pref. shares along with premium payable on redemption as per board resolution no. dt.)		1,95,000 19,500	 2,14,500
	General reserve A/c Dr. To General redemption reserve A/c (Being general reserve transferred)		50,000	 50,000
	Bank A/c Dr. To equity share capital A/c To securities premium A/c (Being issue of 14,500 equity shares at a premium)		1,74,000	 1,45,000 29,000

	Securities premium A/c Dr.		19,500	
	To premium on redemption A/c			19,500
	(Being premium payable adjusted)			
	Preference shareholders A/c Dr.		2,14,500	
	To bank A/c			2,14,500
	(Being amount paid off to pref. shareholders)			
	Capital redemption reserve A/c Dr.		50,000	
	To bonus payable to shareholders A/c			50,000
	(Being bonus declared and transferred to capital redemption reserve account)			
	Bonus payable to shareholder A/c Dr.		50,000	
	To equity share capital A/c			50,000
	(Being amount transferred to equity share capital)			

ILLUSTRATION 7.

Following balances are appearing in the books of Well Done Ltd. Redeemable Preference Share Capital Rs. 5,00,000; Calls-in-arrears (Redeemable Preference Shares) Rs. 10,000; General Reserve Rs. 3,00,000; Securities Premium Account Rs. 40,000; Development Rebate Reserve Rs. 2,00,000.

It is ascertained that

Preference share is of Rs.100 each fully called due for immediate redemption at a premium of 10%. Calls in arrears are on account of final call on 500 shares held by four members whose whereabouts are not known.

Balance of General Reserve and Securities Premium Account is to be fully utilised for the purpose of redemption and the short fall is to be made good by issue of equity shares of Rs. 10 each at par. The redemption of preference shares was duly carried out.

Give Journal Entries in the books of the company.

Solution:

Well Done Ltd.
JOURNAL ENTRIES

<u>3.6</u> <u>SOME USEFUL BOOKS</u>

- Tulsian, P.C, Corporate Accounting, S. Chand

- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House, New Delhi.
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co., New Delhi.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication, New Delhi.
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

3.7 TERMINAL QUESTIONS/EXERCISES

1) Fill in the Blanks:

a) Redemption of preference shares cannot be made out of the fresh issue of______________.

b) Debenture premium can be utilised to pay premium on redemption of_____________.

c) Preference shares cannot be redeemed unless they are _____________.

d) Redemption may be made either out of fresh issue of shares or out of _________ profits.

e) If the redemption of preference shares is made out of divisible profits, a sum equal to nominal value of shares being redeemed must be transferred from such divisible Profits to_________Account

f) The redemption of preference shares may be made at par or premium but not at _________.

g) Redeemable preference shares issued by a company must be redeemed within the maximum period of_________________years.

h) When the redemption of preference shares is made out of profits, it is necessary to transfers equivalent amount from reserves to the________________A/c.

Ans. [a. Debenture; b. Preference shares; c. Fully Paid; d. Divisible Profits.; e. Capital Redemption Reserve; f. Discount; g. Twenty years; h. Capital Redemption Reserve;]

2. Answer the following questions in ONE WORD only:

a) The shares that carry the right to arrear of dividend if the company had not paid dividend for any year are called:

b) The preference shares which carry the right to share the surplus profit of the company remaining after paying dividend to equity shareholders at a certain rate are called:

c) The preference shares which carry the right to be converted into equity shares within a specified period or at a specified date according to the terms of issue are called:

d) When the redemption of preference shares is made out of profits, it is necessary to transfer the equivalent amount from reserves to

e) Preference shares cannot be redeemed unless they are
f) Partly paid-up shares must be made be fully paid up before redemption to protect the interest of:
g) No company listed by shares shall after the commencement of the Companies Act, 2013 issue any preference shares which are
h) As per Companies Act 2013, Permission of the court is not necessary if the refund is to be made to:

Ans. [a. Cumulative preference shares; b. Participating preference shares; c. Convertible preference shares; d. Capital Redemption Reserve.; e. Fully Paid up; f. Irredeemable; g. preference Shareholder; h. Capital Redemption Reserve;]

3. Answer the following questions. Short type answers.

a) What are redeemable preference shares?
b) Can partly paid-up redeemable preference shares be redeemed?
c) What are the two sources of redemption of preference shares?
d) Can preference shares be redeemed out of fresh issue of debentures or amount realised from the sale of fixed assets?
e) Give the journal entries when
   i) Partly paid shares are made fully paid up by bonus issue.
   ii) Fully paid bonus shares are issued to existing shareholders in a certain proportion.

4. LONG ANSWER TYPE (FOR 10 MARKS)

a) Discuss the provisions of law with regard to redemption of Redeemable Preference Shares as laid down in Section 55 of the Companies Act, 2013.
b) Under what conditions may a company issue Redeemable Preference Shares and in what manner they may be redeemed?
c) Explain in brief the procedure for Redemption of Preference Shares.
d) What do you mean by Redeemable Preference Shares? Give the journal entries in the books of company.
e) What do you mean by Capital Redemption Reserve Account? How is it created? How can it be utilised?
f) Under which section of the Companies Act, preference shares can be redeemed? Can partly Paid-up preference shares be redeemed?
g) Explain the rules regarding issue and redemption of redeemable preference shares along with its accounting treatment.

Practical Problems

1. (Redemption out of Divisible Profits). Following balances are appearing in the ledger of the company as on 31-03-2020:

Share capital--- Equity Shares (fully paid up) ₹ 6,00,000, Preference Shares (fully paid) ₹ 3,00,000 ; General Reserve ₹ 2,00,000; Surplus Account (Cr. Balance) ₹ 1,25,000 ; Securities Premium Account ₹ 50,000

The company decided to redeem the preference shares at a premium of 10 per cent out of its general reserve and undistributed profit.

Give journal entries relating to the redemption of the preference shares.

Ans. [Amount transferred to capital redemption reserve A/c ₹ 3,00,000]

2. (Redemption by fresh issue and out of profits). A company wishes to redeem its pref. shares amounting to ₹ 1,00,000 at a premium of 5% and for this purpose issue 5,000 equity shares of V 10 each at a premium of 5%. The company has also a balance of ₹ 1,00,000 in general reserve and ₹ 50,000 in surplus account. Give the journal entries to record the above transactions.

3. A company had as part of its share capital 1,000 redeemable pref. shares of ₹ 100 each fully paid. When the shares became due for Redemption, the company had ₹ 60,000 in its reserve funds, the company issued necessary equity shares of ₹ 25 specifically for the purpose of redemption and received cash in full. The redeemable pref. shares were then paid out of the new issue, the balance being met from the reserve fund.

Make the necessary journal entries recording the above transactions.

Ans. [amount transferred to capital redemption reserve A/c ₹ 60,000; no. of fresh equity shares 1,600]

4. (Redemption out of profits and by fresh issue). A company, in a series of operations:

(1) Issue at par 40,000 redeemable preference shares of ₹ 10 each, redeemable at premium of 5 per cent.

(2) Redeems 15,000 of the redeemable pref. shares out of the profits of the company.

(3) Issue for cash 30,000 equity shares of ₹ 10 each at premium of ₹ 1 per share and out of the proceeds. Redeems the balance of the redeemable pref. shares. Journalise these transactions.

5. (Where balance sheet is to be prepared after redemption). X and company issued 50,000 equity shares of ₹ 10 each and 3,000 redeemable pref. shares of ₹ 100 each, all shares being fully called and paid up. On 31st march, 2020 surplus account showed an undistributed profit of ₹ 50,000 and General reserve account stood at ₹ 1,20,000. On 2nd April, 2020 the directors decide to issue 1,500 6% preference shares of ₹ 100 each for cash and to redeem the exiting pref. shares at ₹ 105 utilising as much profits as would be required for the purpose.

Show the journal entries to record these transactions. Prepare also a summarised balance sheet showing the position of the company on completion of the redemption. On 31st March, 2020 the cash balance amounted to ₹ 1,85,000 and sundry creditors stood at ₹ 87,000.

Ans. [Bank balance ₹ 20,000; amount transferred from surplus account to capital redemption reserve account ₹ 45,000].

6. (Where no. of shares to be issued is not given). Spotlight Limited has issued share capital of 60,000, 8% redeemable cumulative preference shares of ₹ 20 each and 4,00,000 equity shares of ₹10 each. The preference shares are redeemable at a premium of 5% on 1st April, 2020.

As at 31st March, 2020 the company's books showed the following position:

	₹
I. Equity and liabilities	
(1) Shareholders' funds	
(a) Share capital:	
(i) 4,00,000 equity shares of ₹ 10 each fully paid	40,00,000
(ii) 60,000 8% redeemable cumulative preference shares of ₹ 20 each fully paid	12,00,000
(b) Reserve and surplus:	
Surplus account	7,00,000
(2) Current liabilities	
Sundry creditors	11,00,000
Total	70,00,000
II. Assets	
(1) Non-current assets	
(a) Plant and machinery	25,00,000
(b) Furniture and fixture	9,00,000
2 Current assets	
(a) Stock	15,00,000
(b) Debtors	14,00,000
(c) Balance at Bank	3,50,000
(d) Investments	3,50,000
Total	70,00,000

In order to facilitate the redemption of preference shares it was decided:

(a) To sell the investment for ₹ 3,00,000.

(b) To finance part of the redemption from company's funds subject to leaving a balance on surplus account of ₹ 2,00,000.

(c) To issue sufficient equity shares of ₹ 10 each at a premium of ₹ 2 per share to raise the balance of funds required.

Preference shares were redeemed on due date and equity shares were fully subscribed. You are required to prepare Journal entries to record the above transactions.

B. COM

SEMESTER III
COURSE: CORPORATE ACCOUNTING

UNIT-4: ACCOUNTING FOR DEBENTURES: ISSUE AND REDEMPTION OF DEBENTURES

STRUCTURE

4.0 OBJECTIVES

After going through this unit, you should be able to:

- Understand the meaning of debenture;
- Difference between a share and a debenture;
- Identify the various types of debentures;
- Determine the accounting entries for the issue of debentures;
- Define multiple ways for the redemption of debentures and the necessary accounting entries therefor.

4.1 INTRODUCTION

We have learned about the various types of shares, forfeiture and reissue, and accounting entries in previous units. In this unit, we shall learn about the concept of debentures, types of debentures, issue and redemption of debentures, the accounting entries made for the issue, and redemption of debentures.

4.2 MEANING OF DEBENTURE

The term debenture comes from the Latin word "debere," which means "to borrow." It is a written instrument acknowledging a debt under the common seal of the company. It contains a contract for the return of principal after a specified period, at intervals, or at the company's discretion. The company pays interest at a fixed rate payable on fixed dates, usually half-yearly or yearly.

According to **Topham,** "*A debenture is a document given by a company as evidence of a debt to the holder usually arising out of a loan and most commonly secured by a charge*."

As per **Section 2(12) of the Companies Act, 2013,** "*Debenture includes debenture stocks, bonds and any other securities of the company whether constituting a charge on the company's assets or not*."

4.3 SHARES VS DEBENTURES

Ownership: A debenture is an acknowledgment of debt, whereas a share represents ownership of the company. A debenture is a part of borrowed capital, whereas a share is a part of the owned capital.

Return: The return on debentures is called interest, whereas the return on shares is called dividend. The rate of return on debentures is predetermined, whereas the rate of return on shares may vary depending upon the availability of profits. The payment of interest is a charge on profits means interest is to be paid when there is no profit, whereas payment of dividend is an appropriation of profits.

Voting Rights: The debenture holders do not have voting rights, while the shareholders have voting rights.

Repayment: The debentures are repayable after the expiry of a specific period, whereas shares are not repayable during the company's life.

Security: Debentures are secured with a fixed charge over the assets, but shares are not secured.

Convertibility: Debentures can be converted into shares, but shares cannot be converted into debentures.

4.4 TYPES OF DEBENTURES

The company may issue different types of debentures. They are as follows:

Based on Security

(i) **Secured Debentures:** The debentures that are issued with collateral. The company issuing the debentures offers a piece of property or other assets to debenture holders along with permission to take possession of the asset if the company doesn't repay the debt.

(ii) **Unsecured Debentures:** The debentures that are not supported by collateral security. It is a loan without any protection. They are also called naked debentures.

Based on Tenure:

(i) **Redeemable Debentures:** Redeemable debentures are payable on the expiry of the specific period, either in a lump sum or in installments. It can be redeemed either at par or at a premium.

(ii) **Irredeemable Debentures:** Irredeemable debentures are those which do not carry any specific date for redemption. The debentures are repayable on the winding-up of a company or the expiry of a long period. It is also known as Perpetual Debentures.

Based on Mode of Redemption:

(i) **Convertible Debentures:** The debentures that are convertible into equity shares or any other security are known as Convertible Debentures. These are either fully convertible or partly convertible.

(ii) **Non-Convertible Debentures:** The debentures that are not convertible into equity shares or any other security are known as Non-Convertible Debentures. Mostly debentures are non-convertible.

Based on Coupon rate:

(i) **Specific Coupon Rate Debentures:** The debentures issued with a specific rate of interest, known as specific coupon rate debentures. The specific coupon rate may be fixed or floating.

(ii) **Zero-Coupon Rate Debentures:** The debentures that do not carry a specific interest rate are known as zero-coupon rate debentures. Usually, these kinds of debentures are issued at a substantial discount. The difference between the nominal value and the issue price is treated as the interest of the debentures.

Based on Registration:

(i) **Registered Debentures:** Registered debentures are those debentures that are duly recorded in the register of debenture holders maintained by the company. It can be transferred by executing a regular transfer deed.

(ii) **Bearer Debentures:** Bearer debentures are those debentures that are not recorded in the register. Usually, the interest in debentures is paid to the person who produces the debenture before the company. It can be transferred by way of delivery.

4.5 ISSUE OF DEBENTURES

The procedure for issuing debentures is identical to that for issuing shares. The interested investors apply for debentures based on the prospectus issued by the company. The company may either ask for the entire amount to be paid on application or by means of installments on application, on allotment, and on various calls. Debentures can be issued at par, at a discount, or at a premium. The debentures can also be issued for consideration other than cash or as collateral security.

4.5.1 When Debentures are issued for Consideration other than Cash

When a company purchases assets from vendors or acquires some other business instead of paying cash, the company may issue debentures to such vendors. Such debentures can be issued at par, or at a premium, or for a discount.

On purchase of assets

Sundry Assets A/c Dr.
To Vendor's

On the issue of debentures

(i) At par

Vendor's Dr.
To Debentures A/c

(ii) At premium

Vendor's Dr.
To Debentures A/c
To Securities Premium Reserve A/c

(iii) At discount

Vendor's Dr.
Discount on Issue of Debenture A/c Dr.
To Debentures A/c

Illustration 1

Sandeep Company Limited purchased assets of Rs. 2,00,000 (book value) from another company and agreed to make payment of purchase consideration by issuing debentures.

i. By issuing 2000, 10% debentures of Rs. 100 each.

ii. By issuing 2000, 10% debentures of Rs. 100 each at a premium of 10%.
iii. By issuing 2000, 10% debentures of Rs. 100 each at a discount of 10%.

Solution:

Books of Sandeep Company Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Sundry Assets A/c Dr. To Vendors (Assets purchased from vendors)		2,00,000	 2,00,000
	(i)Vendors Dr. To 10% Debentures A/c (Allotment of debentures to vendors as purchase consideration)		2,00,000	 2,00,000
	(ii)Vendors Dr. To 10% Debentures A/c To Securities Premium Reserve A/c (Allotment of 2,000 debentures of Rs. 100 each at a premium of 10% as purchase consideration)		2,20,000	 2,00,000 20,000
	(iii)Vendors Dr. Discount on Issue of Debenture A/c Dr. To 10% Debentures A/c (Allotment of 2,000 debentures to vendors of Rs. 100 each at a discount of 10% as purchase consideration)		1,80,000 20,000	 2,00,000

If a company purchases another company, the company may purchase the assets and takeover the liabilities of another concern. In such a situation, the purchase consideration will be equal to the value of net assets (Assets – Liabilities). If the company wishes to pay the whole amount of consideration by the issue of debentures, the journal entry will be:

Sundry Assets A/c Dr.
To Sundry Liabilities A/c
To Vendors
(Purchase of the Vendor's business)

Illustration 2

Mohanty Ltd. acquired assets of Rs. 20 lakh and took over creditors of Rs. 3 lakh from Sahoo Enterprises. Mohanty Ltd. issued 8% debentures of Rs 100 each at par as purchase consideration. Record necessary journal entries in the books of Mohanty Ltd.

Solution:

Books of Mohanty Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Sundry Assets A/c Dr.		20,00,000	
	To Sahoo Enterprises			17,00,000
	To Sundry Creditors A/c			3,00,000
	(Purchase of business from Sahoo Enterprises)			
	Sahoo Enterprises Dr.		17,00,000	
	To 8% Debentures A/c			17,00,000
	(Issue of 17,000, 8% debentures of Rs. 100 each)			

In case of the whole business being taken over, if the amount of debentures issued is greater than the amount of net assets taken over, the difference (excess) will be recognized as goodwill value, and the same will be debited while passing the journal entry for the purchase of vendor's business.

Illustration 3

Galaxy Ltd. purchased building worth Rs.1,55,000, machinery worth Rs.1,40,000, and furniture worth Rs.10,000 from Tiwari Co. and took over its liabilities of Rs. 20,000 for a purchase consideration of Rs. 3,15,000. Blue Prints Ltd. paid the purchase consideration by issuing 12% debentures of Rs.100 each. Record necessary journal entries.

Solution:

Books of Galaxy Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Building A/c Dr.		1,55,000	
	Machinery A/c Dr.		1,40,000	
	Furniture A/c Dr.		10,000	
	Goodwill A/c Dr.		30,000	
	To Liabilities			20,000
	To Tiwari Co.			3,15,000
	(Purchase of assets and taking over liabilities of Tiwari Co.)			
	Tiwari Co. Dr.		3,15,000	
	To 12% Debentures A/c			3,15,000
	(Issue of 3,150, 12% debentures of Rs. 100 each)			

If the whole business is taken over, if the amount of debentures issued is less than the amount of net assets taken over, the difference (deficiency) will be credited to the capital reserve account while passing the journal entry to purchase the vendor's business.

Illustration 4

Agni Limited took over the assets of Rs. 3,00,000 and liabilities of Rs.10,000 from Nayak & Co. Ltd., for an agreed purchase consideration of Rs. 2,70,000 to be satisfied by the issue of 15% debentures of Rs. 100 at 20% premium. Show the journal entries in the journal of A Limited.

Solution:

Books of Agni Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Sundry Assets A/c Dr. To Liabilities A/c To Nayak & Co. Ltd. To Capital Reserve (Purchase of assets and taking over liabilities of Nayak & Co. Ltd.)		3,00,000	 10,000 2,70,000 20,000
	Nayak Co. Ltd. Dr. To 15% Debentures A/c To Securities Premium Reserve A/c (Issue of 2,250, 15% debentures of Rs. 100 each at a premium of 20%)		2,70,000	 2,25,000 45,000

4.5.2 When Debentures are Issued for Cash

Issue of Debentures at Par

When the issue price of debentures is equal to the face value, it is known as issued at par. The journal entries for such issue are described as under:

(a) If the whole amount is received in one installment:

(i) On receipt of the application money

Bank A/c Dr.

To Debenture Application & Allotment A/c

(ii) On Allotment of debentures

Debenture Application & Allotment A/c Dr.

To Debentures A/c

(b) If debenture amount is received in two installments:

(i) On receipt of application money

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

(ii) For adjustment of applications money on allotment
Debenture Application A/c Dr.
To Debentures A/c

(iii) For allotment money due
Debenture Allotment A/c Dr.
To Debentures A/c

(iv) On receipt of allotment money
Bank A/c Dr.
To Debenture Allotment A/c

(c) If debenture money is received in more than two installments

(i) On making the first call
Debenture First Call A/c Dr.
To Debentures A/c

(ii) On the receipt of the first call
Bank A/c Dr.
To Debenture First Call A/c

Note: Similar entries may be made for the second call and final call. Generally, the whole amount is collected on application and allotment.

Illustration 5

Beja Limited issued 10,000, 13% debentures of Rs. 100 each payable Rs. 30 on application and the remaining amount on allotment. The public applied for 9,000 debentures which were fully allotted, and all the relevant allotment money was duly received. Give journal entries in the books of Beja Limited., and produce the relevant information in the balance sheet.

Solution:

Books of Beja Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr. To 13% Debenture Application A/c (Application money received on 9,000 debentures)		2,70,000	2,70,000
	13% Debenture Application A/c Dr. To 13% Debentures A/c (Application money transferred to debentures account on allotment)		2,70,000	2,70,000
	13% Debenture Allotment A/c Dr. To 13% Debentures A/c		6,30,000	6,30,000

	(Amount due on 9,000 debentures on allotment @ Rs. 70 per debenture)			
	Bank A/c Dr. To 13% Debenture Allotment A/c (Amount received on allotment)		6,30,000	6,30,000

Balance Sheet of Beja Limited as at …………

Particulars	Note No.	Amount (Rs.)
I. Equity and Liabilities		
Non-current liabilities		
Long-term borrowings	1	9,00,000
II. Assets		
Current Assets		
Cash and Cash equivalents	2	9,00,000

Notes to Accounts

Particulars	Amount (Rs.)
1. Long-term borrowings	
9,000, 13% Debentures of Rs. 100 each	9,00,000
2. Cash and cash equivalents	
Cash at bank	9,00,000

Issue of Debentures at a Discount

When the issue price of debentures is below the face value, it is said to be issued at a discount. The discount on the issue of debentures can be written off by debiting it to or out of the Securities Premium Reserve, if any, during the lifetime of debentures.

The discount on the issue of debentures to be written off within 12 months of the balance sheet date or the term of the operating cycle is reported under 'Other Current Assets,' while the part that will be written off after 12 months is indicated under 'Other Non-Current Assets.'

The Companies Act, 2013 places no restrictions on the issuance of debentures at a discount.

Illustration 6

Panda Ltd. issued 10,000, 14% debentures of Rs. 100 each at a discount of 5% payable as follows:

On application	Rs. 40
On allotment	Rs. 55

Pass the journal entries, assuming that all the installments are duly collected. Also, show the relevant portion of the balance sheet.

Solution:

Books of Panda Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr. To 14% Debenture Application A/c (Application money received on 10,000 debentures @ Rs. 40)		4,00,000	 4,00,000
	14% Debenture Application A/c Dr. To 14% Debentures A/c (Application money transferred to debentures account on allotment)		4,00,000	 4,00,000
	14% Debenture Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To 14% Debentures A/c (Allotment money due on 10,000 debentures @ Rs. 55 and Rs.5 discount per debenture)		5,50,000 50,000	 6,00,000
	Bank A/c Dr. To 14% Debenture Allotment A/c (Receipt of allotment money on debentures)		5,50,000	 5,50,000
	Securities Premium Reserve A/c Dr. To Discount on Issue of Debentures A/c (Discount on issue of debentures written off)		50,000	 50,000

Balance Sheet of Panda Limited as at …………

Particulars		Note No.	Amount (Rs.)
I.	**Equity and Liabilities**		
	Shareholders' Funds		
	Reserve and Surplus		
	Non-current liabilities		
	Long-term borrowings	1	9,50,000
II.	**Assets**		
	Current Assets		
	Cash and Cash equivalents	2	9,50,000

Notes to Accounts

Particulars	Amount (Rs.)
1. Reserve and Surplus Surplus (Balance in Statement of Profit and Loss)	 (50,000)

2. Long-term borrowings 10,000, 14% Debentures of Rs. 100 each 3. Cash and cash equivalents Cash at bank	 10,00,000 9,50,000

Issue of Debentures at a Premium

When the issue price of debentures is more than the face value, it is said to be issued at a premium. The premium amount is credited to the Securities Premium Reserve account and is shown on the liabilities side of the balance sheet under the head "Reserves and Surpluses."

Illustration 7

Macro Industries Ltd., issued 2,000, 11% debentures of Rs. 100 each, at a premium of Rs. 10 per debenture payable as follows:

On application Rs. 50
On allotment Rs. 60

The debentures were fully subscribed, and all money was duly received. Record the journal entries in the books of Macro Industries Ltd.

Solution:

Books of Macro Industries Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr. To 11% Debenture Application A/c (Application money received on 2,000 debentures @ Rs. 50)		1,00,000	 1,00,000
	11% Debenture Application A/c Dr. To 11% Debentures A/c (Application money transferred to debentures account on allotment)		1,00,000	 1,00,000
	11% Debenture Allotment A/c Dr. To 11% Debentures A/c To Securities Premium Reserve A/c (Allotment money due on 2,000 debentures @ Rs. 60 per debenture)		1,20,000	 1,00,000 20,000
	Bank A/c Dr. To 11% Debenture Allotment A/c (Receipt of allotment money on debentures)		1,20,000	 1,20,000

Balance Sheet of Macro Industries Limited as at …………

Particulars	Note No.	Amount (Rs.)

III.	**Equity and Liabilities**		
	Shareholders' Funds		
	Reserve and Surplus	1	20,000
	Non-current liabilities		
	Long-term borrowings	2	2,00,000
IV.	**Assets**		
	Current Assets		
	Cash and Cash equivalents		2,20,000

Notes to Accounts

Particulars	Amount (Rs.)
1. Reserve and Surplus	
Securities Premium Reserve	20,000
2. Long-term borrowings	
2,000, 11% Debentures of Rs. 100 each	2,00,000
3. Cash and cash equivalents	
Cash at bank	2,20,000

Over Subscription

The issue is considered over-subscribed when the number of debentures applied for exceeds the quantity of debentures offered to the general public. On the other hand, a firm cannot issue more debentures than it has received subscriptions for. However, any additional funds received due to oversubscription may be kept and applied to allotment and subsequent calls. But the money received from applicants who were not assigned debentures will be refunded to them.

Illustration 8

Sahu Limited issued 10,000, 13% debentures of Rs. 100 each payable Rs. 40 on application and Rs. 60 on allotment. The general public applied for 14,000 debentures. Applications for 9,000 debentures were accepted in full; applications for 2,000 debentures were allotted 1,000 debentures, and the remaining applications were rejected. All money was duly received. Pass the journal entries.

Solution:

Books of Sahu Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr.		5,60,000	
	To 13% Debenture Application A/c			5,60,000
	(Application money received on 14,000 debentures @ Rs. 40)			

	13% Debenture Application A/c Dr. To 13% Debentures A/c To Debentures Allotment A/c To Bank A/c (Application money transferred to debentures account on allotment, Excess application money credited to Debenture Allotment account, and money refunded on rejected application)		5,60,000	 4,00,000 40,000 1,20,000
	13% Debenture Allotment A/c Dr. To 13% Debentures A/c (Allotment money due on 10,000 debentures @ Rs. 60 per debenture)		6,00,000	 6,00,000
	Bank A/c Dr. To 13% Debenture Allotment A/c (Receipt of allotment money on debentures)		5,60,000	 5,60,000

4.5.3 Issue of Debentures as a Collateral Security

When a company obtains a loan or overdraft from a bank or other financial institution, collateral security may be defined as a subsidiary, secondary, or additional security in addition to the primary security. It may pledge or mortgage some assets as collateral for the loan. However, lending institutions may insist on additional assets as collateral security so that the loan amount can be recovered in full with the help of collateral security if the proceeds from the sale of the principal security fall short of the loan amount. In this case, the company may issue its own debentures to the lenders, in addition to the assets already pledged. Such an issue of debentures is known as 'Debentures issued as Collateral Security.'

If the company fails to repay the loan in full, including interest, the lender is free to receive his money from the sale of primary security; however, if the realizable value of the primary security is insufficient to cover the entire amount, the lender has the right to invoke the benefit of collateral security, which allows debentures to be presented for redemption or sold on the open market.

Debentures issued as collateral security can be handled in one of two ways in the books of the company:

First Method

No entry is made in the books of accounts since such an issue generates no liability. However, on the liabilities side of the balance sheet, a note to the effect that the loan has been secured by the issuance of debentures as collateral security is placed below the item of loan.

Illustration 9

Panda Co. has issued 8%, 10,000 debentures of Rs. 100 each for a loan of Rs. 10,00,000 taken from State Bank of India. This transaction may be shown in the balance sheet as follow:

Balance Sheet of Panda Co. as at …………

Particulars	Note No.	Amount (Rs.)
I. Equity and Liabilities		
Non-current liabilities		
Long-term borrowings	1	10,00,000

Notes to Accounts

Particulars	Amount (Rs.)
1. Long-term borrowings Bank Loan (Secured by the issue of 10,000, 8% Debentures of Rs. 100 each as collateral Security)	10,00,000

Second Method

The following journal entry can be recorded for issuance of debentures as collateral security:

i. Issue of 8%, 10,000 debentures of Rs. 100 each as collateral security for a bank loan of Rs. 10,00,000.

Debenture Suspense A/c	Dr.	10,00,000	
To 8% Debentures A/c			10,00,000

When the loan is repaid, a reverse entry will cancel the above entry:

ii. For cancellation of 8% debentures as collateral security on repayment of bank loan.

8% Debentures A/c	Dr.	10,00,000	
To Debenture Suspense A/c			10,00,000

Note: In notes to accounts, the Debenture Suspense Account will be deducted from long-term borrowings.

Balance Sheet of Panda Co. as at …………

Particulars	Note No.	Amount (Rs.)
II. Equity and Liabilities		
Non-current liabilities		
Long-term borrowings	1	10,00,000

Notes to Accounts

Particulars	Amount (Rs.)	Amount (Rs.)
1. Long-term borrowings		10,00,000
Bank Loan	10,00,000	
(Secured by the issue of 10,000, 8% Debentures of Rs. 100 each as collateral Security)		
Less: Debenture Suspense	10,00,000	
		10,00,000

4.5.4 Debentures Issued at Different Terms

When a company issues debentures, the terms, and conditions on which they will be redeemed at maturity are usually mentioned. The term "redemption of debentures" refers to the discharge of debenture liability through reimbursement to the debenture holders. Debentures can be redeemed at par or at a premium.

The following six scenarios are frequent in practice depending on the terms and conditions of the issue and redemption of debentures**.**

(i) Issued at par and redeemable at par
(ii) Issued at a discount and redeemable at par
(iii) Issued at a premium and redeemable at par
(iv) Issued at par and redeemable at a premium
(v) Issued at a discount and redeemable at a premium
(vi) Issued at a premium and redeemable at a premium

In each of the six scenarios listed above, the following journal entries will be passed:

(i) Issued at par and redeemable at par

(a) Bank A/c Dr.
To Debenture Application & Allotment A/c
(Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.
To Debentures A/c
(Allotment of debentures)

(ii) Issued at a discount and redeemable at par

(a) Bank A/c Dr.
To Debenture Application & Allotment A/c
(Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.
Discount on Issue of Debentures A/c Dr.
To Debentures A/c
(Allotment of debentures at a discount)

(iii) Issued at a premium and redeemable at par

(a) Bank A/c Dr.
To Debenture Application & Allotment A/c
(Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.
To Debentures A/c
To Securities Premium Reserve A/c
(Allotment of debentures at a premium)

(iv) Issued at par and redeemable at a premium

(a) Bank A/c Dr.
To Debenture Application & Allotment A/c
(Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.
Loss on Issue of Debentures A/c Dr. (With premium on redemption)
To Debentures A/c (With nominal value of debenture)
To Premium on Redemption of Debentures A/c (With premium on redemption)
(Allotment of debentures at par and redeemable at a premium)

(v) Issued at a discount and redeemable at a premium

(a) Bank A/c Dr.
To Debenture Application & Allotment A/c
(Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.
Loss on Issue of Debentures A/c Dr. (With discount on issue plus premium on redemption)
To Debentures A/c (With nominal value of debenture)
To Premium on Redemption of Debentures A/c (With premium on redemption)
(Allotment of debentures at a discount and redeemable at a premium)

(vi) Issued at a premium and redeemable at a premium

(a) Bank A/c Dr.
To Debenture Application & Allotment A/c
(Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.
Loss on Issue of Debentures A/c Dr. (With premium on redemption)
To Debentures A/c (With nominal value of debenture)
To Securities Premium Reserve A/c (With premium on the issue)
To Premium on Redemption of Debentures A/c (With premium on redemption)
(Allotment of debentures at a premium and redeemable at a premium)

Illustration 10

Pass journal entries for the following questions:

a. Issue of Rs. 1,00,000, 10% debentures of Rs. 100 each at par and redeemable at par.
b. Issue of Rs. 1,00,000, 10% debentures of Rs. 100 each at a premium of 5% but redeemable at par.
c. Issue of Rs. 1,00,000, 10% debentures of Rs. 100 each at discount of 5% repayable at par.

d. Issue of Rs. 1,00,000, 10% debentures of Rs. 100 each at par but repayable at a premium of 5%.
e. Issue of Rs. 1,00,000, 10% debentures of Rs. 100 each at a discount of 5% but redeemable at a premium of 5%.
f. Issue of Rs. 1,00,000, 10% debentures of Rs. 100 each at a premium of 5% and redeemable at a premium of 5%.

Solution:

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on debentures)		1,00,000	 1,00,000
a.	Debenture Application & Allotment A/c Dr. To 10% Debentures A/c (Application money transferred to debentures account)		1,00,000	 1,00,000
	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on debentures)		1,05,000	 1,05,000
b.	Debenture Application & Allotment A/c Dr. To 10% Debentures A/c To Securities Premium Reserve A/c (Debentures application money transferred to Debentures & Securities Premium account)		1,05,000	 1,00,000 5,000
	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on debentures)		95,000	 95,000
c.	10% Debenture Application & Allotment A/c Dr. Discount on issue of Debentures A/c Dr. To 10% Debentures A/c (Debentures application money transferred to Debentures)		95,000 5,000	 1,00,000
	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on debentures)		1,00,000	 1,00,000
d.	Debenture Application & Allotment A/c Dr. Loss on the issue of Debentures A/c Dr. To 10% Debentures A/c		1,00,000 5,000	 1,00,000

	To Premium on Redemption on Debentures A/c (Debentures application money transferred to Debentures Account)			5,000
	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on debentures)		95,000	95,000
e.	Debenture Application & Allotment A/c Dr. Loss on the issue of Debentures A/c Dr. To 10% Debentures A/c To Premium on Redemption on Debentures A/c (Debentures application money transferred to Debentures account and premium on debenture account)		95,000 10,000	 1,00,000 5,000
	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on debentures)		1,05,000	1,05,000
f.	Debenture Application & Allotment A/c Dr. Loss on the issue of Debentures A/c Dr. To 10% Debentures A/c To Premium on Redemption on Debentures A/c To Securities Premium Reserve A/c (Debentures application money transferred to Debentures account)		1,05,000 5,000	 1,00,000 5,000 5,000

Interest on Debentures

When a company issues debentures, it is obligated to pay interest on them at a specified rate (half-yearly) periodically until the debentures are paid off. This percentage is frequently included in the name of debentures, such as 6% debentures, 8% debentures, and so on, and interest is computed based on the nominal value of the debentures.

Interest on debenture is a charge against the profit of the company and must be paid whether the company has earned any profit or not. As per the Income Tax Act, 1961, a company must deduct income tax from the interest payable on debentures at a prescribed rate if it exceeds the specified limit. It is known as Tax Deducted at Source (TDS), and the company must deposit this with the tax authorities.

Accounting Treatment of Interest on Debenture

a. When interest is due

Debenture Interest A/c Dr.

To Income Tax Payable A/c

To Debentureholders A/c

(Interest amount is due on debentures and tax deducted at source)

b. For payment of interest to debenture holders
   Debenture holders A/c Dr.
   To Bank A/c
   (Interest amount paid to debenture holders)
c. Transfer of Debenture Interest Account to statement of Profit and Loss A/c
   Statement of Profit and Loss A/c Dr.
   To Debenture Interest A/c
   (Debenture interest transferred to profit and loss A/c)
d. Payment of TDS to the government
   Income Tax Payable A/c Dr.
   To Bank A/c
   (Payment of TDS on interest on debentures)

Illustration 11

Agni Ltd., issued 2,000, 10% debentures of Rs. 100 each on April 01, 2020, at a discount of 10% redeemable at a premium of 10%. Pass journal entries relating to the issue of debentures and debenture interest for the period ending March 31, 2021, assuming that interest was paid half-yearly on September 30 and March 31 and tax deducted at source is 10%.

Solution:

Books of Sahu Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2020 Apr 1	Bank A/c Dr. To 10% Debenture Application & Allotment A/c (Application money received on 2,000 debentures @ Rs. 40)		1,80,000	 1,80,000
Apr 1	10% Debenture Application & Allotment A/c Dr. Loss on Issue of Debenture A/c Dr. To 10% Debentures A/c To Premium on Redemption of Debentures A/c (Allotment of debentures at a discount of 10% and redeemable at a premium of 10%)		1,80,000 40,000	 2,00,000 20,000
Sept 30	Debenture Interest A/c Dr. To Debentureholders A/c To Income Tax Payable A/c (Interest due for 6 months and tax deducted at source)		10,000	 9,000 1,000

Sept 30	Income Tax Payable A/c To Bank A/c (TDS paid to the government)	Dr.		1,000	 1,000
Sept 30	Debenture holders A/c To Bank A/c (Payment of interest)	Dr.		9,000	 9,000

Mar 31	Debenture Interest A/c
	      To Debentureholders A/c
	      To Income Tax Payable A/c
	(Interest due for 6 months and tax deducted at source)
		Dr.		10,000	
					9,000
					1,000

Mar 30	Income Tax Payable A/c To Bank A/c (TDS paid to the government)	Dr.		1,000	 1,000
Mar 31	Debenture holders A/c To Bank A/c (Payment of interest)	Dr.		9,000	 9,000
Mar 31	Statement of Profit and Loss A/c To Debenture Interest A/c (Debenture Interest transferred to profit and loss account)	Dr.		20,000	 20,000

4.5.5 Writing off Loss on Issue of Debentures

The discount or loss on the issue of debentures is a capital loss, and it is written off in the year when debentures are issued. According to Section 52 (2), discount or loss on the issue of debentures can be written off from securities premium reserve. If capital profit does not exist or is insufficient, the loss or discount amount should be written off from the revenue profits of each year.

In such case, the journal entry will be:

Securities Premium Reserve A/c Dr. [If exists to the extent of balance]
Statement of Profit and Loss Dr.
  To Discount or Loss on Issue of Debentures A/c
(Discount or Loss on Issue of Debentures written-off)

Illustration 12

On September 1, 2021, Kalpana Ltd. has issued 50,000, 8% debentures of Rs. 100 each at a discount of 9%. The company has a balance of Rs. 5,00,000 in securities premium reserve. Pass necessary journal entries for the issue of debentures and write-off discount/Loss on the issue of debentures. The debentures are redeemable after 5 years at a premium of 7%.

Solution:

Books of Kalpana Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2021 Sept 1	Bank A/c Dr. To 8% Debenture Application & Allotment A/c (Application money received on 50,000 debentures @ Rs. 100 each at a discount of 9%)		45,50,000	 45,50,000
Sept 1	8% Debenture Application & Allotment A/c Dr. Loss on Issue of Debenture A/c Dr. To 8% Debentures A/c To Premium on Redemption of Debentures A/c (Allotment of debentures at a discount of 9% and redeemable at a premium of 7%)		45,50,000 8,00,000	 50,00,000 3,50,000
Sept 1	Securities Premium Reserve A/c Dr. Statement of Profit and Loss Dr. To Loss & Issue of Debentures A/c (Loss on Issue of Debentures written-off)		5,00,000 3,00,000	 8,00,000

<u>4.6 REDEMPTION OF DEBENTURES</u>

The term "Redemption of Debentures" refers to the process of extinguishing or discharging the liability on account of debentures in accordance with the terms of the issue. In other words, Redemption of Debentures refers to the repayment of amount to the debenture holders by the company. The company should consider the following factors at the time of redemption of debentures:

a. Method of Redemption
b. Sources of Redemption

METHODS OF REDEMPTION OF DEBENTURES

The debentures can be redeemed in four different ways. These are as follows:

4.6.1 Redemption in Lump Sum

The debentures can be redeemed by paying the amount in a lump sum to the debenture holders at maturity or after the expiry of the prefixed period. The debentures may be redeemed at par or at a premium.

4.6.2 Redemption in Installments

In this method, debentures are redeemed in installments on the predetermined date during the tenure of debentures. The redeemable debentures are identified by drawing the requisite number of lots out of the total debentures outstanding for payment. It spreads the burden of repayment of the amount of debentures.

4.6.3 Redemption by Purchase from the Market

Under this method, the company purchases its own debentures for cancellation from the open market. It can only be done if their Article of Association permits. The company may consider the following factors at the time of redemption of debentures:

a. Usually, the company redeems its debentures at the market price of the debenture.
b. The company may redeem its debentures at a premium if promised at the time of issue.
c. The annual interest should be paid at the time of redemption.

4.6.4 Redemption by Conversion

The company can redeem its debentures by converting them into shares, preference shares, or new debentures in this method. The debenture holders can redeem their debentures if they find that the offer is beneficial to them. They may exercise their right to convert their debentures into shares or preference shares or a new class of debentures. The conversion terms, like conversation ratio, conversion timing, etc., are decided at the time of issue. If the debenture holders do not opt for the conversion option, the company will pay the entire amount in cash.

SOURCES OF REDEMPTION OF DEBENTURES

(a) Redemption out of Capital

The debentures are considered to be redeemed out of capital when no amount is set aside from the surplus A/c for redemption, and no arrangements are made to create a Debenture Redemption Reserve. Section 71(4) of the Companies Act of 2013 contains the legal provisions for the redemption of debentures. It specifies that firms should create a Debenture Redemption Reserve (DRR) and that the amount credited to the DRR from profits should be utilized solely to redeem debentures. However, Rule 18(7) of the Companies (Share Capital and Debenture Rules) issued by the Ministry of Corporate Affairs (MCA), the DRR is not required to be created by All India Financial Institutions regulated by RBI and the banking companies. The Non-Banking Financial Companies covered under section 2(72) of the Companies Act are also not required to create DRR as far as privately placed debentures are concerned. As a result, these financial institutions, banking firms, and non-bank financial organizations (NBFCs) can redeem their debentures out of capital.

4.6.1 Redemption in Lump Sum

Accounting Entries

The following journal entries may be passed:

a. If debentures are to be redeemed at par

(i) Debentures A/c Dr.
    To Debenture holders

(ii) Debentureholders Dr.

To Bank A/c

b. If debentures are to be redeemed at a premium

(i) Debentures A/c Dr.
Premium on Redemption of Debenture A/c Dr.
To Debentureholders A/c

(ii) Debenture holders A/c Dr.
To Bank A/c

c. If debentures are to be redeemed at a discount

(i) Debentures A/c Dr.
To Debentureholders A/c
To Capital Reserve A/c

(ii) Debenture holders A/c Dr.
To Bank A/c

Illustration 13

Pass necessary journal entries in each of the following cases:

a) Rajib Ltd. issued 5,000, 10% debentures of Rs. 100 each at par and redeemable at par at the end of 5 years out of capital.
b) Rajib Ltd. issued 1,000, 11% debentures of Rs. 100 each at par and redeemable at 10% premium at the end of 4 years.
c) Rajib Ltd. issued 13% debentures of the total face value of Rs. 1,00,000 at a premium of 5% to be redeemed at par at the end of 4 years.
d) Rajib Ltd. issued Rs. 1,00,000, 15% debentures at a discount of 5% but redeemable at a premium of 5% at the end of 5 years.

Solution:

Books of Rajib Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	10% Debentures A/c Dr. To Debenture holders (Amount due on redemption of debentures)		5,00,000	5,00,000
a.	Debentureholders Dr. To Bank A/c (Amount paid to debenture holders)		5,00,000	5,00,000
	11% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders (Amount due on redemption of debentures)		1,00,000 10,000	1,10,000

b.	Debentureholders Dr. To Bank A/c (Amount paid to debenture holders)		1,10,000	1,10,000
c.	13% Debentures A/c Dr. To Debenture holders (Amount due on redemption of debentures)		1,00,000	1,00,000
	Debentureholders Dr. To Bank A/c (Amount paid to debenture holders)		1,00,000	1,00,000
d.	15% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders (Amount due on redemption of debentures)		1,00,000 5,000	1,05,000
	Debentureholders Dr. To Bank A/c (Amount paid to debenture holders)		1,05,000	1,05,000

(b) Redemption out of Profits

Under this method, the profits are assigned every year from surplus and credited to Debenture Redemption Reserve (the reserve is not allowed to be utilized for any purposes, except for the redemption of debentures), implying that debentures have been redeemed out of profits. The profits that would otherwise be available for distribution as dividends are reduced, and the profits are utilized to redeem debentures. The profits should be invested to assure liquidity at the time of redemption. Therefore, they may be dealt with in three ways:

(a) Continue to invest in the business and make no separate investments. According to the regulations of the Companies Act, 2013, 15 percent of the amount of debentures maturing by March 31st must be invested by April 30th of the same year.

(b) They may be invested in safe, liquid investments such as debenture redemption investments or sinking fund investments outside of the firm.

(c) An insurance policy may be purchased, with the amount credited to DRR used to pay insurance premiums. There will be no risk of timing or amount matching because the policy amount will be the exact amount required to be paid on debenture redemption.

4.6.2 Redemption in Installments

Debenture Redemption Reserve

According to section 71(4), when a company issues debentures under this section, the company must create a debenture redemption reserve (DRR) account out of profits available for dividend payment, and the company must not use the amount credited to such account for any purpose other than the redemption of debentures.

Rule 18 sub-rule (7) deals with creating a debenture redemption reserve to facilitate the redemption of debentures easier. This sub-rule requires the company to establish a debenture redemption reserve to redeem debentures in compliance with the following conditions:

(a) The debenture redemption reserve shall be created out of the profits of the company available for payment of dividends.

(b) The company shall create a debenture redemption reserve in accordance with the following conditions: -

  (i) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking companies for both public and privately placed debentures. For other Financial Institutions (FIs) under clause 72(2) of the Companies Act, 2013, DRR will be applicable to Non-Banking Financial Corporations registered with RBI.

  (ii) For NBFCs registered with the RBI under section 45-IA of the RBI (Amendment) Act, 1997, the adequacy of DRR will be 25% of the value of debentures issued through the public issue as per present SEBI (Issue and Listing of Debt Securities) Regulations, 2008. No DRR is required in the case of privately placed debentures.

  (iii) As per SEBI Regulations, 2008, the adequacy of DRR will be 25% of the value of debentures issued through the public issue for other companies, including manufacturing and infrastructure companies, and also 25% DRR is required in the case of privately placed debentures by listed companies. The DRR will be 25% of the value of debentures for unlisted companies issuing debentures on a private placement basis.

(c) Every company is required to create DRR on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than 15%, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely:-

  (i) in deposits with any scheduled bank, free from any charge or lien;

  (ii) in the Central Government's or any State Government's unencumbered securities;

  (iii) in unencumbered securities, as defined in sections 20(a) to (d) and (ee) of the Indian Trusts Act, 1882;

  (iv) in unencumbered bonds issued by any other firm that has been notified under section 20 of the Indian Trusts Act, 1882, sub-clause (f);

  (v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above;

  Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below 15% of the amount of the debentures maturing during the year ending on the 31st day of March of that year;

(d) In the case of partly convertible debentures, DRR must be created according to this sub-rule for the non-convertible portion of the debenture issue.

(e) The company must use the amount credited to the DRR for the redemption of debentures only.

The companies would now be required to create DRR based on the value of their debentures in the following manner:

Types of Companies	Types of Debentures	DRR %
All India Financial Institutions regulated by the Reserve Bank of India (RBI)	Public and privately placed debentures	Nil
Banking companies	Public and privately placed debentures	Nil
Non-Banking Financial Companies (NBFC) and other financial institutions covered by section 2(72) of the Companies Act, 2013	Publicly issued debentures	25
	Privately placed debentures	Nil
Other companies (listed or unlisted)	Public and privately placed debentures	25

Accounting Entries for Creation of Debenture Redemption Reserve

a. For the creation of Debenture Redemption Reserve (DRR)

Profit and loss appropriation A/c or Surplus A/c Dr.

To Debenture Redemption Reserve A/c

(Amount transferred to debenture redemption reserve A/c)

b. For investing the amount in the debenture redemption investments as statutorily required, i.e., at least 15% of the amount of debentures to be redeemed by 31st March of the next year.

Debenture Redemption Investment A/c Dr.

To Bank A/c

(Amount invested in debenture redemption investment A/c as statutorily required)

c. For making the payment due to debenture holders at the time of redemption. The following are the entries depending upon the redemption price.

(i) If Debentures are redeemed at par

Debentures A/c Dr.

To Debentureholders A/c

(Amount due to debenture holders on redemption)

(ii) If Debentures are redeemed at a premium

Debentures A/c Dr.

Premium on redemption of debentures A/c Dr.

To Debentureholders A/c

(Amount due to debenture holders on redemption at a premium)

(iii) If Debentures are redeemed at Discount

Debentures A/c Dr.

To Debentureholders A/c

To Capital Reserve A/c

(Amount due to debenture holders on redemption at a discount)

d. **For realizing the amount invested in debenture redemption investment A/c**
Bank A/c Dr.
To Debenture Redemption Investments A/c
To Debenture Redemption Reserve A/c
(Amount realized on the sale of investment and in case if there is profit, the profit transferred to the DRR A/c)

e. **For making the payment to the debenture holders**
Debenture holders A/c Dr.
To Bank A/c
(Amount paid to the debenture holders)

f. **For transferring the balance in the Debenture Redemption Reserve A/c**
Debenture Redemption Reserve A/c Dr.
To General Reserve A/c
To Capital Reserve A/c
(Balance fund transferred to General Reserve and the profit on the sale of investment transferred to Capital Reserve)

Illustration 14

Das Ltd. has Rs. 5,00,000, 13% debentures outstanding as on 01.04.2020. It also has a balance of Rs. 3,00,000 in the surplus A/c and a debenture redemption reserve of Rs. 3,50,000. The company has decided to redeem Rs. 5,00,000 (face value) of debentures due for redemption on 31.03.2021, after 5 years from the date of issue. Pass the appropriate journal entries for the year 2020-21 by following all the provisions of the Companies Act, 2013. The amount invested will generate a return of 9% p.a., and debenture interest is paid annually. The debentures are redeemed at a premium of 10%. The investments were realized at par.

Solution:

Books of Kalpana Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2020 April 1	Debenture Redemption Investment A/c Dr. To Bank A/c (Investments made as per the Companies Act, 2013 @ 15% of debentures due for redemption)		75,000	75,000
2021 Mar 31	Debentures interest A/c Dr. To debenture-holders A/c (Amount of debenture interest on 5,00,000 @ 13%)		65,000	65,000
Mar 31	Debenture holders A/c Dr. To Bank A/c		65,000	65,000

	(Interest paid to the debenture holders)			
Mar 31	Bank A/c Dr. To Interest on DRF investments A/c (Interest received at 9% on 75,000)		6,750	6,750
	Surplus A/c Dr. To Debenture Redemption Reserve A/c (Creation of Debenture Redemption Reserve A/c for the balance)		1,50,000	1,50,000
	Bank A/c Dr. To Debenture Redemption Investment A/c (Amount of investments realized at par for the redemption of debentures)		75,000	75,000
	Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To Debenture Redemption Investment A/c (Amount due to debenture holders on redemption together with premium)		5,00,000 50,000	5,50,000
	Debenture holders A/c Dr. To Bank A/c (Amount paid to the debenture holders)		5,50,000	5,50,000
	Profit and Loss A/c Dr. To Debenture Interest A/c (Debenture interest transferred to Profit and Loss A/c)		65,000	65,000
	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Balance in the DRR A/c transferred to General Reserve A/c)		5,00,000	5,00,000

Debenture Redemption Fund or Sinking Fund

The creation of a debenture redemption reserve does not guarantee that the company will have adequate finances to pay the debenture holders. When the lump-sum approach is adopted, there is a significant outflow of capital. Even if the cash is accessible as an investment in the business, a huge withdrawal from the business could have a negative impact. As a result, it is prudent to invest capital in separate designated securities with minimal risk and readily marketable value. The amount invested should at least be enough to meet the legal criteria, i.e., the minimal amount transferred to DRR. A sinking fund, on the other hand, should be created to redeem 100 percent debentures. The amount appropriated from the surplus in the profit and loss statement each year should be sufficient to repay the debentures when compounded over the term of the debentures, plus interest (however, the investments may be non-cumulative, which means the total amount required for redemption has to be appropriated in equal installments and the interest received during this period will not be reinvested and therefore, it will directly be credited to the profit and loss statement, instead of crediting to the Debenture Redemption Fund). These investments might either be made by the company or handed over to the debenture trustees.

Calculation of Amount to be Appropriated Each Year from the Surplus in Profit and Loss Statement to the Debenture Redemption Fund: -

(i) Non-cumulative Fund: - The total amount payable on redemption is simply divided by the number of years after which the debentures are to be redeemed.

(ii) Cumulative Fund: - The amount to be appropriated will be the amount of regular annuity whose future value at a given rate of interest for the term of debentures will exactly match the total amount required for redemption of debentures together with a premium, if any. Therefore, the amount of annuity depends on the following four factors: -

(a) The total amount required for redemption of debentures together with a premium on redemption, if any.

(b) The time of redemption, i.e., the period available from the time of appropriations till the due date for final payment.

(c) The rate of interest is likely to be generated on the amount invested.

The future value interest factor will be used to divide the amount required to arrive at an annuity or the amount of annual appropriation. Thus, the amount to be appropriated will be equal to the amount required for redemption divided by the future value interest factor. The future value interest factor is given by:

$$A = \frac{(1+r)^n - 1}{r}$$

Illustration 15

Sandeep Ltd. wants to redeem Rs. 1,00,000 debentures at a premium of 10% after 5 years from the date of issue. Calculate the amount to be appropriated from the surplus in profit and loss statement and invested in 12% governments assuming:

(a) Interest received will be withdrawn and credited to the Profit and Loss A/c, i.e., the fund is non-cumulative.

(b) Interest received will not be withdrawn, and it will remain invested. The amount of interest will not be credited to the profit and loss A/c; instead, it will be credited to debenture redemption fund A/c and then reinvested, i.e., the fund is cumulative.

Solution:

(a) If Fund is non-cumulative, then the amount of proceeds annual appropriation will be:

Annual Appropriation = 1,00,000/5 = 20,000

(b) If the fund is cumulative, the amount to be appropriate may be calculated using the following annuity factor:

$$A = \frac{(1+r)^n - 1}{r}$$

$$A = \frac{(1 + 0.12)^5 - 1}{0.12}$$

$$A = \frac{(1.12)^5 - 1}{0.12}$$

A = 6.352

Amount = 1,00,000/6.352 = Rs. 15,743 (Approx.)

This appropriated amount is invested, and when interest is received, the appropriated installment and interest (in case of cumulative sinking fund) are again reinvested in the debenture reserve investments.

In the last year, the interest is received, and appropriation is made, but instead of investing, the investments are liquidated to facilitate the payment of debenture holders on redemption. There could be profit or loss on the sale of these investments, which is treated as capital profit or loss. If there is profit, it is transferred to the capital reserve A/c, and the remaining balance of the sinking fund is transferred to the general reserve A/c.

Accounting Entries for Creation of Debenture Redemption Fund and Redemption of Debentures Out of Profits

a. **For the creation of Debenture Redemption Reserve**
   Profit & loss appropriation A/c or Surplus A/c Dr.
   To Debenture Redemption Fund
   (Amount transferred to debenture redemption reserve)
b. **For investing the amount so appropriated in the debenture redemption investments or sinking fund investments**
   Debenture Redemption Investment A/c Dr.
   To Bank A/c
   (Amount invested in the sinking fund or debenture redemption investment A/c)
c. **For receiving interest on investments annually and transferring the interest to Debenture Redemption Reserve**
   Bank A/c Dr.
   To Interest on Debenture Redemption
   Fund Investment A/c
   (Amount received as interest on debenture redemption investment)
d. **For transferring the interest to Debenture Redemption Reserve**
   Interest in Debenture Redemption Investment A/c Dr.
   To Debenture Redemption Fund A/c
   (Amount received as interest on debenture redemption investment transferred to debenture reserve)
e. **For transferring the annual appropriation to Debenture Redemption Reserve**
   Profit & loss appropriation A/c or Surplus A/c Dr.
   To Debenture Redemption Fund A/c
   (Amount transferred to debenture redemption reserve)

f. For investing the amount so appropriated along with interest in the debenture redemption investments or sinking fund investments

Debenture redemption fund investment A/c Dr.

To Bank A/c

(Amount invested together with interest in the debenture redemption investment A/c)

g. For making the payment due to debenture holders at the time of redemption, if debentures are redeemed at par

Debenture A/c Dr.

To Debentureholders A/c

(Amount due to debenture holders on redemption)

h. For realizing the amount invested in debenture redemption investment A/c

(i) When there is a profit

Bank A/c Dr.

To Debenture Redemption Investments A/c

To Debenture Redemption Fund A/c

(Amount realized on the sale of investment and profit transferred to the debenture redemption fund)

(ii) When there is a loss

Bank A/c Dr.

Debenture Redemption Fund A/c Dr.

To Debenture Redemption Investments A/c

(Amount realized on the sale of investment and loss transferred to the debenture redemption fund)

i. For making the payment to the debenture holders

Debenture holders A/c Dr.

To Bank A/c

(Amount paid to the debenture holders)

j. For transferring the balance in the fund to General Reserve, as the reserve is no longer restricted, the obligation for which it was created having been met

Debenture Redemption Fund A/c Dr.

To General Reserve A/c

To Capital Reserve A/c

(Balance in the fund transferred to general reserve and profit on the sale of an investment to capital reserve a/c)

Illustration 16

Behera Ltd. issued on 1st January 2017 10,000 6% debentures of Rs. 100 each at par repayable at the end of 4 years at a premium of 10%. It was decided to create a debenture redemption fund for the redemption of debentures. Investments are expected to earn interest at 5% per annum. On 31-

12-2020, investments were sold for Rs. 8,05,000, and the debentures were redeemed. Pass necessary journal entries.

Note* Investments were made in multiples of Rs. 100 only.

Annuity factor – 0.232012

Solution:

Amount to be appropriated annually: Amount to be paid on redemption x Annuity Factor

= 11,00,000 x 0.232012

= Rs. 2,55,213

Books of Behera Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2017 Jan 1	Bank A/c Dr. Loss on the issue of debentures A/c Dr. To 12% Debentures A/c To Premium on redemption of debentures A/c (Issue of debentures of Rs. 100 each redeemable at 10% premium)		10,00,000 1,00,000	 10,00,000 1,00,000
Dec 31	Surplus A/c Dr. To Debenture Redemption Fund A/c (Amount set aside for redemption of debentures)		2,55,213	 2,55,213
Dec 31	Debenture redemption fund investment A/c Dr. To Bank A/c (Investment made in Multiples of hundred rupees)		2,55,200	 2,55,200
2018 Dec 31	Bank A/c Dr. To Interest on DRF investments A/c (Interest received at 5% on 2,55,200)		12,760	 12,760
Dec 31	Interest in DRF investments A/c Dr. To Debenture Redemption Reserve Fund A/c (Interest transferred to DRF A/c)		12,760	 12,760
Dec 31	Surplus A/c Dr. To Debenture Redemption Fund A/c (Annual appropriation to provide for the redemption of debentures)		2,55,213	 2,55,213
Dec 31	Debenture redemption fund investment A/c Dr.		2,68,000	

	To Bank A/c (Investment of annual appropriation plus interest in multiples of hundred rupees)			2,68,000
2019 Dec 31	Bank A/c Dr. To Interest on DRF investments A/c (Interest received at 5% on 5,23,200)		26,160	26,160
Dec 31	Interest in DRF investments A/c Dr. To Debenture Redemption Fund A/c (Interest transferred to DRF A/c)		26,160	26,160
Dec 31	Surplus A/c Dr. To Debenture Redemption Fund A/c (Annual appropriation to provide for the redemption of debentures)		2,55,213	2,55,213
Dec 31	Debenture redemption fund investment A/c Dr. To Bank A/c (Investment made of annual appropriation plus interest in multiples of hundred rupees)		2,81,400	2,81,400
2020 Dec 31	Bank A/c Dr. To Interest on DRF investments A/c (Interest received at 5% on 5,23,200)		40,230	40,230
Dec 31	Interest in DRF investments A/c Dr. To Debenture Redemption Fund A/c (Interest transferred to DRF A/c)		40,230	40,230
Dec 31	Surplus A/c Dr. To Debenture Redemption Fund A/c (Annual appropriation to provide for the redemption of debentures)		2,55,213	2,55,213
Dec 31	Bank A/c Dr. To Debentures redemption fund investment A/c To DRF A/c (Sale of investments and profit transferred to DRF A/c)		8,05,000	8,04,600 400
Dec 31	6% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To Debentureholders A/c (Amount due on redemption together with premium)		10,00,000 1,00,000	11,00,000
Dec 31	Debenture holders A/c Dr. To Bank A/c		11,00,000	11,00,000

	(Payment made to debenture holders)			
Dec 31	Debenture Redemption Fund A/c Dr. To Bank A/c (Loss on the issue of debentures charged to DRF A/c)		1,00,000	1,00,000
Dec 31	Debenture Redemption Fund A/c Dr. To General Reserve A/c (Transfer of balance fund of DRF to General Reserve)		10,00,402	10,00,402

LEDGER ACCOUNT

6% Debentures A/c

Date	Particulars	Amount	Date	Particulars	Amount
2017			**2017**		
Dec 31	**To Balance c/d**	**10,00,000**	**Jan 1**	**By Bank A/c**	**10,00,000**
2018			**2018**		
Dec 31	**To Balance c/d**	**10,00,000**	**Jan 1**	**By Balance b/d**	**10,00,000**
2019			**2019**		
Dec 31	**To Balance c/d**	**10,00,000**	**Jan 1**	**By Balance b/d**	**10,00,000**
2020			**2020**		
Dec 31	**To Debentureholders A/c**	**10,00,000**	**Jan 1**	**By Balance b/d**	**10,00,000**

DEBENTURE REDEMPTION FUND A/C

Date	Particulars	Amount	Date	Particulars	Amount
2017			**2017**		
Dec 31	**To Balance c/d**	**2,55,213**	**Dec 31**	**By Surplus A/c**	**2,55,213**
2018			**2018**		
Dec 31	**To Balance c/d**	**5,23,186**	**Jan 1**	**By Balance b/d**	**2,55,213**
				By Interest on DRF Investments A/c	**12,760**
				By Surplus A/c	**2,55,213**
		5,23,186			**5,23,186**
2019			**2019**		
Dec 31	**To Balance c/d**	**8,04,559**	**Jan 1**	**By Balance b/d**	**5,23,186**
			Dec 31	**By Interest on DRF Investments A/c**	**26,160**
			Dec 31	**By Surplus A/c**	**2,55,213**
		8,04,559			**8,04,559**
2020			**2020**		
Dec 31	**To Loss on issue of Debentures A/c**	**1,00,000**	**Jan 1**	**By Balance b/d**	**8,04,559**
Dec 31	**To General Reserve A/c**	**10,00,402**	**Dec 31**	**By Interest on DRF Investments A/c**	**40,230**
			Dec 31	**By Surplus A/c**	**2,55,213**

			Dec 31	By Bank (Profit on sale)	400
		11,00,402			11,00,402

DEBENTURE REDEMPTION FUND INVESTMENT A/C

Date	Particulars	Amount	Date	Particulars	Amount
2017			2017		
Dec 31	To Bank A/c	2,55,200	Dec 31	By Balance c/d	2,55,200
2018			2018		
Jan 1	To Balance b/d	2,55,200	Dec 31	By Balance c/d	5,23,200
Dec 31	To Bank A/c	2,68,000			
		5,23,200			5,23,200
2019			2019		
Jan 1	To Balance b/d	5,23,200	Dec 31	By Balance c/d	8,04,600
Dec 31	To Bank A/c	2,81,400			
		8,04,600			8,04,600
2020			2020		
Jan 1	To balance b/d	8,04,600	Dec 31	By Bank A/c	8,05,000
Dec 31	To Debt. Redemption Fund A/c	400			
		8,05,000			8,05,000

PREMIUM PAYBLE ON REDEMPTION OF DEBENTURE A/c

Date	Particulars	Amount	Date	Particulars	Amount
2017			2017		
Dec 31	To Balance c/d	1,00,000	Jan 1	By Loss on issue of Debenture A/c	1,00,000
2018			2018		
Dec 31	To Balance c/d	1,00,000	Jan 1	By Balance b/d	1,00,000
2019			2019		
Dec 31	To Balance c/d	1,00,000	Jan 1	By Balance b/d	1,00,000
2020			2020		
Dec 31	To Debentureholders A/c	1,00,000	Jan 1	By Balance b/d	1,00,000

DEBENTUREHOLDERS A/C

Date	Particulars	Amount	Date	Particulars	Amount
2017			2017		
Dec 31	To Bank A/c	11,00,000	Dec 31	By 6% Debentures A/c	10,00,000
2018			Dec 31	By Premium on Redemption of debentures A/c	1,00,000
		11,00,000			11,00,000

INTEREST ON DRF INVESTMENTS A/c

Date	Particulars	Amount	Date	Particulars	Amount

2018			**2018**		
Dec 31	**To Debenture Redemption Fund A/c**	**12,760**	**Dec 1**	**By Bank A/c**	**12,760**
2018			**2018**		
Dec 31	**To Debenture Redemption Fund A/c**	**26,160**	**Dec 1**	**By Bank A/c**	**26,160**
2019			**2019**		
Dec 31	**To Debenture Redemption Fund A/c**	**40,230**	**Dec 1**	**By Bank A/c**	**40,230**

4.6.3 Redemption by Purchase in Open Market

Under this method, the company purchases its own debentures in the open market for immediate cancellation. The benefit of such a practice is that a company can redeem the debentures at its convenience whenever it has surplus funds. Second, the company can purchase their debentures when they are available in the market at a discount**.**

When the debentures are purchased from the market at a discount and cancelled, the following journal entries are passed:

a. On purchase of own debentures for immediate cancellation:
Debentures A/c Dr.
To Bank A/c
To Profit on Redemption of Debentures A/c

b. On transfer of Profit on Redemption
Profit on Redemption of Debentures A/c Dr.
To Capital Reserve A/c

If the debentures are purchased from the market at a price above the nominal value of debenture, the excess will be debited to loss on redemption of debentures. The journal entry, in that case, will be

a. Debentures A/c Dr.
Loss on Redemption of Debentures A/c Dr.
To Bank A/c

b. Statement of profit and loss A/c Dr.
To Loss on Redemption of Debentures A/c

Illustration 18

Sahoo Ltd. purchased its own debentures of Rs. 100 each of the face value of Rs. 20,000 from the open market for cancellation at Rs. 92. Record necessary journal entries.

Solution:

Books of Sahoo Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*

	Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debentures A/c (Purchased own debentures at Rs. 92 from the market)		20,000	18,400 1,600
	Profit on Redemption of Debentures A/c Dr. To Capital Reserve A/c (Transfer of profit on cancellation of debentures to capital reserve a/c)		1,600	1,600

Illustration 19

B Ltd. decided to redeem 250, 12% debentures of Rs. 100 each. For that, the company purchased debentures amounting to Rs. 20000 in the open market at Rs. 98.50 each. The company made an expense of Rs. 100. The balance of debentures amounting to Rs. 5,000 were redeemed by a draw of lots. Pass necessary journal entries.

Solution:

Books of B Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Balance in Statement of profit and loss A/c Dr. To Debenture Redemption Reserve A/c (Transfer of profits to Debenture Reserve A/c)		6,250	6,250
	Debenture Redemption Investment A/c Dr. To Bank A/c (Amount invested in Debenture Redemption Investment)		3,750	3,750
	Bank A/c Dr. To Debenture Redemption Investment A/c (Debenture Redemption Investment encashed at the time of redemption of debentures)		3,750	3,750
	12% Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debentures A/c (Purchase of 200 debentures @ Rs. 98.50 and expenses amounting to Rs. 100)		20,000	19,800 200
	Profit on Redemption of Debentures A/c Dr. To Capital Reserve A/c (Profit on redemption transferred to capital reserve a/c)		200	200
	12% Debentures A/c Dr. To Bank A/c (Redemption of Rs. 50 debentures)		5,000	5,000

	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Balance of Debenture Redemption Reserve transferred to General Reserve on Redemption of Debentures)		6,250	6,250

4.6.4 Redemption by Conversion

Debentures can also be redeemed by converting them into shares or fresh debentures, as previously stated. Debenture holders will take advantage of the offer if they believe it is beneficial to them. The new shares or debentures may be issued at par, at a discount, or at a premium.

Accounting Entries

If Debentures were issued at par or premium

a. **Shares are issued, and the face value of all the shares is less than the nominal value of debentures**

   Debentures A/c Dr.

   To Securities Premium A/c

   To Equity share capital A/c

   (Debentures converted into equity shares and the face value of shares credited to the equity share capital A/c and the difference to the securities premium A/c)

b. **If Debentures are redeemable at premium and conversion option is exercised at the time of redemptions:**

   (i)

   Debenture A/c Dr.

   Premium on redemption of debentures A/c Dr.

   To Debentureholders A/c

   (Debenture converted into equity shares and the face value of shares credited to the equity share capital A/c and the difference to the securities premium A/c)

   (ii)

   Debenture holders A/c Dr.

   To Equity Share Capital A/c

   To Securities premium A/c

   (Amount paid to the debenture holders)

c. **Suppose debentures were issued at a discount and are converted into shares before the due date of redemption. In that case, the number of shares issued on conversion will be based on the amount received on debentures, and the amount of discount written off to the profit and loss A/c and the discount not so far written off will be credited.**

   Debenture A/c Dr.

   To Profit and loss A/c (with discount written off)

To Discount on issue of debentures
To Equity share capital A/c
(Shares issued to debenture holders for conversion before maturity)

Illustration 17

B Ltd. redeemed 1,000, 15% debentures of Rs. 100 each by converting them into equity shares of Rs. 10 each at a premium of Rs. 2.50 per share. The company also redeemed 500 debentures by utilizing Rs. 50,000 out of profit. Pass necessary journal entries.

Solution:

Books of B Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	15% Debentures A/c Dr. To Debenture holders (Amount due to debenture holders)		1,00,000	1,00,000
	Debenture holders A/c Dr. To Equity Share Capital A/c To Securities Premium Reserve A/c (Issue of 800 equity shares at a premium of Rs. 2.50 per share)		1,00,000	80,000 20,000
	Debenture A/c Dr. To Debentureholders A/c (Amount due to debenture holders)		50,000	50,000
	Debenture holders A/c Dr. To Bank A/c (Payment made to debenture holders)		50,000	50,000

4.7 KEYWORDS

Debenture: It is a document that acknowledges the debt.
Debentures Redemption Fund: It is a sinking fund created to redeem debentures.
Debenture Redemption Reserve: It is created **out of profits available for dividend payment**.
Purchase Consideration: The amount paid by the purchasing company in consideration for purchasing assets/business firm from another business enterprise.
Collateral Security: It means extra security in addition to primary security.
Over Subscription: It was a situation when the number of debentures applied for exceeds the quantity of debentures offered to the general public.
Bearer Debentures: The debentures which are transferable by delivery only.
Naked Debentures: The debentures which are not secured by any mortgage of the asset.

4.8 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House, New Delhi.
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co., New Delhi.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication, New Delhi.
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

4.9 TERMINAL QUESTIONS/EXERCISES

Questions

1. What do you understand by Debenture? Explain the different types of debentures?
2. Differentiate between debenture and share?
3. What are the various methods by which a company can redeem its debentures?
4. Distinguish between the redemption of debentures out of capital and out of profits?
5. State the guidelines of SEBI for creating Debenture Redemption Reserve?
6. Explain the various steps for creating a Sinking Fund to redeem debentures by highlighting accounting entries passed at each stage?
7. “A company can purchase its own debentures from the open market.” Explain?
8. Mohanty Company Limited purchased assets of the value of Rs. 2,20,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs.100 each at a premium of 10%. Pass necessary journal entries.
9. B company purchased assets of the value of Rs.1,90,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs. 100 each at a discount of 5%. Record necessary journal entries.
10. Prasad Limited bought the business of Das Limited consisting of sundry assets of Rs. 3,60,000, sundry creditors Rs.1,00,000 for a consideration of Rs. 3,07,200. It issued 14% debentures of Rs. 100 each fully paid at a discount of 4% in satisfaction of purchase consideration. Pass necessary journal entries.
11. Sethi Limited took a loan of Rs. 30,00,000 from a bank against primary security worth Rs. 40,00,000 and issued 4,000, 5% debentures of Rs. 100 each as collateral security. The company again, after one year, took a loan of Rs. 50,00,000 from the bank against Plant as

primary security and deposited 6,000, 6% debentures of Rs. 100 each as collateral security. Pass necessary journal entries and prepare the balance sheet of the company.

12. Pandey Limited issued 50,000, 11% debentures of Rs. 100 each based on the following conditions:
    a. Debentures issued at par and redeemable at par.
    b. Debentures issued at a discount @ 5% and redeemable at par.
    c. Debentures issued at premium @ 10% and redeemable at par.
    d. Debentures issued at par and redeemable at premium @ 10%.
    e. Debentures issued at a discount of 5% and redeemable at a premium of10%.
    f. Debentures issued at a premium of 6% and redeemable at a premium of 4%.

    Record necessary journal entries in the cases mentioned above at the time of issue and redemption of debentures.
13. Dash Ltd. issued 7,00,000, 10% debentures of Rs. 100 each at par. Interest is to be paid on these debentures half-yearly on September 30 and March 31, every year. Pass necessary journal entries. Assume the income tax is deducted @ 10% of the amount of interest.
14. Smita Ltd. issued 10,000, 9% debentures of Rs. 100 each at a premium of 10% on 1.1.2020. It purchased sundry assets of the value of Rs. 2,50,000 and took over the liabilities of Rs. 60,000 and issued 9% debentures at a discount of 5% to the vendor. On the same date, it took a loan from the Bank for Rs. 1,00,000 and issued 9% debentures as Collateral Security. Pass the necessary journal entries in the books of Smita Ltd. and prepare the extract of the balance sheet on 31.03.2021.
15. A Ltd., issued 3,000, 14% Debentures of Rs. 100 each at a discount of 5% on April 1, 2017. Interest on these debentures is payable annually on March 31 each year. The debentures are redeemable at par in three equal installments at the end of the third, fourth, and fifth years. Prepare 14% Debentures Account, Discount on Issue of Debentures Account, and Debenture Interest Account in the books of the company.
16. LML Ltd. purchased for cancellation of its own 10,00,000, 11% Debentures of Rs. 600 each at Rs. 580 each. Record necessary journal entries.
17. A company issued 1,000, 6% debentures of Rs. 1,000 each at Rs. 960 per debenture on April 1, 2019. The terms of issue provided the redemption of 200 debentures every year starting from 31 March 2021, either by purchase or by drawing the lot at par at the company's option. On 31.03.2021, the company purchased for cancellation debentures of the face value of Rs. 80,000 at Rs. 950 per debenture and of the face value of Rs. 1,20,000 at Rs. 900 per debenture. Journalise the above transaction.

    (**Answer: Profit on redemption: Rs. 16,000**)
18. Anita Ltd. purchased 400 of its own 12% Debentures of Rs. 100 each on March 1, 2020 @ Rs. 98.80. Interest on these debentures is payable half-yearly on June 30 and December 31 each year. The debentures were immediately cancelled after purchase. Pass the necessary journal entries. Ignore Interest.

    (**Answer: Profit on Redemption Rs. 1,280**)

B. COM

SEMESTER III
COURSE: CORPORATE ACCOUNTING

UNIT-5: FINAL ACCOUNTS

STRUCTURE

5.0 OBJECTIVES

After going through this unit, you should be able to:

- Explain the objective of preparing final accounts;
- Prepare the profit and loss statement;
- Prepare the balance sheet;
- Prepare the final accounts in vertical form;

5.1 INTRODUCTION

Final Accounts or financial statements is the final stage of the accounting process where the different ledgers are maintained in the Trial Balance known as books of accounts of the business organization, and final accounts are presented in the specified way to provide the profitability, financial position, and flow of cash of the entity for a specified period to the stakeholders and other interested parties. It is also called the financial statements of an entity. The purpose of preparing financial statements or final accounts is to identify a company's financial performance, financial strength, and liquidity.

5.2 MEANING OF FINANCIAL STATEMENT

Financial statements are the main source of financial information for most decision-makers/ stakeholders. That is why financial accounting and reporting places a high emphasis on the accuracy, reliability, understandability, and relevance of the information on these financial statements. Financial statements are basically reports that depict financial and accounting information relating to businesses. A company's management uses it to communicate with external stakeholders. These include shareholders, tax authorities, regulatory bodies, investors, creditors, etc.

5.3 FEATURES OF FINANCIAL STATEMENT

- Financial statements should present a true and fair view of the balance sheet, profit and loss, and cash flow of an entity
- Financial statements should be prepared assuming that the entity will continue its business for an infinite period in the future.
- Financial statements excluding cash flow statements must be prepared on an accrual basis.
- Each material item should be disclosed separately in the financial statements.
- Consistency in the presentation of financial statements should be maintained to enhance the comparability, relevance, and reliability of financial information.

5.4 REGULATORY PROVISIONS OF COMPANIES ACT, 2013 AND ACCOUNTING STANDARDS

Section 129 of the companies Act 2013 provides for the preparation of financial statements. It is also provided that the financial statements shall be prepared in the form provided in new schedule III **of Companies Act, 2013**. It mentions that the financial statements shall give a true and fair view of the state of affairs of the company and shall comply with the accounting standards notified under new section 133. IND AS-1/ IAS-1 deals with the presentation of financial statements of a company in line with schedule III of the companies Act, 2013. Further, in the new Schedule III, detailed instructions have been given for the preparation of consolidated financial statements as consolidation of accounts of subsidiary companies/associates/joint ventures are now made mandatory in section 129. It may be noted that for the first time, a provision has been made in the new section 129(3) that if a company has one or more subsidiaries, it will have to prepare a consolidated financial statement of the company and all the subsidiaries in the form provided in the **new schedule III of Companies Act, 2013.** But Standalone financial statements are the financial statements of a single company. These statements reflect the position of assets and liabilities of the holding company in isolation without considering the impact of the assets and liabilities of its subsidiary companies.
Section 2(40) states the components of financial statements (Standalone), which include

- Balance sheet/ Statement of Financial Position
- Profit and Loss Account/Income and Expenditure account,
- Cash Flow Statement,
- Statement of Changes in Equity and
- Explanatory note / Notes to Accounts related to the above.

Section 2(41) of companies Ac, 2013 states that the companies must have a uniform financial year, i.e., from 1st April to 31st March every year.

Schedule III of Companies Act, 2013 is applicable to all other companies except banking, insurance, electricity, and any other companies where a specific Act is applicable for the preparation and presentation of financial statements.

5.5 PREPARATION OF FINANCIAL STATEMENTS OF A COMPANY

Balance Sheet: It is a financial statement that presents the financial position of a company by disclosing assets, liabilities, and shareholders' funds at a specific point of time. The balance sheet is prepared on a particular date to show the financial position of the company on that date only. Its position varies with change in time. The balance sheet is prepared in the form prescribed in schedule III of the companies Act, 2013, which is IND AS-1 Compliant.

Schedule-III, section 129, Division-II

Part 1-Balance Sheet
Name of The Company
Balance Sheet as at-------
(Rupees in -----)

Particulars	Note No.	Figures as at the end of the current reporting period	Figures as at the end of the previous period
I. Assets			
1. Non-Current Assets			
a) Property, Plant, and Equipment			
b) Capital Work in Progress			
c) Investment Property			
d) Goodwill			
e) Other Intangible Assets			
f) Intangible Assets under Development			
g) Biological Assets other than Bearer Plants			
h) Financial Assets			
(i) Investment			
(ii) Trade Receivables			
(iii) Loans (Given)			
(iv) Others (to be specified)			
i) Deferred Tax Assets			
j) Other Non-current Assets			
2. Current Assets			
a) Inventories			
b) Financial Assets			
i) Investment			
ii) Trade Receivables			
iii) Cash and Cash Equivalents			

iv) Bank Balance			
v) Loans			
vi) Others (to be specified)			
c) Current Tax Assets (Net)			
d) Other current Assets			
Total Assets		xxx	xxx
II. Equity and Liabilities			
Equity			
a) Equity share capital			
b) Other Equity			
Liabilities			
1. Non- Current Liabilities			
a) Financial Liabilities			
i) Borrowings			
ii) Trade Payables			
iii) Others (to be specified)			
b) Provisions			
c) Deferred Tax Liabilities			
d) Other Non-current Liabilities			
2. Current Liabilities			
a) Financial Liabilities			
i) Borrowings			
ii) Trade payables			
iii) Others (to be specified)			
b) Other current liabilities			
c) Provisions			
d) Current Tax Liabilities (Net)			
Total Equity and Liabilities		Xxx	Xxx

General Instructions for Preparation of Balance Sheet

1. An entity shall classify an asset as current when-
   a) It expects to realize the assets or intends to sell or consume them in its normal operating cycle;

b) It holds the assets primarily for the purpose of trading;

c) It expects to realize the assets within twelve months after reporting period or

d) The asset is cash or cash equivalent.

All other assets are treated as non-current assets.

2. The operating cycle of an entity is the time between the purchase of assets for processing and their realization in cash or cash equivalents. If the operating cycle is not available, then it is assumed to be 12 months.
3. An entity shall classify a liability as current when
   a) It expects to settle the liability in its operating cycle;
   b) It holds the liability primarily for the purpose of trading;
   c) The liability is due to be settled within 12 months after the reporting period or

   All other liabilities are treated as non-current liabilities
4. Trade Receivables are in respect of the amount due on account goods sold or services rendered in the normal course of business.
5. Trade payables are in respect of the amount due on account goods purchased or services received in the normal course of business
6. A company shall disclose the following in the notes:

Non-current Assets

1. Property, Plant, and Equipment (PPE): it includes-
   a) Land
   b) Building
   c) Plant and Equipment
   d) Furniture and Fixtures
   e) Vehicles
   f) Office Equipment
   g) Bearer Plants
   h) Others (to be specified)

   (Assets under the lease shall be separately specified)
2. Investment Property- An investment property is real estate property purchased with the intention of earning a return on the investment either through rental income, the future resale of the property, or both. Examples are-
   a) Land held for long-term capital appreciation.
   b) Land held for a currently undetermined future use.
   c) Building leased out under an operating lease.
   d) The vacant building held to be leased out under an operating lease
3. Goodwill- Goodwill is an intangible asset associated with the purchase of one company by another. The value of a company's brand name, solid customer base, good customer relations, good employee relations, and any patents or proprietary technology represent some examples of goodwill. Only acquired or purchased goodwill will be shown in the

balance sheet. Any self-generated goodwill will not be shown in the balance sheet because measuring it accurately becomes difficult.

4. Other intangible assets-
   a) Brands or Trademarks
   b) Computer Software
   c) Mastheads and publishing rights
   d) Mining rights
   e) Copyrights, Patents, Intellectual property rights, Services, and operating rights
   f) Recipes, formulae, models, designs, and prototypes
   g) Licenses and Franchises
   h) Others (to be Specified)
5. Biological Assets other than Bearer Plants- Biological plants- The International Accounting Standard 41 (IAS 41) states that a biological asset is any living plant or animal owned by the business, and they are typically measured at fair value minus selling costs. For example, livestock such as goats, cows, sheep, pigs, and fish are all considered biological assets.

   A bearer plant is defined as a living plant that:

   (a) is used in the production or supply of agricultural produce;
   (b) is expected to bear produce for more than one period; and
   (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

   Examples: tea bushes, grapevines, oil palms, and rubber trees. (IND AS-16- PPE)

   However, tea leaves, grapes, oil palm fruit, and latex are within the scope of Agriculture (IND AS 41).
6. Investments: it can be classified as-
   a) Investment in an equity instrument
   b) Investment in preference shares
   c) Investment in Government securities
   d) Investment in debentures or bonds
   e) Investment in mutual funds
   f) Investment in partnership firm
   g) Investment in joint ventures
   h) Investment in associates
   i) Investment in subsidiaries
7. Trade Receivables: it can be sub-classified as-
   a) Trade receivables considered good-secured
   b) Trade receivables considered good-unsecured
   c) Trade receivables which have a significant increase in credit risk
   d) Trade receivables – credit impaired
8. Loans: loans can be classified as-

a) Securities deposits;
b) Loans to related parties
c) Other Loans (to be specified)

9. Other financial Assets shall include bank deposits with more than 12 months maturity.
10. Deferred tax assets: In accounting, the **accrual basis** is followed for calculating income /loss, whereas, in income tax, it does not follow **the accrual system** of accounting for all expenses and revenues. Therefore**, it results in a difference in tax (Deferred Tax).** Deferred tax is the difference in tax on accounting profit and that on taxable income. It may be deferred tax assets/ deferred tax liability.

Deferred tax assets: if tax on taxable income > tax on accounting profit
Deferred tax liability: if tax on accounting profit > tax on Taxable income

Tax Expenses= Current Tax + Deferred Tax

Current tax is the tax on taxable income as per income tax laws, whereas tax expense is the tax on accounting profit or income.

Illustration 1

Suppose, Accounting profit = Rs.50,000
Taxable Income under tax laws = Rs. 40,000
Tax rate is 30%
Tax expenses = 30% of 50,000= 15,000
Current tax =30% of 40,000= 12,000
Deferred tax Liability= 15,000- 12,000=3,000
Pass necessary journal entries.

Solution:

Tax expense a/c	Dr. 15,000 (P/L)	
To Current Tax a/c		12,000
To Deferred tax a/c		3,000 (Liability)

When Current tax is paid

Current tax a/c	Dr. 12,000	
To Bank a/c		12,000

If current tax is payable, it will be shown as current liability

Illustration 2

Suppose, Accounting profit 30,000
Taxable income under tax laws = 70,000
Tax rate= 20%
Tax expense= 20% of 30,000= 6,000
Current Tax = 20% of 70,000= 14,000
Deferred tax asset= 14,000-6,000=8,000
Pass necessary journal entries.

Solution:

Tax expense a/c	Dr.	6,000(P/L)
Deferred tax a/c	Dr.	8,000 (Asset)
To current tax a/c		14,000

11. Other current assets: it includes all other current assets which don't fit into any other categories. It includes advances except for long-term advances, prepaid expenses, accrued income, etc.
12. Cash Equivalents: Marketable securities like treasury bills or commercial papers or certificate deposits which can be converted into cash in 3 months or less than 3 months without losing value, are called cash equivalents.
13. Inventories; Inventories shall be classified as-
    a) Raw materials
    b) Work-in-progress
    c) Finished goods
    d) Stock-in-trade
    e) Stores and spares
    f) Loose tools and consumables etc.
14. Capital in progress: Any Non-current tangible assets are under construction yet to be completed will come under capital in progress
15. Intangible assets under development: It includes all intangible assets on which work has begun but is yet to be finished.

Equity

1. Equity Share Capital

For each class of equity share capital:

a) The number and amount of shares authorized;
b) The number of shares issued, subscribed and fully paid and subscribed but not fully paid;
c) Par value per share
d) Reconciliation of the number of shares outstanding at the beginning and at the end of the period;
e) The rights, preferences, and restrictions are attached to each class of share, including distribution of dividends and repayment of capital.
f) Shares in the company held by each shareholder holding more than 5% of shares specifying the number of shares held.
g) Calls unpaid up (showing the aggregate amount of calls unpaid by directors and officers)
h) Share forfeited shares (amount originally paid up)
i) Share application money pending allotment to the extent not refundable will be shown under the head equity.

Particulars (Equity shares, preference shares, right shares, bonus shares)	**Amount**

1. Authorized capital	**xxx**
2. Issued capital	**xxx**
3. Subscribed capital	**xxx**
4. Called up capital **Less calls in arrear** **Add forfeited shares**	**Xxx** **Xxx** **Xxx** **xxx**
Total (To be shown as equity in the amount column of the balance sheet)	**xxx**

2. Other Equity

Particulars	Amount
1. Capital redemption reserves 2. Debenture redemption reserves 3. Share option outstanding account 4. Retained earnings 5. General reserves 6. Specific reserves 7. Capital reserves 8. Security premium Reserve 9. Dividend equalization reserves 10. Investment fluctuation reserves 11. Money received against share warrants 12. Retained earnings 13. Debit balance of statement of profit and Loss shown as a negative figure 14. Reserve and surplus 15. Share application money pending allotment	
Total (to be shown in the amount column under the head other equity)	xxx

Non-Current Liabilities

1. Financial Liabilities:

Any future sacrifices of economic benefits that an entity is required to make as a result of its past transactions or any other activity in the past. The future sacrifices to be made by the entity can be in the form of any money or service owed to the other party.

Non-financial liabilities are typically characterized by an obligation to deliver goods or services rather than an obligation to deliver cash or another financial asset. For example, warranty obligations require the obligor to perform a service to repair or restore the asset to the warranty.

a) Borrowings

i) Loans repayable on demand from banks or other parties

ii) Loans from related parties

iii) Deposits from outsiders

iv) Term Loans

v) Bonds

vi) Debentures

vii) Deferred payment liabilities

viii) Any other Loan (To be specified)

b) Trade payables (to be paid over more than one Year)

c) Provisions

i) Provision for Employee benefits (Superannuation, gratuity, pension, etc.)

ii) Others (specify the nature)

d) Other non-current liabilities

i) Advance received

ii) Others (specify the nature)

C. Current Liabilities

a) Financial Liabilities

i) Short Term Borrowings (Loans, advances, deposits, etc. payable within one year)

ii) Current maturity of long-term debts

iii) Current maturity of finance lease

iv) Interest accrued (Unpaid)

v)Unpaid dividends

vi)Trade payables

vii) Share application money pending allotment to the extent refundable

viii) Others (specify the nature)

b) Other current liabilities include expenses outstanding, revenue received in advance, etc.

c) Provisions include provision for employee benefits for the short term of one year and others to be specified.

Contingent Liabilities:

i) Claims against the company not acknowledged as debt

ii) Guarantees on behalf of the company

iii)Bills discounted with Banks

Illustration 3

The following balances have been extracted from the books of Mango company Ltd. as on 31st March 2020. Prepare the balance sheet of the company.

Particulars	Dr. Amount (Rs. In lakhs)	Cr. Amount (Rs. In lakhs)
Cash in hand	8,500	
Cash at bank	15,000	
Bills receivable	5,000	
Debtors	8,700	
Investment in 6% Government bonds	24,400	
Inventory (Closing)	13,300	
Land	56,000	
Building	67,900	
Furniture	34,800	
Goodwill	24,000	
Patent	4,500	
Copy right	2,400	
Bearer Plants	15,500	
Creditors		4,600
Bills payable		6,800
Reserve fund		56,000
Profit and Loss balance		20,000
Outstanding expense		5,600
Share capital		1,25,700
Debentures		45,700
Bonds		10,000
Bank loans		5,600
Total	2,80,000	2,80,000

Solution:

Name of the Company: Mango

Balance sheet as on 31st March 2020

Particulars	Note No.	Figures as at the end of the current reporting period 2019-2020	Figures as at the end of the previous period 2018-2019
I. Assets			
1. Non-Current Assets			
a) Property, Plant, and Equipment	1	1,74.200	

b) Capital Work in Progress		-	
c) Investment Property		-	
d) Goodwill		24,000	
e) Other Intangible Assets	2	6,900	
f) Intangible Assets under Development		-	
g) Biological Assets other than Bearer Plants		-	
h) Financial Assets			
i)Investment in 6% Government bonds		24,400	
ii)Trade Receivables	-		
iii) Loans (Given)	-		
iv)Others (to be specified)			
i) Deferred Tax Assets	-		
j) Other Non-current Assets	-		
2. Current Assets			
i)Inventories		13,300	
ii)Financial Assets	-		
a) Investment	-		
b) Trade Receivables	3	13,700	
c)Cash and Cash Equivalents		8,500	
d)Bank Balance		15,000	
e) Loans	-		
f) Others (to be specified)	-		
iii)Current Tax Assets (Net)	-		
iv)Other current Assets	-		
Total Assets		2,80,000	xxx
II. Equity and Liabilities			
3. Equity			
i)Equity share capital		1,25,700	
ii)Other Equity	4	76,000	
Liabilities			
4. Non- Current Liabilities			
a) Financial Liabilities			
i)Borrowings	5	61,300	
ii)Trade Payables	-		
iii)Others (to be specified)	-		
b) Provisions	-		
c)Deferred Tax Liabilities	-		
d)Other Non-current Liabilities	-		
5. Current Liabilities			

a) Financial Liabilities			
i)Borrowings	-		
ii)Trade payables	6	11,400	
iii)Others (to be specified)	-		
b) Other current liabilities	7	5,600	
c)Provisions	-		
d)Current Tax Liabilities (Net)	-		
Total Equity and Liabilities		2,80,000	

Notes to Account – 1 (Property, Plant and Equipment) or PPE

	Rs.
Land	56,000
Building	67,900
Furniture	34,800
Bearer Plants	15,500
Total	1,74,200

Notes to Account: 02 other Intangible Assets

	Rs.
Patent	4,500
Copy right	2,400
Total	6,900

Notes to Account: 03 Accounts Receivables

	Rs.
Bills Receivables	5,000
Debtors	8,700
Total	13,700

Notes to Account: 04 Other Equity

	Rs.
Reserve Fund	56,000
Profit and Loss balance	20,000

Total	76,000

Notes to Account: 05 Borrowings

	Rs.
Debentures	45,700
Bonds	10,000
Bank Loans	5,600

Total	61,300

Notes to Account: 06 Trades Payable

	Rs.
Bills Payable	6,800
Creditors	4,600

Total	11,400

Notes to Account: 07 Other current Liabilities

	Rs.
Outstanding Expenses	5,600

Total	5,600

Part II – Statement of Profit and Loss

Name of the Company-----

Statement of Profit and Loss for the period ending 31st March, ---

	Particulars	Note No.	Figure for the Current reporting period	Figure for the Previous reporting period
I	Revenue from Operation			
II	Other Income			
III	Total Income (I +II)			
IV	Expenses 1. Cost of materials consumed 2. Purchase of stock in Trade 3. Change in Inventories of finished goods, work in			

	progress, and stock in trade 4. Employee Benefits Expense 5. Finance costs 6. Depreciation and Amortization 7. Other expenses			
	Total Expenses (1 to 7)			
V	Profit/ (Loss) before exceptional items and tax (III-IV)			
VI	Less Exceptional Items			
VII	Profit/(Loss) before tax- (V-VI)			
VIII	Tax Expense: i)Current tax ii)Deferred Tax			
IX	**Profit after tax from the continuing business operation (VII-VIII)**			
X	Profit from discontinued operations			
XI	Less Tax Thereon			
XII	**Profit /(Loss) from discontinued operations after tax**			
XIII	**Profit/ (Loss) for the period (IX + XII)**			
XIV	Other Comprehensive Incomes a) Revaluation surplus (IND AS-16 & IND AS-38) b) Gain or Loss from Translation c) Gain or Loss from Investment in Equity Instruments designated at fair value d) Gain or Loss on financial assets measured at fair value e) Gain or Loss on Foreign exchange Rate changes			
XV	**Total Comprehensive Income for the period (XIII + XIV)**			
XVI	Earnings per share (EPS) per for continuing operation a) Basic EPS b) Diluted EPS			
XVII	Earnings per share (EPS) per for discontinued operation a) Basic EPS b) Diluted EPS			
XVIII	Earnings per share (EPS) per for continuing & Discontinued operation a) Basic EPS b) Diluted EPS			

Notes to Accounts-

General Instructions for preparation of Statement of Profit and Loss

1. **Revenue from operations**

Particulars		Amount
a) Sale of Goods and services (Gross)		Xxx
Less Sale Return	xxx	
Less Discount	xxx	
Less Excise/Service Tax/Other Levies	xxx	

		Xxx
		Xxx
b) Other operating revenues		xxx
Revenue from operation (Net)		xxx

2. Other incomes

a) Interest received
b) Commission received
c) Royalty received
d) Rent received
e) Dividend received
f) Profit on sale of assets
g) Discount received
h) Bad debt recovered
i) Others, if any (specify the nature)

3. Cost of materials consumed

Opening stock of materials	xxx
Add Purchase of materials less return	xxx
Add expenses on purchase of raw materials	xxx
Less closing stock of materials	xxx

Cost of materials consumed	xxx
	--------

4. Change in inventories

Opening stock of finished goods – closing stock of goods	xxx
Opening stock of work-in-progress-closing stock of work in progress	xxx
Opening stock of stock in trade – closing stock of stock in trade	xxx
	-------
Change in Inventory	xxx

(If positive, it is an expense, if negative, it is deducted instead of addition)

5. Stock in Trade

It means goods purchased for sales lying unsold at the end of the period. It is applicable to the trading business.

6. **Employee Benefit Expenses;**
   It includes all expenses incurred for the employees working in the organization during the period like wages, salaries, bonus, contribution to provident fund, canteen expenses, medical expenses, gratuity, superannuation, employees stock option schemes (ESOS).
7. **Finance cost:**
   Costs incurred on raising finance for the business are finance costs. It includes interest on borrowings and dividends on equity.
8. **Depreciation and Amortization:**
   It includes Depreciation on non-current tangible assets and a decrease in the value of intangible assets (amortization).
9. **Other Expenses:**
   It includes all other expenses which are not included under any other heads like administrative expenses, selling expenses, distribution expenses, factory or manufacturing expenses, etc.
10. **Deferred Tax:**
    The difference in tax on accounting profit and that on taxable income is called deferred tax. It may be deferred tax assets or deferred tax liability.
    Deferred tax assets: if taxable income > accounting profit, then tax difference is deferred tax assets.
    Deferred tax liability: if accounting profit > Taxable income, the tax difference is deferred tax liability.
11. **Exceptional Items:**
    It arises from ordinary activity; they are not expected to be recurring; the nature and amount are relevant to users of financial statements. They are disclosed.
    Examples-
    Profit or loss on sale of assets, Loss on account of theft, damage, etc.
12. **Extraordinary Items:**
    It is an unusual charge and unlikely to happen. It is not disclosed in the financial statements. Rather it is disclosed in notes to accounts.
    Examples
    Loss due to earthquake, flood, fire, Loss from early retirement of debts
13. **Basic EPS:**
    Basic earnings per share shall be calculated by dividing profit or loss attributable to ordinary equity holders of the entity (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period.
    Basic EPS=

$$\frac{\textbf{Net profit or loss attributable to ordinary shares for the period}}{\textbf{Weighted average number of ordinary shares outstanding during the period}}$$

Illustration 4

X Company has 10,000 shares at the beginning of the year on 1st April 2020. The Company purchased 1000 shares on 31st December 2020. It Has 10% 1,000 convertible preference shares of 10 each. The profit available to Equity shareholders is 4,50,000.

Solution:

$$\text{Basic EPS} = \frac{4,50,000}{10,000 \times 9/12 + 9000 \times 3/12} = 4,50,000/9,750 = 46.15 \text{ per share}$$

14. Diluted Earnings per Share can be calculated as follows

Diluted Earnings per Share =

Profit or loss attributable to ordinary shareholders (after adjustment for diluted earnings)

Average number of weighted ordinary shares outstanding during the period (Assuming the conversion of diluted potential ordinary shares)

Diluted Earnings:

Profit or loss (after-tax) for the period attributable to existing ordinary shareholders of the parent entity

Add back dividend along with distribution tax on convertible preference shares previously deducted

Add back interest net of tax effect charged on convertible debenture or loans

Add/subtract any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares.

Average number of weighted ordinary shares outstanding during the period:

Number of ordinary share outstanding at the beginning of period ***Time weighting factor**

Deduct Number of ordinary shares bought back * **Time weighting factor**

Add The weighted average number of ordinary shares outstanding during the period * **Time weighting factor.**

Add The weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares * **Time weighting factor**

Dilutive potential ordinary shares: Those financial securities which have the potential of being converted into ordinary shares are called dilutive potential ordinary shares. Examples are- convertible preference shares, convertible debentures, share warrants, etc.

Illustration 5

If you take illustration 4 for calculating Diluted EPS

No of shares= 10,000 for 9 months

9,000 shares for 3 months

1000 convertible preference shares for 12 months

Profit =4, 50,000

Dividend to preference shareholders @ 10% of 10,000= 1,000

Solution:

Diluted Earning = 450000 + 1000= **4,51,000**

$$\text{Diluted EPS} = \frac{4,51,000}{10,000 \times 9/12 + 9000 \times 3/12 + 1000 \times 12/12}$$

$$= \frac{4,51,000}{7,500 + 2,250 + 1000} = 451000/10,750 = \mathbf{41.95}$$

Illustration 6

From the particulars, prepare the Profit and Loss statement of Green Company Limited for the year ending 31st March 2020.

	Rs. (in Lakhs)
Opening stock of Ram materials	12,500
Closing stock of Raw materials	13,500
Purchase of Raw Materials	45,000
Purchase of stock in Trade	24,600
Opening stock of Finished goods	4,600
Closing stock of finished goods	5,700
Opening stock of work in progress	7,900
Closing stock of work in progress	4,400
Sale of goods	2,59,000
Sales return	9,000
Purchase return of stock in trade	600
Carriage	2,000
Wages	3,400
Salaries	12,400
Bonus	500
Administrative expenses	1,600
Selling and distribution expenses	3,100
Interest on Bank Loans	600
Interest on debentures	700
Depreciation	300
Amortization	250
Loss on sale of fixed assets	1,000
Commission received	5,600
Rent received	3,400

Income tax @30%

Tax calculated under Income Tax Act, 1961 is Rs. 53,500

Number of equity shares is 10,000 of Rs. 100 each

Solution:

Part II – Statement of Profit and Loss

Name of the Company—Green Company Limited

Statement of Profit and Loss for the period ending 31st March 2020

(Figures in Lakhs)

	Particulars	Note No.	2019-20	2018-19
I	Revenue from Operation	1	2,50,000	
II	Other Income	2	9,000	
III	Total Income (I +II)		2,59,000	
IV	Expenses			
	a) Cost of materials consumed	3	44,000	
	b) Purchase of stock in Trade	4	24,000	
	c) Change in Inventories of finished goods, work in progress, and stock in trade	5	2,400	
	d) Employee Benefits Expense	6	16,300	
	e) Finance costs	7	1,300	
	f) Depreciation and Amortization	8	550	
	g) Other expenses	9	6,700	
	Total Expenses (1 to 7)		95,250	
V	Profit/ (Loss) before exceptional items and tax (III-IV)		1,63,750	
VI	Less Exceptional Items (Loss on sale of Fixed Assets)		1000	
VII	Profit/(Loss) before tax- (V-VI)		1,62, 750	
VIII	Tax Expense:			
	i)Current tax (Tax on Accounting profit-30% of 1,62,750)		48,825	
	ii)Deferred Tax (53,500-48,825)		4,675	
IX	Profit after Tax from continuing business		1,09,250	
X	Basic EPS (1,09,250 / 10,000)		10.925	

Notes to Accounts-01 (Revenue from Operation

Particulars	Amount
Sale of goods and services	2,59,000
Less sales Return	9,000

Revenue from operation	2,50,000

Notes to Accounts -02 (Other Incomes)

Particulars	Amount
Commission received	5,600
Rent received	3,400
Other incomes	9,000

Notes to Accounts-03 (cost of Raw Materials Consumed)

Particulars	Amount
Opening stock of Raw materials	12,500
Add Purchase of raw Materials	45,000
	57,500
Less closing stock of Raw Materials	13,500
Cost of Raw Materials consumed	44,000

Notes to Accounts -04 (purchase of stock in Trade)

Particulars	Amount
Purchase of stock in trade	24,600
Less Return of stock in Trade	600
Net purchase of stock in Trade	24,000

Notes to Accounts – 05 (Change in Inventories)

Particulars	Amount
Change in the stock of finished goods (4,600-5,700)	(1,100)
Change in the stock of Work in Progress (7,900 -4,400)	3,500
Change in Inventories	2,400

Notes to Accounts -06 (Employees benefits)

Particulars	Amount
Wages	3,400
Salaries	12,400
Bonus	500
Employees Benefits	16,300

Notes to Accounts -07 (Finance costs)

Particulars	Amount

Interest on Bank Loans Interest on Debentures Finance costs	600 700 1,300

Notes to Accounts -08 (Depreciation and Amortization)

Particulars	Amount
Depreciation Amortization Finance cost	300 250 550

Notes to Accounts -09 (Other Expenses)

Particulars	Amount
Carriage Administrative Expenses Selling and Distribution Expenses Other expenses	2,000 1,600 3,100 6,700

Illustration 7

Prepare profit and Loss statement and Balance sheet of Reliable Company Limited for the year ending 31st March 2020 from the following abstracts:

Particulars	Dr Amount (Rs.)	Cr Amount (Rs.)
Share capital (20,000 shares of Rs.100 each)		2,00,000
General Reserve		15,000
8% Debentures		50,000
Bank Overdraft		2,000
Sundry creditors		8,000
Securities premium		5,000
Debenture Redemption Reserve		20,000
Sales		80,000
Other incomes		20,000
Bank Loans		30,000
Bills payables		5,000
Plant & Machinery	80,000	
Land & Building	60,000	
Investment in Real estate	20,000	
Goodwill	10,000	
Patent	10,000	
Copyright	15,000	

Investment in Government Securities Investment in Debentures Loans and Advances Sundry debtors Bills Receivables Cost of Raw materials consumed Purchase of stock in Trade Employee Benefits Finance costs Intangible assets written off Administrative Expenses Selling and distribution expenses Manufacturing expenses	5,000 1,20,000 20,000 8,000 500 40,000 25,000 4,000 3,000 500 4,000 6,000 4,000	
Total	4,35,000	4,35,000

Adjustments:

a) Salary outstanding Rs. 1,500
b) Advertisement paid in advance Rs. 400
c) Interest due not yet received Rs. 1,200
d) Charge depreciation on Plant and Machinery @10% pa.
e) Bad debts Rs.2000

Solution:

Part II – Statement of Profit and Loss

Name of the Company— Reliable Company Limited

Statement of Profit and Loss for the period ending 31st March 2020

(Figures in Lakhs)

	Particulars	Note No.	2019-20	2018-19
I	Revenue from Operation (Sales)		80,000	
II	Other Income	1	21,200	
III	Total Income (I +II)		1,01,200	
IV	Expenses f) Cost of materials consumed g) Purchase of stock in Trade h) Change in Inventories of finished goods, work in progress, and stock in trade i) Employee Benefits Expense j) Finance costs k) Depreciation and Amortization l) Other expenses	 2 - 3 4	 40,000 25,000 - 5,500 3,000 8,500 15,600	

	Total Expenses (1 to 7)		97,600	
V	Profit/ (Loss) before exceptional items and tax (III-IV)		3,600	
VI	Less Exceptional Items (Loss on sale of Fixed Assets)		-	
VII	Profit/(Loss) before tax- (V-VI)		3,600	
VIII	Tax Expense: i)Current tax (Tax on Accounting profit-30% of 3,600) ii)Deferred Tax		 1,080 -	
IX	Profit after Tax from continuing business		2,520	
X	Basic EPS (2,520 / 20,000)		0.126	

Notes to Accounts -01 (Other Incomes)

Particulars	Amount
Other Incomes Add Accrued Interest	20,000 1,200 21,200

Notes to Accounts -02 (Employees benefits)

Particulars	Amount
Employee Benefits Add Outstanding Salary	4,000 1,500 5,500

Notes to Accounts -03 (Depreciation and Amortization)

Particulars	Amount
Depreciation (10% of 80,000) Amortization	8,000 500 8,500

Notes to Accounts -04 (Other Expenses)

Particulars		Amount
Administrative Expenses		4,000
Selling and Distribution Expense	6,000	
Less prepaid Advertisement	(400)	
Add Bad debts	2,000	
		7,600
Manufacturing expenses		4,000
		15,600

Name of the Company: Reliable Company

Balance sheet as on 31st March 2020

Particulars	Note No.	Figures as at the end of current reporting period 2019-2020	Figures as at the end of previous period 2018-2019
I. Assets			
1. Non-Current Assets			
m) Property, Plant, and Equipment	1	1,32,000	
n) Capital Work in Progress	-		
o) Investment Property		20,000	
p) Goodwill		10,000	
q) Other Intangible Assets	2	25,000	
r) Intangible Assets under Development	-		
s) Biological Assets other than Bearer Plants	-		
t) Financial Assets			
i)Investment in Government Securities		5,000	
ii)Trade Receivables	-		
iii)Loans and Advances		20,000	
iv)Investment in Debentures		1,20,000	
u) Deferred Tax Assets	-		
v) Other Non-current Assets	-		
2. Current Assets			
i)Inventories	-		
ii)Financial Assets	-		
a) Investment			
b) Trade Receivables	3	6,500	
c)Cash and Cash Equivalents	-		
d)Bank Balance	-		
e) Loans	-		
f) Others (to be specified)	-		
iii)Current Tax Assets (Net)	-		
iv)Other current Assets	4	1,600	
Total Assets		3,40,100	
II. Equity and Liabilities			
3. Equity			
i)Equity share capital		2,00,000	
ii)Other Equity	5	42,520	

Liabilities			
4. Non- Current Liabilities			
a) Financial Liabilities			
i) Borrowings (Debenture)	6	80,000	
ii)Trade Payables	-		
iii)Others (to be specified)	-		
b) Provisions	-		
c)Deferred Tax Liabilities	-		
d)Other Non-current Liabilities	-		
5. Current Liabilities			
a) Financial Liabilities			
i)Borrowings	-		
ii)Trade payables	7	13,000	
iii)Others (to be specified)			
b) Other current liabilities	8	3,500	
c)Provisions	-		
d)Current Tax Liabilities (Net)		1,080	
Total Equity and Liabilities		3,40,100	

Notes to Accounts -01: PPE

Particulars		Amount
Plant & Machinery	80,000	
Less Depreciation 10%	8,000	
		72,000
Land & Building		60,000
		1,32,000

Notes to Accounts -02: Other Intangible Assets

Particulars	Amount
Patent	10,000
Copyright	15,000
	25,000

Notes to Accounts -03: Trade Receivables

Particulars		Amount
Sundry Debtors	8,000	
Less Bad Debts	2,000	

Bills Receivables	6,000 500 6,500

Notes to Accounts -04: Other Current Assets

Particulars	Amount
Prepaid Advertisement Accrued Interest	400 1,200 1,600

Notes to Accounts -05: Other Equity

Particulars	Amount
General Reserves Security Premium Debenture Redemption Reserve Balance of profit	15,000 5,000 20,000 2,520 42,520

Notes to Accounts -06: Borrowings

Particulars	Amount
Debentures Bank Loans	50,000 30,000 80,000

Notes to Accounts -07: Trade Payables

Particulars	Amount
Sundry Creditors Bills Payables	8,000 5,000 13,000

Notes to Accounts -08: Other Current Liabilities

Particulars	Amount
Bank Overdraft Outstanding Salary	2,000 1,500 3,500

5.6 KEYWORDS

Financial Statement: These are the main source of financial information for most decision-makers/ stakeholders.

Schedule III: It gives detailed instructions about the preparation of consolidated financial statements.

IND AS-1/IAS-1: It deals with the presentation of financial statements of a company in line with schedule III of the companies Act, 2013.
Companies Act, 2013: It regulates the formation and functioning of companies in India.
Biological Assets: It means any living plant or an animal owned by the business as per International Accounting Standard 41 (IAS 41).
Intangible assets under development: It means all intangible assets on which work has begun but yet to be finished.
Financial Liabilities: It infers any future sacrifices of economic benefits to be made by the entity.
Non-financial Liabilities: It is an obligation to deliver goods or services rather than an obligation to deliver cash or another financial asset.
Deferred Tax: The difference in tax on accounting profit and that on taxable income is called deferred tax.

5.7 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House, New Delhi.
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co., New Delhi.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication, New Delhi.
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

5.8 TERMINAL QUESTIONS/EXERCISES

Questions

1. Prepare a Profit and Loss statement of a company as per IND AS-1 and explain each line item of the Profit and Loss statement.
2. Prepare a classified balance sheet of a company as per IND AS-1 and explain each line and sub-line item of the balance sheet.

3. What are other comprehensive incomes? Explain its accounting treatment in the financial statement with examples.
4. What is EPS? How is it calculated? Explain the types of EPS a company discloses in the Profit and Loss statement.
5. What is the difference between current and non-current assets? Explain them with examples.
6. What is the difference between current and non-current liabilities? Explain them with examples.
7. What are financial assets and financial liabilities? Explain them with examples.
8. write short notes on the following:
   i) Bearer Assets ii) Biological Assets iii) Property, Plant and Equipment (PPP)
   iv) Employee Benefits v) other Equity
9. The following balances have been extracted from the books of the Panda Company Ltd. as on 31st March 2021:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Cash in hand	8,500	Creditors	5,000
Bills receivables	10,000	Interest on Government bonds	1,200
Debtors	20,000	Sales	2,60,000
8% Government bonds (on 30th June 2020)	30,000	20,000 shares of 10 each Rs.8 Paid-up	1,60,000
Security deposits	24,000	Profit and Loss of the last year	25,000
Buildings	80,000	Reserve fund	10,600
Furniture	20,000	Bank overdraft	3,000
Goodwill	30,000	Bank Loan	20,000
Closing stock	40,000		
Adjusted purchase	1,75,000		
Royalties	5,000		
Wages	15,000		
Salaries	10,800		
Commission on sales	12,600		
Printing and stationery	1,400		
Advertisement	2,500		
Total	4,84,800	Total	4,84,800

Additional information:

a) Charge depreciation @ 2% on building and 10% on furniture
b) Amounts Rs. 4,000 and Rs. 3,000 debited to purchase, and wages respectively were used for making furniture during the year
c) Advertisement includes unissued materials Rs. 500
d) Bills discounted not matured Rs. 20,000

Prepare profit and Loss statement and balance sheet of the company as per IND AS-1

(**Answer – Profit after tax Rs. 42,700 and Balance sheet Total Rs. 2,66,300**)

10. From the following balances of Energetic Company Ltd. as on 31st March 2021, prepare Profit and Loss Statement and Balance Sheet as per IND AS-1

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Land	10,000	Share capital 1,00,000	
Building	25,000	Less calls in arrear 6,400	
Plant and Machinery	15,000	-----------	93,600
Furniture and fixture	3,000	Bad debt provision	1,400
Carriage inwards	2,500	Sales	82,000
Wages	21,400	Purchase returns	5,400
Salaries	4,600	Creditors	13,200
Sales return	3,700	General Reserve	6,000
Bank charges	100	Securities premium	24,000
Coal, Gas, and water	700		
Rate, Tax, and Rent	800		
Purchases	52,000		
Bills receivables	1,200		
General expenses	1,900		
Sundry debtors	42,800		
Opening stock	25,000		
Fire insurance	400		
Cash in hand	11,000		
Cash at Bank	4,500		
Total	2,25,600	Total	2,25,600

Additional information:

a) Charge depreciation on building @ 2.5%, on Plant and Machinery @10% and on furniture and fixture @10%
b) Make a provision of 5% on debtors for bad debts
c) Unexpired fire insurance Rs.120
d) Outstanding wages Rs. 3,200
e) Outstanding salary Rs.500
f) Outstanding rent Rs. 200
g) Transfer to general reserve Rs.5,000
h) Closing stock Rs. 80,000

(**Answer- profit Rs. 47,355 and Balance Total Rs. 1,88,055**)

B. COM

SEMESTER III
COURSE: CORPORATE ACCOUNTING

UNIT-6 VALUATION OF GOODWILL AND SHARES

STRUCTURE

6.14 Terminal Questions/exercises

6.0 OBJECTIVES

After going through this unit, you should be able to:

- Understand the meaning of Goodwill and valuation of Shares;
- State the characteristics and nature of Goodwill;
- Identify the factors affecting the valuation of Goodwill and Shares;
- Determine the need for the valuation of Goodwill and Shares;
- Explain the methods of valuation of Goodwill and Shares

6.1 INTRODUCTION

In unit 5, we have learnt about the preparation of profit and loss account, and balance sheet of corporate entities without adjustments and with adjustments. In this unit, we shall learn about the concept of Goodwill and valuation of Shares, its nature, factors affecting the valuation of goodwill and shares, need for the valuation of Goodwill and Shares and several methods of valuation of Goodwill and Shares.

6.2 MEANING OF GOODWILL

Goodwill is the value of good name or the reputation of the business, which is earned by a firm through the hard work and honesty of its owners. If a firm renders good services to the customers, the customers who feel satisfied will come again and again and the firm will be able to earn more profits in future. Goodwill represents the loyal customer base, firm's brand name, and reputation for high quality of products due to which firm earns more profits above the normal profits. This excess of profits over the normal profits is known as super profits.

According to **Kohler,** *"Goodwill is the current value of expected future income in excess of the normal return on investment in net tangible assets."*

6.3 CHARACTERISTICS OF GOODWILL

Goodwill is an intangible asset. It is linked to the acquisition of one corporation by another. Goodwill is defined as the portion of the purchase price that is greater than the total of the net fair value of all assets acquired and liabilities taken in the transaction. There are numerous features of goodwill. They are as follow:

- It is an intangible asset.
- It is helpful in earning excess profits.
- Its value is liable to constant fluctuations.

- It is valuable at the time of sale of business.

6.4 FACTORS AFFECTING THE VALUE OF GOODWILL

The valuation of goodwill depends on several factors. They are as follows:

(a) Location of Business: If a company is in a prominent location, it will draw more consumers, has high sales, earns more profit and build more goodwill.

(b) Management: When a company has good and efficient management, it can generate greater profit and goodwill.

(c) Business longevity: The firm that has been in operation for a longer period of time, or that is older, is known by more customers and thus has more goodwill, as businesses can develop a better reputation over time.

(d) Nature of Product: In comparison to businesses that deal in fancy products, businesses that deal in daily products will have more constant profits and demand, and hence will have greater goodwill.

(e) Risk: If a company's risk is higher, it will have less goodwill; on the other hand, if the risk is lower, the company will have more goodwill.

(f) Competition: If there is a probability that the firm's competition will expand in the near future, the company's goodwill will reduce.

(g) Profit trend: If a company's profits are decreasing from previous years, i.e., profits are diminishing, the company's goodwill will reduce as well, and vice versa.

(h) Licence: If a company has an import licence, its goodwill will undoubtedly improve because it can take advantage of benefits that other companies without licences cannot avail.

(i) Requirement of Capital: The amount of capital required by the company has an impact on its goodwill. If both businesses generate the same rate of return, the one with less capital will have greater goodwill.

6.5 NEED FOR THE VALUATION OF GOODWILL

When a corporation buys another company, it gains goodwill. The quantity of goodwill is equal to the purchase price less the fair market value of the tangible and intangible assets, as well as the liabilities acquired during the transaction. The requirement for goodwill appraisal might arise in a variety of circumstances. They are as follows:

- When profit sharing ratio changes
- On admission of a partner
- On Retirement or death of a partner
- When amalgamation of two firms takes place
- When partnership firm is sold.

6.6 TYPES OF GOODWILL

Goodwill is generally of two types:

Purchased Goodwill: Purchased goodwill means goodwill for which a consideration has been paid e.g., when business is purchased, the excess of purchase consideration paid over its net assets i.e. (Assets – Liabilities) is the Purchased Goodwill. It is separately recorded in the books because it is purchased by paying in the form of cash or kind.

Characteristics

(i) It arises on purchase of a business or brand.
(ii) Consideration is paid for it so it is recorded in books.
(iii) It is shown in the balance sheet as an asset.
(iv) It is amortised (depreciated).
(v) Value is a subjective judgment & ascertained by agreement of seller & purchaser. It is approximate value and cannot be sold separately in the market or in parts.

Self-generated Goodwill: It is also called as inherent goodwill. It is an internally generated goodwill which arises from a number of factors that a running business possesses due to which it is able to earn more profits in the future.

Features

(i) It is generated internally over the years.
(ii) A true cost cannot be placed on this type of goodwill.
(iii) Value depends on subjective judgment.
(iv) It is not shown in the balance sheet as an asset because proper value cannot be assigned to it.

6.7 METHODS OF VALUATION OF GOODWILL

It is very difficult to determine the value of goodwill, because it is an intangible asset. When a firm is sold, the value is determined by the mutual agreement reached between the seller and the buyer. There are various methods for valuing goodwill, but the important methods are as follows:

a) Average Profit Method

b) Weighted Average Profit Method
c) Super Profit Method
d) Capitalization Method
e) Annuity Method
f) Purchase Method

6.7.1 Average Profit Method

Under this method, the goodwill is valued at agreed number of 'years' of purchase of the average profits of the past few years. It is based on the assumption that a new business will not be able to earn any profits during the first few years of its operations. Hence, the person who purchases a running business must pay in the form of goodwill a sum which is equal to the profits he is likely to receive for the first few years. The goodwill is calculated as follows:

Value of goodwill = Average Profit × Number of years of purchase

Illustration 1

The profit for the last five years of a firm were as follows: year 1999 Rs.5,00,000; year 2000 Rs.4,45,000; year 2001 Rs.4,50,000; year 2002 Rs.3,98,000 and year 2003 Rs.4,00,000. Calculate goodwill of the firm on the basis of 4 years purchase of 5 years average profits.

Solution:

Total Profit = 5,00,000 + 4,45,000 + 4,50,000 + 3,98,000 + 4,00,000 = Rs. 21,93,000

Average Profit = Total Profit/No. of years= 21,93,000/5 = Rs. 4,38,600

Goodwill = Average Profit × No. of years of Purchase= 4,38,600 × 4 = Rs. 17,54,400

6.7.2 Weighted Average Profit Method

This method is a modified version of the simple average profit method. In this method, the total product is computed by multiplying the adjusted profits calculated in step 2 above by the appropriate number of weights. The weighted average profits are calculated by dividing the total number of products by the total number of weights. After that, the weighted average profits are then multiplied by the number of years of purchase. This method is generally preferred when the profits show a consistent upward trend over time.

Weighted Average Profits = Total of Products of Profits/Total of weights
Goodwill = Weighted average profits × No of years of purchase

Illustration 2

The profits of Firm A from the last six years were as follows:

Year	Profit
2016	40,000
2017	20,000
2018	40,000
2019	50,000
2020	60,000
2021	70,000

Calculate the goodwill on the basis of four years' purchase of weighted average profits using weights 1,2,3,4,5 and 6 respectively.

Solution:

Year	Profits (Rs.)	Weights	Amount (Rs.)
2016	40,000	1	**40,000**
2017	20,000	2	**40,000**
2018	40,000	3	**1,20,000**
2019	50,000	4	**2,00,000**
2020	60,000	5	**3,00,000**
2021	70,000	6	**4,20,000**
Total		**21**	**11,20,000**

Weighted Average Profits = Total Product / Total Weights = 11,20,000 / 21 = Rs. 53,333
Goodwill = Weighted Average Profits × No. of years of purchase
Goodwill = Rs. 53,333 × 4 = Rs. 2, 13,332

6.7.3 Super Profit Method

The goodwill under the super profit method is ascertained by multiplying the super profits by certain number of years' purchase. Super profit is the excess profits earned over normal profit. The steps involved under the method are:

Step 1: Calculate the Capital Employed

Capital employed = Fixed Assets + Working Capital

Or

Capital Employed = Capital + Reserve/Accumulated Profits – Fictitious Assets

Or

Capital Employed = Fixed Assets + Current Assets – Outside Liabilities

Step 2: Calculation of Current Year profits after tax

Current years' Profit after Tax = [Current year's Profits – Abnormal Gain + Abnormal Loss – Normal Loss + Normal Gain] – Tax

Step 3: Calculation of Average Capital Employed

Average Capital Employed = Capital Employed – ½ of Current Year's Profit after tax

Step 4: Calculate Normal Profits by the following formula

Normal Profit = Average Capital Employed x [Normal rate / 100]

Step 5: Calculate the average/actual profit after tax

Step 6: Calculate the super profits by deducting normal profit from the average profits

Super Profit = Average/Actual Profit after Tax – Normal Profit

Step 7: Calculate goodwill by multiplying the super profits by the given number of years' purchase

Goodwill = Super Profit x Number of years of Purchase

Illustration 3

A firm earns profit of 65,000 on a capital of 4,80,000 and the normal rate of return in similar business is 10%. Then the normal profit is 48,000 [10% of the 4,80,000]. The actual profit is 65,000(Average profit).

Solution:

Super profit = Actual profit – Normal profit= 65,000 – 48,000= Rs17,000

If value of Goodwill is calculated by 3 years' purchase of super profit, then,

Goodwill = super profit x 3 years' purchase =17000 × 3 = Rs.51,000

Illustration 4

The Balance Sheet of ABC Ltd. shows the following information as on 31st March 2021

Equity and Liabilities	**Amount (Rs.)**
Share Capital 60,000 Equity Shares of Rs. 10 each fully paid up	6,00,000
Capital Reserve	1,10,000
Creditors	1,52,000
Provisions for Tax	1,00,000
Profit and Loss A/c	62,000
Total	**10,24,000**
Assets Goodwill	60,000
Plant and Machinery	2,00,000

Land and Building	3,30,000
Stock	2,30,000
Debtors	1,80,000
Cash	24,000
Total	**10,24,000**

Calculate the Value of Goodwill on the basis of three years purchase of Average Super Profits on the basis of the following information:

(i) The reasonable return on average capital employed invested in the class of business done by the company is 12%.

(ii) The rate of tax is 50%.

(iii) Profits of the company before tax are Rs. 2, 00,000.

Solution:

Step 1: Calculation of Capital Employed

Capital Employed = Fixed Assets + Current Assets – Outside Liabilities

Plant and Machinery	Rs. 2,00,000
Land and Building	Rs. 3,30,000
Stock	Rs. 2,30,000
Debtors	Rs. 1,80,000
Cash	Rs. 24,000
Total Assets	**Rs. 9,64,000**
Less: Provisions for Tax	Rs. 1,00,000
Less: Creditors	Rs. 1,52,000
Capital Employed	**Rs. 7,12,000**

Step 2: Calculation of Current year's Profit after tax

Current Year's Profit	Rs. 2,00,000
Less: Tax @ 50%	Rs. 1,00,000
Current year's profit after tax	Rs. 1,00,000

Step 3: Calculation of Average Capital Employed

Average Capital Employed = Capital Employed – ½ of Current Year's Profit after tax

Average Capital Employed = 7,12,000 - ½ x 1,00,000 = Rs. 6,62,000

Step 4: Calculation of Normal Profit

Normal Profit = Average Capital Employed x [Normal rate / 100]

Normal Profit = Rs. 6,62,000 x [12/100] = Rs. 79,440

Step 5: Calculation of Average/Actual profit after tax

Current year's profit	Rs. 2,00,000
Tax @ 50 %	Rs. 1,00,000
Actual profit after tax	Rs. 1,00,000

Step 6: Calculation of Super Profit

Super Profit = Average/Actual Profit after Tax – Normal Profit
Super Profit = Rs. 1,00,000 – Rs. 79,440 = Rs. 20,560
Step 7: Calculation of Goodwill
Goodwill = Super Profit x Number of years of Purchase
Value of Goodwill = Rs. 20,560 x 3 = Rs. 61,680

6.7.4 Capitalization Method

Under this method the goodwill can be calculated in two ways:

(a) By capitalizing the average profits
(b) By capitalizing the super profits

Capitalization of Average profit:

In this method, the value of goodwill is assumed to be excess of the capital value of average profit over the actual capital employed. The key steps involved in this method are as follows:

1. Computation of capitalised value of average profit = Average Profits × 100/Normal Rate of Return
2. Computation of capital employed= Total Assets (excluding goodwill) – outside liabilities
3. Computation of goodwill = Capitalised value of average profits – Capital employed

Illustration 5

A business has earned average profits of 40,000 during the last few years and the normal rate of return in a similar type of business is 10%. Ascertain the value of goodwill by capitalization method, given that the value of net assets of the business is 3,10,000.

Solution:

Capital Employed = Net assets= Rs. 3, 10,000
Capitalised value of average profit = Average Profit × 100/Normal rate of profit
= 40,000 × 100/10= Rs 4,00,000
Goodwill = Capitalised value – Capital employed = 4, 00,000 – 3,10,000= Rs. 90,000

Capitalisation of Super Profit

In this method, the value of goodwill is calculated on the basis of super profit method. Following formula is applied:

Goodwill = Super profit × 100/Normal rate of profit

Illustration 6

A firm earns a profit of 25,000 and has invested capital amounting to 2,20,000. In the same business normal rate of earning profit is 10%. Calculate the value of goodwill with the help of Capitalisation of super profit method.

Solution:

Actual profit = Rs. 25,000
Normal profit = 2, 20,000 x 10/ 100 = Rs. 22,000
Super Profit = Actual Profit – Normal Profit
= 25,000 – 22,000= Rs 3,000
Goodwill = Super profit × 100/Normal rate of profit
= 3,000 × 100/10= Rs 30,000

6.7.5 Annuity Method

Under this method, goodwill is calculated by taking average super profit as the value of an annuity over a certain number of years. The present value of this annuity is computed by discounting at the given rate of interest (normal rate of return). This discounted present value of the annuity is the value of goodwill. The value of annuity for Rupee 1 can be known by reference to the annuity tables.

Goodwill = Super Profit x Annuity

Illustration 7

The net profit after tax of company B for the last five years are as follows:

Year	Profit (Rs.)
2017	40,000
2018	50,000
2019	30,000
2020	70,000
2021	80,000

The net tangible assets in the business are Rs. 5,00,000 on which the normal rate of return is expected to be 10%. It is expected that company B will be able to maintain its super profits for next five years. Calculate the value of goodwill of the business on the basis of an annuity of super profits, taking present value of an annuity of Rs. 1 for five years at 10% interest is Rs. 3.78.

Solution:

Average Profit = (40,000 + 50,000 + 30,000 +70,000 + 80,000) / 5 = Rs. 54,000
Normal Profit = Capital Employed x normal rate of return = 5,00,000 x 10% = 50,000
Super Profit = Average Profit – Normal Profit = 54,000 – 50,000 = 4,000
Value of Goodwill = Super Profit x Value of an annuity = 4,000 x 3.78 = Rs. 15,120

6.7.6 Purchase Method

Under this method, goodwill is calculated as the excess of purchase consideration over the net assets of the business. The purchase consideration is the amount received at the time of sale of the assets.

Net Assets = Total Assets – Outside Liabilities

Goodwill = Purchase consideration – Net assets

Illustration 8

The balance sheet of XYZ Ltd. shows the following information as on 31st March 2021

Equity and Liabilities	**Amount (Rs.)**
Share Capital 20,000 Equity Shares of Rs. 10 each fully paid up	2,00,000
General Reserve	10,000
Creditors	27,500
Workmen Compensation Fund	20,000
Profit and Loss A/c	32,500
Total	**2,90,000**
Assets Plant and Machinery	70,000
Land and Building	92,500
Patent	5,000
Debtors	80,000
Cash	40,000
Advertisement	2,500
Total	**2,90,000**

The company was purchased by B Ltd. which pays Rs. 4,00,000. Calculate the value of Goodwill as per Purchase Method.

Solution:

Step 1: Calculation of Capital Employed

Capital Employed = Total Assets (Fixed Assets + Current Assets) – Outside Liabilities

Plant and Machinery	Rs. 70,000
Land and Building	Rs. 92,500
Patent	Rs. 5,000
Debtors	Rs. 80,000
Cash	Rs. 40,000
Total Assets	Rs. 2,87,500
Less: Creditors	Rs. 27,500
Capital Employed	Rs. 2,60,000

Step 2: Calculation of Value of Goodwill

Purchase Consideration	Rs. 4,00,000
Less: Capital Employed	Rs. 2,60,000
Goodwill	Rs. 1,40,000

6.8 MEANING OF VALUATION OF SHARES

According to Section 2 (46) of the Companies Act, 2013, a share is a share in the share capital of a company, and includes stock except where a distinction stock and shares is expressed or implied. The person who is the owner of the shares is called 'Shareholder' and the return he gets on his investment is called 'Dividend'. **Stock valuation is a process to determine the intrinsic value of a stock.** Share valuation is done based on quantitative techniques and share value will vary depending on the market demand and supply. The share price of the listed companies which are traded publicly can be known easily. However, in the case of private companies whose shares are not publicly traded, share valuation is extremely significant and difficult. The reasons behind valuation of shares are:

- Where there is no market price of the shares as in the case of proprietary companies
- Where the market price does not reflect the true or intrinsic value of the shares

6.9 FACTORS AFFECTING THE VALUATION OF SHARES

Valuation of goodwill and valuation of shares are inter-related. The value of a share is greatly affected by the economic, political and social factors. The factors are:

- Dividend declared by the company in the last years
- Demand and supply of the shares of the company
- Nature of the business
- Future prospect of the business
- Rate of return of the business
- Political condition

- Limitation of government control over the company
- Financial Ratios
- Position of peace and security in the country
- Accumulated reserves of the company
- Prospects of bonus or right issues
- Capital structure of the company
- Number of shareholders
- Management of the company
- Net tangible assets of the company
- Economic conditions of the country

6.10 NEED FOR THE VALUATION OF SHARES

The need for a share valuation arises in the following situations:
(a) For amalgamation and reconstructions: It is necessary to calculate the value of the shares when the companies amalgamate and or reconstructed.
(b) At the time of dissolution: When the partners' shares are held jointly and the firm dissolves, it is required to value the shares in order to properly distribute the partnership property among the partners.
(c) Transfer of shares: When a member of a proprietary firm wishes to give a portion of their shares to another member because they are unable to sell them on the open market, the auditor or accountant must certify the fair pricing of the shares.
(d) At the time of taking loan: When a loan is taken out against the security of shares, it is important to value the shares on which the loan is based.
(e) At the time of conversion: When preference shares or debentures are to be converted into equity shares, the value of the equity shares must be determined in order to calculate the number of equity shares to be issued in place of the preference shares or debentures.
(f) Share of private company: Private company shares are not traded on a stock exchange. The value of such companies' shares must be determined before they may be sold.
(g) At the time of appraisal of shares: When a company's shares aren't traded on a stock exchange and shareholders want to know how much their shares are worth, a share valuation is necessary.
(h) For determination of gift and wealth tax: When shares are received as a gift, the value of the shares must be determined for the purposes of calculating the gift duty and determining the wealth tax by the taxation authorities.
(i) For declaring the Net Assets Value: The valuation of shares is required to find the correct value of assets for declaring the net assets value.

6.11 METHODS OF VALUATION OF SHARES

The different methods of valuation of shares are discussed as under:

a. Net Assets/Intrinsic Value/Breakup Value Method
b. Dividend Yield method
c. Earning Capacity Method
d. Fair Value Method

6.11.1 Net Assets/Intrinsic Value/Breakup Value Method

This method is based on the value of company's Net Asset Value and Shares. Under this method, the value of share is calculated by dividing company's Net Asset Value with the number of shares.

Following are some of the important points to be considered at the time of valuing shares under this method:

- It is necessary to estimate the net tangible assets.
- Non- trading assets are also included in the assets (investment made outside)
- The assets are taken at the market value/realizable value
- Fictitious assets should be ignored
- Intangible assets should be considered.
- Investments are also taken at the market value
- Contingent liabilities likely to mature should be deducted
- Adequate provision should be made
- Claims for preference shareholders should be deducted
- In the absence of market price, book value is also considered.

First Method

Calculation of Net Tangible Assets:

		Rs.
Non-current Assets		------------
Investments		------------
Current Assets		------------
Less:		
Outside Liabilities	-----	
Preference share capital	-----	-------------
Net Tangible Assets		**-------------**

Second Method:

Net Assets = Equity Share Capital + Reserves and Surplus + Accumulated Profits + Profit on Revaluation of Assets – Accumulated Losses – Preliminary Expenses

$$\textbf{Value of Share} = \frac{\text{Value of Net Tangible Assets or Net Assets}}{\text{Number of Equity Shares}}$$

Suitability of the method:

This method is suitable under these conditions:

- When the company is intended to be liquidated.
- When the company is continuously making losses and there are no chances of future prospects.
- When the scheme of amalgamation is formulated.

Illustration 9

The following information of a company are available:

a. Equity share capital: 20,000 Shares of Rs. 20 each fully paid.
b. Reserves: 2,80,000; Profit and Loss A/c 1,60,000.
c. 12% Debentures: 3,00,000; Creditors 1,44,000; Provision for Taxation: 40,000; Employees Provident Fund: 1,15,000.
d. Goodwill: 2,20,000; Plant and Machinery: 2,90,000; Furniture: 50,000.
e. Investments: 4,00,000; Stock: 2,20,000; Debtors: 1,10,000; Bank Balance: 50,000; Preliminary Expenses: 30,000.

Goodwill is revalued at Rs. 2,40,000. Plant and Machinery is expected to realize Rs. 2,95,000. Debtors are subjected to the Provision for bad debts @ 7%. Calculate the value of the share on the Net Asset Basis.

Solution:

Step 1: Calculation of Net Tangible Assets

	Rs.
Goodwill	**2,40,000**
Plant and Machinery	**2,95,000**
Furniture	**50,000**
Investments	**4,00,000**
Stock	**2,20,000**
Debtors	**1,11,600**
(1,20,000 – 7% of 1,20,000)	
Bank Balance	**50,000**
Less: 12% Debentures	**3,00,000**
Less: Creditors	**1,44,000**
Less: Provision for Taxation	**40,000**
Less: Employees Provident Fund	**1,15,000**
Net Tangible Assets	**7,67,600**

$$\textbf{Value of Share} = \frac{\textbf{Net Tangible Assets}}{\textbf{No. of Equity Shares}} = \frac{7,67,000}{20,000} = \textbf{Rs. 38.35}$$

6.11.2 Dividend Yield Method

One of the main limitations of the net assets method is that it can be used at the time of liquidation only. But the **Shareholders are always curious about the value of their stock in terms of their investment return. So, they compare their returns with the price paid by**

them for the share. So, under this method, the value of the share is calculated by comparing the expected rate of dividend with the normal rate of dividend which is prevailing in the company.

$$\textbf{Value of Share} = \frac{\textbf{Expected Rate of Dividend}}{\textbf{Normal Rate of Dividend}} \times \textbf{Paid-Up Value per Share}$$

Calculation of Expected Rate of Dividend: For the calculation of the expected rate of dividend, the profit available for equity shareholders is calculated.

Calculation of Profit Available for Equity Shareholders:

	Rs.
Profit Before Tax	------------
Less: Income Tax	------------
Less: Transfer to Reserve	------------
Less: Transfer to any Fund	------------
Less: Preference Dividend	------------
Less: Transfer to Debenture Sinking Fund	------------
Profit Available for Equity Shareholders	-------------

$$\textbf{Expected Rate of Dividend} = \frac{\textbf{Profit Available for Equity Shareholders}}{\textbf{Paid-Up Equity Share Capital}} \, \textbf{100}$$

Calculation of Normal Rate of Dividend: Normally, Normal Rate of Dividend is given in the question.

Suitability of the Method

This method is suitable under these conditions:

- The shareholders who hold the shares for short term and primarily interested in the dividend.
- When the company is declaring regular dividend.

Illustration 10

From the following information relating to a company calculate the value of the share with Dividend Yield Method.

Issued Equity Share Capital: 10,000 shares of Rs. 10 each

Paid-up Equity Capital: Rs. 8 per share

5% Preference Share Capital: 1,00,000 shares of Rs. 10 each fully paid up

Annual transfer to General Reserve: 20%

Rate of Tax: 50%

Expected Profit before Tax: 3,00,000

Normal Rate of Dividend: 15%

Solution:

Step 1: Calculation of Profit available for Equity Shareholders

	Rs.
Expected Profit before Tax	**3,00,000**
Less: Tax @ 50%	**1,50,000**
Profit after Tax	**1,50,000**
Less: Transfer to General Reserve at 20% of 1,50,000	**30,000**
Profit available for Shareholders	**1,20,000**
Less: Preference dividend 5% on 10,00,000	**50,000**
Profit available for Equity Shareholders	**70,000**

Step:2 Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholders}}{\text{Paid-Up Equity Share Capital}} \times 100$$

$$= \frac{70{,}000}{80{,}000} \times 100 = 87.5\%$$

Step 3: Calculation of Value of Equity Share

$$\text{Value of Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Dividend}} \times \text{Paid-Up Value per Share}$$

$$= \frac{87.5}{15} \times 8 = \text{Rs. } 46.67$$

6.11.3 Earning Capacity Method

This method is particularly suitable in the case of big investors because they are more interested in the company's earnings rather than the company distributes in the form of dividend. This method assumes that the company will continue to operate its business in the near future. Under this method, value of share is calculated as follows:

$$\text{Value of Share} = \frac{\text{Rate of Earnings}}{\text{Normal Rate of Return}} \times \text{Paid-Up Value per Share}$$

Calculation of Rate of Earnings: The formula for rate of earnings is as follows:

$$\text{Rate of Earnings} = \frac{\text{Estimated Future Earnings}}{\text{Capital Employed}} \; 100$$

Calculation of Estimated Future Earnings: For calculating future earnings the following adjustments are to be made in the profits:

- The abnormal loss if any adjusted from the profits should be added back to the profits or vice versa.

- Any income from the investment should be excluded.
- Any incomes/expenses which affect the past profits should be adjusted.
- Income tax is to be deducted.
- Interest on debentures/bonds/ bank loan is then added back to the profits.

Calculation of Capital Employed: The capital employed is calculated as follows:

Capital Employed = Total Assets at market value – investments outside – current liabilities

Illustration 11

From the following information relating to a company calculate the value of the share with Earning Capacity Method.

a. **Equity Share Capital: 60,000 shares of Rs. 10 each; General Reserve: 1,30,000**
b. **10% Debentures: 1,50,000; Current Liabilities: 1,20,000**
c. **Total Assets including Goodwill: 10,00,000**

The market value of the assets is 10% higher. The company earns the Profit of Rs. 3,66,000 p.a. after interest on Debentures but before Tax. The Normal Rate of Return is 12%. Assume Income Tax Rate at 50%.

Solution:

Step 1: Calculation of Profit Earned

	Rs.
Annual Profit	3,66,000
Less: Income Tax@50%	1,83,000
Profit after Tax	**1,83,000**
Add: Interest on Debentures (10% on 1,50,000)	15,000
Profit after tax but before interest	**1,98,000**

Step 2: Calculation of Capital Employed

	Rs.
Total Assets	10,00,000
Add: Increase in Market Value (10% of 10,00,000)	1,00,000
Gross Capital Employed	**11,00,000**
Less: Current Liabilities	1,20,000
Net Capital Employed	**9,80,000**

Step 3: Calculation of Rate of Earnings

$$\textbf{Rate of Earnings} = \frac{\textbf{Estimated Future Earnings}}{\textbf{Capital Employed}} \times \textbf{100}$$

$$= \frac{1,98,000}{\mathbf{9,80,000}} \times 100 = 20.20$$

Step 4: Calculation of Value of Shares

$$\textbf{Value of Share} = \frac{\textbf{Rate of Earnings}}{\textbf{Normal Rate of Return}} \times \textbf{Paid-Up Value per Share}$$

$$= \frac{\mathbf{20.20}}{\mathbf{12}} \times \mathbf{10} = \textbf{Rs. 16.83}$$

6.11.4 Fair Value Method:

Under this method, the value of the share is calculated by averaging the value under any two methods to show the true and fair view of the value of the share.

$$\textbf{Fair Value Per Share} = \frac{\textbf{Value as per Net Assets Method + Value as per Dividend Yield Method}}{\mathbf{2}}$$

Or

$$\textbf{Fair Value Per Share} = \frac{\textbf{Value as per Net Assets Method + Value as per Earning Capacity Method}}{\mathbf{2}}$$

Illustration 12

The Balance Sheet of Z Ltd. As on 31st March 2021 is as follows:

a) **Equity Share Capital: 4,000 shares of Rs. 200 each; General Reserve: 10,000.**
b) **Investment Fluctuation Fund: 25,000; 8% Debentures: 1,00,000; Creditors: 35,000.**
c) **Goodwill: 60,000; Land and Building: 2,00,000; Plant and Machinery: 2,00,000.**
d) **Furniture: 40,000; Investments 1,00,000; Stock: 2,10,000; Debtors: 90,000; Cash: 70,000.**

The Goodwill was valued at Rs. 50,000. All the fixed assets are 20% above their book values. Stock and Debtors are valued 10% below their book values. The company earns the Profit of Rs. 3,47,200 p.a. The Normal Rate of Return is 16%. Assume Income Tax Rate at 50%. Calculate the Fair value of share of the company.

Solution:

Calculation of Value of Share by Net Assets Method

Step 1: Calculation of Net Assets

Net Assets = Net Tangible Assets – Outside Liabilities

	Rs.
Goodwill	50,000
Land and Building (2,00,000+20%)	2,40,000
Plant and Machinery (2,00,000+20%)	2,40,000
Furniture (40,000 + 20%)	48,000
Investments	75,000
Stock (2,10,000-10%)	1,89,000
Debtors (90,000-10%)	81,000
Cash	70,000
Less: 8% Debentures	1,00,000
Less: Creditors	35,000
Net Tangible Assets	**8,58,000**

Step 2: Calculation of Value of Share

$$\textbf{Value of Share} = \frac{\textbf{Net Tangible Assets}}{\textbf{No. of Equity Shares}} = \frac{\textbf{8,58,000}}{\textbf{4,000}} = \textbf{Rs. 214.50}$$

Calculation of Value of Share by Earning Capacity Method

Step 1: Calculation of Profit Earned

	Rs.
Annual Profit	3,47,200
Less: Income Tax@50%	1,73,600
Profit after Tax	**1,73,600**
Add: Interest on Debentures (8% on 1,00,000)	8,000
Profit after tax but before interest	**1,81,600**

Step 2: Calculation of Capital Employed

	Rs.
Goodwill	50,000
Land and Building (2,00,000+20%)	2,40,000
Plant and Machinery (2,00,000+20%)	2,40,000
Furniture (40,000 + 20%)	48,000
Stock (2,10,000-10%)	1,89,000
Debtors (90,000-10%)	81,000
Cash	70,000
Less: Creditors	35,000
Net Capital Employed	**8,83,000**

Step 3: Calculation of Rate of Earnings

$$\text{Rate of Earnings} = \frac{\text{Estimated Future Earnings}}{\text{Capital Employed}} \times 100$$

$$= \frac{1,81,600}{8,83,000} \times 100 = 20.57$$

Step 4: Calculation of Value of Shares

$$\text{Value of Share} = \frac{\text{Rate of Earnings}}{\text{Normal Rate of Return}} \times \text{Paid-Up Value per Share}$$

$$= \frac{20.57}{16} \times 200 = \text{Rs. } 257.12$$

Calculation of Fair Value of Per Share

$$\text{Fair Value Per Share} = \frac{\text{Value as per Net Assets Method} + \text{Value as per Earning Capacity Method}}{2}$$

$$= \frac{214.50 + 257.12}{2} = \text{Rs. } 235.81$$

6.12 KEYWORDS

Goodwill: The reputation of the business, which is earned by a firm through the hard work and honesty of its owners.

Normal Profits: The amount of profit that can be predicted based on the normal rate of return.

Super Profits: Excess of average expected profits over normal profits.

Capital Employed: Capital Employed is the entire amount of money spent on running a firm in order to make money, and it's commonly determined by adding working capital to fixed assets.

Intrinsic Value of Share: Intrinsic value is the anticipated or calculated value of a company, stock, determined through fundamental analysis.

Fair Value of Share: The recognised current worth of one share of a private company's common stock is known as fair market value. It shows how much the stock would be worth if it were traded on the open market.

6.13 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand

- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House, New Delhi.
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co., New Delhi.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication, New Delhi.
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

6.14 TERMINAL QUESTIONS/EXCERSISES

Questions

Valuation of Goodwill

1. What do you understand by Goodwill. Explain the various characteristics of Goodwill.
2. Define Goodwill. Describe the factors affecting the value of goodwill.
3. Discuss various methods of valuation of Goodwill with suitable examples.
4. Explain Super Profit method of valuation of Goodwill.
5. State the necessity for valuation of Goodwill.
6. Write short notes:
   a. Net Assets Method
   b. Yield Method
   c. Annuity Method
7. The following information are available in respect of C Ltd. business.

(a) Profit for the past three years are: 2018-19: Rs. 1,50,000; 2019-20: Rs. 60,000; 2020-21: Rs. 55,000

(b) Average Capital Employed: Rs. 3,00,000

(c) Normal rate of return: 10%

(d) Present value of annuity of one rupee for 5 years at 10%: 3.78

(e) The profit included non-recurring profit on an average basis of Rs. 3,000.

Calculate the value of goodwill as per;

(i) Five years purchase of super profits

(ii) Capitalization of super profit method

(iii) Annuity method

(Answer: Goodwill: Rs. 1,10,000; Rs. 2,20,000; Rs. 83,160)

8. From the following information, calculate the value of Goodwill at 4 years purchase of super profits;

(a) Net profits for past four years were: 1,60,000; 1,48,500; 2,11,000; 1,78,500
(b) Capital employed: 12,00,000
(c) The profit included non-recurring profits on an average basis of Rs. 14,500
(d) The normal rate of return is 11%.

(Answer: Super Profit: Rs. 28,000; Goodwill: Rs. 1,12,000)

9. Capital Employed: Rs. 30,00,000
Normal rate of return: 12%
Future maintainable profits: 4,08,000
Calculate the value of goodwill by using Capitalization method.
(Answer: Goodwill: Rs. 4,00,000)

10. The profits of ABC Company, for the past five years are: 40,000, 42,000, 45,000, 46,000, 47,000. The capital employed is 4,00,000. The normal rate of return is 10%. Calculate the value of goodwill on the basis of annuity of super profits (Present value of annuity of one rupee for five years at 10% interest as Rs. 3.78. Calculate goodwill on 5 years purchase of super profit.

(Answer: Goodwill (Annuity) Rs. 15,120; Goodwill (Super Profit) Rs. 20,000)

11. The balance sheet of Agarwal Ltd. shows the following information as on 31st March 2021

Equity and Liabilities	**Amount (Rs.)**
Share Capital 10,000 Equity Shares of Rs. 10 each fully paid up	1,00,000
General Reserve	15,000
6% Debentures of Rs. 100 each	25,000
Profit and Loss Account: Balance as on 01.04.2020 Rs. 5,000 Profit for the year Rs. 40,000	45,000
Creditors	10,000
Provision for Taxation	5,000
Total	**2,00,000**
Assets Plant and Machinery	40,000
Goodwill	20,000
Land and Building	45,000
Investment	20,000
Stock	25,000
Debtors	20,000
Cash	25,000

Discount on Issue of Debentures	5,000
Total	**2,00,000**

The assets are revalued as: Plant and Machinery Rs. 50,000; Land and Building Rs. 40,000; Investments Rs. 25,000; Profit includes Rs. 1,000 incomes from investment. Calculate the value of Goodwill on the basis of 3 years purchase of Super-Profit as per Purchase Method. The Normal rate of return is 12%.

(Answer: Goodwill: Rs. 12,060)

12. The balance sheet of Sahoo Ltd. shows the following information as on 31st March 2021

Equity and Liabilities	**Amount (Rs.)**
Share Capital 15,000 Equity Shares of Rs. 10 each fully paid up	1,50,000
General Reserve	15,000
Profit and Loss Account:	45,000
Workmen Compensation Fund	15,000
Creditors	38,000
Total	**2,00,000**
Assets Plant and Machinery	40,000
Land and Building	80,000
Trade Marks	15,000
Debtors	1,00,000
Cash	25,000
Advertisement Outlay	3,000
Total	**2,63,000**

The company was purchased by Das Ltd. Which pays Rs. 2,50,000 in all. The Plant and Machinery is valued at Rs. 65,000. Calculate the value of goodwill.

(Answer: Goodwill: Rs. 28,000)

Valuation of Share

13. What do you understand by valuation of shares. Explain the various factors that influence the value of shares.
14. State the necessity for valuation of Shares.
15. Discuss various methods of valuation of Shares with suitable examples.
16. Write short notes:

a. Earning Capacity Method
b. Fair Value Method
c. Dividend Yield Method

17. Calculate the value of equity share from the following information:

a) **Equity Share Capital: 60,000 shares of Rs. 10 each, Rs. 7 paid up; General Reserve: 20% of profits.**
b) **2000 Preference shares (10%) of Rs, 100 each fully paid up; Expected annual profits before tax: 4,00,000.**

The Normal Rate of Return is 20%. Assume Income Tax Rate at 35%. Calculate the Fair value of share of the company.

(Answer: Value of share: Rs. 15.67)

18. The expected rate of return – 20%
The normal rate of return – 12%
Face value per share – 50
Paid-up value per share – 30

Calculate the value of equity share on the basis of Earing Yield Method.

(Answer: Value of share: Rs. 50)

19. Consider the following information relating to ABC Limited:

a) 10,000 Equity Shares of Rs. 10 each, Rs. 9 paid-up
b) 30,000 8% Preference Share Capital of Rs. 10 each fully paid

The expected profit (before tax) is Rs. 84,000. The Tax Rate is 50%. The normal rate of return is 12%. Calculate Profit available for equity shareholders, rate of earnings and the yield value per share.

(Answer: Profit available for ESH: 18,000 Earning Rate: 20%, Value of share: Rs. 15)

20. Calculate the fair value price of equity shares of XYZ limited as under:

(a) Value as per Net Assets method: 140
(b) Value as per Yield method: 160
(c) Face value per share: 100
(d) Paid-up value per share: 80
(e) Normal rate of return: 8%

(Answer: Value of share Rs. 150)

21. The Balance Sheet of Mishra Ltd. as on 31st March 2021 as follows:

Equity and Liabilities	**Amount (Rs.)**
Share Capital 40,000 Equity Shares of Rs. 20 each fully paid up	8,00,000
General Reserve	1,80,000

12% Debentures	1,80,000
Profit and Loss Account	80,000
Current Liabilities	2,80,000
Total	**15,20,000**
Assets Fixed Assets	10,50,000
Current Assets	4,00,000
Goodwill	30,000
Preliminary Expenses	40,000
Total	**15,20,000**

On 31st March, 2021 Fixed Assets are revalued at Rs. 7,00,000 and the Goodwill at Rs. 1,00,000. Compute the value of share by Net Assets Method.

(Answer: Value of share Rs. 18.50)

22. The Balance Sheet of Z Ltd. as on 31st March 2021 as follows:

Equity and Liabilities	**Amount (Rs.)**
Share Capital 60,000 Equity Shares of Rs. 10 each fully paid up	6,00,000
General Reserve	1,70,000
12% Debentures	1,20,000
Current Liabilities	1,10,000
Total	**10,00,000**
Assets (Including goodwill)	10,00,000
Total	**10,00,000**

It is expected that the value of assets will enhance by 10%. The company earns Rs. 4,00,000 per annum after interest on debentures but before tax. The normal rate of return is 12%. Assume the income tax is 50%. Calculate the value of share with earning capacity method.

(Answer: Rate of Earnings: 20.62; Value of share Rs. 17.18

B. COM

SEMESTER III
COURSE: CORPORATE ACCOUNTING

UNIT-7: AMALGAMATION: ACCOUNTING STANDARD

STRUCTURE

7.0 OBJECTIVES

After going through this unit, you should be able to:

- Explain the meaning, objective, merits, and demerits of amalgamation
- Understand the Provisions of AS 14 "Accounting for Amalgamation"
- Understand the Provisions of Ind AS 103 "Business Amalgamation

7.1 INTRODUCTION

In order to derive the economies of large-scale production and to eliminate or reduce the competition, two or more than two companies engaged in the similar nature of business, may combine their undertakings. Combination of the undertakings reduces the duplication of expenditures, decreases the amount of risk of competition and also reduces cost per unit of the production. Amalgamations help in diversification of business. If a company wants to enter a new line of business, it will easier and economical to amalgamate with another company that is already matured in the business rather than setting up the whole new venture from the scratch.

7.2 MEANING OF AMALGAMATION

In an amalgamation, two or more companies are combined into one by merger or by one taking over the other. Therefore, the term 'amalgamation' contemplates two kinds of activities:

(i) two or more companies join to form a new company or

(ii) absorption and blending of one by the other. Thus, amalgamation include absorption.

The purpose of companies joining together is to secure various advantages such as economies of large-scale production, avoiding competition, increasing efficiency, expansion etc.

The companies going into liquidation or merged companies are called vendor companies or transferor companies. The new company which is formed to take over the liquidated companies or the company with which the transferor company is merged is called transferee or vendee.

Amalgamation of Companies

When two or more companies having similar nature of business merge their businesses in order to form a new company, such a merging is known as amalgamation of companies. In other words, two or more existing companies will liquidate themselves and a new company will be formed to take over the business of these companies. Example: Suppose there are two companies X Limited and Y Limited engaged in the similar nature of business. In the case of amalgamation, these two companies will liquidate themselves and a new company (assume X Y Ltd.) will be formed to take over the business of these two existing companies.

Absorption of Companies

In absorption, an existing company takes over the business of one or more existing companies, which dissolve their businesses. In other words, no new company will be formed to take over the business of the liquidating companies. Only an existing company will acquire the business of these companies. Example: If A Limited (an existing company) acquires the business of B Limited (an existing company), it will be a case of absorption. In this case, B Limited has to dissolve itself.

7.3 OBJECTIVES OF AMALGAMATION

- To eliminate or reduce cut-throat competition.
- To reap the economies of the production of goods and services on a large scale.
- To gain control over the market.
- To gain the benefits of the service of the experts.
- To promote research and development schemes.
- To derive the other advantage of the amalgamation.

7.4 MERITS OF AMALGAMATION

- After the amalgamation of two or more companies, the prevailing competition among themselves is eliminated.
- On the amalgamation of two or more companies, certain expenses are reduced.
- When two or more companies amalgamate themselves, it is easy for them to control the market through the supply of goods.
- If there is an amalgamation of two or more companies, there will be more capital and the problem of finance will be removed.
- After amalgamation of companies, there will be greater control on the business.
- Production on a larger scale is possible through the amalgamation of two or more companies.
- In the case of amalgamation, it is possible to avail of the services of experts otherwise, heavy remuneration has to be paid to experts.
- After the amalgamation of companies, distribution channel of the products becomes easy.

7.5 DEMERITS OF AMALGAMATION

- Amalgamation of companies may give rise to problems of over-capitalization.
- Amalgamation of companies reduces the expenditure, cost and price of the products of bigger companies, smaller businessmen therefore, cannot last long when confronted by the bigger players.
- Upon increasing the size of the business after amalgamation, managerial problems multiply.
- The possibilities of exploitation of customers by amalgamated companies are manifold.
- There is also one more danger of monopoly by the amalgamation of company.
- Increased production by the amalgamated companies may give rise to problems of proper distribution and over-production.

- The event of non-cooperation between the managerial staff of the amalgamated companies, may retard the growth of the business.

7.6 ACCOUNTING STANDARD (AS) 14 "ACCOUNTING FOR AMALGAMATION"

- *The following terms are used in the statement with the meaning specified:*

(a) Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 1956, or any other statute which may be applicable to companies.

(b) Transferor Company means the company, which is amalgamated into another company.

(c) Transferee Company means the company into which a transferor company is amalgamated.

(d) Reserve means the portion of earnings, receipts, or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability.

(e) Amalgamation in the nature of merger is an amalgamation, which satisfies all the following conditions:

> (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
>
> (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held, therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
>
> (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
>
> (iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
>
> (v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company, except to ensure uniformity of accounting policies.

(f) Amalgamation in the nature of purchase is an amalgamation that does not satisfy any one or more of the conditions specified in sub-paragraph (e) above.

(g) Consideration for the amalgamation means for the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to theshareholders of the transferor company.

(h) Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

(i) Pooling of interest is a method of accounting for amalgamation, the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

- *Methods of Accounting for Amalgamations*

There are two main methods of accounting for amalgamations:

(a) the pooling of interests method; and

(b) The purchase method.

The use of the pooling of interests method is confined to amalgamation in the nature of merger. The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets. This method is used in accounting for amalgamations in the nature of purchase.

The Pooling of Interest Method

Under the pooling of interests method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts

If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with Accounting Standard (AS)–5, 'Prior Period and Extraordinary Items and Changes in Accounting Policies'.

The Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts, or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company. Example: The transferee company may have a specialized use for an asset, which is not available to other potential buyers. The transferee company may intend to effect changes in the activities of the transferor company which necessitate the creation of specific provisions for the expected costs, e.g., planned employee termination and plant relocation costs.

❖ *Consideration*

The consideration for the amalgamation may consist of securities, cash or other assets. In determining the value of the consideration, an assessment is made of the fair value of its elements. A variety of techniques is applied in arriving at fair values. Example: When the consideration includes securities, the value fixed by the statutory authorities may be taken to be the fair value. This 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.

Many amalgamations recognize that adjustments may have to be made to the consideration in the light of one or more future events. When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration. In all other cases, the adjustment is recognized as soon as the amount is determinable.

❖ *Treatment of Reserves on Amalgamation*

If the amalgamation is an 'amalgamation in the nature of merger' the identity of the reserves is preserved, and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company; the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company. As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation. The difference between the amounts recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of the transferee company.

If the amalgamation is an ‘amalgamation in the nature of purchase’, the identity of the reserves, other than the statutory reserves dealt with in paragraph 1, is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation and dealt with in the manner stated in next section (Treatment of Goodwill arising on Amalgamation). If the result of the computation is positive, the difference is credited to Capital Reserve.

Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under the Income-tax Act, 1961; for example, Development Allowance Reserve, or Investment Allowance Reserve. The Act requires that the identity of the reserves should be preserved for a specified period. Likewise, certain other reserves may have been created in the financial statements of the transferor company in terms of the requirements of other statutes. Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as ‘statutory reserves’) and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statues.

This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with. In such cases, the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable accounts head ‘Amalgamation Adjustment Accounts’ which is disclosed as a part of ‘miscellaneous expenditure’ or other similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

❖ *Treatment of Goodwill Arising on Amalgamation*

Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortized to income on a systematic basis over its useful life. Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is, however, made on a prudent basis. Accordingly, it is considered appropriate to amortized goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

Factors which may be considered in estimation the useful life of goodwill arising on amalgamation include:

(a) The foreseeable life of the business or industry.

(b) The effects of product obsolescence, changes in demand and other economic factors.

(c) The service life expectancies of key individuals or groups of employees.

(d) Expected actions by competitors or potential competitors; and

(e) Legal, regulatory or contractual provisions affecting the useful life.

❖ *Balance of Profit and Loss Account*

In the case of an 'amalgamation in the nature of merger' the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve if any.

In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company whether debit or credit, loses its identity.

❖ *Treatment of Reserve Specified in a Scheme of Amalgamation*

The scheme of amalgamation sanctioned under the provisions of the Companies Act, 1956 or any other statute may prescribe the treatment to be given to the reserve of the transferor company after its amalgamation. Where the treatment is so prescribed, the same is followed.

❖ *Amalgamation after balance sheet date Under Non Ind AS Scenario*

If the financial statements are pending approval by the members in General Meeting, then it is possible to give effect to the amalgamation in case the appointed date is before the end of the financial year.

If the financial statements are already approved by the members in general meeting, then the effect will be given only in the next set of financial statements.

❖ *Acquisition under Business Transfer Agreement (BTA)*

Acquisition of business under BTA is not covered for accounting under AS-14.

Such acquisitions are not covered under any specific standard except that the provisions of AS-10 would apply to such acquisitions to a limited extent.

As per AS-10, the value of the consideration paid is to be apportioned on a fair basis over the assets and liabilities. Therefore, in the case of acquisitions of business under BTA, where specific value of individuals components of the business are not identified, normally the accounting would be as follows

- All current assets including would be accounted at their realizable value.
- All liabilities would be accounted at their respective fair value
- The balance consideration would apportion over the fair value of the PPE.
- If the balance consideration is higher than the aggregate of the fair value of PPE then the PPE would be accounted at fair and the difference would be accounted as Goodwill or another Intangible asset, if identifiable.

❖ *Disclosure*

For all amalgamations, the following disclosures are considered appropriate in the first financial statements following the amalgamation:

(a) Names and general nature of business of the amalgamating companies.

(b) Effective date of amalgamation for accounting purpose.

(c) The method of accounting used to reflect the amalgamation; and

(d) Particulars of the scheme sanctioned under a statute.

For amalgamation accounted for under the pooling of interests method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

(a) Description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;

(b) The amount of any difference between the consideration and the value of net identifiable assets acquired and the treatment thereof.

For amalgamations accounted for under the purchase method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

(a) Consideration for the amalgamation and a description of the consideration paid or contingently payable; and

(b) The amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof, including the period of amortization of any goodwill arising on amalgamation.

7.7 IND AS 103 "BUSINESS COMBINATION"

Indian Accounting Standard (Ind AS) 103, Business Combinations. This Standard lays down the principles for accounting of business combinations by acquisitions/ mergers. This Standard also deals with accounting for combination of entities or businesses under common control. The Ind AS 103 discusses the key requirements of the Standard w.r.t. Business Combinations i.e., Amalgamation of Companies.

❖ *Business Combination*
- ➢ Ind AS 103 applies to a transaction or other event that meets the definition of a business combination.
- ➢ This Ind AS does not apply to:
  - ➢ the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.
  - ➢ the acquisition of an asset or a group of assets that does not constitute a business
  - ➢ The requirements of this Standard do not apply to the acquisition by an investment entity, as defined in Ind AS 110, Consolidated Financial Statements, of an investment in a subsidiary that is required to be measured at fair value through profit or loss.

❖ *Identifying a business combination*
- ➢ An entity shall determine whether a transaction or other event is a business combination by applying the definition in this Ind AS, which requires that the assets acquired, and liabilities assumed constitute a business.
- ➢ If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition.

❖ *Acquisition Method*
- ➢ An entity shall account for each business combination by applying the acquisition method.
- ➢ Applying the acquisition method requires:

    - identifying the acquirer
    - determining the acquisition date
    - recognizing and measuring the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree; and
    - recognizing and measuring goodwill or a gain from a bargain purchase.
- The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.
- The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets, and assumes the liabilities of the acquiree the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date
- Ind AS 103 applies to all methods of acquisition whether through Merger, BTA, Slump Exchange or any other method which results in the acquisition of business by an acquirer from an acquiree.
- Therefore, unlike AS-14, Ind AS 103 applies to all forms of acquisitions so long as it satisfies the test of business and acquirer and acquiree being distinct.

❖ *Accounting Nuances*

- Ind AS 103 requires mandatory use of purchase method of accounting for business combination except for common control transaction.
- It also mandates recording of all assets acquired and liabilities assumed to be recorded at fair value.
- Many intangibles assets which were originally subsumed under goodwill under current Indian GAAP; will now be reflected on the balance sheet – for e.g., in process research, customer relationship, brands etc.
- It is interesting to know that contingent liabilities which are usually not reflected on balance sheet will also get fair valued and recorded in the balance sheet at fair value.

❖ *Accounting for Goodwill*

- Under Indian old GAAP, there was diversity in practice with respect to goodwill accounting. Goodwill arising in amalgamation was required to be amortized whereas it was accounting policy choice in case of business acquisition or acquisition of subsidiary.
- In Ind AS, goodwill is not allowed to be amortized. It is always tested for impairment.

- Therefore, all the intangible assets having no finite life are required to be subjected to Impairment testing.

- *Common Control Accounting*
  - Ind AS 103 prohibits use of pooling of interest method for business combination.
  - Pooling method is permitted only for common control transactions.
  - Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.
  - Pooling of Interest method involve:
    - The assets and liabilities of the combining entities are reflected at their carrying amounts,
    - No adjustments are made to reflect fair values, or recognize any new assets or liabilities,
    - Financials of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination.
    - If business combination had occurred after that date, the prior period information shall be restated only from that date,
    - Consideration may consist of securities, cash or other assets. Securities issued should be recorded at nominal value. Assets other than cash should be measured at fair value.
  - The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.
  - The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.
  - The excess of the consideration over the net book value of assets less liabilities is adjusted in Capital Reserve.

- *Accounting for Transaction Costs*

- An acquirer often incurs acquisition-related costs such as costs for the services of lawyers, investment bankers, accountants, valuation experts, and other third parties including due diligence.
- As such costs are not part of the fair value exchange between the buyer and the seller for the acquired business, they are accounted for as a separate transaction in which payments are made in exchange for services received and will generally be expensed in the period in which the services are received.
- This is a significant difference from current practice.

❖ *Amalgamation after balance sheet date Under Ind AS Scenario*

- If the financial statements are pending approval by the members in General Meeting, then it is possible to give effect to the amalgamation in case the appointed date is before the end of the financial year, and it can be demonstrated that control has passed effective the appointed date.
- Else it will be accounted with effect from the date of passing over of the Control which may be as of the effective date.

❖ *Acquisition under Business Transfer Agreement (BTA)*

- The acquisition under any method including as per the BTA would be covered under Ind AS 103.
- Therefore, all such acquisitions have to be accounted as per the fair value method of acquisition which is similar to the purchase method under AS-14 done on fair value basis.
- Acquisition of control through acquisition of Equity Shares
- Under the Companies (Accounting Standards) Rules 2006, such acquisitions are not covered under As-14 but are covered under As-13.
- Under Ind AS the same are covered under Ind AS103 for the purposes of consolidation so long as the aforementioned tests for the applicability of Ind AS 103 are satisfied.

7.8 KEYWORDS

Amalgamation of Companies: When two or more companies having similar nature of business merge their businesses in order to form a new company, such a merging is known as amalgamation of companies.

Absorption of Companies: In absorption, an existing company takes over the business of one or more existing companies, which dissolve their businesses.

Transferor Company: It means the company, which is amalgamated into another company.

Transferee Company: It means the company into which a transferor company is amalgamated.

AS – 4: It deals with the accounting for holding companies.

IND AS – 103: It deals with the provisions and procedures of Business Combinations.

7.9 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House, New Delhi.
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co., New Delhi.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

7.10 TERMINAL QUESTIONS/EXERCISES

Questions

1. What do you mean by Amalgamation & Absorption of Companies?
2. State the objectives of Amalgamation of Companies.
3. Explain the merits and demerits of Amalgamation of Companies.
4. Write short notes on the following w.r.t. AS – 14:
    a. Amalgamation
    b. Transferor Company

c. Transferee Company
d. Reserve
e. Amalgamation in nature of merger
f. Amalgamation in nature of purchase
g. Consideration

5. State the scope of Ind AS 103.
6. How to identify a business combination as per Ind AS 103?
7. Explain the concept of "Common Control Accounting".
8. Explain the following as per Ind AS 103:
    a. Amalgamation after Balance Sheet Date
    b. Acquisition under Business Transfer Agreement

B. COM

SEMESTER III
COURSE: CORPORATE ACCOUNTING

UNIT-8: ACCOUNTING FOR AMALGAMATION

STRUCTURE

8.0 OBJECTIVES

After going through this unit, you should be able to:

- Explain the types and methods of amalgamation
- Understand the Accounting treatment for Amalgamation

8.1 INTRODUCTION

There are many forms of business combinations to obtain the economies of large-scale production or to avoid the cutthroat competition. They are amalgamation, absorption, external reconstruction etc. The term amalgamation is used when two or more existing companies go into liquidation and a new company is formed to take over the business of liquidated companies. The term absorption is used when an existing company takes over the business of one or more existing companies which go into liquidation. In external reconstruction, one existing company goes into liquidation and a new company is formed to take over the former company.

8.2 TYPES OF AMALGAMATION

Accounting Standard -14 (AS 14) recognizes two types of amalgamation – Amalgamation in the nature of merger is an amalgamation where there is a genuine pooling not merely of assets and liabilities of the transferor and transferee companies but also of the shareholders' interests and of the businesses of the companies. The accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the respective figures of the transferor and transferee companies.

According to AS-14 for the purpose of accounting, the amalgamation of companies is divided into two categories:

Amalgamation in the Nature of Merger

Upon the satisfaction of the following conditions of AS-14, the amalgamation of the companies is considered as merger:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than equality shares already held therein, immediately before the amalgamation of the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of amalgamation.

(iii) The consideration for the amalgamation receivable may those equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferee company is intended to be carried on, after the amalgamation by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company, except to ensure uniformity of accounting policies.

Amalgamation in the Nature of Purchase

If an amalgamation does not satisfy any one or more of the conditions mentioned above for amalgamation in the nature of merger, such an amalgamation is called the amalgamation in the nature of purchases. Example: If X Ltd. purchases the business of Y Ltd. with an intention not to continue the business of Y Ltd., it will be amalgamation in the nature of purchase and not merger.

Difference between Amalgamation in Case of Merger and Purchase of Companies

In the case of an amalgamation of companies in the nature of merger, the identity and business of the Transferor Company and Transferee Company remain in existence. Assets, liabilities and reserves of both the companies are pooled and then shown in the annual financial statements. Along with these, the shareholder interest of both the companies continues.

While in an amalgamation of companies in the natures of purchase, one company acquires another company with an intention of not running the business of Transferor Company. The shareholders of the transferor company normally do not continue to have a proportionate share in the equity of the transferee company.

8.3 PURCHASE CONSIDERATION

The purchase consideration is that amount which is determined at the time of amalgamation. In other words, it is that amount which is payable by the transferee company (purchasing company) to the transferor company (vendor company) for the purchase of business. Purchase consideration may be paid in cash, shares, debentures or other securities. As per Accounting Standard (AS)-14 "consideration is the aggregate of the shares and the other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company." Mode of Payment is generally decided by the mutual agreement between Transferor Company and Transferee Company. Fair value of the different elements of the consideration is also considered as the market value of assets. It is notable that purchase consideration must be paid directly to the shareholders of the transferor company and does not include the sum which the transferee company will directly pay to the debenture holders or creditors of the transferor company. If a certain liability of the transferor company has not been taken over by the transferee company it will be discharged by the transferor company.

The following methods are used to determine the amount of purchase consideration:

(a) Lump Sum Method: It is the simplest method among other methods. Under this method, no calculation is required. The amount of purchase consideration is clearly given as a lump sum amount.

Example: If APL Ltd. acquires the business of PBR Ltd., for ₹ 35,00,000. It will be the purchase consideration in lump sum.

(b) Net Assets Method: Under this method, the purchase consideration is calculated by adding the agreed value of all the assets which have been taken over by the transferee (purchasing) company and deducting there from the total of agreed value of those liabilities, which have been taken by the transferee company.

So, Purchase consideration = Total of agreed value of assets taken over – Total of agreed value of liabilities taken over.

At the time of calculating the purchase consideration by this method, consider the following points:

(i) Only those assets are aggregated which have been taken over by the transferee company.

(ii) The fictitious assets and miscellaneous expenditure such as preliminary expenses, debit balance of profits and loss account etc., are never included in the total of assets.

(iii) In the absence of any contrary information, the book value of the assets and liabilities taken by Transferee Company is treated as agreed value.

(iv) Only those liabilities are considered, which have been taken over by the transferee company. In the absence of contrary information, all the liabilities belonging to third party are assumed to be taken by the transferee company.

(v) Accumulated profits appearing in the liability sides are not considered in calculating the consideration.

(vi) Payments directly made to the debenture holders and outside liabilities of the transferor company by the transferee company are not considered.

(c) Net Payment Method: Under this method, the purchase consideration is calculated by aggregating the payments made by the transferee company to the shareholders of transferor company in the form of cash, shares, debentures and agreed value of assets given. All the payments made by the transferee company only to the shareholders of the transferor company are the parts of purchase consideration. And the payments made by the transferee company to the outside liabilities, creditors and debenture holders of the transferor company are not considered into the above aggregation of payments because it is presumed that outside liabilities are taken over and paid by the transferor company. If the liquidation expenses of the transferor company are paid by the transferee company that must also be added in the purchase consideration. The transferee company may issue the shares and debentures to the transferee company at par, at premium, or at discount. In the absence of information, the transferee company must issue the shares, to the transferor company at par in the case of amalgamation of the companies in the nature of merger, and at market price in case of amalgamation of companies in the nature of purchase.

(d) Intrinsic Worth Method: Under this method, first of all the intrinsic value of the shares of the transferor is calculated on the basis of net assets. The net assets are calculated according to net assets method. Therefore, purchase consideration calculated under this method becomes equal to the purchase consideration calculated under net assets method. To find out the intrinsic value of the shares, the net assets of the company are divided by the number of shares. After finding this value, the rate of exchange of shares between Transferor Company and Transferee Company is determined.

Suppose there are two companies AL Ltd and ST Ltd carrying on business in the same line of activities. Their capitals are ₹ 24,00,000 and ₹ 8,00,000 (value of each share, ₹ 100). The two companies decided to amalgamate in ASLT Limited. If each share of AL Limited and ST Limited is valued at ₹ 150 and ₹ 250 respectively for the purpose of amalgamation, then purchase consideration will be as follows':

AL Ltd.	24,000 shares @ ₹ 150 each	36,00,000
ST Ltd.	8,000 shares @ ₹ 250 each	20,00,000

At the time of issuing the shares to the individual shareholders, there may be fraction of shares. However, the fractional shares cannot be issued by the company. In such a situation, the company can pay cash for the fractions.

Illustration 1

(*Calculation of Purchase Consideration by Net Payment Method)*

TC Limited agrees to take over the business of JC Limited, the consideration being the assumption of trade liabilities ₹ 62,500, the payment of the cost of liquidation ₹ 2,500, the redemption of the 'Y' Debentures of ₹ 2,50,000 at a premium of 10%, the discharge of 'X' Debentures of ₹ 5,00,000 at a premium of 8% by the issue of 10% Debentures in the TC Limited and the payment of ₹ 10 per share in cash and exchange of 2 fully paid shares of ₹ 10 in TC Ltd., at the market price of ₹ 15 per share for every share in the JC Ltd. The share capital of the JC Ltd. consists of 25,000 shares of ₹ 25 each fully paid. Calculate the purchase consideration by net payment method.

Solution

1. Payments in cash for cost of Liquidation	2,500
2. Payment in cash for redemption of 'Y' type Debentures (2,50,000 + 25,000)	2,75,000
3. Payment to 'X' type Debentures (New Debentures)	5,40,000
4. Payment in cash (25,000×10)	2,50,000
5. Payment in shares (25,000×2×15)	7,50,000
Total Purchase Consideration	**18,17,500**

Illustration 2

(Calculation of Purchase Consideration by Net Assets Method)

XC Limited takes over the business of YC Limited on 31st March 2021. The Balance Sheet of YC Limited on this date was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital 30,000 Eq. Sh. of ₹ 10 each	3,00,000	Goodwill	1, 40,000
10% Debentures	50,000	Land & Buildings	80,000
Sundry Creditors	30,000	Plant & Machinery	1,40,000
General Reserve	20,000	Stock	80,000
Profits & Loss A/c	1,00,000	Debtors	40,000
		Cash Balance	10,000
		Preliminary Expenses	10,000
	5,00,000		**5,00,000**

On the basis of above Balance Sheet of YC Limited, calculate the purchase consideration assuming: (a) The values agreed for various assets are Goodwill ₹ 1,10,000, Land & Buildings ₹

1,25,000, Plant and Machinery ₹ 1,20,000, Stock ₹ 65,000 and Debtors ₹ 40,000. (b) XC Limited does not take over cash but agrees to assume the liability of sundry creditors at ₹ 25,000.

Solution

	Agreed value (₹)
Goodwill	1,10,000
Land & Buildings	1,25,000
Plant & Machinery	1,20,000
Stock	65,000
Debtors	40,000
Total of Assets	4,60,000
Less: External liabilities	
Sundry Creditors taken	25,000
Purchase Consideration	**4,35,000**

Illustration 3

(Purchase Consideration by Intrinsic worth Method)

Following are the Balance Sheets of AK Ltd. and GK Ltd. as on 31st March 2021:

Liabilities	**AK Ltd.**	**GK Ltd.**	**Assets**	**AK Ltd.**	**GK Ltd.**
Share Capital: Shares of ₹ 10 each	4,50,000	3,60,000	Fixed Assets: At Cost less depr.	4,20,000	2,25,000
Reserves	2,85,000	30,000	Current Assets:		
Secured Loans:			Stock	1,26,000	1,41,000
10% Debentures	-	60,000	Trade Debtors	90,000	1,50,000
Current Liabilities:			Bank Balance	2,40,000	30,000
Sundry Creditors	1,41,000	96,000			
	8,76,000	**5,46,000**		**8,76,000**	**5,46,000**

AK Ltd. agreed to absorb to GK Ltd., as on 31st March 2021 on the following terms:

(a) AK Ltd. agreed to repay 10% debentures of GK Ltd.

(b) AK Ltd. agreed to revalue its fixed assets at ₹ 5,85,000 to be incorporated in the books.

(c) Shares of both the companies, to be valued on net assets basis after considering ₹ 1,50,000 towards value of goodwill of GK Ltd.

(d) The cost of absorption of ₹ 9,000 is met by AK Ltd.

You are required to calculate the net assets and ratios of exchange of shares.

Solution

Particulars	AK Ltd.	GK Ltd.
Goodwill	–	1,50,000
Fixed Assets	5,85,000	2,25,000
Stock	1,26,000	1,41,000
Trade Debtors	90,000	1,50,000
Bank Balance	2,40,000	30,000
Total of assets	10,41,000	6,96,000
Less: External Liabilities:		
10% Debentures	-	60,000
Sundry Creditors	1,41,000	96,000
Net Assets	**9,00,000**	**5,40,000**
Intrinsic worth of a share	9,00,000/45,000 **= ₹ 20**	5,40,000/36,000 **= ₹15**

Based on above calculation, it can be analyzed that the exchange ratio will be 4 shares of AK Ltd., equal to 3 shares of GK Ltd.

8.4 METHODS OF ACCOUNTING FOR AMALGAMATION

There are two main methods of accounting for amalgamation viz,

The first method is used in case of amalgamation in the nature of merger and the second method are used in case of amalgamation in the nature of purchase.

Pooling of Interest Method

Under pooling of interests method, the assets, liabilities, and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policies followed by these companies. As a result, the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in reserves.

Purchase Method

Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

Reserves: No reserves, other than statutory reserves, of the transferor company should be incorporated in the financial statements of transferee company.

Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as 'statutory reserves') and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with. Statutory reserves of the transferor company should be incorporated in the balance sheet of transferee company by way of the following journal entry.

Amalgamation Adjustment Reserve A/c Dr.

To Statutory Reserves

The balance of Profit and Loss account of the transferor company is not recorded at all.

In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which is presented as a separate line item. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

Difference between the Purchase Consideration and Net Assets transferred: Any excess of the amount of purchase consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognized as goodwill in the financial statement of the transferee company. Any short fall should be shown as capital reserve. Goodwill should be amortized over period of five years unless a somewhat longer period can be justified.

8.5 ACCOUNTING TREATMENT FOR AMALGAMATION

In both amalgamation in the nature of purchase and in the nature of merger, the transferor company has to wind up its business. Hence all the accounts must be closed. All assets are disposed, liabilities are paid off and the surplus (if any) is distributed among its shareholders.

Journal Entries in the Books of Transferor Company

Steps to close the Books of the Vendor Company

1. Open Realisation Account and transfer all assets at book value.

Note: If cash is not taken over by the purchasing company, it should not be transferred.
Note: Profit and Loss Account (Dr.) and expenses not written off are not assets and should not be transferred to the Realization Account.

Realisation A/c Dr.
To Sundries -
Goodwill
Fixed Assets
Intangibles
Current Assets
(Transfer of assets to Realization Account on sale of business)

2. Transfer to the Realisation Account the liabilities which the purchasing company is to take over.

In case of the provisions, the portion which represents liability expected to arise in future should be so transferred and the portion which is not required (i.e., the reserve portion) should be treated as profit.
For liabilities not taken over by the purchasing company, the profit or loss on discharge of such liabilities shall be transferred to Realization Account.

Non-Current Liabilities Dr.
Expected Reserve Liability Dr.
Current Liabilities Dr.
To Realization A/c
(Transfer of liabilities taken over to Realization A/c)

3. Debit purchasing company and credit Realization Account with the purchase consideration.

Purchasing Co. Dr.
To Realization A/c
(Amount receivable from Purchasing Co. for sale of business)

4. On receipt of the purchase consideration debit what is received (cash, debentures, shares etc.) and credit the purchasing company.

Cash Dr.
Preference shares Dr.
Equity shares Dr.
To Purchasing Co.
(Receipt of purchase consideration from the purchase company)

5. Expenses of liquidation must be dealt with according to the circumstances of each case.

a. If the vendor company has to bear and pay them:

Realization A/c Dr.
To Cash A/c

b. If the expenses are to be borne by the purchasing company, the question may be dealt within one of the two ways mentioned below:

   i. It may be ignored in the books of the vendor company.

   ii. If the expenses are to be paid first by the vendor company and afterwards reimbursed by the purchasing company, the following two entries will be passed:

Purchasing Co. Dr.
Realisation A/c Dr.
To Cash A/c
(Liquidation expenses payable by Purchasing Co.)

Cash A/c Dr.
To Purchasing Co.
(Account reimbursed by Purchasing Co. for expense)

6. Liabilities not assumed by the purchasing company, have to be paid off.

On payment, debit the liability concerned and credit cash. Any difference between the amount actually paid and the book figure must be transferred to the Realization Account.

Liabilities (not assumed) A/c Dr.
To Cash A/c
(Liabilities not assumed paid in cash)

7. Credit the preference shareholders with the amount payable to them, debiting Preference Share Capital with the amount shown in the books, transferring the difference between the two, if any, to the Realization Account.

% Pref. Share Capital A/c Dr.
Realization A/c Dr.
To Preference Shareholders A/c
(The amount due to preference shareholders for capital and the extra amount payable)

Note: In the absence of any indication to the contrary, preference shareholders will be entitled only to the capital contributed by them. But if funds available after paying off creditors are not sufficient, they will have to suffer a loss to the extent of the deficit.

8. Pay off preference shareholders by debiting them and crediting whatever is given to them.

Preference shareholders A/c Dr.

To Cash A/c
To % Shares/ Stocks
(Cash and shares in Purchasing Co. given to preference shareholders)

9. Transfer equity share capital and account representing profit or loss (including the balance in Realisation Account) to Equity Shareholders Account. This will determine the amount receivable by the equity shareholders.

Equity Share Capital A/c Dr.
Capital Reserve A/c Dr.
Profit and Loss A/c Dr.
Reserve A/c Dr.
Realization A/c Dr.
To Sundry Equity Shareholders A/c
(Various accounts representing capital and profit transferred to Equity Shareholders Account)

10. On satisfaction of the claims of the equity shareholders, debit their account and credit whatever is given to them.

Equity Shareholders A/c Dr.
To Equity Shares in Purchasing Co.
To Cash A/c

Journal Entries in the Books of Transferee Company

1. For recording the purchase consideration

Business Purchase A/c Dr.
To Liquidator of Transferor Company A/c
(Amount payable to transferor company as purchase consideration)

2. For recording the assets, liabilities and reserves taken over-

Sundry Assets (individually) A/c Dr.
To Sundry Liabilities (individually) A/c
To Various Reserve A/c
To Business Purchase A/c
(Being sundry assets, liabilities and reserves of Transferor Company taken over)

Note: If the total of Liabilities, Reserves, and Purchase Consideration exceed debits of Assets taken over, the difference should be debited to Goodwill Account, in the reverse case, the difference should be credited to Capital Reserve.

3. For making the payment of purchase consideration to the liquidator of the transferor company:

    Liquidator of Transferor Company A/c Dr.
    To Bank A/c
    To Debentures A/c
    To Equity Share Capital A/c
    To Preference Capital A/c
    (Being discharge of purchase consideration in cash, debentures and shares)

    Note: If shares or debentures are issued on discount, discount account will also be debited and if shares or debentures are issued at premium, premium account will be credited in the above entry.

4. For the payment of liquidation expenses of the transferor company

    Goodwill A/c Dr.
    To Bank A/c
    (Being payment of liquidation expenses)

5. For maintaining the Statutory Reserve-

    Amalgamation Adjustment A/c Dr.
    To statutory Reserve A/c
    (Being incorporation of statutory reserves of the transferor company)

6. For the payment of preliminary expenses-

    Preliminary Expenses Account Dr.
    To Bank A/c
    (Being payment of preliminary expenses)

7. For the payment of various liabilities of the transferor company-

    Various Liabilities A/c Dr.
    To Bank A/c
    To Debentures A/c
    To Share capital A/c
    (Being payment of liabilities of the transferor company)

8. For writing off the goodwill against Capital reserves-

    Capital Reserve A/c Dr.
    To Goodwill A/c
    (Being goodwill written off against capital reserves)

8.6 ILLUSTRATIVE EXAMPLES

Illustration 4

AK Ltd. and ZL Ltd. amalgamate to form a new company ALKZ Ltd. The financial position of these two companies on the date of amalgamation was as under:

Liabilities	AK Ltd.	ZL Ltd.	Assets	AK Ltd.	ZL Ltd.
Share Capital: Equity Shares of ₹ 100 each	800000	300000	Goodwill	80000	-
7% Pref Shares of ₹ 100 each	400000	300000	Land & Building	450000	300000
5% Debentures	200000	-	Plant & Machinery	620000	500000
General Reserve	-	100000	Furniture & Fittings	60000	20000
			Trade Receivables	275000	175000
			Stores & Inventory	225000	140000
P & L Account	371375	97175	Cash at Bank	120000	55000
			Cash in Hand	41375	17175
Trade Payables	100000	200000			
Secured Loan	-	200000			
	1871375	**1207175**		**1871375**	**1207175**

The terms of amalgamation are as under:

- (1) The assumption of liabilities of both the Companies.

  (2) Issue of 5 Preference shares of ₹ 20 each in ALKZ Ltd. @ ₹ 18 paid up at premium of ₹ 4 per share for each preference share held in both the Companies.

  (3) Issue of 6 Equity shares of ₹ 20 each in ALKZ Ltd. @ ₹ 18 paid up at a premium of ₹ 4 per share for each equity share held in both the Companies. In addition, necessary cash should be paid to the Equity Shareholders of both the Companies as is required to adjust the rights of shareholders of both the Companies in accordance with the intrinsic value of the shares of both the Companies.

  (4) Issue of such amount of fully paid 6% debentures in ALKZ Ltd. as is sufficient to discharge the 5% debentures in AK Ltd. at a discount of 5% after takeover.

- (1) The assets and liabilities are to be taken at book values inventory and trade receivables for which provisions at 2% and 2 ½ % respectively to be raised.

  (2) The trade receivables of K Ltd. include ₹ 20,000 due from ZL Ltd.

- The ALKZ Ltd. is to issue 15,000 new equity shares of ₹ 20 each, ₹ 18 paid up at premium of ₹ 4 per share so as to have sufficient working capital. Prepare ledger accounts in the books of AK Ltd. and ZL Ltd. to close their books.

<u>Solution</u>

Books of AK Ltd.

Realisation Account

Goodwill	80,000	5% Debentures	2,00,000
Land & Building	4,50,000	Trade payables	1,00,000
Plant & Machinery	6,20,000	ALKZ Ltd. (Purchase consideration)	15,60,000
Furniture & Fitting	60,000	Equity shareholders (loss)	51,375
Trade receivables	2,75,000		
Stores & inventory	2,25,000		
Cash at Bank	1,20,000		
Cash in hand	41,375		
Preference shareholders (excess)	40,000		
	19,11,375		**19,11,375**

Equity Shareholders Account

Realisation A/c (loss)	51,375	Share capital	8,00,000
Equity Shares in ALKZ Ltd.	10,56,000	Profit & Loss A/c	3,71,375
Cash	64,000		
	11,71,375		**11,71,375**

7% Preference Shareholders Account

Preference Shares in ALKZ Ltd.	4,40,000	Share capital	4,00,000
Realisation A/c	40,000		
	4,40,000		**4,40,000**

ALKZ Ltd. Account

Realisation A/c	15,60,000	Equity Shares in ALKZ Ltd.	
		For Equity	10,56,000
		For Pref.	4,40,000
		By Cash	64,000
	15,60,000		**15,60,000**

Books of ZL Ltd.

Realisation Account

Land & Building	3,00,000	Trade payables	2,10,000
Plant & Machinery	5,00,000	Secured loan	2,00,000
Furniture & Fittings	20,000	ALKZ Ltd. (Purchase consideration)	7,90,000
Trade receivables	1,75,000	Equity shareholders (Loss)	37,175
Inventory of stores	1,40,000		
Cash at bank	55,000		
Cash in hand	17,175		
Pref. shareholders	30,000		
	12,37,175		**12,37,175**

Equity Shareholders Account

Equity shares in ALKZ Ltd.	3,96,000	Share Capital	3,00,000
Realisation	37,175	Profit & Loss A/c	97,175
Cash	64,000	Reserve	1,00,000
	4,97,175		**4,97,175**

7% Preference Shareholders Account

Preference Shares in ALKZ Ltd.	3,30,000	Share capital	3,00,000
		Realisation A/c	30,000
	3,30,000		**3,30,000**

ALKZ Ltd. Account

Realisation A/c	7,90,000	Equity shares in ALKZ Ltd.:	
		For Equity	3,96,000
		For Preference	3,30,000
		Cash	64,000
	7,90,000		**7,90,000**

Working Notes:

(i) Purchase consideration

	AK Ltd.	ZL Ltd.
Payable to preference shareholders:		
Preference shares at ₹ 22 per share	4,40,000	3,30,000
Equity Shares at ₹ 22 per share	10,56,000	3,96,000
Cash [See W.N. (ii)]	64,000	64,000
	15,60,000	**7,90,000**

(ii) Value of Net Assets

		AK Ltd.	ZL Ltd.
	Goodwill	80,000	-
	Land & Building	4,50,000	3,00,000
	Plant & Machinery	6,20,000	5,00,000
	Furniture & Fittings	60,000	20,000
	Trade receivables less 2.5%	2,68,125	1,70,625
	Inventory less 2%	2,20,500	1,37,200
	Cash at Bank	1,20,000	55,000
	Cash in hand	41,375	17,175
		18,60,000	**12,00,000**
Less:	Debentures	2,00,000	–
	Trade payables	1,00,000	2,10,000
	Secured Loans	–	2,00,000
		15,60,000	**7,90,000**
	Payable in shares	14,96,000	7,26,000
	Payable in cash	64,000	64,000

Illustration 5

The following are the summarized Balance Sheets of AZ Ltd. and BY Ltd. as on 31.3.2021:

	(₹ in thousands)	
Liabilities	**AZ Ltd.**	**BY Ltd.**
Share capital: Equity shares of 100 each fully paid up	2,000	1,000
Reserves	1,000	-
10% Debentures	500	-
Loans from Banks	250	450
Bank overdrafts	-	50
Trade payables	300	300
Total	4,050	1,800
Assets		
Tangible assets/fixed assets	2,700	850
Investments	700	-
Trade receivables	400	150
Cash at bank	250	-
Accumulated loss	-	800
Total	**4,050**	**1,800**

BY Ltd. has acquired the business of AZ Ltd. The following scheme of merger was approved:

(i) Banks agreed to waive off the loan of ₹ 60 thousands of BY Ltd.

(ii) BY Ltd. will reduce its shares to ₹ 10 per share and then consolidate 10 such shares into one share of ₹ 100 each (new share).

(iii) Shareholders of AZ Ltd. will be given one share (new) of BY Ltd. in exchange of every share held in AZ Ltd.

(iv) Trade payables of BY Ltd. includes ₹ 100 thousands payable to AZ Ltd.

Pass necessary entries in the books of BY Ltd. and prepare Balance Sheet after merger.

Solution

Calculation of purchase consideration

One share of BY Ltd. will be issued in exchange of every share of AZ Ltd. **20,000 shares**

(i.e., 20,000 equity shares of BY Ltd. will be issued against 20,000 equity shares of AZ Ltd.)

Journal Entries in the books of BY Ltd.

		Dr.	Cr.
			(₹ in thousands)
Loan from bank A/c	Dr.	60	
To Capital reduction A/c			60
(Being loan from bank waived off to the extent of ₹ 60 thousand)			
Equity shares capital A/c (₹ 100)	Dr.	1,000	
To Equity share capital A/c (₹10)			100
To Capital reduction A/c			900
(Being equity shares of ₹ 100 each reduced to ₹ 10 each)			
Equity shares capital A/c (₹ 10)	Dr.	100	
To Equity share capital A/c (₹ 100 each)			100
(Being 10 equity shares of ₹ 10 each consolidated to one share of ₹ 100 each)			
Capital reduction A/c	Dr.	960	
To Profit and loss A/c			800
To Capital reserve A/c			160
(Being accumulated losses set off against reconstruction & balance transferred to capital reserve)			
Business purchase A/c	Dr.	2,000	
To Liquidator of AZ Ltd.			2,000
(Being purchase of business of A Ltd.)			
Fixed asset A/c	Dr.	2,700	
Investment A/c	Dr.	700	
Trade receivables A/c	Dr.	400	
Cash at bank A/c	Dr.	250	
To Trade payables A/c			300
To Loans from bank A/c			250
To 10% Debentures A/c			500
To Business purchase A/c			2,000
To Reserves A/c			1,000
(Being assets, liabilities and reserves taken over under pooling of interest method)			
Liquidator of AZ Ltd. A/c	Dr.	2,000	
To Equity share capital A/c			2,000

(Being payment made to liquidators of A Ltd. by allotment of 20,000 new equity shares)

Trade payables A/c	Dr.	100	
To Trade receivables A/c			100

(Being mutual owing cancelled)

Balance Sheet of BY Ltd. after merger as on 31.3.2021

Particulars	Notes	₹ in '000
Equity and Liabilities		
1. Shareholders' funds		
a) Share capital	1	2,100
b) Reserves & Surplus	2	1,160
2. Non-current liabilities		
a) Long term borrowings	3	1,140
3. Current liabilities		
Trade payables		500
Short term borrowings	4	50
Total		**4,950**
Assets		
1. Non-current assets		
a) Property, Plant and Equipment		
Tangible assets		3,550
b) Non-current investments		700
2. Current Assets		
a) Trade Receivables		450
b) Cash & Equivalents		250
Total		**4,950**

Notes to accounts			***₹ in '000***
1	**Share Capital**		
	21,000, Equity shares of ₹ 100 each fully paid		2,100
	(Out of the above, 20,000 shares have been issued for consideration other than cash)		
2	**Reserves and Surplus**		
	Capital reserve	160	
	General reserve	1,000	
	Total		1,160
3	**Long Term Borrowings**		
	10% Debentures	500	
	Loan from Bank (250+450-60)	640	
	Total		1,140
4	**Short term borrowings**		
	Bank overdraft		250

8.7 KEYWORDS

Amalgamation in the nature of Merger: In the case of an amalgamation of companies in the nature of merger, the identity and business of the Transferor Company and Transferee Company remain in existence. Assets, liabilities and reserves of both the companies are pooled and then shown in the annual financial statements. Along with these, the shareholder interest of both the companies continues.

Amalgamation in the nature of Purchase: While in an amalgamation of companies in the natures of purchase, one company acquires another company with an intention of not running the business of Transferor Company. The shareholders of the transferor company normally do not continue to have a proportionate share in the equity of the transferee company.

Purchase Consideration: The purchase consideration is that amount which is determined at the time of amalgamation. In other words, it is that amount which is payable by the transferee company (purchasing company) to the transferor company (vendor company) for the purchase of business. Purchase consideration may be paid in cash, shares, debentures or other securities.

Pooling of Interest Method: Under pooling of interests method, the assets, liabilities, and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policies followed by these companies.

Purchase Method: Assets and Liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

8.8 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House, New Delhi.
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.

- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co., New Delhi.
- Sehgal, Ashok, and Deepak Sehgal. Corporate Accounting. Taxman Publication
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

8.9 TERMINAL QUESTIONS/EXERCISES

Questions

9. What do you mean by Amalgamation & Absorption of Companies?
10. What are the conditions, which must be satisfied for an amalgamation to be in the nature of merger?
11. What do you mean by Purchase Consideration w.r.t. Amalgamation of Companies? Explain the methods of determining the amount of Purchase Consideration.
12. Distinguish between (i) the pooling of interests method and (ii) the purchase method of recording transactions relating to amalgamation
13. The financial position of two companies H Ltd. and V Ltd. as on 31st March 2021 was as under:

Assets	**H Ltd. (₹)**	**V Ltd. (₹)**
Goodwill	50,000	25,000
Building	3,00,000	1,00,000
Machinery	5,00,000	1,50,000
Inventory	2,50,000	1,75,000
Trade receivables	2,00,000	1,00,000
Cash at Bank	50,000	20,000
	13,50,000	**5,70,000**
Liabilities	**H Ltd. (₹)**	**V Ltd. (₹)**
Share Capital:		
Equity Shares of ₹ 10 each	10,00,000	3,00,000
9% Preference Shares of ₹ 100 each	1,00,000	–
10% Preference Shares of ₹ 100 each	–	1,00,000
General Reserve	70,000	70,000
Retirement Gratuity fund	50,000	20,000
Trade payables	1,30,000	80,000
	13,50,000	**5,70,000**

H Ltd. absorbs V Ltd. on the following terms:

(a) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of H Ltd.

(b) Goodwill of V Ltd. is valued at ₹ 50,000, Buildings are valued at ₹ 1,50,000 and the Machinery at ₹ 1,60,000.

(c) Inventory be taken over at 10% less value & Provision for Doubtful Debts be created @ 7.5%.

(d) Equity Shareholders of V Ltd. will be issued Equity Shares @ 5% premium.

Prepare necessary Ledger Accounts to close the books of V Ltd. and show the acquisition entries in the books of H Ltd. Also draft the Balance Sheet after absorption as on 31st March 2021.

Ans. Profit on Realisation: ₹ 50,000; Purchase Consideration: ₹ 5,30,000; Balance Sheet Total: ₹ 19,87,500

14. SE Ltd. and FE Ltd. were in competing business. They decided to form a new company named SFE Ltd. The summarized balance sheets of both the companies were as under:

SE Ltd.

Balance Sheet as on 31st March 2021

	Amount (₹)		**Amount (₹)**
20,000 Equity shares of ₹ 100 each	20,00,000	Buildings	10,00,000
Provident fund	1,00,000	Machinery	4,00,000
Trade Payables	60,000	Inventory	3,00,000
Insurance reserve	1,00,000	Trade receivables	2,40,000
		Cash at bank	2,20,000
		Cash in hand	1,00,000
	22,60,000		**22,60,000**

FE Ltd.

Balance Sheet as on 31st March 2021

	Amount (₹)		**Amount (₹)**
10,000 Equity shares of ₹100 each	10,00,000	Goodwill	1,00,000
Employees profit sharing account	60,000	Buildings	6,00,000
Trade Payables	40,000	Machinery	5,00,000
Reserve account	1,00,000	Inventory	40,000
Surplus	1,00,000	trade receivables	40,000
		Cash at bank & in hand	20,000
	13,00,000		**13,00,000**

The assets and liabilities of both the companies were taken over by the new company at their book values. The companies were allotted equity shares of ₹ 100 each in lieu of purchase consideration amounting to ₹ 30,000 (20,000 for SFE Ltd and 10,000 for Fast Express Ltd.).

Prepare opening balance sheet of SFE Ltd considering pooling method.

Ans.: Balance Sheet Total: ₹ 35,60,000

B.COM

SEMESTER – III

COURSE: CORPORATE ACCOUNTING

UNIT-9: INTERNAL RECONSTRUCTION

STRUCTURE

9.0 OBJECTIVES

After going through this unit, you should be able to:

- Explain the meaning, objective, and provisions of Internal Reconstruction
- Understand the various methods of Internal Reconstruction

9.1 INTRODUCTION

Reconstruction means reorganization of a company's financial structure. In reconstruction of a company, usually the assets and liabilities of the company are revalued, the losses suffered by the company are written off by a deduction of the paid-up value of shares and/or varying of the rights attached to different classes of shares and compounding with the creditors. It may be done without liquidating the company and forming a new company in which case the process is called internal reconstruction. However, there may be external reconstruction in which case the undertaking being carried on by the company is transferred to a newly started company consisting substantially of the same shareholders with a view to the business of the transferee company being continued by the transferee company.

9.2 MEANING OF RECONSTRUCTION

Reconstruction is a process of the company's reorganization, concerning legal, operational, ownership and other structures, by revaluing assets and reassessing the liabilities. It refers to the transfer of company or several companies' business to a new company. This, therefore, means that the old company will get put into liquidation, and shareholders will therefore agree to take shares of equivalent value in the new company. Reconstruction is required when the company is incurring losses for many years, and the statement of account does not reflect the true and fair position of the business, as a higher net worth is depicted, than that of the real one.

In other words, "Reconstruction" involves the winding up of an existing company and the transfer of its assets and liabilities to a new company formed for the purpose of taking over the business and undertaking of the existing company. Shareholders in the existing company become shareholders in the new company. The business undertaking and shareholders of the new company are substantially the same as those of the old company.

9.3 OBJECTIVES OF RECONSTRUCTION

The major objectives of reconstruction are as follows-

- To resolve problem of over-capitalization/huge accumulated losses/over valuation of assets.
- When the capital structure of a company is complex and is required to make it simple
- When change is required in the face value of shares of the company
- To generate surplus for writing off accumulated losses & writing down overstated assets.
- Raising the fresh capital by issuing new shares.
- Changing altogether the memorandum of association of the company.
- To generate cash for working capital needs, replacement of assets, to add balancing equipment's, modernize plant & machinery etc.

9.4 TYPES OF RECONSTRUCTION

Reconstruction of companies may be of two types:

- **External Reconstruction:** When the capital structure of a company is reorganized through the liquidation of the existing company and formation of the new company, it is called external reconstruction. Thus, in the case of external reconstruction, one existing company will go into liquidation and a new company will be formed in order to purchase the business of the existing company. Example: When Ankit Limited goes into liquidation and a new company Ankit Mohan Limited is formed to purchase the business of Ankit Limited, it is a case of external liquidation. In this way, the shareholders and persons interested, and business will be same in the newly formed company as were in the old company.
- **Internal Reconstruction:** Internal reconstruction means the reorganization of the capital structure of a company without forming a new company and without liquidating the existing company. Internal reconstruction of a company is done to alter the share capital or to reduce the share capital without going into liquidation. It means the reorganized form of the company will run the business of the existing company. The claims of the shareholders, creditors and outsiders are adjusted towards the amount of writing off the losses and fictitious assets.

9.5 SIGNIFICANCE & OBJECTIVE OF INTERNAL RECONSTRUCTION

Internal reconstruction is done by the company when:

- There is an overvaluation of assets and undervaluation of liabilities.
- There is a difficulty to meet the financial crisis and there are continuous losses.

The objective of internal reconstruction includes:

- To eliminate the fictitious assets of the company such as preliminary expenses, discount on issue of shares etc.
- To reduce the share capital of the company and to bring it to its real worth.
- Creating confidence among the shareholders by providing them fair return on their true investment.
- To present the true and fair view of the company's financial position.

9.6 CONDITIONS/PROVISIONS OF INTERNAL RECONSTRUCTION

- **Authorization by Articles of Association:** The company must be authorized by its articles of association to resort for capital reduction. Articles of association contains all the details regarding the internal affairs of the company and mention the clause containing manner of reduction of capital.
- **Passing of Special Resolution:** The company must pass the special resolution before resorting to capital reduction. The special resolution can be passed only if the majority of the stakeholders are assenting to the internal reconstruction. This special resolution must be get signed by the tribunal and deposited to the registrar appointed under the Companies Act, 2013.
- **Permission of Tribunal:** The company must get the due permission of the court or tribunal before starting the process of the capital reduction. The tribunal grants permission only it feels satisfied with the point that the company is going fair and there is positive consent of every stakeholder.
- **Payment of borrowings:** As per Section 66 of the Companies Act, 2013, the company has to repay all the amounts it gets deposited and also the interest due thereon before going for capital reduction.
- **Consent of Creditors:** The written consent of the creditors is required for the company which is going for capital reduction. The court requires the company to secure the interest of the dissenting creditors. The company gets the permission of the court after the court thinks fit that reduction of capital will not harm the interest of the creditors.
- **Public Notice:** The company has to make a public notice as per the directions of the tribunal stating that the company is resorting to capital reduction. Also, the company has to state the valid reasons for the same.

9.7 METHODS OF INTERNAL RECONSTRUCTION

For properly deploying the process of internal reconstruction following methods are generally employed or used simultaneously:

(a) Alteration of share capital

(b) Reduction of share capital

9.8 ALTERATION OF SHARE CAPITAL

According to Section 94 of the Companies Act, a limited company having a share capital may, if so, authorized by its Articles of Association, alter the capital clause of its Memorandum of Association by the ordinary resolution in the general meeting. These alterations do not require the approval of the Company Law Board. Alteration in the capital clause may be in any of the following ways:

- Increase in its share capital by the issue of fresh shares of such amount as it thinks expedient.
- Consolidation of existing shares of smaller denomination into shares of larger denomination.
- Sub-division of its shares or part of them of larger denominations into smaller denominations.
- Conversion of all or part of its fully paid shares into stock and vice-versa.
- Cancellation of those shares which have not been issued.

Case – I: Increase in Share Capital by Issue of Fresh Shares

A limited company may increase its nominal or subscribed capital by making fresh issue of shares. To increase its nominal capital, the company has to alter its capital clause in its Memorandum of Association. On the passing of the resolution for increasing of the nominal capital, the Registrar of the Companies must be informed within thirty days of passing such resolution. The offer for the issue of fresh shares must first be made to existing shareholders in the proportion of their holdings, unless the company has decided otherwise by a special resolution or by an ordinary resolution approved by the Central Government. If the existing shareholders fail to exercise their option within fifteen days, the Board of Directors will be free to issue such shares.

Accounting treatment for issue of such shares will be same as is adopted for issue of new shares.

Case – II: Consolidation of Shares

As per Section 94 of the Companies Act, 1956, a limited company may consolidate its shares of smaller denomination (value) into larger denomination (value). Generally, consolidation is done when the value of shares is in very small amount.

On consolidation of shares, the amount of paid-up share capital remains at old figure, but the number of shares decreases.

Example: S Kumar Limited having a share capital of ₹ 10,00,000 divided into 1,00,000 shares of ₹ 10 each on which ₹ 8 per share are paid up, resolve to consolidate 10 shares of ₹ 10 each into one share of ₹ 100. On consolidation the paid-up value of the shares will be same, but the number of shares will reduce. On consolidation, the company will pass the following journal entry–

Share Capital (₹ 10) Account Dr. 8,00,000

To Share Capital (₹ 100) Account 8,00,000

(Being consolidation of 10 shares of ₹ 10 each, ₹ 8 paid up into one share of ₹ 100).

Case – III: Sub-division of Shares

Section 94 of the Companies Act, 1956, also provides that a company may sub-divide its shares of larger amount into shares of smaller amount if so, authorized by the Articles of Association. If the shares are not fully paid up, the proportion between the amount paid and the amount unpaid on each reduced share must be the same as it was before sub-division.

On sub-division of shares, amount of paid-up capital remains same, but number of shares increases.

Example: S Kumar Limited having a share capital of ₹ 10,00,000 divided into 10,000 equity shares of ₹ 100 each, resolves to split up one equity share of ₹ 100 each into 2 equity shares of ₹ 50 each. After sub-division, the company will have the same amount of capital and it will pass the following journal entry–

Equity Share Capital (₹ 100) Account Dr. 10,00,000

To Equity Share Capital (₹ 50) Account 10,00,000

(Being sub-division of 10,000 shares of ₹ 100 each into 20,000 shares of ₹ 50 each).

Case – IV: Conversion of Shares into Stock and Vice-Versa

As per Section 94 of the Companies Act 1956, a company is also allowed to convert its fully paid-up shares into stock or to reconvert that stock into fully paid up shares. Stock is the set of fully paid shares of a number merged into one fund having equal value.

Note: Stock is always made from fully paid-up share, it is never made from partly paid-up shares and shares cannot be transferred into fractions, while stock can be transferred into any fraction.

On the conversion of shares into stock, the shareholder becomes stockholders. The stockholders have the same rights, privileges, and advantages as to dividends and voting as were carried by the shares before conversion into stock took place. On conversion of shares into stock, the work of maintaining register and issuing certificate is very simplified.

Accounting treatment on conversion of fully paid-up shares into stock, the company has to pass the following journal entry-

Equity Share Capital Account Dr.

To Equity Stock Account

(Being conversion of fully paid-up equity shares into equity stock).

On the conversion of equity stock into fully paid-up equity shares, the above journal entry will be just reverse.

Case – V: Cancellation of Unissued Share Capital

As per Section 94(1)(e) of the Companies Act, 1956, a company is permitted to decrease the amount of its nominal capital by cancellation of shares. Cancellation will be of those shares which at the date of passing of the resolution for cancellation of shares in general meeting in that behalf have not taken or agreed to be taken by any person and thus diminish the amount of its nominal share capital. Diminution of share capital is different from the reduction of share capital. Diminution of capital is unissued share capital, while reduction of share capital is for subscribed/paid up capital. For the reduction of capital, sanction of the court is mandatory while cancellation of unissued capital does not require the sanction of court.

Accounting Treatment for the cancellation of the unissued shares capital does not require any journal entry in the books of the company because it does not have any effect on the issued shares capital.

9.9 ILLUSTRATIVE EXAMPLES – I

Illustration 1

XY Limited with a share capital of 50,000 equity shares of ₹ 100 each fully paid, resolves to sub-divide these shares into shares of ₹ 50 each fully paid. Show journal entries.

Solution

Journal of XY Limited

Equity Share Capital (₹ 100) A/c Dr. 50,00,000

To Equity Share Capital (₹ 50) A/c 50,00,000

(Being sub-division of 50,000 equity shares of ₹ 100 each fully paid into 1,00,000 equity shares of ₹ 50 each)

Illustration 2 *(Conversion of Shares into Stock at Discount)*

XYZ Limited passed a resolution for the conversion of its 50,000 equity shares of ₹ 10 each fully paid into ₹ 5,25,000 stock on the basis of ₹ 105 of stock for every 10 fully paid shares of ₹ 10 each. Show the journal entries in the books of XYZ limited.

Solution

Journal of XYZ Limited

Equity Share Capital Account	Dr.	5,00,000	
Discount on Stock Account	Dr.	25,000	
To Equity Stock Account			5,25,000

(Being conversion of 50,000 eq sh of ₹ 10 each fully paid into 5,000 equity stock of ₹ 105 each)

Illustration 3 *(Reconversion of Equity Stock into Fully Paid-up Shares)*

A limited company passed a necessary resolution to convert its ₹ 10,00,000 equity stock of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each fully paid up. Show necessary journal entries in the books of the company.

Solution

Journal Entries

Equity Stock Account	Dr.	10,00,000	
To Equity Share Capital Account			10,00,000

(Being reconversion of 10,000 equity stock in 1,00,000 equity shares of ₹ 10 each fully paid)

Illustration 4 *(Sub-division and Consolidation of Shares)*

On 31-12-20X1, B Ltd. had 20,000, ₹ 10 Equity Shares as authorised capital and the shares were all issued on which ₹ 8 was paid up. In June, 20X2 the company in general meeting decided to sub-divide each share into two shares of ₹ 5 with ₹ 4 paid up. In June, 20X3 the company in general meeting resolved to consolidate 20 shares of ₹ 5, ₹ 4 per share paid up into one share of ₹ 100 each, ₹ 80 paid up.

Pass the necessary journal entries.

Solution

Journal Entries

20X2 June

Equity Share Capital (₹ 10) A/c Dr. 1,60,000

To Equity Share Capital (₹ 5) A/c 1,60,000

(Being the sub-division of 20,000 shares of ₹ 10 each with ₹ 8 paid up into 40,000 shares ₹ 5 each with ₹ 4 paid up by resolution in general meeting dated)

20X3 June

Equity Share Capital (₹ 5) A/c Dr. 1,60,000

To Equity Share Capital (₹ 100) A/c 1,60,000

(Being consolidation of 40,000 sh. of ₹ 5 with ₹ 4 paid up into 2,000 ₹ 100 sh. with ₹ 80 paid up)

Illustration 5 *(Conversion of Fully Paid Shares into Stock and Stock into Shares)*

C Ltd. had ₹ 5,00,000 authorised capital on 31-12-20X1 divided into shares of ₹ 100 each out of which 4,000 shares were issued and fully paid up. In June 220X2 the Company decided to convert the issued shares into stock. But in June, 20X3 the Company re-converted the stock into shares of ₹ 10 each, fully paid up.

Pass the necessary journal entries.

Solution

Journal Entries

20X2 June

Equity Share Capital A/c Dr. 4,00,000

To Equity Stock A/c 4,00,000

(Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated…)

20X3 June

Equity Stock A/c Dr. 4,00,000

To Equity Share Capital A/c 4,00,000

(Being re-conversion of ₹ 4,00,000 Equity Stock into 40,000 shares of ₹ 10 fully paid Equity Shares as per resolution in General Meeting dated...)

9.10 REDUCTION OF SHARE CAPITAL

Capital reduction of a company takes place strictly in accordance with the legal provisions of Section 100 to 105 of the Companies Act, 1956. If the company is authorized by its Articles of Association, it may, by a special resolution and on its confirmation by the court on petition, reduce its shares capital by the following ways:

- Reducing or extinguishing the liability of shareholders in respect of share capital not paid up.
- Writing off or cancelling any paid-up capital which is lost by available assets.
- Paying off paid up capital in excess of the requirements of the company.
- Any other method approved by the court.

As per Section 100, reduction (b) and (c) may be made either in addition to or without extinguishing or reducing the liability of shareholders for uncalled capital.

Any reduction of capital is dangerous for creditors, as issued capital of a company represents the security on which the creditors rely. Generally, companies do not call the full value of shares at one time. The uncalled capital acts as a future security for the creditors of the company. Therefore, any reduction in capital reduces the security of the creditors. In such a situation the creditors are entitled to object to the reduction. For this purpose, the court shall settle a list of creditors and hear their objections, if any, and on being satisfied that either the creditors consent to the reduction or that their debts have been discharged or secured by the company, may confirm the reduction on any terms it thinks fit. As per Sections 101 & 102 the court may direct the company to add the words “and reduced” to its name for a fixed period and to publish the reasons for reduction for the information of the public.

As per Section 103, the order of the court and minutes as approved by the court have to be filed with the Registrar who will register them and issue a certificate of registration which will be conclusive evidence that everything is in order.

Reduction of capital is purely democratic and is decided by securing the consent of the holders of at least three-fourth of the shares concerned in separate class meetings by means of special resolution. If at least one-tenth of the issued shareholders are not satisfied with the resolution of reduction of capital, they may apply to the court within 21 days after the resolution is passed. In this case the decision of the court will be final.

Following are some exceptional cases in which reduction may take place without the sanction of the court:

- When shares are forfeited by the company for non-payment of calls on instalments.
- When redeemable preference shares are redeemed in accordance with provisions of Sec 80.
- When shares are surrendered to the company.
- When the company cancels any share of its nominal capital which has not been taken or agreed to be taken by any person.

Case I: Reducing the Liability of Shareholders in Respect of Uncalled/Unpaid Amount

When unpaid amount of the share capital is reduced/extinguished by the company, shareholders are benefited as they do not have to pay the amount to that extent in future. On the other side the security of the creditors is reduced. As a result, the partly paid-up shares become the fully paid up shares and the face value of the shares reduced. The required journal entry to cancel the uncalled amount will be as follows:

Share Capital (Partly paid up) Account Dr. (With paid up amount of shares)

To Share Capital (fully paid up) account

Case II: Reduction in Capital by Refunding the Excess Capital

If the company is facing a problem of overcapitalization owing to more than one reason, such as closure of a particular line of production, it may reduce the capital by refunding the excess capital to its shareholders. As the reduction of paid-up capital reduces the creditors' security, the creditors may object to such a scheme. Therefore, the scheme of reducing of capital by refunding of excess capital should be sanctioned by the court after meeting out the creditors' objections for the purpose the following journal entries are recorded-

- When refunded amount of capital is due to shareholders:

  Share Capital Account Dr. (Amount to be refunded)

  To Shareholders' Account.

- When excess amount of capital is to be refunded:

  Shareholders' Account Dr. (Amount of refund)

  To Bank Account

Case III: Reduction in Capital by Reducing the Paid-up Capital

If a limited company suffers losses continuously over a number of years, the assets side of its balance sheet will show accumulated losses in the form of deferred expenses, intangible assets, discount on issue of shares and debentures, underwriting commission, cost of issue of shares and debentures, debit balance of P & L A/c etc. In the case of such companies, goodwill appearing in the assets side of the balance sheet will also a form of accumulated loss. Further, such companies may show the fixed assets, both tangible and intangible, at more than reasonable value due to writing off minimum amount of depreciation. It means that the capital of such companies (suffering losses continuously over a number of years) is not represented by its assets in the balance sheet. For the true representation of the assets by capital, A capital reduction programme is adopted. Under this programme that portion of capital which is already lost by assets is washed out. It is carried out by eliminating the lost capital and using the same for writing off the accumulated losses, overvaluation amount of assets and miscellaneous expenses appearing in assets side. This procedure is adopted by opening a new account 'Capital Reduction Account' or 'Reorganization Account' or 'Reconstruction Account' with the amount of Capital Reduction in the books of the company.

For this purpose, the following journal entries are recorded:

- When capital is reduced by writing off the paid-up value (face value) of shares, it means the change the category of shares. For this purpose, old share capital is closed by debiting and new share capital account is opened by crediting and the difference between these two is transferred to Capital Reduction Account. The journal entry will be:

Share Capital (Old) Account	Dr.	(Paid-up value of old shares)
To Share Capital (New) Account		(Paid-up value of new shares)
To Capital Reduction Account		(Amount of reduction)

Note: If capital is reduced by writing off the paid-up amount of shares capital which is lost, it means face value of the shares remains uncharged and the category of the share capital does not change. The journal entry will be:

Share Capital Account Dr. (Amount of reduction of Capital)

To Capital Reduction Account

or

To Reconstruction Account

- If some debenture-holders or creditors have been agreed to sacrifice their claims against company towards reconstruction:

Debentures Account Dr. (Amount of sacrifice)

Creditors Account Dr.

To Reconstruction Account

Sometimes new debentures are issued in the exchange of old debentures:

Old Debentures Account Dr. (Amount of old debenture)

To New Debentures Account (Amount of new debenture)

To Reconstruction Account (Amount of sacrifice)

- When the amount of Reconstruction A/c is utilized in writing off accumulated losses, fictitious assets and bringing down the assets to their reasonable value:

  Reconstruction Account Dr. (Total amount written off)

  To Profit and Loss A/c

  To Discount on Issue of Shares A/c

  To Discount on Issue of Debentures A/c

  To Preliminary Expenses A/c

  To Patents A/c as case may be

  To Goodwill A/c

  To Trademarks A/c

  To Unrecorded Liabilities A/c

  To Other Assets A/c

- If there is any appreciation in the value of any assets:

  Assets' Account Dr. (Amount of appreciation)

  To Capital Reduction Account

- If any contingent liability arises and is paid immediately, journal entry will be:

  Reconstruction (capital reduction) A/c Dr.

  To Contingent Liability A/c

  Contingent Liability A/c Dr.

  To Bank A/c

- If there remains some credit balance in the reconstruction account that will be transferred to capital reserve account.

  Reconstruction Account Dr.

  To Capital Reserve Account

- If the amount of writing off the assets, accumulated losses and deferred expenses is more the capital reduction, excess will be adjusted against the reserves appearing in the liability side. The journal entry will be:

  Reserve Account Dr.

  To Reconstruction/Capital Reduction Account.

9.11 COMPROMISE/ARRANGEMENTS

A scheme of compromise and arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems. Such an arrangement therefore also involves sacrifices by shareholders, or creditors and debenture holders or by all.

Accounting treatment for some of the cases is as follows:

- When equity shareholders give up their claim to reserves and accumulated profits:

  Reserves Account Dr. (With the amount of reserve)

  To Reconstruction Account

- Settlement of outside liabilities at lesser amount: Liabilities such as sundry creditors may agree to accept less amount in lieu of final settlement. Treatment will be as follows:

  Outside Liabilities Account Dr. (With the amount of sacrifice

  Provision Account, if any Dr. made by creditors, debenture

  To Reconstruction Account holders etc.)

9.12 SURRENDER OF SHARES

In this method, shares are divided into shares of smaller denominations and then the shareholders are made to surrender their shares to the company. These shares are then allotted to debenture holders and creditors so that their liabilities are reduced. The unutilized surrendered shares are then cancelled by transfer to Reconstruction Account.

9.13 ILLUSTRATIVE EXAMPLES – II

Illustration 6

The Balance Sheet of Vaibhav Ltd. as on 31st March 20X1 is as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Equity Shares of ₹ 100 each	2,00,00,000	Fixed Assets	2,50,00,000

6% Cumulative Preference Shares of ₹ 100 each	1,00,00,000	Investments (Market Value ₹ 19,00,000)	20,00,000
5% Debentures of ₹ 100 each	80,00,000	Current Assets	2,00,00,000
Sundry Creditors	1,00,00,000	P & L A/c	12,00,000
Provision for taxation	2,00,000		
TOTAL	**4,82,00,000**	**TOTAL**	**4,82,00,000**

Additional Information:

i. All the existing equity shares are reduced to ₹ 40 each.

ii. All preference shares are reduced to ₹ 60 each.

iii. The rate of Interest on Debentures increased to 6%. The Debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.

iv. Fixed assets are to be written down by 20%.

v. Current assets are to be revalued at ₹ 90,00,000.

vi. Investments are to be brought to their market value.

vii. One of the creditors of the company to whom the company owes ₹ 40,00,000 decides to forgo 40% of his claim. The creditor is allotted with 60000 equity shares of ₹ 40 each in full and final settlement of his claim.

viii. The taxation liability is to be settled at ₹ 3,00,000.

ix. It is decided to write off the debit balance of Profit & Loss A/c.

Pass journal entries giving effect to the above.

Solution:

Journal Entries in the books of Vaibhav Ltd.

(i) Equity shares capital (₹ 100) A/c Dr. 2,00,00,000

To Equity Share Capital (₹ 40) A/c 80,00,000

To Capital Reduction A/c 1,20,00,000

(Being conversion of equity share capital of ₹ 100 each into ₹40 each as per reconstruction scheme)

(ii) 6% Cumulative Preference Share capital (₹ 100) A/c Dr. 1,00,00,000

To 6% Cumulative Preference Share Capital (₹ 60) A/c 60,00,000

To Capital Reduction A/c 40,00,000

(Being conversion of 6% cumulative preference share capital of ₹ 100 each into ₹ 60 each as per reconstruction scheme)

(iii)	5% Debentures (₹ 100) A/c	Dr.	80,00,000	
	To 6% Debentures (₹ 70) A/c			56,00,000
	To Capital Reduction A/c			24,00,000

(Being 6% debentures of ₹ 70 each issued to existing 5% debenture holders. The balance transferred to capital reduction account as per reconstruction scheme)

(iv)	Sundry Creditors A/c	Dr.	40,00,000	
	To Equity Share Capital (₹ 40) A/c			24,00,000
	To Capital Reduction A/c			16,00,000

(Being a creditor of ₹ 40,00,000 agreed to surrender his claim by 40% and was allotted 60,000 equity shares of ₹ 40 each in full settlement of his dues as per reconstruction scheme)

(v)	Provision for Taxation A/c	Dr.	2,00,000	
	Capital Reduction A/c	Dr.	1,00,000	
	To Liability for Taxation A/c			3,00,000

(Being conversion of provision for taxation into liability for taxation for settlement)

(vi)	Capital Reduction A/c	Dr.	199,00,000	
	To P & L A/c			12,00,000
	To Fixed Assets A/c			50,00,000
	To Current Assets A/c			110,00,000
	To Investments A/c			1,00,000
	To Capital Reserve A/c (Bal. fig.)			26,00,000

(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments, and the Balance transferred to Capital Reserve)

(vii)	Liability for Taxation A/c	Dr.	3,00,000	
	To Current Assets (Bank A/c)			3,00,000

(Being the payment of tax liability)

Illustration 7

Following is the Summary Balance Sheet of ABC Ltd. as of 31st March, 20X1:

Liabilities	***Amount (₹)***	***Assets***	***Amount (₹)***
Share capital:		*Plant and machinery*	*9,00,000*
2,00,000 Equity shares of ₹ 10 each	*20,00,000*	*Furniture and fixtures*	*2,50,000*
6,000 8% Pref. sh. of ₹ 100 each	*6,00,000*	*Patents and copyrights*	*70,000*
9% Debentures	*12,00,000*	*Investments (at cost) (Market value ₹ 55,000)*	*68,000*
Bank overdraft	*1,50,000*	*Inventory*	*14,00,000*
Trade payables	*5,92,000*	*Trade receivables*	*14,39,000*
		Cash and bank balance	*10,000*
		Profit and Loss A/c	*4,05,000*
	45,42,000		***45,42,000***

Additional Information:

(i) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.

(ii) Debenture holders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.

(iii) Inventory equal to ₹ 5,00,000 in book value will be taken over by trade payables in full settlement of their dues.

(iv) Investment value to be reduced to market price.

(v) The company would issue 11% Debentures for ₹ 3,00,000 and augment its working capital requirement after settlement of bank overdraft.

Pass necessary Journal Entries in the books of the company.

Solution

Journal Entries in the Books of ABC Ltd.

		Dr.	Cr.
8% Preference share capital A/c	Dr.	6,00,000	
To Preference shareholders A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital]			
Preference shareholders A/c	Dr.	4,20,000	
To 11% Debentures A/c		4,20,000	
[Being the issue of debentures to preference shareholders]			

9% Debentures A/c Dr. 12,00,000

To Debenture holder's A/c 12,00,000

[Being transfer of 9% debentures to debenture holder's A/c]

Debenture holder's A/c Dr. 12,00,000

To Plant & machinery A/c 9,00,000

To Capital reduction A/c 3,00,000

[Settlement of debenture holders by allotment of plant & machinery]

Trade payables A/c Dr. 5,92,000

To Inventory A/c 5,00,000

To Capital reduction A/c 92,000

[Being settlement of creditors by giving Inventories]

Bank A/c Dr. 3,00,000

To 11% Debentures A/c 3,00,000

[Being fresh issue of debentures]

Bank overdraft A/c Dr. 1,50,000

To Bank A/c 1,50,000

[Being settlement of bank overdraft]

Capital reduction A/c Dr. 5,72,000

To Investment A/c 13,000

To Profit and loss A/c 4,05,000

To Capital reserve A/c 1,54,000

[Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]

9.8 KEYWORDS

Internal Reconstruction: It is an arrangement made by the companies whereby the claims of. shareholders, debenture holders, creditors and other liabilities are altered/ reduced, so that the accumulated loss are written off, asset are valued at its fair price.

Internal reconstruction refers to the internal re-organization of the financial structure of a company.

Capital Reduction: It is the process of decreasing a company's shareholders equity.

Alteration in share capital: This can be done through a) increase in share capital, b) consolidation of shares, c) sub-division of shares, d) cancellation of unissued shares, and e) conversion of shares into stock

Reduction in share capital: it may be of three types such as: a) reducing the liability in respect of uncalled amt of shares, b) paying off unpaid capital which is in excess of the need of company, and c) cancelling paid-up capital which is already lost or not represented by available assets.

9.9 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House
- Gupta, Nirmal. Corporate Accounting. Sahitya Bhawan, Agra.
- Compendium of Statements and Standards of Accounting. The Institute of Chartered Accountants of India, New Delhi
- Monga, J.R. Fundamentals of Corporate Accounting. Mayur Paper Backs, New Delhi.
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers, New Delhi.
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

9.10 TERMINAL QUESTIONS/EXERCISES

Questions

1. What is Reconstruction? State the objectives of reconstruction.
2. Explain the types of reconstruction of companies.
3. State the significance & objectives of Internal Reconstruction of companies.
4. What are the different methods of Internal Reconstruction of companies? Explain in detail.
5. Describe the procedure of Alteration of Share capital.
6. Discuss the procedure of Reduction of Share Capital.
7. The following is the summarised Balance Sheet of Weak Ltd. as on 31.3.20X1:

Liabilities	Amount (₹)	Assets	Amount (₹)
Equity shares of ₹ 100 each	1,00,00,000	Fixed assets	1,25,00,000

12% cumulative preference shares of ₹ 100 each	50,00,000	Investments (Market value ₹ 9,50,000)	10,00,000
10% debentures of ₹ 100 each	40,00,000	Current assets	1,00,00,000
Trade payables	50,00,000	P & L A/c	6,00,000
Provision for taxation	1,00,000		
	2,41,00,000		**2,41,00,000**

The following scheme of reorganisation is sanctioned:

(i) All the existing equity shares are reduced to ₹ 40 each. ed to ₹ 60 each.

(ii) All preference shares are reduced to ₹ 60 each

(iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.

(iv) One of creditors of the company to whom the company owes ₹ 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of ₹ 40 each in full satisfaction of claim.

(v) Fixed assets are to be written down by 30% & Current assets are revalued at ₹ 45,00,000.

(vi) The taxation liability of the company is settled at ₹ 1,50,000.

(vii) Investments to be brought to their market value.

(viii) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries giving effect to the above.

8. The following is the summarized Balance Sheet of X Ltd. as on 31st March, 20X1:

Liabilities	Amount (₹)	Assets	Amount (₹)
12,000, 10% Pref sh of ₹ 100 each	12,00,000	Goodwill	90,000
24,000, Equity shares of ₹ 100 each	24,00,000	Land & building	12,00,000
10% Debentures	6,00,000	Plant & machinery	18,00,000
Bank overdraft	6,00,000	Inventories	2,60,000
Trade payables	3,00,000	Trade receivables	2,80,000
		Cash	30,000
		Profit & Loss Account	14,40,000
	51,00,000		**51,00,000**

On the above date, the company adopted the following scheme of reconstruction:

(i) The equity shares are to be reduced to shares of ₹ 40 each fully paid and the preference shares to be reduced to fully paid shares of ₹ 75 each.

(ii) Debenture holders took over Inventories & Trade receivables in full satisfaction of claims.

(iii) Land & building to be appreciated by 30% & Plant & Machinery to be depreciated by 30%.

(iv) The debit balance of profit and loss account and intangible assets are to be eliminated.

(v) Expenses of reconstruction amounted to ₹ 5,000.

Give journal entries incorporating the above reconstruction.

9. The following scheme of reconstruction has been approved for Win Limited:

(i) Shareholders to receive in lieu of the present holding at 1,00,000 shares ₹10 each, following:

(a) New fully paid ₹ 10 Equity shares equal to 3/5th of their holding.

(b) 10% Preference shares fully paid to the extent of 1/5th of the above new equity shares.

(c) ₹ 40,000, 8% Debentures.

(ii) An issue of ₹ 1 lakh 10% first debentures was made and allotted, payment for the same being received in cash forthwith.

(iii) Goodwill which stood at ₹ 1,40,000 was completely written off.

(iv) Plant and machinery which stood at ₹ 2,00,000 was written down to ₹ 1,50,000.

(v) Freehold property which stood at ₹ 1,50,000 was written down by ₹ 50,000.

You are required to draw up the necessary Journal entries in the Books of Win Limited for the above reconstruction.

B.COM
SEMESTER – III
COURSE: CORPORATE ACCOUNTING

UNIT-10: ACCOUNTING FOR HOLDING COMPANIES: PREPARATION OF CONSOLIDATED BALANCE SHEET WITH ONE SUBSIDIARY COMPANY

STRUCTURE

10.0 OBJECTIVES

After going through this unit, you should be able to:

- Understand the Accounts of Holding Companies
- Explain the various parts of Consolidated Balance Sheet
- Work-out some illustrative examples w.r.t. Consolidated Balance Sheet.

10.1 INTRODUCTION

A company may purchase either the whole or the majority of shares of another company so as to have controlling interest in such a company or companies. The controlling company is known as the holding company and the company so controlled is known as subsidiary company. Holding company has the power to nominate the majority of the directors of subsidiary company. Consolidated balance sheet is a single balance sheet of holding and subsidiary companies.

As already discussed in the previous unit regarding the concept of Holding Company and the important steps for preparing the consolidated balance sheet as per Ind AS 110, this particular unit is concerned about the preparation of consolidated balance sheet with one subsidiary only.

10.2 ACCOUNTS OF HOLDING COMPANIES

The following documents in respect of a subsidiary or subsidiaries should be attached with the balance sheet of a holding company:

- **(a)** A copy of Balance Sheet of Subsidiary.
- **(b)** A copy of its Statement of Profit and Loss.
- **(c)** A copy of Report of its Board of Directors.
- **(d)** A copy of Report of its Auditors.
- **(e)** A Statement of Holding Company's interest in Subsidiary.

According to section 129(3) of the Companies Act 2013, a holding company shall prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own, which shall also be laid before the annual general meeting of the company along with the laying of its financial statements.

10.3 CONSOLIDATED BALANCE SHEET

Consolidated balance sheet is a single balance sheet of holding and subsidiary companies. In addition to the legal balance sheet as prescribed in Schedule III, the holding company may also publish a Consolidated Balance Sheet in which the assets and liabilities of all the subsidiaries are shown along with its own assets and liabilities as the Balance Sheet of a head office incorporates the assets and liabilities of its branches. By way of Consolidated Balance Sheet, the investments of the holding company in the subsidiary company are replaced by net assets.

10.4 NON-CONTROLLING INTEREST

When some of the shares of the subsidiary company are held by outsiders (other than the holding company), their interest (proportionate share of assets and liabilities) in the subsidiary company is called as Non-Controlling Interest in subsidiary company.

The Non-Controlling Interest is shown on the liabilities side of the Balance Sheet of the holding company under the head 'Share Capital'.

The Non-Controlling Interest can be calculated as follows:

Paid up value of shares held by outsiders	xxx
Add: Proportionate share of capital/ revenue profit and/or reserves	xxx
	xxx
Less: Proportionate share of capital/ revenue losses	xxx
Value of Non-Controlling Interest	**xxx**

If the preference shares are held by outsiders, paid up value of such shares together with dividend thereon (if there is profit) is added to the value of Non-Controlling Interest.

10.5 CAPITAL PROFITS / LOSSES

Capital profit is money brought into the company primarily through internal measures. It is profit that is not earned in the regular course of the business. Capital profit includes items such as income from the sale of a fixed asset (property owned by the business and used in its trade), income from the sale of premium shares of stock and money brought into the business by investments or borrowed from partners, investors, or financial institutions. Capital profits are part of the company equity and can either be deposited into the company’s capital account or credited to the reserve account. If credited to the reserve account, the business should list the amount as a liability on its balance sheet.

These are otherwise known as pre-acquisition profits or losses. These are reserves/P&L balance on the date of purchase of shares of Subsidiary company by Holding company.

These profits/losses are to be divided among Holding company and outsiders (minority) on the basis of their shareholding proportions.

Holding company's share of capital profits/losses is adjusted on the calculation of cost of control (goodwill) / capital reserve.

The outsiders' share of capital profits/losses is adjusted on Non-Controlling Interest.

10.6 REVENUE PROFITS / LOSSES

Revenue profit is the money the business earns through its particular trade. A retail store that sells goods, for example, earns revenue profit when sales of those goods occur. Revenue profit also includes money earned from investments and commissions. Income statements disclose the business’s gross profit for a given time period known as Revenue profit -- gross profit is the total revenue less the cost of sales.

These are otherwise known as post-acquisition profits/losses. These profits/losses are earned by Subsidiary company after the acquisition shares by Holding company.

These profits/losses are divided among Holding company and outsiders (minority) on the basis of their shareholding proportions.

Holding company's share of revenue profits/losses is added / deducted from its P&L account in the consolidated balance sheet.

The outsiders' share of revenue profits/losses is adjusted on Non-Controlling Interest.

10.7 COST OF CONTROL (GOODWILL) OR CAPITAL RESERVE

If the holding company purchases the shares of the subsidiary company at a price more than their paid-up value, the excess is cost of control or goodwill, if there is no reserve or profit & loss balance in the subsidiary company on date of acquisition of shares of the subsidiary company. If the shares are purchased at a price which is less than the paid-up value of the shares, the difference is taken as capital reserve or profit.

The goodwill or cost of control is shown on the assets side and the capital reserve or profit is shown on the liabilities side in the Consolidated Balance Sheet.
The Cost of Control/Capital Reserve is calculated as follows:

Amount paid for 'n' shares of Subsidiary company			**xxx**
Less:	Paid up value of shares held by Holding company	xxx	
	Add/Less: Holding company's share of capital profits/losses	xxx	**xxx**
Cost of Control/Capital Reserve			**xxx***

*If it is positive, the amount will be treated as cost of control and if it is negative, the amount will be treated as capital reserve.
The amount of Cost of Control is shown in the Asset side of the consolidated balance sheet and the Capital Reserve is shown in the Liability of the consolidated balance sheet.

10.8 REVALUATION OF ASSETS AND LIABILITIES

Sometimes, the assets and/or liabilities of subsidiary companies are revalued at the time of acquisition of shares. If assets and liabilities of Subsidiary company are revalued at the time of acquisition of shares, there will be revaluation profits/losses. The revaluation profits/losses are treated as capital profits/losses.
Profits at the end of the year will be charged with depreciation on the revised values in case the value of fixed assets appreciates, and excess depreciation will be credited back to the profit, in case the value of assets depreciates.
Holding company's share of revaluation profits/losses is adjusted in the calculation of Goodwill/Capital Reserve. Outsiders' share of revaluation profits/losses is adjusted in the calculation of Non-Controlling Interest.

10.9 ISSUE OF BONUS SHARES BY SUBSIDIARY COMPANY

Subsidiary company issues bonus shares either out to capital profits or revenue profits.
If bonus shares are issued out of capital profits, there will be no effect on consolidated balance sheet. This is because Holding company’s share of capital profits is reduced on account of issue of bonus shares and on the other hand, paid up value of shares held by Holding company and the outsiders (minority) increases. There will be no change in the values of the Cost of Control/Capital Reserve or Non-Controlling Interest.
Bonus shares issued out of revenue profits will have effect on the consolidated balance sheet. The value of shares held by Holding company and outsiders will increase. The increased paid-up value of shares of Holding company will reduce the Cost of Control or increase the Capital Reserve. But there will be no change in the Non-Controlling Interest.

10.10 TREATMENT OF DIVIDEND

Subsidiary company may declare dividend from either capital profits or revenue profits.
The effect of dividend declared out of the capital profits on the consolidated balance sheet is shown below:

Consolidated Balance Sheet

Liabilities	Amount (₹)	Amount (₹)	Assets	Amount (₹)	Amount (₹)
			Investments in shares of Subsidiary Co.	xxx	
			Less: Holding Co. share of dividend	xxx	xxx*
			Cash/ Bank	xxx	
			Add: Holding Co. share of dividend	xxx	xxx*
		xxx			**xxx**

***This amount will be the amount paid for the purchase of shares for calculating the cost of control/capital reserve.

The effect of dividend declared out of revenue profits on consolidated balance sheet is shown below:

Consolidated Balance Sheet

Liabilities	Amount (₹)	Amount (₹)	Assets	Amount (₹)	Amount (₹)
P & L Account (Holding company)	xxx		Cash/ Bank	xxx	
Add: Holding co. share of dividend	xxx		Add: Holding co. share of dividend	xxx	
		xxx			**xxx**

Note: Outsiders' share of dividend will not affect the consolidated balance sheet. The outsiders receive the dividend in cash and use the dividend amount as they like.

10.11 INTER - COMPANY BALANCES (MUTUAL OWINGS)

In preparing the consolidated balance sheet mutual Owings between Holding company (H Ltd) and Subsidiary company (S Ltd) are to be eliminated. Such transactions are:

1. Goods sold on credit by H Ltd to S Ltd and vice versa.
2. Bills drawn by H Ltd accepted by S Ltd and vice versa.
3. Loans advanced by H Ltd to S Ltd and vice versa.
4. Debentures issued by H Ltd and held by S Ltd and vice versa.

The effects of the above transactions are involved in the consolidated balance sheet is shown below:

Consolidated Balance Sheet

Liabilities	Amount (₹)	Amount (₹)	Assets	Amount (₹)	Amount (₹)
Sundry creditors (H Ltd + S Ltd) Less: Mutual Owings	xxx xxx	xxx	Sundry debtors (H Ltd + S Ltd) Less: Mutual Owings	xxx xxx	xxx
Bills payable (H Ltd + S Ltd) Less: Mutual Owings	xxx xxx	xxx	Bills receivable (H Ltd + S Ltd) Less: Mutual Owings	xxx xxx	xxx
Loans (H Ltd + S Ltd) Less: Mutual Owings	xxx xxx	xxx	Loans (H Ltd + S Ltd) Less: Mutual Owings	xxx xxx	xxx
Debentures (H Ltd + S Ltd) Less: Mutual Owings	xxx xxx	xxx	Investment (H Ltd + S Ltd) Less: Mutual Owings	xxx xxx	xxx

Unrealized profit on Stock Reserve

If intercompany transfer of stock takes place at a profit, there may be an unrealized profit on stock unsold at the close of financial year. The unrealized profits on stock should be deducted from stock on the asset side of the consolidated balance sheet. In the liability side, the amount of stock reserve should be deducted from the P& L account. For example, if Holding company purchased from Subsidiary company goods worth ₹ 40,000 on which Subsidiary company had charged a profit of 25 percent on cost and goods worth ₹25,000 remained unsold at the end of the financial year. The unrealized profit on stock is (25/125% of 25,000) ₹ 5,000. The effect of this transaction on the consolidated balance sheet is shown below:

Consolidated Balance Sheet

Liabilities	**Amount (₹)**	**Amount (₹)**	**Assets**	**Amount (₹)**	**Amount (₹)**
P & L Account	xxx		Stock - Holding Company	xxx	
Less: Stock reserve	xxx	xxx	Subsidiary Company	xxx	
				xxx	
			Less: Stock reserve	xxx	xxx
		xxx			xxx

10.12 ILLUSTRATIVE EXAMPLES

Illustration 1:

The following are the Balance Sheets of a holding company A Ltd. and its subsidiary Y Ltd. as on 31st March 2021:

Liabilities	**A Ltd.**	**Y Ltd.**	**Assets**	**A Ltd.**	**Y Ltd.**
Share Capital:			Sundry Assets	260000	240000
Shares of ₹ 10 each	400000	200000	Investments:		
Profit and Loss A/c	80000	20000	20000 sh. in Y Ltd.	300000	
General Reserve	40000	16000			
Current Liabilities	40000	4000			
	560000	**240000**		**560000**	**240000**

A Ltd. acquired the shares of Y Ltd. on 31st March 2021. Prepare the Consolidated Balance Sheet.

Solution:

Consolidated Balance Sheet of A Ltd. and its Subsidiary Y Ltd. as on 31st March 2021

Particulars	Note No.	Amount (₹)
A. Equity and Liabilities		
a. Share Capital	1	400000
b. Reserves and Surplus	2	120000
Current Liabilities A Ltd. 40000 Y Ltd. 4000		44000
Total		**564000**
B. Assets Non-current Assets		
Fixed Tangible Assets (Sundry Assets) A Ltd. 260000 Y Ltd. 240000		500000
Intangible Assets - Goodwill		64000
Total		**564000**

Notes to Accounts

Note No.	Particulars	Amount (₹)
1.	**Share Capital** **Issued and subscribed** **(40000 Equity shares of ₹ 10 each)**	**400000**
2.	**Reserves and Surplus**	**120000**
	General Reserve	40000
	P & L A/c	80000

Calculation of Goodwill or Cost of Control:

	Amount (₹)	Amount (₹)
Cost of Shares in S Ltd.		**300000**
Less: Face value of shares in S Ltd.	200000	
Profit and Loss Account	20000	
General Reserve	16000	**236000**
Goodwill or Cost of Control		**64000**

Illustration 2:
The Balance Sheets of the holding company X Ltd. and its subsidiary Y Ltd. as on 31st March 2021 are as follows:

Liabilities	X Ltd. (₹)	Y Ltd. (₹)	Assets	X Ltd. (₹)	Y Ltd. (₹)
Share Capital: Shares of Re. 1 each	72000	36000	Sundry Assets Investments:	120000	72000
Profit and Loss Account	18000	12000	36000 shares in Y Ltd.	45000	
General Reserve	12000	6000			
Current Liabilities	63000	18000			
	165000	**72000**		**165000**	**72000**

X Ltd. acquired the shares in Y Ltd. on 31st March 2021. Prepare the Consolidated Balance Sheet.

Solution:

Consolidated Balance Sheet of X Ltd. and its Subsidiary Y Ltd. as on 31st March 2021

Particulars	Note No.	Amount (₹)

A. Equity and Liabilities **Shareholders' Fund**		
a. Share Capital	1	72000
b. Reserves and Surplus	2	39000
Current Liabilities		
X Ltd. 63000		
Y Ltd. 18000		81000
Total		**192000**
B. Assets		
Fixed Assets - Sundry Assets X Ltd. 120000 Y Ltd. 72000		192000
Total		**192000**

Notes to Accounts

Note No.	Particulars	Amount (₹)
1.	**Issued and Subscribed Share Capital** **72000 Equity shares of Re. 1 each**	**72000**
2.	**Reserves and Surplus**	**39000**
	Capital Reserve	9000
	General Reserve	18000
	P & L A/c	12000

Calculation of Capital Reserve:

	Amount (₹)	Amount (₹)
Cost of Shares in B Ltd.		45000
Less: Face value of shares in B Ltd.	36000	
Profit and Loss Account	12000	
General Reserve	6000	54000
Capital Reserve		9000

Illustration 3:

The following are the liabilities and assets of the holding company P Ltd. and its subsidiary Q Ltd. as on 31st March 2021. P Ltd. acquired 12000 shares in Q Ltd on 31st March 2021. Prepare the Consolidated Balance Sheet.

Liabilities	P Ltd. (₹)	Q Ltd. (₹)	Assets	P Ltd. (₹)	Q Ltd. (₹)
Share Capital: Shares of Re. 1 each	36000	15000	Sundry Assets	48000	24000
Sundry Liabilities	24000	9000	Investments: 12000 sh. in Q Ltd.	12000	
	60000	**24000**		**60000**	**24000**

Solution:

Share of holdings by P Ltd.in Q Ltd. = 12000 shares out of 15000 shares = 80%

Share of holdings by Outsiders in Q Ltd. = 3000 shares out of 15000 shares = 20%

Consolidated Balance Sheet of P Ltd. and its Subsidiary Q Ltd. as on 31st March 2021

Particulars	Note No.	Amount (₹)
A. Equity and Liabilities		
a. Share Capital (36000 Equity shares of ₹ 1 each)	1	36000
Non-Controlling Interest		3000
Current Liabilities		

P Ltd. 24000 Q Ltd. 9000		33000
Total		**72000**
B. Assets		
Fixed Assets - Sundry Assets P Ltd. 48000 Q Ltd. 24000		72000
Total		**72000**

Calculation of Non-Controlling Interest = 3000 shares of ₹ 1 each = ₹ 3000

Illustration 4:

The following are the liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st March 2021:

Liabilities	H Ltd. (₹)	S Ltd. (₹)	Assets	H Ltd. (₹)	S Ltd. (₹)
Share Capital: Shares of Re. 1 General Reserve Profit and Loss Account (Current Year)	 300000 120000 90000	 240000 60000 30000	Investments: 192000 sh. in S Ltd. Other Assets	210000 300000	 330000
	510000	330000		510000	330000

On 1st April 2020 H Ltd. acquired the shares in S Ltd. when the plant and machinery were revalued to ₹ 240000 from ₹ 180000 and furniture of S Ltd. was revalued to ₹ 45000 from ₹ 60000. Depreciation for plant and machinery and furniture are 10% and 5% respectively. The balance sheet of S Ltd. showed these assets on revalued basis. Prepare the Consolidated Balance Sheet.

Solution:

Share of holdings by H Ltd.in S Ltd. = 192000 shares out of 240000 shares = 80%

Share of holdings by Outsiders in S Ltd. = 48000 shares out of 240000 shares = 20%

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as on 31st March 2021

Particulars	Note No.	Amount (₹)
A. Equity and Liabilities		

a. Share Capital	1	300000
b. Reserves and Surplus	2	295800
Non-Controlling Interest		73950
Total		**669750**
B. Assets		
Fixed Assets [(240000 – 10% Depr) + (45000 – 5% Depr)]		258750
Other Assets		411000
Total		**669750**

Notes to Accounts

Note No.	Particulars	Amount (₹)
1.	**Share Capital**	
	Issued and Subscribed 300000 Shares of ₹ 1 each	**300000**
2.	**Reserves and Surplus**	
	Capital Reserve	66000
	General Reserve	120000
	P & L A/c (90000+19800)	109800
	Total	**295800**

Working Notes:

Calculation of Capital Profit:

	Amount (₹)	Amount (₹)
Plant and Machinery (240000 – 180000)	60000	
Less: Loss on Furniture (60000 – 45000)	15000	
Revaluation Profit		45000
General Reserve		60000
Capital Profit		**105000**

Distribution of Capital Profit in S Ltd.:

Share of capital profit due to H Ltd. = 105000 x 80% = ₹ 84000

Share of capital profit due to Outsiders in S Ltd. = 105000 x 20% = ₹ 21000

Calculation of Revenue Profit:

	Amount (₹)	Amount (₹)
Profit and Loss Account balance of the year	30000	
Less: Additional Depr. On Plant & Machinery (60000 x 10%)	6000	
		24000
Add: Excess Depr. On Furniture (15000 x 5%)		750
Revenue Profit		**24750**

Distribution of Revenue Profit in S Ltd.:

Share of revenue profit due to H Ltd. = 24750 x 80% = ₹ 19800

Share of revenue profit due to Outsiders in S Ltd. = 24750 x 20% = ₹ 4950

Calculation of Capital Reserve:

	Amount (₹)	Amount (₹)
Cost of Shares in S Ltd.		210000
Less: Face value of shares in S Ltd.	192000	
Capital Profit	84000	276000
Capital Reserve		**66000**

Calculation of Non-Controlling Interest:

	Amount (₹)
Paid up value of Shares held by outsiders in S Ltd.	48000
Add: Share of revenue profit due to Outsiders in S Ltd.	21000
Add: Share of capital profit due to Outsiders in S Ltd.	4950
Non-Controlling Interest	**73950**

10.13 KEYWORDS

Holding Company: A company may purchase either the whole or the majority of shares of another company so as to have controlling interest in such a company or companies. The controlling company is known as the holding company.

Subsidiary Company: A company may purchase either the whole or the majority of shares of another company so as to have controlling interest in such a company or companies. The company so controlled is known as subsidiary company.

Consolidated Balance Sheet: Consolidated balance sheet is a single balance sheet of holding and subsidiary companies.

Non-Controlling Interest: A non-controlling interest, also known as a minority interest, is an ownership position wherein a shareholder owns less than 50% of outstanding shares and has no control over decisions.

Capital Profit: Capital profit is money brought into the company primarily through internal measures. It is profit that is not earned in the regular course of the business.

Revenue Profit: Revenue profit is the money the business earns through its particular trade. With regard to income statements, revenue profits are primary activities, whereas capital profits are secondary activities.

Cost of Control: Cost of control is the surplus paid in the form of premium by the holding company to the subsidiary company. the holding company pays the surplus over the value of assets that it will own in the subsidiary company to compensate for the goodwill earned by the subsidiary firm.

10.14 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

10.15 TERMINAL QUESTIONS/EXERCISES

Questions

1. Explain the following w.r.t. Holding & Subsidiary Company:
   a. Consolidated Balance Sheet
   b. Non-Controlling Interest
   c. Capital Profit/Losses
   d. Revenue Profit/Losses
2. What do you mean by Capital Reserves & Surplus & Revenue Reserves & Surplus?
3. What do you mean by Cost of Control? Explain its calculation & treatment.
4. In preparing the consolidated balance sheet mutual Owings between Holding company (H Ltd) and Subsidiary company (S Ltd) are to be eliminated. Such transactions are:
   a. Goods sold on credit by H Ltd to S Ltd and vice versa.
   b. Bills drawn by H Ltd accepted by S Ltd and vice versa.
   c. Loans advanced by H Ltd to S Ltd and vice versa.
   d. Debentures issued by H Ltd and held by S Ltd and vice versa.

   Give the effects of the above transactions in the consolidated balance sheet.
5. Write short notes on:
   a. Revaluation of Assets & Liabilities of Subsidiary Company
   b. Issue of Bonus Shares by Subsidiary Company
6. The following is the Balance Sheet of Hiny Ltd. and Sury Ltd. as on 31st March 2021

Liabilities	Hiny Ltd	Sury Ltd	Assets	Hiny Ltd	Sury Ltd
Share Capital (Shares of ₹ 10 each)	500000	400000	Sundry Assets	600000	600000
Reserves	200000	-	Investments in 100% shares of Sury Ltd	400000	-
Creditors	300000	200000			
	1000000	**600000**		**1000000**	**600000**

   Prepare a Consolidated Balance Sheet as on 31st March 2021.

   Ans: B/S ₹ 12, 00,000, Goodwill/Capital Reserve: Nil
7. The following is the Balance Sheet of Prem Ltd. and Ratna Ltd. as on 31st March 2021:

Liabilities	Prem Ltd	Ratna Ltd	Assets	Prem Ltd	Ratna Ltd
Share Capital (Shares of ₹ 10 each)	500000	400000	Sundry Assets	700000	600000
Reserves	200000	-	Investments in	300000	-

			100% shares of Ratna Ltd		
Creditors	300000	200000			
	1000000	**600000**		**1000000**	**600000**

Prepare a Consolidated Balance Sheet as on 31st March 2021.

Ans: B/S ₹ 13, 00,000, Goodwill/Capital Reserve: ₹ 1,00,000

8. The following is the Balance Sheet of RPL Ltd. and MPL Ltd. as on 31st March 2021

Liabilities	RPL Ltd	MPL Ltd	Assets	RPL Ltd	MPL Ltd
Share Capital (Shares of ₹ 10 each)	500000	400000	Sundry Assets	760000	600000
Reserves	200000	-	Investments in 60% shares of MPL Ltd	240000	-
Creditors	300000	200000			
	1000000	**600000**		**1000000**	**600000**

Prepare a Consolidated Balance Sheet as on 31st March 2021.

Ans: B/S ₹ 13, 60,000, Goodwill/Capital Reserve: Nil, Minority Interest = ₹ 1, 60,000

9. The following is the Balance Sheet of RPL Ltd. and MPL Ltd. as on 31st March 2021

Liabilities	RPL Ltd	MPL Ltd	Assets	RPL Ltd	MPL Ltd
Share Capital (Shares of ₹ 10 each)	500000	400000	Sundry Assets	700000	600000
Reserves	200000	-	Investments in 60% shares of MPL Ltd	300000	-
Creditors	300000	200000			
	1000000	**600000**		**1000000**	**600000**

Prepare a Consolidated Balance Sheet as on 31st March 2021.

Ans: B/S ₹ 13,60,000, Goodwill/Capital Reserve: ₹ 60,000, Minority Interest = ₹ 1,60,000

10. The following is the Balance Sheet of RPL Ltd. and MPL Ltd. as on 31st March 2021

Liabilities	RPL Ltd	MPL Ltd	Assets	RPL Ltd	MPL Ltd
Share Capital (Shares of ₹ 10 each)	500000	400000	Sundry Assets	800000	600000
Reserves	200000	-	Investments in 60% shares of MPL Ltd	200000	-
Creditors	300000	200000			

	1000000	**600000**		**1000000**	**600000**

Prepare a Consolidated Balance Sheet as on 31st March 2021.

Ans: B/S ₹ 14, 00,000, Goodwill/Capital Reserve: ₹ 40,000, Minority Interest ₹ 1,60,000

B.COM
SEMESTER – III
COURSE: CORPORATE ACCOUNTING

UNIT-11: ACCOUNTS OF HOLDING COMPANIES: RELEVANT PROVISIONS OF ACCOUNTING STANDARD 21/IND AS 110

STRUCTURE

11.0 OBJECTIVES

After going through this unit, you should be able to:

- Explore the concept of Holding, Subsidiary, & Group Company
- Explain the advantages and disadvantages of Holding Company.
- Understand the Steps for consolidation as per Ind AS 110.

11.1 INTRODUCTION

A company may purchase either the whole or the majority of shares of another company so as to have controlling interest in such a company or companies. The controlling company is known as the holding company and the company so controlled is known as subsidiary company. Holding company has the power to nominate the majority of the directors of subsidiary company. Consolidated balance sheet is a single balance sheet of holding and subsidiary companies. This unit explains the theoretical aspects of Holding Company and the important steps for preparing the consolidated balance sheet as per Ind AS 110.

11.2 MEANING OF HOLDING & SUBSIDIARY COMPANY

A Holding Company is the company that holds either the whole of the share capital or a majority of the shares in one or more companies so as to have a controlling interest in such companies. Such other companies are known as subsidiary companies. Unlike in amalgamation or absorption, the subsidiary companies retain their identities because they do businesses in their own names. A Holding company together with its Subsidiaries can be called as the Group of companies.

A Subsidiary Company shall be deemed to be a subsidiary company of another if and only if:

- that other company controls the composition of its board of directors; or
- when the first mentioned company is another company, holds more than half in nominal value of its equity share capital; or
- the company is a subsidiary of any company which is that other company's subsidiary.

A Subsidiary company may be either Wholly Owned Subsidiary or Partly Owned Subsidiary.

11.3 NEED FOR GROUP COMPANY

The following are the advantages for a company to operate as a group:

- Decentralization of financial risk: If one entity fails, it does not affect the other companies in the group. The other companies can continue even if one or two companies in the group fail.
- Lawful obligation: In some cases, the formation of a subsidiary company is a legal requirement.
- Diversification possible at lower cost: One company acquires controlling interest of another company. It helps the company to diversify its business activities at least cost.

11.4 TYPES OF HOLDING COMPANY

- Pure: This refers to those companies which do not participate in another business other than controlling one or more firms. It is formed for the purpose of owning stocks in other companies.
- Mixed Holding Companies: Refers to those companies which do not only control other companies but also engages in its own operations.
- Immediate: refers to that company which retains voting power or control of another company, in spite of the fact that the company itself is already controlled by another entity. It is a company that is already a subsidiary of another.
- Intermediate: It is a firm that is both a holding company of another entity and a subsidiary of a large corporation. This type of firm might be exempted from publishing financial records as a holding company of the smaller group.

11.5 ADVANTAGES OF HOLDING COMPANIES

- Better quality Decisions: The holding companies allow the better-quality decisions at all levels of the company. The holding company concentrates on the corporate policies and strategies and the operating levels in the implementation.

- Better Utilization of Resources: Holding companies facilitate the better utilization of the financial and the other resources of the companies. The holding company pools the resources of group of enterprises.
- Easy method of Acquiring Control: Through this method organizations must spend less in acquiring the control of the other company.
- Reduces Competition: Competition among the two companies is eliminated as both of the companies are managed by the same group.
- Easy Rid from Subsidiary: If the company wants to get rid of the subsidiary; it can easily do so by selling the shares of the subsidiary in the open market.
- Income tax benefits: Separate identities are maintained by both the companies so that they can avail the tax benefits by carrying forward their losses of the previous years.
- Efficient Management: It becomes easier to manage both the companies as both the companies maintain their separate identities. This increases the efficiency of the management.
- Enhances Corporate Planning: The holding company can concentrate to corporate planning, acquisition, and update technology and building of corporate culture on sound business principles.
- Managerial and Commercial Culture: The management of the holding company promotes the commercial and managerial culture instead of bureaucratic culture.

11.6 DISADVANTAGES OF HOLDING COMPANY

- Secret Reserves: To the detriment of the minority interest, the unscrupulous directors can easily create secret reserves.
- Difficulty in Ascertaining Financial Position: The creditors in the subsidiary company and the shareholders in the holding company may not be aware of true financial position of company.
- Mismanagement: When in the holding company number of constituents is more and there is not equivalent management efficiency, it results in the mismanagement of the operations of the company.
- Fraud in Inter-Company Transactions: There are more chances of fraud due to the inter-company transactions. This is due to the reason that inter-company transactions are settled at very high or very low price according to the requirement of the holding company.
- Difficulty in Valuation of Stock: It becomes difficult to value the stock as the stock of the company consists of huge quantity of inter-company goods.
- Oppression of Minority Shareholders: There is always the fear of oppression of minority shareholders as the financial and other resources are totally managed in a way that suits the interest of the holding company.

11.7 REGULATORY FRAMEWORK

- The Companies Act, 1956 - There was no provision for preparing Consolidated Financial Statement. However, the act had specified that parent company has to attach Financial Statements of subsidiary company with its own Standalone Financial Statement.
- Accounting Standard 21 (AS 21) - It had prescribed the format and preparing CFSs.
- The Companies Act, 2013 - It made mandatory for making CFSs by the Parent company U/S 129 (3) of Companies Act,2013.
- Indian Accounting Standard 110 (Ind AS 110) - It prescribed the procedure of preparing CFSs in line with IFRS-10.

11.8 STEPS OF CONSOLIDATION AS PER IND AS 110

STEP-1: MEASUREMENT OF DEGREE OF CONTROL

- "Control means ownership."
- Degree of control means percentage (%) of ownership acquired.
- What is NCI?
    - NCI stands for Non-Controlling Interest.
    - It is also known as Minority Interest.
    - It is the share of ownership by outsiders in the subsidiary company's equity.
    - NCI owns less than 50% share in subsidiary company's equity.
    - NCI has no control over the decisions made in subsidiary company.
- Recognition of NCI-
    - Under AS 21- The term minority interest (MI) was used and shown as liability in Balance sheet.
    - Under Ind AS 110- The term Minority interest is replaced by NCI and shown as a part of shareholders' fund.

Q1. Company B has Authorized shares of 40,000 @ Rs. 100/- each. Company A purchases 32,000 shares of Company B @ Rs. 60,000/-. Calculate the degree of control.

Answer: Company B has 40,000 authorized shares. Company A has purchased 32,000 shares.

Degree of Control by Company A= (32000/40000) * 100= 80%

Degree of Control by Company B= (8000/40000) *100= 20%

STEP-2: DATE OF ACQUISITION

It is the date on which parent company purchases/ acquired the shares of subsidiary company.

It may be-

- At the beginning of Financial Year (Case 1)
- At the end of Financial Year (Case-2)
- In between the Financial Year (Case-3)

Treatment of Profit & loss of subsidiary company in respect of date of acquisition:

- In case 1: Entire profit/loss earned during the year will be post acquisition profit.
- In case 2: Entire profit/ loss earned will be pre-acquisition profit.
- In case 3: Entire profit/ loss will be divided in two parts.
    - From the date of beginning of the year to acquisition date- Pre- acquisition profit.
    - From the Acquisition date to end of the year- post- acquisition profit.

Q2. X Ltd. Company purchased 3/4th shares of company A Ltd.

- Case-1: on 31st March 2019
- Case-2: on 1st April 2019
- Case -3: on 1st September 2019

Net Profit of Company A: 2018-19 = ₹ 30 L; 2019-20 = ₹ 36 L

Calculate Degree of control & show the impact of date of acquisition on profit.

Answer: In this case Company A ltd. is a partially owned company.

- Degree of control by Company X ltd. = (¾)* 100= 75%
- Degree of control by Company A ltd. = (¼)* 100= 25%

In case 1: Date of acquisition is 31st March 2019.

Hence the profit for the period 2018-19 will be considered as pre-acquisition profit which is a capital profit.

In case 2: Date of acquisition is 1st April 2019.

Hence the profit for the period 2019-20 will be considered as post acquisition profit.

In case 3: Date of acquisition is 1st September 2019.

Here pre-acquisition period is from 1st April 2019 to 31st August, 2019= 5 months

Post-acquisition period is from 1st September 2019 to 31st march, 2020 = 7 months

Q3. Reserves & Surplus as on 31st March 2020: P Ltd. ₹ 100 Lakhs S Ltd. ₹ 30 Lakhs

Information: Date of acquisition 1st August 2019.

Calculate Pre & Post acquisition reserves & surplus under the following conditions.

- Case-1: All the profits earned during the F.Y.
- Case-2: Reserves & Surplus of subsidiary company includes reserve of Rs. 10 L which was at the beginning of the year.
- Case-3: Out of Reserves & Surplus of subsidiary company (i.e., 30 L) only Rs. 15L was earned during the financial Year.

Answer: Pre- acquisition period = From 1st April 2019 to 31st July 2019 = 4 Months.

Post – acquisition period= From 1st August 2019 to 31st March, 2020= 8 Months.

Pre-acquisition & Post-acquisition ratio = 1:2

- *<u>Case-1:</u>*

Pre-acquisition reserves & surplus = 30 L * 1/3 = 10 L

Post-acquisition reserves & surplus = 30 L * 2/3 = 20 L

- *<u>Case-2:</u>*

Previous year reserves & surplus as per the question = Rs. 10 L
Current Year Reserves & surplus = (30-10) L = 20 L
Pre-acquisition profit = 20 L * 1/3 = 7 L
Post-acquisition profit = 20 L * 2/3 = 13 L
Total pre-acquisition R&S = (10+ 7) = 17 L
Total post acquisition R&S = 13 L

- *Case- 3:*

Total R & S for the year as per the question Rs. 15 L
Remaining R&S = (30-15) = 15 L. It is previous year profit i.e., pre- acquisition profit.
During the year pre-acquisition profit = 15 L * 1/3 = 5L
During the year post- acquisition profit = 15L * 2/3 = 10 L
Total pre acquisition profit = (15+ 5) L = 20 L
Total post-acquisition profit = 10 L

STEP-3: TREATMENT OF PRE-ACQUISITION PROFIT

Pre-acquisition reserves and surplus (Profit) is a capital reserve (profit).

- In case, it is a wholly owned subsidiary company:

There is no minority shareholder & entire pre-acquisition profit is taken by parent company for calculation of cost of control (Goodwill/ Capital reserve).

- In case, it is a partially owned subsidiary company:

Entire pre-acquisition profit is divided between parent company and subsidiary company in the ratio of degree of control.

Share of parent company is considered for calculation of cost of control

Share of subsidiary company is considered for calculation of non-controlling interest (NCI).

STEP-4: TREATMENT OF POST- ACQUISITION PROFIT

Post-acquisition reserves and surplus is a revenue profit.

- In case it is a wholly owned subsidiary company:

Entire post-acquisition profit of subsidiary company is taken by parent company & disclosed in Consolidated Balance sheet under the head reserves & surplus. (Because it is of revenue in nature.)

- In case it is a partially owned subsidiary company:

Entire post-acquisition profit is divided in between parent company and subsidiary company in the ratio of degree of control.

Share of parent company in the post-acquisition profit will be disclosed in the Consolidated Balance sheet under the head reserves and surplus.

Share of subsidiary company in the post-acquisition profit is considered for calculation of Non-Controlling Interest (NCI)

Q4. X Ltd. Company purchased 3/4th shares of company A Ltd.

- Case-1: on 31st March 2019

- Case-2: on 1st April 2019
- Case -3: on 1st September 2019

Show the treatment for Pre & Post acquisition profit.

Net Profit of Company A:2018-19 = ₹ 30 L; 2019-20 = ₹ 36 L

Answer: Company A is a partially owned company.

Degree of control by Company X ltd. = (¾)* 100= 75%

Degree of control by Company A ltd. = (¼)* 100= 25%

- *<u>In case 1: Date of acquisition is 31st March 2019.</u>*

Profit for the period 2018-19 is pre-acquisition profit.

Share of Parent company (X ltd.) in pre-acquisition profit = 30L * 75% = 22.5 L

It will be considered for calculation of cost of control.

Share of Subsidiary company (A ltd.) in pre-acquisition profit = 30 L * 25% = 7.5 L

It will be considered for calculation of Non-Controlling Interest (NCI).

- *<u>In case 2: Date of acquisition is 1st April 2019.</u>*

Profit for the period 2019-20 is post-acquisition profit.

Share of Parent company (X ltd.) in post-acquisition profit = 36L * 75% = 27L

It will be shown in Consolidated Balance Sheet under the head Reserves & Surplus.

Share of Subsidiary company (A ltd.) in post-acquisition profit = 36 L * 25% = 9L

It will be considered for calculation of Non-Controlling Interest (NCI).

- *<u>In case 3: Date of Acquisition is 1st September 2019.</u>*

Here pre-acquisition period is from 1st April 2019 to 31st August 2019= 5months

Pre- acquisition profit = 36 L * 5/12 = 15 L

Here post-acquisition period is from 1st September 2019 to 31st March 2020 = 7 months.

Post- acquisition profit = 36 L * 7/12 = 21 L

Share of Parent company (X ltd.) in pre-acquisition profit = 15L * 75% = 11.25 L

It will be considered for calculation of cost of control.

Share of Subsidiary company (A ltd.) in pre-acquisition profit = 15L * 25% = 3.75 L

It will be considered for calculation of Non-Controlling Interest (NCI).

Share of Parent company (X ltd.) in post-acquisition profit = 21L * 75% = 15.75L

It will be shown in Consolidated Balance Sheet under the head Reserves & Surplus.

Share of Subsidiary company (A ltd.) in post-acquisition profit = 21 L * 25% = 5.25L

It will be considered for calculation of Non-Controlling Interest (NCI).

STEP-5: CALCULATION OF COST OF CONTROL

	<u>Amount (₹)</u>
Share of parent company in share capital of subsidiary company	xxx
ADD: Share of parent company in pre-acquisition R & S in subsidiary company	<u>xxx</u>
NET WORTH	xxx
LESS: Amount invested by parent company in subsidiary company	<u>xxx</u>

Goodwill/ Capital Reserve <u>***xxx***</u>

STEP-6: NON-CONTROLLING INTEREST (NCI)

	Amount (₹)
Share of Minority Shareholders in share capital of subsidiary company	xxx
ADD: Share of Minority Shareholders in Pre- acquisition profit	xxx
ADD: Share of Minority Shareholders in Post- acquisition profit	xxx
Total NCI	***xxx***

Keynote points of consolidation procedure:

- Items like assets, liabilities, incomes, expenses and cash flows of the parent company and its subsidiaries are to be combined.
- The carrying amount of parent company's investment in each subsidiary (investment by holding company in subsidiary company) & the parents portion of interest in the equity of each subsidiary (Share capital of subsidiary company) are eliminated.

Q5. ***BALANCE SHEET AS ON 31.03.2020***

PARTICULARS	H Ltd. (₹)	S Ltd. (₹)
A. ASSETS		
Non-current assets	100,000	40,000
2) Investment in S company	60,000	-
3) Current assets	40,000	60,000
Total	**200,000**	**100,000**
B. EQUITY & LIABILITIES		
1) Share capital	120,000	40,000
2) Reserves & Surplus	20,000	10,000
3) Non-current liabilities	30,000	30,000
4) Current liabilities	30,000	20,000
Total	**200,000**	**100,000**

Additional information:

a) H company has purchased 80% share of "S" company.

b) Date of acquisition is on 1.09.2019

c) All reserves & surplus of subsidiary company were earned during the F.Y.

Calculate Cost of Control, NCI. Prepare consolidated financial statement.

Answer: Date of Acquisition: 01. 09. 2019

Pre- acquisition period = 01.04.2019 to 31.08.2019 = 5 Months

Post- acquisition period = 01.09.2019 to 31.03.2020 = 7 Months

Pre acquisition & post acquisition ratio = 5:7

- <u>*Degree of Control:*</u>

Degree of control by H company = 80%

Degree of control by S company = 20%

- *Calculation of Pre & Post Reserves & Surplus of Subsidiary company*

  Pre-acquisition reserves & surplus = 10,000 * 5/12 = 4167

  Post-acquisition reserves & surplus = 10,000 * 7/12 = 5833

  - *Calculation of Cost of Control*

	Amount (₹)
Share of H company in share capital of S company (40,000 * 80%)	32,000
Share of H company in pre- acquisition reserves & surplus of S company (4167 * 80%)	3,334
NET WORTH	35,334
LESS: Amount invested by H company in S company	60,000
GOODWILL	*24,666*

  - *Calculation of NCI*

	Amount (₹)
Share of Minority Shareholders (MS) in share capital of S company (40,000 * 20%)	8,000
Share of MS in pre-acquisition reserves & surplus (4167 * 20%)	833
Share of MS in post-acquisition profit (5833 * 20%)	1167
NCI	*10,000*

CONSOLIDATED BALANCE SHEET as on 31.03.2020

PARTICULARS	H + S Ltd. (₹)
A. ASSETS	
1. Non-current assets (100,000 + 40,000)	140,000
2. Goodwill	24,666
3. Current assets (40,000 + 60,000)	100,000
Total	**264,666**
B. EQUITY & LIABILITIES	
1. Share capital	120,000
2. Reserves & Surplus [20,000 + (5833*80%)] = (20,000 + 4666)	24,666
3. Non-Controlling Interest	10,000
4. Non-current Liability	60,000
5. Current Liability	50,000
Total	**264,666**

STEP-7: TREATMENT OF UNREALISED PROFIT (LOSS) ON TRADING STOCK

In case parent company sells goods to subsidiary company vice-versa at profit and the same goods may not be sold at the end of financial year.

- The amount of profit earned by parent company is shown in the profit & loss in the Balance sheet of Parent company.
- The goods purchased by subsidiary company is shown as inventory in the books of subsidiary company.

As per Accounting principle "Any profit earned in between the group company are unrealized profit until the goods are sold outside the group."

Accounting treatment:

- Unrealized profit will be deducted from inventory in consolidated Balance sheet.
- Unrealized profit will be deducted from reserves and surplus in consolidated balance sheet.

Q6.

Particulars	Parent Co.	Subsidiary Co.
Stock	20,000	30,000
P/L	10,000	8,000

P company sold goods worth Rs. 15000/- for Rs. 16200/- and same has not been sold by S company during the F.Y. Give its accounting treatment in consolidated Balance Sheet.

Answer: **Consolidated Balance Sheet as on ……**

Particulars	Details	Amount (Rs.)
Equity & Liabilities		
Reserves & Surplus (P/L) (10,000 + 8000)	18,000	
Less: Unrealized profit (16,200- 15,000)	(1,200)	16,800
Assets		
Stock (20,000 + 30,000)	50,000	
Less: unrealized profit (16,200-15,000	(1200)	48,800

STEP-8: TREAMENT OF INTER-COMPANY OWNING (DEBT)

Inter-Company transactions may take place between parent company and subsidiary company in the following cases. Such as-

Credit sales/ credit purchases; Bills of exchange; Loans & advances

- <u>*Case-1: Accounting Treatment for credit sales/ credit purchases:*</u>

It will be deducted from trade receivables and trade payables from consolidated balance sheet.

Q7. Company A is the parent company of Company B. Company A sold goods worth Rs. 30,000/- to Company B on credit. Show the accounting treatment for it in Consolidated Balance Sheet.

Particulars	Company A	Company B
Trade receivables	100,000	-
Trade payables	50,000	30,000

Answer: **Consolidated Balance Sheet as on ……**

Particulars	Details	Amt. (Rs.)
Assets		
Current Assets		
Trade receivables	100,000	

Less: inter company owning	(30000)	70,000
Equity & Liabilities		
Current Liabilities		
Trade payables	50,000	
Less: inter company owning	(30,000)	20,000

- *<u>Case-2: Accounting Treatment for Bills of Exchange:</u>*

Bills of exchange is a credit instrument. Between parent & subsidiary company, for the drawer company it is Bills Receivables and for drawee company it is Bills payable.

It is deducted from trade receivables & trade payables in consolidated balance sheet.

Conditions in respect of Bills of Exchange:

- If the drawer company gets the B/E discounted with bank, then there are no intercompany transactions between parent & subsidiary company.
- Therefore, nothing will be deducted from bills receivables/ bills payables in the consolidated Balance sheet.
- Discounted B/E is not an inter-company transaction.
- Endorsement is not considered as inter-company transactions.
- If Discounted / Endorsed bills are "dishonored", then they are treated as intercompany transaction.

Q8. P Co. Trade Receivables ₹ 35,000; S Co. Trade Payables ₹ 25,000

P co. draws a bill on S co. for Rs. 3000/- out of which Rs. 1000/- is discounted.

Show the accounting treatment in Consolidated Balance Sheet.

Answer: **Consolidated Balance Sheet as on ……**

Particulars	**Details**	**Amt. (Rs.)**
Assets		
Current Assets		
Trade receivables (35000 – 1000)	34,000	
Less: Intercompany transaction	(2000)	32,000
Equity & Liabilities		
Current Liabilities		
Trade payables	25,000	
Less: inter company owning	(2,000)	23,000

- *<u>Case -3: Accounting Treatment for Loans & Advances:</u>*

If parent company provides loans & advances to subsidiary company & vice- versa, then for one company it is asset and for another company it is liability.

It is deducted from the assets (loans & advances given) in consolidated balance sheet.

It is deducted from the liabilities (loans & advances received) in consolidated balance sheet.

Q9. **Balance Sheet (as on 31.03.2020)**

Particulars	**H ltd. (₹)**	**S ltd. (₹)**
Assets		
Non-current assets	500,000	300,000

Investment in S co.	120,000	-
Current assets	70,000	40,000
Total	**690,000**	**340,000**
Equity & Liabilities		
Share capital	350,000	150,000
Reserves & surplus	50,000	30,000
Non-current liabilities	100,000	70,000
Current liabilities	190,000	90,000
Total	**690,000**	**340,000**

Additional information:

- On 1st December 2019 H company purchased 3/4th shares of S company.
- On 1st April 2019 S company had a profit of Rs. 10,000/-
- Current assets of subsidiary company include a stock of Rs. 20,000/- which was sold by H company at a profit of 25%
- Current assets of subsidiary company include trade receivables of Rs. 5,000/- which is due from H company
- Goods worth Rs. 2,000/- of H company sold to S company on credit basis.

Prepare Consolidated Balance sheet & give calculation regarding Cost of control; NCI

Answer: Date of Acquisition = 01.12.2019

Pre-acquisition period = 01.04.2019 to 30.11.2019 = 8 Months

Post-acquisition period = 01.12. 2019 to 31.03.2020 = 4 Months

Pre & post acquisition period ratio = 2:1

- Degree of Control

  H company = 3/4th share = 75%

  S company = 1/4th share = 25%

- Calculation of Pre & Post acquisition reserves & surplus

  Profit at the beginning of the year = 10,000

  Current year profit = (30,000 – 10,000) = 20,000

  Pre-acquisition profit for the year = 20,000 * 2/3 = 13,333

  Total pre acquisition profit = (10,000 + 13,333) = 23,333

  Post-acquisition profit = 20,000 * 1/3 = 6,667

- Calculation of Cost of Control

PARTICULARS	Amount (₹)
Share of H company in share capital of S company (150,000 * 75%)	112,500
Add: Shares of H company in pre-acquisition reserves & surplus (23,333 * 75%)	17,500
Net worth	130,000
Less: amount invested by H company	(120,000)
Capital reserve	**10,000**

- Calculation of Non-Controlling Interest

PARTICULARS	Amount (₹)
Share of MS in share capital of S company (150,000 * 25%)	37,500
Share of MS in pre-acquisition profit (23,333 * 25%)	5,833
Share of MS in post-acquisition profit (6,667 * 25%)	1,667
NCI	**45,000**

- Calculation of unrealized profit
  Stock = 20,000 * (0.25/1.25) = 4,000
  This will be deducted in consolidated balance sheet from inventory & reserves and surplus.
- Treatment of inter company owning
  Rs. 5,000/- will be deducted from trade receivables (current assets) & trade payables (current liabilities in consolidated balance sheet.
- Treatment of credit sales
  Rs. 2,000/- will be deducted from debtors (current assets) & creditors (current liabilities) in consolidated balance sheet.

CONSOLIDATED BALANCE SHEET as on 31.03.2020

PARTICULARS	Amount (₹)
A. Assets	
Non-current assets (500,000 + 300,000)	800,000
Current assets [70,000 + 40,000 – (4000 + 5000 + 2000)	99,000
Total	**899,000**
B. Equity & Liabilities	
Share capital	350,000
Reserves & surplus [50,000 + (6,667 * ¾) + 10,000 – 4000)	61,000
Non-controlling interest	45,000
Non-current liabilities	170,000
Current liabilities (190,000 + 90,000 – 7000)	273,000
Total	**899,000**

STEP-9: TREATMENT OF REVALUATION OF ASSETS & LIABILITIES

One of accounting principles of Consolidated Financial Statement is that assets & liabilities are to be revalued on the date of acquisition. If there is revaluation profit, it is pre-acquisition profit. If there is revaluation loss, it is pre acquisition loss.

- Assets & liabilities will be increased or decreased by the amount of increase/ decrease in assets & liabilities.
- Revaluation profit, being pre acquisition profit, it is to be shared between holding company & minority shareholders.

- Holding companies share will be considered for calculation of Cost of Control. Minority shareholders share will be considered for calculation of NCI.
- Situations related to revaluation of assets/ liabilities:
  - Due to revaluation in asset, there may be chances of under charge or over charge of depreciation.
  - If depreciation is under charged it is to be deducted from post-acquisition reserves and surplus before sharing between parents & minority shareholders.
  - If depreciation is over charged it is to be added with post acquisition reserves & surplus before sharing between parent & minority shareholders.

Example

Value of PPE = Rs.90,000

Revalued amount = Rs.1,20,000

Date of acquisition is 1-04-2019

Profit on revaluation = 120,000 – 90,000 = 30,000

Depreciation

Value of PPE as on 31-03-2020 Rs.90,000

Rate of depreciation 10% pa

Revalued amount as on 1-04-2019 Rs.1,20,000

Date of acquisition is 1-04-2019

Value of assets on date of acquisition = 90,000 x 100/90 = 1,00,000

Depreciation already charged on value as on date of acquisition = 10% of 1,00,00 = 10,000

Depreciation to be charged on the revalued amount = 10% of 1,20,000 = 12,000

Depreciation under charged = 12,000 - 10,000 = 2,000

STEP-10: TREATMENT OF BONUS SHARE

Bonus shares may be issued either by parent company or subsidiary company out of their respective reserves & surplus.

It can be issued out of revenue / capital profit.

Bonus share can be issued out of reserves & surplus by parent company irrespective of nature of profit.

However subsidiary company can issue bonus shares from pre-acquisition profit / post acquisition profit.

- Case-1: If Parent company issues shares:

In this case share capital of parent company will increase & R/S will decrease

- Case-2: If subsidiary company issues bonus shares, then two situations will arise.
  - Issue of bonus share out of pre-acquisition profit:

  Amount of bonus share will be deducted from pre-acquisition reserves & surplus.

  Issue of bonus share will increase the share of share capital for parent company as well as minority shareholders.

Share of parent company will go for cost of control & share of minority shareholder will go for NCI.

- Issue of bonus share out of post-acquisition profit:

It will be deducted from post-acquisition profit.

Share of parent company in bonus share will increase the share capital

Share of minority shareholder will go for NCI.

Q10.

Particulars	H Co.	S Co.
Share Capital		
Equity	10,000	4,000
R/S	6,000	3,000

DOA = 1-10-2019

Degree of Control = H Co. 4/5 and S Co. 1/5

Investment by H Co. in S Co. Rs. 3,500

Bonus share issued from pre-acquisition profit Rs.500

Answer: **Cost of Control**

H Co share in S Co 4/5 of 4000 =	3,200
H Co share in bonus 4/5 of 500 =	400
H Co share in pre-acquisition profit 4/5 of (1500-500) =	800
	4,400
Less: Investment	3,500
Capital reserve	***900***

Non-Controlling Interest (NCI)

Share of MS in capital 1/5 of 4000 =	800
Share in Bonus share 1/5 of 500 =	100
Share in pre profit 1/5 of 1000 =	200
Share in post profit 1/5 of 1500 =	300
Total NCI =	***1,400***

STEP-11: TREATMENT OF DIVIDEND:

- Dividend is a part of divisible profit paid/ payable to existing shareholder as return on their investment. Dividend may be final dividend (which is usually declared at the end of FY) or interim dividend (in order to issue share in the market, the company may declare dividend in any time during the year).
- Proposed dividend by parent company or subsidiary company is not recorded anyway in consolidated B/S. Dividend paid by Parent company does not require any further adjustments.
- However, if Subsidiary company issues dividend, then there will be 2 consequences. Such as-

- Dividend issued form pre-acquisition profit.

  It is deducted from pre-acquisition profit.

  Share of parent company in dividend is used for calculation of Cost of Control.

  Share of minority shareholders in dividend is used for NCI.

- Dividend issued from post-acquisition profit.

  It is deducted from post-acquisition profit.

  Share of parent company in dividend is income. Hence it is added to Profit/Loss in Consolidated B/S.

  Share of minority shareholder in dividend is used for NCI.

Q11.

Particulars	**H Co.**	**S Co.**
Share Capital		
Equity	10,000	4,000
R/S	6,000	3,000

DOA = 1-10-2019

Degree of Control = H Co. 4/5 and S Co. 1/5

Investment by H Co. in S Co Rs. 3,500

S Co. declared 10% dividend to pay from post profit

Answer: Pre profit 1,500

Post profit 1,500

Post profit after dividend 1,500 - 400 = 1100

H Co share in dividend = 4/5 of 400 = 320

MS share in dividend = 1/5 of 400 = 80

STEP-12: TREATMENT OF PURCHASE OF DEBENTURE/ PREFERENCE SHARES IN SUBSIDIARY COMPANY

- Preference shares of subsidiary company and investment by holding company are eliminated in Consolidated B/S.
- If investment is more than Pref. share capital, it is a loss and shown as goodwill in the Consolidated B/S.
- If investment is less than Pref. share capital, it is a profit and shown as a capital reserve in the Consolidated B/S.

Note: Same as in the case of Debenture also.

11.9 KEYWORDS

Holding Company: A company may purchase either the whole or the majority of shares of another company so as to have controlling interest in such a company or companies. The controlling company is known as the holding company.

Subsidiary Company: A company may purchase either the whole or the majority of shares of another company so as to have controlling interest in such a company or companies. The company so controlled is known as subsidiary company.

Consolidated Balance Sheet: Consolidated balance sheet is a single balance sheet of holding and subsidiary companies.

IND AS-110: It deals with the Business Combinations in line with Companies Act.

11.10 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers
- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

11.11 TERMINAL QUESTIONS/EXERCISES

Questions

15. What do you mean by Holding Company, Subsidiary Company, & Group of Companies?
16. What are the various needs of group of companies?
17. Explain the various types of Holding Company.
18. State the advantages and disadvantages of Holding company.
19. What do you mean by Non-Controlling Interest (NCI) & Degree of Control? How is NCI calculated?
20. How is the Pre & Post Acquisition Reserves treated in a consolidated financial statement?
21. Give the calculation for Non-Controlling Interest.
22. What is the treatment of Unrealized Profit/Loss on Trading stock (Inventory)?
23. How are the following Inter-company transactions treated in a Consolidated Balance Sheet?
    a. Credit Sales / Purchases
    b. Bills of Exchange
    c. Loans & Advances
24. Explain the treatment of Revaluation of Assets & Liabilities.
25. How are issue of bonus shares treated in case of consolidated financial statements?
26. Give the accounting treatment of Dividend in a consolidated financial statement?

27. X Ltd. Company purchased 1/4th shares of company A Ltd.
    - Case-1: on 31st March 2019
    - Case-2: on 1st April 2019
    - Case -3: on 1st September 2019

    Net Profit of Company A:2018-19 = ₹ 60 L; 2019-20 = ₹ 66 L

    Calculate Degree of control & show the impact of date of acquisition on profit.
28. Reserves & Surplus as on 31st March 2021:

    P Ltd. ₹ 200 Lakhs S Ltd. ₹ 60 Lakhs

    Information: Date of acquisition 1st August 2020.

    Calculate Pre & Post acquisition reserves & surplus under the following conditions.
    - Case-1: All the profits earned during the F.Y.
    - Case-2: Reserves & Surplus of subsidiary company includes reserve of Rs. 20 L which was at the beginning of the year.
    - Case-3: Out of Reserves & Surplus of subsidiary company (i.e., 60 L) only Rs. 30L was earned during the financial Year.

Ans.: Case 1: Pre: 20L & Post: 40L; Case 2: Pre: 34L & Post: 26L; Case 2: Pre: 40L & Post: 20L

29. **BALANCE SHEET AS ON 31.03.2021**

PARTICULARS	A Ltd. (₹)	B Ltd. (₹)
A. ASSETS		
Non-current assets	200,000	80,000
2) Investment in S company	120,000	-
3) Current assets	80,000	120,000
Total	**400,000**	**200,000**
B. EQUITY & LIABILITIES		
1) Share capital	240,000	80,000
2) Reserves & Surplus	40,000	20,000
3) Non-current liabilities	60,000	60,000
4) Current liabilities	60,000	40,000
Total	**400,000**	**200,000**

- A Ltd. has purchased 80% share of B Ltd.
- Date of acquisition is on 1st September 2020
- All reserves & surplus of subsidiary company were earned during the F.Y.

Prepare consolidated financial statement, showing calculation of Cost of Control & NCI. **Ans.:** CFS Total ₹ 529,332

Q9. **Balance Sheet as on 31st March 2021**

Particulars	R ltd. (₹)	Y ltd. (₹)
Assets		

Non-current assets	1,000,000	600,000
Investment in S co.	240,000	-
Current assets	140,000	80,000
Total	**1,380,000**	**680,000**
Equity & Liabilities		
Share capital	700,000	300,000
Reserves & surplus	100,000	60,000
Non-current liabilities	200,000	140,000
Current liabilities	380,000	180,000
Total	**1,380,000**	**680,000**

- On 1st December 2020 R company purchased 3/4th shares of Y company.
- On 1st April 2020 Y company had a profit of Rs. 20,000/-
- Current assets of subsidiary company include a stock of Rs. 40,000/- which was sold by R company at a profit of 25%
- Current assets of subsidiary company include trade receivables of Rs. 10,000/- which is due from R company
- Goods worth Rs. 4,000/- of R company sold to Y company on credit basis.

Prepare Consolidated Balance sheet. **Ans.:** ₹ 17, 98,00

B.COM
SEMESTER – III
COURSE: CORPORATE ACCOUNTING

UNIT-12: ACCOUNTS FOR BANKING COMPANIES

STRUCTURE

12.0 OBJECTIVES

After going through this unit, you should be able to:

- Explore the concept of banks, banking companies
- Explain the important accounting provisions of banking regulation act 1949
- Understand the provisions of non-performing assets

12.1 INTRODUCTION

Every banking company has to prepare balance-sheet and profit and loss account as per the provisions of Section 29 of Banking Regulation Act, 1949. While preparing such account, every banking company incorporated in India should cover all business transacted by it and every banking company incorporated outside India i.e. foreign banks should cover all business transacted through their branches in India only. The annual accounts & balance sheet of banking company should be prepared at the end of each financial year or at the end of a period of twelve month ending with such date as the Central Government may specify by notification in the Official Gazette.

12.2 MEANING OF BANK

A bank is a commercial institution, permitted to accept, collect, transfer, lend and exchange money and claims to money both the domestically and internationally and thereby conduct smooth banking activities.

12.3 MEANING OF BANKING COMPANIES

Banking companies are governed by the Banking Regulation Act, 1949 and also subject to the companies act. 1956. According to Banking Regulation act, 1949 Banking means – “the accepting for the purpose of lending or investment, of deposit of money from the public repayable on demand or otherwise and withdrawals by cheque, draft, and order or otherwise.’

12.4 BANKING FUNCTIONS

Business of Banking Companies: As per section 6 of the Act, banking companies may engage in the following business in addition to their usual banking business:

i) The borrowing, raising or taking up on money, the lending or advancing of money either upon or without security, the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, ‘hundies’, promissory notes, drafts, bills of lading, railways receipt, warrants, debentures, certificates, scrip’s and other instruments and securities whether transferable or negotiable or not; granting and issuing of letters of credit, traveller’s cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or other, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities.

ii) Acting as agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as on attorney on behalf of customers but excluding the business of (managing agent or secretary and treasurer) of a company.

iii) Contracting for public and private loans and negotiating and issuing the same.

iv) The effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private of state, municipal or other loans or of shares, stock, debentures or debenture stock of any Company Corporation or association and of the lending of money for the purpose of any such issue.

v) Carrying on and transacting every kind of guarantee and indemnity business.

vi) Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims.

vii) Acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances which may be connected with any such security.

viii) Undertaking and executing trusts.

ix) Undertaking the administration of estates as executor, trustee or otherwise.

x) Establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object.

xi) The acquisition, construction maintenance and alteration of any building or works necessary or convenient for the purpose of the company.

xii) Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company.

xiii) Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in section 6.

xiv) Doing all such other things as are incidental or conclusion to the promotion or advancement of the business of the company.

xv) Any other form of business which the central Government may by notification in the official Gazette, specify as a form of business in which it is lawful for a banking company to engage. No Banking Company shall engage in any form of business other than those referred to in section 6.

12.5 RESTRICTIONS ON BUSINESS

The Banking Companies are restricted from conducting certain activities. A bank cannot directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realization of security given to or held by it, or engage in any trade or buy or sell of barter goods for others otherwise than in connection with bills of exchange, immovable property, except that required for its own use, however acquired, must be disposed of within seven years from the date of acquisition.

12.6 NON-BANKING ASSETS

The case in which the customer to whom a bank sanctioned loan against some security and if he fails to repay the same, the bank decides to acquire such property as security to satisfy its claim. Such property or assets termed as 'Non-Banking Assets'. These Assets are exhibited in schedule 11 – "Other Assets".

12.7 IMPORTANT ACCOUNTING PROVISIONS OF BANKING REGULATION ACT 1949

12.7.1 Books of Accounts

In order to have immediate entry of voluminous transactions and to enable continuous internal check on the record of these transactions, Banks are required to maintain subsidiary books along with its principal books of accounts.

A) Subsidiary books:

i. Receiving cashier's counter cash book;

ii. Paying cashier's counter cash book;

iii. Current accounts ledger.

iv. Savings bank accounts ledger

v. Fixed deposit accounts ledger

vi. Investments Ledger vii. Loans Ledger

viii. Bills discounted and purchased ledger

ix. Customer's acceptances endorsements and guarantee ledger

B) Principal Books

i. Cash book: It records all cash transactions

ii. General Leger : It contains control Accounts of all subsidiary ledgers and different assets and liabilities account

12.7.2 Final Accounts

The Banking Regulation act, 1949 prescribes formats of preparing final accounts of the Banking companies. The third schedule of section 29 gives forms 'A' for the balance sheet and Form 'B' for Profit and loss account. The balance sheet consists of total 12 schedules. Schedule 1 to schedule 5 depicts capital and liabilities and schedule 6 to schedule 11 shows Assets of the bank and schedule 12 shows contingent liabilities.

THE THIRD SCHEDULE (Section 29)

Form 'A'

FORM OF BALANCE SHEET

Name of the Bank----

Balance Sheet as on 31st March (Year)

Particulars	Schedule	Current Year	Previous

	No		Year
I. Capital and Liabilities a) Capital b) Reserve and Surplus c) Deposits d) Borrowings e) Other Liabilities and Provisions	 1 2 3 4 5		
Total			
II. Assets : a) Cash in Hand and Balance with RBI b) Balance with other Banks and Money at call and short notice c) Investments d) Advances e) Fixed Assets f) Other Assets	 6 7 8 9 10 11		
Total			
III. Contingent Liabilities	12		

Schedule 1: Capital

Particulars	Current Year	Previous Year
I. For nationalized Banks Capital fully owned by Central Bank	________	________
Total	________	________
II. For Banks Incorporated outside India i) Amount brought in by the Bank by way of start up capital as prescribed by RBI ii) Amount of deposit kept with the RBI under section 11 of Banking Regulation act, 1949	________	________
Total	________	________
III. For Other Banks a) Authorized Capital (----Shares of Rs----- Each)	________	________
b) Issued capital (----Shares of Rs----- Each)	________	________
c) Subscribed Capital (----Shares of Rs----- Each)	________	________
d) Called up Capital Less calls in Arrear/ calls unpaid Add Forfeited Shares		

Total		

Schedule 02: Reserves

Particulars	Current Year	Previous Year
a) Statutory Reserve(25% of Current year profit to be created) Opening Balance Add created during the year Less deduction during the year b) Capital Reserve Opening Balance Add created during the year Less deduction during the year c) Securities Premium Opening Balance Add created during the year Less deduction during the year d) Revenue and other Reserves Opening Balance Add created during the year Less deduction during the year e) Balance in profit and Loss statement		
Total		

Schedule 03: Deposits

Particulars	Current Year	Previous Year
a) Demand deposits i) From Banks ii) From others b) Saving Bank deposits c) Term Deposits i) From Banks ii) From others d) Deposits from Branches in India e) Deposits from Braches outside India		
Total		

Schedule 04: Borrowings

Particulars	Current Year	Previous Year
a) Borrowings in India i) RBI ii) Other Banks iii) Other Institutions b) Borrowings from outside India		
Total		

Schedule 05: Other Liabilities

Particulars	Current Year	Previous Year
i) Bills payable ii) Inter office Adjustments (Cr) iii) Rebate on Bills Discounted iv) Accrued Interest v) Provisions vi) Bank drafts vii) Travellers Cheque viii) Outstanding Expenses ix) Others if any		
Total		

Schedule 06: cash in Hand and with RBI

Particulars	Current Year	Previous Year
a) Cash in Hand (included foreign currencies) b) Cash Balance with RBI i)In current account ii) In other Account		
Total		

Schedule 07: Cash with Other Banks and Money at Call and Short Notice

Particulars	Current Year	Previous Year
a) Balance with other banks in India and outside India i) In current accounts ii) In other Deposit accounts b) Money at Call and Short Notice in India and outside India		

i) In current accounts ii) In other Deposit accounts		
Total		

Schedule 08: Investments

Particulars	Current Year	Previous Year
a) Investments in India and Outside India i) Government Securities ii) Other Approved Securities iii) Debenture, Bonds and Shares iv) Subsidiaries/Associates/Joint Ventures v) Others to be specified		
Total		

Schedule 09: Advances

Particulars	Current Year	Previous Year
I. i) bills purchased and Discounted ii) cash credits, overdrafts, and Loans Payable on Demand iii) Term Loans II. i) Secured by tangible Assets ii) Covered by Government Securities iii) Unsecured III. Advances in India i) Priority Sectors ii) Public sectors iii) Banks iv) Others IV. Advances outside India i) Due from banks ii) Due from others		
Total		

Schedule 10: Fixed assets

Particulars	Current	Previous Year

	Year	
I. Premises Opening Balance Addition during the year Less deduction during the year Less depreciation during the year II. Other Fixed Assets Opening Balance Addition during the year Less deduction during the year Less depreciation during the year		
Total		

Schedule 11: Other Assets

Particulars	Current Year	Previous Year
a) Non-Banking assets b) Interest Accrued c) Tax paid in Advance d) Stock of stationer and stamps e) Inter office adjustment (Dr) f) Prepaid expenses g) Others		
Total		

Schedule 12: Contingent Liabilities

Particulars	Current Year	Previous Year
a) Claims against banks not yet acknowledged b) Liability for partially paid investments c) Liability for outstanding forward exchange contracts d) Guarantees given e) Acceptances, endorsements and other obligations f) Others for which bank is contingently liable		
Total		

Illustration 1

From the following particulars prepare the balance sheet of Bad Bank Ltd. As on 31st March, 2020:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Cash in had	5,00,000	Share capital	50,00,000
Balance with RBI	6,00,000	Reserve Fund	5,00,000
Balance with Banks	75,000	Capital Reserve	2,00,000
Money at call and short notice	4,25,000	Profit and Loss	1,00,000
Investment in Government securities	40,00,000	Demand Deposits	10,00,000
Investment in Shares	7,00,000	Saving Deposits	5,00,000
Investment in Debentures	50,000	Term Deposits	15,00,000
Other investments	20,000	Borrowings	20,00,000
Bill discounted	20,00,000	Bills Payable	1,00,000
Cash credits	15,00,000	Other Liabilities	2,00,000
Term Loans	6,00,000		
Premises	1,00,000		
Other Assets	20,000		
Interest Accrued	10,000		
Stamps	5,000		
Non- Banking assets	4,95,000		
Total	1,11,00,000	Total	1,11,00,000

Solution:

Form 'A'

FORM OF BALANCE SHEET

Name of the Bank --- Bad Bank Ltd.

Balance Sheet as on 31st March, 2020

Particulars	Schedule No	Current Year 2019-20	Previous Year2018-19
IV. Capital and Liabilities			
f) Capital	1	50,00,000	
g) Reserve and Surplus	2	8,00,000	
h) Deposits	3	30,00,000	
i) Borrowings	4	20,00,000	
j) Other Liabilities and Provisions	5	3,00,000	
Total		1,11,00,000	
V. Assets :			
g) Cash in Hand and Balance with	6	11,00,000	

RBI h) Balance with other Banks and Money at call and short notice i) Investments j) Advances k) Fixed Assets l) Other Assets	7 8 9 10 11	5,00,000 47,70,000 41,00,000 1,00,000 5,30,000	
Total		1,11,00,000	
VI. Contingent Liabilities	12	---	

Schedule 1: Capital

Particulars	Current Year	Previous Year
IV. For nationalized Banks Capital fully owned by Central Bank		
Total		
V. For Banks Incorporated outside India iii) Amount brought in by the Bank by way of start up capital as prescribed by RBI iv) Amount of deposit kept with the RBI under section 11 of Banking Regulation act, 1949		
Total		
VI. For Other Banks e) Authorized Capital (----Shares of Rs----- Each) f) Issued capital (----Shares of Rs----- Each) g) Subscribed Capital (----Shares of Rs----- Each)		
h) Called up Capital Less calls in Arrear/ calls unpaid Add Forfeited Shares	50,00,000 - -	
Total	50,00,000	

Schedule 02: Reserves

Particulars	Current Year	Previous Year
f) Statutory Reserve(25% of Current year profit to be created) Opening Balance	-	

Add created during the year Less deduction during the year		
g) Capital Reserve Opening Balance Add created during the year Less deduction during the year	2,00,000	
h) Securities Premium Opening Balance Add created during the year Less deduction during the year	-	
i) Revenue and other Reserves Opening Balance Add created during the year Less deduction during the year	5,00,000	
j) Balance in profit and Loss statement	1,00,000	
Total	8,00,000	

Schedule 03: Deposits

Particulars	Current Year	Previous Year
f) Demand deposits iii) From Banks iv) From others	10,00,000	
g) Saving Bank deposits	5,00,000	
h) Term Deposits iii) From Banks iv) From others	15,00,000	
i) Deposits from Branches in India		
j) Deposits from Braches outside India		
Total	30,00,000	

Schedule 04: Borrowings

Particulars	Current Year	Previous Year
c) Borrowings in India iv) RBI v) Other Banks vi) Other Institutions	20,00,000	
d) Borrowings from outside India		
Total	20,00,000	

Schedule 05: Other Liabilities

Particulars	Current	Previous Year

	Year	
x) Bills payable xi) Inter office Adjustments (Cr) xii) Rebate on Bills Discounted xiii) Accrued Interest xiv) Provisions xv) Bank drafts xvi) Travellers Cheque xvii) Outstanding Expenses xviii) Others if any	1,00,000 2,00,000	
Total	3,00,000	

Schedule 06: cash in Hand and with RBI

Particulars	Current Year	Previous Year
c) Cash in Hand (included foreign currencies) d) Cash Balance with RBI i)In current account ii) In other Account	5,00,000 6,00,000	
Total	11,00,000	

Schedule 07: Cash with Other Banks and Money at Call and Short Notice

Particulars	Current Year	Previous Year
c) Balance with other banks in India and outside India iii) In current accounts iv) In other Deposit accounts d) Money at Call and Short Notice in India and outside India iv) In current accounts v) In other Deposit accounts	75,000 4,25,000	
Total	5,00,000	

Schedule 08: Investments

Particulars	Current Year	Previous Year
b) Investments in India and Outside India vi) Government Securities vii) Other Approved Securities	 40,00,000	

viii) Debenture, Bonds and Shares ix) Subsidiaries/Associates/Joint Ventures x) Others to be specified	7,50,000 20,000	
Total	47,70,000	

Schedule 09: Advances

Particulars	Current Year	Previous Year
I. i) bills purchased and Discounted ii) cash credits, overdrafts, and Loans Payable on Demand vi) Term Loans II. iv) Secured by tangible Assets v) Covered by Government Securities vi) Unsecured III. Advances in India v) Priority Sectors vi) Public sectors vii) Banks viii) Others IV. Advances outside India iii) Due from banks iv) Due from others	 20,00,000 15,00,000 6,00,000	
Total	41,00,000	

Schedule 10: Fixed assets

Particulars	Current Year	Previous Year
III. Premises Opening Balance Addition during the year Less deduction during the year Less depreciation during the year IV. Other Fixed Assets Opening Balance Addition during the year Less deduction during the year Less depreciation during the year	1,00,000	
Total	1,00,000	

Schedule 11: Other Assets

Particulars	Current Year	Previous Year
h) Non-Banking assets i) Interest Accrued j) Tax paid in Advance k) Stock of stationer and stamps l) Inter office adjustment (Dr) m) Prepaid expenses n) Others	4,95,000 10,000 5,000 20,000	
Total	5,30,000	

Schedule 12: Contingent Liabilities

Particulars	Current Year	Previous Year
g) Claims against banks not yet acknowledged h) Liability for partially paid investments i) Liability for outstanding forward exchange contracts j) Guarantees given k) Acceptances, endorsements and other obligations l) Others for which bank is contingently liable	NIL	

Form B

Form of Profit and Loss statement

Name of the Bank-----

For the year ending 31st March (Year)

Particulars	Schedule No	Current Year	Previous Year
I. Income a) Interest Earned b) Other Income	 13 14		
Total			
II. Expenditure a) Interest Expended b) Operating Expenses	 15 16		

c) Provisions and Contingencies			
Total			
III. Profit/ Loss a) Net profit for the current year b) Profit brought forward			
Total			
IV. Appropriations a) Transfer to Statutory Reserve b) Transfer to General Reserve c) Proposed Dividend d) Transfer to any other Reserve e) Balance carried forward to Balance Sheet			
Total			

Schedule 13 – Interest Earned

Particulars	Current Year	Previous Year
a) Interest on advances and discount on bills • Interest on cash credits • Interest on demand loans • Interest on overdrafts • Discount domestic and foreign bills b) Income from Investments • Interest on investment portfolio • Dividend on investment portfolio c) Interest on balances with RBI and other inter-bank funds d) Others • Interest not included in the above heads • Discount not included in the above heads		
Total		

Schedule 14 – other Income

Particulars	Current Year	Previous Year
a) Commission, Exchange and Brokerage b) Profit on sale of investment Less loss on sale of investment c) Profit on sale of fixed assets Less loss on sale of fixed assets d) Profit on exchange transaction		

Less loss on exchange transaction e) Income earned by way of dividend from subsidiaries, joint ventures in India and abroad f) Miscellaneous income- securities charges, locker rent, transfer fees, insurance etc.		
Total		

Schedule 15 (interest Expended

Particulars	Current Year	Previous Year
a) Interest on Deposits i) Current Deposits ii) Saving Deposits iii) Term Deposits iv) Recurring Deposit b) Interest on Borrowings i) Borrowings from RBI ii) Other Banks iii) Financial Institutions		
Total		

Schedule 16(Operating Expenses)

Particulars	Current Year	Previous Year
a) Payments and Provisions for Employees b) Rent, Taxes and Lighting c) Printing and Stationery d) Depreciation on Bank's Property e) Director's Fee and Allowances f) Auditor's Fee g) Law Charges h) Postage and Stamp i) Repairs and Maintenance j) Insurance k) Advertisement l) License Fees m) Donations n) Travel Expenses o) Entertainment Expenses p) Other Expenses		
Total		

Provisions and Contingencies

Particulars	Current Year	Previous Year
a) Provision for Bad Debts b) Provision for Income Tax c) Provision for Decline in Value of Investment d) Transfer to Contingencies		
Total		

Illustration 2

From the following particulars prepare profit and loss statement of the Good Bank Ltd. For the year ended 31st March, 2020.

Particulars	Amount (Rs)
Interest on Loans	25,30,000
Discount on Bills Discounted	14,60,000
Interest on Fixed deposit	27,50,000
Commission (Expenses)	82,000
Salaries	5,40,000
Interest on cash credit	22,30,000
Depreciation on Bank Property	4,20,000
Rent and Taxes	1,80,000
Interest on Overdraft	15,40,000
Director’s fees	30,000
Auditor’s Fees	12,000
Interest on saving bank deposits	6,80,000
Postage and Telegram	14,000
Printing and stationery	29,000
Sundry charges(Incomes)	17,000
Profit on sale of investment	60,000
Commission, Exchange and Brokerage	12,000
Profit balance of last year	8,90,000

Additional information

a) Bad debts is to be written off amounted to Rs. 4,00,000
b) Provision for taxation is to be made 30%
c) Provide for dividends of Rs.3,00,000
d) Salary outstanding Rs. 5,000
e) Transfer Rs.65,000 to Reserve Fund

Solution:

Form of Profit and Loss statement

Name of the Bank -----Good Bank Ltd.

For the year ending 31st March,2020

Particulars	Schedule No	2019-20	2018-19
Income a) Interest Earned b) Other Income	 13 14	 77,60,000 89,000	
Total		78,49,000	
Expenditure d) Interest Expended e) Operating Expenses f) Provisions and Contingencies	 15 16	 34,30,000 13,12,000 12,12,100	
Total		59,54,100	
Profit/ Loss c) Net profit for the current year d) Profit brought forward		 18,94,900 8,90,000	
Total		27,84,900	
Appropriations f) Transfer to Statutory Reserve (25% of Current profit) g) Transfer to General Reserve h) Proposed Dividend i) Transfer to Reserve fund j) Balance carried forward to Balance Sheet		 4,73,725 - 3,00,000 65,000 19,46,175	
Total		27,84,900	

Schedule 13 – Interest Earned

Particulars	Current Year 2019-20	Previous Year 2018-19
e) Interest on advances and discount on bills • Interest on cash credits • Interest on demand loans • Interest on overdrafts • Discount domestic and foreign bills	 22,30,000 25,30,000 15,40,000 14,60,000	

f) Income from Investments • Interest on investment portfolio • Dividend on investment portfolio g) Interest on balances with RBI and other inter-bank funds h) Others • Interest not included in the above heads • Discount not included in the above heads	- - -	
Total	77,60,000	

Schedule 14 – other Income

Particulars	Current Year 2019-20	Previous Year 2018-19
g) Commission, Exchange and Brokerage	12,000	
h) Profit on sale of investment Less loss on sale of investment	60,000	
i) Profit on sale of fixed assets Less loss on sale of fixed assets	-	
j) Profit on exchange transaction Less loss on exchange transaction	-	
k) Income earned by way of dividend from subsidiaries, joint ventures in India and abroad	-	
l) Miscellaneous income- securities charges, locker rent, transfer fees, insurance etc.	17,000	
Total	89,000	

Schedule 15 (interest Expended

Particulars	Current Year 2019-20	Previous Year2018-19
c) Interest on Deposits		
v) Current Deposits	-	
vi) Saving Deposits	6,80,000	
vii) Term Deposits	27,50,000	
viii) Recurring Deposit	-	
d) Interest on Borrowings	-	
iv) Borrowings from RBI		
v) Other Banks		
vi) Financial Institutions		
Total	34,30,000	

Schedule 16(Operating Expenses)

Particulars	Current Year2019-20	Previous Year2018-19
q) Payments and Provisions for Employees (Including outstanding salary	5,45,000	
r) Rent, Taxes and Lighting	1,80,000	
s) Printing and Stationery	29,000	
t) Depreciation on Bank's Property	4,20,000	
u) Director's Fee and Allowances	30,000	
v) Auditor's Fee	12,000	
w) Law Charges	-	
x) Postage and Stamp	14,000	
y) Repairs and Maintenance	-	
z) Insurance	-	
aa) Advertisement	-	
bb) License Fees	-	
cc) Donations	-	
dd) Travel Expenses	-	
ee) Entertainment Expenses	-	
ff) Other Expenses	82,000	
Total	13,12,000	

Provisions and Contingencies

Particulars	Current Year 2019-20	Previous Year2018-19
e) Provision for Bad Debts	4,00,000	
f) Provision for Income Tax 30% of (78,49,000-47,42,000-4,00,000)	8,12,100	
g) Provision for Decline in Value of Investment		
h) Transfer to Contingencies		
Total	12,12,100	

12.8 PROVISIONING OF NON-PERMORMING ASSETS

In line with the international practices and as per the recommendations made by the Committee on the Financial System (Chairman Shri M. Narasimham), the Reserve Bank of India has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts.

What is Standard Assets?

It is that loan asset/account in which the principal or interest payment or both have remained due for 90 days or less. It can be Regular Assets or Special Mention Assets (SMA). When any loan assets in which the principal or interest is paid on due date is regular assets. Any loan assets in which principal or interest has remained overdue for a period less or up-to 90 days are special Mention Assets or stressed Assets.

What is Non-Performing Assets (NPA)?

It is that loan asset/account in which the principal or interest payment or both have remained **overdue** for a **continuous period of more than 90 days.**

What is Special Mention Assets (SMA)?

It is that loan asset/account in which principal or interest payment or both are overdue but for a period less up to 90 days. It may also refer to an account which is showing any other non-financial signs of stress.

What is Sub-Standard Assets?

An asset is classified as a sub-standard asset if it remains as an NPA for a period less than or equal to 12 months.

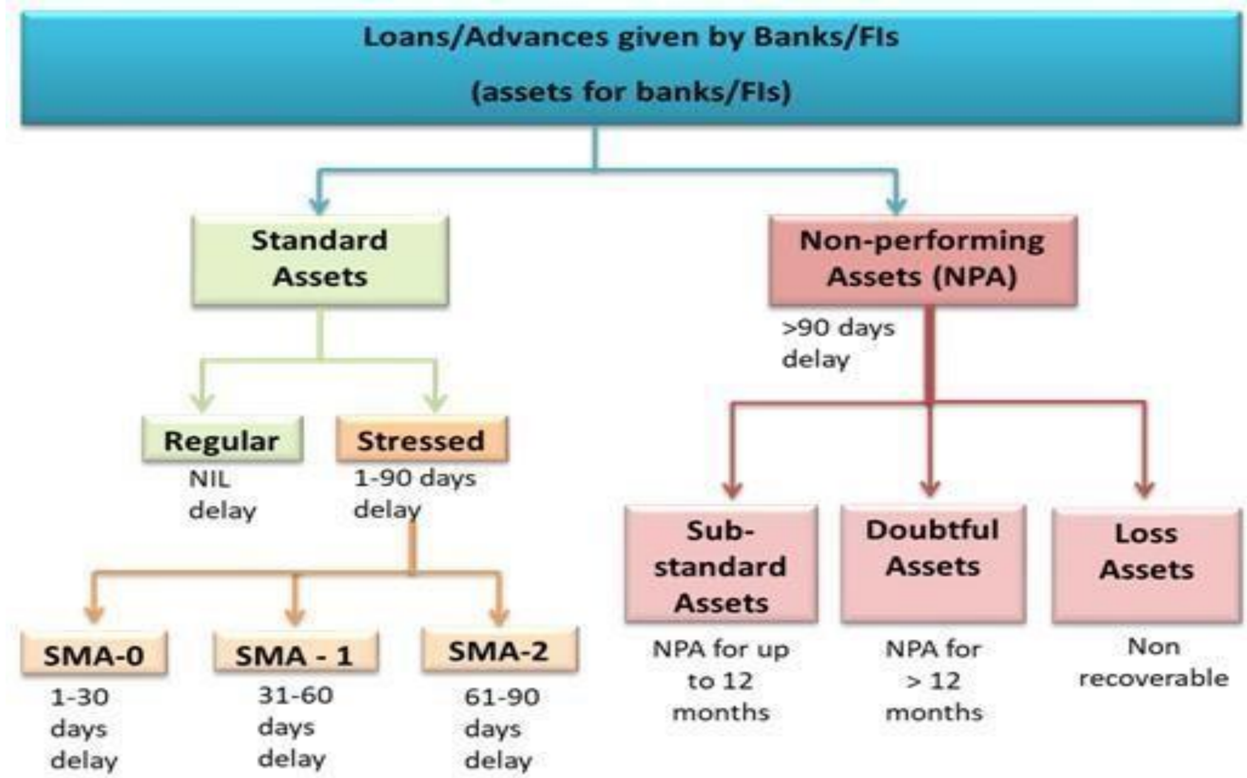
What is Doubtful Assets?

An asset is classified as a doubtful asset if it remained as an NPA for more than 12 months.

What is Loss assets?

An asset is considered as a loss asset when it is "uncollectible" or has such little value that its continuance as a bankable asset is not suggested.

Asset classification:



Provisioning norms for NPA:

Asset classification		**Minimum provision**
Standard assets		SME & Agri – 0.25% Commercial Residential – 0.75% Commercial – 1% Others – 0.40%
Sub-standard assets		15% (25% for unsecured portion)
Doubtful Assets	*Secured*	
	Up to 1Y	25%
	1-3Y	40%
	>3Y	100%

	Unsecured	100%
Loss asset		100%

As seen in the table above that the provisioning norms for NPA increases as the assets' quality deteriorates from regular to SMA to NPA status. As such, a higher proportion of NPA assets will reduce the profitability of the bank/FI and could also result into losses for the bank/FI, thereby eroding its capital base. As per the Revised Framework for Resolution of Stressed assets, released in June 2019, banks may start resolution or Insolvency & Bankruptcy Code (IBC) process within 30 days of default to maintain smoothening of provisioning for NPA.

Accounting for NPA

a) Interest on Performing Loans and Advance is recognized on **accrual basis.**

b) Interest on Non-performing Loans and Advance is recognized only when interest is received (**Cash Basis)**

c) Any interest on NPA is already accrued previously, **it is reversed.**

Illustration 3

Normal bank Ltd. Has the following classified advances as 31st March, 2020 in the books of accounts:

	Rs.
Standard Assets	8,00,000
Sub Standard Assets (Unsecured)	2,00,000
Doubtful Assets (Secured)	
Up to one year	75,000
One to three years	50,000
More than three years	20,000
Loss assets	15,000

Calculate the amount of provision to be maintained by the bank for NPA for the year ending 31st March, 2020.

Solution:

Provision for Bad and Doubtful Debts/ NPA

SL No.	Particulars (Assets)	Amount	Rate (%)	provision
1.	Standard Assets	8,00,000	.40	3,200
2.	Sub-standard Assets	2,00,000	25	50,000

3.	Doubtful Assets - Up to one year - One to three years - More than three years	 75,000 50,000 20,000	 25 40 100	 18,750 20,000 20,000
4.	Loss Assets	15,000	100	15,000
	Total			1,26,950

12.9 MEANING OF REBATE ON BILLS DISCOUNTED

Rebate on Bills Discounted is also known as Discount Received in Advance, or, Unexpired Discount or, Discount Received but not earned.

Journal Entries for Bills discounted

1. For opening balance of rebate on bills discounted
   Rebate on bills discounted a/c Dr
   To Discount on bills discounted
2. For discounting the bills
   Bill discounted a/c Dr
   To Bank a/c (With amount paid to the customer)
   To Discount on Bills Discounted a/c (Discount deducted by the bank)
3. For closing rebate on bills discounted
   Discount on Bills Discounted Dr
   To Rebate on Bills discounted
4. Balance of discount on bills discounted is transferred to Profit and Loss statement of the year
   Discount on bills discounted Dr.
   To profit and Loss a/c

Accounting Treatment of Rebate on Bills Discounted

(i) If it is given only in the Trial Balance:(opening Rebate)

The same will be shown as a liability and will appear in the liability side of the Balance Sheet.

(ii) If it is given in adjustment (Closing Rebate)

In that case, the same is deducted from the Income from Interest and Discount in Profit and Loss Account and the same also will appear in the liability side of the Balance Sheet.

(iii) Calculation of Discount to be shown as for the Financial Year:

Rebate on bills discounted at the beginning xxx

Add discount Received during the Year xxx

		Xxx
Less Rebate on bills discounted at the end	xxx	

Discount to be shown as Income	xxx	

Illustration 4

A customer discounts a bill of Rs. 30,000 for 3 months at 12% on 1st March 2020, opening rebate on bills discounted is Rs. 124. Calculate the discount to be shown as income. Make necessary entries to record in the books of accounts. Give treatment of rebate in the financial statements.

Solution:

Due date inclusive of 3 days of grace is 4th june, 2020

Due Date= Date of Discounting + Term of the Bill + 3Days of Grace

= 1st March + 3 moths + 3Days

Bank will earn discount @ 12% for 95 days (March 30days +April 30 days + May 31 days +June 4 days) i.e., = Rs. 30,000 x 12/100 x 95/365 = Rs. 937.

Note: date of discounting the bill is not considered for calculating due date.

But this amount of discount is meant for March, April and May and 4 days of June. As accounts are prepared on 31st March each year, discount received for 65 days (30 + 31 +4) for April, May and June is not actually earned. Thus, discount of 65 days i.e., 30,000 x 12% x 65/365= Rs. 641 is called Rebate on Bill Discounted.

So, actual income is Rs. 296 (i.e., 937 – Rs. 641).

Journal Entries:

a) For opening balance of rebate on bills discounted

Rebate on bills discounted a/c Dr		124	
To Discount on bills discounted			124

b) For discounting the bills

Bill discounted a/c Dr		30,000	
To Bank a/c (With amount paid to the customer)			29,063

To Discount on Bills Discounted a/c 937

(Discount deducted by the bank)

c) For closing rebate on bills discounted

Discount on Bills Discounted Dr. 641

To Rebate on Bills discounted 641

d) Balance of discount on bills discounted is transferred to Profit and Loss statement of the year

Discount on bills discounted Dr. 420

To profit and Loss a/c(296 +124) 420

Calculation of Discount to be shown as for the Financial Year:

Rebate on bills discounted at the beginning	124
Add discount Received during the Year	937

	1061
Less Rebate on bills discounted at the end	641

Discount to be shown as Income	420

Note: Closing rebate on bills discounted Rs. 641 will be shown as liability in the balance sheet.

12.10 CAPITAL ADEQUACY RATIO

a) The banking company must maintain adequate capital to ensure their financial stability & soundness.

b) Capital adequacy ratio is the ratio between the minimum **capital fund** to be held by the bank against the **risk weighted asset** it holds.

c) Capital Adequacy Ratio (CAR)= (capital fund*100)/ risk adjusted assets and off-Balance sheet items.

Capital Fund

- It consists of:
- ✓ **Tier 1** capital (Core Capital)
- ✓ **Tier 2** Capital (Supplementary Capital)

Tier 1 Capital includes-

- Equity capital
- Statutory reserve
- Disclosed Reserves (Retained Earnings)
- Sometimes it includes non-cumulative and non-redeemable preferences

Tier 2 Capital

- Revaluation reserves,
- Hybrid instruments,
- undisclosed reserves (off Balance sheet items)
- Preference shares
- Debentures
- Bonds
- Debts
- Long term loans

Risk Weighted Assets

Nature of Assets	Risk weight (%)
Government Securities	0
Investment in Shares	125
Secured Loans	50
Corporate Loans	50
Other Loans	100
Balance with Banks	20
Cash Balance	0
Balance with RBI	0
Housing Loans	50
Loans against FD/LIC	0
Government Approved Securities	2.5
Venture capital Investment	150
Retail Lending	75
Consumer Credit	125
Other Assets	100

Risk weighted assets: Summation of product of assets and their corresponding risk weights

12.11 SOME USEFUL BOOKS

- Tulsian, P.C, Corporate Accounting, S. Chand
- Maheshwari, S.N. and S. K. Maheshwari. Corporate Accounting. Vikas Publishing House
- Shukla, M.C., T.S. Grewal, and S.C. Gupta. Advanced Accounts. Vol.-II. S. Chand & Co.
- Sehgal, Ashok and Deepak Sehgal. Corporate Accounting. Taxman Publication
- Jain, S.P. and K.L. Narang. Corporate Accounting. Kalyani Publishers

- Bhushan Kumar Goyal, Fundamentals of Corporate Accounting, International Book House

12.12 TERMINAL QUESTIONS/EXERCISES

Q.1 What is non-performing assets? Explain its classification.

Q.2. Discuss the provision for bad and doubtful debts to maintained on different types of advances before calculating profit and loss of a banking company.

Q.3. Explain the schedules dealing with preparation of profit and Loss statement of a Banking Company as per the Banking Regulations Act, 1949

Q.4. Explain the schedules dealing with the preparation of balance sheet of a Banking company as per the Banking Regulations Act, 1949

Q.5. what is rebate on bills discounted? How is it calculated? Give the accounting treatment of rebate on bills discounted.

Q.6. Give the journal entries to record the bills discounted and rebate n bills discounted wit an imaginary example.

Q.7. what is capital adequacy ratio? How is it calculated? Discuss with an example.

Q.8. Write short notes on the following:

i) Statutory Reserve
ii) Provision and Contingencies
iii) Contingent Liabilities
iv)Money at call and short notice
v)Cash Credits
vi)Overdrafts
vii)Deposits

Q.9. Abormal bank Ltd. Has the following classified advances as 31st March, 2020 in the books of accounts:

	Rs.
Standard Assets (Commercial)	4,00,000
Sub Standard Assets (Unsecured 50%)	1,00,000
Doubtful Assets (Secured)	
Up to one year	40,000
One to three years	20,000
More than three years	60,000
Loss assets	10,000

Calculate the amount of provision to be maintained by the bank for NPA for the year ending 31st March, 2020.

(Answer: Provision for NPA – Rs. 1,12,000)

Q.10. calculate the amount of rebate on bills discounted from the following particulars:

Date of bills	Amount (Rs.)	Term	Rate of Discount
12.10.2020	18,250	6 months	14%
7.11.2020	36,500	7 months	13%
5.02.2021	9,125	4 months	10%
5.09.2020	5,000	5 months	15%

(**Answer: Closing Rebate-Rs.1,200.50**)

Q.11. The following figures have been obtained from the books of the General Bank Ltd. For the year ending 31st March, 2020:

Particulars	Amount (Rs. In ,000)
Interest and discount earned	3,800
Commission and exchange	195
Interest paid	2,000
Salaries and wages	210
Director's fees	35
Rent and Taxes	70
Postage and Telegrams	61
Profit on sale of investment	240
Loss on sale of investment	38
Rent received	62
Depreciation	31
Stationery	60
Auditor's fees	8

Additional Information:

a) The profit and loss account had a balance of Rs. 10,00,000 on 1st April, 2019
b) An advance of Rs. 5,68,000 has become doubtful and expected that only 50% can be recovered
c) The provision for tax be made at 35%
d) A dividend @ 10% of current year profit is proposed

(Answer: Net profit for the current year- Rs. 9,75,000)

Q.12. From the following Trial Balance of Local Bank Ltd. As on 31st March, 2020, prepare profit and Loss statement and Balance Sheet:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Cash in hand	57,500	Travellers cheque	43,500
Cash with other banks	1,04,500	Circular notes	16,500
Loans and Advances	13,38,000	Current Deposits	4,00,000
Furniture	25,000	Saving Deposits	2,50,000
Depreciation on Furniture	2,500	Recurring deposits	1,25,000
Silver	65,000	Share Capital (Rs.10 each	6,00,000

Salaries	1,00,000	Rs. 6 paid up)	
Money at call	11,500	Bank Drafts	80,000
Investments	1,00,000	Telegraphic Transfer	62,000
Books	15,000	Dividend Equalization fund	1,50,000
Bills purchased	1,75,000	Provident fund	1,25,000
Premises	1,10,000	Profit and loss of last year	1,12,500
Stamps in hand	2,500	Interest and Discount	2,10,000
Gold	1,15,000	Provision for doubtful debts	15,000
Contribution to PF	10,000	Commission and exchange	40,000
Bonus to staff	15,000	Transfer fees	500
Interest on Deposits and Borrowings	62,500	Rebate on bills discounted at the beginning	2,500
Insurance	1,500	General Reserve	1,13,500
Unexpired insurance	500		
Preliminary expenses	30,000		
Postage	1,000		
Auditor's fees	4,500		
Total	23,46,500	Total	23,46,500

Additional Information:

a) Rebate on bills discounted Rs. 4,000 at the end of the year
b) Rs. 40,000 added to the premise during the year and depreciation at 5% on the opening balance is required
c) Write off 20% of the preliminary expenses
d) Market value of investments on 31st March, 2020 was 1,25,000
e) Transfer Rs. 20,000 to General Reserve

(Answer-Net Profit: Rs. 42,500 and Balance Total: 21,25,000)