S.Y.B.COM.
(ACCOUNTING & FINANCE)
SEMESTER - IV

FINANCIAL ACCOUNTING (SPECIAL ACCOUNTING AREAS) - IV

SUBJECT CODE : UA_FFSIV.1

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May 2023, Print - 1

Published by : Director,
Institute of Distance and Open Learning ,
University of Mumbai,
Vidyanagari, Mumbai - 400 098.

DTP Composed & Printed : **Mumbai University Press**
Vidyanagri, Santacruz (E),
Mumbai - 400098

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Programme at Semester IV
with Effect from the Academic Year 2022-2023

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Financial Accounting (Special Accounting Areas) - IV

Modules at a Glance

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2	Redemption of Preference Shares	10
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4	Ascertainment and Treatment of Profit Prior to Incorporation	10
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	Total	**60**

Sr. No.	Modules / Units
1	**Preparation of Final Accounts of Companies**
	Relevant provisions of Companies Act related to preparation of Final Account (excluding cash flow statement) Preparation of financial statements as per Companies Act. (excluding cash flow statement) AS 1 in relation to final accounts of companies (disclosure of accounting policies)
2	**Redemption of Preference Shares**
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3	**Redemption of Debentures**
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4	**Ascertainment and Treatment of Profit Prior to Incorporation**
	Principles for ascertainment Preparation of separate, combined and columnar Profit and Loss Account including different basis of allocation of expenses/ incomes
5	**Foreign Branch**
	Conversion as per AS 11 and incorporation in HO accounts

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PREPARATION OF FINAL ACCOUNTS OF COMPANIES - I

Unit Structure:

1.0 OBJECTIVES

After studying this chapter, you will be able to understand

- the nature of the financial statements;
- the Provisions relating to financial statements
- Accounting Standards 1
- Various adjustments with respect to the preparation of financial statements

1.1 INTRODUCTION

One of the goals of any organisation is to publish relevant information to various stakeholders so that they can make informed decisions. A stakeholder is anyone who has an interest in the company. Different stakeholders may have monetary or non-monetary stakes. The stakes can be direct or indirect, active or passive. The business owner and lenders would have financial stakes. Non-financial stakes in the company will be held by the government, consumers, or researchers. Users, also known as stakeholders, are typically classified as internal or external based on whether they are located within or outside of the company.

As a result, every firm is ultimately interested in knowing the business's end result. Because these are the final accounts prepared at the end of the fiscal year, they are referred to as final accounts. They ultimately serve the purpose of maintaining records. Their goal is to investigate the impact of various incomes and expenses over the course of the year, as well as the resulting profit or loss. The trading account, profit and loss account, and balance sheet are all part of the final accounts.

1.2 PROVISIONS RELATING TO FINANCIAL STATEMENTS UNDER THE NEW COMPANIES ACT

According to Section 128 of the Companies Act of 2013, every company must prepare and keep at its head office books of accounts and other relevant books and papers and financial statements for each year that give a true and fair view of the company's state of affairs, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches, and that such books must be kept on an accrual basis and in accordance with the Companies Act of 2013.
All or any of the aforementioned books of account and other relevant papers may be kept at such other location in India as the Board of Directors may decide, and where such a decision is made, the company shall file with the Registrar a notice in writing giving the full address of that other location within seven days of that decision.

The corporation may store prescribed books of accounts or other relevant papers in electronic form.

The books of account and other books and papers kept by the company within India shall be open for inspection by any director during business hours at the registered office of the company or at such other place in India, and copies of such financial information kept outside the country shall be kept and produced for inspection by any director subject to such conditions as may be prescribed. All assistance that the company can reasonably be expected to provide must be provided by the company's executives and other employees to the person conducting the inspection.

1.2.1 Nature of Financial Statements

1. Section 129 of companies act 2013, provides for preparation of financial statements.

2. Financial statements include the balance sheet, profit and loss account/ income and expenditure account, cash flow statement, statement of changes in equity, and any accompanying explanatory notes.

3. Section 129 replaces existing Section 210. It states that the financial statements must give a true and fair picture of the company's financial situation and must adhere to the accounting standards notified under new section 133.

4. It is also stated that financial statements must be prepared in the format specified in new Schedule III of the Companies Act of 2013.

5. It should be noted that the provisions in the new schedule III for preparing the balance sheet and profit and loss statement are similar to those in the old schedule VI.

6. In addition, the new Schedule III includes detailed instructions for preparing consolidated financial statements, as consolidation of subsidiary company accounts is now required under section 129.

7. It should be noted that, for the first time, a provision in the new section 129(3) states that if a company has one or more subsidiaries, the company and all subsidiaries must prepare a consolidated financial statement in the form specified in the new Schedule III of the Companies Act, 2013.

8. In addition, the firm must attach to its financial statement a separate statement covering the significant aspects of the financials of the subsidiary companies in the form prescribed by the regulations.

9. If the firm owns a stake in an associate company or a joint venture, the accounts of that company and the joint venture must be merged.

10. As a result, an associate company has been defined as a company with significant influence, defined as owning 20% of the company's total share capital or having power over business decisions under an agreement.

11. The Central Government has the authority to exempt any company from any of the section's requirements.

1.2.2 Objectives of Financial Statements

- Stakeholders in a company rely heavily on financial statements to understand how it operates. They represent the company's true state of affairs. Here are some examples of financial statement objectives:

- These accounts accurately reflect the economic assets and liabilities of a company. External stakeholders, such as investors and governments, would not otherwise have access to this information.

- They help to forecast a company's ability to generate profits. Shareholders and investors can use this information to make financial decisions.

- These assertions demonstrate a corporation's management effectiveness. As evidenced by these statements, a corporation's profitability determines how well it performs.

- They also help readers understand the accounting practises used in these statements. This allows for a more thorough understanding of statements.

- These statements also include data on the company's financial flows. Investors and creditors can use this information to forecast the company's liquidity and financial needs.

- Finally, they discuss the social impact of business. This is due to the fact that it demonstrates how the company's external circumstances impact its operations.

1.3 A S 1 – DISCLOSURE OF ACCOUNTING POLICIES

AS 1 – Disclosure of Accounting Policies

The information contained in an organization's financial statements represents its financial status. Accounting policies can have a large impact on profit or loss. Accounting policies vary from organisation to organisation. Significant accounting policies must be disclosed in order for the financial statements to be accessible. In some cases, the disclosure is required by law. In recent years, Indian organisations have begun to provide a clear explanation of their accounting policies in their annual reports to shareholders.

Many organisations include their accounting standards in the notes to their financial statements, but the disclosures are inconsistent. In other words, in some cases, the disclosure is included in the accounting, whereas in others, it is provided as supplemental information. This standard's goal is to improve financial statement understanding by establishing the practise of disclosing major accounting policies followed and how they are communicated in financial statements. Transparency would also make comparing the financial statements of different organisations easier.

Nature of Accounting Policies

Accounting policies refer to accounting principles and the techniques used by a company to put these principles into practise in the preparation of financial statements. There is no universal set of accounting policies that applies in all circumstances. Because of the variety of contexts in which organisations operate, alternative accounting concepts are permissible. The selection of appropriate accounting principles requires considerable judgement on the part of the organization's management.

In recent years, the numerous standards of the Institute of Chartered Accountants of India, combined with the efforts of the Government and other regulatory authorities, have reduced the number of permissible alternatives, particularly for corporates. While future efforts in this area are likely to reduce the number even further, the availability of alternative accounting principles is unlikely to be completely eliminated given the variety of scenarios that organisations face.

Areas in which differing Accounting Policies are possible

The following are examples of areas in which different accounting policies may be adopted by organisations.

1. Methods of depreciation, depletion and amortisation
2. Treatment of expenditure during construction
3. Conversion or translation of foreign currency items
4. Valuation of inventories
5. Treatment of goodwill
6. Valuation of investments
7. Treatment of retirement benefits
8. Recognition of profit on long-term contracts
9. Valuation of fixed assets
10. Treatment of contingent liabilities

The above list of examples is not exhaustive.

Considerations in the Selection of Accounting Policies

- The primary concern in the adoption of accounting policies by an organisation is that the financial statements provide a true and fair representation of the financial situation for the period. The following are the primary considerations that guide the selection and application of accounting policies for this purpose:
- Prudence: Because future events are unpredictable, earnings are not anticipated but recognised only when they are earned, which is not always in cash. Nonetheless, despite the fact that the amount cannot be determined with certainty and is only an estimate, provision is made for all known liabilities and losses.
- Substance Over Form: In financial statements, the accounting treatment and presentation of transactions and events should be guided by their substance rather than their legal form.
- Materiality: All "material" facts, that is, items about which financial statements should be disclosed, should be disclosed.

Disclosure of Accounting Policies

The primary concern in the adoption of accounting policies by an organisation is that the financial statements provide a true and fair representation of the financial situation for the period. The following are the primary considerations that guide the selection and application of accounting policies for this purpose:

Prudence: Because future events are unpredictable, earnings are not anticipated but recognised only when they are earned, which is not always in cash. Nonetheless, despite the fact that the amount cannot be determined with certainty and is only an estimate, provision is made for all known liabilities and losses.

Substance Over Form: In financial statements, the accounting treatment and presentation of transactions and events should be guided by their substance rather than their legal form.

Materiality: All "material" facts, that is, items about which financial statements should be disclosed, should be disclosed.

If an accounting policy change is implemented that has no significant impact on the financial statements for the current period but is likely to have a significant impact in subsequent periods, the fact of the change must be appropriately declared in the period in which the change is implemented. Accounting rule or change disclosure is not a remedy for incorrect or inappropriate accounting treatment of items.

Remember the following:

- All key accounting policies used in the preparation and presentation of financial statements must be disclosed.
- The disclosure should be included in the financial statements, ideally all at one place.
- Any accounting policy change that has a significant impact on the current period or is expected to have a significant impact on subsequent periods should be declared. If accounting policies change and have a significant impact on the current period, the amount by which any item in the financial statements is impacted should be declared to the extent that it can be computed. Where such a figure cannot be determined, either completely or partially, the fact should be stated.
- If financial statements are prepared using the basic accounting assumptions of Going Concern, Consistency, and Accrual, specific disclosure is not required. If an important accounting principle is not followed, a fact must be revealed.

1.4 ADJUSTMENTS IN PREPARATION OF FINANCIAL STATEMENTS

The accrual concept of accounting, which states that all income earned during an accounting period should be recorded regardless of whether it has been paid or not, is where it all really begins. Similarly, regardless of the actual payment, all expenses incurred over time should be documented. This is the main reason for final accounting adjustments. If such adjustments in the compilation of financial statements are overlooked, the numbers shown by the company in their final accounts will not be precise and true. Any necessary adjusting entries are reflected in the published journal entries.

Need for Adjustments:

Adjustments are done to:

1. To record the unrecorded transactions.
2. To provide for anticipated losses.
3. To rectify the located errors.
4. To present fair and unbiased presentation of assets and liabilities.

Important Point to be Noted while passing adjustment entries:

- The CGST and SGST will be levied on the sums if they are connected to an intra-state transaction.
- If the sums are connected to an interstate transaction, IGST will be levied on them.

List of Adjustments in Final Accounts

1. Closing Stock
2. Depreciation
3. Outstanding expenses and income
4. Prepaid expenses and Pre received income
5. Proposed Dividend and Unclaimed Dividend
6. Provision for Tax and Advance Tax
7. Bill of exchange (Endorsement, Honour, Dishonour)
8. Capital Expenditure included in Revenue expenditure and vice versa eg- purchase of furniture included in purchases
9. Unrecorded Sales and Purchases
10. Good sold on sale or return basis
11. Managerial remuneration on Net Profit before tax
12. Transfer to Reserves
13. Bad debt and Provision for bad debts
14. Calls in Arrears
15. Loss by fire (Partly and fully insured goods)
16. Goods distributed as free samples.
17. Any other adjustments as per the prevailing accounting standard.

Note: Adjustments would appear outside the trial balance.

1. Closing Stock

The closing stock is the inventory that was held at the end of the fiscal year. We keep an actual account called Closing Stock to obtain information on closing stock. It provides information on the value of unsold stock at the end of the fiscal period. Closing stock is valued by physically verifying it and valuing it at cost or market price, whichever is lower.

Because closing stock is determined by physical verification, which takes time to bring up the value, the closing stock usually does not appear in the Trial Balance when the accounts are finalised. As a result, it appears as part of the adjustment entry, which must be completed before Final Accounts are prepared.

If the closing stock is shown in the trial balance, it means that the closing stock adjustment has already been made, and it will be shown as a current asset in the balance sheet. The following accounting treatment is used in the preparation of the accounts:

1st Effect	Assets	Current Assets	Inventories
2nd Effect	Revenue Statement	Expenses	(c) Changes in inventories of finished goods, work-in-progress and stock-in-trade

Journal Entry for Adjustment of Closing Stock in Final Accounts
Closing Stock A/C Dr

To Trading A/C

(Recording ending inventory)
Closing stock is valued at cost or market, whichever is less.

2. Depreciation:
Depreciation occurs when the value of an asset decreases due to wear and tear or the passage of time. The amount of depreciation represents the business's operating expenses. If depreciation is not accounted for, the period's net profit will be overstated. Even on the Balance Sheet, the asset value should not be shown at its true value.

The double effect of depreciation is:
1. Depreciation is shown on the debit side of Profit and Loss Account.
2. The amount of depreciation is deducted from the concerned asset, in the asset side of the Balance Sheet.

A. When Provision for Depreciation is Not Maintained
Journal Entry When Provision is Not Maintained
Depreciation A/C Dr

To Asset A/C

(Charging depreciation on fixed asset)

Profit and Loss A/C Dr

To Depreciation A/C

(Depreciation charged transferred to Profit & Loss A/C)

B. When Provision for Depreciation is Maintained

Journal Entry When Provision is Maintained
Depreciation A/C Dr

To Provision for Depreciation A/C

(Being provision for depreciation made)

Step 2
Profit and Loss A/C Dr

To Depreciation A/C

(Depreciation charged transferred to Profit & Loss A/C)

3. Outstanding expenses and income

A. Outstanding Expenses

An expense that has been incurred but has not been paid within the current fiscal year, such as salary, rent, interest, and so on. Adjustments in final accounts are made to minimise overstating earnings. Outstanding rent, salary, wages, interest, and so forth.

- It is not generally included in the Trial Balance but is provided as additional information following the trial balance.
- If it is included in the Trial Balance, it signifies that the expense has already been adjusted and is thus solely presented as a liability on the Balance Sheet.
- If it is given after the Trial Balance (as an adjustment), it must be accounted for as an expense for the current fiscal year and thus debited to the Trading and Profit and Loss Account by adding it to the existing amount of the respective expense. Furthermore, because such an item is payable by the entity, it is recorded as a liability in the Balance Sheet by making the following adjustment:

Expenses A/c …Dr.

Input CGST A/c …Dr.

Input SGST A/c …Dr. or Input IGST A/c …Dr

To Outstanding Expenses A/c (Being unpaid expenses now recorded in the books

B. Accrued Income or Outstanding Income

These expenses are sometimes known as income generated but not yet received. Accrued income is income that the company has already earned but has not yet received. Examples include accumulated rent, commission due but not received, and so forth.

Journal Entry for Adjustment of Accrued Income in Final Accounts

Accrued Income A/C Dr

To Income A/C

To Output CGST A/C

To Output SGST A/C

To Output IGST A/C

(Recording income earned but not received)

Treatment of Accrued Income Adjustment in Financial Statements

- Trading Account: No effect
- Profit & Loss Account: Show on the credit side (Add to respective income)
- Balance Sheet: Show on the assets side (usually under the head current assets)

4. Prepaid expenses and Pre-received income

A. Pre-paid Expenses

These are also known as expenses paid in advance. Prepaid expenses are those paid in advance for a benefit that has not yet been obtained.

It is critical to record profits near the conclusion of an accounting year to avoid understating them. Prepaid rent, prepaid interest, prepaid insurance, and so forth are examples.

Journal Entry for Adjustment of Prepaid Expenses in Final Accounts

Prepaid Expense A/C Dr

To Expense A/C

(Recording expenses paid in advance, GST paid is not transferred in Prepaid Expense A/C)

B. Pre-received Income or Income Received in Advance

It is also known as unearned income. Income received in advance is income that the company has already received but has not yet earned. Rent received in advance, commission earned in advance, and so forth.

Journal Entry for Adjustment of Income Received in Advance in Final Accounts

Income A/C Dr

To Income Received in Advance A/C

To Output CGST A/C

To Output SGST A/C

(Recording income received but not earned)

Treatment of Income Received in Advance in Financial Statements
- Trading Account: No effect
- Profit & Loss Account: Show on the credit side (Subtract from the respectiveincome)
- Balance Sheet: Show on the liability side (usually under the head current liabilities)

5. Proposed Dividend and Unclaimed Dividend

Dividends:

A dividend is a share of profits and retained earnings that a company pays out to its shareholders. When a company generates a profit and accumulates retained earnings, those earnings can be either reinvested in the business or paid out to shareholders as a dividend. The annual dividend per share divided by the share price is the dividend yield.

Legal Provisions regarding Dividend

A company may pay dividends from any or all of the three following sources:
(i) Profits of the current year
(ii) Undistributed profits of previous years after providing for depreciation as per Schedule II of the Companies Act, 2013
(iii) Out of both or
(iv) Moneys provided by the Central or any State Government for the payment of dividends in pursuance of a guarantee given by the government concerned.

Proposed Dividend:
According to Amended Accounting Standard 4 read with Schedule 3 of the Companies Act 2013, proposed dividends should only be shown as a footnote to the balance sheet.

Proposed Dividend accounting treatment and presentation in the final Financial Statement shall be as follows:

Accounting Data Entry: No accounting entry should be made for the Board of Directors' recommendation of the final Dividend if it is made after the Financial Statement's closing date.

Profit and Loss Account Treatment: The proposed dividend may have no effect on the company's profit and loss statement. The effect of such dividend, however, shall be taken in the fiscal year in which it is actually declared by shareholders in the Annual General Meeting.

Presentation in the Balance sheet: Dividend proposed by the Board of Directors for the financial year, 2020-21 is not a liability till it has been approved by the shareholders in the ensuing Annual General Meeting.

Interim Dividend

Though dividends can only be declared by a shareholder resolution, if the company's articles allow, the Directors can declare an interim dividend between two annual general meetings. When an interim dividend is paid, the payment will be recorded as follows:

Interim Dividend A/c Dr.
  To Bank A/c

The interim dividend paid during a year will appear in the Company's Trial Balance as of the end of the accounting period and will be transferred to the debit side of the profit and loss appropriation a/c as an item of profit appropriation.

Unclaimed Dividend

If a dividend is transferred to the Dividend Account but not claimed by the shareholder within 30 days of its declaration, the Company must transfer the unpaid amount to the 'Unpaid Dividend Account' within 37 days of its declaration. The company must transfer any amount transferred under subsection (1) to the Unpaid Dividend Account within ninety days. Any money transferred to a company's Unpaid Dividend Account in accordance with this section that remains unpaid or unclaimed for seven years (7 years and 37 days from the date of dividend declaration) from the date of such transfer shall be transferred by the company, along with any interest accrued.

6. Provision for Tax and Advance Tax

A. Provision for Income Tax:

The tax that the company expects to pay in the current year is calculated by making adjustments to the company's net income by temporary and permanent differences, which are then multiplied by the applicable tax rate.

Income Tax Provision Formula = Income Earned Before Tax * Tax Rate

Profit drives the creation of this provision. This is the entry below the line. After deducting necessary items from gross profit (for example, depreciation recorded in books of accounts and allowable under income tax rules), taxable income is calculated. On that taxable profit, we must make provision for income tax at the applicable rate. The accounting entry will be as follows:

Profit & Loss A/C DR (provision for income tax)
      To Provision for Income Tax A/C

This provision being a liability, showed at “Capital & Liability” side of Balance Sheet in the bracket of “Other Liabilities”.

B. Advance Income Tax:

Advance tax refers to the payment of taxes in advance. In other words, "pay as you go." Advance tax is payable during the fiscal year if the tax payable is INR 10,000 or more (section 208). If the following conditions are met, the provisions of the advance tax do not apply to an individual resident in India (section 207) –

1. The resident individual has no income chargeable under the heading 'Profit and gain of business or profession'; and

2. The resident individual is 60 years of age or older at any time during the previous year. It should be noted that advance tax applies to all taxpayers; however, if the resident individual meets the above two conditions, he is exempt from making an advance tax payment.

As per Income Tax Act, we have to pay advance income tax and that is showed at "Property & Assets" side of Balance Sheet in the bracket of "Other Assets".

Accounting entry will be as under
: Advance Income Tax paid A/C Dr
        To Bank A/C
In case of self-assessment tax also this entry is passed but the narration will be for self-assessment.

7. Bill of exchange (Endorsement, Honour, Dishonour)

Meaning of Bill of Exchange

According to the Negotiable Instruments Act 1881, a bill of exchange is defined as "an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument".

ENDORSEMENT OF BILL OF EXCHANGE:

"The person receiving the bill of exchange becomes the endorsee when the bill's holder signs the bill's reverse with the intention of transferring the property it contains (the right to receive money from the acceptor). "Endorsement" is the process through which a bill is moved from one person to another for the payment of debts.
Endorsement of the bill refers to the process by which the creator or holder of the bill transfers the title of the bill in aid of his or her creditors. The person transferring the title is known as the "Endorser," while the person receiving the bill is known as the "Endorsee." Signing at the back of the bill constitutes an endorsement.

Journal Entries in the Books of Endorser and Endorsee:

When a bill of exchange is endorsed the following journal entries are made in the books of endorser and endorsee as the drawee will remain unaffected.

Endorser's Journal (A)	Endorsee's Journal (B)
When a bill is endorsed: Endorsee's A/C......XXX Bill receivable A/C...........XXX	When a bill is endorsed: Bill receivable A/C.........XXX Endorser's A/C.................XXX
No journal entry in the books of endorser when the bill is honoured at the date of maturity.	On the due date, the bill is presented to the acceptor and cash is received from him, the entry is: Cash A/C.........XXX Bill receivable A/C..........XXX

Dishonour of Bill

A bill is considered to be dishonoured when the drawee (the person who is obligated to pay) is unable to make the payment on the bill's maturity date. In this case, the drawee's obligation is reinstated. Bill dishonour can occur through either non-acceptance or non-payment. A dishonoured bill is the same as a bounced check.

Dishonour by Non-Payment

It is stated to be dishonoured of a bill of exchange by non-payment when the drawee of the bill of exchange fails to pay the bill on maturity to the drawer. Possible causes of non-payment dishonour

- Because there are insufficient funds in the drawee's account.
- Because of insolvency, the drawee is unable to pay.
- The drawee simply refuses to pay.

When a bill is dishonoured, any entries made at the time of receipt are reversed.

8. Capital Expenditure included in Revenue expenditure and vice versa

a. Capital Expenditure incorrectly treated as Revenue

Expenditure:Misclassifying a capital expenditure as a revenue expenditure has an impact on the expenditure, asset, and depreciation accounts. The initial journal entry exaggerates expenses while understating assets. A capital asset purchase journal entry, for example, debits an asset account and credits cash. An erroneous revenue expenditure journal entry debits expense while crediting cash. Because capital assets are depreciated on a regular basis, incorrectly classifying an asset understates the depreciation expense over time. An accountant can correct the error by reversing the initial journal entry, booking the correct entry, and recording any depreciation that is required.

For example, furniture purchases may be included in purchases.

b. Revenue Expenditure incorrectly treated as Capital Expenditure

The result will be that expenses will be reduced. As a result, the profit figure for the year will be incorrect on the income statement. The non-current asset will be highlighted more. As a result, the non-current asset value in the Statement of Financial Position will be incorrect. Profit for the year will be overstated, as will non-current assets.

9. Unrecorded Sales and Purchases

a. Unrecorded Sales

Unrecorded Sales are revenues earned by an entity during an accounting period but not recorded during that period. The company usually records the sales in a later accounting period, which violates the matching principle, which states that revenues and related expenses should be recognised in the same accounting period. Unrecorded revenue should be accrued in the period in which it is earned, with a credit to the Accrued Revenue account and a debit to the Accounts Receivable account. You would then reverse this entry in the period when the customer is invoiced.

b. Unrecorded Purchases

When the purchases remain unrecorded in a financial year, the profits are overvalued as an expense item remains unrecorded. This affects the profitability as well as the position of the company is not properly reflected. The company has to now rectify it’s error by now recording the purchases and the other effect will be the trade payables will be increased.

10. Good sold on sale or return basis

Goods sold on Sale on Approval is a business arrangement in which an individual or company interested in purchasing a specific item is granted permission to use the item for a set period of time. If the individual is satisfied with the item at the end of that time, they agree to purchase it. However, if the individual is dissatisfied for any reason, they have the option to return the item and are not obligated to buy it.

If a potential customer approves the sale, the transaction is recorded as credit sales; otherwise, it is not recorded. However, if the customer has not given any approval as of the end of the fiscal year, the goods are considered unsold and must be included in the supplier's stock.

11. Managerial remuneration on Net Profit before tax

A company may decide to pay its management a fixed percentage of its profits in the form of a commission. It is known as manager's commission, and it can be based on earnings before or after the commission is charged.

A. Manager’s Commission Payable Before Charging the Commission

In this case, the computation is as simple as multiplying the commission rate by the amount of net profit made by the business.

Journal Entry for Adjustment of Manager’s Commission in Final Accounts

Profit and Loss A/C Dr

To Manager's Commission Payable

(Recording outstanding commission payable to managers)

Treatment of Manager's Commission in Financial Statements

- Trading Account: No effect
- Profit & Loss Account: Show on the debit side as an expense
- Balance Sheet: Show on the liability side (usually under the head current liabilities)

B. Manager's Commission Payable After Charging the Commission

In this situation, the calculation is based on the net profit remaining after deducting such a commission. The handling in the final account is the same in both circumstances.

Calculation of Net Profit for Managerial Remuneration

The net profit shown in financial documents such as the statement of financial performance (P&L statement) should not be used to compute director remuneration, according to the Companies Act. The Companies Act of 2013 now requires that net profit calculated in accordance with Section 198 of the Act be considered for CSR as well. In this section, we will discuss how to calculate net profit for managerial salary.

Profit before tax as per P&L Statement	xxxx
Add the following items if debited to P&L Statement before arriving profit before tax	
Managerial remuneration	xxxx
Provision for Bad doubtful debts	xxxx
Loss on sale/disposal/discarding of assets.	xxxx
Loss on sale of investments	xxxx
Provision for diminution in the value of investments	xxxx
fixed assets written off	xxxx
Fall in the value of foreign currency monetary assets	xxxx
Loss on cancellation of foreign exchange contracts	xxxx
Write off of investments	xxxx
Provision for contingencies and unascertained liabilities	xxxx

Lease premium written off	xxxx
Provision for warranty spares/supplies	xxxx
Infructuous project expenses written off	xxxx
Provision for anticipated loss in case of contracts	xxxx
Loss on sale of undertaking	xxxx
Provision for wealth tax	xxxx
compensation paid under VRS	xxxx
Less the following if credited to P&L statement for arriving at profit before tax:	xxxx
Capital profit on sale/disposal of fixed assets (the same should be added if the co., business comprises of buying & selling any such property or asset) and revenue profit (difference between original cost and WDV should not be deducted)	xxxx
Profit on sale of any undertaking or its part	xxxx
Profit on buy back of shares	xxxx
Profit/discount on redemption of shares or debentures	xxxx
Profit on sale of investments	xxxx
Compensation received on non-compete agreements	xxxx
Write back of provision for doubtful debts	xxxx
Write back of provision for doubtful advances	xxxx
Appreciation in value of any investments	xxxx
Compensation received on surrender of tenancy rights	xxxx
Profit on sale of undertaking	xxxx
Write back of provision for diminution in the value of investments	xxxx
Profit on sale of forfeited shares & shares of subsidiary/associated companies	xxxx

After computing the profit, the act's remuneration limits can be utilised to establish the maximum allowable remuneration. If the actual salary exceeds the maximum allowable remuneration, we must obtain approval from the Central Government.

12. Transfer to Reserves

I. Section 123 (1) of the Companies Act, 2013 allows the Board of Directors to appropriate a portion of profits to the credit of a reserve or reserves.

II Appropriation of a part of profit is sometimes made under law.

(a) For example, the Banking Regulation Act requires that a fixed percentage of a banking company's profit be transferred to the General Reserve before any dividend can be distributed.

(b) Transfer of a portion of profit to a reserve is also required where the company has agreed, at the time of loan raising, that before any portion of its profit is distributed, a specified percentage of the profit should be credited to a reserve for loan repayment and the amount should remain invested in a specified manner until the time for repayment arrives.

III Apart from the aforementioned appropriations, it may also be necessary to provide for losses and depreciation arrears, as well as to exclude capital profit, as previously mentioned, in order to arrive at the amount of divisible profit.

13. Bad debt and Provision for bad debts

A. Bad Debts

Debts can be classified into three categories which are as under:

- **Bad Debts:** It means which are uncollectable or irrecoverable debts.
- **Doubtful debts:** It means which will be receivable or cannot be ascertainable at the date of preparing the financial statements, in simple words those debts which are doubtful to realize.

- **Good debts:** It means which are not bad, i.e., neither there is the possibility of bad debts nor any doubt about its realization is known as good debts.

Not all the debtors of a business may be able to pay 100% of their debts at all the time. This may lead to a loss to the receiving business and is termed as bad debts.

Journal Entry for Adjustment of Bad Debts in Final Accounts

Bad Debts A/C   Dr

    To Debtor’s A/C

(Recording bad debts)

Step 2

Profit and Loss A/C Dr

To Bad Debts A/C

(Bad debts transferred to Profit & Loss A/C)

Treatment of Bad Debts in Financial Statements

Situation 1 – When bad debts are given inside the trial balance – No Adjustment, only show in P&L

Situation 2 – When bad debts are given outside the trial balance as an adjustment – They are called further bad debts and adjustments in final accounts are posted.

- Trading Account: No effect
- Profit & Loss Account: Show on the debit side (add to bad debts already written off)
- Balance Sheet: Show on the asset side (subtract from sundry debtors)

Journal Entry for Adjustment of Further Bad Debts in Final Accounts

Bad Debts A/C Dr

To Debtor's A/C

(Recording further bad debts)

B. Provision for Doubtful Debts

The provision for doubtful debts is the estimated amount of bad debt that will arise from accounts receivable that have been issued but not yet collected. It is identical to the allowance for doubtful accounts.

The accounting concept of prudence and conservatism cautions that each business should be ready to absorb all anticipated losses. Due to this, all businesses provide for possible bad debts arising due to non-payment by creditors in form of provision for doubtful debts.

When Provision for Doubtful Debts does not Appear in Trial Balance

Journal Entry for Adjustment of Provision for Doubtful Debts in Final Accounts

Profit and Loss A/C Dr

To Provision for Doubtful Debts A/C

(Recording provision for doubtful debts)

Treatment of Provision for Doubtful Debts in Financial Statements

- Trading Account: No effect
- Profit & Loss Account: Show on the debit side (calculate as % on Debtors)
- Balance Sheet: Show on the asset side (subtract from sundry debtors)

Note: Provisions do not reduce the amount due from debtors.

Provision for Discount on Debtors

Debtors are given a monetary discount as an incentive to make early payments. In some situations, the payment may be paid in the next fiscal year. This means that, according to the accrual accounting concept, such discounts should be regarded as a cost in the current year. When such a provision is made, it is referred to as a provision for discount on debtors.

Journal Entry for Adjustment of Provision for Discount on Debtors in Final Accounts

Profit and Loss A/C Dr

To Provision for Discount on Debtors A/C

(Recording provision for discount on debtors)

Treatment of Provision for Discount on Debtors in Financial Statements

- Trading Account: No effect
- Profit & Loss Account: Show on the debit side (calculate on good debtors i.e. after adjusting bad debts & provision for doubtful debts)
- Balance Sheet: Show on the asset side (subtract from sundry debtors)

14. Calls in Arrears

Calls in Arrears and Calls in Advance

Calls-In-Arrears

If a shareholder is unable to pay the call amount due on allotment or any subsequent calls in accordance with the terms, the amount that becomes due is called Calls-In-Arrears. We have the option of transferring or not transferring the arrear amount due to allotment or calls to the Calls-in-Arrears Account.

Methods of Accounting Treatment of Calls-In-Arrears

Without opening Calls-in-Arrears Account

By opening Calls-in-Arrears Account

Without opening Calls-in-Arrears Account

Under this method, we credit the receipt from shareholders to the relevant call account and various call accounts will show debit balance equal to the total unpaid amount of calls.On a subsequent date, when we receive the amount of Calls-in-Arrears, we debit Bank Account and credit the relevant Call Account.

15. Loss by fire (Partly and fully insured goods)

Loss by fire as well as accidental losses or abnormal losses occur when a company experiences any form of loss as a result of a fire, an accident, an earthquake, or another natural disaster.

The loss is recorded in the profit and loss account and credited to the asset account. The stock of items may be destroyed, resulting in a drop in the firm's gross and net profit. GST is reversed on these items because the tax paid on them cannot be offset against the tax collected.

A. If Goods are Not Insured

Journal Entry for Abnormal or Accidental Loss in Final Accounts (Goods Not Insured)

Profit and Loss A/C Dr

To Trading A/C

To Input CGST A/C

To Input SGST A/C

(Recording total value of abnormal loss)

Treatment of Abnormal or Accidental Loss in Financial Statements (Goods Not Insured)

- Trading Account: Show on the credit side (with the cost of goods destroyed)
- Profit & Loss Account: Show on the debit side (with the cost of goods destroyed)
- Balance Sheet: No effect

B. If Goods are Insured

Journal Entry for Abnormal or Accidental Loss in Final Accounts (Goods Insured)

Accidental Loss A/C Dr

To Trading A/C

To Input CGST A/C

To Input SGST A/C

(Recording total value of abnormal loss)

Step 2

Insurance Claim A/C Dr

Profit and Loss A/C Dr

To Accidental Loss A/C

(Adjusting the insurance claim received)

1. Amount of insurance claim
2. Amount of irrecoverable loss
3. Total abnormal loss

Treatment of Abnormal or Accidental Loss in Financial Statements (Goods Insured)

- Trading Account: Show on the credit side (with the cost of goods destroyed)
- Profit & Loss Account: Show on the debit side (with the cost of goods destroyed)

Balance Sheet: No effect

16. Goods distributed as free samples:
It is very common for businesses to distribute goods as free samples. Free samples are frequently used in marketing and consumer outreach programmes. The following are the primary goals of distributing goods as free samples:

- Introducing a new product in the market
- Introducing an existing product in a new market
- Introducing a feature upgrade to an existing product
- Increasing the market share of a particular product
- Receiving feedback from product users

The outflow of merchandise caused by free sample distribution cannot be recorded as a sale. This is because there is no monetary compensation for the distribution of goods as free samples. Instead, giving away free samples to customers is viewed as an advertising expense. As a result, it is charged to the advertisement expense account.

17. Any other adjustments as per the prevailing accounting standard:
As per the companies Act 2013, in case of any clash between Accounting standard and Companies Act, Accounting standard will prevail over the Companies Act provision.

1.5 PREPARATION OF FINANCIAL ACCOUNTS IN VERTICAL FORMAT SCHEDULE III OF THE COMPANIES ACT, 2013

Introduction:
According to Section 129 of the Companies Act 2013, all the companies registered under this Act will have to present its financial statements in Schedule III of the Act. The Schedule III of the Companies Act 2013 has been formulated to keep pace with the changes in the economic philosophy leading to privatization and globalization and consequent desired changes/reforms in the corporate financial reporting practices. It deals with the Form of Balance sheet, Statement of Profit and Loss and disclosures to be made therein and it applies uniformly to all the companies registered under the Companies Act, 2013, for the preparation of financial statements of an accounting year. It has several new features like:

– A vertical format for presentation of balance sheet with classification of Balance Sheet items into current and non-current categories. –
 A vertical format of Statement of Profit and Loss with classification of expenses based on nature
. – Elimination the concept of "Schedules" and such information is now to be furnished in terms of "Notes to Accounts". –
 It does not contain any specific disclosure for items included in Schedule VI under the head, "Miscellaneous Expenditure".

Presentation of Balance Sheet

A Balance sheet is a statement of the financial position of an enterprise as at a given date, which exhibits its assets, liabilities, capital, reserves and other account balances at their respective book values

Key features of Balance Sheet

1) The Schedule III permits only Vertical form of presentation.
2) It uses "Equity and Liabilities" and "Assets" as headings.
3) All assets and liabilities classified into current and non-current and presented separately on the face of the Balance Sheet.
4) Number of shares held by each shareholder holding more than 5% shares now needs to be disclosed.
5) Details pertaining to aggregate number and class of shares allotted for consideration other than cash, bonus shares and shares bought back will need to be disclosed only for a period of five years immediately preceding the Balance Sheet date
6) Any debit balance in the Statement of Profit and Loss will be disclosed under the head "Reserves and surplus." Earlier, any debit balance in Profit and Loss Account carried forward after deduction from uncommitted reserves was required to be shown as the last item on the asset side of the Balance Sheet
7) Specific disclosures are prescribed for Share Application money. The application money not exceeding the capital offered for issuance and to the extent not refundable will be shown separately on the face of the Balance Sheet. The amount in excess of subscription or if the requirements of minimum subscription are not met will be shown under "Other current liabilities."
8) The term "sundry debtors" has been replaced with the term "trade receivables." 'Trade receivables' are defined as dues arising only from goods sold or services rendered in the normal course of business. Hence, amounts due on account of other contractual obligations can no longer be included in the trade receivables.
9) It requires separate disclosure of "trade receivables" outstanding for a period exceeding six months from the date the bill/invoice is due for payment."
10) "Capital advances" are specifically required to be presented separately under the head "Loans & advances" rather than including elsewhere.

11) Tangible assets under lease are required to be separately specified under each class of asset. In the absence of any further clarification, the term "under lease" should be taken to mean assets given on operating lease in the case of lessor and assets held under finance lease in the case of lessee.

12) Under the Schedule III, other commitments also need to be disclosed.

The format of balance sheet as given in Part I of Schedule III of the Companies Act 2013 is given below.

Schedule III (See section - 129) GENERAL INSTRUCTION FOR PREPARATION OF BALANCE SHEET AND STATEMENT OF PROFIT AND LOSS OF A COMPANY	
GENERAL INSTRUCTIONS	(1) If compliance with the Act's requirements, including Accounting Standards applicable to companies, necessitates any change in treatment or disclosure, including addition, amendment, substitution, or deletion in the head or sub-head or any changes, in the financial statements or statements forming part thereof, the same shall be made, and the requirements of this Schedule shall be modified accordingly. (2)The disclosure requirements specified in this Schedule supplement, rather than replace, the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act of 2013. Unless required to be disclosed on the face of the Financial Statements, additional disclosures specified in the Accounting Standards must be made in the notes to accounts or by way of an additional statement. Similarly, in addition to the requirements set out in this Schedule, all other disclosures required by the Companies Act must be made in the notes to accounts. (3) (i) Notes to accounts must include information in addition to what is presented in the Financial Statements, such as a) narrative descriptions or disaggregation of items recognised in those statements, and b) information about items that do not qualify for recognition in those statements. (ii) Each item on the balance sheet and profit and

	loss statement must be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements, including the notes to accounts, a balance must be struck between providing excessive detail that may not be useful to users of financial statements and failing to provide important information due to excessive aggregation. (4) (i) Depending on the company's turnover, the figures in the Financial Statements may be rounded off as shown below:
	(ii) Once a unit of measurement is established, it must be used consistently in the Financial Statements. (5)Except in the case of the first Financial Statements laid before the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given. (6) For the purpose of this Schedule, the terms used herein shall be as per the notes applicable
Accounting Standards.	Note:This section of the Schedule specifies the minimum requirements for the Balance Sheet, Statement of Profit and Loss (hereinafter referred to as - Financial Statements for the purposes of this Schedule), and Notes. Line items, sub-line items, and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company's financial position or performance, or to cater to

Turnover	Rounding off
(a) less than one hundred’ crore rupees	To the nearest hundreds, thousands, lakhsormillions, or decimals thereof
(b) one hundred crore rupees or more	To the nearest lakhs, millions or crores, or decimals thereof.

	industry/sector-specific disclosure requirements, or when required for compliance with amendments to the Companies Act or under the Accounting Standards.

1.6 VERTICAL FINANCIAL STATEMENT

ABC LIMITED Balance Sheet As On 31st March, 2022			
Particulars	**Note No.**	**Figures as at the end of current reporting period Rs.**	**Figures as at the end of previous reporting Period Rs.**
A EQUITY AND LIABILITIES			
1 Shareholders' funds			
(a) Share capital	1	XX	XX
(b) Reserves and surplus	2	XX	XX
(b) Money Received against share warrants		XX	XX
2 Share application money pending allotments		XX	XX
3 Non-current liabilities			
(a) Long-term borrowings	3	XX	XX
(b) Deferred tax liabilities (net)		XX	XX
(c) Other Long Term Liabilities		XX	XX
(d) Long term provision		XX	XX
4 Current liabilities			
(a) Short Term Borrowings	4	XX	XX
(b) Trade payables	5	XX	XX
(c) Other current liabilities	6	XX	XX
(d) Short-term provisions	7	XX	XX
Total		**XX**	**XX**
B ASSETS			
1 Non-current assets			
(a) Fixed Assets			
(i) Property, Plant and Equipment	8	XX	-
(ii) Intangible assets		XX	-
(iii) Capital Work in progress		XX	-

	(iv) Intangible Assets under Development		XX	-
	(b) Non-current investments	9	XX	-
	(c) Deferred Tax Assets		XX	
	(d) Long term loans and Advances		XX	
	(e) Other Non-Current Assets		XX	
2	**Current assets**			
	(a) Current Investments	10	XX	
	(b) Inventories	11	XX	-
	(c) Trade receivables	12	XX	-
	(d) Cash and cash equivalents	13	XX	-
	(e) Short-term loans and advances	14	XX	-
	(f) Other Current Assets	15	XX	-
	Total		**XX**	**XX**

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

1. An asset shall be classified as current when it satisfies any of the following criteria:

a. It is expected to be realised in, or is intended for sale or consumption in, the company's normal operating cycle;
b. It is held primarily for the purpose of being traded;
c. It is expected to be realised within twelve months after the reporting date; or
d. It is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non-current.

2. The time between the acquisition of assets for processing and their realisation in cash or cash equivalents is referred to as an operating cycle. Where the normal operating cycle cannot be determined, it is assumed to last for a period of twelve months.
3. A liability shall be classified as current when it satisfies any of the following criteria:

a. It is expected to be settled during the normal operating cycle of the company;
b. it is held primarily for trading purposes;
c. it is due to be settled within twelve months of the reporting date; or
d. The company does not have an unconditional right to postpone liability settlement for at least twelve months after the reporting date. The terms of a liability that, at the option of the counterparty, could result in its settlement through the issuance of equity instruments have no bearing on its classification.

All other liabilities must be designated as non-current.

4. A receivable is classified as a "trade receivable" if the amount owed is for goods sold or services rendered in the normal course of business.
5. A payable is classified as a "trade payable" if the amount due is for goods purchased or services received in the normal course of business.

A company shall disclose the following in the notes to accounts.

A. Share Capital

For each class of share capital (different classes of preference shares to be treated separately):

a. The number and amount of shares authorised;
b. The number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
c. Par value per share;
d. A reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;
e. The rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;
f. Shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
g. Shares in the company held by each share holder holding more than 5 per cent shares specifying the number of shares held;
h. Shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;
i. For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
A. Aggregate number and class of shares allotted as fully paid-up pursuant to contract(s) without payment being received in cash.
B. Aggregate number and class of shares allotted as fully paid-up by way of bonus shares.
C. Aggregate number and class of shares bought back.
j. Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date;
k. Calls unpaid (showing aggregate value of calls unpaid by directors and officers);
l. Forfeited shares (amount originally paid-up).

B. Reserves and Surplus

i. Reserves and Surplus shall be classified as:
a. Capital Reserves;
b. Capital Redemption Reserve;
c. Securities Premium Reserve;
d. Debenture Redemption Reserve;

e. Revaluation Reserve;
f. Share Options Outstanding Account;
g. Other Reserves(specify the nature and purpose of each reserve and the amount in respect thereof);
h. Surplus i.e., balance in Statement of Profit and Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/ from reserves, etc.;
(Additions and deductions since last balance sheet to be shown under each of the specified heads);

ii. A reserve specifically represented by earmarked investments shall be termed as a "fund".
iii. The debit balance of the profit and loss statement must be shown as a negative figure under the heading "Surplus." Similarly, even if the resulting figure is negative, the balance of "Reserves and Surplus," after adjusting for any negative balance of surplus, shall be shown under the heading "Reserves and Surplus."

C. Long-term Borrowings

i. Long-term borrowings shall be classified as:
a. Bonds/debentures;
b. Term loans:
A. From banks.
B. From other parties.
c. Deferred payment liabilities;
d. Deposits;
e. Loans and advances from related parties;
f. Long-term maturities of finance lease obligations;
g. Other loans and advances (specify nature).

ii. Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
iii. Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
iv. Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due.
v. Particulars of any redeemed bonds/debentures which the company has power to reissue shall be disclosed.
vi. Terms of repayment of term loans and other loans shall be stated.
vii. Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

D. Other Long-term Liabilities

Other Long-term Liabilities shall be classified as:

a. Trade payables;
b. Others.

E. Long-term provisions

The amounts shall be classified as:

a. Provision for employee benefits;
b. Others (specify nature).

F. Short-term borrowings

i. Short-term borrowings shall be classified as:
a. Loans repayable on demand;
A. From banks.
B. From other parties.
b. Loans and advances from related parties;
c. Deposits;
d. Other loans and advances (specify nature).
ii. Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
iii. Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
iv. Period and amount of default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

G. Other current liabilities

The amounts shall be classified as:

a. Current maturities of long-term debt;
b. Current maturities of finance lease obligations;
c. Interest accrued but not due on borrowings;
d. Interest accrued and due on borrowings;
e. Income received in advance;
f. Unpaid dividends;
g. Application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms and conditions including the number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether the company has sufficient authorised capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be

shown under the head Equity and share application money to the extent refundable, i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under "Óther current liabilities";

h. Unpaid matured deposits and interest accrued thereon;
i. Unpaid matured debentures and interest accrued thereon;
j. Other payables (specify nature).

H. Short-term provisions

The amounts shall be classified as:

a. Provision for employee benefits.
b. Others (specify nature).

I. Tangible assets

i. Classification shall be given as:
a. Land;
b. Buildings;
c. Plant and Equipment;
d. Furniture and Fixtures;
e. Vehicles;
f. Office equipment;
g. Others (specify nature).
ii. Assets under lease shall be separately specified under each class of asset.
iii. A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.
iv. Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

J. Intangible assets

i. Classification shall be given as:
a. Goodwill;
b. Brands/trademarks;
c. Computer software;
d. Mastheads and publishing titles;
e. Mining rights;
f. Copyrights, and patents and other intellectual property rights, services and operating rights;
g. Recipes, formulae, models, designs and prototypes;

h. Licences and franchise;
i. Others (specify nature).

ii. A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related amortization and impairment losses/reversals shall be disclosed separately.

iii. Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

K. Non-current investments

i. Non-current investments shall be classified as trade investments and other investments and further classified as:
a. Investment property;
b. Investments in Equity Instruments;
c. Investments in preference shares;
d. Investments in Government or trust securities;
e. Investments in debentures or bonds;
f. Investments in Mutual Funds;
g. Investments in partnership firms;
h. Other non-current investments (specify nature).
Under each classification, details shall be given of names of the bodies corporate indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

ii. Investments carried at other than at cost should be separately stated specifying the basis for valuation thereof;

iii. The following shall also be disclosed:
a. Aggregate amount of quoted investments and market value thereof;
b. Aggregate amount of unquoted investments;
c. Aggregate provision for diminution in value of investments.

L. Long-term loans and advances

i. Long-term loans and advances shall be classified as:
a. Capital Advances;
b. Security Deposits;
c. Loans and advances to related parties (giving details thereof);
d. Other loans and advances (specify nature).

ii. The above shall also be separately sub-classified as:
a. Secured, considered good;
b. Unsecured, considered good;
c. Doubtful.
iii. Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.
iv. Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

M. Other non-current assets

Other non-current assets shall be classified as:

i. Long-term Trade Receivables (including trade receivables on deferred credit terms);
ii. Others (specify nature);
iii. Long-term Trade Receivables, shall be sub-classified as:
A.
i. Secured, considered good;
B. Unsecured, considered good;
C. Doubtful.
i. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
ii. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

N. Current Investments

i. Current investments shall be classified as:
a. Investments in Equity Instruments;
b. Investment in Preference Shares;
c. Investments in Government or trust securities;
d. Investments in debentures or bonds;
e. Investments in Mutual Funds;
f. Investments in partnership firms;
g. Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate [indicating separately whether such bodies are: (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities] in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

ii. The following shall also be disclosed:
a. The basis of valuation of individual investments;
b. Aggregate amount of quoted investments and market value thereof;
c. Aggregate amount of unquoted investments;
d. Aggregate provision made for diminution in value of investments.

O. Inventories

i. Inventories shall be classified as:
a. Raw materials;
b. Work-in-progress;
c. Finished goods;
d. Stock-in-trade (in respect of goods acquired for trading);
e. Stores and spares;
f. Loose tools;
g. Others (specify nature).
ii. Goods-in-transit shall be disclosed under the relevant sub-head of inventories.
iii. Mode of valuation shall be stated.

P. Trade Receivables

i. Aggregate amount of Trade Receivables outstanding for a period exceeding six months from the date they are due for payment should be separately stated.
ii. Trade receivables shall be sub-classified as:
a. Secured, considered good;
b. Unsecured, considered good;
c. Doubtful.
iii. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
iv. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Q. Cash and cash equivalents

i. Cash and cash equivalents shall be classified as:
a. Balances with banks;
b. Cheques, drafts on hand;
c. Cash on hand;
d. Others (specify nature).
ii. Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
iii. Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
iv. Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
v. Bank deposits with more than twelve months maturity shall be disclosed separately.

R. Short-term loans and advances

i. Short-term loans and advances shall be classified as:
a. Loans and advances to related parties (giving details thereof);
b. Others (specify nature).

ii. The above shall also be sub-classified as:
a. Secured, considered good;
b. Unsecured, considered good;
c. Doubtful.

iii. Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

iv. Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

S. Other current assets (specify nature)
This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

T. Contingent liabilities and commitments (to the extent not provided for)

i. Contingent liabilities shall be classified as:
a. Claims against the company not acknowledged as debt;
b. Guarantees;
c. Other money for which the company is contingently liable.
ii. (ii) Commitments shall be classified as:
a. Estimated amount of contracts remaining to be executed on capital account and not provided for;
b. Uncalled liability on shares and other investments partly paid;
c. Other commitments (specify nature).

U. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and the related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on preference shares shall also be disclosed separately.

V. Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested.

W. If, in the opinion of the Board, any of the assets other than fixed assets and non-current investments do not have a value on realisation in the ordinary course of business at least equal to the amount at which they are stated, the

1.7 STATEMENT OF PROFIT AND LOSS

Statement of Profit and Loss

ABC PRIVATE LIMITED				
STATEMENT OF PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31st MARCH 2022				
	Particulars	**Note No.**	**Figures for the current reporting period**	**Figures for the previous reporting period**
			Rs.	**Rs.**
I	Revenue from operations	16	XX	XX
II	Other Income	17	XX	XX
III	**Total Income (I+II)**		**XX**	**XX**
IV	**Expenses**			
	(a) Cost of materials consumed	18	XX	XX
	(b) Purchase of Stock in Trade		XX	XX
	(c) Changes in inventories of finished goods, work-in-progress and stock-in-trade	19	XX	XX
	(d) Employee benefits expenses	20	XX	XX
	(e) Finance costs	21	XX	XX
	(f) Depreciation and amortisation expenses		XX	XX
	(g) Other expenses	22	XX	XX
V	**Total Expenses**		**XX**	**XX**
VI	**Profit before exceptional and extraordinary item and tax**		**XX**	**XX**
VII	**Exceptional Items**		XX	XX
VIII	**Profit before**		XX	XX

	extraordinary item and tax			
IX	**Extraordinary Items**		XX	XX
X	**Profit before Tax**		XX	XX
XI	**Tax Expense:**			
	(a) Current tax expense		XX	XX
	(b) Deferred tax		XX	XX
XII	**Profit / (Loss) for the period from continuing operations**		XX	XX
XIII	**Profit / (Loss) from discontinuing operations**		**XX**	**XX**
XIV	**Tax from discontinuing operations**		**XX**	**XX**
XV	**Profit/ (Loss) from discontinuing operations**		**XX**	**XX**
XVI	**(Loss) for the Period**		**XX**	**XX**
XVII	**Earning per equity share:**		**XX**	**XX**
	(1) Basic		**XX**	**XX**
	(2) Diluted		**XX**	**XX**

Salient features of the statement of Profit and Loss:

1) The name of 'Profit and Loss Account' has been changed to "Statement of Profit and Loss"

2) This format of Statement of Profit and Loss does not mention any appropriation item on its face. Further, 'below the line' adjustments to be presented under "Reserves and Surplus" in the Balance Sheet.

3) Any item of income or expense which exceeds one per cent of the revenue from operations or Rs. 100,000 (earlier 1 % of total revenue or Rs. 5,000), whichever is higher, needs to be disclosed separately.

4) In respect of companies other than finance companies, revenue from operations need to be disclosed separately as revenue from (a) sale of products, (b) sale of services and (c) other operating revenues

5) Net exchange gain/loss on foreign currency borrowings to the extent considered as an adjustment to interest cost needs to be disclosed separately as finance cost

6) Break-up in terms of quantitative disclosures for significant items of Statement of Profit and Loss, such as raw materials, stocks, purchases and sales have been simplified and replaced with the disclosure of "broad heads" only. The broad heads need to be decided based on materiality and presentation of true and fair view of the financial statements.

GENERAL INSTRUCTIONS FORPREPARATION OF STATEMENT OF PROFIT AND LOSS

i. The provisions of this Part shall apply to the income and expenditure account referred to in sub-clause (ii) of clause (40) of section 2 in like manner as they apply to a statement of profit and loss.

ii. (A) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from—

- Sale of products;
- Sale of services;
- Other operating revenues;
- Less:
- Excise duty.

(B) In respect of a finance company, revenue from operations shall include revenue from—

- Interest; and
- Other financial services.

Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.

iii. Finance Costs

Finance costs shall be classified as:

- Interest expense;
- Other borrowing costs;
- Applicable net gain/loss on foreign currency transactions and translation.

iv. Other Income

Other income shall be classified as:

- Interest Income (in case of a company other than a finance company);
- Dividend Income;
- Net gain/loss on sale of investments;
- Other non-operating income (net of expenses directly attributable to such income).

v. Additional Information:

A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:—

- Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses].
- Depreciation and amortisation expense;
- Any item of income or expenditure which exceeds one per cent of the revenue from operations or Rs.1,00,000, whichever is higher;
- Interest Income;
- Interest expense;
- Dividend income;
- Net gain/loss on sale of investments;
- Adjustments to the carrying amount of investments;
- Net gain or loss on foreign currency transaction and translation (other than considered as finance cost);
- Payments to the auditor as (a) auditor; (b) for taxation matters; (c) for company law matters; (d) for management services; (e) for other services; and (f) for reimbursement of expenses;
- In case of Companies covered under section 135, amount of expenditure incurred on corporate social responsibility activities;
- Details of items of exceptional and extraordinary nature;
- Prior period items;

vi. In the case of manufacturing companies:
- Raw materials under broad heads
- goods purchased under broad heads
- In the case of trading companies, purchases in respect of goods traded in by the company under broad heads.
- In the case of companies rendering or supplying services, gross income derived from services rendered or supplied under broad heads.
- In the case of a company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if purchases, sales and consumption of raw material and the gross income from services rendered is shown under broad heads.
- In the case of other companies, gross income derived under broad heads.

vii. In the case of all concerns having works in progress, works-in-progress under broad heads.

viii. (a) The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as to which the balance sheet is made up.
- The aggregate, if material, of any amounts withdrawn from such reserves.

ix. (a) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.
(b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.

x. Expenditure incurred on each of the following items, separately for each item:—
- Consumption of stores and spare parts;
- Power and fuel;
- Rent;
- Repairs to buildings;
- Repairs to machinery;
- Insurance;
- Rates and taxes, excluding, taxes on income;
- Miscellaneous expenses,

xi. (a) Dividends from subsidiary companies.
- Provisions for losses of subsidiary companies.
- The profit and loss account shall also contain by way of a note the following information, viz:
- Value of imports calculated on C.I.F basis by the company during the financial year in respect of—
- Raw materials;
- Components and spare parts;
- Capital goods;
- Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;
- Total value if all imported raw materials, spare parts and components consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;
- The amount remitted during the year in foreign currencies on account of dividends with a specific mention of the total number of non-resident shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related;
- Earnings in foreign exchange classified under the following heads, namely:—
- Export of goods calculated on F.O.B. basis;
- Royalty, know-how, professional and consultation fees;
- Interest and dividend;
- Other income, indicating the nature thereof.

Exercise:
Choose the correct alternative:

1. Every Balance Sheet must comply with the requirements of _______ of Schedule III of the Companies Act, 2013.

a.	Part IV	b.	Part III	c.	Part II	d.	Part I

2. Every Statement of Profit & Loss must comply with the requirements of Part II of ________of the Companies Act, 2013.

a.	Schedule I	b.	Schedule II	c.	Schedule III	d.	Schedule IV

3. The Schedule III prescribes only the _______ format for presentation of Financial Statements.

a.	Horizontal	b.	Vertical	c.	Comparative	d.	T Account

4. The appropriations are to be presented under _____________ in the Balance Sheet.

a.	Reserves and Surplus	b.	Long term Provision	c.	Short Term Provision	d.	Share Capital

5. An operating cycle is assumed to have a duration of _______.

a.	18 months	b.	24 months	c.	6 months	d.	12 months

6. Claims not acknowledged as debts

a.	is shown under Trade Receivables in the balance Sheet of a company	b.	is shown under Trade payable in the balance Sheet of a company	c.	is shown under provision in the balance Sheet of a company	d.	is shown by way of a note to the balance sheet of a company under contingent liabilities

7. Any amount payable within 12 months from the date of Balance Sheet is called_________.

b.	Loan	c.	Current Liabilities	d.	Contingent Liabilities

8. Which of the following is not an example of fixed assets?

a.	plant & machinery	b.	building	c.	royalty	d.	patents

9. Unclaimed dividend is shown under

a.	current liability	b.	secured loan	c.	provisions	d.	reserves

10. The example of accounting policy is ________.

a.	consistency	b.	going concern	c.	accrual	d.	depreciation

11. The preference capital redeemed can be aggregate of ______.

a.	free reserves & proceeds of fresh issue of shares	b.	security premium and free reserves	c.	secured loan and Capital	d.	Debentures

12. When new shares are issued at discount, proceeds of fresh issue is the_____.

a.	nominal value	b.	net receipt	c.	discount	d.	premium value

Correct Answer:

1	2	3	4	5	6	7	8	9	10	11	12
D	c	b	a	d	d	c	c	a	d	a	b

Short Notes:

1. Nature of Financial Statements

2. Objectives of Financial Statements

3. Current investment.

4. Operating cycle.

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2

PREPARATION OF FINAL ACCOUNTS OF COMPANIES - II

Unit Structure:

2.0 OBJECTIVES

After studying this chapter, you will be able to understand

- Application of Various adjustments with respect to the preparation of financial statements
- Preparation of final accounts both under the vertical format as suggested by the Revised Schedule – III

2.1 ILLUSTRATIONS

Illustration 01:

Show the presentation of the following items under appropriate notes to accounts forming part of the Balance Sheet of Mehul Ltd. as on 31-3-2017:

Particulars	Amount (₹)
General Reserve (Opening Balance)	50,00,000
Debenture Redemption Reserve (Opening Balance)	10,00,000
Profit and Loss Account (Opening Balance)	30,00,000
Net Profit for the year (before Transfers and Appropriations)	40,00,000
Transfer to General Reserve	10,00,000
Transfer to Debenture Redemption Reserve	5,00,000
Proposed Equity Dividend	7,00,000
Interim Dividend paid	1,00,000

Solution 01:

Notes to Accounts of Mehul Ltd. For Year Ended 31-3-2017

Particulars	₹	₹	₹
Reserves and Surplus			
Debenture Redemption Reserve			
Opening Balance		10,00,000	
Transferred from P & L A/c		5,00,000	15,00,000
General Reserve			
Opening Balance		50,00,000	
Transferred from P & L A/c		10,00,000	60,00,000
Profit & Loss A/c			
Opening Balance		30,00,000	
Add: Profit during the year		40,00,000	
Profit Available for Appropriation		70,00,000	
Less : Allocations and Appropriations			
Transfer to General Reserve	10,00,000		
Transfer to Debenture Redemption Reserve	5,00,000		
Dividend - Interim	1,00,000	(16,00,000)	54,00,000
			1,29,00,000

Note: Proposed Equity Dividend (₹ 7,00,000) [This is to be shown only by way of a note vide MCA / ICAI Rules]

Illustration 02:

A company has following position for the year ended 31-3-2017:

Particulars	₹
Provision for tax (Cr.)	5,00,000
Advance payment of tax (Dr.)	4,75,000
Tax deducted at source (Dr.)	20,000

The assessment of a company is completed and tax liability is settled at ₹ 5,10,000. Pass journal entries.

Solution 02:

No.	Particulars		Debit (₹)	Cr. (₹)
1.	Profit & Loss A/c	Dr.	10,000	
	To Provision for Tax A/c			10,000
	[Being entry for recording short provision for tax]			
2.	Provision for Tax A/c	Dr.	5,10,000	
	To Advance Tax A/c			4,75,000
	To Tax Deducted at Source			20,000
	To Income Tax Payable			15,000
	[Being entry for recording Gross Demand]			

Working Note:

(1) Calculation of Tax Refund/(Payable):

Particulars	₹	₹
Gross Demand (Tax Liability)		5,10,000
Less :		
Tax Paid Advance payment for Tax	4,75,000	
Tax deducted at source	20,000	(4,95,000)
Tax Payable (Shown as Other Current Liability in Balance Sheet)		15,000

(2) Calculation of Excess/(Shortage) of Tax Provisions

Gross Demand		5,10,000
Less : Provision for Tax		(5,00,000)
Tax Provisions (Short)		10,000

Illustration 03:

Following is the extract of the Trial Balance of Satya Ltd. as on 31-3-2016.

Particulars	Dr. ₹	Cr. ₹
Profit and Loss Account (Opening)	-	25,00,000
Advance Income Tax (2014-15)	1,20,000	-
Provision for Income Tax (2014-15)	-	1,70,000
Advance Income Tax (2015-16)	1,30,000	-

Additional Information:

1. Net Profit before Tax for the year ended 31-3-2016 is ₹ 6,00,000.

2. Income Tax Provision to be made for the year 2015-16 is ₹ 1,40,000.

3. No effect is given to Income Tax Assessment which is completed for 2014-15, resulting ina Gross Demand of ₹ 1,50,000.

You are required to show, how the relevant items will appear in the Statement of Profit and Loss of Satya Ltd. for the year ended 31-3-2016 and also in the Balance Sheet as on 31-3-2016.

Solution 03:

Extract of Statement of Profit & Loss for the year ended 31-3-2016

Particulars	₹	₹
I. Profit Before Tax		6,00,000
Less: Tax Expense (Current Year)	1,40,000	
Add: Excess Provision for Previous Year (WN. 1)	(20,000)	(1,20,000)
Net Profit for the Period		4,80,000

Extract of Balance Sheet as at 31-3-2016

Particulars	Note	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
Reserves and Surplus	1	29,80,000
2. Current Liabilities		
a. Other Current Liabilities	2	30,000
b. Short Term Provisions	3	10,000

Notes to Accounts		₹
1. Reserves and Surplus		
Profit and Loss Account (Opening Balance)		25,00,000
Add: Net Profit		4,80,000
Total		29,80,000
2. Other Current Liabilities		
Income Tax Payable (WN 2)		30,000
3. Short Term Provisions		
Provision for Tax for 2015-16		1,40,000
Less: Advance Tax for 2015-16		(1,30,000)
Total (WN 3)		10,000

WN. 1: Calculation of Excess/Shortage Provision

Gross Demand (2014-15)	1,50,000
Less: Provision for Tax (2014-15)	(1,70,000)
Excess Provision credited to P&L A/c	(20,000)

WN. 2: Income Tax Payable

Gross Demand	1,50,000
Less : Advance Tax (2014-15)	(1,20,000)
Income Tax Payable	30,000

WN. 3: At the end of the year provision for tax and advance tax are netted out and net amount is shown in the Balance Sheet.

Illustration 04: (Fixed Assets Schedule)

A company has Opening balance of ₹ 10,00,000 in its Tangible Assets Account (W.D.V.). Accumulated Depreciation was ₹6,00,000. There was an addition of fixed Assets of ₹ 5,00,000 at the beginning of the year while there was no sale of fixed asset.

Prepare note on Tangible Assets if the Depreciation is charged for the year @ 15% on original cost.

Solution:

Note for Tangible Assets:

Particulars	Gross Block			Depreciation			Net Block	
	Opening	Additions	Closing	Opening	During Year	Closing	Opening	Closing
Tangible Assets	16,00,000	5,00,000	21,00,000	6,00,000	3,15,000	9,15,000	10,00,000	11,85,000
Total	16,00,000	5,00,000	21,00,000	6,00,000	3,15,000	9,15,000	10,00,000	11,85,000

Illustration 5:

Following is the extract of the Trial Balance of Ram Ltd. as on 31st March, 2022:

Particulars	Amount (□)	Amount (□)
Sales		2,40,00,000
Opening Stock of Raw Material		20,00,000
Opening Stock of Finished Goods		10,00,000
Purchase of Raw Materials		54,00,000
Purchase Returns		4,00,000
Sales Returns		40,00,000
Dividend Received		10,00,000
Sundry Income		8,00,000
Freight on Raw Material		60,000
Salaries and Wages		8,00,000
Bonus to Employees		1,60,000
Directors Remuneration		16,00,000
Depreciation on :		
- Plant and Machinery	10,00,000	
- Furniture and Fixture	6,00,000	
- Motor Vehicle	2,00,000	18,00,000
Interest on Loan from Bank of India		14,00,000
Repairs and Maintenance Expenses		1,60,000
Insurance Premium of Office Premises		60,000
Electricity Charges		80,000
Rent, Rates and Taxes		40,000
Audit Fees		1,00,000
Advertisement Expenses		2,40,000
Sundry Expenses		20,000

Further Information:

(a) Closing inventory of Raw Material and Finished Goods were ₹ 10,00,000 and ₹ 12,00,000 respectively.

(b) Salaries and Wages due during the period were ₹ 1,00,000.

(c) Sundry income receivable was ₹ 50,000.

(d) □ 50,000 is to be provided for Bad and Doubtful Debts.

(e) Advertisement expenses of ₹ 40,000 was prepaid.

(f) Provide for Income Tax for ₹ 4,00,000.

(g) Raw materials worth ₹ 30,000 destroyed by fire. Goods were uninsured.

Prepare statement of Profit and Loss for the year ended 31st March, 2022 as per the provisions of the Companies Act, 2013. (T.Y.B.Com., Oct. 2015, April 2016, adapted)

Solution 05:

In the Books of Ram Ltd.

Profit and Loss Statement for the year ended 31st March, 2022

Particulars	Note	Amount (₹)
1. Revenue from Operations	1	2,00,00,000
2. Other Income	2	18,50,000
I. Total Revenue		2,18,50,000
Expenses:		
1. Cost of Materials Consumed	3	60,30,000
2. Decrease / (Increase) in Inventories	4	(2,00,000)
3. Employee Benefits Expense	5	10,60,000
4. Finance Costs	6	14,00,000
5. Depreciation and Amortization Expense	7	18,00,000
6. Other Expenses	8	23,40,000
II. Total Expenses		1,24,30,000
III. Profit Before Tax (I - II)		94,20,000
Tax Expense: Provision for tax for current year		(4,00,000)
IV. Profit/(Loss) for the Period		90,20,000

Notes to Accounts

Particulars	Amount	Amount
1. Revenue from Operations		
Sales		2,40,00,000
Less: Returns		(40,00,000)
Total		2,00,00,000
2. Other Income		
a. Dividend Income		10,00,000
b. Sundry Income	8,00,000	

Add: Income Receivable	50,000	8,50,000
Total		18,50,000
3. Cost of Materials Consumed		
a. Opening Stock	20,00,000	
b. Add : Purchases (Net)	54,00,000	
c. Carriage Inward	60,000	74,60,000
d. Less: Purchase Returns	4,00,000	
e. Less: Material lost by fire	30,000	
f. Less: Closing Stock	10,00,000	(14,30,000)
Total		60,30,000
4. Change in Inventories		
Finished Goods		
Opening Stock	10,00,000	
Less : Closing Stock	(12,00,000)	(2,00,000)
Total		
5. Employee Benefits Expense		
a. Salaries and Wages	8,00,000	
Add: Outstanding	1,00,000	9,00,000
b. Bonus		1,60,000
Total		10,60,000
6. Finance Costs		
Interest on Bank Loans		14,00,000
7. Depreciation and Amortisation		
Depreciation on		
- Plant and Machinery	10,00,000	
- Furniture and Fixtures	6,00,000	
- Motor Vehicle	2,00,000	
Total		18,00,000

8. Other Expenses		
Directors Remuneration		16,00,000
Repairs and Maintenance		1,60,000
Insurance Premium		60,000
Electricity		80,000
Rent, Rates and Taxes		40,000
Audit Fees		1,00,000
Advertisement	2,40,000	
Less: Pre-paid	(40,000)	2,00,000
Sundry Expenses		20,000
Provision for Bad and Doubtful Debts		50,000
Loss by Fire		30,000
Total		23,40,000

Illustration 6:

Diamond Ltd. provides the following information for the year ended 31st March, 2022.

Particulars	₹ in lakhs	Particulars	₹ in lakhs
Excise Duty paid	92.50	Sale of Services	15.00
Net Loss on Sale of Investments	2.00	Trading Commission Received	30.00
Rental Collection Expenses	0.50	Interest Income	10.00
Opening Stock of Materials	42.30	Dividends from Companies	5.00
Opening Stock of WIP	75.00	Rental Income	7.50
Opening Stock of Finished Goods	87.50	Gain on Foreign Currency Transactions and Translation	4.00
Purchases of Materials	477.60	50 lakhs Equity Shares of ₹ 10 each, ₹ 8 paid up	400.00
Salaries and Wages	300.00	60 lakhs Equity Shares of ₹ 10 each	600.00
Contribution to Provident	36.00	Profit and Loss Account [1-4-	226.00

Fund		2016]	
Expense on Employee Stock Option Scheme (ESOP)	14.00	10%, 70 lakhs Preference Shares of ₹ 10 each	700.00
Staff Welfare Expenses	75.00	General Reserve	80.00
Interest Expense	12.00	12% Debentures	100.00
Other Borrowing Costs (Brokerage)	2.00	Provision for Doubtful Debts	1.00
Buildings	200.00	Consumption of Stores and Spares Parts	7.00
Plant and Equipment	100.00	Power and Fuel	8.00
Vehicles	25.00	Rent	5.00
Furniture and Fixtures	30.00	Repairs to Buildings	4.00
Brands	100.00	Repairs to Machinery	3.00
Computer Software	45.00	Insurance	2.00
Prepaid Expenses	1.00	Rates and Taxes	1.00
Interim Dividend Paid	50.00	Miscellaneous Expenses	1.00
Sundry Debtors	40.00		
Payment to the Auditor	16.00		
Sale of Products	1,350.00		

Additional Information:

(a) Closing Stocks: Materials ₹ 19.9 lakhs, WIP ₹ 100, Finished Goods ₹ 200 lakhs

(b) Depreciate Buildings @ 5%, Plant and Equipment @ 20%, Vehicles @ 20%, Furniture and Fixtures @ 10% and Brands @ 10%, Computer Software @ 60%.

(c) Payments to the Auditor include as Auditor ₹ 5 lakhs, for Taxation Matters ₹4 lakhs, for Company Law Matters ₹ 3 lakhs, for Management Services ₹ 2 lakhs, for Other Services ₹ 2 lakhs.

(d) Make a Provision for Doubtful Debts @ 10%.

(e) The director's recommended: (i) Transfer to Debenture Redemption Reserve @ 25% of Debentures (ii) Transfer to General Reserve @ 5%.

(f) Income Tax Rate 30%.

Required: Prepare Statement of Profit and Loss for the year ended 31st March, 2022 and a Note showing the computation of Surplus in the Statement of Profit and Loss to be taken to the Balance Sheet (as per Schedule III to the Companies Act, 2013) as on that date.

Solution 06:

M Ltd.

Profit and Loss Statement for the year ended 31st March, 2022

Particulars	Note	₹ in lakhs	₹ in lakhs
1. Revenue From Operations	1		1,302.50
2. Other Income	2		20.00
I. Total Revenue			1,322.50
Expenses:			
1. Cost of Materials Consumed	3	500.00	
2. Changes in Inventories	4	(137.50)	
3. Employee Benefits Expense	5	425.00	
4. Finance Costs	6	10.00	
5. Depreciation and Amortization Expenses	7	75.00	
6. Other Expenses	8	50.00	922.50
II. Total Expenses			
III. Profit Before Tax			400.00
Tax Expense @ 30%			(120.00)
IV. Profit/(Loss) for the Period			280.00

Notes to Accounts:

Particulars	₹ in lakhs	₹ in lakhs
1. Revenue from Operations		
a. From Sale of Products		1,350.00
b. From Sale of Services		15.00
c. From Other Operating Revenues [Trading Commission]		30.00
d. Less: Excise Duty		(92.50)
Total		1,302.50
2. Other Income		
a. Interest Income		10.00
b. Dividends from Companies		5.00
c. Net Loss on Sale of Investments		(2.00)
d. Rental Income (7.5 lakhs – 0.5 lakhs Collection		7.00

Expenses)		
Total		20.00
3. Cost of Materials Consumed		
a. Opening Stock of Materials		42.30
b. Add: Purchases of Materials		477.60
c. Less: Closing Stock of Materials		(19.90)
Total		500.00
4. Change in Inventories		
Work in Progress		
Opening Stock	75.00	
Less : Closing Stock	(100.00)	
Total WIP	**(25.00)**	
Finished Goods		
Opening Stock	87.50	
Less : Closing Stock	(200.00)	
Total FG	**(112.50)**	
Total Changes in inventory		(137.50)
5. Employee Benefits Expense		
a. Salaries and Wages		300
b. Contribution to Provident Fund		36
c. Expense on Employee Stock Option Scheme (ESOP)		14
d. Staff Welfare Expenses		75
Total		425
6. Finance Costs		
a. Interest Expense	12.00	
b. Other Borrowing Costs (Brokerage)	2.00	
c. Gain on Foreign Currency Transactions and Translation	(4.00)	
Total		10.00
7.Depreciation and Amortisation Expense		
a. Buildings [5% of ₹200 lakhs]	10.00	
b. Plant and Equipment [20% of ₹ 100 lakhs]	20.00	
c. Vehicles [20% of ₹ 25 lakhs]	5.00	
d. Furniture and Fixtures [10% of ₹30 lakhs]	3.00	
e. Brands [10% of ₹ 100 lakhs]	10.00	
f. Computer Software [60% of ₹ 45 lakhs]	27.00	
Total		75.00

8. Other Expenses		
a. Consumption of Stores and Spare Parts		7.00
b. Power and Fuel		8.00
c. Rent		5.00
d. Repairs to Buildings		4.00
e. Repairs to Machinery		3.00
f. Insurance		2.00
g. Rates and Taxes		1.00
h. Miscellaneous Expenses		1.00
i. Provision for Doubtful Debts [(10% of ₹40 lakhs) - ₹ 1 lakh]		3.00
j. Payments to the Auditor as:		
(i) Auditor	5.00	
(ii) For Taxation Matters	4.00	
(iii) For Company Law Matters	3.00	
(iv)For Management Services	2.00	
(v)For Other Services	2.00	16.00
Total		50.00
9. Surplus in the Statement of Profit and Loss to be Taken to Balance Sheet		
Opening Balance	226.00	
Add : Profit for the period	280.00	
Less : Transfer to General Reserve @ 5%	(14.00)	
Less : Interim Dividend Paid	(50.00)	
Less : Debenture Redemption Reserve [25% of ₹ 100 lakhs]	(25.00)	
Closing Balance		417.00

Illustration 7:

From the following ledger balances of Statistics Limited as on 31st March, 2022, you are required to prepare the Balance Sheet as on 31st March, 2022 as per Schedule III of the Companies Act.

Particulars	Amount (₹)	Particulars	Amount (₹)
Office Equipment	4,80,600	General Reserve	4,15,000
9% Debentures in APCO Ltd.	2,45,000	Creditors for Goods	1,68,500
Loose Tools	1,63,000	Creditors for Expenses	36,000
Plant and Machinery	18,00,000	Cash Credit	75,000
Computer Software	83,250	Mortgage Loan	3,10,000

Debtors for Goods	1,90,000	8% Preference Share Capital	5,50,000
Share Issue Expense (unwritten off)	30,000	Equity Share Capital	15,00,000
Stores and Spares	1,00,200	Staff Welfare Fund	85,000
Interest Accrued on Investment	51,000	Provision for Taxation	26,550
Cash at Bank	23,000		

In the books of Statistics Ltd.

Balance Sheet as on 31st March, 2022

Particulars	**Note**	**Amount (₹)**
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital		
– Equity Share Capital		15,00,000
– Preference Share Capital		5,50,000
b. Reserves and Surplus (General Reserve)		4,15,000
2. Non-Current Liabilities		
a. Long Term Borrowings (Mortgage Loan)		3,10,000
b. Long Term Provisions (Staff Welfare Fund)		85,000
3. Current Liabilities		
a. Short Term Borrowings (Cash Credit)		75,000
b. Trade Payables	1	2,04,500
c. Short Term Provisions (Tax)		26,550
Total		31,66,050
II. ASSETS		
1. Non-Current Assets		
a. Property, Plant and Equipment		
- Tangible Assets	2	22,80,600
- Intangible Assets (Computer Software)		83,250
b. Other Non-Current Assets (Share Issue Expenses)		30,000
2. Current Assets		
a. Current Investments (9% Debentures)		2,45,000
b. Inventories	3	2,63,200

c. Trade Receivables		1,90,000
d. Cash and Cash Equivalents (Bank)		23,000
e. Other Current Assets (Interest Accrued on Investment)		51,000
Total		31,66,050

Notes to Accounts

Particulars	Amount (₹)
1. Trade Payables	
a. Creditors for Goods	1,68,500
b. Creditors for Expenses	36,000
Total	2,04,500
2. Tangible Assets	
a. Office Equipment	4,80,600
b. Plant and Machinery	18,00,000
Total	22,80,600
3. Inventories	
a. Loose Tools	1,63,000
b. Stores and Spares	1,00,200
Total	2,63,200

Illustration 8:

You are required to prepare a Balance Sheet as at 31st March, 2018, as per Schedule III of the Companies Act, 2013, from the following information of Gold Ltd.:

Particulars	Amount (₹)	Particulars	Amount (₹)
Term Loans (Secured)	40,00,000	Investments (Non-current)	9,00,000
Trade Payables	45,80,000	Profit for the year	32,00,000
Other Advances	14,88,000	Trade Receivables	49,00,000
Cash and Bank Balances	38,40,000	Miscellaneous Expenses	2,32,000
Staff Advances	2,20,000	Loan from Other Parties	8,00,000

Provision for Taxation	10,20,000	Provision for Doubtful Debts	80,000
Securities Premium	19,00,000	Stores	16,00,000
Loose Tools	2,00,000	Fixed Assets (WDV)	2,26,00,000
General Reserve	62,00,000	Finished Goods	30,00,000
Capital Work-in-Progress	8,00,000	Profit and Loss Account	2,00,000

Adjustments needed:

1. Share Capital consist of:

(a) 1,20,000 Equity Shares of ₹ 100 each fully paid up.

(b) 40,000, 10% Redeemable Preference Shares of ₹ 100 each fully paid up.

2. Depreciate assets by ₹ 20,00,000.

Gold Ltd.

Balance Sheet as at 31st March, 2018

Particulars	**Note**	**Amount ₹**
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds	1	1,60,00,000
a. Share Capital	2	1,10,68,000
b. Reserves and Surplus		
2. Non-Current Liabilities		40,00,000
Long Term Borrowings - Term Loans (Secured)		
3. Current Liabilities		
a. Trade Payables		45,80,000
b. Other Current Liabilities	3	8,00,000
c. Short-Term Provisions (Provision for Taxation)		10,20,000
Total		3,74,68,000
II. ASSETS		
1. Non-Current Assets		
a. Property, Plant and Equipment	4	2,06,00,000
– Tangible Assets		8,00,000

– Capital WIP		9,00,000
b. Non-Current Investments		
2. Current Assets		
a. Inventories	5	48,00,000
b. Trade Receivables	6	48,20,000
c. Cash and Cash Equivalents		38,40,000
d. Short Term Loans and Advances	7	17,08,000
Total		3,74,68,000

Notes to Accounts:

Particulars	Amount ₹	Amount ₹
1. Share Capital		
Authorised, Issued, Subscribed and Called-up		
1,20,000, Equity Shares of ₹ 100 each		1,20,00,000
40,000, 10% Redeemable Preference Shares of ₹ 100 each		40,00,000
Total		1,60,00,000
2. Reserves and Surplus		
a. Securities Premium Account		19,00,000
b. General Reserve		62,00,000
c. Profit and Loss Account		
Opening Balance	2,00,000	
Add: Profit of the current year	30,00,000	
Less: Miscellaneous Expenditure written off	(2,32,000)	29,68,000
Total		1,10,68,000
3. Other Current Liabilities		
Loan from Other Parties		8,00,000
4. Tangible Assets		
Opening Balance	2,26,00,000	
Less : Depreciation	(20,00,000)	
Total (Closing Balance)		2,06,00,000
5. Inventories		
a. Finished Goods		30,00,000
b. Stores		16,00,000
c. Loose Tools		2,00,000
Total		48,00,000

6. Trade Receivables		49,00,000
Less : Provision for Doubtful Debts		(80,000)
Total		48,20,000
7. Short Term Loans and Advances		
a. Staff Advances		2,20,000
b. Other Advances		14,88,000
Total		17,08,000

Illustration 09:

Following is the Trial Balance of Jasmeet Ltd. as on 31st March, 2017.

Particulars	Dr. ₹	Cr. ₹
Land at Cost	9,00,000	
Plant and Machinery at Cost	38,50,000	
Debtors	4,30,000	
Investments	4,80,000	
Bank	1,00,000	
Gross Profit		19,00,000
Sundry Expenses	1,00,000	
Salaries	3,50,000	
Selling Expenses	1,50,000	
Debenture Interest	1,00,000	
Printing and Stationery	1,20,000	
Share Issue Expenses	20,000	
Advance Income Tax (for year ending 31st March, 2017)	2,00,000	
Advance Income Tax (for year ending 31st March, 2016)	3,50,000	
Equity Share Capital (Shares of ₹ 100 each, fully paid)		15,00,000
10% Debentures		10,00,000
Capital Redemption Reserve		6,70,000
Profit and Loss A/c		3,60,000
Securities Premium		2,00,000
Creditors		2,60,000
Provision for Depreciation on Plant and Machinery		8,40,000
Suspense Account		20,000
Provision for Tax (for year ending 31st March, 2016)		4,00,000
Total	71,50,000	71,50,000

Additional Information:

1) On 31st March, 2016, the company issued bonus shares in the ratio of 1 bonus for every 3 Equity Shares held. No entry has been passed for the same.
2) The Authorised Share Capital is 25,000 Equity Shares of ₹ 100 each.
3) Suspense Account of ₹ 20,000 represents cash received for the sale of some part of the machinery on 1st April, 2016. The cost of the machinery was ₹ 50,000 and accumulated depreciation there on being ₹ 40,000.
4) Depreciation is to be provided on Plant and Machinery at 20% p.a. on Reducing Balance Method.
5) It is the policy of the company to write off 1/5th of Share Issue Expenses every year, upto 31st March, 2016, 4/5th of total Share Issue Expenses was written off.
6) Debtors include ₹ 80,000 due for more than 6 months.
7) Provision for Taxation to be made for ₹ 1,20,000.
8) Income Tax Assessment for the Accounting year 2015-16 is completed on 27th March, 2017 resulting with a gross demand of ₹ 3,30,000 but no effect has been given so far.

Prepare:

1. Profit and Loss Account for the year ended 31st March, 2017.

2. Balance Sheet as on 31st March, 2017 as per the provisions of the Companies Act.

3. Ignore Previous year's figures.

Solution 09:

Balance Sheet of Jasmeet Ltd. as on 31st March, 2017

Particulars	Note	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital	1	20,00,000
b. Reserves and Surplus	2	11,50,000
2. Non-Current Liabilities		
Long Term Borrowings	3	10,00,000
3. Current Liabilities		
Trade Payables		2,60,000
Total		44,10,000

II. ASSETS		
1. Non-Current Assets		
a. Property, Plant and Equipment	4	33,00,000
– Tangible Assets		4,80,000
b. Non-Current Investments	5	80,000
c. Other Non-Current Assets		
2. Current Assets		
a. Trade Receivables	6	4,30,000
b. Cash and Cash Equivalents	7	1,00,000
c. Other Current Assets	8	20,000
Total		44,10,000

Profit and Loss Statement for the Year Ended 31st March, 2017

Particulars	**Note**	**₹**
1. Revenue From Operations	9	19,00,000
2. Other Income	10	10,000
I. Total Revenue		19,10,000
Expenses:		
1. Employee Benefits Expense	11	3,50,000
2. Finance Costs	12	1,00,000
3. Depreciation and Amortization Expense		6,00,000
4. Other Expenses	13	3,90,000
II. Total Expenses		14,40,000
III. Profit Before Tax		4,70,000
Provision for Tax for Current Year		(1,20,000)
Excess Provision for Tax for Last Year		70,000
IV. Profit/(Loss) for the Period		4,20,000

Notes to Account

Particulars	**Amount (₹)**	**Amount (₹)**
1. Share Capital		
Equity Share Capital		
Authorised Shares (Par Value per Share : ₹ 100)		
25,000 Equity Shares of ₹ 100 each		25,00,000
Issued, subscribed & fully paid Shares		
20,000 Equity Shares of ₹ 100 each		20,00,000

(Of the above, 5,000 Equity shares of ₹ 100 each issued as Bonus Shares)		
Total		20,00,000
2. Reserves and Surplus		
a. Capital Redemption Reserve	6,70,000	
Less: Utilized for Bonus Issue	(5,00,000)	1,70,000
b. Securities Premium Account		2,00,000
c. Profit and Loss Account		
Balance in Statement of Profit & Loss A/c b/d	3,60,000	
Surplus for the year	4,20,000	7,80,000
Total		11,50,000
3. Long Term Borrowings		
10% Debentures		10,00,000
5. Other Non-Current Assets		
Advance Tax		2,00,000
Less : Provision for Tax		(1,20,000)
Total		80,000
6. Trade Receivables		
Unsecured, Considered Good		
- Outstanding for more than 6 months		80,000
- Others		3,50,000
Total		4,30,000
7. Cash and Cash Equivalents		
Bank		1,00,000
8. Other Current Assets		
Tax Refund Due		20,000
9. Revenue From Operations		
Gross Profit		19,00,000
10. Other Income		
Profit on Sale of Machinery		10,000

11. Employee Benefits Expense		
Salaries		3,50,000
12. Finance Costs		
Debenture Interest		1,00,000
13. Other Expenses		
a. Sundry Expenses		1,00,000
b. Selling Expenses		1,50,000
c. Printing and Stationery		1,20,000
d. Share Issue Expenses w/o		20,000
Total		3,90,000

Schedule 04: Tangible Fixed Assets

Particulars	Opening	Additions	Deductions	Closing	Total
Land	9,00,000	-	-	9,00,000	9,00,000
Plant and Machinery	38,50,000	-	(50,000)	38,00,000	
Less: Depreciation	8,40,000	6,00,000	(40,000)	(14,00,000)	24,00,000
Total					33,00,000

EXERCISE:

1. Which of the following is shown under Reserve & Surplus?

a.	Calls in advance	b.	Calls in Arrears	c.	Securities premium	d.	bonus shares

2. Bills Receivable is shown under __________.

a.	Loans & Advances	b.	Current Assets	c.	Current Liabilities	d.	Contingent Liabilities

3. Short term loan is the loan due for not more than_______.

a.	3 years	b.	2 years	c.	5 years	d.	1 years

4. Interim Dividend is declared between _____ annual general meetings.

a.	two	b.	three	c.	four	d.	five

5. Future bad debts are usually estimated as ____________.

a.	Percentage of Creditors	b.	Percentage of Debtors	c.	Percentage of Sales	d.	Percentage of Purchases

6. Which of the following is shown under current assets?

a.	Goodwill	b.	Machinery	c.	Vehicles	d.	Loose Tools

7. Bank Balance is shown under ________.

a.	Cash & Cash Equivalents	b.	Other Current Assets	c.	Trade Receivable	d.	Current Investment

8. The broad heading under which balance sheet is divided under the Schedule III are _______.

a.	Liabilities & Assets'	b.	Current & Non-current'	c.	Sources of funds & Application of funds '	d.	Equity and Liabilities and Assets'

9. Preliminary Expenses are shown under

a.	Other Current Assets	b.	Capital WIP	c.	Loans & Advance	d.	added to Profit & Loss Account

Solution:

1	2	3	4	5	6	7	8	9
c	b	d	a	b	d	a	d	a

Unsolved Problems

Problem 1:

VK Ltd. has authorised capital of ₹ 20,00,000 divided in 1,00,000 equity shares of ₹ 10 each, 50,000 8% Preference shares of ₹ 10 each and 50,000 10% Convertible Preference shares of ₹ 10 each. The company has issued 60,000 shares out of which 58,000 shares have been subscribed. The company has received ₹ 8 per share. The company had made the final call of ₹ 2 per share. It has not received the call money on 2,000 shares. The company has fully issued its 8% Preference shares and paid up. However only 50% of the 10% convertible shares are issued and it is subscribed upto 95% which are fully paid up. Show detailed note to accounts of Share capital.

Problem 2:

A company has the following information on 31.03.2017:

	Original Cost	Accumulated Depreciation
Furniture	10,00,000	6,00,000
Building	6,00,000	4,00,000
Vehicles	4,00,000	100000
Land	5,00,000	0

The company provides depreciation on Furniture, Building and Motor Car @ 12%, 5% and 10% respectively on original cost. The company has purchased a new Furniture on 31.12.2018 of ₹ 3,00,000. During the year a part of the land costing ₹ 1,00,000 was sold at cost. Show detailed note to accounts of Fixed Assets for the year ending on 31.03.2018.

Problem 3

The following income and expenses appeared in the books of Happy Go Lucky Ltd. involved in the business of selling computers and providing maintenance services for the year ended 31.03.2022.

Particulars	Amount (₹)
Purchases	8,00,000
Sales	15,00,000
Salaries	1,20,000
Wages	80,000
<u>Opening Stock</u>	
Raw materials	35,000
Work in progress	50,000
Finished goods	60,000
Interest on debentures	30,000
Interest on cash credit	20,000
Bonus to employees	20,000
Rent	20,000
Depreciation on Machinery	40,000
Depreciation on Furniture	20,000
Depreciation on Motor vehicles	30,000
Dividend received	30,000
Interest received	20,000

1. During the year Directors proposed dividend @ 10% on Capital of ₹ 1,00,00,000.
2. Income Tax is to be provided @ 30%.
3. Closing stock as on 31.03.2022 were as follows:

Raw Material	₹ 20,000
Work in progress	₹ 30,000
Finished goods	₹ 40,000

4. Salaries outstanding were ₹ 5,000

Prepare the income statement from the given information.

Problem 4:

Dr. The following is the trial balance of Sling Ltd. for the year ended 31.03.2018 Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
Opening stock	30,000	Equity share capital	10,00,000
Purchase	3,00,000	12% Preference share capital	6,00,000
Wages	1,00,000	6% Debentures	4,00,000
Salaries	90,000	Sales	8,00,000
Machinery	50,000	Dividend received	50,000
Land	9,00,000	P&L A/c (01.04.2017)	1,50,000
Furniture	8,00,000	Creditors	70,000
Investment	5,00,000	Bills payable	30,000
Debtors	90,000		
Rent	46,000		
Interest on debentures	24,000		
Cash	60,000		
Bills receivable	10,000		
Printing & stationery	40,000		
Electricity charges	60,000		
	31,00,000		31,00,000

Additional Information:

a. The company has Authorised Share capital of ₹ 50,00,000 divided in 3,00,000 equity shares of ₹ 10 each and 2,00,000 equity share of ₹ 10 each.

b. Closing stock was ₹ 50,000.

c. The depreciation is to be provided @ 5% and 10% on Machinery and furniture respectively.

d. Income tax to be provided at 40%.

e. Rent includes ₹ 6,000 paid for the upcoming year financial year.

Prepare the income statement and Balance sheet from the given information.

Problem 5:

The following is the trial balance of SS Ltd. as on 31.03.2018

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
Machinery	15,00,000	Equity Share capital	10,00,000
Land	10,00,000	9% Preference Share capital	8,00,000
Debtors	3,00,000	Sales	20,00,000
Purchases	8,00,000	Bills Payable	2,00,000
Advance Tax	50,000	Cash credit	1,00,000
Investments	3,00,000	Unclaimed dividend	20,000
Wages	30,000	General Reserve	80,000
Salaries	1,50,000	P & L A/c	2,00,000
Rent	60,000	10% Debentures	1,00,000
Opening Stock	90,000		
Interest on Debentures	10,000		
Licenses and Franchise	1,80,000		
Interim Dividend	30,000		
	45,00,000		45,00,000

Additional Information:

i The authorised capital of the company was 20,000 equity shares of ₹ 100 each & 8,000 9% Preference of ₹ 100 each.
ii Closing stock as on 31.03.2018 was ₹ 60,000.
iii Depreciation was to be provided on Machinery @ 10%.
iv 10% of the investments were short term in nature.
v Debentures were to be redeemed on 31.08.2018.
vi Create provision for doubtful debt @ 10%.
vii During the year ₹ 20,000 were transferred to General reserve.
viii Provide for Taxation @ 30%.

Prepare Income statement & Balance sheet from the given information.

❖❖❖❖

Module II

3

REDEMPTION OF PREFERENCE SHARES

Unit Structure

3.0 OBJECTIVE

After studying this unit students will be able to:

- Know the Concept of Redemption and purpose of issuingredeemable Preference Shares.
- Understand various provision of the Companies Act regardingredemption of Preference Shares.
- Know the sources of redemption including divisible profits andproceeds of fresh issue of shares
- Understand the concept of Premium on Redemption & CapitalRedemption Reserve.
- Know to prepare Capital Redemption Reserve Account and use.
- Know the Methods of redemption of Preference Shares
- Understand the Accounting procedure of redemption of Preference Shares.
- Prepare the Balance Sheet (Schedule III) of the Company after redemption of Preference Shares.

3.1 INTRODUCTION

As studied in the earlier chapter, a share is the part of the amount of the capital of a company. The preference shares are the one's which have a fixed rate of dividend and enjoy preferential rights of repayment at the time of winding up of the company.

55 of the Companies Act 2013 has laid down various provisions in respect of the issue and redemption of the preference shares which has been briefed as under :

1) With the commencement of the Co. Act 2013 the Companies that are limited by shares shall issue only redeemable preference shares.

2) Such companies may issue redeemable preference shares for a period of 20 years only.

3) However if the company is undertaking infrastructure projects then such shares may be issued for a period exceeding 20 years subject to certain laid down conditions for issue as well as redemption.

4) The redemption of the preference shares may be carried out by either

   i) Proceeds of fresh issue of shares

   ii) Divisible profits of the company.

5) Only fully paid shares can be redeemed.

6) In case the redemption is out of profits, a sum equal to the nominal value (NV) of the shares redeemed must be transferred to the Capital Redemption Reserve (CRR)

7) The redemption may be carried out at par or premium. In case of the premium on redemption, it may be provided out of the security premium A/c. However as per S. 133, the companies that are required to use divisible profits itself for providing the premium on redemption of the preference shares.

8) The redemption require the consent of three fourth of the preference share holders.

9) Incase there are untraceable share holders or the company is unable to redeem the preference shares or pay the dividends, then the company upon the approval of the tribunal may issue further redeemable preference shares to a matching amount.

10) Also for the dissenting shareholders, such redeemable shares may be issue. However such issue of shares under this section does not deem an increase in the share capital of the company.

11) The balance generated through the CRR may be after the redemption used for the issuance of bonus shares.

3.2 ACCOUNTING PROCEDURE

1) Making final calls incasethe shares are partly paid.

   Calls on Preference share A/c or

      To Preference Capital A/c

2) Receiving money on the call

Bank A/c Dr

To calls on Preference share A/c

3) Share forfeiture on non payment

i) Preference Capital A/c Dr.

To Share forfeiture A/c

(Reduction of the shares that are to be forfeited)

ii) Share forfeiture A/c Dr

To Capital Reserve

(Share forfeiture balance transferred)

4) Create the claim of the Preference share holders.

Preference Capital A/c Dr.

Premium on Redemption A/c Dr.

To Preference Share holders A/c

(Premium on Redemption will appear only if the shares are redeemed at a premium).

5) Sale of assets to fund redemption Bank A/c Dr.

Profit & Loss A/c Dr.

To Assets A/c

To Profit & Loss A/c

(Depending on the gain or loss an the sale value of the asset, Profit and Loss A/c will be either debited or credited)

6) Issue of shares

Bank A/c Dr.

To Equity Capital A/c

To Security premium A/c

(Where shares are issued at a premium)

7) Payment to preference share holders

Preference share Holders A/c Dr.

To Bank A/c

8) A mortising the premium on redumption

Profit and Loss A/c Dr.

To Premium on Redemption A/c

9) Creating the CRR

Profit and Loss A/c Dr.

General Reserve A/c Dr.

To CRR A/c

10) Declaration of Bonus

Bonus to Equity share holder A/c Dr.

To Equity Capital A/c

11) Capitalising the reserves for Bonus

CRR A/c / Profit & Loss / General Reserves A/c Dr.

To Bonus to Equity share capital A/c

Study Note : (A) Bonus

For the purpose of calculation of bonus shares, the following steps are to be followed.

1) Calculate the number of equity share = originally in the B/s + Fresh issue made.

2) Look upon the ratio given Eg : 1 bonus for 5 shares held.

3) Calculate the bonus : (for 20,000 equity shares)

Eg :	Held	Bonus
	5	1
	20,000	2

Bonus = $\frac{20,000}{5} \times 1 =$ 40000 shares

Refer Q. No. - 4 & 5 in this chapter)

B) Divisible Profits :

The profits which can be distributed to the shareholders or may be used for any business purpose by the company are called as divisible profits. These include - Profit and Loss A/c, General Reserve, Investment fluctuation Reserve, dividend EqualisationReserve.

Also specifically created funds like sinking Fund, Workmen Compensation Fund may be treated as divisible profits subject to the deduction of the liability in respect of that particular fund.

II) Practical Questions :

Redemption fully out of new issue.

Q.1 Salman Ltd. has 50,000 8% Preference shares of ₹100 each fully paid. On 31/12/18, the Company decided to redeem the preference shares at 10% premium. For funding the redemption the Company issued 5,00,000 equity shares of ₹10 each issued at ₹12 are. The issue was fully subscribed and the redemption was duly carried out Journalise the transactions in the books of the Company.

Ans. Journal of Salman Ltd.

1) 8% Preference Capital A/c Dr. 50,00,000

Premium on Redeem A/c Dr. 5,00,000

To Preference Share Holders A/c 55,00,000

(Being the claim of Preference Share holders created)

2) Bank A/c Dr.	60,00000
To Equity Capital A/c	50,00,000
To Security Premium A/c	10,00,000

(Being equity shares issued at a premium of ₹2/ share)

3) Profit and Loss A/c Dr	5,00,000
To premium on Redeem A/c	5,00,000

(Being premium on redeem W/off)

4) Preference share holders A/c Dr.	55,00,000
To Bank A/c	55,00,000

(Being the claim of the preference shares holders settled)

Redemption fully out of the profits

Q.2 The following balances are extracted from the books of Katrina Ltd. as on 31/3/18

5,000 10% Preference Shares ₹100 each	5,00,000
General Reserve A/c	2,80,000
Profit & Loss A/c	3,00,000

The Company decided to redeem at far the preference shares fully out of the available reserves on 1/4/18. Journalise the above transactions.

Ans. Journal of Katrina Ltd.

1) 10% Preference share capital A/c Dr. 5,00,000

To Preference share holder A/c 5,00,000

(Being the claim of the preference share holders created)

2) Profit and Loss A/c Dr 3,00,000

General Reserve A/c Dr. 2,00,000

To Capital Redeem Reserve A/c 5,00,000

(Being CRR created for the redemption of preference share capital)

3) Preference share holders A/c Dr. 5,00,000

To Bank A/c 5,00,000

(Being Preference share holders claim settled)

Redemption partly out of the fresh issue and partly out of profits.

Q.3 Shahrukh Ltd. has 6000 9% Preference shares of ₹100 each redeemable at 5% premium. To fund the redemption, the Co. issued 30,000 equity share of ₹10 each at 10% premium. The divisible profits of the firm included.

General Reserve ₹2,00,000

Profit & Loss A/c ₹2,00,000

Journalise the transactions.

Ans. Journal of Sharukh Ltd.

1) 9% Preference Capital A/c Dr. 6,00,000

Premium on Redeem A/c Dr. 30,000

To Preference share holders A/c 6,30,000

(Being Preference share holders claim created)

2) Bank A/c Dr 3,30,000

To Equity Capital A/c 3,00,000

To Security Premium A/c 30,000

(Being equity shares issued at a premium)

3) Profit and Loss A/c Dr 2,00,000

General Reserve A/c Dr 1,00,000

To CRR A/c 3,00,000

(Being CRR created for redemption of Preference shares) (Balance Amount)

4) General Reserves A/c Dr. 30,000

To Premium on Redeem 30,000

(Being premium on Redeem w/off)

5) Preference share holders A/c Dr. 6,30,000

To Bank A/c 6,30,000

(Being preference share holders claim settled)

Redemption then bonus - declaration

Q.4 Ranveer Ltd.'s Balance sheet as on 31/12/2018 is as follows

10% Preference Capital	2,50,000	Bank	1,75,000
Equity capital	5,00,000	Investments	2,00,000
General Reserve	2,00,000	Stock	2,75,000
Profit & Loss A/c	4,00,000	Debtors	3,00,000
11% Debentures	2,00,000	Land & Building	4,00,000
Creditors	2,00,000	Equipments	4,00,000
	17,50,000		17,50,000

On the above date, the Company decided to redeem the preference shares at 10% premium. For this purpose, the Co. sold 50% of the investments at 20% Profit and issued 1200 equity share of ₹100 each at part. The issue was fully subscribed and the redemption was carried out.

Post redemption the company insured bonus @ 1 share for 10 shares held by the owners.

Journalise all the above transactions.

Ans. Journal of Ranveer Ltd.

1) 10% Preference Capital A/c Dr. 2,50,000

Premium on Redeem A/c Dr. 25,000

To preference share holder A/c 2,75,000

(Being the claim of preference share holders created)

2) Bank A/c Dr. 1,20,000

To Investment A/c 1,00,000

To Profit & Loss A/c 20,000

(Being investments sold at a gain, WN1)

3) Bank A/c Dr. 1,20,000

To Investment A/c 1,20,000

To Profit & Loss A/c 20,000

(Being equity share issued at par)

4) Profit and Loss A/c Dr. 1,30,000

To CRR A/c 1,30,000

(Being CRR created for redemption)

5) Profit and Loss A/c Dr. 25,000

To Premium on Redeem A/c 25,000

(Being premium on redeem w/off)

6) Preference share holders A/c Dr. 2,75,000

To Bank A/c 2,75,000

(Being preference share holders paid)

7) CRR A/c Dr 51,200

Bonus to Equity share Holders 51,200

(Being bonus shares declared)

8) Bonus to Equity share holder A/c Dr. 51,200

To Equity Capital A/c 51,200

(Being bonus shares declared)

WN1 - Calculate of sale value of investments MC of investment = 2,00,000

Extent of investment sold = 50% = 1,00,000

Profit = 20% = 20,000

∴ Sale value = 1,00,000 + 20,000 = 1,20,000

WN2 - Calculation of Bonus shares

Total no. of equity share = (before bonus)

Originally issued + Fresh issue

= 50,000 + 1200

= 51,200

Held	Bonus
10	1
51200	?

Bonus = $\frac{51200 \times 1}{10}$ = 5120 shares of ₹10 each

Redemption with untraceable preference shareholders and Balance sheet.

(Comprehensive question)

5) Balance sheet of Adira Ltd. as on 31/3/18 is as follows :

9% Preference share of ₹100 each	4,00,000	Fixed Assets	16,00,000
Equity share of ₹100 each	8,00,000	Investments (M.V. - 2,00,000)	1,60,000
Security Premium	24,000	Stock	2,80,000
General Reserve	2,40,000	Debtors	2,80,000
Profit & Loss A/c	1,04,000	Bank	80,000
Current Liabilities	8,32,000		
	24,00,000		24,00,000

Adjustments :

1) The Company decided to redeem all the preference shares at 10% premium.

2) The Company decided to use 2,00,000 from general reserve & 50,000 from Profit & Loss to fund the redemption. The balance was arranged from the fresh issue of equity shares at 20% premium.

3) The company has arranged for a temporary overdraft facility from the bank in case of shortage of funds.

4) The redemption was carried out on 1/4/18 except for 2 shareholders shares.

5) Post redemption, the company declared a bonus @ 1 share for 25 shares held.

Journalise the above transaction in the books of Adira Ltd. and also prepare a balance sheet.

WN1

Calculation of extent of issue of equity share

NV of preference share to be redeemed		4,00,000
Premium @ 10%		40,000
Redemption value		4,40,000
(-) Divisible Profits used (given)		
General Reserve	2,00,000	
Profit & Loss	50,000	(2,50,000)
(-) Premium W/off through Profit & Loss		(40,000)
Extent of equity shares funding		1,50,000

NV of equity shares = ₹100 each

IP = 20% Premium = 100+ 20% = 120

No. of equity shares = $\frac{1,50,000}{120} = 1250$ shares

WN2

Actual Payment made to PSH

No. of preference shares = 4,00,000 / 100 = 4,000

Redeem value = 4,40,000

∴ Redeem value / share = 110

No. of share unpaid = 500

Amount unpaid = 500 x 110 = 55,000

∴ Amount paid = 4,40,000 - 55,000

= 3,85,000

WN3

Calculation of Bonus

Total no. of Equity shares = 8000 + 1250

= 9250

Bonus	Held
1	25
2	9250

Bonus = $\frac{9250 \times 1}{25} = 370$ shares x ₹100 each

Journal of Adira Ltd.

1) 9% preference Capital A/c Dr. 4,00,000

   Premium on Redeem A/c Dr 40,000

   To PSH A/c 4,40,000

   (Being the claim of PSH created)

2) General Reserve A/c Dr. 2,00,000

   Profit & Loss A/c Dr 50,000

   To CR RA/C 2,50,000

   (Being CRR created for redemption of preference share)

3) Profit and Loss A/c Dr. 40,000

   To Premium on Redeem A/c 40,000

   (Being the premium on redemption amountised through profit and loss A/c)

4) Bank A/c Dr 1,50,000

   To Equity Capital A/c 1,25,000

   To security premium A/c 25,000

   (Being equity shares issued at a premium)

5) PSH A/c Dr. 4,40,000

   To Bank A/c 85,000

   (Being PSH Claim settled) 55,000

6) CRR A/c Dr. 37,000

   To Bonus to ESH A/c 37,000

   (Being bonus declared)

7) Bonus to ESH A/c Dr. 37,000

   To Equity Capital A/c 37,000

   (Being bonus shares issued)

Balance sheet of Adira Ltd. as on 1/4/2018

Capital & Liabilities

1	Shareholders funds		
a	Share Capital	1	9,62,000
b	Reserves & Surplus	2	3,16,000

2	Non Current Liabilities		Nil
3	Current Liabilities	3	10,42,000
	Total		23,20,000
Assets			
1	Non Current Assets	4	17,60,000
2	Current assets	5	5,60,000
	Total		23,20,000

Note 1 : Share Capital

9620 Equity Share of ₹100 each	9,62,000

(Out of these 370 shares were issued as bonus shares so no consideration has been received)

Note 2 : Reserves & Surplus

Security Premium	99,000
(24000 + 25000)	
(RR (250-37)	2,13,000
General Reserves (240 - 200)	40,000
Profit and Loss A/c (104 - 50 - 40)	14,000
	3,16,000

Note 3 : Current Liabilities

Current Liabilities	8,32,000
UnclaimPSH balance	55,000
Bank O/D	1,55,000
	10,42,000

Note 4 : Non CA

Fixed Assets	16,00,000
Non Current Assets	1,60,000
(M.V. - 2,00,000)	17,60,000

Note 5 : CA

Stock	2,80,000
Debtors	2,80,000
	5,60,000

WN4 : Calculation of Bank balance

Opening balance	80,000
+ Fresh issue	1,50,000
- Payment to PSH	(3,85,000)
Bank O/D	1,55,000

3.3 QUESTIONS

I) True or False.

1) Preference shareholders are also known ordinary shareholders.
2) Partly paid preference shares can not be redeemed
3) Redeemable preference shares can be issued only if authorized by the Company's Articles of Association.
4) Dividends of a preference share are directly paid to the preference shareholders every year.
5) Redemption of preference shares results in the resolution of the issued capital always.

(Ans : True - 2, 3, False - 1, 4, 5)

II) Fill in the blanks.

1) Workmen Compensation Fund is a _______________ profit.
2) Capital Redemption Reserve may be used for issuing _________ shares.
3) Preference shareholders have ___________ rights of repayment at the time of winding up.
4) A company limited by shares can issue preference shares for ___________ years.
5) Bonus issue helps in ______________ the profits.

(1-divisible, 2-bonus, 3-preferential, 4-20, 5- capitalizing utilizing)

Questions for self Test

1) Ranbir Ltd. has 1,00,000 9% Preference shares of ₹10 each fully paid. The company decided to redeem these preference shares at 10% premium. The board of directors decided to redeem the shares on 31/3/18 by raising funds through the issue of 10,000 equity share of ₹100 each at 20% premium. The issue was fully subscribed and the redemption was carried out. Journalise the above transactions in the books of Ranbir Ltd.

2) Sara Ltd. provided the following information

10% preference share of ₹100 each	8,00,000
General Reserve	4,00,000
Profit & Loss A/c	5,00,000

The directors decided to redeem the preference shares at 10% premium by using the profits. The company carried out the redemption as decided at par. Journalise the above transactions in the books of the company.

3) Taimur Ltd. provides the following information to you

12% Preference share of ₹10 each	10,00,000
General Reserve	3,00,000
Profit & Loss A/c	4,00,000

The preference shares were due for redemption on 1/1/2019 at 10% premium. For the redemption the company issued 70,000 equity share of ₹10 each at par. The balance funds were utilized from the divisible profits. Journalise the above transactions in the books of the company.

4) Following is the Balance sheet of Rishi Ltd. as on 31/3/18

Equity share of ₹10 each	4,00,000	Fixed assets	6,00,000
9% Preference share of ₹100 each	2,00,000	Bank	2,00,000
General Reserve	1,00,000	Other current assets	2,40,000
Profit & Loss A/c	1,00,000		
Creditors	2,40,000		
	10,40,000		10,40,000

The Board of Directors decided to redeem the preference shares at 10% premium. The Company issued 10,000 equity share of ₹10 each at 10% premium. The balance was funded through the profits.

Post redemption the company declared a bonus of share for 5 shares held.

Journalise the above transactions and also prepare the Balance sheet.

5) The Balance sheet of Twinkle Ltd. as on 31/3/19 is as follows :

Equity share of ₹100 each	15,00,000
10% preference share of ₹100 each	6,00,000
Profit & Loss A/c	6,00,000
Current Liabilities	5,00,000

	32,00,000
Fixed Assets	10,00,000
Investments	5,00,000
Bank	3,00,000
Other Current assets	14,00,000
	32,00,000

On the 1st April the Company

1) Redeemed the preference shares at 20% premium
2) Realised 50% of the investments at 10% profits.
3) Issued 5,000 equity share of ₹100 each at 10% premium.
4) The Company redeemed the preference share except 10 preference share holders holding 1000 shares who were untraceable.
5) The Company issued 1 bonus share for every 10 shares held.

Journalise the above transactions and prepare the Balance sheet.

❖❖❖❖

Module III

4

REDEMPTION OF DEBENTURES

Unit Structure:

4.0 OBJECTIVE

The objective of the unit is to enable the students to understand the accounting treating for regarding the redemption of debentures in accordance with the provisions the Companies Act, 2013

4.1 INTRODUCTION

Redemption of debentures means to repay the debenture holders the amount paid by them to the company towards the debentures issued by the company. It is repayment of the debenture liability to debenture holders. In simple words, redemption of debentures implies repayment of debenture capital.

The redemption of debentures depends upon the type of debentures issued by the company and the terms of redemption. A company can issue two type of debentures viz. Redeemable and Irredeemable. Redeemable debentures are redeemable after a specific period, as per the terms and conditions. Irredeemable debentures are paid at the time of winding up of the company.

4.2 PROVISIONS OF SECTION 71 (1) AND (4) OF THE COMPANIES ACT, 2013

Sec. 71(1) of the Companies Act 2013 provides that a company may issue debentures with an option to convert such debentures into shares either wholly or partly at the time of redemption.

Conversion of debentures must be approved by a special resolution passed at a general meeting. A company may issue either fully convertible or partly convertible debentures.

Rule 18(7) of the Companies (Share Capital and Debentures) Rules 2014provides that in case of partly convertible debentures, D.R.R. shall be created in respect of Non-convertible portion of the debenture issue.

D.R.R. is not required in the case of fully convertible debentures.

Sec. 71(4) of the Companies Act,2013 together with The Companies (Share Capital and Debentures) Rules, 2014 requires a company to create a Debenture Redemption Reserve A/c (DRR A/c) out of profits of the company available for payment of dividend and the amount credited to such account shall be used only for the redemption of Debentures.

4.3 THE METHODS OF WRITING OFF DISCOUNT/ LOSS ON ISSUE OF DEBENTURES

When debentures are issued at a price less than their nominal/face value, then the debentures are said to be issued at a discount.

If debentures are redeemed at a price greater than their nominal/face value, they are said to be redeemable at a premium. Such premium though payable on redemption, must be provided as a liability at the time of issue itself. Such premium payable on redemption is a capital loss for the company.

There is no legal obligation to write off discount/loss on issue of debentures. Since discount/loss on issue of debentures is a capital loss for the company, it should be written off as early as possible. The discount/loss on issue of debentures shown in the balance sheet until written off. The amount of discount/loss written off is shown on debit side of Profit and Loss Account under the head, 'Other Expenses" and the amount not written off is shown in the Balance Sheet under the head, "Other Non-Current Assets"

The following are the two methods by which the amount of discount/loss on issue of debentures can be written off:

1. Fixed Instalment Method

When debentures are redeemed in lump sum at the end of a certain period, total discount/loss is spread equally over the period over which the debentures will be redeemed. In this method, the amount of discount to be written over every year is a fixed amount.

$$\text{Discount/loss written off} = \frac{\text{Total Discount}}{\text{No. of years}}$$

2. Fluctuating Instalment Method

When debentures are to be redeemed in instalments, the total amount of discount/loss on issue of debentures should be written off in the ratio in which the amount of debentures has been used each year. In this method, the amount of discount reduces every year.

The discount/loss on issue of debentures being a capital loss can be written off against capital profit / capital reserve. As per Section 52 of the Companies Act 2013, securities premium can be used to write off discount on issue of debentures.

4.4 METHODS OF WRITING OFF DISCOUNT/LOSS ISSUE OF DEBENTURES

Journal entry to write off Discount/Loss on issue of debentures:
Securities Premium A/cDr.
Profit and Loss/General Reserve A/cDr.
To Discount/Loss on issue of Debentures A/c

Illustration 1:

On 1st January, 2015, HK Ltd. issued 5,000 15% debentures of ₹100 each at a discount of 10% redeemable at a premium of 10%.

Show Loss on Issue of Debentures A/c if:

1. Such debentures are redeemable after four years.
2. Such debentures are redeemable by equal annual drawings in 4 years.

   HK Ltd. follows calendar year as its accounting year.

Solution:

1. Such debentures are redeemable after four years.

a. Total amount of discount = 10% of ₹10,00,000 = ₹1,00,000

b. Amount of premium on redemption = 10% of ₹10,00,000 = ₹1,00,000

Total Loss (a+b) = ₹2,00,000

Term of Debenture = 4 years

Amount of loss to be written off = ₹2,00,000 / 4 years = ₹50,000

In the books of HK Ltd.

Loss on Issue of Debentures A/c

Date	Particulars	₹	Date	Particulars	₹
1-1-2015	To 15% debentures a/c	2,00,000	31-12-2015	By P&L a/c By Balance c/d	50,000 1,50,000
	Total	**2,00,000**		**Total**	**2,00,000**
1-1-2016	To Balance b/d	1,50,000	31-12-2016	By P&L a/c By Balance c/d	50,000 1,00,000
	Total	**1,50,000**		**Total**	**1,50,000**
1-1-2017	To Balance b/d	1,00,000	31-12-2017	By P&L a/c By Balance c/d	50,000 50,000
	Total	**1,00,000**		**Total**	**1,00,000**
1-1-2108	To Balance b/d	50,000	31-12-2018	By P&L a/c	50,000
	Total	**50,000**		**Total**	**50,000**

2. Such debentures are redeemable by equal annual drawings in 4 years.
   FV of debentures redeemed each year ₹10,00,000 = ₹2,50,000

Discount/Loss to be written off each year

Year ended	FV of debentures used	Ratio	Loss to be written off
31-12-2015	₹10,00,000	4	₹2,00,000 x 4/10 = ₹80,000
31-12-2016	₹7,50,000 (10,00,00-2,50,000)	3	₹2,00,000 x 3/10 = ₹60,000
31-12-2017	₹5,00,000 (7,50,00-2,50,000)	2	₹2,00,000 x 2/10 = ₹40,000
31-12-2018	₹2,50,000 (5,00,00-2,50,000)	1	₹2,00,000 x 1/10 = ₹20,000
	Total	10	₹2,00,000

In the books of HK Ltd.

Loss on Issue of Debentures A/c

Date	Particulars	₹	Date	Particulars	₹
1-1-2015	To 15% debentures a/c	2,00,000	31-12-2015	By P&L a/c By Balance c/d	80,000 1,20,000
	Total	**2,00,000**		**Total**	**2,00,000**
1-1-2016	To Balance b/d	1,20,000	31-12-2016	By P&L a/c By Balance c/d	60,000 60,000
	Total	**1,20,000**		**Total**	**1,20,000**

1-1-2017	To Balance b/d	60,000	31-12-2017	By P&L a/c By Balance c/d	40,000 20,000
	Total	**60,000**		**Total**	**60,000**
1-1-2108	To Balance b/d	20,000	31-12-2018	By P&L a/c	20,000
	Total	**20,000**		**Total**	**20,000**

Illustration 2:

On 1st April, 2015, R Ltd. issued 50,000, 7% debentures of ₹100 each at a discount of 6% redeemable at par as follows:

Year End	Face value of debentures to be redeemed
1	10%
2	20%
3	30%
4	40%

Calculate the amount of discount to be written off each year assuming that the company close its accounts on 31st March each year.

Solution:

Amount of discount = 6% of 50,000 debentures x ₹100 = ₹3,00,000

Discount to be written off each year

Year ending 31-3	FV of debentures used `	Ratio	Loss to be written off
2016	₹50,00,000	10	₹3,00,000 x 10/30 = ₹1,00,000
2017	₹45,00,000 (50,00,000 -10% of 50,00,000)	9	₹3,00,000 x 9/30 = ₹90,000
2018	₹35,00,000(45,00,000 -20% of 50,00,000)	7	₹3,00,000 x 7/30 = ₹70,000
2019	₹20,00,000 (35,00,000 -30% of 50,00,000)	4	₹3,00,000 x 4/30 = ₹40,000
	Total	30	₹3,00,000

In the books of R Ltd.

Loss on Issue of Debentures A/c

Date	Particulars	₹	Date	Particulars	₹
1-1-2015	To 7% debentures a/c	3,00,000	31-12-2015	By P&L a/c By Balance c/d	1,00,000 2,00,000
	Total	**3,00,000**		**Total**	**3,00,000**
1-1-2016	To Balance b/d	2,00,000	31-12-2016	By P&L a/c By Balance c/d	90,000 1,10,000
	Total	**2,00,000**		**Total**	**2,00,000**

1-1-2017	To Balance b/d	1,10,000	31-12-2017	By P&L a/c By Balance c/d	70,000 40,000
	Total	**1,10,000**		**Total**	**1,10,000**
1-1-2108	To Balance b/d	40,000	31-12-2018	By P&L a/c	40,000
	Total	**40,000**		**Total**	**40,000**

A. **Terms of issue of debentures**
There are no legal restrictions on the terms of issue of debentures. The debentures can be issue at par, premium or discount.

This topic has been dealt in Introduction to Companies Account

B. **Methods of redemption of debentures**

The different methods of redemption of debentures are:

1. **By drawing lots in instalments:** In this case debentures are redeemed by annual or periodic drawings within a specific period.

2. **In lump sum:** In this method debentures are redeemed in one lump sum after a specific period of time from the date of issue.

3. **By purchase of own debentures in the open market:** In this case, the company purchases its own debentures for immediate cancellation or for investment.

4. **By conversion:** In this case debentures are redeemed by converting them into equity shares or into preference shares or converting into a new class of debentures.

SOURCES OF REDEMPTION

1. Redemption out of Capital
In this method, debentures are redeemed out of capital of the company. The debenture holders are paid out of cash or bank account and not out of profits, hence, it is termed as redemption out of capital. Since the redemption is not out of profits, the entry regarding transfer of profits to Debenture Redemption Reserve account is not passed. As a result, balance of profits is not reduced by the amount utilised for redemption of debenture. As per the SEBI Guidelines, redemption of debentures wholly out of capital is not possible. Redemption out of capital is done when the debentures are for a period of less than 18 months or profits are not enough for creation of Debentures Redemption Reserve.

The Government has put a restriction on this method by requiring every company to create Debentures Redemption Reserve.

Illustration 3:

On 1st April, 2015, ITI Ltd. issued 8,000 6% debentures of ₹100 each at 10% discount, redeemable at a premium of 5% at the end of the 4th year.

Pass Journal entries. Ignore the treatment of loss on issue of debenture and interest.

Solution:
Journal Entries in the books of ITI Ltd.

Date	Particulars	Debit (₹)	Credit (₹)
1-4-2015	Bank A/c Dr. Discount on issue of debentures A/c Dr. Loss on issue of debentures A/c Dr. To 6% Debentures A/c To Premium on redemption of debentures A/c (Being 8,000 6% debentures issued at a 10% discount, redeemable at 5% premium)	7,20,000 80,000 40,000	 8,00,000 40,000
31-3-2019	6% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To6% Debentureholders A/c (Being amount due to debentureholders on redemption)	8,00,000 40,000	 8,40,000
31-3-2019	6% Debentureholders A/c Dr. To Bank A/c (Being debentureholders paid off)	8,40,000	 8,40,000

2. Redemption out of Profits

In this method, debentures are redeemed out of profit earned. Profits are utilised for redemption of debentures. The following are the two methods by which debentures can be redeemed out of profits.

A. Creating Debenture Redemption Reserve &B. Creating Sinking Fund

A. Creating Debenture Redemption Reserve (DRR)

In this method, amount is appropriated from Profits and Loss Appropriation Account and it is transferred to Debenture Redemption Reserve Account before redemption. This reduces the profit available for distribution as dividend.

As per Sec. 71(4) of the Companies Act,2013 a company shall create a Debenture Redemption Reserve A/c out of profits of the company available for payment of dividend and the amount credited to such account shall not be utilised except for the redemption of Debentures.

Rule 18(7) The Companies (Share Capital and Debentures) Rules, 2014 requires that an amount equal to atleast 25% of nominal value of debentures must be transferred to DRR by the company before commencement of redemption of debentures. The company can transfer at its option, more than 25% to DRR account.

As per Rule 18(7) the following categories of companies are exempted from creating a DRR A/c:

1. All India Financial Institutes regulated by the RBI
2. Debentures placed publicly and privately by Banking Companies
3. Debentures placed privately by Non- banking and other Financial institutions (NBFC)
4. Fully convertible debentures

As per SEBI it is not mandatory to create DRR in case of:
1. Debentures maturing in 18 months or less
2. For Infrastructure Companies.

Further every company requiring to create DRR a/c, shall before 30th April of each year deposit or invest atleast 15% of the face value of debentures maturing during the year ending on 31st March next, in any one or more of the following:

1. In deposit with any scheduled bank free from charge or lien.
2. In unencumbered securities of the central or any of the state government.
3. In unencumbered securities mentioned under section 20 (a) to (d) and (ee) of the Indian Trust Act 1882
4. In unencumbered bonds issued by any other company which is notified under section 20 (f) of the Indian Trust Act 1882

Illustration 4:

Zebra Ltd. issued on 1st April 2016, 10,000 8% debentures of ₹100 each redeemable by draw of lots as under:

1. During the year ending on 31st March,2018 – 15%
2. During the year ending on 31st March, 2019 – 20%
3. During the year ending on 31st March, 2020 – 25%
4. During the year ending on 31st March, 2021 – 15%
5. During the year ending on 31st March, 2022 – 25%

What is the minimum deposit or investment Zebra Ltd. should make as per the Companies Act, 2013 before debentures are redeemed? Also state when the investment should be made. State the minimum amount to be transferred to Debenture Redemption Reserve A/c as per Companies Act, 2013

Solution:

Date of Redemption	**Date of Investments**	**Nominal value of debentures maturing**	**Minimum depositor investment**	**Minimum amount to be transferred to DRR A/c**
31st March, 2018	On or before 30th April, 2017	15% of ₹10,00,000 = ₹1,50,000	15% of ₹1,50,000 =₹22,500	25% of ₹1,50,000 =₹37,500
31st March, 2019	On or before 30th April, 2018	20% of ₹10,00,000 = ₹2,00,000	15% of ₹2,00,000 =₹30,000	25% of ₹2,00,000 =₹50,000
31st March, 2020	On or before 30th April, 2019	25% of ₹10,00,000 = ₹2,50,000	15% of ₹2,50,000 =₹37,500	25% of ₹2,50,000 =₹62,500
31st March, 2021	On or before 30th April, 2020	15% of ₹10,00,000 = ₹1,50,000	15% of ₹1,50,000 =₹22,500	25% of ₹1,50,000 =₹37,500
31st March, 2022	On or before 30th April, 2021	25% of ₹10,00,000 = ₹2,50,000	15% of ₹2,50,000 =₹37,500	25% of ₹2,50,000 =₹62,500

Illustration 5:

Prakash Ltd. issued 4,000 8% debentures of ₹100 each on 1st April, 2015 at a discount of 10%, redeemable at a premium of 10% out of profits. Give journal entries both at the time of issue and redemption of debentures if:

a) the debentures are redeemable in lump sum at the end of 4th year from the date of issue and

b) the Company has decided to create a Debenture Redemption Reserve, every year.

(Ignore the treatment of loss on issue of debenture and interest. March 31st is the accounting year of Prakash Ltd)

Solution:

Journal Entries in the books of Prakash Ltd.

Date	Particulars	Debit (₹)	Credit (₹)
1-4-2015	Bank A/c Dr. Discount on issue of debentures A/c Dr. Loss on issue of debentures A/c Dr. To 8% Debentures A/c To Premium on redemption of debentures A/c (Being 4,000 8% debentures issued at a 10% discount, redeemable at 10% premium)	3,60,000 40,000 40,000	4,00,000 40,000
31-3-2016	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits equal to 25% of the nominal value of debentures issued)	1,00,000	1,00,000
31-3-2017	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits equal to 25% of the nominal value of debentures issued)	1,00,000	1,00,000
31-3-2018	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits equal to 25% of the nominal value of debentures issued)	1,00,000	1,00,000
29-4-2018	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be redeemed)	60,000	60,000
31-3-2019	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits equal to 25% of the nominal value of debentures issued)	1,00,000	1,00,000

31-3-2019	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	60,000	60,000
31-3-2019	8% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To 8% Debentureholders A/c (Being amount due to debenture holders on redemption)	4,00,000 40,000	4,40,000
31-3-2019	8% Debentureholders A/c Dr. To Bank A/c (Being debentureholders paid off)	4,40,000	4,40,000
31-3-2019	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being transfer of balance in DRR a/c to general reserve a/c on redemption of debentures)	4,00,000	4,00,000

Illustration 6:

Kajal Ltd. has 12,000, 9% debentures of ₹100 each due for redemption in four equal instalments starting from 31st March, 2016. On that date the Debenture Redemption Reserve Account has a balance of ₹70,000. Record necessary journal entries in the books of the Company.

Solution:

Journal Entries in the books of Kajal Ltd.

Date	Particulars	Debit (₹)	Credit (₹)
30-4-2015	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be on 31st March 2016)	45,000	45,000
31-3-2016	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	45,000	45,000
31-3-2016	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c, 25% ₹3,00,000 = ₹75,000 – ₹70,000)	5,000	5,000

31-3-2016	9% Debentures A/c Dr. To 9% Debenture holders A/c (Being 1/4th amount due to debenture holders on redemption)	300,000	 3,00,000
31-3-2016	9% Debenture holders A/c Dr. To Bank A/c (Being 1/4thdebentureholders paid off)	3,00,000	 3,00,000
30-4-2016	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be redeemed on 31st March 2017))	45,000	 45,000
31-3-2017	Bank A/c Dr. To Debenture Redemption Investment A/c (Being investments encashed)	45,000	 45,000
31-3-2017	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c @ 25% of the nominal value of debentures to be redeemed)	75,000	 75,000
31-3-2017	9% Debentures A/c Dr. To 9% Debentureholders A/c (Being 1/4th amount due to debentureholders on redemption)	300,000	 3,00,000
31-3-2017	9% Debentureholders A/c Dr. To Bank A/c (Being 1/4thdebentureholders paid off)	3,00,000	 3,00,000
30-4-2017	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be on 31st March 2018)	45,000	 45,000
31-3-2018	Bank A/c Dr. To Debenture Redemption Investment A/c (Being investments encashed)	45,000	 45,000
31-3-2018	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c @ 25% of the nominal value of debentures to be redeemed)	75,000	 75,000

31-3-2018	9% Debentures A/c Dr. To 9% Debentureholders A/c (Being 1/4th amount due to debentureholders on redemption)	300,000	3,00,000
31-3-2018	9% Debentureholders A/c Dr. To Bank A/c (Being 1/4thdebentureholders paid off)	3,00,000	3,00,000
30-4-2018	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be on 31st March 2019)	45,000	45,000
31-3-2019	Bank A/c Dr. To Debenture Redemption Investment A/c (Being investments encashed)	45,000	45,000
31-3-2019	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c @ 25% of the nominal value of debentures to be redeemed)	75,000	75,000
31-3-2019	9% Debentures A/c Dr. To 9% Debenture holders A/c (Being 1/4th amount due to debenture holders on redemption)	300,000	3,00,000
31-3-2019	9% Debenture holders A/c Dr. To Bank A/c (Being 1/4thdebentureholders paid off)	3,00,000	3,00,000
31-3-2019	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being transfer of balance in DRR a/c to general reserve a/c on redemption of debentures)	3,00,000	3,00,000

Illustration 7:

Raman Ltd. issued 21,000, 7% debentures of ₹100 each on 1st October, 2011 redeemable in three equal annual instalments starting from 31st March, 2015. The Board of directors decides to transfer to Debenture Redemption Reserve A/c ₹50,000 and ₹4,00,000 on 31st March, 2012 and 2013 respectively and the balance required on 31st March, 2014. Ignore payment of interest. Investments as required by law are made by the Company in bank fixed deposits. Pass necessary journal entries.

Solution:

Journal Entries in the books of Raman Ltd**.**

Date	**Particulars**	**Debit (₹)**	**Credit (₹)**
1-9-2011	Bank A/c Dr. To 7% Debentures A/c (Being 21,000 7% debentures issued at par)	21,00,000	 21,00,000
31-3-2012	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c)	50,000	 50,000
31-3-2013	Profit & Loss A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c)	4,00,000	 4,00,000
31-3-2014	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of balance required profits to DRR A/c, 25% of ₹21,00,000 – ₹50,000 -₹4,00,000)	75,000	 75,000
30-4-2014	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹7,00,000)	1,05,000	 1,05,000
31-3-2015	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	1,05,000	 1,05,000
31-3-2015	7% Debentures A/c Dr. To 7% Debentureholders A/c (Being 1st instalment due to debentureholders on redemption, ₹21,00,000/3)	7,00,000	 7,00,000
31-3-2015	7% Debentureholders A/c Dr. To Bank A/c (Being 1st instalment paid to debentureholders)	7,00,000	 7,00,000
30-4-2015	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹7,00,000)	1,05,000	 1,05,000

31-3-2016	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	1,05,000	 1,05,000
31-3-2016	7% Debentures A/c Dr. To 7% Debentureholders A/c (Being 2nd instalment due to debentureholders on redemption)	7,00,000	 7,00,000
31-3-2016	7% Debentureholders A/c Dr. To Bank A/c (Being 2nd instalment paid to debentureholders)	7,00,000	 7,00,000
30-4-2016	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹7,00,000)	1,05,000	 1,05,000
31-3-2017	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	1,05,000	 1,05,000
31-3-2017	7% Debentures A/c Dr. To 7% Debentureholders A/c (Being 1st instalment due to debentureholders on redemption)	7,00,000	 7,00,000
31-3-2017	7% Debentureholders A/c Dr. To Bank A/c (Being 1st instalment paid to debentureholders)	7,00,000	 7,00,000
31-3-2017	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being trf. of balance in DRR a/c to general reserve a/c on redemption of debentures)	5,25,000	 5,25,000

Illustration 8:

Apple Ltd. issued 9,000, 6% debentures of ₹100 each on 1st November, 2011 redeemable at a premium of 7% as under:

On 31st March, 2017 3,000 debentures
On 31st March, 2018 3,000 debentures
On 31st March, 2019 3,000 debentures

The Board of directors decides to transfer to the required amount to Debenture Redemption Reserve A/c in four equal annual instalments starting with 31st March, 2014. Ignore entries for payment of interest and write off of loss on issue of debentures. Investments as required by law are made by the Company in bank fixed deposits. Pass necessary journal entries.

Solution:

Journal Entries in the books of Apple Ltd.

Date	Particulars	Debit (₹)	Credit (₹)
1-11-2011	Bank A/c Dr. Loss on issue of debentures A/c Dr. To 6% Debentures A/c To Premium on redemption of debentures A/c (Being 9,000 6% debentures issued at a par, redeemable at 7% premium)	9,00,000 63,000	 9,00,000 63,000
31-3-2013	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of 1st instalment of profits to DRR A/c, 25% of 9,00,000 = 2,25,000/4)	56,250	56,250
31-3-2014	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of 2nd instalment of profits to DRR A/c)	56,250	56,250
31-3-2015	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of 3rd instalment of profits to DRR A/c)	56,250	56,250
31-3-2016	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of 4th instalment of profits to DRR A/c)	56,250	56,250
30-4-2016	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹3,00,000)	45,000	45,000

31-3-2017	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	45,000	45,000
31-3-2017	6% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To 6% Debentureholders A/c (Being 1st instalment due to debentureholders on redemption)	3,00,000 21,000	3,21,000
31-3-2017	6% Debentureholders A/c Dr. To Bank A/c (Being 1st instalment paid to debentureholders)	3,21,000	3,21,000
30-4-2017	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹3,00,000)	45,000	45,000
31-3-2018	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	45,000	45,000
31-3-2018	6% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To 6% Debentureholders A/c (Being 2nd instalment due to debentureholders on redemption)	3,00,000 21,000	3,21,000
31-3-2018	6% Debentureholders A/c Dr. To Bank A/c (Being 1st instalment paid to debentureholders)	3,21,000	3,21,000
30-4-2018	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹3,00,000)	45,000	45,000
31-3-2019	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	45,000	45,000

31-3-2019	6% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To 6% Debentureholders A/c (Being 1st instalment due to debentureholderson redemption)	3,00,000 21,000	3,21,000
31-3-2019	6% Debentureholders A/c Dr. To Bank A/c (Being 3rd instalment paid to debentureholders)	3,21,000	3,21,000
31-3-2019	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being transfer of balance in DRR a/c to general reserve a/c on redemption of debentures)	2,25,000	2,25,000

Illustration 9:
Mala Ltd. has a balance of ₹25,00,000 in the Profit & Loss A/c. The company decided to redeem fully out of profits ₹25,00,000 10% debentures which were issued on 1st April, 2015. These debentures are redeemable at a premium of 10% on 30th June, 2019. Interest is payable annually on 31st December every year when the accounts are closed. The company has a balance of ₹6,25,000 in DRR A/c. Journalise the transaction during the year of redemption.

Solution:
Journal entries in the books of Mala Ltd.

30-4-2019	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹25,00,000)	3,75,000	3,75,000
30-6-2019	Bank A/c Dr. To Debenture Redemption Investment A/c (Being investments encashed)	3,75,000	3,75,000
30-6-2019	Debenture Interest A/c Dr. To 10% Debentureholders A/c (Being half year debenture interest due, `25,00,000 x 10/100 x 6/12 months)	1,25,000	1,25,000

30-6-2019	10% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To 10% Debentureholders A/c (Being amount due to debentureholders on redemption)	25,00,000 2,50,000	27,50,000
30-6-2019	10% Debentureholders A/c Dr. To Bank A/c (Being debentureholders paid along with interest)	28,75,000	28,75,000
30-6-2019	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being transfer of balance in DRR a/c to general reserve a/c on redemption of debentures)	6,25,000	6,25,000
30-6-2019	Profit & Loss A/c Dr. To Debenture Interest A/c To Premium on redemption of debentures A/c (Being debenture interest & premium on redemption of debentures transferred to P&L A/c)	3,75,000	1,25,000 2,50,000

Note: premium on redemption of debentures is transferred to P&L A/c on the assumption that it was not written off in the earlier year.

B. Creating Sinking Fund

This method is known as Sinking Fund (SF) Method / Debenture Redemption Fund (DRF) Method. In this method a fixed amount is kept aside or appropriated out of profits every year and invested outside the business by creating a sinking fund or debenture redemption fund. This fixed amount is also known as Annual Instalment towards sinking fund. Out of the fund the company either purchases investments or takes an insurance policy.

The sinking fund may be cumulative or non- cumulative. In case of Cumulative SF, the income from the investment/policy is added back to the fund and reinvested. In case on non-cumulative SF, the income from investment/policy is credited to Sinking Fund account.

In the year of redemption, the investments are sold or the policy is surrendered in order to obtain money required to pay off the debenture holders. Any profit or loss on sale of investments is transferred to Sinking Fund Account. After redemption of the debentures the balance if any in the Sinking Fund Account is transferred to General Reserve Account.

The amount to be kept aside/appropriated depends on the rate of interest to be received and the terms of redemption. There are mathematical tables available for this purpose. These are called Annuity Tables. The annual amount set aside or appropriation required is calculated as follows:

Amount to be kept aside/appropriated = Amount of redemption x factor in annuity table

Model Journal Entries:

I.	**1st Year**	**Amount**
1.	For making yearly appropriations Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c	Annual Instalment
2.	For making investment Sinking Fund Investments A/c Dr. To Bank A/c	Annual Instalment
II.	**2nd Year Onwards**	
1.	For interest received in SF Investments Bank A/c Dr. To Sinking Fund A/c	Interest received on Investments
2.	For making yearly appropriations Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c	Annual Instalment
3.	For making investment Sinking Fund Investments A/c Dr. To Bank A/c	Annual Instalment +Interest
III.	**Year of Redemption**	
1.	For interest received in Sinking Fund Investments Bank A/c Dr. To Sinking Fund A/c	Interest received on Investments
2.	For making yearly appropriations Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c	Annual Instalment
	No investments are made in the year of redemption	
3.	When Sinking Fund Investments are sold	
	a. At par Bank A/c Dr. To Sinking Fund Investments A/c	Selling price of Investments

	b. At Profit Bank A/c Dr. To Sinking Fund Investments A/c To Sinking Fund A/c	 Selling price Cost Price Profit
	c. At Loss Bank A/c Dr. Sinking Fund A/c Dr. To Sinking Fund Investments A/c	 Selling price Loss Cost Price
4.	Sinking fund balance transferred to General Reserve Sinking Fund A/c Dr. To General Reserve A/c	Balance in Sinking Fund A/c

Illustration 10:

CIT Ltd. issued 1,100 6% debentures of ₹100 each at par on 1st April, 2016 redeemable at par. The Company decided to set aside every year a sum of ₹34,893 to be invested @ 5% outside the business. The investments were sold at ₹71,580 at the end of the third year and the debentures were redeemed. Give journal entries. Also prepare Sinking Fund Account and Sinking Fund Investments Account. Ignore interest on debentures.

Solution:

Journal Entries in the books of CIT Ltd.

Date	Particulars	Debit (₹)	Credit (₹)
1-4-2016	Bank A/c Dr. To 6% Debentures A/c (Being 1,100 6% debentures ₹100 each issued at par, redeemable at par)	1,10,000	 1,10,000
31-3-2017	Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c (Being amount appropriated out of profits and transferred to SF A/c)	34,893	 34,893
31-3-2017	Sinking Fund Investment A/c Dr. To Bank A/c (Being amount invested out of SF A/c)	34,893	 34,893
31-3-2018	Bank A/c Dr. To Sinking Fund A/c (Being interest received on SF investments @ 5% on ₹34,893)	1,745	 1,745

31-3-2018	Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c (Being amount appropriated out of profits and transferred to SF A/c)	34,893	 34,893
31-3-2018	Sinking Fund Investment A/c Dr. To Bank A/c (Being amount invested out of SF A/c + interest)	36,638	 36,638
31-3-2019	Bank A/c Dr. To Sinking Fund A/c (Being interest received on SF investments @ 5% on ₹71,531)	3,577	 3,577
31-3-2019	Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c (Being amount appropriated out of profits and transferred to SF A/c)	34,893	 34,893
31-3-2019	Bank A/c Dr. To Sinking Fund Investment A/c To Sinking Fund A/c (Being SF investments sold at a profit)	71,580	 71,531 49
31-3-2019	6% Debentures A/c Dr. To 6% Debentureholders A/c (Being amount due to debentureholders on redemption)	1,10,000	 1,10,000
31-3-2019	6% Debentureholders A/c Dr. To Bank A/c (Being 1/4thdebentureholders paid off)	1,10,000	 1,10,000
31-3-2019	Sinking Fund A/c Dr. To General Reserve A/c (Being transfer of balance in SF a/c to general reserve a/c on redemption of debentures)	1,10,050	 1,10,050

In the books of CIT Ltd.

Sinking Fund A/c

Date	**Particulars**	**₹**	**Date**	**Particulars**	**₹**
31-3-2017	To Balance c/d	34,893	31-3-2017	By P&L Appr. a/c	34,893
	Total	**34,893**		**Total**	**34,893**
31-3-2018	To Balance c/d	71,531	01-4-2017 31-3-2018 31-3-2018	By Balance b/d By Bank A/c By P&L Appr. a/c	34,893 1,745 34,893
	Total	**71,531**		**Total**	**71,531**
31-3-2019	To General Reserve A/c	1,10,050	01-4-2018 31-3-2019 31-3-2019 31-3-2019	By Balance b/d By Bank A/c By P&L Appr. a/c By Bank A/c	71,531 3,577 34,893 49
	Total	**1,10,050**		**Total**	**1,10,050**

Sinking Fund Investment A/c

Date	**Particulars**	**₹**	**Date**	**Particulars**	**₹**
31-3-2017	To Bank A/c	34,893	31-3-2017	By Balance c/d	34,893
	Total	**34,893**		**Total**	**34,893**
01-4-2017 31-3-2018	To Balance b/d To Bank A/c	34,893 36,638	31-3-2018	By Balance c/d	71,531
	Total	**71,531**		**Total**	**71,531**
01-4-2018 31-3-2019	To Balance b/d To Sinking Fund A/c (Profit)	71,531 49	31-3-2019	By Bank A/c	71,580
	Total	**71,580**		**Total**	**71,580**

Illustration 11:

On 31st March, 2019 the following balance stood in the books of Jani Ltd.

8% Second Mortgage Debenture Stock	₹ 4,00,000
Income received on Sinking Fund Investments	₹ 14,500
Discount on issue of Debentures	₹ 25,000
Sinking Fund	₹ 3,65,500
Sinking Fund Investments:	
₹ 80,000, 6% SD Loans	₹ 76,000
₹ 90,000, 7% ND Bonds	₹ 1,00,000
₹ 70,000, 8% PD Loans	₹ 70,000
₹1,80,000 8½% CD Securities	₹ 1,85,000

On the same day the investments were sold: the 5% SD Loans at 90; the 6% ND Bonds at par; the 7% PD at 115 and the 7½% CD at 120. On 1st April, 2019 the debentures of ₹3,00,000 were redeemed at a premium of 2½%. On the very same day, the 8% MD Loans of ₹1,00,000 were purchased at a premium of 3%.

Annual contribution for redemption was ₹50,000. Ignore interest.

Prepare the following accounts:

i. Debenture Stock;

ii. Sinking Fund;

iii. Sinking Fund Investments

iv. General Reserve

Solution:

In the books of Jani Ltd.

8% Debentures Stock A/c

Particulars	₹	Particulars	₹
To Bank a/c To Balance c/d	3,00,000 1,00,000	By Balance b/d	4,00,000
Total	**4,00,000**	**Total**	**4,00,000**

Sinking Fund A/c

Particulars	₹	Particulars	₹
To discount on issue of debentures a/c(₹25,000x3/4) To Premium on redemption of debentures To General Reserve a/c To Balance c/d	18,750 7,500 3,00,000 1,31,250	By Balance b/d By Income on SFI By P&L Appr. By SFI a/c	3,65,500 14,500 50,000 27,500
Total	**4,57,500**	**Total**	**4,57,500**

Sinking Fund Investments A/c

Particulars	₹	Particulars	₹
To Balance b/d To Sinking Fund a/c (profit on sale of invests) To Bank a/c	4,31,000 27,500 1,03,000	By Bank a/c (Sale of Invests) By Balance c/d	4,58,500 1,03,000
Total	**5,61,500**	**Total**	**5,61,500**

General Reserve A/c

Particulars	₹	Particulars	₹
To Balance c/d	3,00,000	By Sinking Fund a/c	3,00,000
Total	**3,00,000**	**Total**	**3,00,000**

Working Note:

1. Calculation of selling price & profit or loss on sale of investments

Investments	Selling Price (A) ₹	Cost Price (B) ₹	Profit/(Loss) (A-B) ₹
6% SD Loans	72,000 ₹80,000 x 90/100	76,000	(4000)
7% ND Bonds	90,000 ₹90,000 at par	1,00,000	(10,000)
8% PD Loans	80,500 ₹70,000 x 115/100	70,000	10,500
8½% CD Securities	2,16,000 ₹1,80,000 x 120/100	1,85,000	31,000
Total	**4,58,500**	**4,31,000**	**27,500**

2. Since only ₹3,00,000 nominal value of debentures are redeemed, only proportionate amount of discount on issue of debentures is written off and amount equal to nominal value of debentures redeemed is transferred from sinking fund account to general reserve account.

4. Redemption by Conversion

Redemption by conversion means redeeming the debentures by converting them into new class of shares or even issuing new class of debentures. The new shares or debentures issued by way of conversion may be issued at par or at a premium after complying the relevant provisions of the Companies Act. The conversion may be made at a discount on the market price of shares or at premium on the face value of shares. Debenture Redemption Reserve is not to be created for redemption of fully convertible debentures.

Sec. 71(1) of the Companies Act 2013 provides that a company may issue debentures with an option to convert such debentures into shares either wholly or partly at the time of redemption.

Conversion of debentures must be approved by a special resolution passed at a general meeting. A company may issue either fully convertible or partly convertible debentures.

Illustration 12:

Alpha Limited issued 5,000 8% debentures of `100 each redeemable on 31st December, 2018 at a premium of 5%.

The Company offered three options to debenture holders as under:

i. 7% preference shares of ₹10 at ₹12

ii. 9% debentures of ₹100 at par

iii. Redemption in cash (assume redemption out of capital only)

The options were accepted as under

i. Option by holders of 1500 Debentures

ii. Option by holders of 1500 Debentures

iii. Option by holders of 2000 Debentures

The redemption was carried over by the Company. Show the Journal entries.

Solution:

Options	i	ii	ii
NV of debentures redeemed (Options accepted x ₹100)+ Premium on redemption 5%	₹1,50,000 (1,500 x 100) ₹7,500	₹1,50,000 (1,500 x 100) ₹7,500	₹2,00,000 (2,000 x 100) ₹10,000
Total amount due on redemption	₹1,57,500	₹1,57,500	₹2,10,000
Number of Preference shares & debentures issued on conversion = Total amount due/ Issue price	13,125 shares 1,57,500/12	1,575 debentures 1,57,500/100	Redemption in cash
7% Pref.sh capital13,125 x ₹10 Securities Premium 13,125 x ₹2	₹1,31,250 ₹26,250		
9% Debentures at par 1,575 x ₹100		₹1,57,500	

Journal Entries in the books of Alpha Ltd.

Sr. No.	Particulars	Debit (₹)	Credit (₹)
1.	8% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 8% Debentureholders A/c (Being amount due to debentureholders on redemption against option i)	1,50,000 7,500	1,57,500
2.	8% Debentureholders A/c To 7% Preference Share Capital A/c, To Securities Premium A/c (Being 1,500 8% debentures converted into 13,125 7% preference shares of ₹10 each issued at premium of ₹2 per share)	1,57,500	1,31,250 26,250
4.	8% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 8% Debentureholders A/c (Being amount due to debentureholders on redemption against option ii)	1,50,000 7,500	1,57,500

4.	8% Debentureholders A/c To 9% Debentures A/c (Being 1,500 8% debentures converted into 1,5759% debentures of `100 each issued at par)	1,57,500	 1,57,500
5.	8% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 8% Debentureholders A/c (Being amount due to debentureholders on redemption against option iii)	2,00,000 10,000	 2,10,000
6.	8% Debentureholders A/c To Bank A/c (Being 2,000 8% debentures paid in cash)	2,10,000	 2,10,000
7.	Securities Premium A/c Dr. To Premium on redemption of debentures a/c (Being premium on redemption of debentures written off)	25,000	 25,000

Note: Premium on redemption of debentures is written off on the assumption that it was not written off in the earlier year.

Illustration 13:

Tony Limited gave notice of its intention to redeem its 7% debentures amounting to ₹4,00,000 of ₹100 each at ₹102 and offered the debenture holders the following three options, to apply the redemption money to subscribe for:

a) 5% cumulative preference shares of ₹20 each at ₹22.50 per share.

b) 7% debentures at ₹96 and

c) to have their holdings redeemed for cash

i. Debenture holders for ₹1,71,000 accepted the proposal (a)
ii. Debenture holders for ₹1,44,000 accepted the proposal (b)
iii. Remaining debenture holders accepted the proposal (c) (assume redemption out of profits only)

Pass the necessary journal entries to record the above transactions in the books of the Company. Ignore entry pertaining to minimum required investments.

Solution:

Options	i	ii	ii
NV of debentures redeemed + Premium on redemption 2%	₹1,71,000 ₹3,420	₹1,44,000 ₹2,880	*₹85,000 ₹1,700
Total amount due on redemption	₹1,74,420	₹1,46,880	₹86,700
Number of Preference shares & debentures issued on conversion = Total amount due/ Issue price	7,752 shares 1,74,420/22.5	1,530 debentures 1,46,880/96	Redemption in cash
5% Pref.sh capital7,752 x `20 Securities Premium 7,752 x ₹2.50	₹1,55,040 ₹19,380		
7% Debentures at ₹96 1,530 x ₹100		₹1,53,000	

₹4,00,000 – ₹1,71,000 – ₹1,44,000 = *₹85,000

Journal Entries in the books of Tony Ltd.

Sr. No.	Particulars	Debit (₹)	Credit (₹)
1.	7% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 7% Debentureholders A/c (Being amount due to debentureholders on redemption against option i)	1,71,000 3,420	 1,74,420
2.	8% Debentureholders A/c To 5% cumulative preference Share Capital a/c To Securities Premium A/c (Being 7% debentures of NV ₹1,71,000 converted into 7,7525% cumulative preference shares of ₹20 each issued at premium of ₹2.50 per share)	1,74,420	 1,55,040 19,380

4.	7% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 7% Debentureholders A/c (Being amount due to debentureholders on redemption against option ii)	1,44,000 2,880	1,46,880
4.	7% Debentureholders A/c Discount on issue of debentures A/c Dr. To 6% Debentures (New) A/c (Being 7% debentures of NV ₹1,44,000 converted into 1,530 new 6% debentures of `100 each issued at `96 per debenture)	1,46,880 6,120	1,53,000
5.	7% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 7% Debentureholders A/c (Being amount due to debentureholders on redemption against option iii)	85,000 1,700	86,700
6.	7% Debentureholders A/c To Bank A/c (Being balance 7% debentures paid in cash)	86,700	86,700
7.	Securities Premium A/c Dr. To Premium on redemption of debentures a/c (Being prem on redemption of deb written off)	8,000	8,000
8.	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits equal to 25% of the nominal value of debentures redeemed in cash, 25% of 85,000)	21,250	21,250
9.	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being transfer of balance in DRR a/c to general reserve a/c on redemption of debentures in cash)	21,250	21,250

Note: Premium on redemption of debentures is written off on the assumption that it was not written off in the earlier year.

4.5 SUMMARY

1. Repayment of the amount due to the Debenture holders on an agreed date is called redemption of debentures.
2. Debenture can be redeemed at par, premium or discount
3. The redemption of debentures depend upon the type of debentures issued by the company and the terms of redemption.
4. Discount/loss on issue of debentures is a capital loss for the company and it should be written off as early as possible
5. There are different methods of redemption of debentures
6. Debentures can be redeemed out of capital, profits and by conversion by complying the provisions of Companies Act, 2013

4.6 EXERCISE

1. Explain the accounting treatment for write off of discount/loss on issue of debentures?
2. Explain the methods of write off of discount/loss on issue of debentures?
3. Explain the different methods of redemption of debentures?
4. What are the provisions of the Companies Act, 2013 regarding redemption of debentures by creating Debenture Redemption Reserve?
5. Write Short Notes on:
   i. Sources of Redemption of debentures
   ii. Methods of Redemption of debentures
   iii. Redemption by Conversion
   iv. Debenture Redemption Reserve
   v. Sinking Fund Method
   vi. Redemption out of Capital
   vii. Write off of discount/loss on issue of debentures
   viii. Redemption out of profits
6. State whether the following statements are True or False
   I. Conversion of debentures must be approved by a special resolution passed at a general meeting.
   II. A company can issue only fully convertible debentures.
   III. In case of partly convertible debentures, D.R.R. shall be created in respect of Non-convertible portion of the debenture issue.
   IV. D.R.R. is not required in the case of fully convertible debentures
   V. D.R.R. can be created out of non-divisible profits

VI. Discount/loss on issue of debentures is a capital loss for the company.

VII. When debentures are redeemed out of capital, the entry regarding transfer of profits to Debenture Redemption Reserve account is not passed.

VIII. As per the SEBI Guidelines, redemption of debentures wholly out of capital is not possible.

IX. As per SEBI it is not mandatory to create DRR in case of debentures maturing in 18 months or less

X. As per SEBI it is mandatory to create DRR for Infrastructure Companies.

XI. As per Rule 18(7), All India Financial Institutes regulated by the RBI is exempted from creating a DRR A/c

XII. As per Rule 18(7), banking companies are compulsorily required to create DRR A/c, when redeeming debentures.

XIII. As per Companies Act, 2013, every company requiring to create DRR a/c, is required to deposit or invest atleast 10% of the face value of debentures being redeemed.

XIV. On redemption of debentures, the balance in sinking fund account is transferred to P&L A/c.

XV. In case of redemption by conversion debentures can be converted into equity shares only.

7. Fill in the blanks choosing correct alternative

1. Company requiring to create DRR a/c, are required to deposit or invest atleast ______ of the face value of debentures being redeemed. (10%/15%)

2. On redemption of debentures, the balance in DRR account is transferred to ________account (P & L /General Reserve)

3. As per SEBI it is not mandatory to create DRR in case of debentures maturing in ______18 months. (18/15)

4. Discount/loss on issue of debentures is a ________loss for the company. (Capital/Revenue)

5. Conversion of debentures must be approved by a ________resolution passed at a general meeting. (Special/Ordinary)

6. D.R.R. can be created out of ______profits. (Divisible/Non-divisible)

8. Match the Columns

Column A	Column B
1. Creation of DRR	a. Capital Loss
2. Discountissue of debenres	b. Creation of DRR not mandatory
3. Balance in Sinking fund A/c	c. Requires special resolution
4. Conversion of debentures	d. Transferred to general reserve A/c
5. Infrastructure Companies	e. From divisible profits

9. Z Ltd. issued ₹10,00,000 7% debentures at 15% discount. Debentures are to be redeemed in the following manner:

Year End	2	3	4	5
FV of Debentures (₹)	1,00,000	2,00,000	3,00,000	4,00,000

Give discount on issue of debentures account for five years

10. Amar Ltd. issued 15,000, 9% debentures of `100 each on 1st November, 2011 redeemable at a premium of 8% as under:
    On 31st March, 2017 5,000 debentures
    On 31st March, 2018 5,000 debentures
    On 31st March, 2019 5,000 debentures

The Board of directors decides to transfer to the required amount to Debenture Redemption Reserve A/c in four equal annual instalments starting with 31st March, 2014. Ignore payment of interest. Investments as required by law are made by the Company in bank fixed deposits. Pass necessary journal entries.

11. On 1st April, 2016, King Ltd. issued ₹ 20,00,000 7% debentures of ₹100 each at par redeemable at a premium of 5%. The terms of issue was that 60% of the debentures are to be redeemed at the end of 2nd year and the balance at the end of 3rd year. The Board of directors decides to transfer to the minimum required amount to Debenture Redemption Reserve A/c at the end of first year. Ignore entries pertaining to payment of interest and loss on issue of debentures.
    Pass necessary journal entries.

12. Rani Ltd. has a balance of ₹20,00,000 in the Profit & Loss A/c. The company decided to redeem fully out of profits ₹20,00,000 10% debentures which were issued on 1st April, 2015. These debentures are redeemable at a premium of 5% on 30th June, 2019. Interest is payable

annually on 31st December every year when the accounts are closed. The company has a balance of ₹5,00,000 in DRR A/c. Journalise the transaction during the year of redemption.

13. On 1st January, 2014 Sagar Ltd. issued 60,000 10% redeemable debentures of ₹100 each at 5% discount, redeemable at 10% premium on 31st December 2018. The amount is to be invested in 10% PR Bonds. Amount of annual appropriation is fixed at ₹8,00,000. Pass necessary Journal Entries and show Sinking Fund Account and Sinking Fund Investments Account for first 5 years.

14. Idea Ltd. issued on 1st April, 2015, 4,000 7% redeemable debentures of ₹100 each at par redeemable at a premium of 10% at the end of the 4th years. The company decided to set up a sinking fund for the redemption of debentures setting aside necessary amount every year and investing it in investments carrying interest @ 12% p.a. The sinking fund factor for 4 years @ 12% was ₹0.20964. On 31st March, 2019, the sinking fund investments were sold for ₹3,15,000.

    You are required to show the necessary ledger accounts in the books of Idea Ltd.

    (Hint: Annual Appropriation = 4,40,000 x 0.20964 = ₹92,242)

15. Tetron Ltd gave notice of its intention to redeem its outstanding ₹12,00,000 – 7% debentures at ₹103 and offered the holders the following options:-

    a) 10% Preference shares of ₹20 each at `25

    b) 9% debentures at ₹96 and

    c) To have their holdings redeemed for cash

i. The holders of ₹3,60,000 debentures accepted the proposal (a)

ii. The holders of ₹4,80,000 debentures accepted the proposal (b)

iii. The remaining debenture holders accepted the proposal (c) (assume redemption out of capital only)

Pass journal entries in the books of Tetron Ltd.

16. Adarsh Limited issued 10,000 6% debentures of ₹100 each redeemable on 31st December, 2018 at a premium of 5%.

    The Company offered three options to debenture holders as under:

    a. 7% preference shares of ₹10 at ₹12

    b. 8% debentures of ₹100 at par

    c. Redemption in cash (assume redemption out of profits only)

    The options were accepted as under

a. Option by holders of 3,000 Debentures

b. Option by holders of 3,000 Debentures

c. Option by holders of 4,000 Debentures

The redemption was carried over by the Company. Show the Journal entries ignoring entry for minimum required investments.

17. B Ltd gave notice of its intention to redeem its outstanding ₹4,00,000 – 8% debentures at `105 (nominal value ₹100) and offered the holders the following options:-

    a. 11% Preference shares of `40 each at `50

    b. 9% debentures at `100 (at par) and

    c. To have their holdings redeemed for cash (assume redemption out of profits only)

    i. The holders of ₹1,40,000 debentures accepted the proposal (a)

    ii. The holders of ₹1,60,000 debentures accepted the proposal (b)

    iii. The remaining debenture holders accepted the proposal (c)

    Pass journal entries in the books of B Ltd.

Answers:

6. True :i, iii, iv, v, vii, viii, ix, xi

   False : ii, vi, x, xii, xiii, xiv, xv
7. i.15%, ii.General Reserve, iii. 18, iv. Capital, v. Special, vi. Divisible.
8. 1- e, 2-a, 3- d, 4-c, 5-b

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Module IV

5

ASCERTAINMENT AND TREATMENT OF PROFIT PRIOR TO INCORPORATION

Unit Structure

5.0 OBJECTIVES

After studying the unit, the students will be able to:

- Understanding the concept of Profit prior to incorporation
- Understanding the accounting treatment of Profit prior to and Post incorporation.
- Understanding the basis of allocation of various items of Income and Expenses in Pre and Post incorporation periods
- Calculating the Profit/Loss for pre and post incorporation periods separately.

5.1 INTRODUCTION

Prior means before and post means after. Profit prior to incorporation refers to the profit before incorporation. For computing the profit before incorporation, the profit and loss account is to be prepared in a columnar form to arrive at profit earned before and after incorporation separately. Alternatively, a statement in columnar form showing the results in the pre/ post incorporation period may be prepared.

5.1.1 Concept-

The profit earned before incorporation cannot be treated as a business profit and hence is not available for distribution as dividend to the shareholders .It is a capital profit and should be transferred to Capital Reserve. The profit earned after incorporation is available for appropriations.

5.1.2 Utilisation of Profit prior to incorporation-

1. For writing off fixed assets acquired
2. For writing off goodwill, if any
3. For paying interest to vendors, if any on the value of purchase consideration
4. For writing off preliminary expenses.

5.2 COMPUTATION OF PROFIT BEFORE INCORPORATION

Step-1 Calculate the Time ratio and Sales ratio-

- Time ratio refers to the number of months in the accounting period before incorporation and after incorporation.
- Sales ratio refers to the sales in the pre incorporation and post incorporation periods.
- For example- The accounting period is from 1-4-2010 to 31-3-2011(12 months) and the date of incorporation is 1-7-2010 .In this case the accounting period can be divided into two distinct periods- 1-4-2010 to 1-7-2010 (3 months before incorporation) and 1-7-2010 to 31-3-2011(9 months after incorporation) Time ratio is 3 months : 9 months or 1:3.
- Sales during the pre incorporation period is Rs. 150000 and the total sales during the entire accounting year is Rs. 900000 This means that the sales in the post incorporation period is 750000(900000-150000). Thus the sales ratio is 150000:750000 or 1:5.

Step-2 Prepare profit and loss account in a columnar format and allocate the expenses profit and incomes on a suitable basis

- If the gross profit is given in the problem, allocate the gross profit in the sales ratio calculated in step 1.
- If the gross profit is not given, then find out the gross profit by preparing trading account as is normally done in final accounts.
- The gross profit can also be worked out by using the formula Gross profit =Sales- Cost of Goods Sold.

Step 3- Allocate all items appearing on the debit side of Profit and loss account and credit side of Profit and Loss a/c on suitable basis. Generally the expenses are allocated in the following manner-

- All fixed expenses, period costs, administration expenses, general expenses in time ratio.
- All selling and distribution expenses, variable expenses in sales ratio

Step 4- There are some items of expenditure and income which are not to be allocated.

- They pertain wholly to the pre incorporation period- for example- Partners salaries, interest on partners' capitals.
- Similarly expenses like preliminary expenses, directors fees , interest on debentures are to be shown in post incorporation only.
- Incomes like share transfer fees will appear on the credit side in the post incorporation column only.
- However, if specific information is given about a particular item of expense, it must be considered while allocating the expense. For example- bad debts are generally allocated on sales ratio but if there is an additional information about bad debts that bad debts relate to sales effected in the pre-incorporation period, then in such case bad debts should not be allocated on sales ratio but it should be shown only in the pre- incorporation column on the debit side of profit and loss account.

Profit and Loss account

For the year ended 31st March 2018

Dr. Cr

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salary	Time	xx	xx	By Gross Profit	Sales	xx	xx
To Rent	Time	xx	xx	By Share transfer fees	Post	-	xx
To Discount	Sales	xx	xx				
To Directors fees	Post	---	xx				
To Partners salary	Pre	xx	---				
To Advertisement	Sales	xx	xx				
To Commission	Sales	xx	xx				
To Capital reserve		xx					
To net profit			xx				
Total		xx	xx	Total		xx	xx

Alternatively the details of profit before and after incorporation may be presented in a statement format as under -

Statement of Profit and loss account for the year ended 31st March 2018

Particulars	Basis	Pre-incorporation	Post incorporation
Incomes Gross Profit	Sales ratio	xxxxx	xxxxx
Less Expenses			
Salaries	Time ratio	xxxxx	xxxxx
Advertisement	Sales Ratio	xxxx	xxxx
Directors fees	Post	-------	xxxx
Debenture Interest	Post	-------	xxxx
Capital Reserve (Balancing figure)		xxxxxxx	
Profit and Loss account (Balancing figure)			xxxxx
Total		xxxxx	xxxxx

Step-5 Balance the Profit and loss account and find out profit/loss.

- Profit in the pre- incorporation period- is to be transferred to Capital Reserve account.
- Loss in the pre- incorporation period- debited to Goodwill account.
- Profit in the post- incorporation period- Transferred to Profit and loss appropriation account.

Check your progress

Calculate time ratio and sales ratio from the following information-

The company was incorporated on 1st June 2015 for the purpose of purchasing an established business as from 1st April 2015. The books of account for the year ended 31st March 2016 showed the total sales for the year as Rs 3,21,040 and sales from 1st April to 1st June as Rs 80,260. The gross profit for the year was Rs 41,280

Calculation of TIME RATIO

Accounting period –

Date of incorporation-

Pre incorporation period—

Post incorporation period –

TIME RATIO-

Calculation of SALES RATIO

Total sales during the year –

Sales in the pre incorporation period –

Sales in the post incorporation period –

SALES RATIO

(Answer- TR-1:5, SR -1:3)

5.3 SOLVED PROBLEMS

Illustration 1

Calculate Time ratio and Sales Ratio from the following information-

A limited company was registered on 1st January 2016 to take over a business as on 1st October 2015. The books of accounts are closed on 30th September 2016. The certificate of commencement of business was obtained on 1st February 2016. The turnover (sales) for the year ending 30th Sept 2016 was Rs 3,00,000 of which Rs 50,000 related to the period from 1st Oct 2015 to 1st January 2016. (Answer: TR 1:3 SR 1:5)

The Trading account showed a total gross profit of Rs 1,20,000 . How will the gross profit be allocated?

Illustration 2-

Calculate Time Ratio and Sales Ratio from the following information.

A limited company was incorporated on 1st July 2017 to take over a business as on 1st January 2017 and the company follows calendar year. The books of accounts were closed on 31st December 2017 and the monthly sales effected from 1st Jan to 31st December 2017 were as follows-

January, February, March and April - Rs 50,000 each month May, June Rs 75,000 each month and Sales from July to December was uniform at Rs 1,00,000 each month

Solution:

Time Ratio:

Accounting period – 1 January to 31st December 2017

Date of Incorporation 1st July 2017

Pre incorporation period – 1st January to 30th June 2017 – 6 months

Post Incorporation - 1st July to 31st December 2017 – 6 months

Time Ratio 1:1

Sales Ratio

Sales in pre incorporation period January to June -
50,000+50,000+50,000+50,000+75,000+75,000 = 3,50,000

Sales in the post incorporation period July to December-
1,00,000+1,00,000+1,00,000+1,00,000+1,00,000+1,00,000= 6,00,000

Sales Ratio – 3,50,000 : 6,00,000 or 7:12

Illustration 3

Big Co. Ltd took over the business of Small &Sons, a firm w.e.f. 1-4-2007. The company was registered on 1-11-2007. Profit and loss account for the year ended 31-3-2008 was as under-

Particulars	Amt(Rs.)	Particulars	Amt(Rs.)
To Salaries	2,40,000	By Gross profit b/d	12,60,000
To Rent and rates	1,80,000		
To Printing and stationery	96,000		
To Audit fees	30,000		
To Sundry expenses	24,000		
To Carriage outward	90,000		
To Advertising	63,000		
To Electricity charges	72,000		
To Commission on sales	1,08,000		
To Debenture interest	28,000		
To Depreciation	42,000		
To Interest on purchase consideration	27,000		
To Net profit c/f	2,60,000		
	12,60,000		12,60,000

Additional information:

1. Sales for each of the months July, August, September, January, February and March were twice the sales for each of the months April, May, June, October, November and December.
2. Depreciation shown above includes depreciation on furniture worth Rs. 2,40,000 @ 10% and on delivery van worth Rs.90,000 @ 20%. Both these assets were taken over from Small and sons.

3. Big Co. Ltd. settled Purchase consideration on 1st January,2008
4. Audit fees are payable for the whole year.

Prepare Profit and Loss account for the year ended 31st March, 2008 showing profits for pre- incorporation and post incorporation periods separately.

(University of Mumbai- October 2009)

Solution:--

WN - Time ratio-

Pre- incorporation period- 1-4-2007 to 1-11-2007(7 months)

Post- incorporation period- 1-11-2007 to 31-3-2008(5 months)

Time ratio - 7:5

Sales ratio-

Let monthly sales be-1

Pre-incorporation period- 1+1+1+2+2+2+1=10

Post- incorporation period-1+1+2+2+2=8

Sales Ratio- 10:8 or 5:4

Interest on purchase consideration-

(payable for 9 months from April to December)

Pre-incorporation- 1-4-2007 to 1-11-2007 (7 months)

Post- incorporation- 1-11-2007 to 31-12-2007(2 months)

Specific ratio- 7:2

Depreciation on assets- Furniture- 240000x10%= 24,000

Delivery van- 90,000x 20%= 18,000

Total Depreciation (24,000+ 18,000) = 42,000 in Time Ratio 7:5

Profit and Loss account for the year ended 31st March, 2008

Dr. Cr

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salaries	Time	1,40,000	1,00,000	By Gross profit	Sales	7,00,000	5,60,000
To Rent and taxes	Time	1,05,000	75,000				
To Printing &Stationery	Time	56,000	40,000				
To Audit fees	Time	17,500	12,500				

To Sundry expenses	Time	14,000	10,000				
To Carriage outward	Sales	50,000	40,000				
To Advertising	Sales	35,000	28,000				
To Electricity charges	Time	42,000	30,000				
To Commission on sales	Sales	60,000	48,000				
To Debenture interest	Post	----------	28,000				
To Depreciation	Time	24,500	17,500				
To Interest on purchase consideration	7:2	21,000	6,000				
To Capital Reserve (bal fig)		1,35,000	-----------				
To Net Profit (bal fig)		-----------	1,25,000				
Total		7,00,000	5,60,000	Total		7,00,000	5,60,000

Note: Alternatively the depreciation on Delivery van may be allocated in sales ratio also. The working note on depreciation will be as follows –

Depreciation on Furniture in Time ratio (Rs 24,000 in Time ratio) and Depreciation on delivery van in sales ratio (Rs 18,000 in sales ratio).

In such case the answer will change and profit before incorporation would be Rs 1,35,500 which will be transferred to capital reserve and the profit after incorporation would be Rs 1,24,500

Illustration 4

M/s Abani Offshore Ltd took over a running business with effect from 1st April, 2018. The company was incorporated on 1st September, 2018. The summarized Profit and Loss Account for the year ended 31st March,2019 is as under:

Particulars	Rs.	Particulars	Rs.
To Printing and Stationery	2,40,000	By Gross Profit	1,70,00,000
To Salaries	39,00,000	By Interest on Fixed Deposit	12,00,000
To Directors fees	5,00,000		
To Selling expenses	24,30,000		
To Debenture Interest	5,80,000		
To Auditors Fees	1,00,000		
To Rent and taxes	9,60,000		
To Office Expenses	6,00,000		
To Bad Debts	12,00,000		
To Preliminary Expenses	10,00,000		
To Net Profit	66,90,000		
	1,82,00,000		1,82,00,000

Additional Information:

1. It is ascertained that monthly sales from October 2018 to March 2019 was twice the average of the monthly turnover from April 2018 to September 2018.
2. Out of bad debts Rs. 2,00,000 relate to debts created prior to incorporation. Remaining bad debts are out of sales affected throughout the year.
3. Rent is doubled from 1st December, 2018.
4. Salaries include salary of three employees at equal monthly remuneration. However one of them was appointed as manager from 1st January, 2019. His salary was doubled from that date.
5. Vendors were entitled to 40% of the profit earned in Pre-incorporation period.
6. Interest on Fixed Deposit was received for the entire year.

Prepare the Statement of Profit and Loss in columnar form, showing distinctly the allocation of profits between pre incorporation and post incorporation periods, indicating the basis of allocation.

Solution:

Working Notes –

Time Ratio 5:7

Sales Ratio 5: 13

Basis for Allocating Rent 5:11

Salaries 15:24 or 5:8

Bad Debts Rs. 12,00,000

Rs 2,00,000 in pre incorporation (given)

Balance bad debts Rs 10,00,000 to be divided in Sales Ratio:

Pre incorporation: 2, 77,778

Post Incorporation: 7, 22,222

Total Pre Incorporation Bad Debts Amount:

2,00,000 + 2,77,778 = 477778

Post Incorporation Bad Debts=722222

Statement of Profit And Loss

For The Year Ended 31ST March 2019

	Pre-Incorporation	**Post-Incorporation**
INCOMES		
Gross profit (SR)	47,22,222	122,77,778
Interest on FD (TR)	+ 5,00,000	+ 7,00,000
Total Income (A)	52,22,222	129,77,778
EXPENSES		
Printing and Stationery (TR)	1,00,000	1,40,000
Salaries (5:8)	15,00,000	24,00,000
Directors Fees (Post)	-------------	5,00,000
Selling Expenses (SR)	6,75,000	17,55,000
Debenture Interest (Post)	--------------	5,80,000
Auditors fees (TR)	41,667	58,333
Rent and Taxes (5:11)	3,00,000	6,60,000
Office Expenses (TR)	2,50,000	3,50,000
Bad Debts (WN)	4,77,778	7,22,222
Preliminary expenses (Post)	------------	10,00,000
Total expenses (B)	33,44,445	81,65,555
Capital Reserve (A-B) (bal.fig)	18,77,777	
Net Profit (A-B) (bal.fig)		48,12,223

Illustration 5:

Avenue Ltd was incorporated on 1st August, 2017 to acquire the business of Shah and Bros from 1st April, 2017. The company received the certificate of commencement of business on 1st October, 2017.

The agreement also provided that vendors are entitled to 60% of Profits (or Loss, if any) for the period upto 1st August, 2017.

The following Profit & Loss Account for the year ended 31st March, 2018 is presented as under:

Particulars	Rs.	Particulars	Rs.
To Office Salaries	36,00,000	By Gross Profit	1,20,00,000
To Bad Debts	5,00,000	By Profit on sale of Investment	20,00,000
To Depreciation	18,00,000		
To Office rent	9,00,000		
To Commission on Sales	15,00,000		
To Debenture Interest	8,00,000		
To Directors Fees	8,00,000		
To Interest on Purchase Consideration	6,00,000		
To Net Profit	35,00,000		
	1,40,00,000		1,40,00,000

You obtained the following additional information :

(a) Monthly Sales for October, 2017 to March, 2018 is 150% of monthly sales for April, 2017 to September, 2017.

(b) Office rent was increased from Rs. 50,000 per month to Rs. 1,00,000 per month effective from 1st October, 2017.

(c) Investment was sold on 1st November, 2017.

(d) Bad debts were in respect of sales affected two years ago.

(e) Consideration to Vendors was paid on 1st October, 2017.

Prepare the Statement of Profit and Loss in columnar form, showing distinctly the allocation of profits between pre incorporation and post incorporation periods, indicating the basis of allocation.

Working notes-

Time Ratio 1:2

Sales Ratio 4:11

Interest on Purchase Consideration 4: 2 or 2:1

Interest is paid for 6 months from April to September.

(April, May, June, July) 4 months pre incorporation period

While (August and September) 2 months post incorporation period.

Office rent	Pre	Post
50,000x4 months	2,00,000	
50,000x2 months		1,00,000
1,00,000x6 months		6,00,000
Total office rent	2,00,000	7,00,000

Statement of Profit and Loss

For the year ended 31st March 2018

	Pre-Incorporation	Post-Incorporation
Incomes		
Gross Profit (SR)	32,00,000	88,00,000
Profit on Investment (Post)	-------------	+20,00,000
Total Income (A)	32,00,000	1,08,00,000
Expenses		
Office Salaries(TR)	12,00,000	24,00,000
Bad Debts(Pre)	5,00,000	----------
Depreciation (TR)	6,00,000	12,00,000
Office Rent(WN)	2,00,000	7,00,000
Commission on Sales (SR)	4,00,000	11,00,000
Debenture Interest(Post)	------------	8,00,000
Directors Fees(Post)	-------------	8,00,000
Interest on Purchase consideration (2:1)	4,00,000	2,00,000
Total Expenses (B)	33,00,000	72,00,000
Loss(A-B) Less Vendors share 60% Loss transferred to Goodwill	1,00,000 (60,000) 40,000	
Net Profit (A-B)		36,00,000

Illustration 6

Kalpana Limited was registered on 1st February 2013 to acquire the business of M/s. XYZ as on 1st October 2012. The accounts of the company for the period ended 30th September 2013 disclosed the following facts:

1) The turnover for the whole period 1st October 2012 to 30th September 2013 was Rs. 2,40,000 of which 40,000 related to the period from 1st October 2012 to 1st February 2013
2) The trading account showed a gross profit of Rs. 96,000
3) The following items appeared in the Profit and Loss Account:

a. Directors Fees – Rs. 1,500
b. Auditors fees – Rs. 750
c. Rent, rates and Taxes – Rs. 4,800
d. Bad debts (of which Rs. 700 related to book debts created before 1st February 2013) – Rs. 2000
e. Salaries – Rs. 12,000
f. Interest on Debentures – Rs. 6,000
g. Depreciation – Rs. 3,600
h. Preliminary expenses – Rs. 2,400
i. General Expenses – Rs. 1,800
j. Commission on sales – Rs. 3,600
k. Printing and Stationery – Rs. 2,400
l. Advertising – Rs. 4,200
m. Traveller's salaries – Rs. 8,400
n. Interest to Vendor at 10% p.a. on Rs. 1,00,000 from 1st October 2012 to 31st May 2013 – Rs. 6,667

Prepare a statement showing profits earned by the company prior to incorporation and after incorporation clearly indicating the basis of allocation of expenses. Assume Audit fees is for the entire year.

Solution-

WN 1

Time ratio – 1:2

Sales Ratio 1: 5

Total Turnover for the accounting periods = Rs 2,40,000

Sales in the pre incorporation period (OCT- FEB) = Rs. 40,000

Therefore Sales in post incorporation period = Rs. 2, 00,000

Therefore SR 1: 5

WN2

Interest to Vendor

10% on 1,00,000 for 8 months – Rs 6666.66

Rounded off to Rs 6667

Out of which from 1st October 2012 to 1st February 2013 –

4 months will be pre incorporation.

From 1st Feb 2013 to 31st May 2013-

4 months will be post incorporation.

Thus the amount will be allocated in the ratio 4: 4 or equally among the pre and post incorporation periods.

Statement showing Profit and loss

For the year ended 30th September 2013.

Particulars	Basis	Pre-Incorporation		Post-Incorporation	
		Debit	**Credit**	**Debit**	**Credit**
Gross Profit –SR	Turnover		16,000		80,000
Expenses					
Directors fees	Post			1,500	
Auditors fees –TR	1:2	250		500	
Rent , Rates	1:2	1600		3200	
Bad Debts	Given	700		1300	
Salaries	1:2	4000		8000	
Debenture Interest	Post			6000	
Depreciation	1:2	1200		2400	
Preliminary expenses	Post			2400	
General expenses	1:2	600		1200	
Commission on sales	1:5	600		3000	
Printing and Stationery	1:2	800		1600	
Advertising	1:5	700		3500	
Travellers Salary	1:5	1400		7000	
Interest to vendor	4:4	3333		3334	
Total of expenses		15183		44934	
Capital Reserve (Bal. fig)		817			
Net Profit (Bal Fig)				35066	
Total		16,000	16,000	80000	80,000

Illustration 7

Sunderam Brothers was taken over by Sunderam Ltd on 1st May 2017. However the company was incorporated on 1st February 2018. The following was the Profit and Loss a/c for the period from 1st May 2017 to 31st March 2018.

To Salaries	72,000	By Gross Profit	7,00,000
To Rent(Net)	39,000	By Discount	7,000
To Delivery van expenses	14,000		
To General Expenses	22,000		
To Advertisement expenses	3,50,000		
To Bad debts written off	14,000		
To Debenture Interest	70,000		
To Directors meeting fees	10,000		
To Preliminary expenses	4,000		
To Net profit c/d	1,12,000		
Total	7,07,000	Total	7,07,000

You are informed that –

a) Salaries in pre- incorporation and post- incorporation period were Rs 6,000 p.m and Rs 9,000 p.m respectively.

b) Gross profit percentage is fixed. Average monthly turnover is nine times in May, October and November 2017 as compared to average monthly turnover of remaining months .

c) Audit fees Rs 4,400 is to be provided for the above period.

d) Rent on the debit side is after subtracting rent received at Rs 4,000 p.m from 1st December 2017.

You are requested to prepare Statement of Profit and Loss in columnar form apportioning various incomes and expenses on suitable basis in the pre and post incorporation period from 1st May 2017 to 31st March 2018.

(Mumbai University April 2010)

Solution:

Working notes1:

Pre incorporation period 1st May 2017 to 1 Feb 2018 = 9 months
post incorporation 1st Feb. 2018 to 31st Mar. 2018 = 2 months
Time ratio (TR) 9:2 and
Sales ratio (SR) 33:2
WN-2 Salaries
Pre incorporation Rs 6,000x 9 months = 54,000
Post incorporation Rs 9,000x 2 months = 18,000
WN- 3 Rent received
Pre incorporation 4000 x 2 months = 8,000
Post incorporation 4,000 x 2 months= 8,000
WN-4 Rent paid
Pre incorporation 5,000x 9 months =45,000 post incorporation 5,000x 2 months =10,000
WN-4 Audit fees to be allocated in the Time ratio 9:2
In the books of Sunderam Ltd –
Profit and Loss a/c
For the period 1st May 2017 to 31st March 2018
Dr. Cr.

Particulars	Pre	Post	Particulars	Pre	Post
To Salaries –WN1	54,000	18,000	By Gross Profit -SR	6,60,000	40,000
To Rent –WN 3	45,000	10,000	By Rent received	8,000	8,000
To Delivery van expenses –SR	13,200	800	By Discount – SR	6,600	400
To General Expenses –TR	18,000	4,000	By Net Loss (Bal. Fig)		90,000
To Advertisement expenses - SR	3,30,000	20,000			
To Bad debts written off – SR	13,200	800			
To Debenture Interest- Post		70,000			
To Directors meeting fees- Post		10,000			
To Preliminary expenses –Post		4,000			
To Audit - TR	3,600	800			
To Capital Reserve (Bal Fig)	1,97,600				
	6,74,600	1,38,400		6,74,600	1,38,400

Illustration 8

Abhishekh Ltd was incorporated on 1st August 2017 to take over a running partnership business with effect from 1st April 2017. Following are the details of Income and Expenses for the year ended 31st March 2018

Particulars	Amt Rs	Amt Rs
Gross Profit		19,20,000
Less Expenses		
Directors Fees	98,000	
Rent	1,71,000	
Bad debts	24,000	
Salaries	3,66,000	
Interest on Debentures	45,000	
Depreciation	1,32,000	
Preliminary expenses written off	87,000	
General Expenses	98,400	
Commission on Sales	72,000	
Printing and Stationery	1,86,000	
Advertisement Expenses	2,41,000	
Audit Fees	1,17,200	
Carriage Outward	1,45,600	
Electricity charges	88,800	
Insurance Premium	48,000	
Net Profit	NIL	
	19,20,000	19,20,000

Additional information-

a) Rent is paid on the basis of floor space occupied .Floor space occupied was doubled in the post incorporation period

b) Sales for each month of December 2017 to March 2018 were double the monthly sales of April 2017 to November 2017.

c) Audit fees is for entire year

d) Bad debts Rs 4,000 is in respect of sales effected two years ago.

e) Mr Anil was a working partner in the firm entitled to a remuneration of Rs 24,000 per month From 1st August 2017, he was made the

Managing Director of the company and was entitled to salary Rs 30,000 per month. The remaining salary is to two clerks employed during the period from 1st July 2017 to 31November 2017.

Prepare a statement showing profits in the pre and post incorporation period separately.

Solution:

WN 1-

Time ratio- TR 4: 8 or 1: 2

Sales Ratio- SR 4:12 or 1: 3

WN-2

Bad debts total 24,000 to be allocated as under

	Pre	Post
Given	4,000	
Balance Rs. 20,000 in SR	5,000	15,000
TOTAL	9,000	15,000

WN-3

Rent to be allocated on the basis of floor space which was doubled in post incorporation ratio is 1:4

WN-4

Salary to Anil as partner

24,000 x 4 months= 96,000 in pre incorporation

Salary to Anil as Managing director –

30,000 x 8 months = 2,40,000 in post incorporation

Balance salary

3,66,000 – (96000+240000) = 30,000 to be paid to clerks from 1st July 2017 to 30th November in 1: 4 ratio

Statement Showing Pre and Post Incorporation Profit/ Loss

For The Year Ended 31st March 2018

Particulars	Basis	Pre	Post
Gross Profit	SR(1:3)	4,80,000	14,40,000
Less Expenses			
Directors fees	POST		98,000
Rent	WN 2 (1:4)	34,200	1,36,800
Bad debts	WN 1	9,000	15,000
Salary--- Anil	WN 3	96,000	2,40,000
Clerks	WN 3 (1:4)	6,000	24,000

Interest on Debentures	POST		45,000
Depreciation	TR (1:2)	44,000	88,000
Preliminary expenses written off	POST		87,000
General expenses	TR(1:2)	32,800	65,600
Commission on sales	SR	18,000	54,000
Printing and stationery	TR	62,000	1,24,000
Advertising expenses	SR	60,250	1,80,750
Auditors fees	TR	39,066	78,134
Carriage outward	SR	36,400	1,09,200
Electricity charges	TR	29,600	59,200
Insurance premium	TR	16,000	32,000
Total expenses		4,83,316	14,36,684
Loss transferred to Goodwill (Bal. Fig)		3,316	
Net Profit (Bal. Fig)			3,316

5.4 EXERCISE

Practical Problems

1. A limited company was incorporated on 1st July 2018 to take over business as a going concern as from 1stApril 2018. The profit and loss a/c was drawn as on 31st December 2018. Calculate Time ratio.

   (Answer: Time Ratio-3: 6 or 1:2)

2. A limited company was incorporated on 1st April 2018 to take over business with effect from 1st January 2018.The company prepared its Profit and Loss account for the year ended 31st March 2019.The company was able to double the average monthly sales from 1st April 2018. Calculate Time Ratio and Sales Ratio.

(Answer: Time Ratio 3: 12 or 1: 4 Sales Ratio 3: 24 or 1: 8)

3. A limited company took over the business of a partnership firm with effect from 1st January 2018. The company was registered on 1st August, 2018. Details of Income and expenses for the year ended 31st December 2018 is as under –

Particulars	Amt (Rs)	Amt (Rs)
Gross Profit		37,80,000
Less Expenses		
Salaries	7,20,000	
Rates and Insurance	5,40,000	
Printing and Stationery	2,88,000	

Audit Fees	90,000	
Directors Fees	72,000	
Carriage Outward	2,70,000	
Advertising	1,89,000	
Electricity charges	2,16,000	
Commission on sales	3,24,000	
Debenture Interest	84,000	
Depreciation	1,26,000	
Interest on Purchase consideration	81,000	30,00,000
NET PROFIT		7,80,000

Additional Information-

1) Sales for each of the months April, May, June, October, November and December were twice the sales for each of the months January, February, March, July, August and September.

2) The purchase consideration was settled on 1st November 2018.

3) Audit fees are payable for the entire year .Calculate the profits for Pre and post incorporation periods separately.

(Answer – Time Ratio 7: 5   Sales Ratio 5:4)

(Hints- Rs 81,000 Interest on Purchase consideration to be allocated in 7:

3 Ratio. Amount in pre incorporation Rs 56,700 and in post incorporation Rs 24,300 Final answer Profit prior to incorporation transferred to Capital Reserve Rs 453300 and Profit post incorporation Rs 326700)

4. RJ Ltd was incorporated on 1st August 2017 to acquire business as on 1st April 2017. The first accounts were closed on 31st March 20118. The following items appeared in the Profit and Loss Account .

Profit and Loss A/c for the year ended 31st March 2018
Dr   Cr

Particulars	Amt (Rs)	Particulars	Amt (Rs)
To Directors Fees	49,000	By Gross Profit	9,60,000
To Rent	85,500		
To Bad Debts	12,000		
To Salaries	1,83,000		
To Interest on Debentures	24,000		
To Depreciation	66,000		
To Preliminary expenses	42,000		

To General Expenses	49,200		
To Commission on Sales	36,000		
To Printing and Stationery	93,000		
To Advertising	1,20,000		
To Audit Fees	58,600		
To Carriage Outward	72,800		
To Electricity charges	44,400		
To Insurance Premium	24,000		
Total	9,60,000	Total	9,60,000

Additional Information-

1) Rent is paid on the basis of floor space occupied. The floor space was doubled in the post incorporation period.
2) Sales for each month of December 2017 to March 2018 were double the monthly sales of April to November 2017.
3) Bad Debts Rs 2,000 were in respect of sales effected two years ago.
4) Mr Amit was working partner in the firm entitled to a remuneration @ Rs 12,000 p.m from 1st August 2017. He was Managing Director of a company entitled to salary @Rs 15,000 p.m . The remaining salary is to two clerks employed during the period 1st July to 30th November 2017.You are required to prepare Statement of Profit and Loss for the year ended 31st March 2018 and show the Pre and post incorporation profit or Loss .

(Answer: Time Ratio 1:2 Sales Ratio 1: 3 Pre incorporation loss Rs 1658 Post Incorporation Profit Rs 1658)
(Hints-

- Bad debts Rs 12,000 Rs 2000 old bad debts to be shown in pre incorporation and balance (12000-2000=10,000) to be allocated in the sales ratio 1: 3 Allocation of Bad debts in -Pre incorporation period (2000+ 2500) 4500 and Post incorporation 7500.
- Rent to be allocated in 4: 16 ratio
- Salaries a) Amit pre incorporation 12000x4 months =48,000 post incorporation From August2017 to March 2018 8 months @ 15,000 per month 15000x8= 1,20,000 Total Salary as per P&L a/c Rs 1,83,000 Total salary to Amit (48000+ 120000) 1,68,000 Therefore balance amount to clerks for 5 months July to November is 183000-168000=15000

b) For clerks pre incorporation 1 month Rs 3000 and post incorporation for 4 months August to November 2017 3000x4 =12,000)

Objective Questions

5. Match the Columns-

GROUP A	GROUP B
1) Sales related expenses 2) Time related expenses 3) Share transfer fees 4) Debenture Interest 5) Partners Salaries 6) Pre- incorporation profit 7) Post incorporation profit	a) Transferred to Profit and loss Appropriation account b) Transferred to Capital Reserve c) Shown in debit side pre incorporation column only d) Shown in debit side post incorporation column only e) Shown in credit side pre incorporation column only f) Shown in credit side post incorporation column only g) Allocated in time ratio h) Allocated in Sales ratio

(Answers 1-h 2-g 3-f 4-d 5-c 6-b 7-a)

GROUP A	GROUP B
1) Gross Profit 2) Audit Fees 3) Profit prior to incorporation 4) Profit post incorporation 5) Loss prior to incorporation 6) Dividing point for pre and post incorporation 7) Preliminary expenses	a) is revenue profit b) Transferred to Goodwill account c) Date of incorporation d) is not available for dividend e) Allocated in Sales Ratio f) Allocated in Time ratio g) Shown in pre incorporation only h) Transferred to General Reserve i) Shown in post incorporation

(Answers - 1— e 2— f 3— d 4— a 5— b 6— c 7— i)

6. **State whether the following statements are True or False**

1) The fixed expenses are normally to be allocated in Time ratio- True

2) The variable expenses are normally to be allocated in sales ratio- True

3) Gross profit is to be allocated in Sales ratio- True

4) Directors fees are to be allocated equally in the Pre and Post incorporation periods –False

5) The Profit before incorporation is to be transferred to General Reserve – False

6) The Profit after corporation is a revenue Profit- True

7) While computing pre and post incorporation profits, Audit fees are allocated on Time basis – True

8) Profit prior to incorporation is available for payment of dividend – False

9) Loss prior to incorporation is debited to Goodwill account- True

10) Preliminary expenses should be debited to pre-incorporation period- False

7. **Multiple Choice Questions**

1) While calculating profit prior to incorporation, the fixed expenses are to be allocated _____
a) in Sales ratio b) in Time ratio
c) equally d) none of the above

2) While calculating profit prior to incorporation, the variable expenses are to be allocated _____
a) in Sales ratio b) in Time ratio
c) equally d) none of the above

3) While calculating profit prior to incorporation, the Directors fees are to be ______
a) allocated in sales ratio b) shown as pre incorporation expense
c) shown as post incorporation expenses d) ignored

4) While calculating profit prior to incorporation, the partners salaries are to be _______
a) allocated in sales ratio b) shown as pre incorporation expense
c) shown as post incorporation expenses d) ignored

5) The profit prior to incorporation is transferred to _________
a) Capital Reserve b) General Reserve
c) Securities Premium d) Goodwill

6) The share transfer fees are _______
a) to be shown on the credit side of P&L A/c in the pre-incorporation column
b) to be allocated equally
c) to be shown on the debit side of P&L A/c in the pre-incorporation column
d) to be shown on the credit side of P&L A/c in the post - incorporation column

(Answer: 1- b, 2- a, 3- c, 4- b, 5- a, 6- d.)

8. **Short Numerical Objective Questions –**

1) Kalpana Limited was registered on 1st February 2013 to acquire the business of M/s. XYZ as on 1st October 2012. The accounts of the company for the period ended 30th September 2013 disclosed the following facts:

a) The turnover for the whole period 1st October 2012 to 30th September 2013 was Rs. 2,40,000 of which 40,000 related to the period from 1st October 2012 to 1st February 2013

b) The Trading account showed a Gross profit of Rs. 96,000

Calculate Time Ratio and Sales Ratio. State how the Gross profit will be allocated between the pre and post incorporation periods.

(Answer- Time ratio 4:8 or 1:2 Sales Ratio 1: 5 Gross profit Rs 96,000 to be allocated in Sales Ratio Pre incorporation amount Rs 16,000 post incorporation Rs 80,000)

2) Friendship Ltd was incorporated on 1st April 2017 to take over business of the partnership firm with effect from 1st January 2017. The company prepared its Profit and Loss a/c for the year ended 31st March 2018. The company was able to double the average monthly sales from 1st April 2017. Calculate Time ratio and Sales ratio

(Answer Time Ratio 3:12 or 1:4 Sales Ratio 3:24 or 1:8)

3) Indo-Japan Ltd was incorporated on 1st May 2018 to take over a business as a going concern from 1st January of the same year. The total turnover for the year ended 31st December was Rs 2,00,000 namely Rs 60,000 for the first period upto 1st May and Rs 1,40,000for the remaining period. Calculate Time Ratio and Sales Ratio

(Answer Time ratio 4: 8 or 1:2 and Sales ratio 6:14 or 3: 7)

❖❖❖❖

6

FOREIGN BRANCH

Unit Structure

6.1 INTRODUCTION

A Foreign branch usually maintains a complete set of books under double entry principles. So, the accounting principles of a Foreign Branch will be the same as those applying to an Inland Branch. Before a Trial Balance of the Foreign Branch is incorporated in the

H. O. books, it has to be converted home currency.

6.2 RULES FOR CONVERSION

In case of fluctuating rates of exchange, the following rules for conversion are applied:

No	Nature of Account	Exchange Rate Applicable
1.	Fixed Assets	Rates ruling at the time they were acquired.
2.	Fixed Liabilities	Rates ruling as on the date of the Trial Balance.
3.	Current Assets & Liabilities	Rates ruling as on the date of the Trial Balance.
4.	Remittance sent by the branch	At the actual rates at which they were made.
6.	Goods received from H. O. as well as goods returned to H. O.	At the rate ruling on the date of dispatch or the date of receipt.
6.	The Nominal A/c's (except next two)	Average rate ruling during the accounting period.

7.	Depreciation on Fixed Assets	Rate of conversion applicable in case of the particular asset concerned [as indicated in (a) above].
8.	Opening and Closing stocks	Rates ruling of on the opening and closing dates respectively.
9.	Balance in H. O. A/c	Value at which the Branch A/c appears in H. O. books on the date.

6.3 BRANCH ACCOUNTING (FOREIGN BRANCH)

FOREIGN BRANCHES

When a branch is established abroad it is called as a Foreign Branch. The accounting arrangements for a foreign branch are exactly the same as for any independent branch up to the Trial Balance. But in this case accounts are maintained in foreign currency to correspond with the local conditions the main problem which the Head Office has to face is the restatement of accounts one currency into another. In order to incorporate the Trial Balance of a foreign branch in the books of the head office it must be translated (using appropriate exchange rates) into the currency of the Head Office.

Rules for conversion of Branch Trial Balance when ExchangeRates are 'Stable'

Exchange rate is said to be stable, when it does not vary to agreat extent from time to time. In this situation, a fixed exchange rate can be used to convert the branch Trial Balance into thecurrency of the Head Office with the exception of (a) Remittances, and (b) Head office Current Account.

a. Remittances: These are converted at the actual rates at which they were made.

b. Head Office Current Account: The actual figures shown for the Branch Current Account in the books of the Head Office (after taking into consideration in-transit items).

When the foreign branch Trial Balance is converted into localcurrency, a new Trial Balance takes birth known as "Difference on Exchange Account" is opened to make the Trial Balance agree.

Closing of Difference on Exchange Account

i. For debit entry on trialbalance

Profit and Loss Account	Dr.OR
Exchange Reserve Account	Dr. (if any)

To Difference on Exchange Account

ii. For credit entry on trialbalance

Difference on Exchange Account Dr. To Exchange Reserve Account Big Differences)

(If the difference is very small, it can credited to Profit & Loss account)

The format of the new Trial Balance of the branch is generally drawn up as follows:

Foreign Branch Converted Trial Balance as at 31st December, 2006

Sr. No.	Heads of	L. F.	Currency		Rate of Exchanq	Rupee	
			Dr. $	Cr. $		Dr.	Cr.

6.4 SOLVED PROBLEMS

Q.1 ABC Ltd. has a branch in New York as on 31st March 2011 the trial balance of the branch was as follows:

Particulars	Dr. $	Cr. $
Head office account	-	8,500
Goods from head office	44,000	-
Furniture	9,000	-
Bank Balance	1,250	-
Cash	250	-
Rent	1,200	-
Outstanding Expenses	-	800
Sundry debtors	3,150	-
Sales	-	61,000
Stock – 1.4.2010	8,500	-
Salaries	2,800	-
Insurance	150	
	70,300	**70,300**

The branch account in head office shows debit balance Rs.2,14,500 and goods sent to branch credit balance of Rs. 13,12,500.

Depreciation furniture @ 10% p.a.

Stock at branch 31st March 2011 was $ 7,500 Furniture was purchased in

1997 when 1$ = Rs. 20Exchange Rates were:

On 1.4.2010 1$= Rs. 28

On 31.3.2011 1$= Rs. 30

Average rate 1$= Rs. 29

You are required to prepare branch trial balance by converting in rupees and prepare branch trading and profit and loss a/c for the year ended 31.3.2011 and balance sheet as on that date.

Solution:

Converted Trial Balance as on 31st March 2011In the Books of Branch

Sr. no.	Particulars	Dr. ($)	Cr.($)	Rate	Dr. ($)	Cr. (Rs)
1	Head office account		8,500	Actual	-	214,500
2	Sales		61,000	29	-	1,769,000
3	Goods from Head Office	44,000	-	Actual	1,312,500	
4	Stock on 1-4-10	8,500	-	28	238,000	
5	Furniture	9,000	-	20	180,000	
6	Cash in box	250	-	30	7,500	
7	Bank Balance	1,250	-	30	37,500	
8	Salaries	2,800	-	29	81,200	
9	Rent	1,200	-	29	34,800	
10	Insurance	150	-	29	4,350	
11	Outstanding expenses	-	800	29		24,000
12	Sundry debtors	3,150	-	30	94,500	-
13	Difference in Exchange	-	-	30	17,150	-
		70,300	70,300		2,007,500	2,007,500

In the books of Branch, Trading & Loss a/c for the year ended 31st March 2011

Particulars	Dr. Amt	Particulars	Cr. Amt
To Opening stock a/c	238,000	By Sales	1,769,000
To Goods from H. O.	1,312,500	By Closing stock	226.000
To Rent	34,800		
To Gross profit c/d	408,700		
	1,994,000		1,994,000
To Salaries	81,200	By Gross profit b/d	408.700
To Insurance	4,350		
To Depreciation	18,000		
To Diff. in exchange	17,150		
To Net profit c/d	288,000		
	408.700		408.700

Balance sheet as on 31st March 2011

Liabilities		Amt	Assets		Amt
Head office a/c	2,14,500		Furniture	1,80,000	
Add: Net profit	2,88,000	5,02,500	Less: Depreciation	18,000	1,62,000
			Cash in box		7,500
Outstanding expenses		24,000	Bank balance		37,500
			Sundry debtors		94,500
			Closing Stock		2,25,000
		5,26,500			5,26,500

Q.2 The following balance appeared in the books of Surat branchof firm in London as on 31st December 2010.

Particular	Dr. Rs.	Cr. Rs.	Particular	Dr. Rs.	Cr. Rs.
Sales	-	225,000	Stock as on 1st Jan 2008	25,200	-
Debtors	78,000	-	Purchases	150,000	-
Bills Receivable	20,800	-	Wages/salaries	9,600	-
Head Office account	-	66,400	Rent, Rates, Taxes	7,200	-
Cash at Axis Bank	57,980	-	Furniture	9,820	18,200
Miscellaneous Exp	3,000	-	Bills payable Creditors		52,000
				361,600	**361,600**

Stock on 31st December 2010 was Rs. 65,000. Surat branch a/c in the books of London head office showed a debit balance of Rs. 2.680 on 1st December 2010.

Furniture was purchased from a remittance of Rs. 350 received from London H. O. which exactly covered the cost of the item.

The rates of exchange were:

31.12.2009 Rs. 28/1 pound

31.12.2010 Rs. 26/1 pound

The average rate for 2008 may be taken at Rs. 24 per 1 pound.

Prepare the trading and p&I account and balance sheet of Surat branch in the books of London H. O. assuming the branch operations to be integral to the main operation.Solution:

Converted Trail Balance as on 31st Dec. 2010

Sr. No.	Particulars	Rs.	Rs.	Rate	Pound	Pound
1	Stock as on 1.1.10	25,200	-	28	900	-
2	Purchases	1,50,000	-	24	6,250	-
3	Sales	-	2,25,000	24	-	9,375
4	Debtors	78,000	-	26	3,000	-
5	Creditors	-	52,000	26	-	2,000
6	Bills receivable	20,800	-	26	800	-
7	Bills payable	-	18,200	26	-	700
8	Wages/Salaries	9,600	-	24	400	-
9	Rent, rates, taxes	7,200	-	24	300	-
10	Miscellaneous exp	3,000	-	26	115	-
11	Furniture	9,820	-	-	350	-
12	Cash at Axit Bank	57,980	-	26	2,230	-
13	Head office a/c	-	66,400		-	2,680
14	Diff. in exchange	-	-		410	-
					14,755	14,755

Trading and profit n Loss a/c for the year ending 31.12.2010

Particular	Amt	Particular	Amt
To opening stock a/c	900	By sales	9,375
To purchases	6,250	By closing stock	2,500
To wages/salaries	400		
To gross profit c/d	4,325		
	11,875		11,875
		By gross profit b/d	4,325
To rent, rates and taxes	300		
To difference in exchange	410		
To N. P. c/d	3,615		
	4,325		4,325

Balance sheet as on 31st Dec 2010

Liabilities		Amt	Assets	Amt
Head office a/c	2,680		Debtors	3,000
Add: N. P	3,615	6,295	Bills Receivable	800
			Furniture	350
Creditors		2,000	Cash at Axis bank	2,230
Bills payable		700	Closing Stock	2,500
			Miscellaneous Exp	115
		8,995		8,995

Q.3 Kaun Banga Koredpati Computers Ltd. has head office at Mumbai and Branch at California. The branch submits the following trial balance as on 31st Mar. 2011.

Particulars	Dr. US $	Cr. US $	Assets	Dr. US $	Cr. Us $
Head office a/c	-	11,606	Salaries	71,130	-
Goods received			Office rent	44,316	-
From H.O.	12,725		Taxes & insurance	13,655	-
Purchases & sales	5,06,323	7,87,777	Debtorsand	1,17,117	-
Stock (1.4.10)	13,100		creditors	37,119	1,57,617
Plant & machinery	27,650		Printing & stationary	16,303	-
Furniture & fixtures	18,220		Postage & telegrams	14,784	-
Cash in hand	3,233		Freight	14,784	-
Cost atbank	60,180		conveyance	1,145	-

1. The branch a/c in H. O. showed a debit balance of Rs. 5,11,100 and goods sent to branch a/c showed a credit balance of Rs. 5,66,600.
2. Plant & machinery was acquired when US$ Rs. 46. furniture was acquired by branch on 1st Jan'11 when Rs. 100 were equivalent to US $ 2.50 H. O. office charges depreciation on plant & machinery @20% p.a. & on furniture & fixture @10%

p.a. The closing stock as on 31st Mar'11 at branch was US $ 16,550. The exchange rates were as under 1st Apr.'10 US $ 38.50 31st Mar'11 US $ 2.50 Aug US $ 44 convert the branch trial balance into rupees & prepare profit & loss a/c for the year ended 31st Mar'11 prepare balance sheet of California branch of Kaun Banega Karodpati Ltd. as on 31st Mar'11 the foreign operation is in the nature of an integral operation.

Solution:

Converted Trial Balance for the year ending 31st Mar'11

Particulars	Dr. ($)	Cr. ($)	Rate	Dr. ₹	Cr. ₹
Head office a/c	-	11606	Actual		511100
Goods received from H. O.	12725		Actual	566600	
Purchases & sales	506323	787777	44	22278212	34662188
Stock (1.4.10)	13100		38.50	504350	
Plant & Machinery	27650		46	1271900	
Furn & fixtures	18220		40	728800	
Salaries	71130		44	3129720	
Office rent	44316		44	1949904	
Taxes & insurance	13655		44	600820	
Drs/ & creditors	117117	157617	40	4684680	6304680
Priting & creditors	37119		44	1633236	
Printing & stationery	37119		44	717332	
Postage & telegram	16303		44	650496	
Freight	14784		44	50380	
Conveyance	1145		44	129320	
Cash in hand	3233		40		
Diff. in exchanges				2407200	
Cash at bank	60180		40	175018	
Diff in exchange				41477968	41477968

In the books of branch Trading and Profit & Loss a/c for year ended 31st Mar'11

Particulars	Amt	Particulars	Amt
To opening stock	5,04,350	By sales	34662188
To purchases	2,22,78,212		6,62,000
To goods from H. O.	5,66,600	By closing stock (16550 x 40)	
To gross profit c/d	1,19,75,026		
	35324188		35324188
To salaries	31,29,720	By gross profit b/d	1,19,75,026
To office rent	19,49,904		
To taxes & insurance	6,00,820		
To printing & stationery	16,33,236		
To postage & telegram	7,17,332		
To freight	650496		
To conveyance	50380		
To depreciation	327260		
To diff in exchange	1,75,018		
To net profit c/d	27,40,860		
	1,19,75,026		1,19,75,026

Balance sheet as on 31st Mar'11

Liabilities	Amt	Amt	Assets	Amt	Amt
Head office a/c	5,11,100		Plant &mach.	12,71,900	
(+) Net profit	2740860	3251960	(-) & fixtures	2,54,380	10,17,520
			(-) dep^n	728800	6,55,920
creditors		63,04,680	Debtors	72,880	46,84,680
			Cash in hand		1,29,320
			Cash at bank		24,07,200
			Closing stock		6,62,000
		9556640			9556640

Q.5 XY Ltd has a branch in New York. At the end of each year (Dec' 31) a trial balance sent by the branch in dollar currency is converted into rupee currency at the head office. (Bhopal)

The following trial balance for the year has been compiled at the branch as on 31st Dec.'10

Particulars	Dr. $	Cr. $
Bill receivable	2,500	-
Sundry debtors	3,800	-
Sundry creditors	-	1,100
Purchases	1,3,500	-
Sales	-	22,800
Furniture & fixtures	1,340	-
Stock (1st Jan'10)	2,000	-
Establishment expenses	2,000	-
Salaries	1,400	-
Rent, rates & taxes	400	-
Sundry expenses	1,450	-
Depreciation on furniture & fixtures	128	-

Remittances to H. O.	1,502	-
Head office account	-	6,920
Cash on hand & at bank	800	
	30,820	30,820

The stock in hand on Dec 31st '10 was \$ 2,500 the rates of exchange were:-

Dec 31'09 to June 30'10 1 \$ = 34 July 1st '10 to 31st Dec '10

1\$ = 36.

In the Bhopal books the balance of New York branch a/c & of the remittances from New York branch a/c appear as 1,78,847 & Rs. 37,068 respectively. The original furniture & fixture were boughtwhen the rate of exchange was \$ 1 = Rs. 30. Convest the above trail balance into rupee currency & prepare the final a/c of the branch.

Solution:

Converted trial bal. as on 31st Dec.'10 in bks of brch

Particulars	Dr. \$	Cr.\$	Rate	Dr.₹	Cr.₹
Bills receivable	2500		36	90,000	
Sundrydebtors	3,800		36	1,36,800	
Sundry creditors		1100	36		39,600
Purchases & sales	13500	22800	35	472500	798000
Furn & fixtures	1340		30	40,200	
Stock 1st Jan 2010	2000		34	68,000	
Establishment expenses	2000		35	70,000	
Salaries	1400		35	49,000	
Rent, rates & taxes	400		35	14,000	
Sundry expenses	1450		35	50,750	
Dep. On furn& fixture	128		30	3840	

Remittance to H. O.	1502		Actual	37068	
H O. account		6920	Actual		178847
Cash on hand& at bank	800		36	28800	
Diff in exchange					44511
				1060958	1060958

In the books of XY Ltd Co. Trading & Profit and Loss a/c forthe year ending 31st Dec'10

Particulars	₹	Particulars	₹
To opening stock	68,000	By sales	7,98,000
To purchases	4,72,500	By closing stock ($2500x 36)	90,000
To gross profit b/d	3,47,500		
	8,88,000		8,88,000
To establishment exps	70,000	By gross profit b/d	3,47,500
To salaries	49,000	By diff. in exchange	44511
To rent rates & taxes	14,000		
To sundry expenses	50,750		
To Dep on furniture	3,840		
To net profit c/d	2,04,421		
	3,92,011		3,92,011

Balance sheet as on 31st Dec'10

Liabilities	₹	₹	Assets	₹
H. O. current a/c	1,78,847		fixture	40,200
(+) net profit	2,04,421			
	383268		Bills receivable	90,000
(-) remittance	37068	346200	Sundry debtors	1,36,800
Sundry creditors		39,600	cash in hand & at bank	28800
			Closing stock	90,00
		3,85,800		3,85,800

6.5 EXERCISE

Q.1 White Coller Ltd have branch in Canada. On 31st December 2010 the trial balance of the branch was as given below.

Particulars	Dr. $	Cr. $
Stock as on 1.1.2010	7,500	-
Head office account	-	9,000
Sales	-	81,000
Goods from head office a/c	45,000	-
Furniture's and fixtures	10,000	-
Owing for expenses	-	-
Rent	1,000	-
Taxes. Insurance etc	250	-
Salaries	13,000	-
Sundry debtors	12,250	-
Cash in hand	1,050	-
Cash in bank	950	1,000
	91,000	**91,000**

The branch account in the head office showed a debit balance of Rs. 1,12,500 and goods sent to branch account a credit balance of Rs. 8,07,500.

Furniture and fixtures are acquired on 1.1.2010. 1 pound = Rs. 16. Provide depreciation @ 10% p.a.

The exchange rates were:> January 1 pound = Rs. 17.50

December 1 pound = Rs. 18.50

Average 1 pound = Rs. 18.00

The stock at branch on 31st December 2010 were valued at 4500 pounds. Prepare Trading, P & L A/c Balance Sheet of Canada branch account for the year ended 31.12.2010

Q.2 Zenith Computers Ltd. has H. O. at Mumbai and branch at Boston U. S. A. The branch submits the following trail branch as on 31st March 2011.

Particular	Dr. $	Cr. $
H. O. account	-	12,707
Goods received from H. O.	11,600	-
Purchases and sales	387,516	610,416
Stock as on 1.4.2010	14,316	-
Plant & Machinery	34,120	-
Furniture and fixtures	16,316	--
Cash at bank	3,816	-
Cash in hand	1,314	-
Salaries	68,016	-
Office rent	42,340	-
Taxes and insurance	11,672	-
Debtors and creditors	125,430	127,977
Printing and stationary	12,148	-
Postage and telegram	11,010	-
Courier charges	6,316	-
Internet charges	2,718	-
Legal expenses	2,452	-
	751,100	**751,100**

The branch account in head office showed a debit balance or Rs. 5,84,222 and goods sent to branch account showed a credit balance of Rs. 5,56,800. Plant & Machinery was acquired by the branch as on 31st December 2010, when 1US $ = Rs. 46. Furniture & fixtures were acquired by the Boston branch on 30th June 2010 when Rs. 100 was equal to US $ 2.50. H. O. provides depreciation on the P&M @ 25 % p.a. and on furniture and fixture @ 10% p.a.

The Boston branch reported closing stock of US$ 15,350 on 31st March 2002. The exchange rates were at under.

1.4.2010	US $ 1 = 43.50
31.3.2011	Rs. 100 = US $ 2.00
Average	US $ 1 = 46.50

Convert the branch trial balance into rupees and prepare branch profit and loss a/c for the year ended 31st March 2011. also you are required to prepare balance sheet of Boston branch Zenith Computers Ltd. as on 31st March 2011.

Q.3 GHCL & Co. has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch furnishes you with its trail balance as on 31st March 2011 and the additional information given thereafter.

Particulars	Dr. Rs.	Cr. Rs.	Particulars	Dr. Rs.	Cr. Rs.
Stock on 1.4.2004	300	-	Rent, rates & taxes	360	-
Purchases and sales	800	1,200	Sundry charges	160	-
Sundry debtors	400	-	Computers	240	-
Sundry creditors	-	300	Bank balance	420	-
Bills of exchange	120	240	New York office a/c	-	1,620
Wages and salaries	560	-			
				3,360	3,360

Additional Information:

1. Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.
2. Unsold stock of Mumbai branch was worth Rs. 4,20,000 on 31st march 2011.
3. The rates of exchange may be taken as follows:

   a. On 1.4.2010 @ Rs. 40 per US $

   b. On 31.3.2011 @ 42 per US $

   c. Average exchange rate for the year @ Rs. 41 per US $

   d. Conversion in $ shall be made upto two decimal accuracy.

You are asked to prepare in US $ the revenue statement of the year ended 31st March 2011 and the balance sheet as on that date of Mumbai branch as would appear in the book of New York head office of GHCL & Co.

You are informed that Mumbai branch account showed a debit balance of US $ 39,609.18 on 31.03.2011 in New York books and there were no items pending reconciliation. The foreign operation is in the nature of an integral operation.

Q.4 The foll. Balance appeared in the books of PQR Branch ofthe firm in Sydney on 31st Dec. 2010.

Particulars	Dr. Rs.	Cr. Rs.	articulars	Dr. Rs.	Cr. Rs.
Stock as on 1st Jan '10	50,400		Wages & salaries	19,200	
Purchases	3,00,000		Rent rates & taxes	14,400	
Debtors	1,56,000		Miscellan e ous exp	6,000	
Bills receivable	41,600		Furniture & fitting	19,640	
Sales		4,50,000	Cash at bank	1,15,960	
Creditors		1,04,000	Head office a/c		1,32,800
Bills payable		36,400			
				7,23,200	**7,23,200**

1. Stock as on 31st Dec'10 was Rs. 1,43,000 PQR Branch a/c in the books of Sydney head office showed Dr. balance on £5,360 on 31st Dec'10.

2. Furniture which exactly were purchased from a remittance of £ 700 received from Sydney head office which exactly covered the cost of item.

3. The rates of exchange were: 31st Dec' 09 Rs. 28 per £, 31st Dec'10 Rs. 26 per £. Average rate for year 2010 may be taken at Rs. 24 per £.

4. Prepare trading profit and loss a/c and balance sheet of PQR branch in the books of Sydney head office assuming branch operation to be integral to the main operations.

Q.5 KBK Ltd has a branch in Sydney, Australia at the end of 31st Mar 2011 the foll. ledger of the Sydney office.

Sydney (Australia Dollars thousand)

Particulars	**Dr. A$**	**Cr. A$**	**Particulars**	**Dr.A$**	**Cr. A$**
Plant & machinery (cost)	200	-	Goods sent to branch	5	
Prov. For plant			Wages & salaries	45	
& machinery	-	130	Rent	12	
Debtors / creditors	60	30	Office expenses	18	
Stock (1.4.10)	20		Commission receipts		100
Cash/bank balance	10		Branch H. O.		
Purchases/sales	20	123	Current a/c		7
				390	390

Theory Question

1. What is Foreign Branch Accounting.
2. Short note on Conversion of Foreign Branch Trial Balance**.**

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