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CS-EXECUTIVE  
(MODULE-2)

**CORPORATE & MANAGEMENT  
ACCOUNTING  
(Vol.-1)**

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*With the Blessings of*  
***“MAA SARASWATI”***

**Dedicated**  
**To My Lovely Parents**  
**Sh. MUNENDRA PAL SINGH TOMAR**  
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## **SEVEN GOLDEN MESSAGES TO ALL STUDENTS**

- ✚ *Dear student, always believe in yourself. You have the ability to do any kind of work whatever it is easy or tough. So be confident and work hard to get your dream.*
- ✚ *Be a good human who helps everyone. Be a good partner, a good friend, a good soul who is honest, trustworthy and responsible. Happiness will find you.*
- ✚ *You are the person who can change the world. You have a big responsibility to make the world better. I know you can do this very well. All the best my dear student.*
- ✚ *Dear, my true success will be seeing you in a better position. Wishing you will be a successful person in life, that will be the best gift for me. So work hard and achieve your success.*
- ✚ *In your life, you will face many bad and hard times. Never lose hope in your bad time. After the heavy rain, we can see the sunshine. Always be positive.*
- ✚ *I am proud that I have got the chance to teach you. You all are very brave and active. Always keep this spirit up. I wish you all the very best.*
- ✚ *Dear Student, there is nothing you can't do, only thing is that you really want to do or not. If you really want then nothing is impossible for you my dear. Yes you may fail some times to achieve your success but remember "You are not defined by failure, but you are empowered by them."*



Thanking You

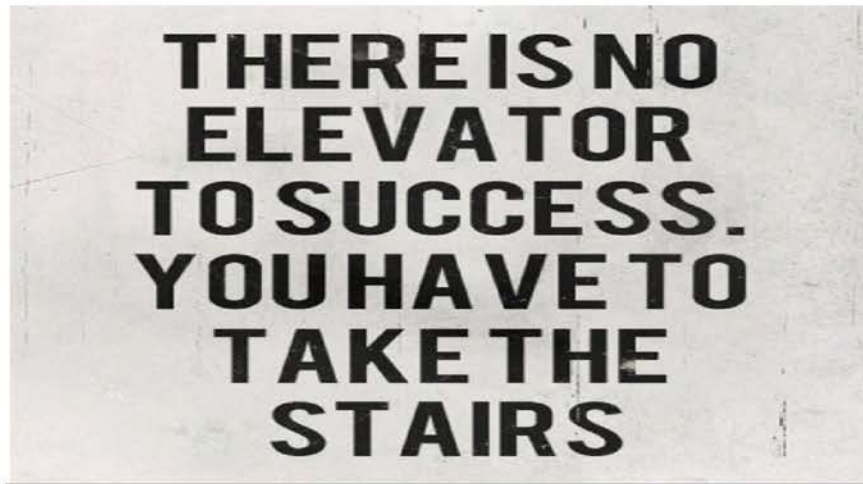
CA Anuj Singh Tomar

(CA, B.Com (Hons.))

# YOUR & MY DREAM



**“Always Remember there is no shortcut of Success”**



**“Don’t stop yourself because nothing is impossible for you.”**

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# **CHAPTER-1 | ISSUE OF SHARE CAPITAL**

*"A company is an artificial person, created by law having separate entity with a perpetual succession and a common seal"*

*By Prof. Haney*

## **Features of Company:**

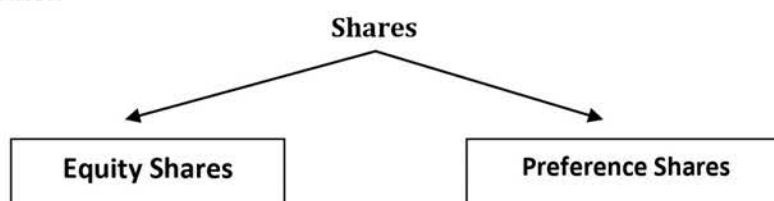
1. Separate legal Entity from its member.
2. Artificial Person created by law.
3. Perpetual Succession i.e. its existence cannot be affected by death, lunacy, or insolvency of its member.
4. Limited Liability of its member.
5. Common Seal
6. Transferability of shares allowed except in private companies.

## **Kinds/Types of Companies**

1. One Person Company
2. Private Company
3. Public Company

Basis	One Person Company	Private Company	Public Company
1. No of Member	Min = 1 Max = 1.	Min = 2, Max =200	Min = 7 Max = unlimited
2. Number of director	Min = 2 and Max 15.	Min = 2 and Max 15.	Min = 3 and Max 15.
3. Transferability of Shares	Not Applicable	Article of Association may restricts	Allowed
4. Prospectus	Not Applicable	Not required	Must be required to invite public to subscribe shares.
5. Subscription of Shares	Shares cannot be offered to Public	Shares cannot be offered to Public	Shares can be offered to Public
6. Name	The word "OPC" is used at the end of Name of Company	The word "Private Limited" is used at the end of Name of Company	The word "Limited" is used at the end of Name of Company
7. Public Deposit	Can not accepted	Can not accepted	Can accepted

**SHARE:** According to sec 2 (84) of companies Act 2013 'share' means share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied where a distinction between stock and share is expressed or implied. A share is one unit into which the total share capital is dividend. The nature of shares of a company are considered as movable asset which can be transferable.



## 1. Preference Shares:

These are those shares, which carry the following preferential rights as to:

1. The payment of dividend at a fixed rate and
2. The return of capital on winding up of the company

### Types/Classes of preference shares capital:

#### A. On the basis of Dividend

- i. **Cumulative Preference Shares:** Those preference shares whose holders are entitled to receive **arrears of dividend** before any dividend is paid to equity shareholders.
- ii. **Non Cumulative Preference Shares:** Those preference shares whose holders **do not have the right to receive arrears of dividend** before any dividend is paid to equity shareholders.

#### B. On the basis of Participation

- i. **Participating Preference Shares:** These shares have right to receive share in surplus profit, if any, after providing dividend at a stipulated rate to equity shareholders in addition to the fixed percentages of preference dividend.
- ii. **Non Participating Preference Shares:** These shares get only a fixed percentage of preference dividend every year.

#### C. On the basis of Convertibility

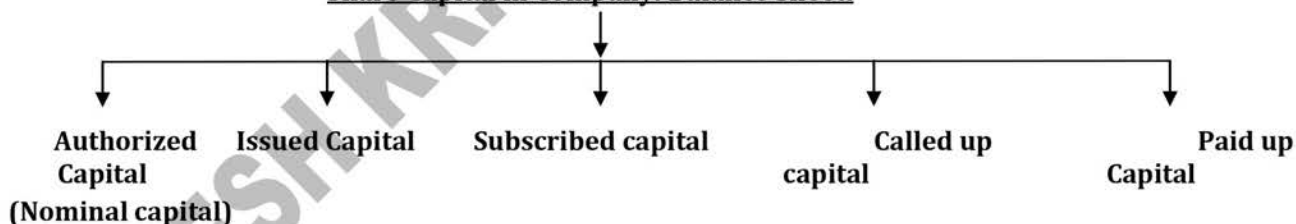
- i. **Convertible Preference Shares:** Preference shareholders have option to get converted into equity shares.
- ii. **Non Convertible Preference Shares:** Preference shareholders do not have option to get converted into equity shares.

## 2. Equity Shares:

These are those shares, which are not preference shares.

There are normally risk-bearing shares.

### Share Capital in Company: Balance Sheet:



#### 1. Authorised / Nominal Share Capital:

Authorised or Nominal capital means such capital as is authorised by the memorandum of a company to be maximum amount of share capital of a company.

#### 2. Issued Share Capital:

Issued Share Capital means such part of capital which company issues to the public for subscription

#### 3. Subscribed Share Capital:

- ✓ Subscribed Share Capital means such part of capital which is for the time being subscribed by member of company.
- ✓ Subscribed Capital is also classified under the followings:

##### 1. Subscribed and fully Paid up

Shares are classified into this category when:



- c) The company has fully called up face value of shares but not received fully, or  
d) The company has not called fully face value of share.

### Entries on First Call:

(5) When Shareholders are informed to pay the First Call:

Share capital A/c                      Dr.  
    To Share Capital A/c  
(First call due on .... Shares at the rate of `.. Per share)

(6) On receipt of First Call Money:

Bank A/c                                  Dr.  
    To Share First Call A/c  
(First Call money received on ... shares at the rate of ` ...per share)

### Entries on Second Call:

(7) When shareholders are informed to pay the Second Call:

Share Second Capital A/c              Dr.  
    To Share Capital A/c  
(Second call due on .... shares at the rate of ` ...Per share)

(8) On receipt of Second Call money:

Bank A/c                                  Dr.  
    To Share Capital Call A/c  
(Second Call money received on .... Shares at the rate of `... per share)  
Similarly, entries for other calls may be prepared.

### Issue of Shares at Par

Shares are issued at par when they are issued at a price equal to the face value. For example, if a share of `10 is issued at `10, it is said that the share has been issued at par.

- All monies received shall be kept in a separate bank account maintained with a scheduled bank

### Important provisions of Companies Act, 2013 & SEBI Guidelines relating to issue of shares.

- When a public company desires to raise capital by issuing its shares to the public, it invites the public to subscribe for its shares. The invitation is made through a document called the "Prospectus". The prospectus must mention the exact manner in which the amount of shares is payable by the public.
- No allotment of shares can be made in pursuance of a prospectus issued generally, until the beginning of the 5<sup>th</sup> day after that on which the prospectus is first so issued.
- As per the SEBI Guidelines, the subscription list for public issues should be kept open for **at least 3 working days and not more than 10 working days** as disclosed in the prospectus.
- No allotment shall be made in the case of first allotment of shares unless the amount stated in the prospectus as the minimum subscription has been subscribed and the sum payable on application for the stated amount has been received by the company.
- As per SEBI Guidelines, the **minimum subscription** has been fixed at **90%** of the issued amount.
- As per **Section 39(2)**, the **amount payable on applications money** to be paid shall not be less than 25% of the issue price.
- If the shares of a company are listed in a stock exchange, approval of the stock exchange has to be sought as to the manner of allotment before the shares are allotted.
- As per **Section 29**, every company making public offer and such other class or classes of public companies as may be prescribed, shall issue the securities only in dematerialized form by complying with the provisions of the Depositories Act, 1996 and the regulations made there under.
- **Table F of the Companies Act, 2013** imposes the following restrictions :
  - Period of one month must elapse before another call is made,
  - The amount of the call should not exceed 1/4<sup>th</sup> of the nominal value of the share, and
  - **14 days notice** is given to the shareholders to pay the amount.



## Issue of shares at premium

When shares are issued at a price higher than the face value, they are said to be issued at a premium. Thus, the excess of issue price over the face value is the amount of premium. For example, if a share of Rs. 10 is issued at Rs. 12 Rs. (12-10) = Rs. 2 is the premium.

The premium on issue of shares must be regarded as **Capital receipt** and must be credited to a separate account called "Securities Premium Account" There are no restrictions on the issue of shares at a premium, but there are restrictions on its disposal.

## Securities Premium Account:

The premium on issue of shares is not to be treated as revenue profits. In fact it is considered as capital receipt.

As per the Companies Act, 2013, when a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium collected on shares must be credited to a separate account called "Securities Premium Account". There are no restrictions in the Companies Act on the issue of shares at a premium, but there are certain restrictions at the time of its disposal.

**Restrictions on application of premium money received: Under Section 52(2) of the Companies Act, 2013, the Securities Premium Account may be applied by the company -**

**(a) towards the issue of unissued shares of the company to the members of the company as fully paid**

**bonus shares;**

**(b) in writing off the preliminary expenses of the company;**

**(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or**

**debentures of the company;**

**(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or**

**(e) for the purchase of its own shares or other securities under section 68.**

It is to be noted here that utilization of the amount of Securities Premium Account except in any of the modes specified above, will attract the provisions relating to the reduction of share capital of a company under the Section 66 of the Companies Act, 2013.

**Disclosure:** The Securities Premium Account must be shown as "**Securities premium reserves**" separately on the liabilities side of the balance sheet under the head "**Reserves & Surplus**".

**Note:** The premium is usually payable with the installment due on allotment. However, some companies may charge premium with share application money or partly with share application money and partly at the time of allotment of shares. It may be included in call money also.

## Issue of shares at discount

- When shares are issued at a price lower than the face value, they are said to be issued at discount.
- The Companies Act, 1956 contained provisions for issue of shares at a discount, but the **Companies Act, 2013 totally prohibits** the issue of shares at discount.
- **Section 53** provides that, a company shall not issue shares at a discount. Any share issued by a company at a discounted price shall be **void**.
- **Penalty :** Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh and every officer who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh or with both.

## **Issue of shares for consideration other than cash**

A company may also issue shares for consideration other than cash to vendors who sell some assets to the company or to the promoters for their services. Such issue may be one of the following types:

- (1) **Issue of shares to vendors** : A company may purchase assets from the vendors and instead of paying the vendors cash, may settle the purchase price by issuing fully paid shares of the company. This type of issue of shares to the vendors is called issue of shares for consideration other than cash.
- (2) **Issue of shares to promoters** : A company may allot fully paid shares to promoters for the services rendered for incorporation of company. This type of issue of shares to promoters is called issue of shares for consideration other than cash. As the amount paid to promoters for services rendered is capital expenditure and debited to Good will Account.

## **Can a company pay dividend on partly paid-up shares?**

As per **Section 51** of the **Companies Act, 2013**, a company may, if so authorized by its articles, pay dividends in proportion to the amount paid-up on each share. Thus dividend can be paid on partly paid up shares in proportion to the amount paid-up on each share.

## **Calls-in-Advance**

A company may receive from a shareholder the amount remaining unpaid on shares. This is known as calls-in-advance. The **Companies Act, 2013** specifically allows companies to accept calls-in-advance.

**Section 50** provides that the company may, if so authorized by its articles, accept from any member, the whole or a part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up. However person paying calls in advance have voting right in respect of amount paid-up on shares only.

**Interest on calls-in-advance: Regulation 18 of Table F of the Companies Act, 2013** provides that the Board may receive from any member calls in advance and may pay interest at such rate not exceeding **12% p.a.** The company is liable to pay interest on the amount of calls-in-advance from the date of receipt of the amount till the date when the call is due for payment.

It is noted that the money received on calls-in-advance does not become part of share capital. It is shown under a separate heading, namely 'calls-in-advance' on the liabilities side.

No dividend can be paid on calls-in-advance.

## **Calls-in-Arrear**

When calls are made upon shares allotted, the shareholders holding the shares are bound to pay the call money within the date fixed for such payment. If a shareholder makes a default in sending the call money within the appointed date, the amount thus failed is called calls-in-arrear.

**Interest on calls-in-arrear: Regulation 16 of Table F of the Companies Act, 2013** provides that, if a call is not paid before or on the day appointed for payment, the shareholder shall pay interest from the day appointed for payment thereof to the time of actual payment at **10% p.a.** or at such lower rate, as the Board may determine. The Board shall be at liberty to waive payment of any such interest.



## Distinguish between : Calls-in-Advance & Calls-in-Arrear

Following are the main points of distinction between calls-in-advance & calls-in-arrear.

Point	Calls-in-Advance	Calls-in-Arrear
<b>Meaning</b>	A company may receive from a shareholder the amount remaining unpaid on shares. This is known as calls-in-advance.	When calls are made upon shares allotted, the shareholders holding the shares are bound to pay the call money within the date fixed for such payment. If a shareholder makes a default in sending the call money within the appointed date, the amount thus failed is called calls-in-arrear.
<b>Interest</b>	<b>Regulation 18 of Table F of the Companies Act, 2013</b> provides that the Board may receive from any member calls in advance and may pay interest at such rate not exceeding <b>12% p.a.</b> The Company is liable to pay interest on the amount of calls-in-advance from the date of receipt of the amount till the date when the call is due for payment.	<b>Regulation 16 of Table F of the Companies Act, 2013</b> provides that, if a call is not paid before or on the day appointed for payment, the shareholder shall pay interest from the day appointed for payment to the time of actual payment at <b>10% p.a.</b> or at such lower rate, as the Board may determine.
<b>Nature</b>	<b>Interest on calls-in-Advance</b> is expenses and debited to profit & loss account.	Interest on calls-in-arrear is income and credited to profit & loss account.

## Forfeiture of shares

### Meaning & Procedure :

In case where a shareholder fails to pay the allotment money and/or calls made on him, his shares are liable to be forfeited. Forfeiture of shares may be said to be the compulsory termination of his membership by way of penalty for non-payment of allotment and/or any call money.

**Effect:** The effect of forfeiture of shares is that the defaulting shareholder loses all his rights in the forfeited shares and ceases to be a member of the company. The name of the shareholder is removed from the Register of Members and the amount already paid by him is forfeited. He is not entitled in future to dividends and rights of membership.

**Illustration :** S.K. Ltd. issued 100000 shares of Rs. 10 each payable as Rs. 2 on application, Rs. 2 on allotment, Rs. 3 on first call and Rs. 3 on second and final call. Mr. Harish, the allottee of 100 shares, fails to pay the second and final call money made by the company. In this case if the Board of Directors decides to forfeit his shares, his membership will be cancelled and the amount of Rs 700 paid by him (on 100 shares Rs. 2 on application, Rs. 2 on allotment and Rs. 3 on first call per share) will be forfeited. Now Mr. Harish will no longer be the member of the company and the issued capital of the company will be reduced by Rs. 1000.

### Procedure for Forfeiture of Shares

Articles of Association of the Company provide the authority to forfeit shares to the Board of Directors.

- The Board has to give at least 14 days' notice to the defaulting members calling upon them to pay outstanding amount, with or without interest as the case may be, before the specified date.
- The notice must also state that if the shareholders fail to remit the amount mentioned therein within the stipulated period, their shares will be forfeited.
- If they still fail to pay the amount within the specified period of time, the Board of Directors of the company may decide to forfeit such shares by passing a resolution.
- The decision regarding the forfeiture of shares should be communicated to the concerned allottees



**Disclosure:** Forfeited shares account is to be shown in the balance sheet by way of addition to the paid-up share capital on the 'liabilities' side, until the concerned shares are reissued.

## **Re-issue of forfeited shares**

**Regulation 31 of Table F of the Companies Act, 2013** provides that, forfeited share may be sold or otherwise disposed of on such terms and in such manner as the Board thinks fit. Thus, even though originally shares cannot be issued at discount, but forfeited shares can be issued at discount.

- The amount receivable on re-issue of such shares together with the amount already received from the defaulting member shall not be less than the face value of the shares.
- If forfeited shares are re-issued at a discount, the amount of discount can, in no case, exceed the amount credited to "shares forfeited account".
- Discount allowed on re-issue should be less than the forfeited amount.
- After reissue of forfeited shares amount left in 'shares forfeited account' which will be transferred to 'capital reserve account' will appear under the head "Reserves and Surplus".

## **ISSUE OF SWEAT EQUITY SHARES**

**Introduction:** Sweat equity shares refer to equity shares which are given to the company's employees on favourable terms, in recognition of their work. Sweat equity shares are one of the modes of making share based payments to employees. Sweat equity shares rewards the beneficiaries by giving them incentives in lieu of their contribution towards development of the company. Further, sweat equity shares facilitate greater employee stakes as well as interest in company's growth and encourages employees to add more value towards the company.

### **Definition**

(1) Sweat Equity Shares: As per Section 2(88) of the Companies Act, 2013 "sweat equity shares" means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;

### **Conditions to be fulfilled**

- (1) Not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business;
- (2) The issue is authorized by a special resolution passed by the company;
- (3) The resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- (4) The special resolution authorizing the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.
- (5) The sweat equity shares issued to directors or employees shall be locked in/non-transferable for a period of three years from the date of allotment and the fact that the share certificates are under lock-in and the period of expiry of lock-in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.
- (6) Where the equity shares of the company are listed on a recognized stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with the Companies (Share Capital and Debentures) Rules, 2014.

### **Quantum of sweat equity share**

The company shall not issue sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. Provided that the issuance of sweat equity shares in the company shall not exceed twenty five percent, of the paid up equity capital of the company at any time.



Provided further that a startup company, as defined in notification number GSR 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, may issue sweat equity shares not exceeding fifty percent of its paid up capital upto five years from the date of its incorporation or registration.

### **Pricing of sweat equity share**

- (1) The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.
- (2) The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of Directors with justification for such valuation.
- (3) A copy of gist along with critical elements of the valuation report obtained under clause (1) and clause (2) shall be sent to the shareholders with the notice of the general meeting.

### **Procedure for issue of sweat equity share**

For issue to sweat equity shares, the following broad procedure needs to be followed:

- (1) Convene and hold a board meeting to consider the proposal of issue of sweat equity shares and to fix up the date, time, place and agenda for general meeting and to pass a special resolution for the same.
- (2) Issue notices in writing to shareholders for general meeting alongwith explanatory statement. The explanatory statement to be annexed to the notice for the general meeting pursuant to section 102 of the Act must contain the following particulars:
  - (a) the date of the Board meeting at which the proposal for issue of sweat equity shares was approved;
  - (b) the reasons or justification for the issue;
  - (c) the class of shares under which sweat equity shares are intended to be issued;
  - (d) the total number of shares to be issued as sweat equity;
  - (e) the class or classes of directors or employees to whom such equity shares are to be issued;
  - (f) the principal terms and conditions on which sweat equity shares are to be issued, including basis of valuation;
  - (g) the time period of association of such person with the company;
  - (h) the names of the directors or employees to whom the sweat equity shares will be issued and their relationship with the promoter or/and Key Managerial Personnel;
  - (i) the price at which the sweat equity shares are proposed to be issued;
  - (j) the consideration including consideration other than cash, if any to be received for the sweat equity;
  - (k) the ceiling on managerial remuneration, if any, be breached by issuance of such sweat equity and how it is proposed to be dealt with;
  - (l) a statement to the effect that the company shall conform to the applicable accounting standards; and
  - (m) diluted Earnings per Share pursuant to the issue of sweat equity shares are calculated in accordance with the applicable accounting standards.
- (3) Convene the General Meeting and Pass a special resolution;
- (4) File the resolution with MCA in Form No. MGT-14 within 30 days of passing the same;
- (5) Call a Board meeting and allot sweat equity shares in the meeting;
- (6) File Form No. PAS-3 within 30 days of passing of the Board resolution for allotting sweat equity shares;
- (7) The company shall maintain a Register of Sweat Equity Shares in Form No. SH-3 and shall forthwith enter therein the particulars of Sweat Equity Shares issued.
- (8) The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide.
- (9) The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

### **Disclosure in the directors' report in respect of sweat equity share**

The Board of Directors shall, inter alia, disclose in the Directors' Report for the year in which such shares are issued. The following are the details about the issue of sweat equity shares namely:

- (1) the class of director or employee to whom sweat equity shares were issued;
- (2) the class of shares issued as Sweat Equity Shares;
- (3) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them, if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital;



- (4) the reasons or justification for the issue;
- (5) the principal terms and conditions for the issue of sweat equity shares, including pricing formula;
- (6) the total number of shares arising as a result of issuing of sweat equity shares; the percentage of the sweat equity shares of the total post issued and paid up share capital;
- (8) the consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares;

### **Accounting treatment of sweat equity share issued**

(1) Where sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company

(a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or

(b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

(2) The amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purposes of sections 197 and 198 of the Act, if the following conditions are fulfilled, namely:-

(i) the sweat equity shares are issued to any director or manager; and

(ii) they are issued for consideration other than cash, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the applicable accounting standards.

(3) In respect of sweat equity shares issued during an accounting period, the accounting value of sweat equity shares shall be treated as a form of compensation to the employee or the director in the financial statements of the company, if the sweat equity shares are not issued as pursuant to the acquisition of an asset.

(4) If the shares are issued as pursuant to the acquisition of an asset, the value of the asset, as determined by the valuation report, shall be carried in the balance sheet as per the Accounting Standards, and such amount of the accounting value of the sweat equity shares that is in excess of the value of the asset acquired, as per the valuation report, shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

### **ISSUE OF RIGHT SHARES**

**Meaning:** Right issue means offering shares to existing members in proportion to their existing shareholding

(1) Where at any time, a company having a share capital proposes to increase its subscribed capital by the issuing further shares, such shares shall be offered –

(a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid up share capital on those shares by sending a letter of offer subject to the following conditions, namely: -

(i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

(ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement about this right;

(iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice was given and he declined to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and company;

(b) to employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed; or

(c) to any persons, if it is authorized by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

(2) The notice referred to in sub-clause (i) of clause (a) of sub-section (1) shall be despatched through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.



(3) Nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company:  
Provided that the terms of issue of such debentures or loans containing such an option have been approved before the issue of such debentures or the raising of loans by a special resolution passed by the company in the general body meeting.

NITESH KR. JAISWAL CS CLASSES

## PRACTICE QUESTIONS

**Q 1 X Ltd. issued 30,000 shares of Rs.10 each, payable as under:**

Rs 3.00 on Application	Payable on 1 <sup>st</sup> April 2005
Rs. 2.00 on Allotment	Payable on 1 <sup>st</sup> June 2005
Rs. 2.50 on First Call	Payable on 1 <sup>st</sup> September 2005
Rs. 2.50 on Final Call	Payable on 1 <sup>st</sup> February

**Application were received for 50,000 shares and the allotments were made as under:**

To application for 24,000 shares	Full
To applicants for 18,000 shares	6,000
To applicants for 8,000 shares	Nil

**Applications were received on application was utilized towards allotment & subsequent calls, interest on calls in advance was paid @ 6% annum.**

**On 15<sup>th</sup> February 2006, the company also allotted 800 shares of Rs. 10 each at the rate of Rs. 9 per share as sweet equity shares to the employees of the company.**

**Journalize the transactions, assuming all sums due were received and company closes its books every year on 31<sup>st</sup> March.**

**Solution:**

2005 April 1	Bank A/c Dr. To Share Application A/c (Applications money received on 50,000 shares)	1,50,000	1,50,000
June 1	Share Application A/c Dr. To Share capital A/c To Allotment A/c To Call in Advance A/c To Bank A/c (Transfer of application money on 30,000 shares @ `3 on share capital a/c; on 6,000 shares @ `2 to Share Allotment a/c and excess amount to Calls in Advance A/c and amount returned on 8,000 shares)	1,50,000	90,000 12,000 24,000 24,000
June 1	Share Allotment A/c Dr. To Share Capital A/c (Allotment due on 30,000 shares)	60,000	60,000
June 1	Bank A/c Dr. To Share Allotment A/c (Allotment received less `12, 000 received along with applications)	48,000	48,000
Sept. 1	Share First Call A/c Dr. To Share Capital A/c (First call due on 30,000 shares)	75,000	75,000
Sept. 1	Bank A/c Dr. Calls in Advance A/c Dr. To Share First Call A/c (First Call money received less `15, 000 received in advance)	60,000 15,000	75,000
2006 Feb 1	Share Final Call A/c Dr. To Share Capital A/c (Final Call due on final Call)	75,000	75,000
Feb 1	Bank A/c Dr. Call in Advance A/c Dr To Share Final Call A/c	66,000 9,000	75,000

	(Amount received on final call after adjustment of call in advance money)		
Feb 1	Interest on Calls in advance A/c Dr. To Bank A/c (Interest on calls in advance)	585	585
Feb 15	Bank A/c Dr. Share Discount A/c Dr. To Share Capital A/c (Allotment of 800 sweat equity shares @ `9 each to the employee of the company)	7,200 800	8,000
March 31	Profit & Loss A/c Dr. To interest on Calls in Advance A/c (Interest on Calls in Advance transferred to Profit & Loss A/c)	585	585

**Working Note: (1)** Applicants for 18,000 shares have been allotted 6,000 shares. Hence, excess application money received

On 12,000 shares @ `3 per share = `36,000

Less: Amount adjusted on Allotment on 6,000 shares

@ `2 per share = `12,000

Balance = `24,000

This amount of `24,000 will be transferred to Calls in Advance A/c, as it will be adjusted on future calls.

Less: Amount adjusted on 1<sup>st</sup> Call on 6,000 shares

@ `2.50 per share = `15,000

Balance `9,000

This amount of `9,000 will be adjusted on Second Call.

**(2)** Interest will be allowed only on `24,000, as interest is allowed only on that amount, which is transferred to "Calls in Advance A/c".

Out of this amount:

Interest on `15,000 will be allowed from Allotment to first call, i.e., for 3 months.

Interest on `9,000 will be allowed from Allotment to Second Call i.e., for 8 months.

$$15,000 \times \frac{6}{100} \times \frac{3}{12} = \text{Rs.}225$$

$$9,000 \times \frac{6}{100} \times \frac{8}{12} = \text{Rs.}360$$

Total interest = Rs.585

**Q 2 Pass Journal entries for the Forfeiture and Re-issue in the following cases:**

- X Ltd. forfeited 200 shares of `10 each `8 called up; on he had paid application and allotment money of `3 per share. Out of these, 100 shares were re-issues as fully paid up for `8 per share.
- Y Ltd. forfeited 300 shares of `10 each, `7 called up, for non-payment of First Call of `2 per share. Out of these, 100 shares were immediately re-issued at `6 per share.
- Z Ltd. forfeited 600 shares of `10 each, on which first call of `3 per share was not received; the second and final call of `2 per share has not yet been called. Out of these, 200 shares were re-issued as `8 paid up for `7 per share.



**Solution:****JOURNAL**

(a)	Share Capital A/c (200 shares x `8) Dr To Calls in Arrear A/c (200 x `5) To Share Forfeiture A/c (200 x `3) (Forfeiture of 200 shares of Ravi)	1,600	1,000 600
	Bank A/c Dr. Share Forfeiture A/c Dr. To Share Capital A/c (Re-issue of 100 shares @ `8 per shares fully paid)	800 200	1,000
	Shares Forfeiture A/c Dr. To Capital Account A/c (Profit on 100 re-issued shares transferred to Capital Reserve)	100	100
(b)	Share Capital A/c (300 shares x `7) Dr. To Share first Call A/c (300 x `2)\ To Share Forfeiture A/c (300 x `5) (Forfeiture of 300 shares)	2,100	600 1,500
	Bank A/c Dr. Share Forfeiture A/c Dr. To Share capital A/c (Re-issue of 100 shares at `6 per share, Loss of `1 per share)	600 100	700
	Share Forfeiture A/c Dr. To Capital Reserve a/c (Profit on 100 re-issued shares transferred to Capital reserve A/c)	400	400
©	ShareCapitalA/c (600 shares x `8) Dr To Share First call A/c (600 shares x `3) To Share Forfeiture A/c (600 shares x `5) (Forfeiture of 600 shares)	4,800	1,800 3,000
	Bank A/c Dr. Share forfeiture A/c Dr To share capital A/c (Re-issue of 200 shares at `7 per share, loss of `1 per share debited of Forfeiture A/c)	1,400 200	1,600
	Share forfeiture A/c Dr. To Capital Reserve A/c (Profit on 200 shares transferred to Capital Reserve A/c)	800	800

**Notes:** (1) profit on 200 shares = `600

Hence, Profit on 100 shares  $600/200 \times 100 = 300$

Less: Loss on re-issue: 100 shares x `2 = 200

Transferred to Capital Reserve = 100

(2) Profit on 300 shares = `1,500

Hence, profit on 100 shares =  $1,500/300 \times 100 = 500$

Less: Loss on Re-issue 100 shares x `1 = 100

Transferred to Capital Reserve = 400

(3) Profit on 600 shares = `3,000 = 1,000

Hence, profit on 200 shares =  $3,000/600 \times 200 = 200$

Less: Loss on Re-issue: 200 shares x `1 = 200

Transferred to Capital Reserve

= 800

Q 3

- (a) Ravi Ltd., forfeited 800 shares of `10 each, `7.50 paid for non-payment of Final Call of `2.50 per share. Out of these, 600 shares were re-issued for `6 per share as fully paid up. Pass journal entries.
- (b) X Ltd., forfeited 800 shares `10 each, `7.50 called up, for non-payment of First call of `2.50 per share. Out of these, 600 shares were re-issued for `6 per share as 7.50 paid up. Pass journal entries.
- (c) 400 shares of `10, on which `8 have been called and `6 have been paid, are forfeited. Out of these, 300 are re-issued for `7 as fully paid. Give journal entries.

**Solution: (a)**

**JOURNAL**

Share capital A/c	Dr.	8,000	
To Share first call A/c (800 x `2.50)			2,000
To Share Forfeiture A/c (800 x `7.50)			6,000
(Forfeiture of 800 shares)			
Bank A/c	Dr.	3,600	
Share Forfeiture A/c	Dr.	2,400	
To Share capital A/c			6,000
(Re-issue of 600 shares @ `6 per share as fully paid up)			
Share Forfeiture A/c	Dr.	2,100	
To Capital Reserve A/c			2,100
(Profit on 600 shares transferred to capital reserve)			

**Note:** Profit on 800 shares = `6,000

Profit on 600 shares =  $6,000/800 \times 600$  4,500

(-) Loss on re-issue on 600 shares @ `4 each 2,400

**2,100**

(b)

**JOURNAL**

Share capital A/c (800 x `7.50)	Dr.	6,000	
To Share First Call A/c (800 x `2.50)			2,000
To Share Forfeiture A/c (800 x `5)			4,000
(Forfeiture of 800 shares)			
Bank A/c	Dr.	3,600	
Share Forfeiture A/c	Dr.	900	
To Share capital A/c			4,500
(Re-issue of 600 shares @ `6 per share as `7.50 paid up)			
Share Forfeiture A/c	Dr.	2,100	
To Capital Reserve A/c			2,100
(Profit on 600 re-issued shares transferred to Capital Reserve)			

**Note: (2)**

Profit on 800 shares = `4,000

Profit on 600 shares =  $4,000 \times 600/800 =$  3,000

(-) Loss on re-issue of 600 shares @ `1.50 each = 900

**2,100**

(3)

**JOURNAL**

Share Capital A/c	Dr.	3,200	
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To Calls in Arrear A/c To Share Forfeiture A/c (Forfeiture of 400 shares)			3,200
Bank A/c Dr. Share Forfeiture A/c Dr. To Share Capital A/c (Re-issue of 300 shares at `7 as fully paid)	2,100 900		3,000
Share Forfeiture A/c Dr. To Capital Reserve A/c (Profit on re-issue of 300 shares transferred to Capital Reserve)	900		900

**Note: 3**

Profit on 400 shares = `2,400 RS.  
 Profit on 300 shares = `2,400 x 300/400 = 1,800  
 (-) Loss on re-issue of 300 shares @ `3 each = 900

900

### Forfeiture in Case of Over-subscription and Pro-rata Allotment

**Q4 Nav Lakshmi Ltd. issued a prospectus inviting applications for 50,000 shares of ` 10 each. These shares were issued at par on the following terms:**

**On application `3, on allotment `60,000 shares Allotments were made on the followings basis:**

- (i) To applicants for 10,000 shares – in full;
- (ii) To applicants for 20,000 shares – 15,000 shares;
- (iii) To applicants for 30,000 shares – 25,000 shares;

**All excess amount paid on application is to be adjusted against due on allotment.**

**The shares were fully called and paid up except the amount of allotment, first & final call not paid by those who applied for 2,000 shares of the group applying for 20,000 shares.**

**The Board of Directors forfeited all the shares which calls were not paid**

**1,000 forfeited shares were re-issued as fully paid on receipt of `8 per share.**

**Show the journal entries in the Books of Nav Lakshmi Ltd.**

**Solution:**

#### **JOURNAL**

Bank A/c Dr. To Share Application A/c (Application money received on 60,000 shares @ `3 per shares)	1,80,000	1,80,000
Share Application A/c Dr. To Share Capital A/c (Application money transferred to shares capital account and the excess money to share allotment account)	1,80,000	1,80,000
Share Allotment A/c Dr. To Share Capital A/c (Allotment money due on 5,000 shares @ `4 per share)	2,00,000	2,00,000
Bank A/c Dr. To Share Allotment A/c (Allotment money received, except on 1,500 shares)	1,65,500	1,65,500
Share First Call A/c Dr. To Share Capital A/c (First Call due on 50,000 shares @ `2 per share)	1,00,000	1,00,000
Bank A/c Dr.	97,000	



To Share First Call A/c (First Call money received, except on 1,500 shares @ `2 per share)		97,000
Share Final Call A/c To Share Capital A/c (Final Call due on 50,000 shares @ `1 per share)	Dr.	50,000 50,000
Bank A/c To Share Final Call A/c (Final Call received, except on 1,500 shares @ `1 per share)	Dr.	48,500 48,500
Share Capital A/c To Share Allotment A/c To Share First Call A/c To Share Final Call A/c To Share Forfeiture A/c (Forfeiture of 1,500 shares)	Dr.	15,000 4,500 3,000 1,500 6,000
Bank A/c Share Forfeiture A/c To Share Capital A/c (Re-issue of 1,000 shares at `8 per share)	Dr. Dr.	8,000 2,000 10,000
Share Forfeiture A/c To Capital Reserve A/c (Profit on 1,000 forfeited shares were transferred to Capital Reserve A/c)	Dr.	2,000 2,000

#### Working Note:

(1) (A) As applicants for 20,000 shares were allotted = 15,000 shares  
Applicants for 2,000 shares were allotted =  $15,000/20,000 \times 2000$   
= 1,500 shares

Excess application money received on these:  
(2,000 shares - 1,500 shares) x `3 = `1,500

(B) Amount due on allotment on these shares = 1,500 shares x `4 = `6,000  
(-) Excess received on application from these shares = `1,500  
Amount not received on allotment = `4,500

© Amount received on allotment:  
Total amount due on allotment 50,000 shares x `4 = 2,00,000  
(-) Excess amount received on applications 10,000 Shares x `3 = 30,000  
Balance Due = 1,70,000  
(-) Amount not received on allotment 4,500  
Net amount received on allotment in cash = 65,500

(2) Since only 1,000 shares have been re-issued, therefore the Profit on 1,000 shares will be transferred to Capital Reserve  
Profit on 1,500 shares = `4,000  
Profit on 1,000 shares =  $6,000/1,500 \times 1,000$   
Shares @ `2 per share = `2,000  
Amount transferred to Capital Reserve = `2,000

**Q 5 X Ltd. issued for public subscription 40,000 equity shares of `10 at a premium of `2 per share payable as under, on application `3 per share; on allotment `5 per share (including premium), on first call `2 per share and on second call `2 per share.**

**Applications were received for 60,000 shares. Allotment was made pro-rata to the applicants for 48,000 shares, the remaining applications being refused. Money overpaid on application was utilized towards sums due on allotment.**

**Shri Ramdas, to whom 1,600 shares were allotted, failed to pay the allotment, first and second call money and Shri Hussain to whom 2,000 shares were allotted failed to pay the two calls. These shares were subsequently forfeited after the second call was made. All the forfeited shares were sold to Shri Banerjee as fully paid up at `8 per share. Show the journal entries to record the above transactions and prepare the Balance Sheet.**

**Solution:**

### JOURNAL

Particulars			
Bank A/c Dr. To Equity Share Application A/c (Application money received on 60,000 shares @ `3 per share)	1,80,000		1,80,000
Equity Share Applications A/c Dr. To Equity Share capital A/c To Equity Share Allotment A/c To bank A/c (Application money transferred to Share Capital A/c for 40,000 shares, to Allotment A/c for 8,000 shares and amount returned on 12,000 shares @ `3 per share)	1,80,000		1,20,000 24,000 36,000
Equity Share Allotment A/c Dr. To equity Share Capital A/c To Securities Premium A/c (Allotment due on 40,000 shares @ `5 per share)	2,00,000		1,20,000 80,000
Bank A/c Dr. To equity Share Allotment A/c (Allotment money received except on 1,600 shares of Ramdas)	1,68,960		1,68,960
Equity Share First call A/c Dr. To equity Share Capital A/c (First call due on 40,000 shares @ `2 per share)	80,000		80,000
Bank A/c Dr. To Equity Share first call A/c (First call received except on 3,600 shares @ `2 per share)	72,800		72,800
Equity Share Second and Final Call A/c Dr. To equity Share Capital A/c (Second & Final call due on 40,000 shares @ `2 per share)	80,000		80,000
Bank A/c Dr. To Equity Share Second & Final Call A/c (Second & final call received except on 3,600 shares @ `2 per share)	72,800		72,800
Equity Share Capital A/c Dr. Securities Premium A/c Dr. To Equity Share Allotment A/c To Equity Share First Call A/c To equity Share Second Call & Final Call To Share Forfeiture A/c(5760 + 12000) (Forfeiture of 3,600 shares)	36,000 3,200		7,040 7,200 7,200 17760
Bank A/c Dr. Share Forfeiture A/c Dr. To Equity Share Capital A/c	28,800 7,200		36000



	(Re-issue 3,600 shares at `8 per share)		
	Share Forfeiture A/c Dr. To Capital Reserve A/c (Balance of Share Forfeiture A/c transferred to capital reserve A/c)	10,560	10,560

# **BALANCE SHEET OF X LTD.**

As on.....

Equity & Liabilities	Note No.		
Shareholder's Funds:			
<b>(a) Share Capital</b>	1	<b>4,00,000</b>	
<b>(b) Reserve &amp; Surplus</b>	2	<b><u>87,360</u></b>	<b>4,87,360</b>
Assets	Note No.		
Current Assets:			
<b>Cash &amp; Cash Equivalents (Cash at bank)</b>		<b>4,87,360</b>	

## **Notes To Accounts:**

(1) Share Capital:		
Authorised Capital:		
Issued, Subscribed and Fully Paid Capital:		
<b>40,000 Equity shares of `10 each</b>	<b>4,00,000</b>	
(2) Reserves & Surplus:		
<b>Capital Reserve</b>	<b>10,560</b>	
<b>Securities Premium</b>	<b>76,800</b>	
	<b><u>87,360</u></b>	

(3) (A) Excess amount received from Ramdas on application:

Ramdas has been allotted 1,600 shares. He must have applied for more shares.

If shares allotted were 40,000, shares applied for were = 48,000

If shares allotted were 1,600 shares applied for were =  $48,000 / 40,000 \times 1,600 = 1,920$

Excess application money received from Ramdas =  $1,920 \text{ shares} - 1,600 \text{ shares} = 320 \text{ shares} \times `3 = `960$ .

(B) Amount due from Ramdas on allotment:

1,600 shares `5 = 8,000

Less: Excess received from ramdas on app. = 960

Net amount due from Ramdas on allotment

Which has not been received = 7,040

(C) Total amount due on allotment 40,000 shares x rs.5 = 2,00,000

Less: Excess amount received on applications = 24,000

Balance due 1,76,000

Less: Amount not received from Ramdas from Ramdas on allotment 7,040

Net amount received on allotment in cash 1,68,960

(4) Premium is due with allotment and only Ramdas has not paid the amount of allotment. Therefore, Securities Premium account has been debited from the amount of premium due from Ramdas only i.e.  $1,600 \text{ shares} \times `2 = `3,200$ .

**Q 6 A limited company issued a prospectus inviting applications for 2,00,000 shares of ₹10 each at a premium of ₹2 per share payable as follows: On Application ₹3; On Allotment ₹4 (including premium); On First Call ₹3 and On Second Call ₹2.**

**Applications were received for 3,00,000 shares and allotment was made on pro-rata basis. Money overpaid on applications was employed on account of sums due allotment.**

**R, to whom 400 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the First call his shares were forfeited. M the holder of 600 shares failed to pay the two calls and his shares were forfeited after the Second call. Of the shares forfeited, 800 shares were sold to K as fully paid, K paying ₹9 per share, the whole of R's share being included.**

**Give journal entries; prepare Bank Account and Balance Sheet.**

**Solution:**

### JOURNAL

Bank A/c	Dr.	9,00,000	
To Share Application A/c			9,00,000
(Application money received 3,00,000 shares @ ₹3 per share)			
Share Application A/c	Dr.	9,00,000	
To Share Capital A/c			6,00,000
To Share Allotment A/c			3,00,000
(Application money transferred to share capital A/c for 2,00,000 shares @ ₹3 per share and to Allotment A/c for 1,00,000 shares @ ₹3 per share)			
Share Allotment A/c	Dr.	8,00,000	
To Share Capital A/c			4,00,000
To Securities Premium A/c			4,00,000
(Allotment due on 2,00,000 shares @ ₹4 per share)			
Bank A/c	Dr.	4,99,000	
To Share Allotment A/c			4,99,000
(Allotment money received except on 400 shares of R)			
Share First Call A/c	Dr.	6,00,000	
To Share Capital A/c			6,00,000
(First call due on 2,00,000 sharers at ₹3 per share)			
Bank A/c	Dr.	5,97,000	
To Share First Call A/c			5,97,000
(First call money received except on 400 shares of R and 600 shares of M)			
Share Capital A/c	Dr.	3,200	
Securities Premium A/c	Dr.	800	
To Share Premium A/c			1,000
To Share First Call A/c			1,200
To Share Forfeiture A/c			1,800
(Forfeiture of 400 shares of R; Share capital A/c debited @ ₹8 per share called up)			
Share Second call A/c	Dr.	3,99,200	
To Share Capital A/c			3,99,200
(Second call money due on 1,99,600 shares at ₹2 per share)			
Bank A/c	Dr.	3,98,000	
To Share Second Call A/c			3,98,000
(Second call money received on 1,99,000 shares)			
Share Capital A/c	Dr.	6,000	
To Share First Call A/c			1,800
To Share Second Call A/c			1,200
To Share Forfeiture A/c			3,000



	(Forfeiture of 600 shares of M)		
Bank A/c	Dr.	7,200	
Share Forfeiture A/c	Dr.	800	
To Share Capital A/c			8,000
(800 shares re-issued at `9 per share)			
Share Forfeiture A/c	Dr.	3,000	
To capital Reserve A/c			3,000
(Profit on 800 re-issued shares transferred to capital reserve A/c)			

#### BANK ACCOUNT

To Share Application A/c	9,00,000	By Balance c/d	24,02,200
To Share Allotment A/c	4,99,000		
To Share First Call A/c	5,97,000		
To Share Second Call A/c	3,98,000		
To Share Capital A/c	7,200		
	<b>24,01,200</b>		<b>24,01,200</b>

**Note:** In the above question a Cashbook is not required. However, if a cashbook is asked, the bank A/c as prepared above will become a Cash Book and Cash transaction will not be recorded in journal.

#### BALANCE SHEET

As on .....

Equity & Liabilities	Note No.		
Shareholder's Funds:			
<b>(a) Share Capital</b>	<b>1</b>	<b>19,90,000</b>	
<b>(b) Reserves &amp; Surplus</b>	<b>2</b>	<b>4,02,200</b>	<b>24,01,200</b>
Assets	Note No.		
Current Assets:			
<b>Cash &amp; Cash Equivalents (Cash at bank)</b>		<b>24,01,200</b>	

Notes to Accounts:

(1) Share Capital:			
Authorised:		<u>?</u>	
Issued:		<u>20,00,000</u>	
<b>2,00,000 shares of `10 each fully paid</b>			
Subscribed and fully paid-capital:			
<b>1,99,800 shares of `10 each</b>	<b>19,98,000</b>		
<b>Add: Share Forfeiture A/c</b>	<b><u>1,000</u></b>	<b>19,99,000</b>	
(2) Reserve & Surplus			
<b>Capital Reserve A/c</b>		<b>3,000</b>	
<b>Securities premium A/c</b>		<b>2,99,200</b>	
		<b>4,02,200</b>	

(3) (A): Excess amount received from R on application:

R has been allotted 400 shares. He must have applied for more shares.

If shares allotted were 2,00,000, shares applied for were = 3,00,000

If shares allotted were 400, shares applied for were =  $3,00,000 / 2,00,000 \times 400 = 600$  shares

Excess application money received from R = 600 shares – 400 shares = 200 shares x `3 = `600

(B) Amount due from R on allotment: 400 shares x `4 = 1,600

Less: Excess received from R on application = 6,00

Net amount due from R on allotment, which has not been received		<u>1,00,000</u>
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(C) Total amount due on allotment 2,00,000 shares x `4	=	8,00,000
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Less: Excess amount received on application (1,00,000 shares x `3)		<u>3,00,000</u>
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Balance Due	=	5,00,000
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Less: Amount not received from R on allotment	=	<u>1,000</u>
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Net amount received on allotment	=	<u>4,99,000</u>
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(4) Premium is due with allotment. R has not paid premium also. Therefore, Securities Premium A/c will be debited by 400 shares x `2 = `800

(5) M has paid the amount of allotment. Therefore, he has paid premium also. Premium once collected cannot be cancelled. As such 'Securities Premium A/c' will not be debited when his shares are forfeited.

Only 800 shares are re-issued. Therefore, the profit on 800 shares will only be transferred to capital Reserve:

Profit on 400 shares of R	=	1,800
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Profit on 400 shares of M = `3,000/600 shares x 400 shares		<u>2,000</u>
--	--	--------------

		<u>3,800</u>
--	--	--------------

Less: Loss on re-issue of 800 shares @ `1 each		<u>3,000</u>
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(7) Profit on 600 shares of M was `3,000 out of which 400 shares have been reissued. Therefore, the balance of profit remaining in Share Forfeiture A/c for 200 shares = 3,000/600 x 200 = `1,000. This balance of `1,000 will be shown on the liabilities side of the Balance Sheet under the head 'Share Capital'.

## **Minimum Subscription**

A public ltd company cannot issue any security unless minimum subscription as stated in the prospectus has been subscribed; sum payable on applications has been received in cash. The amount of minimum subscription must be stated in the prospectus. Shares allotted for consideration other than cash are not to be included for minimum subscription.

The companies act, 2013 prescribes that the company must receive the minimum subscription within a period of 30 days from the date of issue of prospectus or such other period as may be specified by SEBI. In case company has not received minimum subscription then application money shall be repaid within a period of 15 days from closure of issue. In case of failure, the entire amount is to be repaid, without interest, within 45(30+15) from the date of issue of the prospectus. Beyond 45 days, the directors become liable to repay the money with an interest of 15% p.a.

As per SEBI (issue of capital and disclosure requirements) Regulations 2009, the minimum subscription to be received in an issue shall not be less than 90% of the offer through offer document.

### **Minimum share application money**

The amount payable on application on every security shall be minimum 5% of the nominal value of the security or such other percentage or amount as specified by SEBI by regulations

### **Lien on shares**

Lien means to retain anything belonging to another until his claims are satisfied. The articles of a company invariably provide that the company shall have a first and paramount lien on shares not fully paid up or for debts due to the company. In case of fully paid up shares as well, the articles may provide for the company's first and paramount lien on them. This enables the company to secure and recover the debts due from a member. Where such power is given by the articles, the company may sell the shares on which it has a lien for the recovery of a debt which is presently payable after giving 14 days notice. Any surplus is to be paid to the concerned members.



## **MCQ FOR PRACTICE**

Q1. Which of the following statement is false?

- (A) A company is a legal entity distinct from its members.
- (B) A company can buy its own shares.
- (C) A shareholder is the agent of the company
- (D) A company has common seal

Q2. Which of the capital is not shown in the company's Balance sheet

- (A) Authorised Capital
- (B) Issued share capital
- (C) Called and paid up share capital
- (D) Reserve Capital

Q3. The portion of authorised capital which can be called up only on the liquidation of the company is called:

- (A) Authorised Share Capital
- (B) Reserve Capital
- (C) Issued Share Capital
- (D) Called up Capital

Q4. When shares are issued to promoters for the services offered by them, the account that will be debited with the nominal value of shares is \_\_\_\_\_.

- (A) Preliminary expenses
- (b) Goodwill
- (c) Asset account
- (d) Share capital

Q5. X Co. Ltd. was incorporated with an authorized share capital of 1,00,000 equity shares of Rs. 10 each. The directors decided to allot 10,000 shares credited as fully paid to the promoters for their services. The account that will be debited with the nominal value of shares is \_\_\_\_\_.

- (A) Preliminary expenses
- (b) Goodwill
- (c) Asset account
- (d) Share capital

Q6. The excess price received over the par value of shares, should be credited to \_\_\_\_\_.

- (A) Calls in Advance Account
- (B) Share Capital Account
- (C) Reserve Capital Account
- (D) Securities Premium Account

Q7. On allotment of shares, the following entry is passed in the books of accounts:

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

(B) Share Application A/c      Dr.  
                    To Share Capital A/c

(C) Share Application A/c      Dr.  
                    To Bank A/c

(D) Bank A/c                      Dr.  
                    To Call in advance A/c

**(CS Sample Paper)**

Q8. The securities Premium accounts must be shown as "Securities premium reserve" separately on the liability side of the balance sheet under the head \_\_\_\_\_.

- (A) Current Assets
- (B) Non-current assets
- (C) Reserve & Surplus
- (D) Current liabilities

**(CS Sample Paper)**

Q9. The maximum rate of interest on calls in advance can be \_\_\_\_\_.

- (A) 6% (B) 10%  
(C) 12% (D) 14%

Q10. The maximum rate of interest on calls in arrears can be \_\_\_\_\_.

- (A) 6% (B) 10%  
(C) 12% (D) 14%

Q11. Which type of the following shares have the right to receive dividend unpaid in prior years, whenever earnings become adequate?

- (A) Cumulative preference shares  
(B) Participating preference shares  
(C) Convertible preference shares  
(D) Callable preference shares

Q12. Capital Reserves are created out of \_\_\_\_\_.

- (A) Balance in Profit and Loss Account (B) Capital Profits  
(C) Revenue Profits (D) Provisions

Q13. As per Schedule III of the Companies Act, 2013, under which of the following heads is 'Premium on issue of Preferences & Equity Shares' shown in the balance sheet of a company?

- (A) Non-current assets (B) Debentures  
(C) Reserves on Surplus (D) Current liabilities and provisions

Q14. The excess price received over the par value of shares, should be credited to

- (A) Calls-in-advance account (B) Share capital account  
(C) Reserve capital account (D) Securities premium account

Q15. The Securities Premium Account should be shown under

- (A) Share capital (B) Current Liabilities  
(C) Current assets (D) Reserves and Surplus

Q16. The maximum amount beyond which a company is not allowed to raise funds, by issue of shares is known as \_\_\_\_\_.

- (A) Issued capital (B) Reserve capital (C) Nominal capital (D) Subscribed capital

Q17. The following statements apply to equity / preference shareholders. Which one of them applies only to Preference Shareholders?

- (A) Shareholders risk the loss of investment  
(B) Shareholders bear the risk of no dividends in the event of losses  
(C) Shareholders usually have the right to vote  
(D) Dividends are usually a set amount in every financial year

Q18. Share Allotment Account is a:

- (A) Real Account (B) Nominal Account  
(C) Personal Account (D) Company Account

(CS Sample Paper)

Q19. The subscribed share capital of Sun Ltd. is Rs 90,00,000 of Rs 100 each. There were no calls in arrears till the final call made. The final call made was paid on 80,000 shares and the total amount of calls in arrears amounted to Rs 250,000. The amount of final call per share made was:

- (A) Rs 20 (B) Rs 25  
(C) Rs 100 (D) Rs 50

Q20. The subscribed share capital of Bright Ltd. is Rs 80,00,000 of Rs 100 each. There were no calls in arrears till the final call made. The final call made was paid on 77,500 shares and the total amount of calls in arrears amounted to Rs 62,500. The amount of final call per share made was:

- (A) Rs 20 (B) Rs 25  
(C) Rs 100 (D) Rs 50

Q21. The director of X Ltd. made a final call of Rs 50 per share on 1<sup>st</sup> July 2014 indicating the last date of payment of call money to be 31<sup>st</sup> July 2014.

Mr. Mohit holding 5,000 shares paid the call money on 15<sup>th</sup> Sept 2014. If the company adopts Table F, the amount of interest on calls in arrears to be paid:

- (A) Rs 1562.5 (B) Rs. 3,125  
(C) Rs 1,000 (D) Rs 1,500

Q22. The director of X Ltd. made a final call of Rs 40 per share on 1<sup>st</sup> Oct 2017 indicating the last date of payment of call money to be 31<sup>st</sup> Oct 2017.

Mr. Mohit holding 6,000 shares paid the call money on 15<sup>th</sup> Jan 2018. If the company adopts Table F, the amount of interest on calls in arrears to be paid:

- (A) Rs 6,000 (B) Rs. 8,000  
(C) Rs 5,000 (D) Rs 7,000

Q23. Z Ltd. invited application for 50,000 equity shares of Rs 10 each payable as follows:

On Application	Rs 2.5
On Allotment (on 1 <sup>st</sup> July 2018)	Rs 2.5
On Final Call (on 1 <sup>st</sup> Sept 2018)	Rs 5.0

Sonu a shareholder holding 1,000 shares paid the whole of the amount due along with the allotment.

Calculate the interest on calls in advance according to Table F.

- (A) Rs 100 (B) Rs 1,200  
(C) Rs 83.33 (D) Rs 600

Q24. Calls in arrears are shown in Balance sheet as \_\_\_\_\_.

- (A) deduction from Called up share capital  
(B) Addition to called up share capital  
(C) Addition to issued share capital  
(D) Deduction from issued share capital

Q25. Calls in advance are shown in Balance sheet as \_\_\_\_\_.

- (A) Deduction from share capital  
(B) Addition to share capital  
(C) Current Liability  
(D) Non Current Liability

Q26. The following information pertains to X Ltd.

Equity Share capital (Called up)	Rs 500,000
Calls in arrears	Rs 40,000
Calls in advance	Rs 25,000
Dividend Payable	15%

The amount of dividend payable:

- (A) 69,000 (B) 72,750  
(C) 75,000 (D) None of the above



Q27. G Ltd. acquired assets worth Rs 7,50,000 from H Ltd. by issue of shares of Rs 100 at a premium of 25%. The number of shares to be issued by G Ltd. to settle the purchase consideration =?

- (A) 6,000 shares (B) 7,500 shares (C) 9,375 shares (D) 5,625 shares

Q28. A Ltd. acquired assets worth Rs 12,50,000 from H Ltd. by issue of shares of Rs 100 at a premium of 25%. The number of shares to be issued by G Ltd. to settle the purchase consideration =?

- (A) 10,000 shares (B) 7,500 shares (C) 9,375 shares (D) 5,625 shares

Q29. John Ltd. acquired business of Star Ltd at an agreed price of Rs 18,00,000. In consideration, received sundry assets worth Rs 35,00,000 and Sundry liabilities worth of Rs 14,00,000. It was further decided to settle Rs 300,000 through a draft and for balance, issue equity shares of Rs 100 each at premium of 25%. Calculate the amount of capital reserve and no. of share issued.

- (A) Rs 300,000 and 12,000 share (B) Rs 300,000 and 14,400 share  
(C) Rs Nil and 14,400 share (D) None of the above

Q30. Star Ltd. acquired business of Moon Ltd. for a purchase consideration of Rs 15,00,000. Star Ltd. issued draft of Rs 300,000 for 3 months and balance by issue of equity shares of Rs 100 each at a premium of Rs 50 per share. Following are the assets and liabilities of Moon Ltd:

Machine	Rs 650,000
Building	Rs 380,000
Debtors	Rs 670,000
Creditors	Rs 350,000

The number of shares to be issued by Star Ltd. to settle the purchase Consideration?

- (A) 10,000 shares (B) 15,000 shares (C) 8,000 shares (D) None of the above

**Use the following information for questions 31 to 35**

B LTD. was registered with a share capital of Rs 1,00,00,000 divided into equity shares of Rs 10 each. It issued 9,00,000 equity shares to the general public at par payable as to Rs 3 on application, Rs 3 on allotment and balance in 2 equal calls. The public had subscribed for 8,50,000 shares. Till 31<sup>st</sup> March, 2011, only first call had been made. All the shareholders had paid up except Mr. C, a holder of 25,000 shares, who did not pay the final call money.

Q31. How much is B Ltd.'s authorized share capital?

- (A) Rs 1,00,00,000 (B) Rs 90,00,000 (C) Rs 85,00,000 (D) Rs 68,00,000

Q32. How much is B Ltd.'s issued capital?

- (A) Rs 1,00,00,000 (B) Rs 90,00,000 (C) Rs 85,00,000 (D) Rs 68,00,000

Q33. How much is B Ltd.'s subscribed capital?

- (A) Rs 1,00,00,000 (B) Rs 90,00,000 (C) Rs 85,00,000 (D) Rs 68,00,000

Q34. How much is B Ltd.'s called up capital?

- (A) Rs 1,00,00,000 (B) Rs 90,00,000 (C) Rs 85,00,000 (D) Rs 68,00,000

Q35. How much is B Ltd.'s paid up capital?

- (A) Rs 1,00,00,000 (B) Rs 90,00,000 (C) Rs 85,00,000 (D) Rs 67,50,000

**Use the following information for the questions 36 to 40**

B Ltd. issued 80,000 equity shares of Rs 10 each, payable as under:

On application	Rs 3
On allotment	Rs 4
On first call	Rs 2
On final call	Rs 1

The applications received for 1,20,000 shares were dealt with as under:

- Applicants of 20,000 shares were allotted in full.
- Applicants of 80,000 shares were allotted 60,000 shares pro-rata.
- Applications for 20,000 shares were rejected.

Q36. Amount received on applications is \_\_\_\_\_

- (A) Rs 2,40,000      (B) Rs 3,60,000      (C) Rs 5,60,000      (D) Rs 8,00,000

Q37. Total excess money received as compared to the number of shares allotted = ?

- (A) Rs 3,00,000      (B) Rs 2,40,000      (C) Rs 3,60,000      (D) Rs 1,20,000

Q38. Amount to be refunded = ?

- (A) Nil      (B) Rs 60,000      (C) Rs 1,20,000      (D) Rs 1,80,000

Q39. Amount of excess application money available for adjustment against allotment money = ?

- (A) Nil      (B) Rs 60,000      (C) Rs 1,20,000      (D) Rs 1,80,000

Q40. Amount of excess application money available for adjustment against call money = ?

- (A) Nil      (B) Rs 60,000      (C) Rs 1,20,000      (D) Rs 1,80,000

Q41. E Ltd. had allotted 10,000 shares to the applicants of 14,000 shares on pro rata basis. The amount payable on applications is Rs 2. F applied for 420 shares. The number of shares allotted and the amount carried forward for adjustment against allotment money due from F = ?

- (A) 60 shares; Rs 120      (B) 340 shares; Rs 160  
(C) 320 shares; Rs 200      (D) 300 shares; Rs 240

Q42. Which of the following statements is **false**?

- (A) The forfeited shares should not be issued at a premium  
(B) At the time of forfeiture of shares, securities premium should not be debited with the amount of premium already received  
(C) Shares can be issued at a discount only after one year from the commencement of business  
(D) Securities premium account cannot be utilized to redeem preference shares

Q43. A Ltd forfeited 300 equity shares of Rs. 10 fully called-up, held by Mr. X for non-payment of allotment @ Rs. 4 each and final call @ Rs. 4 each. However, he paid application money @ Rs. 2 per share. These shares were originally issued at par. The forfeited account will be credited by:

- (A) Rs 3,000      (B) Rs 1200      (C) Rs 2400      (D) Rs 600

Q44. X Ltd forfeited 200 equity shares of Rs. 10 each, Rs. 8 called-up for non-payment of allotment @ Rs. 4 each and first call money @ Rs. 2 each. Application money @ Rs. 2 per share have already been received by the company. On forfeiture, the amount debited to share capital will be:

- (A) Rs 1,200      (B) Rs 1600      (C) Rs 2000      (D) Rs 400



Q45. X Ltd. forfeited 1000 equity shares of Rs. 10 each fully called-up which were issued at a premium of 20%. Amount payable on shares were: on application Rs. 2; on allotment Rs. 4 (including premium) on First and Final call Rs.6. Only application & Allotment money was paid by the shareholders in respect of these shares. The forfeited account will be credited by:

- (A) Rs 6,000 (B) Rs 2,000 (C) Rs 4,000 (D) Rs. 10,000

Q46. Mr. Long who was the holder of 100 preference shares of Rs. 100 each, on which Rs. 75 per share has been called up could not pay his dues on Allotment and First call each at Rs. 25 per share. The forfeited account will be credited by:

- (A) Rs 2,500 (B) Rs 5,000 (C) Rs 7,500 (D) None of the these

Q47. Asha Ltd. issued shares of Rs 10 each at premium of 25%. Mamta, who has 2,000 shares of Asha Ltd., failed to pay first and final call total of Rs 5. Premium was taken at the time of allotment. On forfeiture of Mamta's shares, the amount to be debited to shares premium account will be

- (A) Rs 10,000 (B) Rs 5,000 (C) Rs 15,000 (D) NIL

Q48. X was issued 100 shares of Rs 10 each at premium of Rs 1 per share, he paid application money and allotment money which is in total to Rs 5 (excluding premium) and failed to pay the balance final call of Rs 5 per share. Find the maximum discount that can be given at the time reissue of shares:

- (A) Rs 4 per shares (B) Rs 5 per shares  
(C) Rs 2 per shares (D) Rs 6 per shares

Q49. A company forfeited 2,000 shares of Rs 10 each ( which were issued at par ) held by Mr. John for non-payment of allotment money of Rs 4 per share. The called-up value per share was Rs 9. On forfeiture, the amount debited to share capital = ?

- (A) Rs 10,000 (B) Rs 8,000 (C) Rs 2,000 (D) Rs 18,000

Q50. When shares are forfeited, the share capital account is debited with \_\_\_\_\_ and the share forfeiture account is credited with \_\_\_\_\_

- (A) Paid-up capital of shares forfeited; Called up capital of shares forfeited  
(B) Called up capital of shares forfeited; Calls in arrear of shares forfeited  
(C) Called up capital of shared forfeited; Amount received on shares forfeited  
(D) Calls in arrears of shares forfeited; Amount received on shares forfeited

Q51. Which type of the following shares have the right to receive dividends unpaid in prior years, whenever earnings become adequate?

- (A) Cumulative preference shares (B) Participating preference shares  
(C) Convertible preference shares (D) Callable preference shares

Q52. Z Ltd. issued 10,000 shares of Rs 10 each. The called up value per share was Rs 8. The company forfeited 200 shares of Mr. A for non- payment of 1<sup>st</sup> call money of Rs 2 per share. He paid Rs 6 for application and allotment money. On forfeiture, the share capital account will be \_\_\_\_\_.

- (A) Debited by Rs 2,000 (B) Debited by Rs 1,600  
(C) Credited by Rs 1,600 (D) Debited by Rs 1,200

### **Use the following information for questions 53 and 54**

B Ltd. invited applications for 5,000 shares of Rs 10 each at a premium of Rs 2 per share payable as follows:

On application	Rs 5 (including Rs 1 premium)
On allotment	Rs 4 (including Rs 1 premium)
On final call	Rs 3

Allotment was made on pro rata basis to the applicants of 6,000 shares. Mr. C to whom 60 shares were allotted, failed to pay allotment money and call money.

Q53. On forfeiture, the amount credited to shares allotment account on Account of Mr. C = ?

- (A) Rs 480 (B) Rs 240 (C) Rs 180 (D) Rs 400

Q54. On forfeiture, the amount credited to share forfeiture account on Account of Mr. C = ?

- (A) Rs 300 (B) Rs 880 (C) Rs 320 (D) Rs 240

Q55. A company invited applications for 25,000 equity shares of Rs 10 each and received 30,000 applications along with the application money of Rs 4 per share. Which of the following alternatives can be followed?

- I. Refund the excess applications.
- II. Make pro rata allotment to all the applicants, and refund the excess application money.
- III. Not to allot any shares to some applicants, full allotment to some of the applicants and pro rata allotment to the rest of the applicants.
- IV. Not to allot any shares to some applicants and make pro rata allotment to other applicants.
- V. Make pro rata allotment to all the applicants and adjust the excess money received towards call Money

- (A) Only (II) above (B) Both (I) and (IV) above  
(C) All (I), (II), (III), (IV) and (V) above (D) Only (III) above

Q56. The document inviting offers from public to subscribe for the debentures or shares or deposits of a body corporate is known as \_\_\_\_\_

- (A) Shares certificate (B) stock invest  
(C) fixed deposit receipt (D) Prospectus

Q57. As per Schedule III of the Companies Act, 2013, forfeited shares account (not yet re-issued) shown under the heading will be \_\_\_\_\_

- (A) Share Capital (B) Long-term borrowings  
(C) Reserves and Surplus (D) Current liabilities

Q58. At the time of forfeiture of shares which were originally issued at a premium, the accounting entry involves \_\_\_\_\_.

- I. A debit to Share capital account with the called-up value of shares forfeited
- II. A credit to Share forfeiture account with the amount received on forfeited shares
- III. A debit to security premium account with the amount of security premium not received on forfeited shares
- IV. A credit to Calls-in-arrears with the amount due but not paid on forfeited shares.

- (A) Both (I) and (IV) above (B) Both (IV) and (III) above  
(C) Both (I) and (II) above (D) (I), (II), (III) and (IV) above

Q59. Which of the following is not true?

- (A) Loss on reissue of shares cannot be more than the gain on forfeiture of those shares
- (B) Where all the forfeited shares are not reissued the share forfeited account will show a credit balance equal to gain on forfeiture of shares not yet re-issued
- (C) When the shares are forfeited, securities premium is debited along with share capital where premium has not been received
- (D) Where forfeited shares are re-issued at premium, the amount of such premium is credited to capital reserve account.



Q60. Dividends are usually paid as a percentage of \_\_\_\_\_

- (A) Authorized share capital (B) Net Profit  
(C) Paid-up capital (D) Called-up capital

Q61. Which of the following should be deducted from the called-up share capital to find out paid-up capital?

- (A) Calls-in-advance (B) Calls-in-arrears  
(C) Share forfeiture (D) Discount on issue of shares.

Q62. If a shareholder does not pay his dues on allotment, for the amount due, there will be a \_\_\_\_\_

- (A) Credit in the share allotment account  
(B) Debit in the share forfeiture account  
(C) Credit in the share forfeiture account  
(D) Debit in the share allotment account

Q63. The company issued shares of Rs 10 each at a premium of Rs 2 payable as :

- On application \_\_\_\_\_Rs 3  
On allotment \_\_\_\_\_Rs 4 (including premium)  
On first call \_\_\_\_\_Rs 3  
On second and final call \_\_\_\_\_Rs 2

Mr. E who holds 100 shares failed to pay the first call money. The company has forfeited the 100 shares after the first call. On forfeiture, the amount debited to share capital account =?

- (A) Rs 1,200 (B) Rs 1,000 (C) Rs 800 (D) Rs 700

**Use the following information for question 64 and 65**

D Ltd. issued 10,000 shares of Rs 10 each at a premium of 20%. The share amount was payable as :

- On application \_\_\_\_\_Rs 2  
On allotment (including premium ) \_\_\_\_\_Rs 5  
On first call \_\_\_\_\_Rs 3  
On second and final call \_\_\_\_\_Rs 2

Applications were received for 14,000 shares and the shares were allotted to applicants on pro-rata basis. E, who was allotted 300 shares, failed to pay the first call. On his subsequent failure to pay the second and final call, all his shares were forfeited. Out of the forfeited shares, 200 shares were re-issued @ Rs 9 per share fully paid up.

Q64. The amount transferred to capital reserve =?

- (A) Rs 200 (B) Rs 1,100 (C) Rs 800 (D) Rs 1,300

Q65. Balance in share forfeiture accounts =?

- (A) Rs Nil (B) Rs 700 (C) Rs 500 (D) Rs 400

Q66. The interest on calls-in-advance is paid for the period from the \_\_\_\_\_

- (A) Date of receipt of application money to the date of appropriation  
(B) Date of receipt of allotment money to the date of appropriation  
(C) Date of receipt of calls-in-advance to the date of appropriation of the call  
(D) Date of appropriation to the date of dividend payment

Q67. If a company is not able to refund the excess shares application money within the reasonable time. The company will give interest @

- (A) 15% p.a. (B) 5% p.a. (C) 12% p.a. (D) 10% p.a.



Q68. The directors of E LTD. made the final call of Rs 30 per share on May 15, 2011 indicating the last date of payment of call money to the May 31, 2011. Mr. F, holding 5,000 shares paid the call money on July 15, 2011.

If the company adopts Table F, the amount of interest on calls-in-arrear to be paid by Mr. F = ?

- (A) Rs 1875.00                      (B) Rs 1250.00                      (C) Rs 2500.00                      (D) Rs 750.00

Q69. Which of the following statements is false?

- (A) Interest on calls-in-advance is paid from the date of receipt of advance to the date of relevant Call  
(B) Calls-in-advance are not entitled for any dividend  
(C) According to the Table F, interest on calls-in-advance is paid at the rate of 12% p.a.  
(D) Payment of interest on calls-in-advance is at the discretion of the company

Q70. T Ltd. proposed to issue 6,000 equity shares of Rs 100 each at a premium of 40%. The minimum amount of application money to be collected per shares as per the Companies Act, 2013 =?

- (A) Rs 5.00                      (B) Rs 6.00                      (C) Rs 7.00                      (D) Rs 8.40

Q71. The Securities Premium amount may be utilized by a company for \_\_\_\_\_

- (A) Writing off any loss on sale of fixed asset  
(B) Writing off any loss of revenue nature  
(C) Payment of dividends  
(D) Writing off the expenses on the issue of shares.

Q72. Which of the following is not a feature of a company?

- (A) Separate Legal Entity  
(B) Perpetual Succession  
(C) Members have unlimited liability  
(D) Common Seal

Q73. In a Government Company, the holding of the Central Government in paid-up capital should not be less than:

- (A) 25%                      (B) 50%                      (C) 51%                      (D) 49%

Q74. Which of the following statement is true in case of Foreign Company?

- (A) A company incorporated in India and has a place of business outside India.  
(B) A company incorporated outside India and has a place of business in India.  
(C) A company incorporated in India and has a place of business in India.  
(D) None of the above

Q75. Which of the following is not a feature of a Private Company.

- (A) Restricts the rights of member to transfer its shares.  
(B) Does not restrict on the number of its member to any limit.  
(C) Does not involve participation of public in general.  
(D) None of the above

Q76. Forfeited shares can be issued at:

- (a) par  
(b) premium  
(c) discount  
(d) any of the above

(CS SAMPLE PAPER)

Q77. A fixed rate of dividend is paid on \_\_\_\_\_.

- (a) Equity shares
- (c) debentures

- (b) preference shares
- (d) Term loans

(CS SAMPLE PAPER)

Q78. Who has a right to vote in the meeting of shareholders?

- (a) Equity shareholders
- (c) Debenture holders

- (b) Preference share holders
- (d) Creditors

(CS SAMPLE PAPER)

Q79. The maximum amount of capital a company can issue is called \_\_\_\_\_.

- (a) Issued capital
- (b) Paid up capital
- (c) Authorized capital
- (d) Called up capital

(CS SAMPLE PAPER)

Q80. The Journal entry passed when shares are issued to promoters of the company in lieu of the services provided by them during the incorporation of company is:

- (a) Share application account Dr.  
To share capital a/c

- (b) Goodwill a/c Dr.  
To Share capital a/c

- (c) Sundry asset a/c Dr.  
To Promoters a/c

- (d) Profit and loss a/c Dr.  
To Interest on calls in advance

(CS SAMPLE PAPER)

Q81. Preliminary expense is a \_\_\_\_\_ asset.

- (a) Current
- (c) Tangible

- (b) Fixed
- (d) Fictitious

(CS SAMPLE PAPER)

# ANSWERS

## Issue of Share Capital

1. C	2. D	3. B	4. A
5. A	6. D	7. -	8. C
9. C	10. B	11. A	12. B
13. C	14. D	15. D	16. C
17. D	18. C	19. B	20. B
21. B	22. C	23. A	24. A
25. C	26. A	27. A	28. A
29. A	30. C	31. A	32. B
33. C	34. D	35. D	36. B
37. D	38. B	39. B	40. A
41. D	42. A	43. B	44. B
45. C	46. A	47. D	48. B
49. D	50. C	51. A	52. B
53. B	54. D	55. C	56. D
57. A	58. D	59. D	60. C
61. B	62. A	63. C	64. C
65. B	66. C	67. C	68. A
69. D	70. A	71. D	72. C
73. C	74. B	75. B	76. D
77. B	78. A	79. C	80. B
81. D			



## **CHAPTER – 2| UNDERWRITING OF SHARES OR DEBENTURES**

An underwriting agreement is an agreement between the company and certain party (known as underwriter) under which the latter agrees to take up the whole or part of the securities, which may not be subscribed by the public for an agreed consideration (known as underwriting commission). It is in the nature of an assurance against the risk involved in placing the securities before the public.

**Note:** An underwriting agreement is enforceable against the executors of deceased underwriter.

### **PURPOSE FOR WHICH UNDERWRITING COMMISSION MAY BE PAID**

A company may pay a commission to any person in consideration of:

- (a) His subscribing or agreed to subscribe, whether absolutely or conditionally, for any shares in, or debentures of, the company, or
- (b) His procuring of agreeing to procure subscription, whether absolute or conditional for any shares in, or debentures of, the company.

### **CONDITIONS FOR PAYMENT OF UNDERWRITING COMMISSION**

A company may pay underwriting commission if the following conditions are fulfilled namely:

1. **Authorized by Article:** The articles must authorize the payment of the commission.
2. **Maximum Rate of Commission:** The commission paid or agreed to be paid must not exceed in the case of shares, 5% of the price at which the shares are issued or the amount or rate authorized by the articles, whichever is less and in the case of Debentures, 2-1/2% of the price at which the debentures are issued or the amount or rate authorized by the articles, whichever is less.
3. **Disclosure of Amount of Rate:** The amount or rate per cent of the commission paid or agreed to be paid must be disclosed in the prospectus or in the statement in lieu of prospectus or in a statement in the prescribed form signed in a like manner as a statement in lieu of prospectus and filed before the payment of the commission with the Registrar.
4. **Disclosure of Number of Securities Underwritten:** The number of shares or debentures underwritten by each of the underwriters must be disclosed in the prospectus or statement in lieu of prospectus.
5. **Delivery of the Contract:** A copy of the contract for the payment of the commission must be delivered to the Register at the time of delivery of the prospectus or the statement in lieu of prospectus for registration.

### **BROKERAGE**

Brokerage is the sum paid to a person by the company for placing the shares (i.e. for finding the person who will take shares).

The company is empowered to pay lawful brokerage. Lawful brokerage means reasonable brokerage payable to a person carrying on the business of a broker and not to the person who had casually induced others to subscribe.

### **DISTINCTION BETWEEN BROKERAGE AND UNDERWRITING COMMISSION**

1 Brokerage is paid to brokers for procuring other persons who will take shares or debentures where underwriter commission is paid to the underwriters for agreeing to take up the whole or part of shares or debentures, which may not be subscribed by the public.

2 If broker falls to place any share, he is not personally liable to take them nor he is entitled to any brokerage. On the other hand, the underwriter is bound to take up the shares, which have not been subscribed by public.

## **TERMS USED IN UNDERWRITING**

### **1 Marked Applications**

- (a) The application forms bearing the stamp of the underwriter are termed as “marked Application forms.
- (b) The benefit of marked applications is given to the concerned underwriters in whose favor application forms have been marked.

### **2 Unmarked Applications**

- (a) The application forms, which do not bear the stamp of the underwriter, are termed as “Unmarked Application forms”.
- (b) The benefit of unmarked applications by applications is given first to the company to the extent of issue not underwritten by underwriters (In case any part of the issue is not underwritten).
- (c) In case there is surplus, the benefit of surplus unmarked applications will be given to the underwriters in the ratio of their gross liability.

### **3 Full Underwriting**

- (a) When the entire issue is underwritten such underwriting is termed as ‘full underwriting’. Full example, X Ltd. decided to make a public issue of 1,00,000. Equity Shares of `10 each, which is entirely underwritten by A, B, C and D in the ratio of 2: 2: 1: 1.
- (b) In such a case the benefit of unmarked applications is given to the underwriter in the ratio of their gross liability i.e. 2: 2: 1: 1

### **4 Partial Underwriting**

- (a) When only a part of issue is underwritten, such underwriting is termed as ‘Partial Underwriting’. For example, X Ltd. decided to make a public issue of 1,00,000. Equity Shares of `10 each out of which 90,000 shares is underwritten by the company itself.
- (b) In such case, the benefit of unmarked applications will first be given to the company.
- (c) In case there is surplus, such surplus will be distributed among other underwriters in the ratio of their gross liability.

### **5 Sole Underwriting**

- (a) When only one underwriter underwrites the issue, such underwriting is termed as ‘Sole Underwriting’. For example, if an issue of 1,00,000 a share of `10 each of X Ltd. is underwritten by A, B, C and D in the ratio of 2: 2: 1: 1, it is a case of joint underwriting.
- (b) In such case the benefit of unmarked applications is given to the underwriters in the ratio of their gross liability.
- (c) The benefit of marked applications is given to the concerned underwriters in whose favour applications have been marked.

### **6 Firm Underwriting**

**(a) Meaning:** Firm underwriting refers to a definite commitment by the underwriters to take up a specified number of securities irrespective of the number of securities subscribed by the public.

For example, the entire issue of X Ltd is underwritten as follows:

- A. 1,60,000 shares (firm underwriting 3,600 shares)
- B. 1,60,000 shares (firm underwriting 2,000 shares)
- C. 80,000 shares (firm underwriting 1,200 shares)
- D. 80,000 shares (firm underwriting 10,000 shares)

In case only 4,63,200 shares (i.e. 4,80,000 shares – firm underwriting of 16,800 shares) will be offered to public and 16,800 shares will be taken up by the underwriters even if the issue is oversubscribed.

**(b) Treatment:** The benefit of firm underwriting may be given either.

- (i) To an individual underwriter on the basis of his individual firm underwriting, or
- (ii) To all the underwriters in the ratio of their gross liability

In other words, firm-underwriting shares may be treated at par with either ‘Marked Applications’ or ‘Unmarked Applications’.



## **PRACTICAL STEPS INVOLVED IN THE CALCULATION OF NET AND TOTAL LIABILITY**

<b>Step 1</b>	Calculate Gross Liability of each underwriter by dividing the number of securities underwritten in the ratio of shares underwritten by underwriters.
<b>Step 2</b>	Give credit for marked Application on actual basis.
<b>Step 3</b>	Give credit for 'Unmarked application' in the ratio of their gross liability. <b>Note:</b> In case of partial Underwriting, the credit of unmarked applications will first be given to the company to the extent of securities not underwritten and then to the underwriters.
<b>Step 4</b>	Give credit for 'Firm Underwriting Applications either in the ratio of individual firm underwriting applications or in the ratio of gross liability.
<b>Step 5</b>	Calculate the balance (i.e. Step 1 – Step 2- Step 3 – Step 4).
<b>Step 6</b>	Give the credit for total negative balance to the underwriters (s) having positive balance (s) in the ratio of their gross liability. At the same time, eliminate the negative balance (s) of underwriter (s) of adding an equivalent number.
<b>Step 7</b>	Calculate the Balance
<b>Step 8</b>	If Balance of any underwriter is still negative, go to Step 6, otherwise go to Step 9. <b>Note</b> Net Positive Balance represents Net Liability.
<b>Step 9</b>	Additionally for firm underwriting to individual underwriter on actual basis.
<b>Step 10</b>	Calculate total liability by adding Step 8 and Step 9

## **HOW TO PREPARE STATEMENT SHOWING THE NET AND TOTAL LIABILITY OF UNDERWRITERS**

### STATEMENT SHOWING THE NET AND TOTAL LIABILITY OF UNDERWRITERS (NO. OF SHARES)

Particulars	Basis	A	B	C	Total
<b>A. Gross Liability (No. of Shares)</b>	Ratio of shares underwritten	.....	.....	.....	.....
<b>B. Less: Marked Applications</b>	Actual				
<b>C. Balance (A-B)</b>		(...)	(...)	(...)	(...)
<b>D. Less: Unmarked Applications</b>	Ratio of Gross Liability	.....	.....	.....	.....
<b>[Total Applications-Marked Applications]</b>		(....)	(....)	(....)	(....)
<b>E. Balance (C - D)</b>	Actual Ratio/Ratio of Gross Liability	(....)	(....)	(....)	.....
<b>F. Less: Firm Underwriting</b>					(....)
<b>G. Net Liability (If no. Balance is negative) [E - F]</b>	Actual	.....	.....	.....	.....
<b>H. Add: Liability for firm underwriting</b>		.....	.....	.....	.....
<b>I. Total Liability (G + H)</b>		.....	.....	.....	.....



## **HOW TO PREPARE STATEMENT SHOWING THE NET AMOUNT DUE TO/FROM UNDERWRITERS**

### **STATEMENT SHOWING THE NET AMOUNT DUE TO/FROM UNDERWRITING**

<b>Particulars</b>	<b>A</b>	<b>B</b>	<b>C</b>
A. Total Liability (including firm underwriting) (Number shares)	....	....	....
B. Amount due on Total Liability	.....	.....	.....
C. Less: Amount already paid on Firm Applications	(...)	(...)	(...)
D. Amount due on Net Liability	.....	.....	.....
E. Less: Underwriting Commission	(...)	(...)	(...)
F. Net Amount Due to Underwriters			
Or			
Net Amount Due from Underwriters			

## PRACTICAL QUESTIONS:

Q1. S Ltd issued 50,000 equity shares. The whole of the issue was underwritten as follows:

Red 40%;      Whole 30%;      Blue 30%

Application for 40,000 shares were received in all, out of which applications for 10,000 shares had the stamp of Red; those for 5,000 shares that of White and those for 10,000 shares that of Blue. The remaining applications for 15,000 shares did not bear any stamp.

Determine the liability of the underwriters.

Solution:

Net Liability of Underwriters

	Red (40%) Shares	White (30%) Shares	Blue (30%) Shares
<b>Gross liability in the agreed Ratio of 40: 30: 30</b>	<b>20,000</b>	<b>15,000</b>	<b>15,000</b>
<b>Less: marked applications</b>	<b><u>10,000</u></b>	<b><u>5,000</u></b>	<b><u>10,000</u></b>
<b>Balance left</b>	<b>10,000</b>	<b>10,000</b>	<b>5,000</b>
<b>Less: Unmarked applications In the ratio of gross liability i.e. 40: 30: 30</b>	<b>6,000</b>	<b>4,500</b>	<b>4,500</b>
<b>Net Liability</b>	<b>4,000</b>	<b>5,500</b>	<b>500</b>

Q 2 Albert Ltd issued 50,00,000 Equity shares of `10 each. The whole issue was underwritten by A, B and C as below:

**A 15,00,000 shares**

**B 25,00,000 shares**

**C 10,00,000 shares**

**Applications were received for 48, 50,000 shares of which the market applications were as follows:**

**A 12,00,000 shares**

**B 25,00,000 shares**

**C 8,50,000 shares**

**Calculate the number of shares to be taken up by the underwriters.**

Solution: Calculation of Number of shares to be taken up by the underwriters

	<b>A</b>	<b>B</b>	<b>C</b>
Gross Liabilities (3: 5: 2)	15,00,000	25,00,000	10,00,000
Less: Market applications	12,00,000	25,00,000	8,50,000
	3,00,000	Nil	1,50,000
Less: Unmarked applications in #: 5: 2 ratio (Refer working note 1)	90,000	1,50,000	60,000
	2,10,000	(1,50,000)	90,000
Less: Surplus B allocated to A & C in 3: 2 ratio	90,000	1,50,000	60,000
Number of shares to be taken up by the underwriters	1,20,000	Nil	30,000

### **Working Notes: Unmarked applications**

To applications received

48,50,000

Less: Marked applications

A 12,00,000

B 25,00,000

C 8,50,000

45, 50,000

Unmarked applications

3,00,000

**Q 3 Consider the following data pertaining to three underwriters, Ajay, Samay and Vijay:**

Particulars	Ajay	Samay	Vijay
Share underwritten	8,000	16,000	24,000
Marked application	6,000	8,000	11,000

If total application received are for 44,800 shares. Compute the final liability of Vijay.

**Solution:**

Particulars	Ajay	Samay	Vijay	Total
Share underwritten	8,000	16,000	24,000	48,000
Less: 19,800 Unmarked applications (in the ratio 1: 2; 3) (Refer Note 2)	3,300	6,600	9,900	19,800
	4,700	9,400	14,100	28,200
Less: Marked applications	6,000	8,000	11,000	25,000
	(1,300)	1,400	3,100	3,200
Less: Surplus of Ajay's share (In the ratio 2: 3)	1,300	520	780	Nil
Final Liabilities	Nil	880	2,320	3,200

**Q 4 Gemini Ltd came up with public issue of 30,00,000 Equity shares of ₹10 each at ₹15 per share. A, B and C took underwriting of the issue in 3: 2; 1 ratio.**

Applications were received for 27, 00,000 shares.

The market applications were received as under:

A	8,00,000	shares
B	7,00,000	shares
C	6,00,000	shares

Commission payable to underwriters is at 5% on the face value of shares.

- Compute the liability of each underwriter as regards the number of shares to be taken up.
- Pass journal entries in the books of Gemini Ltd to record the transactions relating to underwriters.

**Solution:**

**(i) Computation of Liability of underwriters in respect of shares**

	(In shares)		
	A	B	C
Gross Liabilities	15,00,000	10,00,000	5,00,000
Less: Unmarked applications	<u>3,00,000</u>	<u>2,00,000</u>	<u>1,00,000</u>
	12,00,000	8,00,000	4,00,000
Less: Marked applications	<u>8,00,000</u>	<u>7,00,000</u>	<u>6,00,000</u>
	4,00,000	1,00,000	(2,00,000)
Surplus of C distributed to A & B in 3: 2 ratio	<u>1,20,000</u>	<u>80,000</u>	<u>2,00,000</u>
Net Liability	<u>2,80,000</u>	<u>20,000</u>	<u>Nil</u>

**(ii)**

**Journal Entries in the books of Gemini Ltd**

Particulars			
A's Account	Dr	42,00,000	
B's Account	Dr	3,00,000	
To Share Capital Account			30,00,000
To Securities Premium Account			15,00,000
(Being the shares to be taken up by the underwriters)			
Underwriting Commission Account	Dr	15,00,000	
To A's Account			7,50,000
To B's Account			5,00,000
To C's Account			2,50,000
(Being the underwriting commission due to the underwriters)			
Bank Account	Dr	34,50,000	
To A's Account			



(Being the amount received from underwriters A for the sales taken up by him after adjustment of his commission)		34,50,000
B's Account Dr To Bank Account (Being the amount paid to underwriters B after adjustment of the shares taken by him against underwriters commission due to him)	2,00,000	2,00,000
C's Account Dr To bank Account (Being the underwriting commission paid to C)	2,50,000	2,50,000

**Q 5 Chaitanya Limited issues 40,000 shares. Issue is underwritten by A, B and C in the ratio of 5: 3: 2 respectively. Unmarked applications totaled 2,000 whereas marked applications are as follows:**

Underwriters	Application (Number of debentures)
A	16,000
B	5,700
C	8,300

**Calculate the net liability of each one of the underwriters.**

**Solution:**

**Statement showing net liability of underwriters**

Particulars	A	B	C	Total
Gross Liability	20,000	12,000	8,000	40,000
Less: Unmarked applications In the ratio of 5: 3: 2	1,000	600	400	2,000
	19,000	11,400	7,600	38,000
Less: Marked applications	16,000	5,700	8,300	30,000
	3,000	5,700	(700)	8,000
Credit of C's surplus to A and B in the ratio of 5:3	(438)	(262)	700	-
No Liability	2,562	5,438	-	8,000

**Q 6 Delta Ltd issue 25,00,000 equity shares of `10 each at par. 7,00,000 shares were issued to the promoters and the balance offered to the public was underwritten by three underwriters P, Q & R in the ratio of 2: 3: 4 with firm underwriting of 50,000, 60,000 and 70,000 shares each respectively. Total subscription received 13,88,000 shares including marked application and excluding firm underwriting were as:**

P	3,00,000
Q	3,50,000
R	4,50,000

**Unmarked and surplus applications to be distributed in Gross liability ratio.**

**Ascertain the liability of each underwriter.**

**Solution:**

**Calculation of Liability of Underwriters  
(In Shares)**

Particulars	P	Q	R	Total
Gross Liability	4,00,000	6,00,000	8,00,000	18,00,000
Less: Firm underwriting	(50,000)	(60,000)	(70,000)	(1,80,000)
	3,50,000	5,40,000	7,30,000	16,20,000
Less: Marked applications received	(3,00,000)	(3,50,000)	(4,50,000)	(11,00,000)
	50,000	1,90,000	2,80,000	5,20,000
Less: Unmarked applications (In gross liability ratio 4: 6: 8)	(64,000)	(96,000)	(1,28,000)	(2,88,000)
Balance	(14,000)	94,000	1,52,000	2,32,000
Excess of P distributed to Q & R in ratio (3: 4)	14,000	(6,000)	(8,000)	-
Net liability (Other than firm underwriting)				

Add: Firm underwriting	-	88,000	1,44,000	2,32,000
	50,000	60,000	70,000	1,80,000
Total liability of underwriters Including Firm underwriting	50,000	1,48,000	2,14,000	4,12,000
Total liability in amount @ `10 each	5,00,000	14,80,000	21,40,000	41,20,000

**Q 7 A Company entered into an underwriting agreement with Mr. B for 60% of the issue of `50, 00,000 15% debentures, with a firm underwriting of `5, 00,000. Marked applications were in respect of debentures worth `35, 00,000. Compute liability of Mr. B and commission payable to him.**  
**Solution:**

Gross Liability (`50, 00,000 x 60%)	30,00,000
Less: Marked applications `35, 00,000 which is more than the Liability but credit will not be given more than gross liability	30,00,000
Net Liability	Nil
Add: Firm underwriting	5,00,000
Total Liability	5,00,000

Calculation of underwriting commission =  $30,00,000 \times 2.5/100$  = `75, 000  
Underwriting Commission Payable @ 2.5% 75,000

**Q 8 M Ltd issued 50,000 equity shares of which Green underwrote only 60%. Applications for 45,000 shares were received in all out of which applications for 26,000 were marked. Determine the liability of Green.**

**Solution:**

Gross liability of Green being 60% of 50,000 shares  
i.e.  $60/100 \times 50,000$  = 30,000 shares  
Less: Marked applications = 26,000 shares  
Net liability of Green = 4,000 shares

**Notes:**

- (1) If the marked applications were for 30,000 shares or more. Green would have had no liability at all.
- (2) If the applications received by the company were for all the 50,000 shares. Green would have no liability at all even though the marked applications were for 26,000 shares.
- (3) If the applications received by the company were for 48,000 shares. Green's liability would have been restricted to  $(50,000 - 48,000) = 2,000$  shares, even though the marked applications were for 26,000 shares.

Sometimes, it may so happen that the information as to the marked applications and unmarked applications may not be given in the problem. In such a case, it has to be assumed that out of the total applications received by the company, the number of applications proportionate to that part of the issue underwritten have been received through the underwriters.

**Q 9 Goods Earths Ltd. Issued 30,000 6% Debentures of `100 each. 60% of the issue was underwritten by Black. Applications for 28,000 debentures were by the company.**

**Determine the liability of Black.**

**Solution:**

Gross liability of Black being 60% of 30,000 Debentures i.e.  $60/100 \times 30,000$  = 18,000 debentures

Less: marked applications assumed 60% of 28,000 i.e.  $60/100 \times 28,000$  = 16,800 debentures

Net liability of Black = 1,200 debentures

Alternatively, Black's liability can be determined in the following way:

Number of debentures not subscribed for by the public =  $(30,000 - 28,000)$   
= 2,000 debentures

Black's liability = 60% of 2,000 debentures  
=  $60/100 \times 2,000 = 1,200$  debentures



**Q 10** Satellite Ltd. Issued 12% 10,000 Preference Shares of `10 each. The issue was underwritten as follows:

**Apple 30%; Mango 30%; Orange 20%**

Application for 8,000 shares were received by the company in all. Determine the liability of the respective underwriters.

**Solution:**

	<b>Apple (30%) Shares</b>	<b>Mango (30%) Shares</b>	<b>Orange (20%) Shares</b>
Gross Liability in the agreed ratio Or 30: 30: 20	3,000	3,000	2,000
Less: Marked application i.e. 8,000 application in the ratio of 3/10: 3/20: 2/10	2,400	2,400	1,600
Net liability	600	600	400

Alternatively, the liability of the respective underwriters can also be determined the following manner:

Shares Issued 10,000

Less: Application received 8,000

Unsubscribe Shares 2,000

Apple's liability = 30% of 2,000 = 600 shares

Mango's liability = 30% of 2,000 = 600 shares

Orange's liability = 20% of 2,000 = 400 shares

Total liability of Apple, Mango and Orange

= 600 + 600 + 400 = 1,600 shares

Which represent 80% of the total issue underwritten. The balance (2,000 - 1,600) = 400 shares representing 20% of the issue not underwritten will remain as unissued.



## **MCQ FOR PRACTICE**

Q1. Application forms bearing the stamps of respective underwriters are known as:

- (A) Unmarked Applications
- (B) Firm Applications
- (C) Marked Applications
- (D) None of the Above

Q2. Applications forms received directly by the company are known as:

- (A) Unmarked Applications
- (B) Firm Applications
- (C) Marked Applications
- (D) None of the Above

Q3. Applications forms which do not bear any stamp of the underwriters are termed as:

- (A) Unmarked Applications
- (B) Firm Applications
- (C) Marked Applications
- (D) None of the Above

Q4. The benefit of unmarked applications is given to the:

- (A) To the company
- (B) To all the underwriters in equal proportion
- (C) To the underwriters having maximum gross liability
- (D) To all the underwriters in the ratio of gross liability

Q5. The benefit of surplus/negative balance of any individual underwriter is given:

- (A) To company
- (B) To all the other underwriters in proportion in gross liability
- (C) To all the other underwriters in equal proportion
- (D) None of the above

Q6. The benefit of marked applications is given:

- (A) To all the underwriters in the ratio of gross liability
- (B) To the respective underwriters in whose applications forms have been marked
- (C) To the company
- (D) None of the above

Q7. Lilies Ltd. issued 100,000 equity shares, where the issue was underwritten by 3 underwriters as follows: A 40%; B 30%; C 30%

Applications for 60,000 shares were received in all, out of which applications for 20,000 shares had the stamp of A; those for 10,000 shares that of B and those for 20,000 shares that of C. The remaining applications for 10,000 shares did not bear any stamp. Determine the net liability of the A and B.

- (A) 20,000 shares & 20,000 shares
- (B) 16,000 shares and 7,000 shares
- (C) 16,000 shares & 17,000 shares
- (D) None of the above

Q8. Charu Ltd. issued 50,000 equity shares. The whole of the issue was underwritten as follows: Rohit 40%; Shikhar 30%; Kholi 30%

Applications for 40,000 shares were received in all, out of which applications for 10,000 shares had the stamp of Rohit; those for 5,000 shares that of Shikhar and those for 10,000 shares that of Kholi. The remaining application for 15,000 shares did not bear any stamp.

Determine the liability of Mr. Rohit and Kholi.

- (A) 4,000 and 500 shares
- (B) 4000 and 10,000 shares
- (C) 4,000 and 5500 shares
- (D) None of the above

Q9. Hyper Ltd. issued 100,000 shares for public subscription and these shares were underwritten by A, B and C in the ratio of 25%, 30% and 45% respectively. 20,000 shares had the stamp of B. Unmarked applications received by the company 10,000 shares. Calculate net liability of Mr. B

- (A) 30,000 shares
- (B) 10,000 shares
- (C) 7,000 shares
- (D) 9,000 shares

Q10. Kabir Ltd issued 60,000 10% preference shares. The whole of the issue was underwritten as follows: A - 40%, B - 30%; C - Balance.

Applications for 16,000 shares had the stamp of underwriter C. Applications for 10,000 shares did not bear any stamp. Calculate net liability of Mr. C:

- (A) 2,000 shares
- (B) NIL
- (C) 1,000 shares
- (D) None of the above

Q11. Newton Limited incorporated on 1<sup>st</sup> Jan 2019 issued a prospectus inviting applications for 20,000 equity shares of Rs 10 each. The whole issue was fully underwritten by A, B and C as follows:

A - 10,000 shares; B - 6,000 shares; C - 4,000 shares

Applications were received for 16,000 shares, out of which marked applications were as follows:

- A 8,000 shares
- B 2,850 shares
- C 4,150 shares

You are required to find out the net liabilities of individual underwriters

- (A) 1500, 2850 & Nil
- (B) 1500, 2850, 350
- (C) 1281, 2719 & Nil
- (D) None of the above

Q12. Sampada Ltd. was formed with a capital of Rs 20,00,000 divided into 200,000 equity shares of Rs 10 each. The issue was underwritten as follows:

Ajay : 80,000 shares; Bijoy : 60,000 shares; and Rajat : 60,000 shares.

Marked applications were received in favour of Ajay for 32,000 shares; Bijoy for 58,000 shares and Rajat for 42,000 shares. Applications for 30,000 shares were not marked.

Determine net liability of Ajay, Bijoy and Rajat

- (A) 32,000 shares; Nil; 6000 Shares

- (B) 36,000 shares; NIL; 9,000 shares
- (C) 32,000 shares; 7,000 shares and 6,000 shares
- (D) None of the above

Q13. The distinction of marked and unmarked applications is not required if:

- (A) There is single underwriter
- (B) There are only two underwriters
- (C) There are multiple underwriters
- (D) None of the above

Q14. In case of single underwriter, it is not necessary to calculate how many applications are marked i.e. sent through underwriter or unmarked i.e. received directly by the company.

- (A) Statement is correct
- (B) Statement is not correct
- (C) Statement is partially correct
- (D) Can't say

Q15. If shares are oversubscribed by the public, the underwriter is free from his liability.

- (A) Statement is correct
- (B) Statement is not correct
- (C) Statement is partially correct
- (D) Can't say

Q16. The consideration which is payable to underwriters for underwriting the issue is known as:

- (A) Brokerage
- (B) Underwriting Commission
- (C) Underwriting Charges
- (D) None of the above

Q17. In case of underwriting of equity or preference shares, the maximum rate of commission payable to the underwriters as per Companies Act 2013:

- (A) 2.5%
- (B) 5%
- (C) 7.5%
- (D) 4%

Q18. Section \_\_\_\_\_ of the Companies Act 2013, provides that a company may pay commission to underwriters.

- (A) 40(6)
- (B) 76(6)
- (C) 41(6)
- (D) 43(6)

Q19. In case of underwriting of debentures/Bonds, the maximum rate of commission payable to the underwriters as per Companies Act 2013:

- (A) 2.5%
- (B) 5%
- (C) 7.5%



(D) 4%

Q20. The underwriting Commission is always payable on \_\_\_\_\_ of shares.

- (A) Face Value
- (B) Issue Value
- (C) Called Up value
- (D) Paid up Value

Q21. Underwriting Commission is payable on the shares taken up by the promoters is

- (A) 5% of the issue value of shares
- (B) 5% of the face value of shares
- (C) Nil
- (D) 2.5% of the issue value of shares

Q22. Application for shares which are eligible for underwriting commission

- (A) Marked Applications
- (B) Unmarked Applications
- (C) Shares subscribed by Underwriters
- (D) Shares underwritten by Underwriters

Q23. Underwriting Commission is payable to underwriters on:

- (A) Net Liability
- (B) Gross Liability
- (C) Marked Applications
- (D) Unmarked Applications

Q24. X Ltd. issued to public 150,000 equity shares of Rs 10 each at premium of Rs 5 per share. The entire issue is underwritten by M Ltd. Marked Applications received by the company are 120,000 shares. What is the underwriting commission payable to M Ltd.

- (A) Rs 37,500
- (B) Rs 112,500
- (C) Rs 56,250
- (D) Rs 75,000

Q25. X Ltd. issued to public 150,000 12% Debentures of Rs 100 each at premium of Rs 50 per share. The entire issue is underwritten by M Ltd. Marked Applications received by the company are 120,000 debentures. What is the underwriting commission payable to M Ltd.

- (A) Rs 375,000
- (B) Rs 11,25,000
- (C) Rs 562,500
- (D) Rs 750,000

Q26. X Ltd. issued to public 150,000 10% Debentures of Rs 100 each issued at Rs 96 per share. The entire issue is underwritten by M Ltd. Marked Applications received by the company are 120,000 debentures. What is the underwriting commission payable to M Ltd.

- (A) Rs 375,000
- (B) Rs 720,000
- (C) Rs 360,000
- (D) Rs 750,000

Q27. X Ltd. issued to public 150,000 10% Debentures of Rs 100 each issued at Rs 96 per share. The entire issue is underwritten by M Ltd. Marked Applications received by the company are 120,000 debentures. The underwriters discharged liability and were paid commission at the rate of 2% on the nominal value of debentures. What is the underwriting commission payable to M Ltd.

- (A) Rs 300,000
- (B) Rs 288,000
- (C) Rs 360,000
- (D) Rs 750,000

Q28. XYZ Ltd. issued 60,000 shares of Rs 10 each at a premium of Rs 15. Entire issue is underwritten by A, B and C equally. Calculate commission payable to Mr. B

- (A) Rs 25,000
- (B) Rs 35,000
- (C) Rs 15,000
- (D) Rs 30,000

Q29. XYZ Ltd. issued 60,000 shares of Rs 10 each at Rs 15. Entire issue is underwritten by A, B and C equally. Calculate commission payable to Mr. B

- (A) Rs 25,000
- (B) Rs 35,000
- (C) Rs 15,000
- (D) Rs 30,000

Q30. ABC Ltd. issued 100,000 equity shares of Rs 100 each at Rs 140. 20% of the issue is reserved for promoters. Entire public issue is underwritten by Mr. Mohit for a commission permitted by Companies Act. Calculate commission payable to Mr Mohit

- (A) Rs 630,000
- (B) Rs 560,000
- (C) Rs 500,000
- (D) Rs 700,000

Q31. ABC Ltd issued 50,000 equity shares of Rs 100 each at premium of Rs 20. Entire issue is underwritten by A, B and C in 4:3:3. It was decided to pay commission @ 4% on face value of shares. Calculate commission payable to Mr. C

- (A) Rs 20,000
- (B) Rs 60,000
- (C) Rs 25,000
- (D) Rs 75,000

Q32. ABC Ltd. issued 100,000 debentures of Rs 100 each at Rs 96. Entire issue is underwritten by Mr. Ansh. Calculate the maximum commission payable to Mr. Ansh.

- (A) 250,000
- (B) 240,000
- (C) 340,000
- (D) 480,000

Q33. Abhi Ltd. issued to public 20,000 equity share of Rs 100 each at par payable Rs 70 per share along with application and balance on allotment. The issue was underwritten equally A and B for a commission of 4%. What is the commission payable to Mr. B

- (A) 40,000
- (B) 28,000
- (C) 50,000
- (D) 80,000

Q34. Sunny Ltd. issued to public 20,000 equity share of Rs 100 each at premium of Rs 20 per share, payable Rs 70 per share along with application and balance on allotment. The issue was underwritten equally A and B for a commission of 4%. What is the commission payable to Mr. B

- (A) 40,000
- (B) 28,000
- (C) 48,000
- (D) 80,000

Q35. Which of the following statement is correct?

- (A) Firm Underwriting Shares can be treated same as marked applications
- (B) Firm Underwriting shares can be treated same as unmarked applications
- (C) Both A and B
- (D) None of the above

Q36. The underwriter is liable to take to:

- (A) The number of share he/she has applied for "Firm"
- (B) The number of shares he/she is liable to take up on the basis of the underwriting agreement
- (C) Both (A) and (B)
- (D) None of the above

Q37. The underwriters take up the agreed number of share or debentures in addition to his net liability of shares or debentures, these shares are known as \_\_\_\_\_.

- (A) Company Underwriting
- (B) Shares Underwriting
- (C) Debentures Underwriting
- (D) Firm Underwriting

Q38. The total liability of each underwriter consist of

- (A) Net liability as per agreement
- (B) Firm Underwriting
- (C) Both of the above
- (D) None of the above

Q39. XYZ Ltd. issued 200,000 equity shares of Rs 10 each. The entire issue was underwritten by Mr. S with a provision of firm underwriting of 30,000 shares. Marked application received 85,000 shares. Unmarked Applications received 25,000 shares. Calculate total liability of Mr. S.

- (A) 60,000 shares
- (B) 90,000 shares
- (C) 120,000 shares
- (D) None of the above



Q40. XYZ Ltd. issued 100,000 equity shares of Rs 10 each. The entire issue was underwritten by Mr. A with a provision of firm underwriting of 15,000 shares. Marked application received 65,000 shares. Unmarked Applications received 10,000 shares. Calculate total liability of Mr. A.

- (A) 25,000 shares
- (B) 10,000 shares
- (C) 40,000 shares
- (D) None of the above

Q41. XYZ Ltd. issued 100,000 equity shares of Rs 10 each. The entire issue was underwritten by Mr. A with a provision of firm underwriting of 10,000 shares. Marked application received 85,000 shares. Unmarked Applications received 5,000 shares. Calculate total liability of Mr. A.

- (A) 20,000 shares
- (B) Nil
- (C) 10,000 shares
- (D) None of the above

Q42. XYZ Ltd. issued 100,000 equity shares of Rs 10 each. The entire issue was underwritten by A, B and C in the 4:3:3.

Firm Underwriting for C 4,000 shares, Marked Application received of C 15,000 shares. The unmarked applications are 20,000 shares

Calculate total liability of Mr. C.

- (A) 5,000 shares
- (B) Nil
- (C) 9,000 shares
- (D) None of the above

Q43. Airlinks Ltd. made a public issue of 250,000 equity shares of Rs 10 each, the entire amount payable on application. The entire issue was underwritten as follows:

Red – 30%; Yellow – 25%; Green – 25%; White – 20%

Red, Yellow, Green and White had also agreed on firm underwriting of 8,000 shares, 12,000 shares, nil and 30,00 shares respectively. The total subscription excluding firm underwriting, including marked applications were 180,000 shares.

The marked applications received were as follows:

RED – 48,000 shares; Yellow – 40,000 shares; Green – 24,000 shares; White – 48,000 shares Ascertain the net liability of all the underwriters:

- (A) Nil, Nil, Nil, 20,000 shares
- (B) Nil, Nil, 20,000 shares, Nil
- (C) 20,000 shares, Nil, Nil, Nil
- (D) Nil, 20,000 shares, Nil, Nil

Q44. Royal Ltd. came up with a public issue of 200,000 equity share of Rs 10 each at Rs 20 per share. A, B and C took underwriting of the issue in the ratio of 3:2:1 with the provisions of firm underwriting of 10,000, 4,000 and 5,000 shares respectively.

Applications were received for 150,000 shares excluding firm underwriting. The marked applications from the public were received as under:

A – 70,000 shares, B – 40,000 shares; C – 40,000 shares

Compute the net liability of A, B and C as regards the number of shares to be taken up assuming that the benefit of firm underwriting is given to individual underwriters.

- (A) 14,600, 16,400 and NIL
- (B) 20,500, 20,334 and Nil
- (C) 13,000, 18000 and NIL
- (D) None of the above

Q45. Royal Ltd. came up with a public issue of 200,000 equity share of Rs 10 each at Rs 20 per share. A, B and C took underwriting of the issue in the ratio of 3:2:1 with the provisions of firm underwriting of 10,000, 4,000 and 5,000 shares respectively.

Applications were received for 150,000 shares excluding firm underwriting. The marked applications from the public were received as under:

A – 70,000 shares, B – 40,000 shares; C – 40,000 shares

Compute the net liability of A, B and C as regards the number of shares to be taken up assuming that the benefit of firm underwriting is **not** given to individual underwriters.

- (E) 14,600, 16,400 and NIL
- (F) 20,500, 20,334 and Nil
- (G) 13,000, 18000 and NIL
- (H) None of the above

Q46. Sunshine Ltd. issued a public issue of 10,000 shares of Rs 10 each at Rs 15 per share. The entire issue was underwritten by A and B in the ratio of 3:2. Firm Underwriting by A and B are 2,000 and 1000 shares respectively. Firm underwriting is treated at par with **marked applications**. How much firm applications will be adjusted against liability of A and B.

- (A) 1500 and 1500 shares
- (B) 2,000 and 1000 shares
- (C) 1800 and 1200 shares
- (D) None of the above

Q47. Sunshine Ltd. issued a public issue of 10,000 shares of Rs 10 each at Rs 15 per share. The entire issue was underwritten by A and B in the ratio of 3:2. Firm Underwriting by A and B are 2,000 and 1000 shares respectively. Firm underwriting is treated at par with **unmarked applications**. How much firm applications will be adjusted against liability of A and B.

- (A) 1500 and 1500 shares
- (B) 2,000 and 1000 shares
- (C) 1800 and 1200 shares
- (D) None of the above

### **Use the following Problem to Solve Questions 48 to 54**

Sam Limited invited applications from public for 1,00,000 equity shares of Rs 10 each on a premium of Rs. 5 per share. The entire issue was underwritten by the underwriters Anita, Babita, Chavi and David to the extent of 30%, 30%, 20% and 20% respectively with the provision of firm underwriting of 3,000, 2,000, 1,000 and 1,000 shares respectively. The underwriters were entitled to the commission @ 2.5%.

The company received applications for 70,000 shares from public out of which applications for 19,000, 10,000; 21000 and 8,000 shares were marked in favour of Anita, Babita, Chavi and David respectively.

Q48. What is net liability of Mr. Babita?

- (A) 2750 shares
- (B) 12750 shares
- (C) 14750 shares
- (D) Nil

Q49. What is the net liability of Mr. David?

- (A) 8,500 shares
- (B) 7,500 shares
- (C) 1,000 shares
- (D) 14,750 shares

Q50. What is the liability of Anita?

- (A) 2,750 shares
- (B) 12,750 shares
- (C) 5,750 shares
- (D) 3,000 shares

Q51. What is underwriting Commission payable to Babita?

- (A) Rs 7,500
- (B) Rs 11,250
- (C) Rs 7,000
- (D) None of the above

Q52. What is the Gross amount receivable from Anita on account of shares subscribed?

- (A) Rs 41,250
- (B) Rs 85,000
- (C) Rs 57,500
- (D) Rs 86,250

Q53. What is net amount received/paid in full settlement from/to David?

- (A) Rs 120,000
- (B) Rs 105,000
- (C) Rs 67,500
- (D) Rs 77,500

Q54. What is net amount received/paid in full settlement from/to Chavi?

- (A) Rs 7,500 received from Chavi
- (B) Rs 7,500 paid to Chavi
- (C) Nil
- (D) None of the above

Q55. Aditiya Ltd. issued 120,000 equity shares of Rs 10 each at Rs 15 per share. The entire issue was underwritten by Mr. A. Applications received from public 110,000 shares. How much amount will be receivable from A in final settlement.

- (A) Rs 150,000
- (B) Rs 90,000



- (C) Rs 60,000
- (D) None of the above

Q56. Shiva Ltd. issued 150,000 equity shares of Rs 10 each at Rs 15 per share. The entire issue was underwritten by Mr. Raman. Raman has committed firm applications for 15,000 shares. Applications received from public 140,000 shares. How much amount will be receivable from Mr. Raman in final settlement.

- (A) Rs 225,000
- (B) Rs 150,000
- (C) Rs 112,500
- (D) None of the above

Q57. Which of the following is the correct Entry for shares issued to underwriter:

- (A) Underwriter                      Dr.  
     To Equity Share Capital A/c  
     To Security Premium Reserve A/c
- (B) Underwriter                      Dr.  
     To Equity Share Capital A/c
- (C) Underwriter                      Dr.  
     To Underwriting Commission A/c
- (D) None of the above

Q58. Which of the following is the correct Entry for underwriting Commission Payable to underwriters:

- (A) Underwriter                      Dr.  
     To Equity Share Capital A/c
- (B) Underwriter Commission A/c                      Dr.  
     To Underwriters
- (C) Underwriter                      Dr.  
     To Underwriting Commission A/c
- (D) None of the above

Q59. When we allot shares or debentures to underwriters, underwriter A/c is

- (A) Credited
- (B) Debited
- (C) Neither Debited nor credited
- (D) None of these

Q60. When the amount receivable on account of shares issued to underwriter because of liability is more than the underwriting commission payable, then in final settlement cash is \_\_\_\_\_ from underwriter

- (A) Received
- (B) Paid
- (C) Ignored
- (D) None of these above

Q61. When the amount receivable on account of shares issued to underwriter because of liability is less than the underwriting commission payable, then in final settlement cash is \_\_\_\_\_ from underwriter

- (A) Received
- (B) Paid
- (C) Ignored

(D) None of these above

Q62. When the amount receivable on account of shares issued to underwriter because of liability is more than the underwriting commission payable, then journal entry for full settlement:

(A) Bank A/c Dr.

To Underwriter A/c

(B) Underwriter A/c Dr.

To Bank A/c

(C) No Entry

(D) None of these above

Q63. When the amount receivable on account of shares issued to underwriter because of liability is less than the underwriting commission payable, then journal entry for full settlement:

(A) Bank A/c Dr.

To Underwriter A/c

(B) Underwriter A/c Dr.

To Bank A/c

(C) No Entry

(D) None of these above

Q64. When the whole of the issue of share or debentures is underwritten, it is said to be

(A) Incomplete Undertaking

(B) Firm Undertaking

(C) Partial Undertaking

(D) Complete Underwriting

Q65. Where the only a part of shares or debentures issue of a company is underwritten, it is said to be

(A) Incomplete Undertaking

(B) Firm Undertaking

(C) Partial Undertaking

(D) Complete Underwriting

Q66. ABC Ltd. wants to issue 50,000 shares of Rs 10 each which is underwritten by A and B as under: A 40%; B 30%

Marked Applications of A and B are 12,000 shares and 10,000 shares. Unmarked applications received by Company are 20,000 shares. Calculate net liability of Mr. A and Mr. B

(A) 5143 and 2857 Shares

(B) 6000 and 3500 Shares

(C) 8000 and 5000 Shares

(D) None of the above

Q67. Mona Ltd. issued 50,000 shares out of which 60% was underwritten by Sun Ltd. Application for 45,000 shares were received in all out of which application for 26,000 were marked. Determine the liability of Sun Ltd.

(A) 4,000 shares

(B) 1,000 shares

(C) 1,900 shares

(D) None of the above

Q68. Ramson Ltd., issued 50,000 equity shares of which only 60% was underwritten by Green. Applications for 45,000 shares were received in all out of which applications for 26,000 were marked. Determine the liability of Green.

- (A) 5,000 shares
- (B) 4,000 shares
- (C) NIL
- (D) None of the above

Q69. Ramson Ltd., issued 50,000 equity shares of which only 60% was underwritten by Green. Applications for 48,000 shares were received in all out of which applications for 26,000 were marked. Determine the liability of Green.

- (A) 2,000 shares
- (B) 4,000 shares
- (C) Nil
- (D) None of the above

Q70. ABC Ltd. issued 30,000 6% debentures of Rs 100 each. 60% of the issue was underwritten by Delton. Applications for 28,000 debentures were received by the company. Determine the net liability of delton.

- (A) 2,000 shares
- (B) 1,200 shares
- (C) Nil
- (D) None of the above

Q71. Binsar Ltd. issued 12% 10,000 preference shares of Rs 10 each. The issue was underwritten as follows: Apple 30%; Mango 30%, Orange 20%. Applications for 8,000 shares were received by company in all. Determine the liability of the respective underwriters.

- (A) 3000, 3000 and 2000 shares
- (B) 2400, 2400 and 1600 shares
- (C) 600, 600 and 400 shares
- (D) None of the above

Q72. Gentle Ltd. issued 30,000 6% Debentures of Rs 100 each. 60% of the issue was underwritten by Sam. Applications for 28,000 debentures were received by the company. Determine the net liability of Sam.

- (A) 1200 Debentures
- (B) 800 Debentures
- (C) 11,200 debentures
- (D) None of the above

Q73. Strong Ltd. issued 14% 20,000 Preference shares of Rs 100 each. The issue was underwritten by A 30%; B 30% and C 20%.

Applications for 18,000 shares were received by the company in all. Determine the liability of A, B and C.

- (A) 600, 600 and 400 Shares
- (B) 600, 400 and 600 Shares
- (C) 400, 600 and 600 shares
- (D) None of the above



Q74. In case of partial underwriting, the benefit of unmarked is first given to

- (A) Company
- (B) Underwriter
- (C) Shareholder
- (D) None of the above

Q75. In partial Underwriting, it is said that a portion of issue is underwritten by \_\_\_\_\_ itself.

- (A) Company
- (B) Creditors
- (C) Shareholder
- (D) None of the above

Q76. Brokers merely \_\_\_\_\_ to attempt of secure subscriptions of shares or debentures while underwriters \_\_\_\_\_ to get the shares or debentures subscribed.

- (A) Promise; Promise
- (B) Guarantee; Guarantee
- (C) Guarantee; Promise
- (D) Promise; Guarantee

Q77. Underwriters may be:

- (A) Individuals
- (B) Partnership firms
- (C) Company
- (D) All of the above

Q78. Which of the following statement is true?

- (A) Brokers guarantee the subscription of shares or debentures
- (B) Underwriters get commission on shares taken by promoters.
- (C) In Case of Partial Undertaking, the benefit of unmarked applications is first given to company
- (D) Underwriters can only be partnership firm

Q79. At the time of issuance, shares can be underwritten by-

- (A) Only one underwritten
- (B) At least 2 or more person jointly
- (C) Any number of underwriters
- (D) None of the above

Q80. Statement 1: An underwriter while entering into a contract for issue of shares should be a registered company.

Statement 2: The applications bearing the stamp of the respective underwriter is known as unmarked applications

- (A) Both statement are incorrect
- (B) Both statement are correct
- (C) Statement 1 is incorrect but statement 2 is correct
- (D) Statement 1 is correct but statement 2 is incorrect

Q81. The issue of 100,000 shares of Rs. 10 each at Rs. 11 made by X Ltd. was underwritten by M/s A and B. Subscriptions totalled 125,000 shares. What is the liability of the underwriters and what is the maximum commission that they can get under the law?

- (A) NIL and Rs 27,500 (B) 25,000 and Rs 55,000  
(C) NIL and Rs 55,000 (D) None of these

Q82. M/s X and Y entered into an underwriting agreement with Y Ltd. for 60% of the issue of 15% 50,00,000 Debentures with a firm underwriting of 5,00,000. Marked applications were for 35,00,000 debentures.

What is the liability of the underwriter?

- (A) Nil (B) 500,000 (C) 900,000 (D) 400,000

Q83. 70% of an issue of 10,00,000 shares of Rs 10 each is underwritten by M/s K and Y. Applications totalled 8,00,000 shares. What is the liability of the underwriters?

- (A) Nil (B) 140,000 (C) 200,000 (D) None of these

Q84. 80% of an issue of 1,00,000 shares of Rs. 100 each, issued at a premium of 20% was underwritten by M/s G and G along with a firm underwriting of 10,000 shares. The total number of shares applied for was 90,000. How many shares must G and G take?

- (A) 10,000 (B) 18,000 (C) 8,000 (D) Nil

Q85. The Underwriters Ltd. agreed to underwrite the new issue of 50,000 equity shares of Rs. 100 each of A Ltd. The agreed commission was 5% payable as 40% in cash and rest in fully paid-up equity shares. The public subscribed for 30,000 shares and the rest had to be taken by the underwriters. These shares were subsequently quoted in the market at 10% discount. Calculate Total number of equity shares issued to underwriters Ltd.

- (A) 20,000 (B) 21,500 (C) 21,667 (D) None of these

Q86. Doon Ltd. issued 20,000 equity shares of Rs 100 each at Rs 160. 30% of the issue is reserved for promoters. 60% of the public issue is underwritten by Mr. A for a commission permitted by Companies Act. Calculate commission payable to Mr. A

- (A) Rs 160,000  
(B) Rs 67,200  
(C) Rs 96,000  
(D) None of the above

Q87. Wye Co. Ltd, invited the public to subscribe to the following:

- (i) 10,000 equity shares of Rs. 100 each at a premium of 5% and  
(ii) 2,500, 14% Debentures of Rs. 100 @ 96.

60% of the shares and the whole of the issue of debentures were underwritten by M/s Sure and Fast for the commission allowable by the Government. The applications from the public totalled 6,000 shares and 2,000 debentures. The underwriters fulfilled their obligations of the company. Underwriting commission is paid at 2.5%. Calculate underwriting Commission:

- (A) Rs 15,750 (B) Rs 20,550  
(C) Rs 21,750 (D) None of the above

# ANSWERS

1. C	2. A	3. A	4. D
5. B	6. B	7. C	8. A
9. C	10. B	11. C	12. A
13. A	14. A	15. A	16. B
17. B	18. A	19. A	20. B
21. C	22. D	23. B	24. B
25. C	26. C	27. A	28. A
29. C	30. B	31. B	32. B
33. A	34. C	35. C	36. C
37. D	38. C	39. B	40. A
41. C	42. C	43. B	44. C
45. A	46. B	47. C	48. B
49. B	50. C	51. B	52. D
53. A	54. A	55. C	56. C
57. A	58. B	59. B	60. A
61. B	62. A	63. B	64. D
65. C	66. A	67. A	68. B
69. A	70. B	71. C	72. A
73. A	74. A	75. A	76. D
77. D	78. C	79. C	80. A
81. C	82. B	83. B	84. A
85. C	86. B	87. C	



# CHAPTER – 3 | BONUS SHARES

Section 63 of the companies act 2013 deals with the issue of bonus shares. According to sub section(1) of this section, a company may issue fully paid bonus shares to the members, in any manner whatsoever, out of-

- i) its free reserves
- ii) the securities premium account
- iii) capital redemption reserve account

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

## **Conditions for bonus issue:**

- a) it is authorised by its articles
- b) it has, on the recommendation of the board, been authorised in the general meeting of the company.
- c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
- d) it has not defaulted in respect of payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.
- e) the partly paid up shares, if any outstanding on the date of allotment, are made fully paid up
- f) it complies with such conditions as may be prescribed

## **Journal Entries:**

### **A) 1) Upon the sanction of bonus issue:**

Capital redemption reserve A/c	.....Dr
Securities premium A/c	.....Dr
Capital reserve A/c(realised in cash)	.....Dr
General reserve A/c	.....Dr
P/L A/c	.....Dr
To Bonus to shareholders A/c	

### **2) Upon issue of bonus shares**

Bonus to shareholders A/c	.....Dr
To Share capital A/c	

### **B) 1) Upon the sanction of bonus by converting partly paid shares into fully paid shares**

Capital Reserve A/c(realised in cash only)	.....Dr
General Reserve A/c	.....Dr
Profit & Loss A/c	.....Dr
To Bonus to shareholders A/c	

### **2) On making final call due**

Share final call A/c	.....Dr
To Share capital A/c	

### **3) On adjustment of final call**

Bonus to shareholders A/c	.....Dr
To share final call A/c	

## **Provisions of Companies Act, 2013 relating to bonus issue of shares**

**Section 63 of the Companies Act, 2013** makes the following provisions relating to bonus issue:

(1) A company may issue fully pair-up bonus shares to its members out of:

- Free reserves
- Securities premium
- Capital redemption reserve

However, revaluation reserve created by the revaluation of assets cannot be used for the bonus issue.

(2) A company shall comply with following additional condition for bonus shares:

- Bonus issue is authorized by its articles.
- Bonus issue is made on the recommendation of the Board and authorization from general meeting of the company.
- Company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
- Company has not defaulted in payment of statutory dues of the employees like PF contribution, gratuity and bonus.
- Company has not defaulted in payment of statutory dues of the employees like PF contribution, gratuity and bonus.
- Bonus issue can be made only on fully paid up shares.
- Company also has to comply with other prescribed conditions.
- The bonus shares shall not be issued in lieu of dividend.

### **Distinguish between : Bonus Shares & Right Shares**

Following are the main points of distinction between bonus shares & right shares :

Points	Bonus Shares	Right Shares
<b>Meaning</b>	Bonus shares are shares issued by a company free of cost to its existing shareholders on a pro rata basis out of free reserve.	When company issues further shares to existing shareholder in ratio of their holding such issue is known as right issue.
<b>Cash flow</b>	In case of bonus issue there is <b>no cash flow</b> .	In case of right issue there is <b>cash inflow</b> to the company.
<b>Consideration</b>	Company does not receive any consideration in case of bonus issue.	Company received consideration as shares are issued against cash.
<b>Authorization</b>	Bonus issue is made on the recommendation of the <b>Board</b> and authorization from general meeting of the company.	In case of right issue authorization from <b>members</b> through ordinary or special resolution is necessary.
<b>Market value</b>	Issue of bonus shares <b>does not affect</b> the market value of the company.	Right issue of shares <b>affects</b> the market value of the company.
<b>Section</b>	It is governed by <b>Section 63</b> of the companies Act, 2013.	It is governed by <b>Section 62</b> of the companies Act, 2013.



## PRACTICAL QUESTIONS

**Q 1** Following information was taken from the books of Golden Tea Ltd. As on 30<sup>th</sup> June 1995: -

10,000 Equity Shares of ` 100 each ` 80 paid up	8,00,000
Capital Reserve	5,80,000
Profit & Loss A/c (Cr.)	3,00,000

The company resolved that all the capital reserve on this date and part of the Profit & Loss A/c be applied in the following manner:-

- (i) The declaration of a bonus at the rate of `20 per Share on equity shares for the purpose of making the above equity shares fully paid;
- (ii) The issue of bonus shares to the equity shareholders in the ratio of one share for every two shares held by them.

**SOLUTION:**

**Total amount required for bonus: -**

(i) ` 20 per share on 10,000 equity shares for making them fully paid      2,00,000

(ii) 1 share for every 2 shares =  $10,000/2 = 5,000$  Shares of ` 100 each      5,00,000  
7,00,000

### JOURNAL

Capital Reserve A/c	Dr.	5,80,000	
Profit & Loss Appropriation A/c	Dr.	1,20,000	
To Bonus to Shareholder's A/c			7,00,000
(All the balance of Capital Reserve and part of the Profit & Loss A/c utilised for declaration of bonus to shareholders)			
Equity share Final Call A/c	Dr.	2,00,000	
To Equity Share Capital A/c			2,00,000
(Final call due on 10,000 equity shares @ `20 per share)			
Bonus to Shareholder's A/c	Dr.	2,00,000	
To Equity Share Final Call A/c			2,00,000
(Final Call adjusted towards payment of bonus)			
Bonus to Shareholder's A/c	Dr.	5,00,000	
To Equity Share Final Call A/c			5,00,000
(Issue of 5,000 shares of ` 100 each as bonus in the ratio of 1 bonus share for 2 shares held)			

**Q 2.** A Company's share capital consists of 20,000 equity shares of ` 100 each, ` 75 paid. It has ` 15,00,000 in Reserve Fund. The directors recommended the following with a view capitalising the reserve:

- (a) The existing shares are made fully paid without the shareholders having to pay anything.
- (b) Each shareholder to be given (proportionate to his holding) bonus shares for the remaining amount, the shares to be valued at ` 125.

Assuming that the scheme is accepted and that all the legal formalities preformed, give journal entries and show in what proportion bonus shares will be distributed among shareholders.

**SOLUTION:**

Amount required as bonus for making the 20,000 equity shares fully paid @ ` 25 per share = ` 5,00,000.  
 Balance left in Reserve Fund will be ` 15,00,000 - ` 5,00,000 = ` 10,00,000

This amount can be utilised for giving new bonus shares at the rate of 125 each. (`100 + ` 25 for premium).

It means the number of new bonus shares will be  $\frac{10,00,000}{125} = 8000$  shares

20,000 equity shares will get these 8,000 bonus shares in the ratio of 20,000: 8,000 i.e., 5 : 2. It means that each holder of 5 equity shares will get 2 bonus shares.



**JOURNAL**

Reserve Fund A/c	Dr.	15,00,000	
To Bonus to Shareholders (All the Reserve fund utilised for declaration of bonus to Shareholders)		5,00,000	15,00,000
Equity Share Final Call A/c	Dr.		5,00,000
To Equity Share Capital A/c (Final call due on 20,000 equity shares @ ` 25 Per share)		5,00,000	
Bonus to Shareholder's A/c	Dr.		5,00,000
To Equity Share Final Call A/c (Final Call adjusted towards payment of bonus)		1000000	
Bonus to shareholders	Dr.		1000000
To Equity share capital (Issue of 8,000 equity shares of ` 100 each at a premium of ` 25 per share, as bonus in the ratio of 2 bonus share for 2 shares already held)			

**Q 2**

Share Capital of Madhu Ltd. Is divided into 4,000 Equity Shares of ` 100 each of which ` 75 has been called up and paid. Following resolutions were passed in its Annual General Meeting held on 20<sup>th</sup> June 1995:

(i) That a capital bonus be distributed out of the profits for the year ending 31<sup>st</sup> March 1995 to make the existing Equity Shares fully paid up.

(ii) That 2,000 new Equity Shares be issued for cash at a premium of 20% on the basis of one Equity Share for every two existing Shares fully held.

The new Shares were all fully subscribed and paid for up to 31<sup>st</sup> July 1995.

Give necessary journal entries in the books of the company.

**SOLUTION:**

**JOURNAL**

Profit & Loss Appropriation A/c	Dr.	1,00,000	
To Bonus to Shareholder's A/c (Bonus to Shareholders declared out of /current Year's profits)			1,00,000
Equity /Share Final Call A/c	Dr.	1,00,000	
To Equity Share Capital A/c (Final Call due on Equity Shares)		1,00,000	1,00,000
Bonus to Shareholder's A/c	Dr.	1,00,000	
To Equity Share Final Call A/c (Final call adjusted towards payment of bonus)		2,40,000	1,00,000
Bank A/c	Dr.		2,40,000
To Equity Share Application & Allotment A/c (Receipt of application money)		2,40,000	
Equity Share Application & Allotment A/c	Dr.		2,00,000
To Equity Share Capital A/c To Securities Premium A/c (Transfer of application money on issue of 2,000 equity shares of ` 100 each at a premium of ` 20 each)			40,000

**Q 3.** SSI Ltd. Has paid-up capital of ` 4,00,000 ( ` 10 per share, ` 8 paid - up). It has balances in general reserve ` 2,00,000, securities premium ` 4,00,000 and Capital redemption reserve ` 1,00,000. It capitalised its reserves to make the shares fully paid-up and then issued bonus shares in the ratio of 1: 2. Pass journal entries.

**SOLUTION:****JOURNAL ENTRIES**

General Reserve A/c (1)	Dr.	1,00,000	
To Bonus to Shareholders A/c			1,00,000
(Bonus declared @ ` 2 per share on 50,000(2) share to Make them fully paid)			
Share Final Call A/c	Dr.	1,00,000	
To Share Capital A/c			1,00,000
(Final call due on partly paid shares)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Share Final Call A/c			1,00,000
(Final Call adjusted towards payment of bonus)			
Capital Redemption Reserve A/c	Dr.	1,00,000	
Securities Premium A/c	Dr.	1,50,000	
To Bonus to Shareholders A/c			2,50,000
(Declaration of bonus of one share for 2 shares on 50,000 Share)			
Bonus to Shareholders A/c	Dr.	2,50,000	
To Share Capital A/c			2,50,000
(Issue of 25,000 shares of ` 10 each as bonus shares)			

**Working Notes:** (1) Securities Premium and Capital Redemption Reserve cannot be used for making the partly paid shares fully paid-up

(2) Number of Shares =  $4,00,000 / 8 = 50,000$

## **MCQ FOR PRACTICE**

Q1. Section \_\_\_\_\_ of Companies Act, 2013 deals with bonus shares.

- (A) Section 53 (B) Section 63  
(C) Section 55 (D) Section 52

Q2. Issues of bonus shares is also known as

- (A) Capitalisation of Reserves (B) Capitalisation of Liability  
(C) Capitalisation of Assets (D) Capitalisation of Shares Capital

Q3. Which of the following reserves cannot be used for issuing bonus shares?

- (A) Capital Redemption Reserve (B) General Reserves  
(C) Profit & Loss Balance (D) Revaluation Reserves

Q4. Which of the following reserves cannot be used for issuing bonus shares?

- (A) Capital Redemption Reserve (B) General Reserves  
(C) Capital reserve (realized in cash) (D) Securities Premium (Not realized in cash)

Q5. Which of the following reserves can be used for issuing fully paid up bonus shares.

- (A) Capital Redemption Reserve (B) Investment Allowance Reserve  
(C) Development Rebate Reserve (D) Debenture Redemption Reserve

Q6. STAR Ltd. has Securities premium of Rs 70,000. It includes a premium of Rs 30,000 for shares issued to vendor for purchase of a Plant and machinery.

How much Securities premium Reserve can be used for issuing bonus shares?

- (A) Rs 40,000 (B) Rs 30,000 (C) Rs 50,000 (D) None of these

Q7. Bright Ltd. has Capital reserve of Rs 250,000. It includes Rs 60,000 being profit on exchange of Equipment.

How much capital reserve can be used for issuing bonus shares?

- (A) Rs 250,000 (B) Rs 190,000 (C) Rs 160,000 (D) None of the above

Q8. Following are the Extract of balance sheet of Shine Ltd. is given as under

<b><u>Equity and Liabilities</u></b>	
Equity shares of Rs 10 each	4,00,000
Preference Share Capital	4,00,000
Capital Redemption Reserve	200,000
Securities Premium	100,000
Capital reserves	60,000
General Reserve	10,000
Revaluation Reserves	5,80,000

Calculate amount of reserves available for issuing fully paid up bonus shares

- (A) Rs 3,60,000 (B) Rs 3,70,000 (C) Rs 3,10,000 (D) None of these

Q9. The Extract of balance sheet of Rocket Ltd. is given as under

<b><u>Equity and Liabilities</u></b>	
Equity shares of Rs 10 each	3,00,000
Preference Share Capital	2,00,000
Capital Redemption Reserve	1,00,000



Securities Premium ( includes Rs 20,000 for issue of shares to Vendor for purchase of Sundry Asset)	50,000
Capital reserves	45,000
General Reserve	15,000
Development Reserve	50,000
Revaluation Reserve	1,20,000

Calculate amount of reserves available for issuing fully paid up bonus shares

- (A) Rs 145,000      (B) Rs 190,000      (C) Rs 240,000      (D) Rs 360,000

### **Use the following information for Questions 10 to 12**

Following items appear in the Trial Balance of Hero Ltd. as on 31<sup>st</sup> March 2019:

<b><u>Equities and Liabilities</u></b>	
19,500 equity of Rs 100 each	19,50,000
Capital Reserve (including Rs 30,000 being profit on sale of Building)	200,000
Securities Premium	90,000
Capital Redemption Reserve	40,000
General Reserve	210,000
Profit and Loss Account (Cr. Balance)	590,000

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

Q10. What is the amount of free reserves which will be used for issuing bonus shares?

- (A) Rs 490,000      (B) Rs 350,000      (C) Rs 320,000      (D) None of the above

Q11. How much capital reserves can be used for issuing bonus shares?

- (A) Rs 200,000      (B) Rs 30,000      (C) Rs 170,000      (D) Nil

Q12. What will be share capital of the company after bonus issue?

- (A) Rs 1100,000      (B) Rs 650,000      (C) Rs 19,50,000      (D) Rs 26,00,000

### **Use the following information for Questions 13 to 14**

Following is the extract of balance sheet of Blue high Ltd. as on 31<sup>st</sup> March, 2019:

Shareholder's Fund :

Rs

30,000, 9% Preference shares of Rs 10 each fully paid	300,000
60,000 Equity shares of Rs 10 each, Rs 8 paid-up	480,000
Reserves and surplus :	
Capital reserve	
(includes Rs. 40,000 being profit on exchange of machinery)	120,000
General reserve	150,000
Securities premium	
( include Rs 30,000 against share issued to vendor)	70,000
Surplus	220,000

The company made the final call of Rs 2 per share from equity shareholders and duly received it. Thereafter, it was decided to issue bonus shares at the rate of 1 share of every 3 shares held by each shareholder.

Q13. What is the amount of bonus share capital?

- (A) Rs 300,000 (B) Rs 160,000 (C) Rs 200,000 (D) Rs. 260,000

Q14. What will be Total share capital after bonus issue?

- (A) Rs 11,00,000 (B) Rs 800,000 (C) Rs 900,000 (D) None of these

Q15. The Extract of the balance sheet of Prime Ltd. is given as under:

<b>Equity and Liabilities</b>	
20,000 equity Shares of Rs 10 each, Rs 6 paid up	120,000
Capital Redemption Reserve	25,000
General Reserves	50,000
Capital Reserve	60,000
Surplus	15,000
Investment Fluctuation Reserve	85,000
Revaluation Reserve	105,000

The company decided to convert all the partly paid up shares are converted in fully paid up by the way of bonus call. The amount of reserves available for such purpose:

- (A) Rs 50,000 (B) Rs 90,000 (C) Rs 65,000 (D) Rs 150,000

Q16. Which of the following reserves cannot be used for issuing bonus call?

- (A) General Reserve (B) Surplus  
(C) Capital reserve (Realized in cash) (D) Capital Redemption Reserve

Q17. Which of the following reserves can be used if partly paid up shares are converted in fully paid up by way of bonus call.

- (A) Plant revaluation reserve (B) Surplus  
(C) Investment Allowance Reserve (D) Development Rebate Reserve

Q18. Rule \_\_\_\_\_ of Companies (Share Capital and Debentures ) Rules, 2014 specifies that company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

- (A) Rule 15 (B) Rule 20 (C) Rule 14 (D) Rule 25

Q19. Which of the following statement(s) is (are) false.

- Bonus shares shall be issued if authorized by its articles.
  - Bonus shares can be issued if company has not defaulted in respect of payment of statutory dues.
  - Bonus shares can be issued if company has not defaulted in respect of payment of fixed deposits.
  - Bonus shares can be issued if existing shares are fully paid up
- (A) 1 and 3 (B) 1 and 4 (C) 2 and 3 (D) None of the statement

Q20. No issue of bonus shares shall be made by-

- (a) Its free reserves  
(b) the securities premium account  
(c) capitalizing reserves created by revaluation of assets  
(d) the capital redemption reserve account

(CS TEST PAPER)

# ANSWERS

## ISSUE OF BONUS SHARES

1. B	2. A	3. D	4. D
5. A	6. A	7. B	8. C
9. A	10. A	11. B	12. D
13. C	14. A	15. C	16. D
17. B	18. C	19. D	



NITESH KR. JAISWAL CS CLASSES

# CHAPTER – 4 | REDEMPTION OF PREFERENCE SHARE

Redemption of preference shares means return of share money to the shareholders. With effect from 1st March 1997 a Company cannot issue irredeemable preference shares or shares which can be redeemed beyond a period of 20 years. It means that a Company can issue only redeemable preference shares if it is authorised by the Articles of the Company. Companies to make the redemption valid. These are stated as under:

**1. Fully Paid:** - No preference shares can be redeemed unless they are fully paid. It has been made compulsory, under section 55 of companies' act 2013, that partly paid preference shares be always made fully paid up before redemption takes place.

**2. Out of profits or new issue:-** Such shares can be redeemed either (i) out of the profits of the Company which would otherwise be available for dividend or (ii) out of the proceeds of fresh issue of shares made for the purpose of redemption. Both sources can be used simultaneously, i.e., a part of the amount needed for redemption may be collected out of the proceeds of a fresh issue of shares and the balance by using that would otherwise be available for distribution of dividends.

**3. Capital Redemption Reserve:** -Where shares are redeemed out of profits otherwise available for dividend, a sum equal to the nominal amount of the shares redeemed must be transferred to a reserve account styled as 'Capital Redemption Reserve Account'. This provision is made with a view to prevent the profits from being used for any other purpose such as declaration of dividends, redemption of debentures, etc. However, Capital Redemption Reserve can be utilised for the issue of fully paid bonus shares to the shareholders of the Company.

The following table given the profits which are available for dividend and which are not available for dividend:

Profits available for dividend (Transfer to Capital Redemption Reserve A/c is allowed from these profits)	Profits available for dividend (Transfer to Capital Redemption Reserve A/c is allowed from these profits)
1. General Reserve 2. Reserve Fund 3. Dividend Equalisation Fund 4. Insurance Fund 5. Workmen's Compensation Fund 6. Workmen's Accident Fund 7. Voluntary Debenture Redemption Fund 8. Profit and Loss Account	1. Securities Premium Account 2. Capital Reserve 3. Share Forfeiture Account 4. Profit Prior to Incorporation 5. Development Rebate Reserve

4. The Redemption of preference shares by a Company shall not be taken as reducing the amount of its authorized share capital. Hence, the shares so redeemed shall remain part of the authorized capital in the balance sheet and the Company shall have the power to issue up to the nominal amount of the shares redeemed.

5. If new shares are issued for the purpose of redemption of preference shares, it will not be treated as increase of capital. Redeemable preference shares must be redeemed within one month of the issue of new shares.

6. If the shares are redeemed at premium then it is desirable to provide such premium first out of the 'Securities Premium Account' and the balance out of the profits of the company.

After the redemption of preference shares the Company must send the information in this regard to the registrar of Companies within 30 days.

4. Redeemable Preference Shares cannot be redeemed by issuing debentures.

**The Intention of Section 55:** -The intention of imposing the legal restrictions under Section 55 is to protect the interests of creditors of the Company by keeping the share capital intact even after the redemption of redeemable preference shares. When preference shares are redeemed out of proceeds of a



fresh issue of shares, the security available to the creditors in the form of assets prior to redemption remains intact. On the contrary, if the redemption is allowed from borrowings, although it results in an increase in the available assets, it also results in an increase in the liabilities and therefore does not safeguard the interests of the creditors.

In case of redemption out of divisible profits, Capital Redemption Reserve Account takes the place of Redeemable Preference Share Capital Account in the balance sheet. There is no depletion of the Company's assets after the redemption since retaining permanently the profits, which may otherwise be utilised for paying dividend to shareholders at any time, creates Capital Redemption Reserve Account.

The purpose of disallowing the redemption of partly paid preference shares is also to protect the interests of creditors because in case of winding up, if the liquidator will call upon the preference shareholders to pay the uncalled amount and he will utilise this amount to meet the creditors claim. If redemption of partly paid preference shares is allowed. It would mean the replacement of such shares and hence the uncalled amount will never be available to the creditors.

## **Accounting Entries on the Redemption of Preference Shares**

**Step1.** When preference shares are being redeemed out of the proceeds of new issue of shares, any of the following entries will be passed for the issue of new shares: -

1. When new shares are issued at a premium: -

Bank A/c	Dr.
<u>To Share Application and Allotment A/c*</u>	
Share Application and Allotment A/c	Dr.
<u>To Share Capital A/c</u>	

2. When new shares are issued at a discount: -

Bank A/c	Dr.
<u>To Share Application and Allotment A/c*</u>	
Share Application and Allotment A/c	Dr.
<u>To Share Capital A/c</u>	
<u>To Securities Premium A/c</u>	

3. When new shares are issued at a discount: -

Bank A/c	Dr.
<u>To Share Application and Allotment A/c*</u>	
Share Application and Allotment A/c	Dr.
Share Discount A/c	Dr.
<u>To Share Capital A/c</u>	

**Step2.** In case the preference shares are redeemable at a premium, the premium on redemption should be set off first against the 'Securities Premium Account' and then the balance, if any, should be provided for either out of the profits of the Company or any reserve: -

Securities Premium A/c	Dr.
Or	

Profit & Loss A/c and all Revenue Reserves	Dr.
<u>To Premium on Redemption A/c</u>	

(Provision of premium payable on redemption)

**Step3.** Compare the amount of preference shares redeemed (without premium) With the proceeds of fresh issue of shares (without premium but after discount). Thus the word 'proceeds of fresh issue' does not include the amount of premium if shares are issued at a premium but stands for the net amount received if shares are issued at a discount. If the proceeds of fresh issue is less than the amount of shares redeemed, the amount equal to the difference must be transferred to 'Capital Redemption Reserve Account'. Journal entry is: -

Profit & Loss Appropriation A/c	Dr.
General Reserve or any other Reserve	Dr.
(Profits available for dividend)	
<u>To Capital Redemption Reserve A/c</u>	

**Step4.** For the total amount due to preference shareholders on redemption: -

Redeemable Preference Share Capital A/c	Dr.
Premium on Redemption A/c	Dr.
<u>To Redeemable Preference Shareholder's A/c</u>	



\*It should be noted that in case the full amount is received in one lump sum it would be credited to Share Application & Allotment A/c

**Step5.** When payment is made: -

Redeemable Preference Shareholders' A/c                      Dr  
 To Bank A/c

## **Conditions which must be fulfilled for redemption of preference shares**

As per **Section 55** of the **Companies Act, 2013** company limited by shares shall not issue preference shares which are irredeemable.

A company limited by shares may, if so authorized by its articles, issue preference shares which are liable to be redeemed within a period **20 years** from the date of issue.

A company may issue preference shares for a period **exceeding 20 years** for **infrastructure projects**, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders.

**Other important points relating to redemption of preference shares are as follows:**

- Preference shares shall be redeemed:
  - Out of the profits available for dividend or
  - Out of the proceeds of a fresh issue of shares
- Preference shares shall be redeemed unless they are **fully paid-up**.
- Where preference shares are proposed to be redeemed out of the profits a sum equal to the nominal amount of the shares should be transferred to the **Capital Redemption Reserve Account**.
- The premium payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.
- **Premium payable on redemption** of any preference shares shall be provided for:
  - Out of the profits or
  - Out of the securities premium account, before such shares are redeemed.
- **Explanation :** The term "infrastructure projects" means the infrastructure projects specified in **Schedule VI**.

## **Profits of the company available for dividend**

One of the ways to redeem preference share is to use the profit available for dividend. Where any preference shares are redeemed out of profits, a sum equal to the nominal amount of the shares so redeemed must be transferred out of the profits of the company which would otherwise be available for dividend to a reserve fund called '**Capital Redemption Reserve Account**'.

Profits available for dividend	Profits not available for dividend
- Profit & Loss Account	- Securities Premium Account
- General Reserve	- Capital Reserve
- Dividend Equalization Fund	- Investment Allowance Reserve
- Reserve Fund	- Development Rebate Reserve
- Workmen's Compensation Fund	- Profit Prior to Incorporation

✚ **Preference shares can be redeemed out of the “proceeds of a fresh issue of shares**

One of the ways to redeem preference share is to use the proceeds of a fresh issue of shares. Proceeds of a fresh issue of shares in case of new issue of equity shares are to be considered as follows :

If equity shares are issued at par	Entire amount received at par will be treated as proceeds of a fresh issue of shares.
If equity shares are issued of premium	Only amount equal to face value of shares will be treated as proceeds of a fresh issue of shares. Amount equal to securities premium will be excluded.
If equity shares are issued at discount.	Net amount received after deducting discount will be treated as proceeds of a fresh issue of shares.

**Logic behind creation of capital Redemption reserve:**

- (1) The main purpose to create CRR is to keep the capital structure of the company intact.
- (2) Another purpose to create CRR is to protect the interest of creditors, since CRR cannot be utilized for payment of dividend.

## Redeemable Preference Shares at Par

**Q 1. Pass Journal Entries in the following cases: -**

**(I) A Ltd. Redeems its 10,000 Redeemable Preference Share of ` 10 each at par. For the purpose it issued 8,000 Equity Shares of ` 10 each at 5% premium, and for the balance it utilises the Profit & Loss A/c, which had a sufficient balance.**

**SOLUTION:**

**(I) JOURNAL OF A LTD.**

Bank A/c	Dr.	84,000	
To Equity Share Application & Allotment A/c			84,000
(Application money received on issue of 8,000 new equity shares @ ` 10.50 each)			
Equity Share Application & Allotment A/c	Dr.	84,000	
To Equity Share Capital A/c			80,000
To Securities Premium A/c			4,000
(Transfer of application money on issue of 8,000 new equity shares of ` 10 each at 5% premium)			
Profit & Loss Appropriation A/c	Dr.	20,000 <sup>(1)</sup>	
To Capital Redemption Reserve A/c			20,000
(Profit transferred, ` 1,00,000 Less ` 80,000, being the face value of new shares)			
Redeemable Pref. Share Capital A/c	Dr.	1,00,000	
To Redeemable Pref. Shareholder's A/c			1,00,000
(Amount due)			
Redeemable Pref. Shareholder's A/c	Dr.	1,00,000	
To Bank A/c			1,00,000
(Amount Paid)			

**Note (1):** When the fresh shares are issued at a premium, only the nominal value of shares issued is considered for determining the amount of 'Capital Redemption Reserve'

## Redemption of Preference Shares at Premium

**Q 2. For payment of 1,000 8% Redeemable Preference Shares of ` 100 each at a premium of 7% company used its profits. Give Journal Entries.**

**SOLUTION:**

**JOURNAL**

Profit & Loss A/c	Dr.	7,000	
To Premium on Redemption			7,000
(Premium on redemption provided out of P&L)			
Profit & Loss Appropriation A/c	Dr.	1,00,000	
To Capital Redemption Reserve A/c			1,00,000
(Amount equal to the face value of shares transferred to Capital Redemption Reserve A/c)			
8% Redeemable pref. Share Capital A/c	Dr.	1,00,000	
Premium on Redemption A/c	Dr.	7,000	
To Redeemable Pref. Shareholder's A/c			1,07,000
(Amount due)			
Redeemable Pref. Shareholder's A/c	Dr.	1,07,000	
To Bank A/c			1,07,000
(Payment made)			

**Note (1):** Although 'premium on Redemption' is written off against P&L A/c, the transfer to Capital Redemption Reserve should be made from P&L Appropriation A/c as it is an appropriation of profit.



(2) When preference shares are redeemed at premium, 'premium or redemption' should be provided first out of the 'Securities Premium Account' and if the sufficient balance is not available in the Securities Premium Account the balance should be provided out of the profit and loss account.

**Q 3 A company has 4,000 6% redeemable preference shares of ` 100 each fully paid .The company decided to redeem the shares on December 31, 1985 at a premium of 5% The Company makes the following issues:**

**(a) 1,000 equity shares of ` 100 each at a premium of 10%.**

**(b) 1,000 9% debentures of ` 100 each.**

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

**SOLUTION:**

**JOURNAL**

1985 Dec. 31	Bank A/c Equity Share Application & Allotment A/c Dr. (Receipt of application money on 1,000 shares @ ` 110 each)	1,10,000	1,10,000
Dec. 31	Equity Share Application & Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Transfer of application money on issue of 1,000 Shares of ` 100 each at a premium of 10%)	1,10,000 1,10,000 10,000	
Dec. 31	Bank A/c Dr. To 9% Debentures Application & Allotment A/c (Receipt of application money on 1,000 debentures @ ` 100 each)	1,00,000	1,00,000
Dec. 31	9% Debentures Application & Allotment A/c Dr. To 9% Debentures A/c (Transfer of application money on issue of 1,000 Debentures of ` 100 each)	1,00,000	1,00,000
Dec. 31	Securities Premium A/c Dr. Profit & Loss A/c Dr. To Premium On Redemption A/c (Premium on redemption provided partly out of Securities premium and partly out of profits)	10,000 10,000	20,000
Dec. 31	Profit & Loss Appropriation A/c Dr. To Capital Redemption Reserve A/c (Amount transferred, being the amount uncovered by fresh issue of shares)	3,00,000 <sup>(1)</sup>	3,00,000
Dec. 31	Redeemable Preference Share Capital A/c Dr. Premium on Redemption A/c Dr. To Redeemable Preference Shareholder's A/c (Amount due on redemption of Preference Shares At 5% premium)	4,00,000 20,000	4,20,000
Dec. 31	Redeemable Preference Shareholder's A/c Dr. To Bank A/c (Payment made)	4,20,000	4,20,000

Note: - Preference shares cannot be redeemed out of the proceeds of issue of debentures because the Act lays down that such shares can be redeemed either out of the profits of the Company or out of the proceeds of fresh issue of shares. As such, the amount transferred to Capital Redemption Reserve is:

Nominal value of Redeemable Preference Shares: 4,00,000

Less: Nominal value of fresh issue of Equity Shares: 1,00,000  
3,00,000

**Q 4 Pass necessary entries in the following cases:**

1. For redemption of 1,000 8% Redeemable Preference Shares of ` 100 each at a premium of 5% the company issued 8,000 equity shares of ` 10 each at a premium of 10%.

2. For redemption of 2,000 Redeemable Preference Shares of ` 100 each at a premium of 10% the company issued 22,000 12% new preference shares of ` 10 each at par.

**SOLUTION:**

**JOURNAL**

(1)	Bank A/c Dr. To Equity Share Application & Allotment A/c (Receipt of application money on 8,000 equity shares @ ` 11 each)	88,000	88,000
	Equity Share Application & Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Transfer of application money on issue of 8,000 Equity shares of ` 10 each at a 10% premium)	88,000	88,000 8,000
	Securities Premium A/c Dr. To Premium on Redemption A/c (Premium on redemption provided out of premium on issue of shares)	5,000	5,000
	P & L Appropriation A/c Dr. To Capital Redemption Reserve A/c (Amount uncovered by the fresh issue of shares transferred)	20,000	20,000
	8% Redeemable Pref. Share Capital A/c Dr. Premium on Redemption A/c Dr. To Redeemable Pref. Shareholder's A/c (Amount due)	1,00,000 5,000	1,05,000
	Redeemable Pref. Shareholder's A/c Dr. To Bank (Amount paid)	1,05,000	1,05,000

Note: If the amount of securities premium received on issue of shares exceeds the premium payable on redemption; the excess amount will be left unutilised.

(2)	Bank A/c Dr. To 12% Preference Share Application & Allotment (Application money received on 22,000 preference shares of `10 each)	2,20,000	2,20,000
	12% Preference Share Application & Allotment A/c Dr. To Preference Share Capital A/c (Transfer of application money on issue of 22,000 Preference shares of ` 10 each)	2,20,000	2,20,000
	P&L A/c Dr. To Premium on Redemption A/c (Premium on redemption provide out of P & L A/c)	20,000	20,000
	12% Redeemable Pref. Share Capital A/c Dr. Premium on Redemption A/c Dr. To Redeemable Pref. Shareholder's A/c (Amount due)	2,00,000 20,000	2,20,000
	Redeemable Pref. Shareholder's A/c Dr. To Bank A/c (Amount paid)	2,20,000	2,20,000



**Q 5. The Following items appear in the Balance Sheet of Deshbandhu Limited as on 31<sup>st</sup> March 2000:**

**(i) Share Capital:**

**Equity-**

**Authorised** - 5,00,000 shares of ` 10 each.

**Issued, subscribed, called and paid up** - 4,00,000 shares of ` 10 each.

**Preference-**

**Authorised, Issued and subscribed** - 60,000, 12% preference shares  
Of `20 each fully paid.

**(i) Investments - ` 3,50,000**

**(ii) Profit & Loss Account (Credit Balance) - ` 7,00,000**

**It was decided to redeem the preference shares at a premium of 5% as on 31<sup>st</sup> March 2000.**

**It was further decided to:**

**(a) Sell investments for ` 3,00,000;**

**(b) Finance part of the redemption from company funds, subject to leaving a balance of ` 2, 00,000 in the profit and Loss account; and**

**(C) Issue sufficient number of equity shares at a premium of ` 2 to raise the balance of the funds required.**

**The above decisions have been carried out the preference shares redeemed. Give journal entries to record the above transactions.**

**SOLUTION:**

**JOURNAL OF DESHBANDHU LTD.**

Bank A/c	Dr.	3,00,000	
Profits & Loss A/c	Dr.	50,000	
To Investments A/c			3,50,000
(Sale of investments at loss)			
Profit & Loss Appropriation A/c (1)	Dr.	4,50,000	
To Capital Redemption Reserve A/c			4,50,000
(Transfer of available balance in Profit & Loss A/c to Capital redemption reserve A/c)			
Bank A/c	Dr.	9,00,000	
To Equity Share Application & Allotment A/c			9,00,000
(Application money received on 75,000 equity Share @ ` 12 each)			
Equity Share Application & Allotment A/c	Dr.	9,00,000	
To Equity Share Capital A/c			7,50,000
To Securities Premium A/c			1,50,000
(Transfer of application money on issue of 75,000 equity shares of ` 10 each at a premium of ` 2 each)			
Securities Premium A/c	Dr.	60,000	
To Premium on Redemption A/c			60,000
(Premium on redemption provided out of securities premium)			
12% Redeemable Preference Shares Capital A/c Dr		12,60,000	
Premium on Redemption A/c	Dr.	60,000	
To Preference Shareholder's A/c			12,60,000
(60,000 Preference Share of ` 20 each due for redemption at a premium of 5%)			
Preference Shareholder's A/c	Dr.	12,60,000	
To Bank A/c			12,60,000
(Preference Share Redeemed)			



## Redemption when Calls are in Arrears

**Q 6.**

**The Balance Sheet of X Ltd, as on 31<sup>st</sup> March 1995 was as follows.**

50,000 Equity Shares Of ` 10 each	5,00,000	Machinery	4,00,000
2,000 12% Redeemable Preference Shares of ` 100 each		Stock	2,00,000
Fully called 2,00,000		Debtors	1,60,000
Less: Calls in arrears (` 20 per share) 2,000		Cash at Bank	3,40,000
Securities Premium	1,98,000		
Profit & Loss Account	1,600		
Sundry Creditors	3,40,000		
	60,400		
	<b>11,00,000</b>		<b>11,00,000</b>

**It was decided to redeem the preference on the shares on the above date at a premium of 6% for this purpose 8,000 new equity shares of ` 10 each are issued at a premium of ` 1 per share. Pass journal entries and prepare the revised balance sheet.**

**SOLUTION:**

### JOURNAL

1995 March 31	Bank A/c To Equity Share Application & Allotment A/c (Application money received on 8,000 equity Shares at ` 11 each)	Dr. 88,000	88,000
March 31	Equity Share Application & Allotment A/c To Equity Share Capital A/c To Securities Premium A/c (Transfer of application money on issue of 8,000 equity shares of ` 10 each at a premium of ` 1 per share)	Dr. 88,000	80,000 8,000
March 31	Securities Premium A/c (` 8,000 + ` 1,600) P&L A/c To Premium on Redemption A/c (Premium on redemption provided partly out of securities premium and partly out of profit & Loss A/c)	Dr. 9,600 2,400	12,000
March 31	P & L Appropriation A/c To Capital Redemption Reserve A/c (Premium on redemption provided out of profit & Loss A/c)	Dr. 1,20,000	1,20,000
March 31	12% Redeemable Preference Share Capital A/c Premium on Redemption A/c To Redeemable Pref. Shareholder's A/c (Amount of payable to those redeemable preference shareholder's whose shares are fully paid)	Dr. 1,90,000 11,400	2,01,400
March 31	Redeemable Preference Shareholder's A/c To Bank A/c (Payment made)	Dr. 2,01,400	2,01,400

## Redemption of partly paid Preference Shares

It has been made compulsory under section 55 that partly paid preference shares be always made fully paid-up before redemption takes place. The amount of call should be collected in cash from partly paid preference shareholders.

The purpose of imposing the restriction that the preference shares must be fully paid before they can be redeemed is to protect the interests of creditors who calculate the security of their loans on the basis of the face value and not the paid up value of the issued capital. As such, it is not the paid up value but the face value of the shares, which requires replacement. Thus, the fresh issue of shares or the Capital Redemption Reserve will have to be created equal to the face value of redeemable preference shares and hence the security available to creditors remains intact when preference shares are redeemed.

**Q 7. Balance Sheet of Ltd. As on 31<sup>st</sup> December, 1989 was as follows:**

<b>Share Capital</b>		<b>Sundry Assets</b>	<b>2,80,000</b>
20,000 Equity Shares of ` 10 each	2,00,000	Investments	30,000
10,000 12% Redeemable Preference Shares of ` 10		Cash at Bank	70,000
Each, ` 8 paid	80,000		
Sundry Creditors	42,000		
Profit & Loss A/c	58,000		
	<u>3,80,000</u>		<u>3,80,000</u>

On the above date Directors gave notice to redeem the Preference Shares at a premium of 5%. In order to provide cash towards the redemption of the preference shares all the investments were sold for `25, 000. Directors desire that minimum number of fresh equity shares be issued at par. Show journal entries and Balance Sheet.

**SOLUTION:**

1. Since partly paid shares cannot be redeemed, a final call of ` 2 per share will be made and received in cash.

Balance in Profit & Loss A/c	58,000
Less: Loss on sale of Investment	<u>5,000</u>
	53,000
Less: Premium payable on redemption (5% on ` 1,00,000)	<u>5,000</u>
	<u>48,000</u>

As such, only ` 48,000 can be transferred from Profit & Loss A/c to Capital Redemption Reserve A/c. Hence new issue required is `1, 00,000 – ` 48,000 = ` 52,000

### **JOURNAL ENTRIES**

1989				
Dec. 31	Redeemable Preference Share Final Call A/c	Dr.	20,000	
	To Redeemable Preference Share Capital A/c			20,000
	(Final call of ` 2 per share due)			
Dec. 31	Bank A/c	Dr.	20,000	
	To Redeemable Preference Share Final Call A/c			20,000
	(Receipt of final call on redeemable preference shares)			
Dec. 31	Bank A/c	Dr.	25,000	
	Profit & Loss A/c	Dr.	5,000	
	To Investment A/c			30,000
	(Investment sold at a loss of ` 5,000)			
Dec. 31	Profit & Loss A/c	Dr.	5,000	
	To premium on Redemption A/c	Dr.		5,000
	(Premium on redemption provided out of profit & loss A/c)			
Dec. 31	Profit & Loss Appropriation A/c	Dr.	48,000	
	To Capital Redemption Reserve A/c			48,000
	(Profits transferred to Capital Redemption Reserve)			



Dec. 31	Bank A/c Dr. To Equity Share Application & Allotment A/c (Receipt of application money)	52,000	52,000
Dec. 31	Equity Share Application & Allotment A/c Dr. To Equity Share Capital A/c (Transfer of application money on issue of 5,200 new equity shares of ` 10 each)	52,000	52,000
Dec. 31	12% Redeemable Preference Share Capital A/c Dr. Premium on Redemption A/c Dr. To Redeemable Preference Shareholders A/c (Amount due)	1,00,000 5,000	1,05,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (Payment made)	1,05,000	1,05,000

**BALANCE SHEET OF A LTD.  
as on 31<sup>st</sup> December 1989**

Share Capital: - 25,200 Equity Shares Of ` 10 each	2,52,000	Sundry Assets Cash at Bank ( ` 70,000 + 25,000 + 52,000 - 85,000)	2,80,000 62,000
Capital Redemption Reserve	48,000		
Sundry Creditors	42,000		
	<u>3,42,000</u>		<u>3,42,000</u>

**Use of Equation for Determining the Amount of New Issue**

In some cases it is required to make the minimum possible fresh issue of shares. This problem becomes difficult when the existing redeemable preference shares are required to be redeemed at premium and the new issue of shares is to be either at premium or at discount. In such cases premium account (Which is not known), and then against other divisible profits. The balance left in the divisible profits determines the amount of Capital Redemption Reserve and only then the amount of fresh issue can be ascertained. Thus, how can a student know the premium on fresh issue unless he knows the fresh issue? As such, one factor depends on another factor. In such a case, the amount of fresh issue will have to be calculated with the help of an equation explained in the following illustration.

**Q 8 A company wants to redeem its 20,000 12% Preference Shares of ` 10 each at 10% premium. Following balance is obtained from their book.**

Securities Premium	6,000
Profit & Loss account	30,000

**Directors redeemed the shares by making minimum fresh issue of equity shares of ` 10 each at 5% premium. Give necessary journal entries.**

**SOLUTION:**

Premium required for redemption is ` 20,000 (i.e., 2,00,000 x  $\frac{10}{100}$ ). Out of this

` 6,000 could be met from Securities Premium given in the question and the balance ` 14,000 will be met, first out of the premium from the proceeds of fresh issue (which is not known) and the remaining balance from Profit & Loss A/c. As such, the amount of fresh issue will have to be ascertained with the help of algebraic equation: -

Let fresh issue be ` X

Thus,

$$\text{Pref. Share Capital} + \text{Premium on Redemption} = \text{Securities Premium} + \text{P\&L A/c} + X + \frac{5X}{100}$$

$$` 2,00,000 + ` 20,000 = ` 6,000 + ` 30,000 + X + \frac{5X}{100}$$

$$` 2,20,000 = ` 36,000 + X + \frac{X}{20}$$



$$\begin{aligned}
 & \text{` 44,00,000} & = & \text{20} \\
 & \text{` 36,80,000} & = & \text{` 7,20,000 + 20 X + X} \\
 & \text{X} & = & \text{21X} \\
 & \text{OR X} & = & \text{` 1,75,238} \\
 & \text{OR} & = & \text{17,523.8 Shares of ` 10 each} \\
 & & & \text{17,524 Shares of ` 10 each} \\
 & & & \text{(As fresh issue of a share in fraction i.e., .8 shares is not possible)}
 \end{aligned}$$

### JOURNAL

(1)	Bank A/c Dr. To Equity Share Application & Allotment A/c (Application money received on issue of 17,524 equity shares @ ` 10.50 each)	1,84,002	1,84,002
(2)	Equity Share Application & Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Transfer of application money on issue of 17,524 equity shares of ` 10 each at 5% premium)	1,84,002	1,75,240 8,762
(3)	Securities Premium A/c Dr. Profit & Loss A/c Dr. To Premium on Redemption A/c (Premium on redemption written off `6,000 from securities premium already given and ` 8,762 from securities premium received from fresh issue of shares and the balance from P & L A/c)	14,762 5,238	20,000
(4)	Profit & Loss Appropriation A/c Dr. To Capital Redemption Reserve A/c (Profits transferred to Capital Redemption Reserve ` 2,00 000 - ` 1,75,240)	24,760	24,760
(5)	12% Redeemable Preference Share Capital A/c Dr. Premium on Redemption A/c Dr. To Redeemable Preference Shareholder's A/c (Amount due)	2,00,000 20,000	2,20,000
(6)	Redeemable Preference Shareholder's A/c Dr. To Bank A/c (Amount paid)	2,20,000	2,20,000

Note: ` 2 is left in P & L A/c. This balance in P & L A/c is left because the fresh issue of a share in fraction is not possible.

NITESH KR. JAISWAL CS CLASSES

## **MCQ FOR PRACTICE**

Q1. According to Companies Act 2013, a company can issue preference share for a period not more than:

- (A) 10 years
- (B) 20 years
- (C) 5 years
- (D) None of the above

Q2. According to Companies Act 2013, Preference Shares can be redeemed:

- (A) Whether they are fully paid or not
- (B) Only if they are not fully paid
- (C) Only if they are fully paid
- (D) None of the above

Q3. According to Companies Act 2013, Preference Shares can be redeemed:

- (A) Only out of divisible profit available for dividend
- (B) Only out of fresh issue of shares
- (C) Out of Both A and B
- (D) None of the above

Q4. When Preference shares are redeemed out of profits otherwise available for dividend, a sum equal to the nominal value of the shares redeemed must be transferred to \_\_\_\_\_.

- (A) Debenture Redemption Reserve
- (B) Security Premium Reserve
- (C) Dividend Equalisation Reserve
- (D) Capital Redemption Reserve

Q5. Capital Redemption Reserve is created when:

- (A) Preference shares are issued.
- (B) Preference shares are redeemed out of Fresh issue of shares
- (C) Preference shares are redeemed out of Profit otherwise available for dividend.
- (D) None of the above.

Q6. Capital Redemption Reserve is created a sum equal to \_\_\_\_\_ of the preference shares redeemed.

- (A) Redeemed Value
- (B) Nominal Value
- (C) Premium Value
- (D) None of the above

Q7. Capital Redemption Reserve can be utilised for the

- (A) Write off Preliminary Expenses
- (B) Issue of Fully Paid Bonus Shares
- (C) Write off the premium on redemption of shares or debentures
- (D) All of the above

Q8. Which section of the Companies Act 2013 deals with the redemption of Preference shares?

- (A) 56
- (B) 52
- (C) 55
- (D) 77



Q9. Which of the following is not an example of divisible/distributable profit?

- (A) General Reserve
- (B) Dividend Equalisation Reserve
- (C) Security Premium
- (D) Reserve Fund

Q10. Which of the following is not an example of divisible/distributable profit?

- (A) Surplus i.e. Profit and Loss (Cr.) Balance
- (B) General Reserve
- (C) Dividend Fluctuation Reserve
- (D) Debenture Redemption Reserve

Q11. Which of the following is an example of Divisible Profit?

- (A) Pre – incorporation profit
- (B) Debenture Redemption Reserve
- (C) Revaluation Reserve
- (D) General Reserve

Q12. Which of the following is an example of Profit available for dividend?

- (A) Revaluation Reserve
- (B) Capital Reserve
- (C) Security Reserve
- (D) Profit and Loss Account

Q13. Which of the following is an example of free reserve?

- (A) Profit and Loss Account
- (B) Debenture Redemption Reserve
- (C) Capital Reserve
- (D) Capital Redemption Reserve

Q14. Security Premium Reserve can be utilised:

- (A) To write off preliminary expenses
- (B) To write off premium on redemption of preference shares or debentures
- (C) To write off underwriting commission
- (D) All of the above

Q15. Security premium reserve cannot be utilised:

- (A) To issue fully paid bonus shares
- (B) To write off expenses on issue of shares or debentures or underwriting commission paid or discount allowed on such issue
- (C) To purchased its own equity shares
- (D) To creation of capital Redemption Reserve

Q16. Which of the following section deal with Securities premium Account:

- (A) Section 52
- (B) Section 78
- (C) Section 68
- (D) Section 73

Q17. If Preference shares are redeemed out of fresh issue for equity shares, which account will be credited when fresh equity shares are issued?

- (A) Capital Reserve Account
- (B) Capital Redemption Reserve Account
- (C) Preference Share Capital Account
- (D) Equity Share Capital Account

Q18. 10% Preference Shares of Rs 200,000 are redeemed at 10% premium.

Security Premium – Rs 50,000

Profit & Loss Account – Rs 300,000

Issue 5,000 equity shares of Rs 10 each at premium of 10% for the purpose of redemption.

Calculate CRR to be created.

- |                |                |
|----------------|----------------|
| (B) Rs 200,000 | (B) Rs 170,000 |
| (D) Rs 150,000 | (D) Rs 175,000 |

Q19. The paid up share capital of Foresight Ltd. includes 5,000, 9% redeemable preference shares of Rs 100 each, repayable at a premium of 6%. As the shares have become ready for redemption, the company has decided to redeem preference shares out of the fresh issue of 50,000 equity shares of Rs 10 each at Rs 10.60 per share. How much CRR is required to be created?

- |                |                       |
|----------------|-----------------------|
| (A) Rs 530,000 | (B) Rs 500,000        |
| (C) NIL        | (D) None of the above |

Q20. 15,000, 9% Redeemable preference shares of Rs 100 each of Global Customer Care Ltd. repayable at a premium of 12% are now due for redemption. The company has accumulated reserves, the amount of which is much in excess of the sum required for redemption. In addition, there is a large balance lying in securities premium account which is available for payment of premium on redemption.

How much CRR is required to be created?

- (A) Rs 1500,000 (B) Rs 16,80,000  
(C) NIL (D) None of the above

Q21. Rs 500,000 preference shares are to be redeemed by issue of 2,000 equity shares @ 100 each for Rs 125 each, then CRR is to be created by what amount?

- (A) Rs 300,000 (B) Rs 250,000  
(C) Rs 200,000 (D) Rs 500,000

Q22. A company issued 10,000 equity shares of Rs 10 each at a premium of 20% for the redemption of 15,000 preference shares of Rs 10 each. If the company had sufficient profit, the amount transferred to Capital Redemption Reserve would be?

- (A) Rs 50,000 (B) Rs 150,000  
(C) Rs 100,000 (D) Rs 30,000

Q23. Rs 900,000 preference shares are to be redeemed by issue of 3,000 equity shares, face value Rs 100 each at Rs 140 each. Capital redemption reserve would be:

- (A) Rs 480,000 (B) Rs 120,000  
(C) Rs 420,000 (D) Rs 600,000

Q24. Preference shares amounting to Rs 400,000 are redeemed at a premium of 2%, by issue of equity shares amounting to Rs 200,000 at a premium of 12%. The amount to be transferred to CRR is \_\_\_\_\_.

- (A) Rs 224,000 (B) Rs 184,000  
(C) Rs 204,000 (D) Rs 200,000

Q25. Preference shares amounting to Rs 300,000 are redeemed at a premium of 5%, by issue of equity shares amounting to Rs 200,000 at a premium of 10%. How much amount is to be transferred to CRR?

- (A) Rs 300,000 (B) Rs 200,000  
(C) Rs 100,000 (D) Rs 210,000

Q26. The capital of a company consists of Rs 15,000, 14% preference shares of Rs 10 each fully paid. The company has a credit balance of Rs 200,000 in profits & loss account and Rs 75,000 in general reserves. If the company wants to redeem preference shares at a premium of Rs 2 per share. Calculate the amount to be transferred to the capital redemption reserve

- (A) Rs 150,000 (B) Rs 280,000  
(C) Rs 180,000 (D) Rs 30,000

Q27. Wye Ltd. redeemed 1,000 10% preference shares of Rs 100 each at a premium of Rs 10 per share. It had a balance of Rs 50,000 in general reserve and Rs 27,000 in profit and loss account. For the purpose of redemption WYE Ltd. issued 5,000 equity shares of Rs 10 each at a premium of 20%. The amount to be transferred to Capital Redemption Reserve at the time of redemption will be

- (A) Rs 23,000 (B) Rs 40,000  
(C) Rs 50,000 (D) Rs 33,000



Q28. A ltd. had 3,000, 12% Redeemable Preference shares of Rs 100 each, fully paid up. The company issued 25,000 equity shares of Rs 10 each at par and 1,000 14% debentures of 100 each. All amounts were received in full. The amount to be transferred to Capital Redemption Reserve:

- |                |                |
|----------------|----------------|
| (A) NIL        | (B) Rs 200,000 |
| (C) Rs 300,000 | (D) Rs 50,000  |

Q29. 10% Preference Shares of Rs 300,000 are redeemed at 10% premium.

Security Premium – Rs 50,000

Profit & Loss Account – Nil

Issue Sufficient equity shares of Rs 10 each at par

Calculate number of shares to be issued.

- |                   |                   |
|-------------------|-------------------|
| (A) 30,000 shares | (B) 27,000 shares |
| (C) 31,500 shares | (D) 28,500 shares |

Q30. 10% Preference Shares of Rs 200,000 are redeemed at 10% premium.

Security Premium – Rs 50,000

Profit & Loss Account – Nil

Issue Sufficient equity shares of Rs 10 each at premium of 10%.

Calculate number of shares to be issued.

- |                   |                   |
|-------------------|-------------------|
| (A) 18,182 shares | (B) 20,000 shares |
| (C) 8,000 shares  | (D) 7,273 shares  |

Q31. Preference Shares of Rs 200,000 are redeemed at 10% premium.

Security Premium – Rs 50,000

General Reserve – Rs 30,000

Profit & Loss Account – Rs 10,000

Workmen Compensation Reserve – Rs 20,000 (out of which workmen compensation claim Rs 10,000)

Revaluation Reserve – Rs 10,000

Capital Reserve – Rs 25,000

Issue Sufficient equity shares of Rs 10 each at premium of 10%.

Calculate number of shares to be issued.

- |                   |                   |
|-------------------|-------------------|
| (A) 20,000 shares | (B) 14,000 shares |
| (C) 15,000 shares | (D) 13,000 shares |

Q32. Preference Shares of Rs 500,000 are redeemed at 10% premium.

Security Premium – Rs 30,000

Profit & Loss Account – Rs 200,000

Issue Sufficient equity shares of Rs 10 each at par.

Calculate number of shares to be issued.

- |                   |                   |
|-------------------|-------------------|
| (A) 50,000 shares | (B) 30,000 shares |
| (C) 35,000 shares | (D) 32,000 shares |

Q33. Preference Shares of Rs 300,000 are redeemed at 10% premium.

Security Premium – Rs 10,000

Profit & Loss Account – Rs 20,000

General Reserve – Rs 40,000

Dividend Equalisation Reserve – Rs 60,000

Capital Reserve – Rs 100,000

Issue Sufficient equity shares of Rs 10 each at par.

Calculate number of shares to be issued.

- |                   |                   |
|-------------------|-------------------|
| (A) 20,000 shares | (B) 30,000 shares |
| (C) 18,000 shares | (D) 8,000 shares  |

Q34. X Ltd. had 5,000 12% preference shares of Rs 100 each. The company decided to redeem them by issuing equity shares of Rs 100 each at a premium of 25%. The number of equity shares to be issued are:

- (A) 4,000 shares (B) 5,000 shares  
(C) 5,600 shares (D) 4,480 shares

Q35. The board of directors of a company decided to issue minimum number of equity shares of Rs 8 each to redeem 45,000 preference shares of Rs 10 each. The maximum amount of distributable profit is Rs 250,550. Number of shares required to be issued by a company to ensure that provision of section 55 are not violated. Also determine the number of shares, if the company decided to issue shares in multiple of Rs 50 only.

- (A) 24,931 and 24950 (B) 24,931 and 24900  
(C) 24,932 and 24,950 (D) 24,932 and 24,900

Q36. ABC Ltd. wants to redeem the 10% preference shares of Rs 400,000. The company have sufficient divisible profits but do not have necessary cash. How many shares of Rs 10 each at a premium of Rs 30 per share, the company must issue to arrange necessary Cash:

- (A) 40,000 shares (B) 10,000 shares  
(C) NIL (D) None of the above

Q37. Following are the relevant extract of the Balance sheet of Sunshine Ltd.

Preference share capital	Rs 200,000
General Reserve	Rs 230,000
Cash at Bank	Rs 80,000

The company wants to redeem its preference shares at par. Issue equity shares of Rs 10 each at Rs 15 so that required cash is required.

Calculate number of equity shares to be issued and CRR to be created.

- (A) NIL shares and Rs 200,000 (B) 12,000 shares and Rs 80,000  
(C) 8,000 shares and Rs 120,000 (D) None of the above

Q38. Following are the relevant extract of the Balance sheet of Bright Ltd.

10% Preference share capital	Rs 10,00,000
General Reserve	Rs 15,00,000
Investment	Rs 520,000
Cash at Bank	Rs 250,000

In order to facilitate the redemption of preference shares at a premium of 10%, the company decided:

- To sell all the investment for Rs 500,000
- To finance part of redemption from company funds, subject to, leaving a bank balance of Rs 50,000.
- To Issue minimum equity shares of Rs 10 each at a premium of Rs 10 per share to raise the balance of funds required.

Calculate number of equity shares to be issued and CRR to be created.

- (A) 20,000 shares and Rs 800,000 (B) 40,000 shares and Rs 600,000  
(C) 10,000 shares and Rs 900,000 (D) None of the above

### **Use the following Problem to Solve Questions 39 to 40**

The Draft of Balance Sheet of A Ltd. as on 31<sup>st</sup> March 2012 as under:

Liabilities	Amount	Assets	Amount
Share Capital:		Land and Building	400,000
Equity Share Capital of Rs 100 each	500,000		
12% Preference share Capital of Rs 10			



each	300,000		
General Reserve	150,000	Plant and Machinery	300,000
Profit & Loss Account	250,000	Furniture & Fixture	250,000
18% Debentures	200,000	Investment	225,000
Trade Payable	50,000	Trade Receivable	100,000
Bills payable	25,000	Inventories	150,000
		Cash	50,000
	<b>14,75,000</b>		<b>14,75,000</b>

The 12% preference shares are redeemable at premium of 10%. The company wishes to maintain the cash balance at Rs 25,000. For the purpose of redemption of preference shares, it is proposed to sell the investment for Rs 200,000. The company proposes to issue sufficient number of equity shares of Rs 100 each at premium of 5% to raised required cash balance.

Q39. Total Cash required to effect the above decision is \_\_\_\_\_.

- (A) Rs 330,000 (B) Rs 355,000  
(C) Rs 25,000 (D) Rs 105,000

Q40. Number of equity shares to be issued is \_\_\_\_\_.

- (A) 1500 shares (B) 950 shares  
(C) 1,000 shares (D) 1200 shares

Q41. A company decided that 15,000 Preference shares of Rs 10 each are to be redeemed at a premium of 10%. Company has security premium Reserve Rs 5,000 and General Reserve Rs 25,000.

Calculate number of equity shares to be issued at 10% premium having face value of Rs 10 per share.

- (A) 15,000 shares (B) 12,500 shares  
(C) 13,500 shares (D) None of the above

Q42. A company decided that 15,000 Preference shares of Rs 10 each are to be redeemed at a premium of 10%. Company has security premium Reserve Rs 5,000 and General Reserve Rs 25,000.

Calculate number of equity shares to be issued at 5% premium having face value of Rs 10 per share.

- (A) 15,000 shares (B) 12,857 shares  
(C) 12,858 shares (D) None of the above

Q43. A company decided that 20,000 Preference shares of Rs 10 each are to be redeemed at a premium of 10%. Company has security premium Reserve Rs 15,000 and General Reserve Rs 50,000.

Calculate number of equity shares to be issued at 10% premium having face value of Rs 10 per share.

- (A) 15,000 shares (B) 12,500 shares  
(C) 15,500 shares (D) None of the above

Q44. Following are the relevant extracts from the balance sheet of the RED Ltd.

20,000 Preference shares of Rs 100 each, fully paid up Rs 20,00,000

8,000 Preference shares of Rs 100 each, Rs 80 paid up Rs 640,000

General Reserve Rs 24,00,000

The Board of directors decided to redeem preference shares at 10% premium out of divisible profits. How much CRR is required to be created?

- (A) Rs 26,40,000 (B) Rs 20,00,000  
(C) Rs 24,00,000 (D) Rs 640,000



Q45. Following are the relevant extracts from the balance sheet of the White Ltd.

10,000 Preference shares of Rs 100 each, Rs 80 paid up	Rs 800,000
General Reserve	Rs 14,00,000

The Board of directors decided to redeem preference shares at 10% premium out of divisible profits. How much CRR is required to be created?

- (A) Rs 10,00,000
- (B) Rs 8,00,000
- (C) Rs 14,00,000
- (D) None of the above

Q46. Which of the following statements is false?

- (A) A company can redeem its preference shares
- (B) Preference shareholders are creditors of a company
- (C) That part of the authorised capital which can be called up only in the event of liquidation of a company is called reserve capital.
- (D) Capital Redemption Reserve can be utilised for issuing fully paid bonus shares.

Q47. Which of the following statement is True?

- (A) Capital Redemption Reserve cannot be used for writing off miscellaneous expenses and losses
- (B) Capital profits realized in cash cannot be used for payment of dividend
- (C) Reserves created by revaluation of fixed assets are not permitted to be capitalized.
- (D) Dividend is payable on the calls paid in advance by shareholder.

Q48. Which of the following can be utilized for redemption of preference shares?

- (A) The proceeds of fresh issue of equity shares
- (B) The proceeds of fresh issue of Debentures
- (C) The proceeds of fresh issue of fixed deposits
- (D) All of the above

Q49. Preference shares can be redeemed

- (A) Only if they are fully paid up
- (B) Even if they are partly paid up
- (C) After getting the permission from the court
- (D) All of the above

Q50. A company may issue preference shares for a period exceeding 20 years but not beyond \_\_\_\_\_ for infrastructure project.

- (A) 35 Years
- (B) 30 Years
- (C) 40 Years
- (D) 45 Years

Q51. A company may issue preference shares for a period exceeding 20 years but not beyond 30 years for \_\_\_\_\_.

- (A) Hospitality Project
- (B) Consumer Project
- (B) Educational Project
- (D) Infrastructure Project

Q52. A company having free reserves of Rs. 30,000 wants to redeem Rs. 100,000 preference shares at a premium of 10%.

Calculate the face value of fresh issue of shares of Rs.10 each to be made at a premium of 10%.

- (A) 7,000 shares
- (B) 7,273 shares
- (C) 8,000 shares
- (D) None of the above

Q53. C Ltd. had 3000, 9% Preference shares of Rs 100 each, fully paid up. The Company had to redeem these shares at a premium of 10%. It was decided these shares issued at premium of 10%.

- I. 20,000 Equity shares of Rs 10 each at par
- II. 1,000 14% Preference shares of Rs 100 each.

The issue was fully subscribed and all amounts were received in full. The payment was duly made. The company has sufficient profits. The amount transferred to CRR

- (A) Rs 100,000
- (B) Rs 300,000
- (C) Nil
- (D) None of these

Q54. A preference shares which carry the right of participating in the surplus after paying equity dividend is called:

- (A) Convertible Preference shares
- (B) Cumulative Preference shares
- (C) Participating Preference Shares
- (D) All of the above

Q55. Redemption of preference shares of a company is:

- (A) Compulsory
- (B) Optional
- (C) Conditional
- (D) None of the above

Q56. Extract of Ledger balance of Kalpana Ltd. as on 31<sup>st</sup> March 2015, includes the following:

2000, 12% Preference shares of Rs 100 each, fully paid	Rs 200,000
Surplus	Rs 40,000
Securities Premium	Rs 12,000

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

You are required to ascertain the no of fresh issue to be made.

- (A) 200,000 shares
- (B) 16,000 shares
- (C) 20,000 shares
- (D) None of the above

Q57. Statement 1: Reduction of preference shares amounts to reduction in the capital of the company.

Statement 2: The logic behind the Section 55 is to maintain the capital structure intact after redemption.

- (A) Both statement are correct
- (B) Both statement are incorrect
- (C) Statement 1 is correct but statement 2 is incorrect
- (D) Statement 2 is correct but statement 1 is incorrect

# ANSWERS

## REDEMPTION OF PREFERENCE SHARES

1. B	2. C	3. C	4. D
5. C	6. B	7. B	8. C
9. C	10. D	11. D	12. D
13. A	14. D	15. D	16. A
17. D	18. D	19. C	20. A
21. A	22. A	23. D	24. D
25. C	26. A	27. C	28. D
29. A	30. B	31. C	32. D
33. A	34. B	35. C	36. B
37. C	38. A	39. A	40. C
41. B	42. C	43. A	44. A
45. A	46. B	47. A	48. A
49. A	50. B	51. D	52. B
53. C	54. C	55. A	56. B
57. D			



## CHAPTER – 5 | BUY BACK OF SHARES

Q1. \_\_\_\_\_ of the companies act, 2013 authorised the buy back of shares.

- (A) Section 62 (B) Section 68  
(C) Section 72 (D) None of the above

Q2. Every Buy Back should be completed within \_\_\_\_\_ from the date of passing the special resolution.

- (A) 2 Years (B) 1 years  
(C) 3 years (D) No limit

Q3. Balance Sheet of Power Link Ltd. as on 31<sup>st</sup> March 2014 is as follows:

Liabilities	Rs.	Assets	Rs.
500,000 equity share of Rs 10 each, fully paid up	50,00,000	Fixed Assets	66,00,000
Security Premium Reserve		Non Current Investment	18,00,000
General Reserve	540,000	Stock	11,87,000
Profit & Loss Account	650,000	Sundry Debtor	960,000
12% Debentures	375,000	Cash and Cash Equivalent	710,000
Term Loan	25,00,000		
Sundry Creditors	13,25,000		
Provision for tax	742,000		
	125,000		
	<b>1,12,57,000</b>		<b>1,12,57,000</b>

The shareholders adopted the resolution on the date of the abovementioned balance sheet to:

- (i) buy back 20% of the paid-up capital @ Rs. 15 each.  
(ii) issue 13% debentures of Rs. 5,00,000 at a premium of 10% to finance the buy back of shares.  
(iii) maintain a balance of Rs. 3,00,000 in general reserve account, and  
(iv) sell investments worth Rs. 8,00,000 for Rs. 6,50,000.

Pass necessary journal entries to record the above transactions and prepare the balance sheet immediately after the buy back.

(Study Material, CS DEC 2003, CS DEC 2004)

Q4. According to section 68(1) of the Companies Act, 2013, a company may purchase its own shares or other specified securities out of –

- (a) its free reserves  
(b) the securities premium account  
(c) the proceeds of the issue of any shares or same kind of other specified securities  
(d) Any of the above

(CS TEST PAPER)

Q5. When a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of the shares so purchase shall be transferred to the \_\_\_\_\_.

- (a) Debenture redemption reserve account  
(b) Capital redemption reserve account  
(c) Profit and loss account  
(d) Contingent liability

(CS TEST PAPER)

Q6. The company shall maintain a register of shares or other securities which have been bought back in form No.\_\_\_\_\_.

- (a) CRA 3
- (b) SH 10
- (c) SH 8
- (d) PR 5

**(CS TEST PAPER)**

Q7. A special resolution passed at general meeting of the company authorizing buy back of shares is not required when:

- (a) The buy back is 10% or less of the total paid up equity capital and free reserves of the company.
- (b) Buy back has been authorized by the board by means of a resolution passed at its meeting.
- (c) Both of the above
- (d) None of the above

**(CS TEST PAPER)**

Q8. A company may buy back its shares or other specifies securities by the following method(s):

- (a) From the existing shareholders or other specified security holders on a proportionate basis through the tender offer
- (b) From open market through book-building process or stock exchange
- (c) From odd lot holders, provided no offer of buy back for 15% or more of the paid up capital and free reserves of the company shall be made from the open market
- (d) Any of the above

**(CS TEST PAPER)**

Q9. The Escrow account under Regulation 9(xi) of SEBI (Buy back of Securities) Regulations, 2018 does not includes:

- (a) Cash deposited with a scheduled commercial bank
- (b) bank guarantee in favour of the merchant banker
- (c) Deposit of acceptable securities with appropriate margin, with the merchant banker
- (d) Deposits of acceptable securities with appropriate margin, with the company

**(CS TEST PAPER)**

# ANSWERS

## Buy Back of Shares

1. B	2. B	3.	4. D
5. B	6. B	7. C	8. D
9.D			

NITESH KR. JAISWAL CS CLASSES



## **CHAPTER – 6 | ACCOUNTING FOR DEBENTURES**

### **Meaning of Debentures:**

According to section 2(30) of the Companies Act, 2013 “Debenture includes debentures, inventory bonds and any other securities of a Company, whether constituting a charge on the assets of the Company or not.”

### **Characteristics or features of debentures:**

1. A Company in the form of a Certificate issues a debenture, which is a written acknowledgement of debt taken by the Company.
2. A debenture is issued under the seal of the company.
3. It contains a contract for the repayment of principle sum at a specified date.
4. Usually the debentures are issued with a specified rate of interest, which is called ‘Coupon Rate’. A debenture holder receives interest on his debentures at this specified rate, as mentioned in the certificate. Payment of interest is made, normally after every six months, whether the Company makes a profit or not.
5. A debenture is generally secured by a charge on the assets of the Company. This means that if the Company is unable to repay the debentures as per the terms of issue, the debenture holders can move the Court and realize their money by getting the assets of company sold.
6. Funds raised by the issue of debentures are of long-term nature and usually the debentures are repaid after a long period. Such as seven years, ten years or twelve years. As such, the loan raised by the issue of debentures is also called as ‘Loan capital’.

**Bond:** It is very much similar to that of debenture. Traditionally, bonds had been issued by the government organizations. Main distinction between debenture and bond is with respect to all the rate non-government organization. Main distinction between debenture and bond is with respect to the rate of interest. Debentures are issued with a fixed rate of interest whereas bonds can be issued without predetermined rate of interest as in the case of **deep discount bonds or zero coupon bonds**. A deep discount bond or zero coupon bonds is one, which is issued without prefixed rate of interest and its issue price is heavily discounted. The difference between issue price and the redemption price represents the total interest to be spread over the duration of the bond. A proportionate amount of total interest is charged to Profit & Loss Account every year over the lifetime of bond.

### **Kinds of Debentures:**

A Company may issue the following types of debentures:

1. **Secured or Mortgage Debentures:** These debentures are those which are secured either on particular assets of the Company called fixed charge or on all assets of the Company is general, called a floating charge does not prevent the Company from using the assets. If the Company is unable to repay the debentures on the due date, the debenture holders can realize their money from the assets mortgaged with them. First mortgage debentures are those that have a first claim on the assets charged and second mortgage debentures are those having a second claim on the assets charged. In India, debentures have necessarily to be secured.
2. **Unsecured or naked Debentures:** These debentures are those, which are given any security. The holders of such debentures are treated as unsecured Trade Payables at the time of liquidation of the Company. Such debentures are not very common these days, so much so that, unless otherwise stated a debenture is presumed to be secured.



3. **Registered debentures:** Names and addresses of the holders of such debentures are recorded on a register of the company called, "Register of Debenture holders". Such debentures are not freely transferable. The transfer of such debentures requires the execution of a proper transfer deed. Principal amount and interest on such a debenture is paid to the person whose name appears in the Company's register.
4. **Bearer Debentures:** Names and address of the holders of such debentures are not recorded in the Company and these debentures are transferable by mere delivery. Payment of principal and the interest is paid to such people who produce the coupon in the specified bank.
5. **Redeemable Debentures:** Redeemable debentures are those debentures, which will be repaid by the Company at the end of a specified period either in lump sum or by installments during the lifetime of the Company. Most of the debentures are generally of this type.
6. **Irredeemable or perpetual Debentures:** Irredeemable debentures are those debentures, which are not repayable by the Company during its lifetime. These debentures are repayable only at the time of liquidation of the Company.
7. **Convertible Debentures:** Convertible debentures are those debentures, which are convertible into equity shares or other securities at a stated rate of exchange either at the option of debenture holders or at the option of the company after a specified period. When only a part of the amount of debenture is convertible into shares, such debentures are called 'Partly Convertible Debentures'. When the full amount of debenture is convertible into shares, such debentures are called 'Fully Convertible debentures'. SEBI Guidelines require that where the conversion is to be made at or after 18 months the part of the debenture holders. Convertible debentures are very popular these days, as they provide liquidity, safety, capital appreciation and assured return to the investors.

#### Distinction Between a Share and a Debenture

S. N.	Basis of Distinction	Share	Debenture
1.	<b>Capital vs Loan</b>	A share is a part of the Capital of the Company; therefore, the shareholders are the owners of the Company.	A debenture is part is a part of the loan and as such, the debenture holders are the trade payables of the company.
2.	<b>Dividend vs Interest</b>	A shareholder gets dividend from the Company.	A debenture holder gets interest from the Company.
3.	<b>Fluctuating or Fixed rate of dividend or interest</b>	Dividend is paid only when there are profits. The rate of dividend may fluctuate from year to year depending upon the profits and decision of the directors.	The rate of interest is fixed and it must be paid irrespective of the company making a profit or incurring a loss.
4.	<b>Voluntary or compulsory redemption</b>	It is at the option of the Company to return the amount of shares by buying back its own shares.	The amount of debentures must be returned according to the terms of the issue.
5.	<b>Priority of repayment of</b>	In the case of winding up, the payment of share capital is made	In the case of winding up, the payment of





Bank A/c Dr.  
 To 12% Debenture Allotment A/c  
 (Allotment money received)

7. On making the call money due:  
 12% Debenture First Call A/c Dr.  
 To 12% Debentures A/c  
 (First Call money due)

8. On receipt of call money:  
 Bank A/c Dr.  
 To 12% Debenture First Call A/c  
 (First Call money received.)

If there is more call, separate entries for each call will be passed, like above.

### • Distinguish between: Shares & Debentures

Following are the main points of distinction between shares & debentures:

Points	Debentures	Shares
Status	Debenture holders are the <b>creditors</b> of the company.	Shareholders are the <b>owners</b> of the company.
Voting rights	Debenture holders have <b>no voting rights</b> .	Shareholders <b>have voting rights</b> .
Rate of income	Debenture interest is paid at a pre-determined <b>fixed rate</b> .	Dividend on equity shares is paid at a <b>variable rate</b> .
Treatment against profit	Interest on debentures is the <b>charge</b> against profits.	Dividends are <b>appropriation</b> of profits.
Types	There are <b>different kinds</b> of debentures, such as Secured/ Unsecured, Redeemable/ Irredeemable, Registered/ Bearer, Convertible/Non-convertible etc.	There are only <b>two kinds</b> of shares-equity shares and preference shares.
Balance sheet presentation	In the company's balance sheet, debentures are shown under " <b>Non-Current Liabilities</b> ".	In the company's balance sheet, shares are shown under " <b>Shareholders Funds</b> ".
Conversion	Debentures can be <b>converted into shares</b> as per the terms of issue of debenture.	Shares <b>cannot be converted</b> into debentures in any circumstances.
Forfeiture	Debentures <b>cannot be forfeited</b> for non-payment of call moneys.	Shares <b>can be forfeited</b> for non-payment of allotment and call moneys.

<b>Liquidation</b>	At the time of liquidation, debenture holders are paid-off before the shareholders.	At the time of liquidation shareholders are paid at last, after paying debenture holders, creditors, etc.
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### **Debentures issued as collateral security**

'Collateral security' means **additional security** given for a loan. Where a company takes a loan from a bank, it may issue its own debentures to the lender as collateral security against the loan in addition to any other security that may be offered. In such a case, the lender has the absolute right over the debentures until and unless the loan is repaid. On repayment of the loan, the lender has to release the debentures. But in case the loan is not repaid by the company, the lender has the right to retain these debentures and to realize them. The holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures. Such an issue of debentures is known as "Debentures issued as Collateral Security".

### **Loss on issue of debentures**

If a company issues debentures at par or at a discount which are redeemable at a premium, the premium payable on redemption of the debentures should also be treated as capital loss and as such it should be dealt with in the same manner as discount on issue of debentures. Redemption of debentures at a premium is a known loss at the time of issue of debentures as the terms of issue generally contain such provision for redemption. As such, it would be prudent to write off such loss during the life time of the debentures.

### **Interest on debentures**

- ✓ Interest on debentures is a charge against the profits. Interest is normally payable half-yearly and it is calculated at the fixed percentage on the nominal value of debentures issued.
- ✓ A company is liable to deduct TDS at the prescribed rate from the gross amount of interest payable and to pay it to the Government.
- ✓ If the debentures are tax-free, the income-tax on such interest will be paid by the company itself on behalf of the debenture holders. However, the interest paid by the company has to be grossed up for calculating the interest expense of the company.

**Interest Accrued and Due (outstanding)** : Suppose a company has issued 13.5% Debentures for Rs. 10,00,000 interest is payable on 30<sup>th</sup> September and 31<sup>st</sup> March. The company will pay Rs. 67,500 in every 6 months. Suppose, the company closes its books on 31<sup>st</sup> March, the interest due on that date may be unpaid. In that case, there will be a liability which will be recorded by the entry:

<b>On interest becoming due:</b>			
Debenture Interest A/c	Dr.	67,500	
To Debenture Interest Outstanding A/c			67,500

**Interest accrued but not due :** Suppose, in the example given above, the company closes its books on 31<sup>st</sup> December. Interest up to 30<sup>th</sup> September must have been paid but that up to 31<sup>st</sup> December is not yet due. For proper accounting, however, interest from 1<sup>st</sup> October to 31<sup>st</sup> December (3months) must be taken into account. Interest for such a period is termed as 'Interest accrued but not due'. The entry for recording this interest is:

<b>On interest becoming accrued:</b>			
Debenture Interest A/c (10,00,000X13.5%X3/12)	Dr.	33,750	
To Debenture Interest Accrued but not due A/c			33,750

Note : Debenture 'Interest accrued and due' and 'interest accrued but not due' both are shown in balance sheet under heading **"Other Current Liabilities"**.



# PRACTICE QUESTIONS

## Issue at debentures at Par

Q 1 Indian Carpets Ltd. issued 1,00,000, 8% Debentures of ₹100 each, at par, payable as follows:

**On Application ₹25; On Allotment ₹25; On First Call ₹30; and On Final Call ₹20**

**Public applied for 1,20,000 debentures. Applications for 90,000 debentures were accepted in full. Applications for 16,000 debentures were allotted 10,000 debentures and applications for 14,000 debentures were rejected. Money overpaid on applications was utilized towards allotment.**

**Pass journal entries assuming that all moneys due were duly received, except final call on 2,000 debentures.**

**Solution:**

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		\	\
Bank A/c	Dr.	30,00,000	
To 8% Debenture Application A/c			30,00,000
(Application money received on 1,20,000 debentures @ ₹25 each)			
8% debenture Application A/c	Dr.	30,00,000	
To 8% Debenture A/c			25,00,000
To 8% Debenture Allotment A/c			1,50,000
To Bank A/c			3,50,000
(Application money transferred)			
8% Debenture Allotment A/c	Dr.	25,00,000	
To 8% Debentures A/c			25,00,000
(Allotment money due on 1,00,000 debentures @ ₹25 each)			
Bank A/c	Dr.	23,50,000	
To 8% Debenture Allotment A/c			23,50,000
(Balance of allotment money received)			
8% Debenture First Call A/c	Dr.	30,00,000	
To 8% debentures A/c			30,00,000
(First Call due)			
Bank A/c	Dr.	30,00,000	
To 8% Debenture First Call A/c			30,00,000
(First Call money received)			
8% debenture Second & Final Call A/c	Dr.	20,00,000	
To 8% Debentures A/c			20,00,000
(Second & Final Call due)			
Bank A/c	Dr.	19,60,000	
To 8% Debenture Second & Final Call A/c			19,60,000
(Second & Final Call money received on 98,000 debentures @ ₹20 per Debenture)			

### Issue of Debentures at Premium

Q 2 Traditionally Products Ltd. offered 2,00,000, 8% debentures of ₹500 each at a premium of 10% payable as ₹200 on application (including premium) and balance on allotment, redeemable at par after 8 years. But applications are received for 3,00,000 debentures and the allotment is made on pro-rata basis. All the money due on application and allotment is received. Record necessary entries regarding issue of debentures.

**Solution:**

#### **JOURNAL OF TRADITIONAL PRODUCTS LTD**

		₹	₹
Bank A/c	Dr.	6,00,00,000	
To 8% debenture Application A/c			6,00,00,000
(Application money received on 3,00,000 debentures @ ₹200 each)			
8% Debenture Application A/c	Dr.	6,00,00,000	
To 8% Debentures A/c			3,00,00,000
To Securities Premium A/c			1,00,00,000
To 8% Debenture Allotment A/c			2,00,00,000
(Transfer of application money to 8% Debentures A/c and the excess money to Allotment A/c)			
8% Debenture Allotment A/c	Dr.	7,00,00,000	
To 8% Debentures A/c			7,00,00,000
(Allotment due on 2,00,000 debentures @ ₹350 each)			
Bank A/c	Dr.	5,00,00,000	
To 8% Debentures Allotment A/c			5,00,00,000
(Allotment money received)			

### Issue of Debentures at Discount

Q 3 Surya Ltd. issued 2,500, 15% Debentures of ₹100 each at a discount of 10% payable as follows:

₹25 on application; ₹25 on allotment and the balance on First call.

Applications were received for 2,000 debentures and the allotment was made. All the moneys were duly received. Expenses on issue of debentures amounted to ₹10,000. Directors decided to write off 1/4<sup>th</sup> of "Expenses on Issue A/c" and "Discount on Debentures A/c" from Profit & Loss A/c each year.

Pass Journal entries and show the above accounts in the company's Balance Sheet at the end of the first year.

**Solution:**

#### **JOURNAL OF SURYA LTD.**

		₹	₹
Bank A/c	Dr.	50,000	
To 15% Debenture Application A/c			50,000
(Application money received for 2,000 debentures @ ₹25 each)			
15% Debentures Application A/c	Dr.	50,000	
To 15% Debentures A/c			50,000
(Application money transferred)			
15% Debentures Allotment A/c	Dr.	50,000	
Discount on Debentures A/c	Dr.	20,000	
To 15% Discount A/c			70,000
(Allotment due)			



Bank A/c	Dr.	50,000	50,000
To 15% Debentures Allotment A/c			
(Amount received on allotment)			
15% Debentures First & Final Call A/c	Dr.	80,000	80,000
To 15% Debentures A/c			
(First & Final call due)			
Bank A/c	Dr.	80,000	80,000
To 15% Debentures First & Final Call A/c			
(Amount received on First & Final Call)			
Expenses on issue A/c	Dr.	10,000	10,000
To Bank A/c			
(Expenses paid on issue of debentures)			
Profit & Loss A/c	Dr.	7,500	5,000
To Discount on Debentures A/c			2,500
To Expenses on Issue A/c			
(1/4 <sup>th</sup> of "discount on debentures" and 1/4 <sup>th</sup> of "expenses on issue" written off)			

**BALANCE SHEET as on.....**  
**(at the end of first year)**

Equity & Liabilities	Note No.		
Non-Current Liabilities			
<b>Long term Borrowings (9% Debentures)</b>		<b>2,00,000</b>	
Assets			
Other Current/Non-Current Assets:			
<b>Unamortized Expenses</b>		<b>22,500</b>	

**Notes To Accounts:**

(1) Unamortized Expenses:			
<b>Discount on Debentures</b>		<b>15,000</b>	
<b>Expenses on Issue</b>		<b>7,500</b>	
		<b>22,500</b>	

**It should be noted that in case, full amount of a debenture is received in one installment, the amount should be credited to 'Debenture Application & Allotment A/c' instead of; Debenture Application A/c'.**

Q 4 A company purchased assets of the books value of `99, 000 from another Co. It was agreed that the purchase consideration be paid by issuing 11% Debentures of `100 each. Assume that the debentures have been issued (i) at par, (ii) at a discount of 10%, and (iii) at a premium of 10%. Give necessary journal entries in the books of purchasing company.

**Solution:**

**JOURNAL**

	Sundry Assets A/c	Dr.	99,000
	To Vendor's A/c		99,000
	(Assets purchased)		
(i)	When Debentures are issued at par:		
	Vendor's A/c	Dr.	99,000
	To 11% Debentures A/c		99,000
	(Issue of debentures at par)		
(ii)	When Debentures are issued at Discount:		
	Vendor's A/c	Dr.	99,000
	Discount on debentures A/c	Dr.	



	To 11% Debentures A/c (Issue of 1,100 debentures of `100 each at 10% discount calculated as follows)	11,000	1,10,000
(iii)	When debentures are issued at Premium: Vendor's A/c Dr. To 11% Debentures A/c To Securities Premium A/c (Issue of 900 debentures of `100 each at 10% premium, calculated as follows: $99,000/110 = 900$ debentures)	99,000	90,000 9,000

Q 5 The promising Company Ltd. took over assets of `3, 50,000 and liabilities of `30, 000 of X Ltd for a purchase consideration of `3, 30,000. The Promising Company Ltd. paid the purchase consideration by issuing 12% debentures of `100 each at 10% Premium.

Give journal entries in the books of the Promising Company.

Solution:

#### JOURNAL OF PROMISING COMPANY

	Sundry Assets A/c Dr. Goodwill A/c Dr. To Sundry Liabilities A/c To X Ltd. (Purchase of assets and liabilities of X Ltd.)	3,50,000 10,000	30,000 3,30,000
	X ltd. Dr. To 12% Debentures A/c To Securities Premium A/c (Issue of 3,000 Debentures of `100 each at 10% premium, calculated as follows: $3,30,000/110 = 3,000$ Debentures)	3,30,000	3,00,000 30,000

#### Issue of Debentures as Collateral Security

Sometimes, when a Company takes a loan from a bank or from some other party, the Company may have to issue debentures as a subsidiary or security in addition to the principal security. In other words, collateral security means secondary security in addition to the principal security. In other words, collateral security means secondary security in addition to the principal security. The bank or the other persons to whom such debentures are issued as collateral security will not be entitled to any interest on these debentures. They are entitled to get interest on the original loan advances by them. If default is made either in the payment of interest or in the full amount of principal debt, the lender will first realize its debt from the principal security. But if the full amount of debt is not realized from the principal security, it may claim all the rights of a debenture holder.

As soon as the Company pays the final installments of loan, it can take its debentures back.

There are two methods of dealing with such debentures in the books of accounts of the Company:

**(1) First Method:** In this method, no entry needs to be passed in the books of accounts of the company, as the debentures are not actually issued, but only given away as collateral security. As such, under this method, entry is passed only for taking a loan. If the loan is taken from a bank, the entry will be:

Bank A/c Dr.  
    To bank Loan A/c

On the equity and liabilities side of the balance sheet, a note is appended below the loan that the loan is secured by the issue of debentures as collateral security.

**(2) Second Method:** In this method, the entry for issuing debentures as Collateral Security is also recorded with the entry for taking the loan.

I. On taking a loan:

Bank A/c Dr.  
To Bank Loan A/c

II. On issuing the debentures as Collateral security:

Debentures Suspense A/c Dr.  
To Debentures A/c

In the Balance Sheet, debenture Suspense A/c will be shown as a deduction from the Debentures Account on the Equity and Liabilities side. As and when the loan is repaid, both the entries passed above are reverses.

**Q 9 A Company had Rs10,00,000 12% debentures outstanding as on 1<sup>st</sup> April 2011. During the year company took a loan of `2, 00,000 from the State Bank of India for which the Company placed with the bank debentures for `2, 50,000 as Collateral Security. Pass Journal entries, if any. Also show how the Debentures and Bank Loan will appear in the Company's balance Sheet on 31<sup>st</sup> March 2012.**

**Solution:**

**First Method:** No entry is passed for the issue of debentures in this method. Entry is passed only for taking a loan from the bank, as under:

Bank A/c Dr. 2,00,000  
To bank Loan A/c 2,00,000  
(Loan taken from the Bank and `2, 50,000 debentures deposited as collateral security)

**BALANCE SHEET**  
As on 31<sup>st</sup> March 2012

Equity & Liabilities	`	`
<b>Non-Current Liabilities:</b>		
<b>Long term Borrowings:</b>		
12% Debentures (In addition, debentures for `2, 50,000 have been issued as collateral security)	10,00,000	
Bank Loan (On Collateral security of Debentures of `2, 50,000)	2,00,000	

**Second Method:** Following entries are passed in this method:

1. Bank A/c Dr. 2,00,000  
To bank Loan A/c 2,00,000  
(Loan taken from the Bank)

2. Debentures Suspense A/c Dr. 2,50,000  
To 12% debentures A/c 2, 50,000  
(Issue of `2, 50,000 debentures as collateral security to secure a loan of `2, 00,000 from the Bank)

**BALANCE SHEET**  
As on 31<sup>st</sup> March 2012

Equity & Liabilities	`	`
<b>Non-Current Liabilities:</b>		
<b>Long-term Borrowings:</b>		
12% Debentures 12,50,000		
Less: debentures Suspense A/c <u>2,50,000</u>	10,00,000	
Bank Loan	2,00,000	
(On Collateral security of Debentures of `2, 50,000)		



### Interest on Debentures

Following entries are passed for interest on debentures:

- ### 1. When interest is due and tax is deducted at source (TDS)

Interest on Debentures A/c	Dr
----------------------------	----

To debenture holders A/c

To income Tax Payable

(Interest due to debenture holders and tax deducted at source)

2. When interest is paid to the debenture holders:

Debenture holders A/c Dr.

To Bank A/c

(Payment of interest)

3. On payment of tax deducted at source:

Income tax payable A/c	Dr.
------------------------	-----

To bank A/c

(Depositing the amount of TDS with income tax authorities)

4. On transfer of debenture interest to Profit & Loss Account at the end of the year:

Profit & Loss A/c	Dr
-------------------	----

To Interest A/c

(Interest transferred to P&L A/c)

**Q 11 X Limited issued 5,000, 12% debentures of ₹100 each on 1<sup>st</sup> April 2010 at par redeemable at a premium of 5%. Interest on these debentures is paid half-yearly, i.e. on 30<sup>th</sup> September and 31<sup>st</sup> March. Pass necessary journal entries for the year ended 31<sup>st</sup> March, 2011 assuming income tax is deducted @ 20% on the amount of interest.**

**Solution:**

## JOURNAL

2010			
April 1	Bank A/c To Debenture Application & Allotment A/c (Amount received on application)	Dr. 5,00,000	5,00,000
April 1	Debenture Application & Allotment A/c Loss on Issue of Debentures A/c To 12% Debentures A/c To Premium on redemption of Debentures A/c (Issue of Debentures at par and redeemable at 5% premium)	Dr. 5,00,000 25,000	5,00,000 25,000
Sep. 30	Interest on Debentures A/c To Debenture holders A/c To Income tax Payable (Half-yearly interest due on debentures and tax deducted at source)	Dr. 30,000	24,000 6,000
Sept. 30	Debenture holders A/c To Bank A/c (Payment of interest)	Dr. 24,000	24,000
Sept. 30	Income Tax payable A/c To bank A/c (TDS deposited with income tax authorities)	Dr. 6,000	6,000
2011 march	Interest on Debentures A/c To Debenture holders A/c	Dr. 30,000	24,000



31	To Income tax Payable A/c (Half-yearly interest due on debentures and tax deducted at source)		6,000
March 31	Debenture holders A/c To bank A/c (Payments of interest)	Dr. 24,000	24,000
March 31	Income Tax Payable A/c To bank A/c (TDS deposited with income tax authorities)	Dr. 6,000	6,000
March 31	Profit & Loss A/c To Interest on Debentures A/c (`30,000 + `30,000) (Interest transferred to Profit & Loss Account)	Dr. 60,000	60,000

### **Redemption of Debentures**

Debentures are the liabilities of the company. the repayment of debentures is called the redemption of debentures. The repayment of debentures is made by the Company in accordance with the terms of issue, as stated in the prospectus.

Following entries are passed for the redemption of debentures:

Debentures A/c Dr.

To Debenture holders A/c

Debenture holders A/c Dr.

To Bank A/c

Accounting for Issue of debentures Considering the Terms and Conditions of Redemption

Debentures may be redeemed either at par or at premium, according to the terms laid down at the time of issue. After taking into account the three possibilities of issue and two possibilities of redemption a Company can issue debentures from the following six types:

1. When debentures are issued at par and are redeemable at par: For example, if any of `100 is issued at `100 and is redeemable at Rd.100, the following entries will be passed.

Entries for Issue	`	`	Entries for redemption	`	`
Bank A/c Dr. To deb. App. & Allot.	100	100	Debenture A/c Dr. To Debenture holders A/c	100	100
Deb. App. & Allot. A/c Dr. To Debentures A/c	100	100	Debenture holder A/c Dr. To Bank A/c	100	100

### **2. When debentures are issued at a discount and are redeemable at par:**

For example, if a debenture of `100 is issued at `95 and is redeemable at `100, the following entries will be passed:

Entries for Issue	`	`	Entries for redemption	`	`
Bank A/c To deb. App. Allt.	95	95	Debenture A/c Dr. To Debenture holder A/c	100	100
Deb. App. & Allot A/c Dis. On issue of deb. To Debenture	95 5	100	Debenture holders A/c To Bank A/c	100	100

'Discount on issue' is a capital loss and will be written off during the lifetime of the debentures. But till then it will be shown as 'Unamortized Expenses' on the Assets side of the Balance Sheet.

3. When debentures are issued at a premium and are redeemable at par: For example, if a debenture of `100 is issued at `105 and is redeemable at `100, the following entries will be passed:

Entries for Issue	`	`	Entries for redemption	`	`
Bank A/c Dr. To Deb. App. & Alot	105	105	Debenture A/c Dr. To Debenture holders	100	100
Deb. App. & Allot A/c	105		Debenture holders A/c	100	

To Deb. A/c To Securities premium		100 5	To Bank A/c		100
---	--	----------	-------------	--	-----

Securities Premium A/c has a credit balance and is a capital profit, to be shown on the equity and liabilities side under the head, "Reserves & Surplus".

**4. When debenture are issued at par and are redeemable at a premium:** Sometimes the debentures are issued with the specified condition that the Company will pay a premium at the time of their redemption. Although, such premium will be paid at the time of actual redemption, but as it is a known loss the Company records such loss at the time of issue by debiting an account called. "Loss on issue of debentures A/c". It is done in keeping with the convention of conservatism.

For example, if a debenture of `100 is issued at `100 and is redeemable at `105, the following entries will be passed:

Entries for Issue	`	`	Entries for redemption	`	`
Bank A/c Dr. To deb. App. & Allott.	100	100	Deb. A/c Dr. Prem. On red. Of deb. A/c Dr To Deb holders A/c	100 5	105
Deb. App. & Allot. A/c Loss on issue of deb. To debenture A/c To pre. On red. Of deb. A/c	100 5	100 5	Debenture holders A/c To Bank A/c	105	105

"Loss on Issue of debentures A/c" is a loss on account of promise to pay debentures at premium at the time of their redemption. This is a capital loss and is written off gradually every year during the lifetime of the debentures. The entry for writing off will be;

Profit & Loss A/c Dr  
To Loss on issue of deb A/c

The balance of "Loss on issue of Debentures A/c" is shown as 'Unamortized Expenses' on the Assets side of the Balance Sheet.

'Premium on Redemption of Debentures A/c' shows a credit balance. It is a liability on the part of the Company and appears under the head: 'Non-Current Liabilities' under sub-head 'Long-term provisions' on the equity and liability side of the balance sheet each year, until the debentures are repaid. At the time of redemption of debentures, this account is debited and closed off.

**5. When debentures are issued at discount and are redeemable at a premium:** For example, if a debenture of `100 is issued at `98 and is redeemable at `105, the following entries will be passed:

Entries for Issue	`	`	Entries for redemption	`	`
Bank A/c Dr To Deb. App. & Allot A/c	98	98	Deb. A/c Prem. On Red. Of Deb. A/c To Debenture holders A/c	100 5	105
Deb. App. & Allot A/c Loss on issue of Deb. To deb. To Prem. On redemption of deb. A/c	98 7	100 5	Debenture holders A/c To bank A/c	105	105

**Both, the amount of discount allowed `2 and premium on redemption `5 are capital losses and therefore, grouped together and debited to "Loss on 'issue' as `7**

**6. When debentures are issued at premium and are redeemable at a premium: For example, if a debenture of `100 is issued at `106 and is redeemable at `110, the following entries will be passed:**

Entries for Issue	`	`	Entries for redemption	`	`
-------------------	---	---	------------------------	---	---



Bank A/c Dr To Deb. App. & Allot A/c	106	106	Deb. A/c Prem. On Red. Of Deb. A/c To Debenture holders A/c	100 10	110
De. App. & Allot A/c Loss on issue of Debentures A/c To Deb A/c To Sec. Prem To Pre. On red. Of deb. A/c	106 10	100 6 10	Debenture holders A/c To bank A/c	110	110

On the equity & liabilities side, securities premium will be shown under the head "Reserves & Surplus" and Premium on Redemption will be shown under the head "Non-Current Liabilities" under the sub-head 'Long-term provisions'.

**Q 15 B Ltd. issued 5,000 9% debentures of `500 each. Pass the journal entries for the issue of Debentures in the books of the company in the following cases:**

- When debentures are issued at 10% premium and redeemable at par.
- When debentures are issued at par and redeemable at 10% premium.
- When debentures are issued at 5% premium and redeemable at 10% premium.
- When debentures are issued at a premium of 25% to the vendors for machinery purchased for `6, 25,000.

**Solution:**

**Beeta Ltd.  
JOURNAL**

		Dr.	
(a)	Bank A/c To debenture Application & Allotment A/c (Application money received)	27,50,000	27,50,000
	Debentures Application & Allotment A/c Dr To 9% debentures A/c To Securities premium A/c (Debentures issued at a premium of 10%)	27,50,000	25,00,000 2,50,000
(b)	Bank A/c Dr. To debenture Application & Allotment A/c (Application money received)	25,00,000	25,00,000
	Debentures Application & Allotment A/c Dr. Loss on issue of debentures A/c Dr To 9% debentures A/c To Premium on redemption of Debentures A/c (Debentures issued at par, redeemable at a premium of 10%)	26,25,000 2,50,000	25,00,000 2,50,000
(c)	Bank A/c Dr. To debenture Application & Allotment A/c (Application money received)	26,25,000	26,25,000



## Writing off Discount/Loss on Issue of debentures

Discount on issue of debentures can be written off in two ways:

(1) Writing off equal amount each year:

**Q. On 1<sup>st</sup> April 2007, a Limited Company issued 11% `10, 00,000 debentures at a discount of 6% repayable at the end of 5 years. Show 'Discount A/c' for 5 years. Accounts are closed on 31<sup>st</sup> march each year.**

**Solution:**

### DISCOUNT ON DEBENTURES ACCOUNT

2007			2008		
April 1	To 11% debentures A/c	60,000	March 31	By P&L A/c (1/5 of `60, 000)	12,000
			March 31	By Balance c/d	48,000
		60,000			60,000
2008 April 1	To balance b/d	48,000	2009 March 31	By P&L A/c	12,000
			March 31	By balance c/d	36,000
		48,000			48,000
2009 April 1	To Balance b/d	36,000	2010 March 31	By P&L A/c	12,000
			March 31	By Balance c/d	24,000
		36,000			36,000
2010 April 1	To Balance b/d	24,000	2011 March 31	By P&L A/c	12,000
			March 31	By balance c/d	12,000
		24,000			24,000
2011 April 1	To balance b/d	12,000	2012 March 31	By P&L A/c	12,000
		12,000			12,000

(2) Writing off proportionate amount each year:

**Q. A Company issued debentures of the face value of `10, 00,000 at a discount of 6% on 1<sup>st</sup> April, 2007. These debentures are redeemable by annual drawings of `2, 00,000 made on 31<sup>st</sup> March each year. The directors decided to write off discount based on the debentures outstanding each year. Prepare Discount account for five years.**

**Solution:**

Total Discount on the issue of debentures =  $10,00,000 \times 6/100 = `60, 000$

Since debentures amounting to `2, 00,000 are to be redeemed each year the amount of discount written off from P&L A/c is determined as follows:

Year Ending	Debentures Outstanding	Ratio	Amount of Discount to be written off each year
31 <sup>st</sup> Mar 2008	10,00,000	5 or 5/15	$60,000 \times 5/15 = 20,000$
	8,00,000	4 or 4/15	$60,000 \times 4/15 = 16,000$

<b>31<sup>st</sup> Mar 2009</b>	6,00,000	3 or 3/15	60,000 x 3/15 = 12,000
<b>31<sup>st</sup> Mar 2010</b>	4,00,000	2 or 2/15	60,000 x 2/15 = 8,000
<b>31<sup>st</sup> Mar 2011</b>	2,00,000	1 or 1/15	60,000 x 1/15 = 4,000
<b>31<sup>st</sup> Mar 2012</b>			

Ratio has been obtained by dividing Debentures Outstanding by 2,00,000

#### DEBENTURE DISCOUNT ACCOUNT

2007		`	2008		`
April 1	To Debentures A/c	60,000	March 31	By P&L A/c	20,000
			March 31	By Balance c/d	40,000
		60,000			60,000
2008 April 1	To Balance b/d	40,000	2009 March 31	By P&L A/c	16,000
			March 31	By Balance c/d	24,000
		40,000			40,000
2009 April 1	To Balance b/d	24,000	2010 March 31	By P&L A/c	12,000
			March		12,000
		24,000			24,000
2010 April 1	To balance b/d	12,000	2011 March 31	By P&L A/c	8,000
			March 31	By balance c/d	4,000
		12,000			12,000
2011 April 1	To Balance b/d	4,000	2012 March 31	By P&L A/c	4,000
		4,000			4,000

**Q. A Ltd. issued 50, 00,000, 8% Debenture of `100 each at a discount of 6% on April 12, 000 redeemable at premium of 4% by draw of lots as under:**

**20,00,000 Debentures on March 31 2003**

**10,00,000 Debentures on March 31 2004**

**20,00,000 Debentures on March 31 2005**

**Compute the amount of discount to be written off in each year till debentures are paid. Also prepare discount/loss in issue of debentures account.**

**Solution:**

Discount on Issue = `50Crores x 6/100 = `3Crores

Premium on Redemption = `50Crores x 4/100 = `2Crores

Total Loss on Issue of Debentures = `5Crores

The loss in issue of debentures will be written off from P&L A/c in the following manner:

Year Ending	Debentures Outstanding	Ratio	Amount of Loss on Issue to be written off to P&L A/c
Mar 31 2001	50	5	5/20 x `5 = 1.25
Mar 31 2002	50	5	5/20 x `5 = 1.25
Mar 31 2003	50	5	5/20 x `5 = 1.25
Mar 31 2004	30	3	3/20 x `5 = 0.75
Mar 31 2005	20	2	2/20 x `5 = 0.5
		20	5

#### LOSS ON ISSUE OF DEBENTURES A/C

2000		`	2001		`
April	To 8% debentures A/c	3	March 31	By P&L A/c	1.25



1 April 1	(6% Discount on 5 Crores) To Premium on Redemption of Debentures A/c	2	March 31	By balance c/f	3.75
		5			5
2001 April 1	To balance b/f	3.75	2002 March 31 March 31	By profit & Loss A/c By Balance c/f	1.25 2.5
		3.75			3.75
2002 April 1	To Balance b/f	2.5	2003 March 31 March 31	By P&L A/c By Balance c/f	1.25 1.25
		2.5			2.5
2003 April 1	To balance b/f	1.25	2004 March 31 March 31	By P&L A/c By balance c/f	0.75 0.5
		1.25			1.25

**Q. X Ltd. issued 9% Debentures of `5, 00,000 at 94% on 1<sup>st</sup> July 2000 repayable by five equal annual installments of `1, 00,000 each, Accounts of the company are closed on 31<sup>st</sup> march every year. Compute the amount of discount to be written off each year and prepare the Debenture Discount Account for the period of duration of debentures.**

**Solution:**

$$\text{Total Discount} = 5,00,000 \times 6/100 = \text{`}30,000$$

Year ended	Debenture Outstanding	Months for which amount used	Products	Ratio	Discount written off
31 <sup>st</sup> March 2001	5,00,000	9 (From 1 <sup>st</sup> July 2000 to 31 <sup>st</sup> March 2001)	45,00,000		
			45,00,000	15	$15/60 \times \text{`}30,000 = 7,500$
31 <sup>st</sup> March 2002	5,00,000 4,00,000	3 (From 1 <sup>st</sup> April 2001 to 30 <sup>th</sup> June 2001) 9 (From 1 <sup>st</sup> July 2001 to 31 <sup>st</sup> March 2002)	15,00,000 36,00,000		
			51,00,000	17	$17/60 \times \text{`}30,000 = 8,500$
31 <sup>st</sup> March 2003	4,00,000 3,00,000	3 (From 1 <sup>st</sup> April 2002 to 30 <sup>th</sup> June 2002) 19 (From 1 <sup>st</sup> July 2002 to 31 <sup>st</sup> March 2003)	12,00,000 27,00,000		
			39,00,000	13	$13/60 \times \text{`}30,000 = 6,500$
31 <sup>st</sup> March 2004	3,00,000 2,00,000	3 (From 1 <sup>st</sup> April 2003 to 30 <sup>th</sup> June 2003) 9 (From 1 <sup>st</sup> July 2003 to 31 <sup>st</sup> March 2004)	9,00,000 18,00,000		
			27,00,000	9	$9/60 \times \text{`}30,000 = 4,500$
31 <sup>st</sup> March 2005	2,00,000 1,00,000	3 (From 1 <sup>st</sup> April 2004 to 30 <sup>th</sup> June 2004)	6,00,000 9,00,000		



		9 (From 1 <sup>st</sup> July 2004 to 31 <sup>st</sup> March 2005)			
			15,00,000	5	$5/60 \times 30,000 = 2,500$
31 <sup>st</sup> March 2006	1,00,000	3 (From 1 <sup>st</sup> April 2005 to 30 <sup>th</sup> June 2005)	3,00,000		
			3,00,000	1	$1/60 \times 30,000 = 500$
				<b>60</b>	<b>30,000</b>

#### DEBENTURE DISCOUNT ACCOUNT

Year			Year		
2,000 July 1	To 9% debentures A/c	30,000	March 31	By P&L A/c	7,500
			March 31	By Balance c/d	22,500
		30,000			30,000
2001 April 1	To balance b/d	22,500	2002 March 31	By P&L A/c	8,500
			March 31	By Balance c/d	14,000
		22,500			22,500
2002 April 1	To Balance b/d	14,000	2003 March 31	By P&L A/c	6,500
			March 31	By Balance c/d	7,500
		14,000			14,000
2003 April 1	To Balance b/d	7,500	2004 March 31	By P&L A/c	4,500
			31 March 31	By Balance c/d	3,000
		7,500			7,500
2004 April 1	To balance b/d	3,000	2005 March 31	By P&L A/c	2,500
			March 31	By balance c/d	500
		3,000			3,000
2005 April 1	To balance b/d	500	2006 March 31	By Profit & Loss A/c	500
		500			500

## **REDEMPTION OF DEBENTURES**

Many debentures are issued with the notice that they may be redeemed at the option of the company within a specified period of time and at a price specified. Redemption of debentures may seriously affect the liquidity of the company. Keeping the date and mode of redemption in mind, every company diverts some of the profits available to the shareholders towards a special fund (called Sinking Fund). Where the amount of debentures to be redeemed is small or it is to be redeemed by annual instalments, the company may not create any special fund. The accounting entries will differ according to the situations. We would like to discuss the accounting entries under two broad headings: a) Where there is no Sinking Fund; (b) Where there is Sinking Fund.

### **1. Where there is no Sinking Fund**

Generally, no Sinking Fund is created where the amount of debentures to be redeemed to be redeemed is small. The debentures may be redeemed:

- (i) By Payment in a lump sum at the end of the specified period
- (ii) By payment in annual instalments
- (iii) By purchase in the open market

#### **Payment in a lump sum at the End of a Specified Period**

In this case, all debentures are redeemed at a time at the end of a specified period. The accounting entries are:

- a) When debentures are redeemed at par

(i) Debentures Account Dr  
    To debenture holders Account

(ii) Debenture holders Account Dr  
    To Bank Account

- b) When debentures are redeemed at a premium

(i) Debentures Account Dr (Nominal Value)  
Premium on redemption of debenture account Dr (Premium)  
    To debenture holders accounts

(ii) Debenture holders Account Dr  
    To Bank Account

- c) When debentures are redeemed at a discount

(i) Debentures Account Dr (Nominal Value)  
    To debenture holders account (Actual Amount)  
    To profit on redemption of debentures Account (Discount)

(ii) Debenture holders Account Dr  
    To Bank Account

#### **Payment in Annual Instalments**

In this case, debentures to be redeemed are selected by lottery or drawings. The accounting entries are simple.

Accounting Entries

- a) When debentures are redeemed at par

(i) Debentures Account Dr (Nominal Value)  
    To Debenture holders Account (Actual Amount)

(ii) Debenture holders Account Dr (Actual amount paid)  
    To Bank A/c



b) When debentures are redeemed at a premium

- |   |                         |
|---|-------------------------|
| (i) Debentures account                      | Dr (Nominal Value)      |
| Premium on Redemption of debentures Account | Dr (Premium)            |
| To debentures Holders account               |                         |
| (ii) Debenture holders Account              | Dr (Actual amount paid) |
| To Bank Account                             |                         |

c) When debentures are redeemed at a discount

- |  |                         |
|--|-------------------------|
| (i) Debentures Account                                   | Dr (Actual amount paid) |
| To debenture holders Account                             |                         |
| To profit on Redemption of debentures account (Discount) |                         |
| (ii) Debentures holders Account                          | Dr                      |
| To Bank Account  |                         |

In fact premium paid on redemption is a loss. Generally, at the time of issue of debentures, a provision is made for the premium payable on redemption by debiting "Loss on Issue of Debentures account" and crediting "Premium on Redemption Debentures Account". Till the date of redemption, it is shown on the liabilities side of the Balance Sheet. However, a portion of "Loss on Issue of debentures" Is written-off every year by debiting Profit and Loss Account.

Where no provision is made, premium on redemption of Debentures Account is closed by passing the following entry:

- |   |     |
|---|-----|
| Securities Premium Account                      | Dr. |
| Profit & Loss Account                           | Dr. |
| To Premium on Redemption of debentures Accounts |     |

### **Early Extinguishment of Debentures – Purchase In the Open Market**

A company may redeem its debentures prior to maturity. The company may purchase its own debentures from stock market either: (i) for immediate cancellation, or (ii) as an investment (to be cancelled when required).

The principal reason for cancelling debentures before maturity date is to relieve the issuing company of the obligation to make future interest payments. If the debentures issuing company of the obligation to make future interest payments. If the debentures are listed in the stock market, they can be easily purchased and sold.

Generally, the company is interested to purchase its own debentures when the interest rate on the debentures is considerably higher than the current market interest rate.

The advantage of the company is hat by issuing new debentures or by arranging-loan at a lower interest rate; it can use the funds to require the original, higher interest debentures.

### **(i) Purchase of Debentures for immediate Cancellation-On the Date of Interest**

A Company may purchase its own debentures at any date for immediate cancellation. If the date of purchase of debentures and the date for payment of interest on debentures are the same, interest up to the date of purchase will be paid to the (old) debenture holders. The entries for purchase and cancellation of debentures will be as follows:

a) When debentures are purchased

- |                               |   |
|-------------------------------|---|
| Debentures Redemption Account | DR (Quoted price x No. of deb. purchased) |
| To Bank Account               |   |

b) When debentures are cancelled

- |                        |                     |
|------------------------|---------------------|
| (i) Debentures Account | Dr (Purchase price) |
|------------------------|---------------------|



To debentures Redemption Account (Purchase [profit])  
 (ii) If there is a loss on cancellation, it is transferred to profit and loss account  
 Profit and loss Account                      Dr (Loss)  
     To Debentures Redemption Account

c) When profit on cancellation of debentures is transferred to Capital Reserve  
 Profit on cancellation of debentures Account      Dr  
     To Capital Reserve Account

\*Profit on cancellation is a capital profit; it should be transferred to capital reserve.

### **Purchase of Debentures for immediate Cancellation-Before the Date of Payment of interest**

When debentures are purchased before the date of interest, a problem may arise whether the quoted price includes interest up to the date of purchase or not. Price may be quoted "Ex-interest" or "Cum-interest"

### **Meaning of Cum-interest and Ex-interest**

'Cum' and 'Ex' are latin words 'cum' means with and 'ex' means without. Cum-interest can be expanded as cumulative or inclusive of interest and Ex-interest can be expanded as exclusive of interest. The quotation, Cum-interest, not only covers the cost but also includes the interest accrued up to the date of purchase; when interest becomes due, it would be the right of the buyer to claim that. Conversely, the quotation, Ex-interest, only covers the cost of the debentures and the buyer is liable to pay additional amount as interest accrued up to the date of Purchase of debentures. **In this connection, the following points are important: In respect of Government securities and debentures, the price quoted is Ex-Interest unless otherwise stated; and (ii) In respect of Non-Government securities and debentures, it is Cum-interest unless otherwise stated.** When debentures are purchased Cum-interest, care must be taken at the time of passing entry of purchase of debentures. In case, quotation price consists of cost plus accrued interest. Payments of accrued interest on debenture requisition are separately treated as a debit to debenture interest. Debentures Redemption Account will be debited with the cost price only and Debenture Interest Account will be debited with the accrued interest up to the date of purchase from the date of last interest paid. Bank account will be credited with the quotation price.

For calculating cost and accrued interest, the following steps should be followed:

**Step 1:** Calculate the prepaid between the date of last interest paid and the date of purchase of debentures

**Step 2:** Calculate accrued interest by applying the following formula:

**Rate of interest x Period (In month)/12 x Face value of debentures purchased**

**Step 3:** Calculate cost as follows:

(Quotation price x No. of debentures purchased) less Accrued interest as calculated in Step 2

When debentures are purchased Ex-interest, the debentures Redemption Account will be debited with quotation price (which is, in fact, nothing but the cost price) and Debentures Interest Account will be debited with accrued interest. Bank account will be credited with the quotation price plus accrued interest.

Accounting Entries

a) When debentures are purchased

Debentures Redemption Account	Dr (Cost)
Debenture Interest Account	Dr (Accrued interest)

- To Bank Account (Total Payment)
- b) When debentures are cancelled
- (i) Debentures Account Dr (Face value)
- To Debentures Redemption Account (Cost)
- To Profit on Cancellation of Debentures Account (Profit)
- (ii) Loss on cancellation is transferred to profit and loss account
- Profit and Loss Account DR.
- To debentures Redemption Account
- c) When profit on cancellation of debentures is transferred to Capital Reserve
- Profit on Cancellation of Debentures Account Dr.
- To Capital reserve Account

**We should remember that profits or loss on redemption of debentures arises only on cancellation or sale.**

A Company may purchase its own debentures as investment. Such debentures are kept alive. In future, it can be sold in the market again or it will be cancelled. When own debentures are purchased as investment, an account called "Investment in Own debentures Account" or "Own Debentures Account" is debited with the quotation price and Bank Account is credited with the same amount. "Investment in Own Debentures

"Account" is shown on the assets side of the Balance Sheet under the heading "Investment".

Interest on own debentures of the post-purchase period is credited to profit and loss account just like any other income from other investments. Debenture interest account is debited with the total interest (Payable to outside debentures holders plus interest on own debentures held as investment).

**The accounting entries will be as follows:**

- (a) When debentures are purchased
- Investment in Own Debentures Account Dr (Quotation price x no. of debenture purchased)
- To Bank Account
- (Being the purchase of.....debentures @ Rs.....each as investment)
- (b) When interest on debentures is due and paid
- Debenture interest Account Dr (Total Interest)
- To Bank A/c (Interest paid to outside debenture holders)
- To Interest on Own Debentures Account (Own Debentures)]
- (Being the interest on debentures paid and adjusted)
- (c) When debentures are cancelled
- Debentures Account Dr (Face value)
- To Investment in Own Debentures Account (Purchased Price)
- To profit on Cancellation of Debentures Account (Profit)
- (Being the cancellation of....debentures)
- (d) When profit on cancellation is transferred to Capital Reserve
- Profit on Cancellation of debenture Account Dr
- To Capital Reserve Account
- (Being profit on cancellation is transferred to capital reserve Account)
- (e) When interest on own debentures is transferred
- Interest on own Debenture Account Dr
- To profit and Loss Account



(Being the interest on own debentures is transferred to profit and loss account)

(f) When debentures interest (paid during the year) is transferred to profit and loss Account

Profit and Loss Account                      Dr

    To debentures Interest Account

(Being interest charged to profit and loss account)

**Purchase of debentures as investment-Before the Date of payment of interest**

When debentures are purchased before the date of interest. Investment in Own Debentures Account is debited with the cost (which is determined in the same manner as we do in case of purchase of debenture for immediate cancellation). Debenture Interest Account is also debited with the amount of accrued interest up to the date of purchase from the date of last payment of interest. The bank Account is credited with the amount paid to the seller of debentures. Interest on own debentures of the post-purchase period is credited to profit and loss Account. Until cancellation. Investment in Own debentures is shown in the Balance Sheet under the heading "Investments"

Accounting Entries:

(a) When debentures are purchased

Investment in own Debentures Account    Dr (Cost)

Debenture Interest Account                      Dr (Accrued Interest)

    To Bank    (Total payment)

(b) When interest on debentures is due and paid

Debenture Interest Account                      Dr (Total int. paid during purchase)

    To Bank    (Interest paid to outside debentures holders)

    To Int. on own debentures Account (Own Debentures)

© When debentures are cancelled

(i) Debentures Account                      Dr (Face value)

    To investment in Own Debentures Account (Cost)

    To Profit and loss on cancellation of debenture account (Profit)

(ii) Loss on cancellation is debited to profit & Loss Account

Profit and Loss Account                      Dr

    To profit and Loss on Cancellation of Debentures Account

(d) When debentures are sold without cancelling

(i) Bank Account                      DR (Sale proceeds)

    To Investment in own Debentures Account                      (Cost)

    To profit on Sale of own Debentures Account (Profit)

(ii) Loss on sale is debited to profit and Loss Account

(e) When profit on cancellation of debentures is transferred to Capital Reserve

Profit on Cancellation of debentures Account    Dr

    To Capital reserve Account

(f) When interest on own debentures is transferred to profit and loss account

Interest on Own Debentures Account    Dr

    To profit and Loss Account

(g) When debentures interest (Paid for the year) is transferred to profit and loss account

Profit and Loss Account    Dr

    To Debentures Interest Account



## 2. Where there is Sinking Fund

A Sinking fund is a fund created for the repayment of a liability or for the replacement of an asset. It is created by equal periodic installments in order to accumulate the amount of money required to repay a loan at a set date in the future.

When the debentures are issued for a fixed period, their payment must be made after the expiry of that period. When the debentures are redeemed, the company requires a huge amount of money to pay-off Debenture holders. If proper provisions are not made there will be a strain on working capital and the company will face liquidity crisis because a lot of money will go out of business.

Every year, an equal amount is debited to profit and loss Appropriation Account and credited to Sinking Fund Account. The amount so as to produce the amount required to repay the debentures holders on the date of redemption. In the Balance Sheet, Sinking Fund Account is shown on the Liability side and Sinking Fund Investment Account is shown on the Asset side. Other things remaining the same balances on these two accounts should be equal. In the year of redemption, sinking fund investments will be realized and debenture holder will be paid-off. After redemption, the balance of the Sinking fund Account is transferred to General Reserve Account.

Accounting Entries for Creation of Sinking Fund

### At the end of the 1st year

(a) For annual contribution (determined with the help of Sinking Fund Table)

Profit And Loss Appropriation Account      Dr  
    To Sinking Fund Account

(b) For Investing the amount set aside

Sinking Fund Investment Account      Dr  
    To Bank account

### At the end of the 2<sup>nd</sup> and subsequent years

(a) For receiving interest on Sinking fund Investment

Bank Account      Dr  
    Sinking Fund Account

### Alternatively

Bank account      Dr  
    To Sinking Fund Account

(c) For annual contribution

Profit and loss Appropriation Account      Dr  
    To Sinking Fund Account

(d) For investing the amount set aside plus interest received during the year

Sinking Fund Investment Account      Dr (Contribution plus interest)  
    To Bank A/c

### At the end of the year of redemption

(a) For receiving interest on sinking fund investment

Bank Account      Dr  
    To interest on Sinking Fund Investment Account

(b) For transferring interest on sinking fund investment to sinking fund account

Interest on Sinking Fund Investment Account      Dr

To Sinking Fund Account

© For annual contribution

Profit and Loss Appropriation Account                      Dr

To Sinking Fund Account

**At the end of the year of redemption of determine, annual contribution and interest of that year are nit invested outside. On that date all the investments are sold.**

(d) For realization of sinking fund investments

Bank Account    Dr

To Sinking Fund Investments Account

(e) For profit on sale of investment

Sinking Fund Account    Dr

To Sinking Fund Investment Account

(f) For loss on sale of investments

Sinking fund Account    Dr

To Sinking Fund investment Account

(g) For redemption of debentures at a premium

Debentures Account    Dr

Premium on Redemption of Debentures Account Dr

To Debenture holders Account

(h) For payment to debenture holders                              Dr

Debenture holders Account

To Bank Account

(i) For transferring premium on redemption of debentures

Sinking Fund Account    Dr

To Premium on Redemption of debenture Account

Note: Reverse entry will be made in case of redemption at a discount

(j) For transferring part of the sinking fund no longer required

Sinking Fund Account    Dr

To General Reserve Account

**The students should note that frequently the expression “debenture Redemption Fund Account” Is used instead of “Sinking Fund Account”. Likewise, “Debenture Redemption Fund Investment Account is used in place of “Sinking Fund Investment Account”. These expressions are used interchangeably.**

### **Purchase in the open Market (here there is sinking fund) for immediate Cancellation**

Somet8ime a company may purchase its own debentures from stock market for immediate cancellation even when there is a sinking fund. Generally, the company is interested to purchase its own debentures when the prevailing price is advantageous to it and loss on sale of sinking fund investment, if any, is minimum.

### **In this connection, the following points are important:**

(a) Any profit or loss on sale of sinking fund investments should be transferred to Sinking Fund Account.

(b) The difference between the face value of debentures cancelled and their actual cost (in case of cum-interest purchase, quotation price less accrued interest; and in case of ex-interest, quotation price) should be treated as profit or loss on cancellation of debentures. This profit on cancellation should be transferred ro Capital Reserve Account as it is a capital profit.



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To Bank Account

c) For sale of sinking fund investment

Bank Account Dr (Total proceeds)

To Sinking Fund Investment Account

d) Profit / Loss on sale of investments is transferring to Sinking Fund Account. For profit, Sinking Fund Account is credited and Sinking Fund Investment Account is debited. In case of loss, the entry is reversed.

e) For cancellation (when required)

(i) Debentures Account Dr (Face value)

To Investment in Own debentures Account (Cost)

To Sinking Fund Account (Profit)

(ii) Debentures Account Dr (Face value)

Sinking Fund Account Dr (Loss)

To Investment in own debentures Account (Cost)

**No profit and loss is calculated at the time of purchase of own debentures. Only when it is cancelled, the profit or loss is calculated and transferred to Sinking Fund Account.**

f) For transferring the face value of debentures cancelled to General Reserve Account

Sinking Fund Account Dr

To General Fund account

(g) For transferring profits on cancellation of debenture to capital reserve account

Sinking Fund Account Dr

To Capital Reserve account

### **Debenture Trust Deed**

A trust is a legal arrangement whereby assets are owned and managed by one or more persons (trustees) on behalf of others (beneficiaries). The debenture holders of a company are interested in the safety of their debentures to protect the interest of the debenture holders a Trust Deed is drawn up. It is a legal document defining a trust and regulating the rights and duties of the trustees as well as the debenture holders.

When debentures are issued to the public, certain persons are appointed as trustees whose main job is to safeguard the interest of the debenture holders. The trustees are empowered to call for a meeting of the debenture holders and also can appoint a Receiver on breach of contract. A Trust Deed may also make a provision that the trustees, without the aid of the Court can exercise the power to sell the debenture.

### Convertible debentures

Convertible debentures are those which carry a provision of conversion in a number of shares at par or at a premium on or before a certain date. The dates and terms of the conversion are established at the time of the issue of debentures. A convertible debenture gives the holder the option to convert in to shares at a later date and also at a fixed price. In fact, it is a delayed form of equity financing. Convertible debentures can be partly or fully convertible. Convertible debenture holders are the secured creditors of the company at the early stage of development. By the process of conversion, they are given option to enjoy the right of becoming proprietors, when the solvency, liquidity and managerial efficiency of the company are assured. **It should be noted that there is no prohibition to issue debentures at a discount. Unlike the prohibition contained in Section 54 of the Companies Act, 2013 for the issue of shares at a discount But, when the debentures are convertible into equity shares, the conversion should be at par or above the nominal value of equity shares.**

Following are the advantages of convertible debenture:

1. The debit is self-liquidating- there will be no cash outflow in the future
2. There will be no capital gains tax for convertible debenture holders
3. Capital gearing is reduced, paving the way for new loans.

The disadvantages are:

1. there may be future dilution in earnings per share.
2. There may not be any possibility of a bonus or rights in the near future.

Valuation techniques for conversion required additional study

Journal Entries:

1. On receipt of application money

Cash/bank Account Dr  
To debentures Application Account

2. For allotment of debentures

Debentures application Account Dr  
To Convertible debentures Account

3. For conversion of the convertible debentures into equity/preference shares at par Convertible debenture Account

To Equity/Preference Share Capital Account

4. For conversion of the convertible debentures into equity/preference shares at a premium

Convertible Debentures Account                      Dr  
To equity/Preference Share Capital Account



## **MCQ FOR PRACTICE**

**Q1.** Loss on issue of debentures is generally written off in \_\_\_\_\_

- (a) 5 years
- (b) 15 years
- (c) 10 years
- (d) over the period of redemption

**Q2.** Which off the following is the method to write off discount/loss on issue of debentures?

- (a) Fixed installment method
- (b) Fluctuating installment method
- (c) ) both (a) and (b)
- (d) None of the above

**Q3.** Which off the following is the method to write off discount/loss on issue of debentures?

- (a) Fixed installment method
- (b) constant installment method
- (c) Straight line installment method
- (d) None of the above

**Q4.** Fluctuating installment method is applied when

- (a) Debentures are redeemed at the end of a specific period.
- (b) Debentures are to be repaid by annual drawings or installments
- (c) Debentures are convertible
- (d) None of the above

**Q5.** Which of the following statement is false

- (a) Discount on issue of debentures can be written off against capital profits
- (b) Discount on issue of debentures can be treated as deferred revenue expenditure
- (c) Any premium on redemption is to be recognized as loss at the time of issue of debentures
- (d) Fixed installment method is applied when debentures are to be repaid by annual drawings

**Q6.** Zen Ltd. Issued 10,000, 7% debentures of Rs. 100 each at a discount of 4% redeemable after 5 years at a premium of 6%. Loss on issue on debentures is:

- (a) Rs. 100,000
- (B) Rs. 60,000
- (C) Rs. 160,000
- (D) Rs. 40,000

**Q7.** A company issued Rs. 500,000, 15% debentures at a discount of 5%, redeemable after 10 years at a premium of 5%. Loss on issue on debentures is:

- (a) Rs. 30,000
- (b) Rs. 25000
- (c) Rs. 50,000
- (d) Rs. None of the above

**Q8.** When debentures are issued at a discount and are redeemable at a premium, which of the following account is debited at the time of issue of debentures?

- (a) Debentures Account
- (b) Premium on redemption of debentures account
- (c) Loss on issue of debentures account
- (d) Capital reserve account

**Q9.** When debentures are issued at a discount and are redeemable at par, which of the following account is debited at the time of issue of debentures?

- (a) Debentures Account
- (b) Premium on redemption of debentures account
- (c) Loss on issue of debentures account
- (d) Discount on issue of debentures account



**Q10.** Issue of 9%, 50,000 debentures of Rs. 100 each is issued at 10% premium and are redeemable at premium of 5%. What is the amount of loss on issue on debenture?

- (a) Rs. 7,50,000
- (b) Rs. 5,00,000
- (c) Rs. 250,000
- (d) Rs. 300,000

**Q11.** Fortune Ltd. Issued Rs. 70,000, 12% of debentures of Rs. 100 each at a premium of 5% redeemable at 110%. What will be total of balance sheet if we prepare balance sheet after this transaction.

- (a) Rs. 80,50,000
- (b) Rs. 80,00,000
- (c) Rs. 80,500
- (d) Rs. None of the above

**Q12.** S Ltd. Issued 10,000 12% debentures of Rs. 100 each at a discount of 5%. These debentures are redeemable at a premium of 10% after 5 years. How much loss to be written off every year?

- (a) Rs. 50,000
- (b) Rs. 30,000
- (c) Rs. 15,000
- (d) Rs. None of the above

**Q13.** Bee Ltd. Issued 2,000, 12% debentures of Rs. 100 each at a discount of 6% on 1.4.2006 repayable by equal instalments in four years. How much discount will be written off each year?

- (a) Rs. 3,000; Rs. 3,000; Rs. 3,000; Rs. 3,000
- (b) Rs. 4,800; Rs. 4,800; Rs. 1,200; Rs. 1,200
- (c) Rs. 4,800; Rs. 3,600; Rs. 2,400; Rs. 1,200
- (d) None of the above

**Q14.** Moon Ltd issued 5,000 debentures of Rs. 100 each at a discount of 10%. The expenses on issue amounted to Rs. 20,000. The company wants to redeem the debentures at the rate of Rs. 1,00,000 each year commencing with the end of fifth year. How much discount and expenses should be written off in 8<sup>th</sup> year?

- (a) Rs. 10,000
- (b) Rs. 6,000
- (c) Rs. 2,000
- (d) Rs. 4,000

**Q15.** Josh Ltd. Issued 2,000, 10% debentures of Rs. 100 each at a discount of 10%. The debentures are redeemable at a premium of 10% after 8 years. You are required to compute the loss on issue of debentures to be written off each year.

- (a) Rs. 8,000
- (b) Rs. 5,000
- (c) Rs. 40,000
- (d) Rs. None of the above

**Q16.** S Ltd. Issued 20,000, 8% debentures of Rs. 10 each at par, which are redeemable after 5 years at a premium of 20%. The amount of loss on redemption of debentures to be written off every year will be:

- (a) Rs. 40,000
- (b) Rs. 10,000
- (c) Rs. 20,000
- (d) Rs. 8,000

**Q17.** Time Ltd. Issued 50,000, 12% debentures of Rs. 10 each at par, which are redeemable after 5 years at a premium of 20%. The amount of loss on redemption of debentures to be written off every year will be:

- (a) Rs. 40,000
- (b) Rs. 10,000
- (c) Rs. 20,000
- (d) Rs. 8,000

**Q18.** ZEN Ltd. Issued 30,000, 9% debentures of Rs. 100 each at premium of 10%, which are redeemable after 10 years at a premium of 20%. The amount of loss on redemption of debentures to be written off every year will be:

- (a) Rs. 75,000
- (b) Rs. 60,000
- (c) Rs. 25,000
- (d) Rs. 1,00,000

**Q19.** XYZ Ltd. Issued 1,000 7% debentures of Rs.100 each at par which are redeemable at the end of each year in equal lots in 5 years at a premium of 30%. The amount of loss on redemption of debentures to be written off in fourth and fifth year will be:

- (a) Rs. 10,000; Nil (b) Rs. 4,000; Rs. 4,000  
(c) Rs. 6,000; Rs. 6,000 (d) Rs. 4,000; Rs. 2,000

**Q20.** M Ltd. Purchased plant worth Rs. 70,000 and furniture worth Rs. 80,000 from N Ltd. M Ltd. Issued debentures of Rs. 100 each at 20% premium to N Ltd. Calculate amount of securities premium to be credited at the time of issue.

- (a) Rs. 1,250 (b) Rs. 1,50,000  
(c) Rs. 1,500 (d) Rs. 25,000

**Q21.** M Ltd. Purchased plant worth Rs. 70,000 and furniture worth Rs. 80,000 from N Ltd. M Ltd. Issued debentures of Rs. 100 each at 20% discount to N Ltd.

Debentures account will be credited with

- (a) Rs. 1,875 (b) Rs. 1,87,500  
(c) Rs.37,500 (d) Rs. 150

**Q22.** X Ltd. Took over the assets of Rs. 6,00,000 and liabilities of Rs. 80,000 of C Ltd. for an agreed purchase consideration of Rs. 5,40,000 to be satisfied by the issue of 10% debentures of Rs. 1,000 each. The difference between Net Assets taken over and purchase consideration will be transferred to

- (a) Goodwill A/C (b) Capital reserve A/C  
(c) Securities premium A/C (d) Discount on issue A/C

**Q23.** X Ltd. Took over the assets of Rs. 6,00,000 and liabilities of Rs. 80,000 of C Ltd. for an agreed purchase consideration of Rs. 5,40,000 to be satisfied by the issue of 10% debentures of Rs. 1,000 each. Calculate number of debentures to be issued at 20% premium to discharge purchase consideration.

- (a) 4,500 debentures (b) 450 debentures  
(c) 45,000 debentures (d) 540 debentures

**Q24.** New Ltd. purchased a Machinery from Blue Ltd. for book value of Rs. 5,40,000. The consideration was paid by issue of 15% debentures of Rs. 100 each at a discount of 10%. The debentures account will be credited by

- (a) Rs. 6,00,000 (b) Rs. 4,80,000  
(c) Rs.5,40,000 (d) Rs. 5,00,000

**Q25.** . New Ltd. purchased machinery from Blue Ltd. for a book value of Rs. 10,00,000. The consideration was paid by issue of 10% debentures of Rs. 100 each at a premium of 25%. The debenture account was credited with:

- (a) Rs. 12,50,000 (b) Rs. 12,00,000  
(c) Rs.10,00,000 (d) Rs. 8,00,000

**Q26.** A Ltd. purchased a building worth Rs. 99,00,000 and issued 12% debentures of Rs. 100 each at a premium of 10%. What will be the amount of premium?

- (a) Rs. 8,00,000 (b) Rs 9,90,000  
(c) Rs 9,00,000 (d) Rs 10,00,000



**Q27.** R Ltd. purchased a machinery worth Rs. 1,20,000 and a building worth Rs. 2,00,000 from D Ltd. for an agreed purchase consideration of Rs. 3,00,000 to be satisfied by the issue of 3,000, 10% debentures of Rs. 100 each. Calculate the amount to be transferred to capital reserve account.

- (a) Rs. 10,000
- (b) Rs. 20,000
- (c) Rs. 30,000
- (d) Rs. 40,000

**Q28.** X Ltd. borrowed Rs. 25,00,000 from a scheduled bank at an annual interest rate of 12% and deposited 14% debentures of the face value of Rs. 40,00,000 as collateral security. Pass journal entries regarding the issue of debentures as collateral security and also show the above items in the company's balance sheet.

**Q29.** 5,000, 12% debentures of Rs. 100 each issued as collateral security. To record this transaction which of the following entry will be passed?

- (a) Debit cash account and credit debentures account
- (b) Debit debentures suspense account and credit debentures account
- (c) Debit debentures suspense account and credit cash account
- (d) None of the above

**Q30.** On Jan 1, 2014, Y Ltd. obtains a loan from ICIDBI Bank of Rs. 10,00,000 at the interest rate of 12.5% p.a. giving as collateral security of Rs. 15,00,000, 14% first mortgage debentures. ICIDBI Bank is entitled to interest on :

- (a) Rs. 10,00,000
- (b) Rs. 15,00,000
- (c) Both on Rs. 10,00,000 and 15,00,000
- (d) None of the above

**Q31.** A company issued 12% debentures of the face value of Rs. 2,00,000 at 10% discount on 1<sup>st</sup> Jan 2010. Debenture interest after deducting tax at source @ 10% was payable on 30<sup>th</sup> June and 31<sup>st</sup> Dec every year. Calculate the amount of interest payable to debenture holder on each due date.

- (a) Rs. 6,000
- (b) Rs. 600
- (c) Rs. 5,400
- (d) Rs. None of the above

**Q32.** When is debenture interest payable?

- (a) Is payable only in case of profit
- (b) Accumulates only in case of losses
- (c) Is payable after the payment of dividend
- (d) Is payable before the payment of dividend on shares

**Q33.** Interest on debentures is calculated on

- (a) Market value
- (b) Issue price
- (c) Redeemable value
- (d) Face value

**Q34.** Interest accrued and due is also known as

- (a) Accrued interest
- (b) Due interest
- (c) Outstanding interest
- (d) None of the above

**Q35.** Interest accrued but not due is also known as

- (a) Accrued interest
- (b) Due interest
- (c) Outstanding interest
- (d) None of the above

**Q36.** Interest accrued and due ( outstanding interest ) will be shown in Balance sheet as

- (a) None current liability
- (b) Current Liability
- (c) None current assets
- (d) None of the above



**Q37.** Interest accrued but not due ( Accrued interest ) will be shown in Balance sheet as

- (a) None current liability
- (b) Current Liability
- (c) None current assets
- (d) None of the above

**Q38.** 8,000, 11% debentures of Rs. 100 each are to be redeemed at 5% premium. Debenture holders are redeemed by issue of equity shares of Rs. 10 each. Calculate the number of shares to be issued

- (a) 80,000 shares
- (b) 84,000 shares
- (c) 85,000 shares
- (d) 70,000 shares

**Q39.** 8,000, 11% debentures of Rs. 100 each are to be redeemed at 5% premium. Debenture holders are redeemed by issue of equity shares of Rs. 10 each at a premium of Rs 2 per share. Calculate the number of shares to be issued

- (a) 80,000 shares
- (b) 84,000 shares
- (c) 85,000 shares
- (d) 70,000 shares

**Q40.** 8,000, 11% debentures of Rs. 100 each are to be redeemed at 5% premium. Debenture holders are redeemed by issue of 9% debentures of Rs 100 each at discount of 20%. Calculate the number of debentures to be issued

- (a) 10,000 shares
- (b) 8400 shares
- (c) 10,500 shares
- (d) 5,000 shares

**Q41.** M Ltd. had issued 10% 5,00,000 debentures of Rs. 100 each redeemable on 31<sup>st</sup> March 2014 at a premium of 5%. The company offered 11% preference shares of Rs. 10 each at Rs. 10.50. The option to convert was accepted by the holders of 1,00,000 debentures. Calculate the face value of shares to be credited at the time of conversion.

- (a) Rs. 100 lakhs
- (b) Rs. 105 lakhs
- (c) Rs.110 lakhs
- (d) None of the above

**Q42.** M Ltd. had issued 10% 5,00,000 debentures of Rs. 100 each redeemable on 31<sup>st</sup> March 2014 at a premium of 5%. The company offered 12% debentures of Rs. 100 each at par. The option to convert was accepted by the holders of 1,00,000 debentures. Calculate the face value of debentures to be credited at the time of conversion.

- (a) Rs. 100 lakhs
- (b) Rs. 105 lakhs
- (c) Rs.110 lakhs
- (d) None of the above

**Q43.** On 1<sup>st</sup> April, 2010, Rosy Ltd. Issued 20,000, 13% debentures of Rs 100 each at 5% discount. Debenture holders have an option to convert their holdings in 14% preference shares of Rs 100 each at a premium of Rs 25 per share. A holder of 100 debentures notified his intention to convert his holdings in 14% preference shares. How many preference shares will be issued to them?

- (a) 200 preference shares
- (b) 50 preference shares
- (c) 80 preference shares
- (d) 76 preference shares

**Q44.** On 1<sup>st</sup> January, 2011, a company issued 1,000, 12% debentures of Rs 500 each at Rs 450 each. Debenture holders were given an option to get their debentures converted into equity shares of Rs 100 each at a premium of Rs 50 per share. A holder of 100 debentures informed that he wanted to exercise the option for conversion of debentures into equity shares. The company, therefore, accepted his requested and redeemed these 100 debentures by issuing him equity shares.

- (a) Rs 33,000
- (b) Rs 45,000
- (c) Rs 33,330
- (d) None of the above

**Q45.** In 1999, Gem Ltd. Issued 10% Rs 20,00,000 debentures at a discount of 10%, the debentures were redeemable in 2004, In 2004, the company gave the debentures holders the option of converting the debentures into equity shares of face value of Rs 10 at premium of 25%. One debenture holders holding Rs 4,00,000 debentures want to exercise the option. What is the face value of the shares that he will get?

- (a) Rs 2,88,000
- (b) Rs 3,20,000
- (c) Rs 4,00,000
- (d) None of the above

**Q46.** \_\_\_\_\_ means the new debentures are issued in place of old debentures.

- (a) Conversion
- (b) Rollover
- (c) Renewal
- (d) None of the above

**Q47.** If debentures are converted into preferences shares or equity shares, it will be termed as

- (a) Conversion
- (b) Rollover
- (c) Renewal
- (d) None of the above

**Q48.** For the purpose for conversion debentures are to be classified as

- (a) Fully convertible debentures
- (b) partly convertible debentures
- (c) Non-convertible debentures
- (d) None of the above

**Q49.** Full form of PCD is

- (a) Partly convertible debtor
- (b) Partly continuous debt.
- (c) Partly convertible debenture
- (d) None of the above

**Q50.** Full form of FCD is

- (a) Fully continuous debt
- (b) Fully convertible debtor
- (c) Fresh credit debit
- (d) Fully convertible debentures

**Q51.** Full form of NCD is

- (a) Non continuous debt
- (b) Non convertible debtor
- (c) Non convertible debenture
- (d) None of the above

**Q52.** Statement 1: In case of conversion, old debentures are replaced by the issue of new debentures.  
Statement 2: In case of rollover, debentures are converted into equity or preference shares.

- (a) Both statement are correct
- (b) Both statement are incorrect
- (c) Statement 1 is correct, but statement 2 is incorrect
- (d) Statement 1 is incorrect, but Statement 2 is correct

**Q53.** Sunshine Ltd. had 2,000, 12% Debentures of Rs 100 each as on 1<sup>st</sup> April, 2015. As per the terms of issue, the company purchased the following debentures in the open market for immediate cancellation:

1<sup>st</sup> May - 400 Debentures at Rs. 98 cum-interest

Assuming that debenture interest was payable half-yearly on 30<sup>th</sup> September and 31<sup>st</sup> March. The company closes its books on 31<sup>st</sup> March. Calculate ex-interest price of 400 debentures.

- (a) Rs 39,200
- (b) Rs 38,800
- (c) Rs 35,000
- (d) None of the above

**Q54.** Sunshine Ltd. had 2,000, 12% Debentures of Rs 100 each as on 1<sup>st</sup> April, 2017. As per the terms of issue, the company purchased the following debentures in the open market for immediate cancellation:

1<sup>st</sup> January - 800 Debentures at Rs. 100.25 cum-interest

Assuming that debenture interest was payable half-yearly on 30<sup>th</sup> September and 31<sup>st</sup> March. The company closes its books on 31<sup>st</sup> March. Calculate ex-interest price of 800 debentures.



- (a) Rs 39,200 (b) Rs 38,800  
(c) Rs 35,000 (d) Rs 77,800

**Q55.** 12% Debentures as on 01/04.15 Rs 3,00,000  
Interest on Debentures is payable on 30<sup>th</sup> September and 31<sup>st</sup> March  
Company purchased following debentures from open market:-  
01/08/2015 : Rs 10,000 debentures were purchased at Rs 9,800 cum-interest  
Calculate amount of Capital Reserve to be credited on account of above:  
(a) Rs 200 (b) Rs Nil  
(c) Rs 600 (d) Rs 400

**Q56.** 12% Debentures as on 01/04/15 (Rs 100 each) Rs 5,00,000  
Interest dates 30<sup>th</sup> September & 31<sup>st</sup> March  
Following debentures were purchased from open market:  
1<sup>st</sup> August 2015 : 500 Debentures at Rs 98 ex-interest.  
1<sup>st</sup> February 2016 : 1,000 debentures at Rs 100.25 cum interest.  
Calculate amount transferred to Capital Reserve as on 31<sup>st</sup> March 2016.  
(a) Rs 1,000 (b) Rs 3,750  
(c) Rs 4,750 (d) None of these

**Q57.** On 01.01.2017, Arav Ltd. Had outstanding in its books, 1000, 12% debentures of Rs 100 each. The interest is payable on 30<sup>th</sup> June and 31<sup>st</sup> December. In accordance with the deed, the directors acquired open market debentures for immediate cancellation as follows:  
1<sup>st</sup> March 2017 – Rs 10,000 debentures @ Rs 98 (Cum-interest)  
1<sup>st</sup> August 2017 – Rs 20,000 debentures @ Rs 100.25 (Cum –interest)  
1<sup>st</sup> November 2017 – Rs 5,000 debentures @ Rs 98.50 (Ex-interest)  
On the basis of above information calculate the amount transferred to Capital Reserve as on 31.12.2017?  
(a) 600 (b) 725  
(c) 700 (d) 625

**Q58.** X ltd. Had 1000, 9% Debentures of Rs 500 each as on 1<sup>st</sup> Jan , 2012. As per the terms of issue, the company purchased the following debentures in the open market for immediate cancellation:  
1<sup>st</sup> February 2012 - Rs 1,50,000 at Rs 495 ( cum-interest)  
1<sup>st</sup> November 2012 - Rs 2,00,000 at Rs 490 ( cum-interest)  
Debentures interest is payable half-yearly on 30<sup>th</sup> June and 31<sup>st</sup> December. On the basis of above information calculate the amount transferred to Capital Reserve as on 31<sup>st</sup> December 2012.  
(a) Rs 22,000 (b) Rs 30,125  
(c) Rs 12,700 (d) Rs 15,000

**Q59.** ABC Ltd. had Rs.10,00,000, 6% Debentures of Rs. 100 each as on 31<sup>st</sup> March, 2015. The company purchased in the open market following debentures for immediate cancellation:  
On 01-07-2015 – 1,000 Debentures@ Rs. 97/ (cum-interest)  
On 29-02-2016 – 1,800 Debentures@ Rs. 99/ (ex – interest)  
Debentures interest due dates are 30<sup>th</sup> September and 31<sup>st</sup> March i.e. twice in a year.  
Calculate profit on cancellation of debenture (CS June 2017)  
(A) Rs. 4,500 (B) Rs. 1,800  
(C) Rs.6,300 (D) None of the above

**Q 60.** On 1<sup>st</sup> April, 2014 Kapil Ltd. had made an issue of 2,000, 6% debentures of Rs. 100 each. The Company during the year 2015-16 purchased for cancellation 500 of these debentures. The Company paid Rs. 95 per debenture for 400 debentures and Rs. 98 per debenture for the rest. The expenses on purchase amounted to Rs. 200. Calculate profit on cancellation of debentures.

- (A) Rs. 4,800 (B) Rs. 2,000  
(C) Rs. 5,000 (D) None of the above (CS June 2017)

**Q 61.** A company purchased 200, 12% debentures of Rs. 100 each at Rs. 97 on cum interest basis on 1<sup>st</sup> July, 2015 for immediate cancellation. Interest is payable on 30<sup>th</sup> September and 31<sup>st</sup> March each year. Calculate profit on cancellation on debentures. (CS June 2016; 3 MARKS)

- (A) Rs. 1,200 (B) Rs. 1,800  
(C) Rs. 600 (D) None of the above

**Q 62.** Following is not a method of redemption of debentures:

- (A) By payment in lumpsum (B) By payment in Installments  
(C) By purchase in open market (D) By conversion into short term loans  
(CS Sample Paper)

**Q 63.** For unlisted companies issuing debentures on private placement basis, the DRR will be \_\_\_\_ of the value of outstanding debentures.

- (A) 25% (B) 30%  
(C) 40% (D) 50% (CS Sample Paper)

**Q 64.** Qwn debentures purchased in open market can used for the following:

- (A) for immediate cancellation (B) for investment in the form of own debentures  
(C) Both of the above (D) None of the above (CS Sample Paper)

**Q 65.** A Ltd. issued 10,000, 10% Debentures of Rs. 100 each at a discount of 10%. The entire amount is payable on application. Applications were received for 12,000 debentures. The amount which should be credited to debenture account will be \_\_\_\_.

- (A) 12,00,000 (B) 10,00,000  
(C) 9,00,000 (D) 10,80,000 (CS Sample Paper)

**Q 66.** According t SEBI guidelines by what percentages of amount of debentures the debenture redemption fund will be raised before redemption?

- (A) 40% (B) 50%  
(C) 60% (D) 100%

**Q67.** A Ltd. purchased a building worth Rs. 99,00,000 and issued 12% Debentures of Rs. 100 each at a premium of 10%. What will be the amount of premium?

- (a) Rs. 8,00,000  
(b) Rs. 9,90,000  
(c) Rs. 9,00,000  
(d) Rs. 10,00,000

(CS SAMPLE PAPER)

**Q68.** Issue of debentures can be for:

- (a) for cash  
(b) for consideration other than cash  
(c) as collateral security  
(d) all of the above

(CS SAMPLE PAPER)



Q69. R Ltd. purchased a machinery worth Rs. 1,20,000 and building worth Rs. 2,00,000 from D Ltd. for an agreed purchase consideration of Rs. 3,00,000 to be satisfied by the issue of 3,000, 10% debentures of Rs. 100 each. Calculate the amount to be transferred to Capital reserve a/c.

- (a) 10,000
- (b) 20,000
- (c) 30,000
- (d) 40,000

(CS SAMPLE PAPER)

Q70. When is Debenture interest payable?

- (a) Is payable only in case of profit
- (b) Accumulates in case of losses
- (c) Is payable after the payment of dividend
- (d) Is payable before the payment of dividend on shares

(CS SAMPLE PAPER)

Q71. Own debentures purchased in open market can used for the following:

- (a) for immediate cancellation
- (b) for investment in the form of own debentures
- (c) Both of the above
- (d) None of the above

(CS SAMPLE PAPER)

Q72. For unlisted companies issuing debentures on private placement basis, the DRR will be \_\_\_\_ of the value of outstanding debentures.

- (a) 25%
- (b) 30%
- (c) 40%
- (d) 50%

(CS SAMPLE PAPER)

Q73. Following is not a method of redemption of debentures:

- (a) By payment in lumpsum
- (b) By payment in Instalments
- (c) By purchase in open market
- (d) By conversion into short term loans

(CS SAMPLE PAPER)

# ANSWERS

## DEBENTURES

1. D	2. C	3. A	4. B
5. D	6. A	7. C	8. C
9. D	10. C	11. C	12. B
13. C	14. D	15. B	16. D
17. C	18. B	19. D	20. D
21. B	22. A	23. B	24. A
25. D	26. C	27. B	28. -
29. B	30. A	31. C	32. D
33. D	34. C	35. A	36. B
37. B	38. B	39. D	40. C
41. A	42. B	43. D	44. A
45. B	46. B	47. A	48. D
49. C	50. D	51. C	52. B
53. B	54. D	55. C	56. C
57. D	58. D	59. C	60. B
61. A	62. D	63. A	64. C
65. B	66. B	67. C	68. D
69. B	70. D	71. C	



# **CHAPTER – 7 | CONSOLIDATION OF ACCOUNTS**

## **HOLDING AND SUBSIDIARY COMPANIES**

**Holding Company:** A holding company is one which acquires all or a majority of the equity shares of any other company called subsidiary company in order to have control over the subsidiary company.

Section 2(46) of Companies Act, 2013 provides that “holding company”, in relation to one or more other companies, means a company of which such companies are subsidiary companies; Section 2 (87) of Companies Act, 2013 states the circumstances, any of which must exist to constitute the relation of holding and subsidiary companies.

Section 2 (87) provides that “subsidiary company” or “subsidiary” in relation to any other company (that is to say the holding company), means a company in which the holding company-

- (i) Controls the composition of the Board of Directors; or
- (ii) Exercise or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies;

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

**Explanation: - For the purpose of this clause,-**

**(a) A company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;**

**(b) The composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;**

**© The expression “company” includes anybody corporate;**

**(d) “Layer” in relation to a holding company means its subsidiary or subsidiaries;**

**Illustration:**

Company B is a subsidiary of Company A and Company C is a subsidiary of Company B. Company C is a subsidiary of Company C, Company D will be a subsidiary of Company B and consequently also of Company A, by virtue of clause © above and so on.

For the purpose of clause (a) above, the control of the composition of the Board of directors of a company means that the holding company has power, at its discretion, to appoint or remove all or majority of the directors of the subsidiary company without the consent of the other persons.

It should be noted that holding and subsidiary companies are incorporated companies and each is a separate legal entity. [Hungerford Investment Ltd. V. Turner Morsion & Co. Ltd.]

Section 2 (87) provides that for the purpose of this section, the term ‘company’ includes body corporate. Thus, holding and subsidiary relationship can be established between an Indian Company and a Foreign Company.

## **ACCOUNTS OF HOLDING AND SUBSIDIARY COMPANIES**

**“Financial year”, in relation to any company or body corporate, means the period ending on the 31<sup>st</sup> day of March every year, and where it has been incorporated on or after the 1<sup>st</sup> day of January of a year, the period ending on the 31<sup>st</sup> day of March of the following year. In respect where of financial statement of the company or body corporate is made up:**

**Provided that on an application made by a company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different financial year or consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year.**

### **Consolidated Financial Statement**

**Section 129 (3)** provides that where a company has one or more subsidiaries, it shall, in addition to financial statements, prepare a consolidated financial statement of the company and of all the subsidiaries in accordance with the provisions of schedule III of Companies Act, 2013 and in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statements.

Provided that the company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in Form AOC-1.

**Explanation:-** For the purpose of this sub-section, the word "Subsidiary" shall include associate company and joint venture.

The provisions of this Act applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements.

### **Schedule III**

#### **GENERAL INSTRUCTIONS FOR THE PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS**

1. Where a company is required to prepare Consolidated Financial Statements, i.e., consolidated balance sheet and consolidated statement of profit and loss, the company shall mutatis mutandis follow the requirements of Schedule III as applicable to a company in the preparation of balance sheet and statement of profit and loss. In addition, the consolidated financial statement shall disclose the information as per the requirements specified in the applicable Accounting Standards including the following:

(i) Profit or loss attributable to "minority interest" and to owners of the parent in the statement of profit and loss shall be presented as allocation for the period.

(ii) "Minority interest" in the balance sheet within equity shall be presented separately from the equity of the owners of the parent.

2. In Consolidated Financial Statement, the following shall be disclosed by way of additional information:

Name of the entity in the	Net Assets i.e. total assets minus		Share in profit or loss	
	Total liabilities			
	AS % of	Amount	AS % of	Amt.
	Consolidated		Consolidated	
	Net assets		profit & loss	
1	2	3	4	5
Parent Subsidiaries Indian				
1				
2				
3				
.				
.				
Foreign				
1				
2				
3				
.				
.				
Minority Interests in all				
Subsidiaries				
Associates (Investment as per the				
Equity method) Indian				
1				
2				
3				
.				
.				
Foreign				
1				



2

3

.

.

Joint Ventures

(as per proportionate

Consolidation/investment as per

The equity method) Indian

1

2

3

.

.

Foreign

1

2

3

.

.

TOTAL

3. All subsidiaries, associates and joint venture (whether Indian or foreign) will be covered under consolidated financial statements.

4. An entity shall disclose the list of subsidiaries or associates or joint ventures which have not been consolidated in the consolidated financial statement along with the reasons of not consolidating.

In Holding Company accounts, the date of acquisition (i.e. the date on which holding company acquired the shares of subsidiary company) is quite important. We should know the date on which holding company acquired share of subsidiary company. Any profit earned by subsidiary company before this date is pre-acquisition profit. Suppose holding company acquired 80 percent shares of subsidiary company on 1/1/20X1, then profits earned by subsidiary company before 1/1/20X1 are referred as pre-acquisition profits.

If Holding Company receives any dividend out of pre-acquisition profit of subsidiary company, such dividend should be credited to "Investments in Shares of Subsidiary Company Account" and not to "Profit and Loss Account". For example, on 1.1.20X1 X Ltd. purchased 80 per cent shares of Y Ltd. From Mr. WYE, who has been holding these shares throughout the year 20X0, of ₹5,00,000 (X Ltd. Should pass the entry with ₹5,00,000. Investment in shares of Y Ltd. A/c Dr. To bank A/c). On 20.3.20X1, Y Ltd. Will get dividend of ₹80,000. (Though X Ltd. because companies pay dividend to the shareholders who hold shares on the date of declaration of dividend). X Ltd. should credit this dividend to "Investment in Share of Y Ltd. A/c" and not to "Profit and loss A/c". The entries should be (i) Bank A/c Dr. ₹80,000 To dividend A/c ₹80,000, (ii) Dividend A/c Dr. ₹80,000, To Investment in Shares of Y Ltd. A/c ₹80,000.

## 2. CONSOLIDATED BALANCE SHEET

Before preparing consolidated balance sheet, we should make four working notes about subsidiary company.

(i) Capital Profit: By Capital profit, here we mean pre-acquisition profit that is still available, i.e., such profit which were earned by subsidiary company in pre-acquisition period and which are still available, i.e., available on the date of Consolidated balance Sheet. Here we are not guided by nature of profit, i.e., whether it is profit of revenue nature or of capital nature, we are guided by the fact that profit was earned in pre-acquisition period. For example, pre-acquisition revenue profit is capital for this purpose.

Example: Acquired 80 per cent share of Y Ltd. on 1.1.20X1. On that date, Y Ltd.'s P & L A/c had Cr. balance of ₹5,00,000. If we have to prepare Consolidated Balance Sheet as on 1.1.20X1. Capital profit is ₹5,00,000. On 20.3.20X1 Y Ltd. paid Dividend for 20X0 ₹1,00,000. After this date, capital profit is only ₹4,00,000. In August 20X1, Y Ltd. issued bonus share for ₹2,00,000 out of pre-acquisition profit. After this, capital profit is only ₹2,00,000. Thus, by the term capital profit we mean pre-acquisition profit (whether of capital nature or of revenue nature) that is still available. Capital profit is dividend between Holding company and Minority.



(ii) Revenue Profit: Post- acquisition profit (whether of capital nature or of revenue nature) that is still available, i.e., here we consider such profit which were earned by subsidiary company after its shares were acquired by holding company and which are still available, i.e., available on the date of Consolidated Balance Sheet. Revenue profit is dividend between holding company and minority.

(iii) Minority Interest: (Outside Shareholder's Interest) = Paid up value of Shares held by outside minority + Minority's shares in revenue profit + Minority's share in Capital profit + Minority's shares in proposed dividend of subsidiary company.

(iv) Cost of Control: It is difference between "Cost of the share of subsidiary company held by holding company" and "Book value of such shares as on date of acquisition". If cost of share is more than book value, the difference is goodwill and if cost of shares is less than book value, the difference is capital reserve. Cost of control can be calculated by either of two methods of calculation:

Method 1:

Gross-cost of share of subsidiary company  
(as held by holding company)

.....

Less:

(i) Pre-acquisition dividend received/receivable

.....

(ii) Paid up value of such shares

.....

(iii) Holding company's share in capital

.....

Profit of subsidiary company

\_\_\_\_\_

If the resultant figure is positive, it is goodwill, if negative, it is capital reserve.

Method 2:

Gross-cost of share of subsidiary company  
(as held by holding company)

.....

Less: Book value of such shares as on date of acquisition

.....

Goodwill or capital Reserve

\_\_\_\_\_

Notes:

(i) If 'Gross Cost' less 'Book Value' is positive, it is goodwill otherwise capital reserve.

(ii) If proposed dividend by subsidiary company was there on the date of acquisition, book value should be cum-dividend.

### 3. RULES FOR PREPARING CONSOLIDATED BALANCE SHEET

(i) Aggregate all the real assets and all the outside liabilities (Secured loans, unsecured loans, current liabilities and provisions) of the two companies except "Investment in shares of subsidiary company" as appearing in holding company Balance Sheet. This rule is subject to rule No.2.

(ii) Eliminate inter-company Owings.

(iii) Take share capital only of holding company.

(iv) Calculate cost of control and show as separate item.

(v) Calculate minority interest and show as separate item.

(v) Create reserve for unrealized amount of profit included in stock at least to the extent of holding company's shares.

For example: subsidiary company purchases certain goods from outside world for `1, 00,000. Subsidiary company sold these goods to holding company for `1,25,000. These goods are still in the stock of holding company as on date of Consolidated Balance Sheet. In the individual balance sheet of holding company. In the consolidated balance sheet we cannot show the stock at `1, 25,000 because Consolidated Balance Sheet in the balance sheet of group as a whole and for group as a whole cost is not `1, 25,000. Hence, we should create reserve for profit element included in stock.

In this connection, there are two opinions:

(i) create full Stock Reserve, i.e., `25,000:

(ii) create proportionate stock reserve. For example, if holding company is holding 80 per cent share subsidiary company, create Stock Reserve of `20, 000.

The first approach is more popular and widely acceptable.

(vii) Take reserve and surplus of holding company. Holding company's share in post-acquisition profit of subsidiary company should be danded to the appropriate (concerned) account of holding company.

Proposed Dividend of Subsidiary Company (Three Types of Situations)

(i) Proposed dividend of subsidiary company appears in subsidiary company balance sheet but holding company has not passed the entry for the receivable amount of dividend. In this situation proposed dividend should be taken as separate items while making analysis of profit.



(ii) Proposed dividend of subsidiary company appears just as note, i.e., neither subsidiary company has passed the entry proposing the dividend nor holding company has passed the entry for receivable amount of proposed dividend. There are two ways of dealing with this situation:

(a) Taking proposed dividend as a separate item.

(b) Taking proposed dividend as part of P & L A/c. (Actually in this way, we have to do nothing, we just ignore the note regarding proposed dividend of subsidiary company).

(iii) Proposed dividend of subsidiary company appears in subsidiary company balance sheet and holding company has passed the entry for receivable amount of the proposed dividend of subsidiary company balance sheet and holding company has passed the entry for receivable amount of the proposed dividend of subsidiary company. In the case, but proportion of proposed dividend of subsidiary company which is to be received by holding company appears in assets side of holding company balance sheet. Hence, this amount we deduct from both side of consolidated balance sheet and the remaining amount of proposed dividend for minorities or add to the amount of minorities' interest.

Chain Holding:

(1) Let, A Ltd. is holding company of B Ltd. and B Ltd. is holding company of C Ltd., we refer C Ltd. as Bottom Company and B Ltd. as middle company.

In this case, first we should make analysis of profit of C Ltd. and then that of B Ltd. B Ltd's share revenue profit of C Ltd. should be added to the revenue profit of B Ltd. (Between B Ltd. and C Ltd., B Ltd. is holding company and C Ltd. is subsidiary company).

We studied in Rule (vii) regarding preparing consolidated balance sheet that holding company's share in revenue profit, i.e., post-acquisition profit of subsidiary company should be added to concerned account of holding company).

(2) What about B Ltd's share in capital of C Ltd.? In this connection there are two opinions.

One opinion is that as we transfer revenue profit from C Ltd. to B Ltd. on the same basis we should transfer capital profit from C Ltd. to B Ltd.

The other opinion is that we should not transfer capital profit from C Ltd. to B Ltd. (And this capital profit, i.e., B Ltd's share in capital profit of C Ltd., should be directly transferred to cost of control).

The logic is that between B Ltd. and C Ltd. B Ltd. is holding company and in case of holding company, we take only its share in post-acquisition profit of its subsidiary.

Chain- Holdings and Different Dates of Acquisitions: Steps

(i) Make analysis of profit of Bottom Company.

(ii) Note the following dates

(a) Date (s) on which too company acquired shares in middle company.

(b) Date of Consolidated Balance Sheet.

(iii) Find profit (reserve & surplus) of middle company on the above-mentioned dates. By profit of middle company we mean its own profit and its share in post-acquisition profit of its subsidiary company (i.e., Bottom Company).

(iv) Make analysis of profit of middle company.

(v) Minority Interest

(vi) Cost of control.

(vii) Consolidated Balance Sheet.

#### 4. CONSOLIDATED PROFIT AND LOSS ACCOUNT

Consolidated profit & Loss Account should be prepared in columnar form. Draw on each side one column for each company, one column for adjustments and one for total. The account may be divided into three parts. In the first part, we determine profits. Second part is concerned with appropriation of profits. Dividend received/receivable by holding company from subsidiary company are also credited to this part. In third part, we make rectification and three consolidation adjustments. In first two parts, inter-company transactions are eliminated.

The rectification in the third part of this account relates to dividend received by holding company out of pre-acquisition profits of subsidiary company, i.e., if holding company's column of this P&L A/c has been credited with pre-acquisition dividend (i.e., dividend out of pre-acquisition profit of subsidiary company) of subsidiary company such dividend should be transferred to Investment in shares of Subsidiary A/c's by debiting the amount in holding company column of Consolidated P&L A/c.

The three adjustments are:

(i) Minority's share in profits of subsidiary company as appearing in this P&L A/c.

(ii) Holding company's share in capital profit of subsidiary company, as appearing in this P&L A/c;



**(iii) Stock reserve.**

Interim Dividend of Subsidiary Company

**(i) If interim dividend relates to any particular period, charge it against profit of that period.**

**(ii) If it does not relate to particular period:**

**(a) Paid in pre-acquisition period-charge against profits of pre-acquisition period. The reason is that because of this dividend, the book value of shares on the date of acquisition got reduced. To find this reduced book value, we reduce capital profit which can be done by charging this interim dividend against pre-acquisition profit.**

**(b) Paid in post-acquisition period- we should pro-rate this dividend against profits of current year on the basis of pre-acquisition and post-acquisition profits of current year.**

Inter-company Holding:

**(i) Find capital profit and revenue profit on the basis of simultaneous equation.**

**(ii) In consolidated balance sheet, we take only that part of share capital of holding company, which is being held by shareholders other than subsidiary company.**

**(iii) In consolidated balance sheet, we do not take 'Investment in shares of holding company as appearing in subsidiary consolidated balance sheet'.**

**(iv) Cost of control to be adjusted by difference between "Amount of Investment in shares of holding company as appearing in subsidiary balance sheet and paid value of such shares".**

Foreign Subsidiary Company: Subsidiary Balance Sheet to be converted in the currency of holding company before preparing consolidated balance sheet. Rules for conversion are as follows:

**(i) Capital profit to be converted at the rate prevailing on the date of acquisition.**

**(ii) Revenue profit to be converted at average rate.**

**(iii) Current assets and current liabilities to be converted at the rate prevailing on the date of consolidated balance sheet.**

**(iv) Such non-current assets and non-current liabilities (including share capital) which existed on the date of acquisition and which still exist (i.e., which exist on the date of consolidated balance sheet) should be converted at the rate prevailing on the date of acquisition.**

**(v) Such items, for which corresponding amounts are available in holding company accounts, should not be converted on the basis of any rate. In this case, corresponding amount from holding company accounts should be taken.**

**(vi) If a special rate is given for any transaction, it should be used for that transaction.**

**(viii) Difference in exchange arises MAINLY due to post-acquisition transactions (as the assets and the liabilities which existed on the date of acquisition and which still exist and also capital profit have been converted at a single rate prevailing on the date of acquisition). Hence difference in exchange is adjusted against post-acquisition profit.**

Statement under Section 212: Under section 212 of the Companies Act, 1956, a statement should be attached to the balance sheet of holding company giving following details in respect of each subsidiary company-

**(A) Interest and profit of holding company in subsidiary company:**

**(i) The extent of holding company's interest in the subsidiary company as at the end of financial year of subsidiary company.**

**(ii) The amount of subsidiary company's profit (less loss) which is attributable to holding company and which has not been dealt with in the accounts of holding company.**

**(a) For the financial year of subsidiary company ending with or within financial year of holding company;**

**(b) For the previous year of subsidiary company since it because subsidiary company.**

**(iii) Information similar to (ii) as to the profits and losses of subsidiary company, which have been dealt with in the accounts of holding company.**

**(B) Where holding company and subsidiary company have different financial years, the following information has to be given in the statement.**

**(i) The changes, if any, in the holding company's shareholdings in subsidiary company, during the time-gap (from end of financial year of subsidiary company to the date of balance sheet of holding company to which the statement is attached).**

**(ii) Details of any material changes which have occurred during time gap in respect of subsidiary's fixed assets, investments, lending and borrowings (other than for the purpose of meeting current liabilities).**

**5. ASSOCIATED COMPANY**



If a company holds 20 per cent or more but up to 50 per cent voting-rights-shares of some other company, the company holding the shares is known as Investor Company and the company the shares of which are being held is known as associated company. Consolidated accounts are not required in case of Associated Company.

International Accounting Standard Committee has recommended that in this case, the investor company should prepare "Memorandum Investment Account" and publish it as a part of its published accounts. (This account is not a part of double-entry system. It is not a part of regular accounts; investment account is prepared in regular way).

For the purpose of this account, the investor company should take credit of its share in post-acquisition profit of associated company. Suppose, associated company earned post-acquisition profit of ₹1,00,000 and the investor company holds 30 per cent shares. The investor company should give effect to the following entry in the published accounts.

Memorandum Investment A/c	Dr.	30,000	
To Profit & Loss A/c			30,000

In case of post-acquisition loss, the entry would be just revenue.

All the dividends (both pre-acquisition) received by Investor Company from associated, should be credited to Memorandum Invested Accounts.

**Q 1 What is 'cost of control' in the context of preparing consolidated balance sheet?**

**Answer:**

In actual practice, it may happen that the cost of acquisition of shares in the subsidiary company agrees exactly with intrinsic value of the shares (i.e. the net assets of the subsidiary company) on the date of acquisition. If the price paid by the holding company for the shares acquired, the difference in the subsidiary company is more than the intrinsic value of the shares acquired, the difference should be treated as Cost of Control or Goodwill. If on the other hand, the price paid by the holding company for the shares acquired in the subsidiary company is less than the intrinsic value of the shares acquired, the difference should be treated as capital profits and credited to Capital on the date of acquisition of control, all profits and losses up to that date, have to be taken into account.

While preparing the consolidated balance sheet, such goodwill or Capital Reserve, whatever may be the case, must be shown in the Balance Sheet.

**Q 2 under what circumstances a company is required to present a 'consolidated financial statement'?**

**Answer:** Consolidated financial statements are the financial statements of the group presented as those of an enterprise. This is done by the parent company and the consolidated statements are presented in addition to the separate financial statements of the enterprise.

A consolidated financial statement normally includes consolidated balance sheet, consolidated statement of profit and loss and notes, other statements and explanatory material that form an integral part thereof.

Section 129(3) provides that where a company has one or more subsidiaries, it shall in addition to financial statements; prepare a consolidated financial statement of the company and of all the subsidiaries in accordance with the provisions of schedule III of Companies Act, 2013.

**Explanation:-** For the purpose of this sub-section, the word "Subsidiary" shall include associate company and joint venture.

As per Accounting Standard-21 issued by the Institute of Chartered Accountants of India, the consolidated financial statements are to be prepared on the basis of financial statements of parent and all enterprise controlled by the parent, other than those subsidiaries excluded for certain specified reasons, e.g. where

the control is intended for a temporary period or where the subsidiary operates under severe long term restrictions which-significantly impair its ability to transfer funds to its parent.

Control exists when the parent owns, directly or indirectly through subsidiary (ies) more than one half of the voting power of an enterprise. Control also exists when an enterprise controls the composition of the board of directors (In the case of a company) or of the corresponding governing body (In case of an enterprise not being a company) so as to obtain economic benefits from its activities.

For the purpose of the consolidated financial statement, an enterprise is considered to control the composition of the board of directors of a company or the governing body of an enterprise that is not a company if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of the directors of that company or of the governing body of that other enterprise.

**Que. No. 1] Under what circumstances, a company is required to present a 'consolidated financial statement'?**

**Ans. :** A company is required to present a 'consolidated financial statement' if it is holding company and other is subsidiary of earlier company.

As per **section 129** of the **Companies Act, 2013**, Where a company has one or more subsidiaries, it shall, in addition to financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that its own which shall also be laid before the AGM of the company along with the laying of its financial statement. The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in such form as may be prescribed.

The Central Government may provide for the consolidation of accounts of companies in such manner as may be prescribed.

Explanation : The word "Subsidiary" shall include associate company and joint venture.

**Que. No. 2] Write a short note on: Minority Interest**

**Ans. :** Minority interest represents shares owned by third parties in a consolidated financial statement of holding company. Minority interest ordinarily appears on the balance sheet between liabilities and shareholders equity. It is calculated as follows.

Minority interest	Rs.
Share capital held by outsider	XXXX
Share of profits	
- Pre acquisition	XXXX
- Post acquisition	XXXX



**Que. No. 3] Issue of bonus shares by the subsidiary company does not affect the cost of control.**

**Comment.**

**Ans.:** Issue of bonus shares by the subsidiary company does not affect the cost of control. This can be discussed under following two headings:

- (1) Issue of bonus out of pre-acquisition profit :** This will not affect cost of control because share of holding company in pre-acquisition profit is reduced and on the other hand paid up value of the shares held by them is increased.
- (2) Issue of bonus out of post-acquisition profit :** This will not affect cost of control because share of holding company in post-acquisition profit is reduced and on the other hand paid up value of the shares held by them is increased.

#### **Question 4**

Write a short note preference share in subsidiary company.

**Answer**

With respect to the Subsidiary firm if preference share capital has been issued there are 2 possibilities.

- All preference shares are held by the outsiders i.e. other than holding company i.e. which case the paid up value of the preference shares of the Subsidiary company is added to the minority interest.
- It is possible that part whole of the preference. shares of the Subsidiary company is held by the Holding Company. In such a case the cost of acquiring of the preference shares [shown in the investment account in the assets side in the Balance Sheet of Subsidiary firm] and the difference if any, adjusted in the cost of control. [if preference shares are issued after date of acquisition the adjustments remain the same]

Arrears of preference dividends may be payable or outstanding at the time of consolidation of Balance Sheet and usually preference dividends are cumulative in nature. If the subsidiary company, has adequate profits, it is reasonable to assume that these dividends will be paid. The minorities shares will be added to Minority Interest while with respect to the holding company the treatment will differ in terms of the dividend being paid out of pre acquisition or post acquisition profits or both.

In case the dividends are paid out of pre-acquisition profits [capital profit], the dividend due to the holding company will be adjusted for in the cost of control. In case post acquisitions revenue profits are employed, the dividend due to the holding company will be credited [added on] to the Profit and Loss Account of the holding company in the consolidated Balance Sheet. It is possible that a combination of both pre and post acquisition profit is employed for the purpose of making dividend payment in which case the dividend paid out of the capital profit will be adjusted for in the cost of control and the portion out of revenue profit will be adjusted for in the P/L Account of Holding company.

### Question 5

Write a short note on Minority Interest.

#### Answer

The claim of outside shareholders in the subsidiary company has to be assessed and shown as a liability in the consolidate balance sheet.

While calculating the amount of minority interest, all these items have to be taken into account and proportionate share of all such profits and reserves should be added to the amount of minority interest while proportionate share of all such losses should be deducted from the minority interest, thus,

Minority Interest = paid-up value of shares held by minority shareholders + proportionate share of the company's profits and reserves + proportionate shares of profits on revaluation of assets of the company – proportionate share of company's losses – proportionate share of loss on revaluation of assets of the company.

But, if there are some preference shares of the subsidiary company held by outsiders, the minority interest in respect of the preference share will consist only of the face value of such shares and the dividend due on such shares if there are profits.



## PRACTICE QUESTIONS

Example 1.

**Balance Sheet (31.3.2010)**

<b>Equity &amp; Liabilities</b>	<b>H</b>	<b>S</b>
<u>Share holders Fund</u> <b>Share Capital</b>	2,00,000	1,00,000
<u>Non- Current Liabilities</u> <b>Loan</b>	90,000	1,00,000
	2,90,000	2,00,000
<b>ASSETS</b>		
<u>Non-Current Assets</u> Fixed Assets <b>Investments (80% Shares)</b>	1,00,000	70,000
<u>Current Assets</u> <b>Debtors</b>	90,000	-
	1,00,000	1,30,000
	2,90,000	2,00,000

**H Ltd. acquired shares on 31.3.2010. Prepare Consolidation Balance Sheet.**

**Answer:** G/W `10,000; Minority Interest `20,000; B/S Total `4,10,000.

Example 2.

**Balance Sheet (31.3.09)**

<b>Equity &amp; Liabilities</b>	<b>H</b>	<b>S</b>
<u>Share holders Fund</u> <b>Share Capital</b>	2,50,000	1,50,000
<b>Reserves &amp; Surplus P/L</b>	50,000	60,000
<u>Non- Current Liabilities</u> <b>Loan</b>	70,000	40,000
	370,000	2,50,000

<b>ASSETS</b>		
<u>Non-Current Assets</u>		
Fixed Assets		
Investments in S Ltd. (70%)	2,00,000	1,50,000
<u>Current Assets</u>	98,000	-
	72,000	1,00,000
	3,70,000	2,50,000

H Ltd. acquires shares on 31.3.09. Prepare Consolidated B/S as on 31.3.09.

**Answer:** Capital Reserve `49,000; Minority Interest `63,000; B/S Total 5,22,000

### Example 3

Balance Sheet (31.3.2012)

Equity & Liabilities	H	S
<u>Share holders Fund</u>		
Share Capital	4,00,000	3,00,000
Reserves & surplus		
P/L	1,50,000	3,50,000
<u>Non- Current Liabilities</u>		
Loan	2,50,000	1,00,000
	7,50,000	7,50,000
<b>ASSETS</b>		
<u>Non-Current Assets</u>		
Fixed Assets		
Investments (60% in S Ltd)	5,00,000	7,00,000
<u>Current Assets</u>	2,00,000	-
	1,00,000	50,000
	8,00,000	7,50,000

H Ltd. had purchased shares of S Ltd. on 31.3.2011 when Balance in P/L of S Ltd. was `2,30,000.  
Prepare Consolidation Balance Sheet.

**Answer:** Capital Reserve `1,18,000; Minority Interest `2,60,000; B/S Total `13,50,000.



**Example 4 P/L A/c Balance S Ltd:**

On 31.3.09 – 60,000

On 1.4.08 – 18,000

Abnormal loss on 1.1.08 – 10,000

Shares acquisition – 1.6.08

Prepare AOP.

Answer:

**Example 5**

P/L Balance of S Ltd. 31.3.04 – 60,000

P/L Balance of S Ltd. 1.4.03 – 18,000

Abnormal Loss on 1.1.03 – 10,000

Share acquisition – 1.4.03

Prepare AOP.

Answer:

**Example 6**

Profit Balance of S Ltd. 1/1/03 – 15,000

Profit Balance of S Ltd. 31/3/04 – 70,000

Share acquisition – 1/4/03

Abnormal Loss 1/2/03 – 10,000

Prepare AOP.

Answer:

**Example 7**

P/L of S Ltd 31/3/04 – 1,00,000

P/L of S Ltd. 1/4/03 – 30,000

Abnormal Loss 1.5.03 – 10,000

Abnormal Loss 1.9.03 – 12,000

Shares purchased on 1.7.03

Abnormal Loss 1.1.03 – 6,000

Prepare AOP.

Answer:

**Example 8**

Balance Sheet (31/3/2010)

	H	S
<u>Equity &amp; Liabilities</u>		
<u>Share holders Fund</u>		
Shares Capital	5,00,000	2,00,000
Reserves & Surplus		
- P/L A/c	3,00,000	1,50,000
<u>Current Liabilities</u>		
Trade payables	2,00,000	1,00,000
	10,00,000	4,50,000
<u>ASSETS</u>	H	S
<u>Non- Current Assets</u>		
Fixed Assets	6,00,000	4,00,000
Investments (80%)	2,50,000	-
<u>Current Assets</u>	1,50,000	50,000
	10,00,000	4,50,000

H Ltd. had acquired shares on 1.4.09 when Balance in P/L of S Ltd. was `90,000 Market Value of fixed assets of S Ltd. on 1/4/09 was `4,50,000 (Book Value `4,00,000 on 1.4.09). Ignore Depreciation Prepare Consolidated B/S.

Answer: **Capital Reserve `22,000; Minority Interest `80,000; B/S Total `12,50,000.**

Example 9

Balance Sheet (31.3.10)

	H	S
<u>Equity &amp; Liabilities</u>		
<u>Shareholders Funds</u>		
Shares Capital	15,00,000	5,00,000
Reserves & Surplus		
P/L A/c	3,00,000	2,00,000
<u>Current Liabilities</u>		
Creditors	2,00,000	3,00,000
	20,00,000	10,00,000
<u>ASSETS</u>	H	S
<u>Non-Current Assets</u>		
Fixed Assets	10,00,000	7,00,000
Investments (75%)	8,00,000	-
<u>Current Assets</u>	2,00,000	3,00,000
	20,00,000	10,00,000

Share acquired on 1/7/09

Abnormal Loss 1/1/09 - `4,000

Abnormal Loss 1/6/09 - `5,000

Abnormal Loss 1/8/09 - `7,000

Market Value of fixed assets of S Ltd. on 1/7/09 was `7,60,000 (Book Value `7,00,000)

Ignore Depreciation

Balance in P/L of S Ltd. on 1/4/09 was `1,20,000. Prepare Consolidation Balance Sheet.

Answer: **Goodwill `2,76,500; Minority Interest `1,90,000; Balance Sheet Total `25,36,500.**

Example 10

Balance Sheet (31.3.2010)

	H	S
<u>Equity &amp; Liabilities</u>		
<u>Shareholder's Funds</u>		
Share Capital	1,00,000	80,000
Reserves & surplus		
- P/L A/c	20,000	30,000
- General Reserve	10,000	7,000
- Securities Premium	4,000	3,000
<u>Current Liabilities:</u>		
- Creditors	1,26,000	20,000
	2,60,000	1,40,000
<u>Assets</u>	H	S
<u>Non-Current Assets</u>		
Fixed Assets	1,00,000	90,000
Investments (60% Shares)	1,50,000	-
<u>Current Assets</u>	10,000	50,000
	2,60,000	1,40,000

Shares acquired on 1/4/09.

P/L and General Reserve on 1/4/09 are `18,000 and `5,000. Market value of fixed assets of S Ltd was `1,20,000 on 1/4/09. Rate of Depreciation 10% per annum.

Prepare Consolidated Balance Sheet.

Answer: **Goodwill `74,400; Minority Interest `55,200.**



### Example 11

Balance Sheet (31/3/2010)

Equity & Liabilities	H	S
Shareholder's Funds:		
Share Capital	1,50,000	1,00,000
Reserves & Surplus		
- P/L	40,000	50,000
- General Reserve	30,000	10,000
Current Liabilities	80,000	20,000
	3,00,000	1,80,000
Assets	H	S
Non-Current Assets		
Fixed Assets	1,00,000	80,000
Investments (70%)	1,00,000	-
Current Assets	1,00,000	1,00,000
	3,00,000	1,80,000

Shares acquired on 1/8/09

Balance in P/L on 1/4/09 `30,000

Abnormal loss on 1/5/09 `4,000

Market Value of fixed assets 1/8/09 `70,000

Book Value 1/4/09 `1,00,000

Prepare Consolidation Balance Sheet.

Answer: **Goodwill `15,533; Minority Interest `41,933**

### Example 12

Balance Sheet (31/3/2010)

Equity & Liability	H	S
Shareholder's Funds		
Share Capital	1,50,000	1,00,000
Reserves & Surplus		
- P/L	1,00,000	30,000
- General Reserves	-	10,000
Current Liabilities		
- Creditors	-	10,000
	2,50,000	1,50,000
Assets	H	S
Non-Current Assets		
Fixed Assets	1,00,000	70,000
Investments (7,000 shares of S Ltd.)	1,00,000	-
Current Assets	50,000	80,000
	2,50,000	1,50,000

1) H Ltd. had purchased 7,000 shares of S Ltd. on 1/4/09 when balance in P/L and General Reserve was `20,000 and `7,000 of S Ltd.

2) During the year S Ltd. declared and distributed bonus in ratio of 1:10. Entry not yet made in S Ltd. Prepare Consolidation Balance Sheet.

Answer: **Goodwill `11,100; Minority Interest `42,000**

Example 13.

Balance Sheet (31.3.10)

Equity & Liabilities	H	S
Shareholder's Funds		
Share Capital	2,00,000	1,00,000
Reserves & surplus		
- P/L	50,000	70,000
- General Reserve	40,000	50,000
Current Liabilities	80,000	90,000
Total	3,70,000	3,10,000
Assets	H	S
Non-Current Assets		
Fixed Assets	2,00,000	1,90,000
Investments (8,000 shares)	1,00,000	-
Current Assets	70,000	1,20,000
	3,70,000	3,10,000

H Ltd. Purchased Share on 1.4.2009 when balance in P/L and General Reserve of S Ltd. was `50, 000 and 40,000.

Bonus of 1:10 was distributed by S Ltd. Entry of Bonus was not made by S Ltd.

Prepare Consolidation Balance Sheet.

Answer: **Capital Reserve `38, 187; Minority Interest `59, 994**



## **MCQ FOR PRACTICE**

Q1. It is compulsory for a holding company to purchase the equity shares of a subsidiary company:

- (A) At least 51% (B) At least 52%  
(C) At least 75% (D) None of the above

Q2. Which section of the companies Act 2013 covers the definition of Holding Company?

- (A) Section 2(47) (B) Section 2(46)  
(C) Section 2(48) (D) Section 2(49)

**(CS TEST PAPER)**

Q3. Which section of the companies Act 2013 covers the definition of Subsidiary Company?

- (A) Section 2(87) (B) Section 2(86)  
(C) Section 2(88) (D) Section 2(89)

Q4. A company in which only the majority of shares (more than 50%) are owned by the holding company, it is said to be \_\_\_\_\_

- (A) Wholly owned subsidiary company (B) Partly owned subsidiary  
(C) Joint venture company (D) Minority company

**(CS TEST PAPER)**

Q5. Subsidiary can be member of its Holding Company if : (i) When subsidiary is a legal representative of deceased member of holding Company; (ii) When subsidiary is concerned in shares as trustee.

- (A) Only (i) (B) Only (ii)  
(C) Both of the above (D) None of the above

**(CS TEST PAPER)**

Q6. If Total capital of subsidiary is Rs.3,00,000 and out of this Rs.2,40,000 is owned by Holding. What is the amount of minority interest if outside shareholder % is 20%.

- (A) Rs. 2,40,000 (B) Rs. 60,000  
(C) Rs. 48,000 (D) None of the above

**(CS TEST PAPER)**

Q7. Profit on revaluation of Assets to be shown as \_\_\_\_\_ in the Consolidated Balance Sheet.

- (A) General Reserve (B) Capital Reserve  
(C) Goodwill (D) None of the above

**(CS TEST PAPER)**

Q8. The Balance Sheet of H Ltd. and S Ltd. as on 31<sup>st</sup> March 2019 are given as follow:

(I) Equities and Liabilities	H Ltd.	S Ltd.
Equity Share Capital	500,000	170,000
Current Liability	200,000	30,000
	<b>700,000</b>	<b>200,000</b>
(II) Assets		
Fixed Asset	400,000	140,000
Investment in 100% shares of S Ltd.	150,000	
Current Assets	150,000	60,000
	<b>700,000</b>	<b>200,000</b>

Prepare Consolidated Balance Sheet.

Q9. The Balance Sheet of H Ltd. and S Ltd. as on 31<sup>st</sup> March 2019 are given as follow:

(I) Equities and Liabilities	H Ltd.	S Ltd.
Equity Share Capital	600,000	300,000
Reserve & Surplus	300,000	100,000
Current Liability	500,000	80,000
	<b>14,00,000</b>	<b>480,000</b>
(II) Assets		
Fixed Asset	600,000	320,000
Investment in 100% shares of S Ltd.	450,000	-
Current Assets	350,000	160,000
	<b>14,00,000</b>	<b>480,000</b>

Prepare Consolidated Balance Sheet.

Q10. The Balance Sheet of H Ltd. and S Ltd. as on 31<sup>st</sup> March 2019 are given as follow:

(I) Equities and Liabilities	H Ltd.	S Ltd.
Equity Share Capital	800,000	300,000
Reserve & Surplus	300,000	250,000
Current Liability	400,000	100,000
	<b>15,00,000</b>	<b>650,000</b>
(II) Assets		
Fixed Asset	800,000	400,000
Investment in 100% shares of S Ltd.	500,000	-
Current Assets	200,000	250,000
	<b>14,00,000</b>	<b>650,000</b>

Shares were purchased on 1<sup>st</sup> April 2018.

Balance of Reserves and surplus of S Ltd. as on 1<sup>st</sup> April 2018 was Rs. 150,000.

Prepare Consolidated Balance Sheet.

Q11. The Balance Sheet of H Ltd. and S Ltd. as on 31<sup>st</sup> March 2019 are given as follow:

(I) Equities and Liabilities	H Ltd.	S Ltd.
Equity Share Capital	800,000	300,000
Reserve & Surplus	300,000	250,000
Current Liability	400,000	100,000
	<b>15,00,000</b>	<b>650,000</b>



(II) Assets		
Fixed Asset	800,000	400,000
Investment in 100% shares of S Ltd.	500,000	-
Current Assets	200,000	250,000
	<b>14,00,000</b>	<b>650,000</b>

Shares were purchased on 1<sup>st</sup> October 2018.

Balance of Reserves and surplus of S Ltd. as on 1<sup>st</sup> April 2018 was Rs. 150,000.

Prepare Consolidated Balance Sheet.

Q12. The Balance Sheet of H Ltd. and S Ltd. as on 31<sup>st</sup> March 2019 are given as follow:

(I) Equities and Liabilities	<b>H Ltd.</b>	<b>S Ltd.</b>
Equity Share Capital	900,000	600,000
Reserve & Surplus	400,000	250,000
Current Liability	200,000	50,000
	<b>15,00,000</b>	<b>900,000</b>
(II) Assets		
Fixed Asset	700,000	600,000
Investment in 80% shares of S Ltd.	500,000	-
Current Assets	300,000	300,000
	<b>15,00,000</b>	<b>900,000</b>

Shares were purchased on 1<sup>st</sup> April 2018.

Balance of Reserves and surplus of S Ltd. as on 1<sup>st</sup> April 2018 was Rs. 150,000.

Prepare Consolidated Balance Sheet.

Q13. The Balance Sheet of H Ltd. and S Ltd. as on 31<sup>st</sup> March 2019 are given as follow:

(I) Equities and Liabilities	<b>H Ltd.</b>	<b>S Ltd.</b>
Equity Share Capital	900,000	600,000
Reserve & Surplus	400,000	250,000
Current Liability	200,000	50,000
	<b>15,00,000</b>	<b>900,000</b>
(II) Assets		
Fixed Asset	700,000	600,000
Investment in 80% shares of S Ltd.	500,000	-
Current Assets	300,000	300,000
	<b>15,00,000</b>	<b>900,000</b>

Shares were purchased on 1<sup>st</sup> October 2018.

Balance of Reserves and surplus of S Ltd. as on 1<sup>st</sup> April 2018 was Rs. 150,000.

Prepare Consolidated Balance Sheet.

Q14. The Balance Sheet of H Ltd. and S Ltd. as on 31<sup>st</sup> March 2019 are given as follow:

(I) Equities and Liabilities	H Ltd.	S Ltd.
Equity Share Capital	900,000	600,000
Reserve & Surplus	400,000	250,000
Current Liability	200,000	50,000
	<b>15,00,000</b>	<b>900,000</b>
(II) Assets		
Fixed Asset	700,000	600,000
Investment in 80% shares of S Ltd.	500,000	-
Current Assets	300,000	300,000
	<b>15,00,000</b>	<b>900,000</b>

Shares were purchased on 1<sup>st</sup> Jan 2019.

(A) There was an abnormal loss due to fire occurred in factory on 1<sup>st</sup> feb 2019 for Rs 9,000.

(B) Balance of Reserves and surplus of S Ltd. as on 1<sup>st</sup> April 2018 was Rs. 150,000.

Prepare Consolidated Balance Sheet.

Q15. The Balance Sheet of H Ltd. and S Ltd. as on 31<sup>st</sup> March 2019 are given as follow:

(I) Equities and Liabilities	H Ltd.	S Ltd.
Equity Share Capital	900,000	600,000
Reserve & Surplus	400,000	250,000
Current Liability	200,000	50,000
	<b>15,00,000</b>	<b>900,000</b>
(II) Assets		
Fixed Asset	700,000	600,000
Investment in 80% shares of S Ltd.	500,000	-
Current Assets	300,000	300,000
	<b>15,00,000</b>	<b>900,000</b>

Shares were purchased on 1<sup>st</sup> Jan 2019.

(A) There was an abnormal loss due to fire occurred in factory on 1<sup>st</sup> October 2018 for Rs 9,000.

(B) Balance of Reserves and surplus of S Ltd. as on 1<sup>st</sup> April 2018 was Rs. 150,000.

Prepare Consolidated Balance Sheet.



Q16. On 31<sup>st</sup> March 2002, the Balance Sheet of Major Ltd. and its subsidiary Minor Ltd. stood as follows:

(I) Equities and Liabilities	Major Ltd.	Minor Ltd.
Equity Share Capital	800,000	200,000
General Reserve	150,000	70,000
Profit and Loss Account	90,000	55,000
Creditors	120,000	80,000
	<b>11,60,000</b>	<b>405,000</b>
(II) Assets		
Fixed Asset	550,000	100,000
Investment in 75% shares of S Ltd.(at cost)	280,000	-
Stock	105,000	177,000
Other Current Assets	225,000	128,000
	<b>11,60,000</b>	<b>405,000</b>

Draw a consolidated balance sheet as at 31<sup>st</sup> March 2002, after taking to consideration the following information:

- (A) Major Ltd. acquired shares on 31<sup>st</sup> July 2001.
- (B) Minor Ltd. earned a profit of Rs 45,000 for the year ended 31<sup>st</sup> March 2002.
- (C) In Jan 2002, Minor Ltd. sold goods to Major Ltd. goods costing Rs 15,000 for Rs 20,000. On 31<sup>st</sup> March 2002, half of these goods were lying as unsold in the godowns of Major Ltd.

(CS DEC 2002)

Q17. On 30 June 2017, two-third of the shares of S Ltd. (with a total capital of Rs.48,00,000) was acquired by H Ltd. the Balance Sheet of S Ltd. showed a debit balance of Rs.24,00,000 on 1st January 2017 and a credit balance of Rs.14,40,000 on 31 December 2017. The investment by H Ltd. in shares of S Ltd. is Rs.36,00,000. Calculate the goodwill or capital reserve under cost of control.

- (A) Rs.7,20,000
- (B) Rs. 6,20,000
- (C) Rs.3,60,000
- (D) Rs.1,80,000

(CS TEST PAPER)

Q18. Stock reserve for unrealized profit in respect of inter company transactions should be created by debiting \_\_\_\_\_ and crediting by \_\_\_\_\_.

- (A) Revenue Reserve; Stock Account
- (B) Stock Account; Revenue Profit
- (C) Capital Reserve; Stock Account
- (D) None of the above

Q19. Post Acquisition dividend received by Holding Company is debited to \_\_\_\_\_.

- (A) Bank Account
- (B) Profit & Loss Account
- (C) Investment Account
- (D) Dividend Account

Q20. Pre Acquisition dividend received by Holding Company is credited to \_\_\_\_\_.

- (A) Bank Account
- (B) Profit & Loss Account
- (C) Investment Account
- (D) Dividend Account

Q21. Minority Interest includes:

- (A) Share in Share Capital
- (B) Share in Capital Profit
- (C) Share in revenue Profit
- (D) All of the above

Q22. Excess of Cost of Investment over paid up value of the shares is considered as:

- (A) Goodwill
- (B) Profit & Loss Account
- (C) capital reserve
- (D) Minority Interest

Q23. Excess of paid up value of the shares over cost of investment is considered as:

- (A) Goodwill
- (B) Profit & Loss Account
- (C) capital reserve
- (D) Minority Interest

Q24. Statement 1: Contingent liability relating to outsiders must be shown on the liability side of the consolidated balance sheet.

Statement 2: Contingent liability relating to outsiders must be shown by way of footnote of the consolidated balance sheet.

- (A) Both the statement are correct
- (B) Both the statements are incorrect
- (C) Statement 1 is correct; Statement 2 is incorrect
- (D) Statement 2 is correct; Statement 1 is incorrect

(CS June 2009)

Q25. Statement 1: While preparing the consolidated balance sheet, a contingent liability in respect of a transaction between the holding and the subsidiary companies is disappeared from the foot note.

Statement 2: For calculating minority interest, there is a need to distinguish between capital and revenue profits of the subsidiary.

- (A) Both the statement are correct
- (B) Both the statements are incorrect
- (C) Statement 1 is correct; Statement 2 is incorrect
- (D) Statement 2 is correct; Statement 1 is incorrect

(CS June 2010)

Q26. Statement 1: Contingent liability in respect of a transaction between the holding and the wholly owned subsidiary companies will not appeared in the foot note of the Consolidated Balance sheet.

Statement 2: In case of inter-company unrealized profit included in unsold goods, minority shareholders are not affected in any way.

- (A) Both the statement are correct
- (B) Both the statements are incorrect
- (C) Statement 1 is correct; Statement 2 is incorrect
- (D) Statement 2 is correct; Statement 1 is incorrect

(CS June 2013)



# ANSWERS

## CONSOLIDATION OF ACCOUNTS

1. A	2. B	3. A	4. B
5. C	6. B	7. B	8. -
9. -	10. -	11. -	12. -
13. -	14. -	15. -	16. -
17. A	18. A	19. B	20. C
21. D	22. A	23. C	24. D
25. C	26. C		

## **CHAPTER – 8 | CASH FLOW STATEMENT**

A statement of changes in the financial position of a company can be found out in two ways:

- (a) Working Capital Basis, i.e., Funds Flow Statement, and
- (b) Cash Basis, i.e., Cash Flow Statement

### **+ DISTINCTION BETWEEN FUNDS FLOW STATEMENT AND CASH FLOW STATEMENT**

The main points of distinction between the two statements are as follows :

**1. Cash position and working capital position.** A cash flow statement is mainly dealt with changes in cash position, while a funds flow statement is concerned with changed working capital.

**2. Usefulness in short-term financial analysis.** For short-term financial analysis the cash flow statement is considered to be more useful to management as compared to funds flow statement.

**3. Method of preparation.** Techniques of preparing the cash flow statement and funds flow statement are different. In funds flow statement, an increase in a current liability brings a decrease in the current asset resulting in decrease in net working capital and vice-versa. In a cash flow statement an increase in a current liability or decrease in a asset (other than cash) might result in an increase in cash and vice versa.

**4. The funds flow statement:** generally gives a picture of changes in the working capital in future; whereas; the funds flow statement does not give such statement.

**5. Opening and closing balances.** In the cash flow statement opening and closing balance (cash and equivalents) is given. But a funds flow statement does not contain in opening and closing balances.

**6. Legal requirement.** There is no legal requirement to prepare funds flow statement but cash flow statement is to be prepared by every listed company as per the requirement of SEBI.

### **+ Cash & Cash Equivalent**

As per Accounting Standard -3 (AS-3) issued by the Institute of Chartered Accountants of India, the term cash

includes :

- 1. Cash in hand;
- 2. Demand deposits with bank ; and
- 3. Cash equivalents. These are short-term highly liquid investments that are readily convertible into known amounts of cash, and which are subject to an insignificant risk of changes in value.



## **CASH FLOW STATEMENT**

- ✓ Cash flow statement is a statement showing the inflow and outflow of cash and cash equivalent during the accounting period.
- ✓ ***The Accounting Standard-3*** shall require preparing and presenting a cash flow statement on annual basis for all listed companies.
- ✓ Cash Equivalents Cash equivalents are 'short-term highly liquid investments that are readily convertible into known amount of cash.

### **Objectives of Cash Flow Statement:**

1. Useful in short-term financial planning.
2. Useful inefficient cash management.
3. Assists in preparation of cash budget.
4. Used for assessment of cash flow from various activities, viz operating, investing and financing activities.

### **Limitations of Cash Flow Statement**

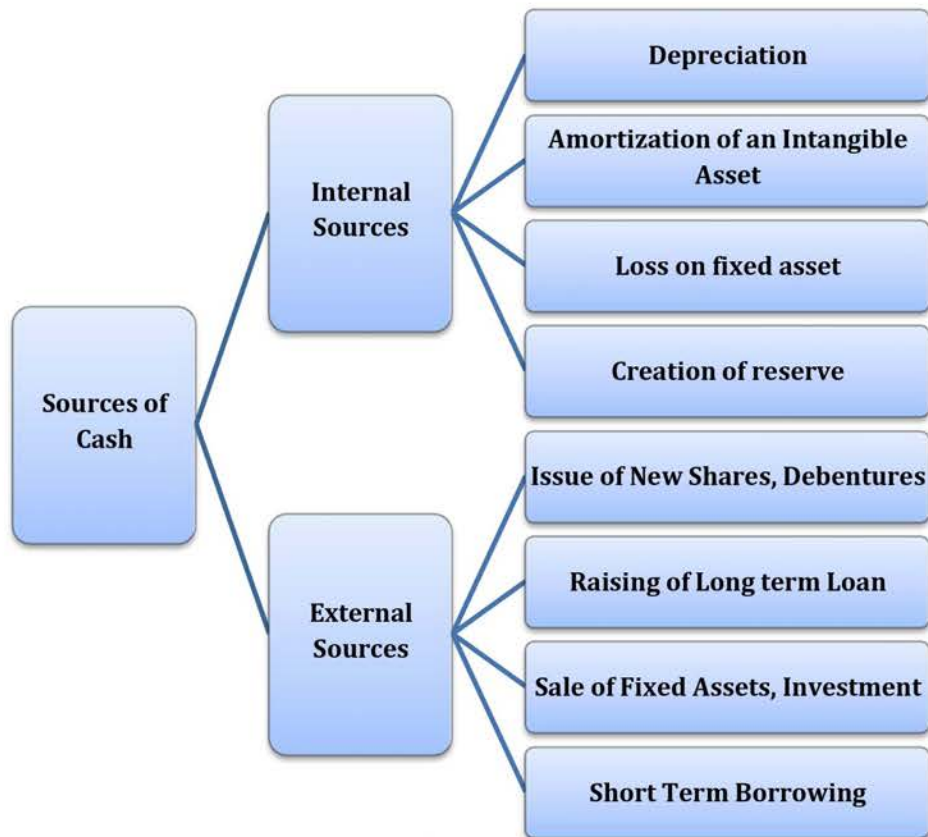
1. Based on historical cost principle.
2. Ignores non-cash transactions.
3. No adherence of basic accounting principles.

### **Classification of Business Activities:**

**Accounting Standard-3** requires that the changes resulting in inflows and outflows of cash and cash equivalents will be classified into following three activities:

- (i) Cash flow from operating activities.
- (ii) Cash flow from investing activities.
- (iii) Cash flow from financing activities

## Sources of Cash & Cash Equivalent



### Right Thing at Right Place

#### 1. INTEREST AND DIVIDEND:

(i) In case of a financing enterprise, cash flows from interest and dividend received should be treated as cash flows from operating activities. Dividends paid should be classified as cash flows from financing activities.

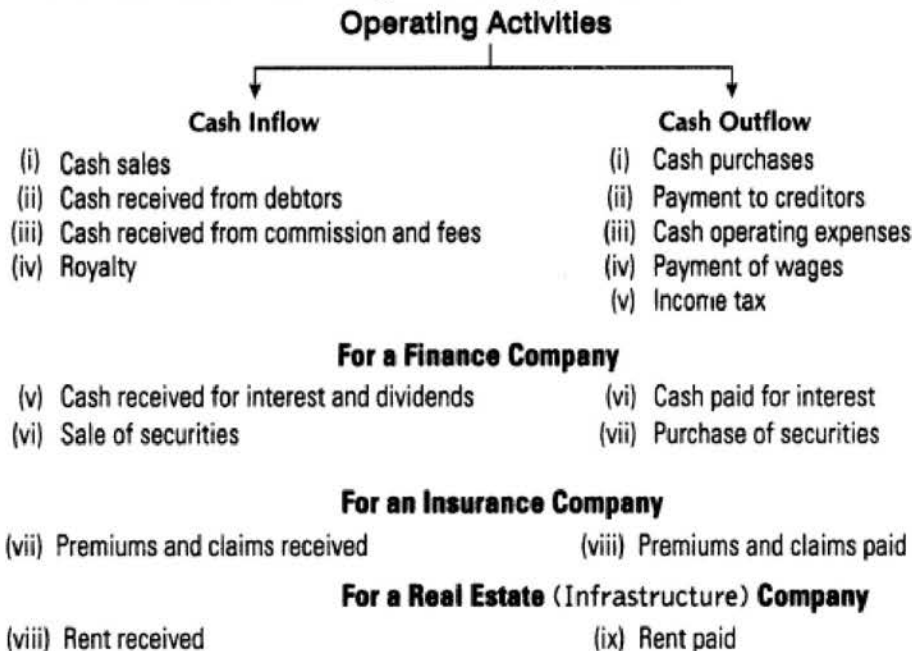
(ii) In the case of other enterprises, cash flows arising from interest and dividend paid should be classified as cash flows from financing activities while interest and dividend received should be classified as cash flows from investing activities.



## **ACTIVITIES INVOLVED IN CASH FLOW STATEMENT**

### **A. Cash Flow from Operating Activities:**

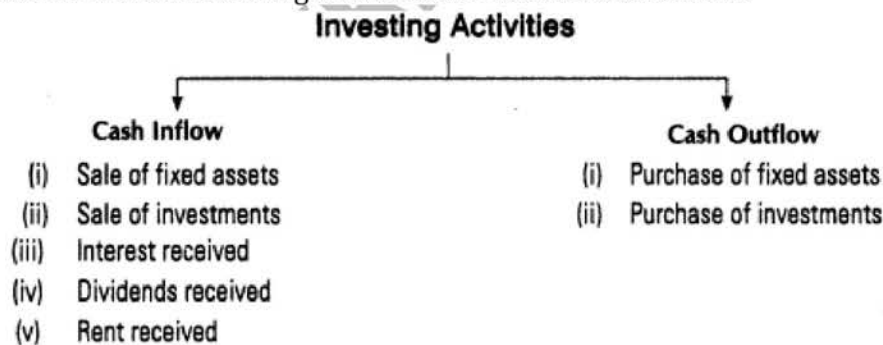
Operating activities are the principal revenue producing activities of the enterprise and other activities that are not investing or financing activities.



### **B. Cash Flow from Investing Activities:**

Investing activities are the acquisition and disposal of the long-term assets and other investments, not included in cash equivalents.

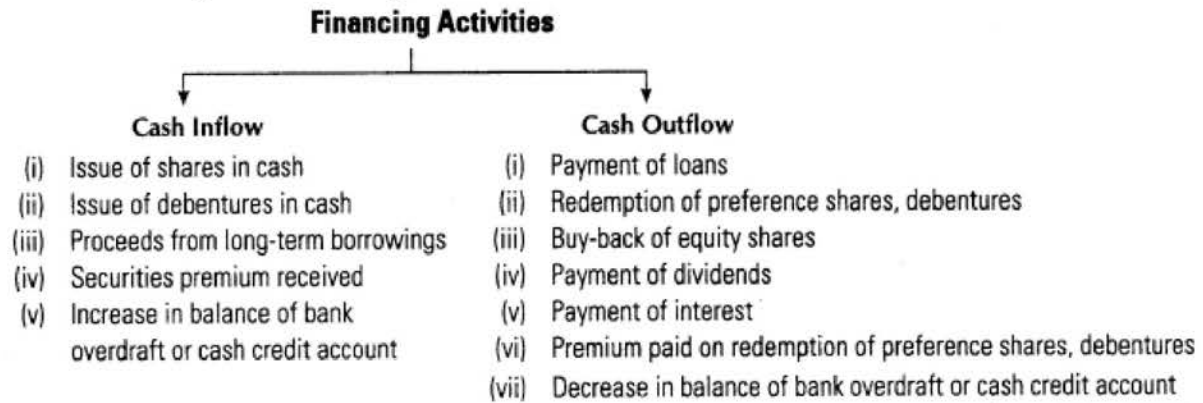
Cash flow from investing activities are exhibited as follows:



### **C. Cash Flow from Financing Activities:**

Financing activities are the activities which result in change in the size and composition of the owner's capital (including preference share capital) and borrowings (including debentures) of the enterprise from other sources.

Cash flow arising from financing activities are exhibited as follows:



**TEACHERS  
OPEN THE  
DOOR, BUT  
YOU MUST  
ENTER BY  
YOURSELF.**



## **Format of Cash Flow Statement**

**Indirect Method** [As per Accounting Standard-3 (Revised)]  
for the year ended...

Particulars	Amt (₹)
<b>I. Cash Flow from Operating Activities</b>	
Net Profit before Taxation and Extraordinary Items (Note)	...
Adjustment for Non-cash and Non-operating Items	
(+) Items to be Added	...
Depreciation	
Interest on Borrowings and Debentures	...
Loss on Sale of Fixed Assets	...
Increase in Provision for Doubtful Debts	...
(-) Items to be Deducted	
Interest Income	(...)
Dividend Income	(...)
Rental Income	(...)
Profit (Gain) on Sale of Fixed Assets	(...)
Operating Profit before Working Capital Changes	...
(+) Decrease in Current Assets and Increase in Current Liabilities	...
(-) Increase in Current Assets and Decrease in Current Liabilities	(...)
Cash Generated from Operations	...
(-) Income Tax Paid (Net of tax refund received)	(...)
Cash Flow before Extraordinary Items	...
* (+/-) Extraordinary Items	...
Net Cash from (or used in) Operating Activities	...
<b>II. Cash Flow from Investing Activities</b>	
Proceeds from Sale of Fixed Assets	...
Proceeds from Sale of Investments (Other than marketable securities)	...
Proceeds from Sale of Intangible Assets	...
Interest and Dividend Received (For non-financial companies only)	...
Rent Income	...
Purchase of Fixed Assets	(...)
Purchase of Investments (Other than marketable securities)	(...)

Particulars	Amt (₹)
Purchase of Intangible Assets Like Goodwill	(...)
* (+/-) Extraordinary Items	...
Net Cash from (or used in) Investing Activities	...
<b>III. Cash Flow from Financing Activities</b>	
Proceeds from Issue of Shares and Debentures	...
Proceeds from Other Long-term Borrowings	...
Increase/Decrease in Bank Overdraft and Cash Credit	
Final Dividend Paid	(...)
Interim Dividend Paid	(...)
Interest on Debentures and Loans Paid	(...)
Repayment of Loans	(...)
Redemption of Debentures/Preference Shares	(...)
Share Issue Expenses	(...)
* (+/-) Extraordinary Items	...
Net Cash from (or used in) Financing Activities	...
<b>IV. Net Increase/Decrease in Cash and Cash Equivalents (I + II + III)</b>	...
<b>V. (+) Cash and Cash Equivalents in the Beginning of the Year</b>	
Cash in Hand	...
Cash in Bank	...
Short-term Deposits	...
Marketable Securities	...
<b>VI. Cash and Cash Equivalents at the End of the Year</b>	
Cash in Hand	...
Cash at Bank	...
Short-term Deposits	...
Marketable Securities	...

#### Working Note

##### Calculation of Net Profit before Tax and Extraordinary Items

Net Profit as per Statement of Profit and Loss or Difference between Closing Balance and Opening Balance of Statement of Profit and Loss	...
<b>(+) Transfer to Reserves</b>	...
*Deferred Tax Liabilities (Net) (Difference between Opening and Closing Balances)	...
Proposed Dividend for Current Year	...
Interim Dividend Paid During the Year	...
Provision for Tax Made During the Current Year	...
*Extraordinary Item, if any Debited to the Statement of Profit and Loss	...
<b>(-) *Extraordinary Item, if any Credited to the Statement of Profit and Loss</b>	(...)
*Deferred Tax Assets (Net) (Difference between Opening and Closing Balances)	(...)
Refund of Tax Credited to the Statement of Profit and Loss	(...)

## **PRACTICE QUESTIONS**

Q1. Prepare a Cash Flow Statement on the basis of the information given in the Balance Sheet of Y.S. Ltd.:

Liabilities	Rs (2016)	Rs (2017)	Assets	Rs (2016)	Rs (2017)
Share Capital	20,000	25,000	Goodwill	1,000	200
12% Debentures	10,000	8,000	Land & Building	20,000	28,000
General reserve	5,000	7,000	Machinery	10,000	13,000
Creditors	4,000	6,000	Debtors	4,000	6,000
Bills Payable	2,000	10,000	Stock	7,000	9,000
Outstanding Expenses	2,500	2,000	Cash	1,500	1,800
	<b>43,500</b>	<b>58,000</b>		<b>43,500</b>	<b>58,000</b>

Q2. Given below are the balance sheets of Veer & Sons.

Liabilities	Rs (2014)	Rs (2015)	Assets	Rs (2014)	Rs (2015)
Creditors	4,000	4,400	Cash	1,000	700
Mrs. A's Loan	2,500	-	Debtor	3,000	5,000
Loan from Bank	4,000	5,000	Stock	3,500	2,500
Capital	12,500	15,300	Machinery	8,000	5,500
			Land	4,000	5,000
			Building	3,500	6,000
	<b>23,000</b>	<b>24,700</b>		<b>23,000</b>	<b>24,700</b>

During the year a machine costing Rs.1000 (accumulated depreciation Rs. 300) is sold for Rs. 500. The provisions for depreciation against machinery as on 31 December 2014 was Rs. 2500 and on 31 December 2015 Rs. 4,000.

Net profit for the year amounts to Rs. 4500.

You are required to prepare a Cash Flow Statement.



## **MCQ FOR PRACTICE**

Q.1 Cash flow statement is dealt under

- (a) AS -3                      (b) AS -4                      (c) AS- 9                      (d) AS-26

Q.2 Which of the following is not the Cash & Cash Equivalent?

- (a) Cash in hand  
(b) Cash at bank  
(c) Short term investment realizable within 6 months  
(d) Short term investment realizable within 3 months

Q.3 Short term highly liquid investments that are readily convertible into known amounts of cash, and which are subject to an insignificant risk of changes in value is known as \_\_\_\_\_

- (a) Bank equivalents                      (b) Cash equivalents  
(c) Working capital                      (d) None of the above

Q.4 Investment normally qualifies as a cash equivalent only when it has a short maturity of any \_\_\_\_\_ or less.

- (a) 5 months                      (b) 6 months                      (c) 4 months                      (d) 3 months

Q.5 As per accounting standard 3 cash equivalent includes –

- (a) Treasury bills                      (b) Commercial papers  
(c) Monthly market funds                      (d) All of the above

### **Use the following information for Questions 6 to 9**

The following are the summary of Cash transactions extracted from the books of Zigzag Ltd:

	(Rs. in Thousand)
Balances as on 1 <sup>st</sup> July 2001	70
Receipt from customer	5566
Issue of shares	600
Sale of fixed assets	256
<b>Total</b>	<b>6492</b>
Payment to Suppliers	4094
Payment for fixed assets	460
Payment of overhead	230
Wages and salaries	138
Taxation	486

Dividends	160
Repayment of bank loans	500
<b>Total</b>	<b>6068</b>
<b>Balance as on 30<sup>th</sup> June 2002</b>	<b>424</b>

You are required to prepare a cash statement of the company for the period ended 30<sup>th</sup> June 2002, in accordance with Accounting Standard-3 (Revised).

Q6. Calculate Cash flow from operating activities

(A) Rs 618,000

(B) Rs 620,000

(C) Rs 625,000

(D) None of the above

Q7. Calculate Cash flow from investing activities

(A) Rs 200,000

(B) Rs (204,000)

(C) Rs (200,000)

(D) None of the above

Q8. Calculate Cash flow from financing activities

(A) Rs 600,000

(B) Rs 60,000

(C) Rs (60,000)

(D) None of the above

Q9. Calculate net increase or decrease in cash and cash equivalent.

(A) Rs 354,000

(B) Rs (354,000)

(C) Rs 350,000

(D) None of the above

### **Use the following information for Questions 10 to 13**

The following are the summary of Cash transactions extracted from the books of Happy Ltd:

	(Rs. in Thousand)
Balances as on 1 <sup>st</sup> April 2012	140
Receipt from customer	11,132
Issue of shares	1,200
Sale of fixed assets	512
<b>Total</b>	<b>12,980</b>
Payment to Suppliers	8,188
Payment for fixed assets	920
Payment of overhead	460
Wages and salaries	276
Taxation	972

Dividends	320
Repayment of bank loans	1,000
<b>Total</b>	<b>12,136</b>
<b>Balance as on 31<sup>st</sup> march 2013</b>	<b>848</b>

You are required to prepare a cash statement of the company for the period ended 31<sup>st</sup> March 2013, in accordance with Accounting Standard-3 (Revised).

Q10. Calculate Cash flow from operating activities

- (A) Rs 12,36,000 (B) Rs 1250,000  
(C) Rs 12,25,000 (D) None of the above

Q11. Calculate Cash flow from investing activities

- (A) Rs 408,000 (B) Rs (400,000)  
(C) Rs (408,000) (D) None of the above

Q12. Calculate Cash flow from financing activities

- (A) Rs 600,000 (B) Rs 120,000  
(C) Rs (120,000) (D) None of the above

Q13. Calculate net increase or decrease in cash and cash equivalent.

- (A) Rs 708,000 (B) Rs (708,000)  
(C) Rs 350,000 (D) None of the above

Q14. Zenith Ltd has provided the following information:

	1/4/2018	31/03/2019
Inventory	20,000	25,000
Creditors	50,000	40,000
Cost of Goods sold during the year		Rs 155,000
Calculate payment made to creditors?		
(A) Rs 200,000		(B) Rs 150,000
(C) Rs 170,000		(D) None of the above

Q15. Zenith Ltd has provided the following information:

	1/4/2018	31/03/2019
Inventory	20,000	30,000
Creditors	50,000	30,000
Sales during the year		Rs 200,000
Gross Profit		20% on Sales
Calculate payment made to creditors?		
(A) Rs 200,000		(B) Rs 150,000
(C) Rs 190,000		(D) None of the above



**Use the following information for Questions 16 to 19**

1. Cash sales for the year were Rs 10,00,000 and sales on account Rs 12,00,000.
2. Payments on accounts payable for inventory totalled Rs 2,80,000.
3. Collection against account receivable were Rs 2,60,000.
4. Rent paid in cash Rs 2,20,000 outstanding rent being Rs 20,000.
5. 4,00,000 Equity shares of Rs 10 per value were issued for Rs 48,00,000.
6. Equipment was purchased for cash Rs 16,80,000.
7. Dividends amounting to Rs 10,00,000 was declared, but yet to be paid.
8. Rs 4,00,000 of dividends declared in the previous year were paid.
9. An equipment having a book value of Rs 1,60,000 was sold for Rs 2.40,000.
10. The cash account was increased by Rs 37,20,000.

Prepare a cash flow statement using direct method.

Q.16 Calculate cash flow from operating activities.

- (a) Rs 7,18,000      (b) 7,20,000      (c) Rs 7,60,000      (d) None of the above

Q.17 Calculate cash flow from investing activities

- (a) (Rs 14,40,000)      (b) Rs 14,40,000      (c) Rs 12,00,000      (d) None of the above

Q.18 Calculate cash flow from financing activities

- (a) Rs 60,00,000      (b) Rs 60,000      (c) (Rs 44,00,000)      (d) Rs 44,00,000

Q.19 Calculate net increase or decrease in cash and cash equivalent

- (a) Rs 37,54,000      (b) Rs 37,20,000      (c) (Rs 37,20,000)      (d) None of these

Q20. Profit after Taxation

Rs 200,000

Transfer to General Reserve

Rs 30,000

Interim Dividend

Rs 20,000

Cash Flow from Operating activities:

(A) Rs 180,000

(B) Rs 200,000

(C) Rs 150,000

(D) None of the above

Q21. Surplus transferred to Balance sheet

Rs 200,000

Transfer to General Reserve

Rs 30,000

Interim Dividend

Rs 20,000

Cash Flow from Operating activities:

(A) Rs 220,000

(B) Rs 200,000

(C) Rs 250,000

(D) None of the above

Q22. Profit after Taxation

Rs 200,000

Transfer to General Reserve

Rs 30,000

Interim Dividend

Rs 20,000

Provision for Taxation

Rs 30,000

Tax Paid

Rs 25,000

Cash Flow from Operating activities:

(A) Rs 170,000

(B) Rs 220,000

(C) Rs 205,000

(D) None of the above

Q23. Surplus from Balance sheet	Rs 200,000
Transfer to General Reserve	Rs 30,000
Interim Dividend	Rs 20,000
Provision for Taxation	Rs 30,000
Tax Paid	Rs 25,000
Cash Flow from Operating activities:	
(A) Rs 170,000	(B) Rs 220,000
(C) Rs 255,000	(D) None of the above

Q24. Net profit before working capital changes of Super Ltd. is Rs 435,000. Change in Working Capital during the year are as follows:

Particulars	Rs
Decrease in Stock	258,000
Decrease in Bills payable	8,400
Increase in Bills receivable	38,800
Increase in Prepaid Expenses	2,500
Increase in Outstanding Expenses	7,800

Cash Flow from Operating Activity will be:

(A) Rs 445,500	(B) Rs 219,900
(C) Rs. 651,100	(D) None of the above

Q25. Company provides the following information:

	31/3/2017	31/3/2018
Provision for Tax	Rs 40,000	Rs 30,000
Tax paid during the year	Rs 70,000	
Profit after tax for the current year	Rs 200,000	

Cash Flow from Operating Activity will be:

(A) Rs 260,000	(B) Rs 190,000
(C) Rs. 200,000	(D) None of the above

Q26. Company provides the following information:

	31/3/2017	31/3/2018
Provision for Tax	Rs 40,000	Rs 30,000
Profit after tax for the current year	Rs 200,000	

Cash Flow from Operating Activity will be:

(A) Rs 210,000	(B) Rs 190,000
(C) Rs. 200,000	(D) None of the above

Q27. Company provides the following information:

	31/3/2017	31/3/2018
Provision for Tax	Rs 40,000	Rs 30,000
Tax made during the year	Rs 70,000	
Profit after tax for the current year	Rs 200,000	

Cash Flow from Operating Activity will be:

(A) Rs 260,000	(B) Rs 190,000
(C) Rs. 200,000	(D) None of the above

Q28. Company provides the following information:

	31/3/2017	31/3/2018
Provision for Tax	Rs 40,000	Rs 30,000
Tax paid during the year	Rs 70,000	
Profit after tax for the current year	Rs 200,000	

Cash Flow from Operating Activity will be:

- (A) Rs 260,000 (B) Rs 190,000  
(C) Rs. 200,000 (D) None of the above

Q29. ABC Ltd. provide you the following information

Balance sheet

Particulars	31.03.12	31.03.13
(I) Equity and liabilities		
Provision for tax	<u>1,00,000</u>	<u>1,20,000</u>
Tax paid during the year	Rs 80,000	

What is the amount of tax provided during the year.

- (a) Rs 1,10,000 (b) Rs 1,00,000 (c) Rs 1,20,000 (d) None of the above

Q30. ABC Ltd. provide you the following information

Balance sheet

Particulars	31.03.12	31.03.13
(I) Equity and liabilities		
Provision for tax	<u>1,00,000</u>	<u>1,20,000</u>
Tax made during the year	Rs 80,000	

What is the amount of tax paid during the year.

- (a) Rs 80,000 (b) Rs 90,000 (c) Rs 60,000 (d) None of the above

Q 31. XYZ Ltd. provide you the following information

Balance sheet

Particulars	31.03.12	31.03.13
(II) Assets		
Plant and Machinery	<u>1,00,000</u>	<u>5,00,000</u>
Adjustment		

During the year, a machinery costing Rs 80,000 (Book Value Rs 42,000) was sold for Rs 40,000

Depreciation of the year – Rs 1,00,000

Calculate the value of plant and machinery purchased during the year.

- (a) Rs 80,000 (b) Rs 5,42,000 (c) Rs 42,000 (d) None of the above

Q32. XYZ Ltd. provide you the following information

Particulars	31.03.12	31.03.13
(II) Assets		
Plant and Machinery	<u>1,00,000</u>	<u>5,00,000</u>
Adjustment		

During the year, a machinery costing Rs 80,000 (Book Value Rs 42,000) was sold for Rs 40,000

Depreciation of the year – Rs 1,00,000

Calculate the value of plant and machinery purchased during the year.

- (a) Rs 80,000 (b) Rs 5,42,000 (c) Rs 42,000 (d) None of the above



Q33. XYZ Ltd. provide you the following information

Balance sheet

Particulars	31.03.12	31.03.13
(II) Assets		
Plant and Machinery	<u>1,00,000</u>	<u>5,00,000</u>

Adjustment

During the year, a machinery costing Rs 80,000 (Book Value Rs 42,000) was sold for Rs 45,000

Depreciation of the year – Rs 1,00,000

Calculate the value of plant and machinery purchased during the year.

- (a) Rs 6,42,000                      (b) Rs 5,42,000                      (c) Rs 42,000                      (d) None of the above

Q34. XYZ Ltd. provide you the following information

Balance sheet

Particulars	31.03.12	31.03.13
(II) Assets		
Plant	1,00,000	3,00,000
Accumulated Depreciation	<u>50,000</u>	<u>80,000</u>

Adjustment

Plant costing Rs 20,000 was sold for Rs 6,000 (accumulated depreciation – Rs 12,000).

Calculate the amount of plant purchased during the year and also state depreciation charged during the year

- (a) Rs 2,20,000; Nil                      (b) Nil; Rs 30,000  
(c) Rs 2,20,000; Rs 42,000                      (d) Rs 2,00,000; Rs 62,000

Q35. XYZ Ltd. provide you the following information

Balance sheet

Particulars	31.03.12	31.03.13
(II) Assets		
Plant	1,00,000	1,50,000
Accumulated Depreciation	<u>50,000</u>	<u>85,000</u>

Adjustment

Plant costing Rs 20,000 was sold for Rs 6,000 (accumulated depreciation – Rs 8,000).

Calculate the amount of plant purchased during the year and also state depreciation charged during the year

- (a) Rs 70,000; Nil                      (b) Rs 50,000; Rs 15,000  
(c) Rs 70,000; Rs 43,000                      (d) None of the above

Q.36 From the following data, find the value of building sold during the year

Particulars	31.03.2013	31.03.2014
Land and building	2,00,000	1,70,000
Capital reserve	Nil	20,000

A piece of land has been sold during the year and the profit on sale has been credited to capital reserve. Depreciation charged on building during the year is Rs 5,000; no addition have been made under this head during the year.

- (a) Rs 30,000                      (b) Rs 50,000                      (c) Rs 40,000                      (d) Rs 45,000

Q.37 An equipment having a book value of Rs 200,000 was sold for Rs 280,000, As a result of this transaction .

- (a) Investing activity will increase by Rs 200,000
- (b) Investing activity will increase by Rs 280,000
- (c) Investing activity will decrease by Rs 200,000
- (d) Investing activity will decrease by Rs 280,000

Q.38 In cash flow statement, interest received by financing company is classified as –

- (A) Operating activities
- (b) Cash and cash equivalents
- (c) Investing activities
- (d) Financing activities

Q.39 In cash flow statement, interest paid by financing company is classified as –

- (A) Operating activities
- (b) Cash and cash equivalents
- (c) Investing activities
- (d) Financing activities

Q.40 In cash flow statement, dividend received in case of financing company is classified as –

- (A) Operating activities
- (b) Cash and cash equivalents
- (c) Investing activities
- (d) Financing activities

Q.41 In cash flow statement, dividend paid in case of financing company is classified as –

- (A) Operating activities
- (b) Cash and cash equivalents
- (c) Investing activities
- (d) Financing activities

Q.42 In cash flow statement, interest received by non-financing company is classified as –

- (A) Operating activities
- (b) Cash and cash equivalents
- (c) Investing activities
- (d) Financing activities

Q.43 In cash flow statement, interest paid by non-financing company is classified as –

- (A) Operating activities
- (b) Cash and cash equivalents
- (c) Investing activities
- (d) Financing activities

Q.44 In cash flow statement, dividend received in case of non-financing company is classified as –

- (A) Operating activities
- (b) Cash and cash equivalents
- (c) Investing activities
- (d) Financing activities

Q.45 In cash flow statement, dividend paid in case of non-financing company is classified as –

- (A) Operating activities
- (b) Cash and cash equivalents
- (c) Investing activities
- (d) Financing activities

Q.46 In a cash flow statement there is no place for

- (a) Issue of equity shares
- (b) Issues of bonus shares
- (c) Conversation of debt to equity
- (d) Both (b) and (c) above

Q.47 SKY Ltd. purchased a special machinery from Earth Ltd. for Rs 50 Lakhs in consideration of 50,000 equity shares of Rs 100 each of the company. Where this transaction will be reflected in the cash flow statement as per AS 03?



- (a) Operating Activities (b) Financing Activities  
(c) Investing Activity (d) None of these

Q.48 Cash Payment to and on behalf of employees is an example of cash flow from –

- (a) Operating Activities (b) Financing Activities  
(c) Investing Activity (d) None of these

Q.49 Which of the following results into decrease in working capital-

- (a) Goods sold on credit (b) Decrease in current liabilities  
(c) Decrease in current assets (d) Increase in current liabilities

Q.50 The following information pertains to Expert Ltd:

Particulars	31.12.2013 (Rs)	31.12.2014 (Rs)
Creditors	86,600	98,400
Outstanding expenses	85,000	1,15,000
Provisions of tax	1,50,000	1,60,000
Debtors	2,68,000	2,54,000
Stock	1,40,000	1,75,000

Net profit before working capital changes is Rs 5,56,000. The cash flow from operating activities will be –

- (a) Rs 4,26,800 (b) Rs 5,76,800  
(c) Rs 5,35,200 (d) Rs 4,16,800

Q.51 Match the following

List –I

List –II

P. Cost accounting

1.Changes in working capital

Q. Funds flow statement

2. Deals with the cost of production

Selling & Distribution

R. Cash flow statement

3. Is an important technique of financial analysis.

S. Ratio analysis

4. Cash and cash equivalents

Select the correct answer from the options given below-

	P	Q	R	S
(a)	4	3	2	1
(b)	2	1	4	3
(c)	4	3	1	2
(d)	3	4	2	1

Q52. Corporate Taxes are Classified into:

- (a) Operating Activities (b) Financing Activities  
(c) Investing Activity (d) None of these

Q53. Premium payable on redemption of Preference shares is classified:

- (a) Operating Activities (b) Financing Activities  
(c) Investing Activity (d) None of these



Q54. Purchase of assets against issue of shares is classified into:

- |                          |                          |
|--------------------------|--------------------------|
| (a) Operating Activities | (b) Financing Activities |
| (c) Investing Activity   | (d) None of these        |

Q55. Royalty, fees, Commission will be classified:

- |                          |                          |
|--------------------------|--------------------------|
| (a) Operating Activities | (b) Financing Activities |
| (c) Investing Activity   | (d) None of these        |

**Q56. Loan advance to employee will be classified:**

- |                          |                          |
|--------------------------|--------------------------|
| (a) Operating Activities | (b) Financing Activities |
| (c) Investing Activity   | (d) None of these        |

**Q57. Loan advanced to supplier will be classified:**

- |                          |                          |
|--------------------------|--------------------------|
| (a) Operating Activities | (b) Financing Activities |
| (c) Investing Activity   | (d) None of these        |

**Q58. Interest earned on loan given to employee will be classified:**

- |                          |                          |
|--------------------------|--------------------------|
| (a) Operating Activities | (b) Financing Activities |
| (c) Investing Activity   | (d) None of these        |

**Q59. Interest earned on loan given to supplier will be classified:**

- |                          |                          |
|--------------------------|--------------------------|
| (a) Operating Activities | (b) Financing Activities |
| (c) Investing Activity   | (d) None of these        |

**Q60. Equity share bought back will be classified into:**

- |                          |                          |
|--------------------------|--------------------------|
| (a) Operating Activities | (b) Financing Activities |
| (c) Investing Activity   | (d) None of these        |

**Q61. Which of the following internal source of cash?**

- |                         |                        |
|-------------------------|------------------------|
| (a) Raising term loans  | (b) depreciation       |
| (c) Issue of new shares | (d) Sale of investment |

**Q62. Which of the following internal source of cash?**

- |                                      |                      |
|--------------------------------------|----------------------|
| (a) Amortization of Intangible asset | (b) depreciation     |
| (c) Loss on sale of asset            | (d) All of the above |

Q63. Cash Flow statement is prepared on the basis of:

- |                           |                      |
|---------------------------|----------------------|
| (a) Accrual Basis         | (b) Cash Basis       |
| (c) Working Capital Basis | (d) All of the above |

Q64. Fund Flow statement is prepared on the basis of:

- |                           |                      |
|---------------------------|----------------------|
| (a) Accrual Basis         | (b) Cash Basis       |
| (c) Working Capital Basis | (d) All of the above |

(CS SAMPLE PAPER)

Q.65 Cash flow statement is required for the financial planning of –

- (a) Short range
- (b) long range
- (c) Medium range
- (d) Very long range

(CS SAMPLE PAPER)

Q66. Cash payments to and on behalf of employees is an example of:

- (a) Cash flow from Operating activities
- (b) Cash flow from Investing activities
- (c) Cash flow from Financing activities
- (d) None of the above

(CS SAMPLE PAPER)

Q67. Which of the following is NOT a cash outflow for a firm-

- (a) Dividends
- (b) Proceeds from issuance of share capital
- (c) Amortisation of preliminary expenses
- (d) Interest payments

(CS SAMPLE PAPER)

Q68. In case of a Financial enterprise, Interest received on Debentures held as Investment is:

- (a) Operating activity
- (b) Investing activity
- (c) Financing activity
- (d) None of the above

(CS SAMPLE PAPER)

Q69. Which of the following results into increase in working capital-

- (a) Decrease in current liabilities
- (b) Decrease in current assets
- (c) Goods sold on credit
- (d) Tax paid

(CS SAMPLE PAPER)

# ANSWERS

## Cash Flow Statement

1. A	2. C	3. B	4. D
5. D	6. A	7. B	8. C
9. A	10. A	11. C	12. C
13. A	14. C	15. C	16. C
17. A	18. D	19. B	20. B
21. C	22. C	23. C	24. C
25. B	26. B	27. B	28. B
29. B	30. C	31. B	32. B
33. B	34. C	35. C	36. D
37. B	38. A	39. A	40. A
41. A	42. C	43. D	44. C
45. D	46. D	47. D	48. A
49. B	50. A	51. B	52. A
53. B	54. D	55. A	56. A
57. A	58. A	59. A	60. B
61. B	62. D	63. B	64. C
65. A	66. A	67. C	68. B
69. B			



# **CHAPTER – 9 | VALUATION OF GOODWILL (AS 26)**

## **Meaning of Goodwill:**

Goodwill means the 'good-name' or the reputation earned by a firm. If a firm renders good service to the customers, the customers who feel satisfied will come again and again and the firm will be able to earn more profits in future.

In technical language it may be defined as "the present value of the firm's anticipated excess earnings".

### **Definitions of Goodwill:**

"The term goodwill is generally used to denote the benefit arising from connections and reputation."

"Goodwill is nothing more than the probability that the old customers will resort to the old place."

## **Features of Goodwill:**

1. It is an intangible asset.
2. It is liable to constant fluctuations
3. It is valuable only when entire business is sold:
4. It is difficult to place an exact value on goodwill
5. There can be no objective valuation of goodwill
6. Goodwill may be purchased or non-purchased (i.e., raised)

## **Factors Affecting the Value of Goodwill**

**1. Favourable location of the business:** If the business is located at convenient or prominent place, it will attract more customers and therefore will have more goodwill.

**2. Efficiency of Management:** If the business is run by experienced and efficient management, its profits will go on increasing, which results in increase in the value of goodwill.

**3. The longevity of the business:** An older business is better known to its customers; therefore it is likely to have more goodwill. When a business enterprise has built up good reputation over a period of time, the number of customer will be more in comparison to the customers of new entrants. Number of customers is an indicator of profit earning capacity of a business.

**4. Nature of Good:** If a business deals in good of daily use, it will have steady profits, as the demand for these goods will be stationery. Such business will have more goodwill. But if it deals in fancy goods, its profits will be uncertain and as such the value of the goodwill is, less.

**5. Possession of Licence:** If a firm hold an import licence, the goodwill of the firm will be more, as it will be very difficult for other firms to enter this business in the absence of this licence.

**6. Monopolistic and other rights:** If a business enjoys monopoly market, it will have assured profits. Similarly, if it holds special rights such as patents, trademarks, copyrights or concession etc., it will have more goodwill.

**7. Risk involved:** If there is more risk involved in the business, the value of the goodwill will be less.

**8. Trend of Profit:** If the profits of a business are increasing continuously, value of its goodwill will be more. If the profits are declining or if the profits are uncertain, the value of its goodwill will be less.

**9. Future Competition:** The likelihood or possibility of increased competition in future would definitely reduce the value of goodwill.

**10. Capital required:** The amount of capital required for a business will also influence the value of goodwill. If two business enterprises earn the same rate of profits, the business with lesser capital requirement shall enjoy more goodwill.

## **Need for Valuation of Goodwill:**

The need for valuing the goodwill arises in the following circumstances:-

### **1. In case of sole trade:**

- (i) When the business is to be disposed off,
- (ii) When someone is to be admitted as a partner, and
- (iii) For assessing the wealth- tax on the death of the proprietor.

### **2. In Case of Partnership:**

- (i) When a new partner is admitted,
- (ii) When a partner retires or dies,
- (iii) When there is a change in the profit sharing ratio among the partners, and
- (iv) When there is dissolution either by sale to a Company or amalgamation with another firm.

### **3. In Case of a Company:**

- (i) When one Company takes over another,
- (ii) When two or more Companies amalgamate,
- (iii) When a Company wants to purchase a large block of shares for acquiring controlling interest in another Company,
- (iv) When government takes over the business, and
- (v) When stock exchange quotations not being available, shares have to be valued for taxation purposes such as estate duty, gift tax etc.

## **Methods of Valuation of Goodwill**

It is very difficult to assess the value of goodwill, as it is an intangible asset. There are various methods of valuing goodwill and all of them are based on the profitability of the concern because the value payable for goodwill depends mainly on the earning capacity of a business. Following are the methods of valuing goodwill.

1. Average Profit Method
2. Super Profit Method
3. Capitalisation Method
4. Purchase Consideration Method
5. Annuity Method

**1. Average Profit Method:-** This is very simple and widely followed method of valuation of goodwill. In this method, goodwill is calculated on the basis of the number of past years profits. Average of such profits is multiplied by the agreed number of years (such as two or three) to find out the value of goodwill. Thus the formula is:

Value of Goodwill = Average Profit x Number of Years purchased

For example, if the goodwill of a firm is estimated at two year's purchase of the average profits of the last four years and if the profits of the last four years are ₹10,000; ₹15,000; ₹20,000 and ₹5,000; the value of the goodwill will be calculated as under:-

Total Profits of last four years = ₹10,000 + ₹15,000 + ₹20,000 + ₹5,000  
= ₹50,000

50,000

Average Profit = ₹  $\frac{50,000}{4}$  = ₹12,500

Goodwill = Average Profits x Number of Years Purchased  
= ₹12,500 x 2 = ₹25,000



## **Precaution while Calculating Actual Average Profits**

The purpose of averaging past profits is to project the future earnings i.e., what profits are likely to be earned in future? As such, the profits earned in the past must be adjusted in the light of future expectations. In arriving at the past average the following adjustments should be made:

**1. Abnormal gain:** If there is some abnormal income in a year, it should be deducted out of the profit of that year. For example, there was profit of ₹5,00,000 on sale of land in the year 1998. It should be deducted from the profit of 1998 in order to arrive at the normal profit of that year.

**2. Abnormal loss:** If there is some abnormal loss in a year resulting from floods, fires, earthquakes, theft etc. it should be added back to the profit of that year, in order to arrive at the normal profit of that year.

**3. Income from investments:** Income from investments should be deducted out of the profit of that year, because this income is received from outside the business and cannot be regarded as part of the main business activity of the Company.

**4. Non-Operating income:** Non- Operating income is the income received from non-trading assets, say, receipt of rent from property. It should be deducted from the profits.

**5. Operating expenses expected to be incurred in future:** If there is some expenditure which was not incurred up to now but which is expected to be incurred in future years, it should be deducted from average profits. For example, if the stock was not insured up to now to be insured in future, the insurance premium must be deducted from average profits.

**6. Income expected in future:** Any income, which was not received so far but is likely to be received regularly in future, should be added to the average profits.

**7. Stoppage of future earnings:** Any income, which used to be received regularly so far but is likely to be discontinued paid in past years, it should be deducted from average profits.

**8. Managerial Remuneration:** If managerial remuneration estimated to be paid in future is in excess of the remuneration paid in past years, it should also be deducted from average profits.

**9. Income Tax:** The past average profits should be calculated after deducting tax at current rates.

After the above adjustments, average profits, which can be expected to be maintained in future, shall be arrived at. These are termed as future maintainable profits.

Value of Goodwill = Average Profit x Number of years Purchased

## **Phases of generation of intangible assets.**

Phases of generation of Intangible assets:

Internally generated goodwill should not be recognised as an asset.

The generation of assets classified in to phases.

**A. Research Phase:** Expenditure on research should not be recognised as an intangible asset. These should be recognised as an expenses when it is incurred.

**B. Development Phase:** An intangible asset arising from Development phase should be recognised only if following conditions are fulfilled.

- (a) The technical feasibility of completing the intangible asset to that it will be available for use or sale.
- (b) Its intention to complete the intangible asset and use or sell it.
- (c) Its ability to use or sell the intangible asset.
- (d) The availability of adequate technical, financial and other resources to complete the development and to use of sell the intangible asset.



## Amortisation period of Intangible assets:

Depreciation amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. Normally, it is presumed that useful life will not exceed 10 years unless there is persuasive evidence that intangible asset has higher useful life.

**Review of Amortisation period and Amortisation method:** the amortisation period and the amortisation method should be reviewed least at each end of financial year. If the expected useful life of the asset is significantly different from previous estimates, the amortization period should be charged accordingly, if there has been a significant change in the expected pattern of economic benefit from the assets; the amortisations method should be changed to reflect the changed pattern.

**Retirement and Disposal:** An intangible asset should be derecognised or disposal or when no future economic benefit are expected from its use and subsequent disposal.

## Valuation of purchased goodwill:

- (1) **Average profit method :** Under this method average profit is calculated on the basis of the past few year's profits. At the time of calculating average profit abnormal profit or loss will be ignored. After calculating average profit, it is multiplied by a number (3 or 4 years), as agreed. The product will be the value of the goodwill.

Goodwill = Average Profit X No. of year purchase

- (2) **Weighted average profit method :** To obtain the average profit, the profit of the year must be multiplied by its weightage and the grand total should be divided by the aggregate number of weights. After calculating average profit, it is multiplied by a number (3 or 5), as agreed. The product will be the value of the goodwill.

Goodwill = Weighted average Profit X No. of year purchase

- (3) **Super-profit method :** Super profit is the excess of actual profit over the normal profit. Under this method, super profits are taken as the basis for calculating goodwill in place of average profit.

Goodwill is calculated as follows:

Step 1	Calculate capital employed	
Step 2	Calculate normal return	
	Normal Return = Capital employed X Rate of normal return	
Step 3	Calculate future maintainable profit	
Step 4	Calculate super profit	
	Future maintainable profit	xxxx
	Less : Normal Return	(xxx)
	Super Profit	xxxx
Step 5	Goodwill = Super profit X No. of years purchases	

- (4) **Annuity method :** Under this method super profits should be discounted using appropriate discount values for converting into the present value.

Goodwill = Super Profit X Annuity factor

- (5) **Capitalization of future maintainable method :** Under this method, the firm is valued by applying the following formula:

Goodwill =  $\left[ \frac{\text{Future maintainable profit}}{\text{Normal rate return}} \times 100 \right] - \text{Capital employed}$

**(6) Capitalization of super profits method :** Under this method, goodwill is calculated by capitalizing super-profits at agreed rate. The goodwill is calculated directly by applying the following formula:

$$\text{Goodwill} = \frac{\text{Super profit}}{\text{Capitalization}} \times 100$$

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## **MCQ FOR PRACTICE**

Q1. Which of the following Accounting Standard applicable to Intangibles Asset?

- (A) 15 (B) 26  
(C) 20 (D) 25

Q2. Which of the following is not a feature of intangible asset?

- (A) It is an asset without physical substance.  
(B) It is monetary asset.  
(C) It is held for use.  
(D) It is an identifiable.

Q3. Statement 1: Self Generated goodwill cannot be recognised as per AS 26

Statement 2: Payment of Goodwill at the time of purchase or amalgamation of business can be recognized as Intangible Asset as per AS 26.

- (A) Both statements are correct.  
(B) Both statements are incorrect  
(C) Statement 1 is correct but Statement 2 is incorrect  
(D) Statement 2 is correct but Statement 1 is incorrect

Q4. It is assumed that the useful life of an intangible asset will not exceed \_\_\_\_\_ from the date when the intangible asset is available for use.

- (A) 5 Years (B) 10 years  
(C) 15 years (D) 20 years

Q5. Goodwill is an \_\_\_\_\_ asset but not a \_\_\_\_\_ asset.

- (A) Tangible; Intangible (B) Intangible; Fictitious  
(C) Fictitious; Intangible (D) Tangible; Fictitious

Q6. The need for valuation of goodwill will arises:

- (A) When the business is about to shut down  
(B) When the business is about to sold or amalgamated to another business.  
(C) When company incurred huge losses  
(D) All of the above

Q7. The profit before tax of XYZ Ltd. is given under:

Year	Profits
2012	Rs 300,000
2013	Rs 250,000
2014	Rs 350,000
2015	Rs 275,000

- a) Closing stock on 31<sup>st</sup> December 2013 was overvalued by Rs 10,000.  
b) Profit for the year 2015 included abnormal gain of Rs 10,000.  
c) In 2012, there was an accident due to which there was a loss of Rs 20,000.  
d) Due to change in location, the company is expected to save Rs 20,000 on transportation.  
Calculate future maintainable profits. Assume Calendar Year.



Q8. The profit before tax of ABC Ltd. is given as under:

Year	2010	2011	2012
Profit	500,000	400,000	450,000

The company purchased 10% non trade investment on 1<sup>st</sup> July 2012 for Rs 320,000.

(Face Value of Investment Rs 300,000)

Tax Rate 40%

Calculate Future maintainable profits.

Q9. P Ltd. proposed to purchase the business carried on by C. Goodwill for this purpose is agreed to be valued at three years' purchase of the weighted average profits of the past four years. The appropriate weights to be used are: 1984: 1; 1985: 2; 1986: 3; 1987: 4.

The profits for these years are:

1984	Rs20,200;
1985	Rs24,800;
1986	Rs20,000;
1987	Rs30,000.

On a scrutiny of the accounts the following matters are revealed:

(i) On 1st September 1986 a major repair was made in respect of the plant incurring Rs. 6,000 which amount was charged to revenues. The said sum is agreed to be capitalised for goodwill calculation subject to adjustment of depreciation of 10% p.a. on reducing balance method.

(ii) The closing stock for the year 1985 was over-valued by Rs2,400.

(iii) To cover management cost an annual charge of Rs4,800 should be made for the purpose of goodwill valuation.

Compute the value of goodwill of the business of C.

(A) Rs 50,000

(B) Rs 65,784

(C) Rs 80,000

(D) None of the above

Q10. X ltd. proposed to purchase the business carried on by B and Co. Goodwill for the purpose is to be valued at three year purchase of the weighted average profits for the past four years.

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

	Weight	Profits (Rs in Lakhs)
1997-98	1	110
1998-99	2	115
1999-00	3	145
2000-01	4	180

On scrutiny of the accounts, the following information is gathered:

I. On 1<sup>st</sup> December 1999, a major repairs were carried out on building incurring Rs. 30 lakhs which amount was charged to revenues. The said sum is agreed to be capitalised for goodwill calculation subject to adjustment of depreciation of 10% p.a. on written down value method.

II. The closing stock for the year 1999-00 was undervalued by Rs 10 lakhs.

III. To cover management cost an annual charge of Rs 20 lakhs should be made for the purpose of goodwill valuation.

Compute the value of goodwill of the business of firm.

(A) Rs 500 lakhs

(B) Rs 450 lakhs

(C) Rs 408.12 lakhs

(D) None of the above

Q11. The profits for the last 4 years are Rs 20,000; Rs 15,000; Rs 25,000 and Rs 40,000. Find out the value of goodwill, if it is calculated on average profits of last year 4 years on the basis of 2 years of purchase.

(A) Rs 100,000

(B) Rs 50,000

(C) Rs 25,000

(D) None of the above

Q12. The profits for the last 5 years are Rs 30,000; Rs 25,000; (Rs 5,000), Rs 10,000 and Rs 40,000. Find out the value of goodwill, if it is calculated on average profits of last year 5 years on the basis of 3 years of purchase.

- (A) Rs 100,000 (B) Rs 60,000  
(C) Rs 75,000 (D) None of the above

Q13. The profits for the last 5 years are Rs 130,000; Rs 125,000; Rs 15,000, Rs 110,000 and Rs 240,000. Capital Employed of the firm Rs 500,000 and normal rate of return of similar business is 10% p.a. Find out the value of goodwill, if it is calculated on super profits on the basis of 3 years of purchase.

- (A) Rs 222,000 (B) Rs 372,000  
(C) Rs 74,000 (D) None of the above

Q14. The profits for the last 5 years are Rs 180,000; Rs 140,000; Rs 80,000, Rs 90,000 and Rs 120,000. Capital Employed of the firm Rs 900,000 and normal rate of return of similar business is 10% p.a. Find out the value of goodwill, if it is calculated on super profits on the basis of 3 years of purchase.

- (A) Rs 32,000 (B) Rs 78,000  
(C) Rs 96,000 (D) None of the above

Q15. The net profit of a business after providing for taxation, for the past five years are: Rs 36,000, Rs 48,000, Rs 46,500, Rs 74,500 and Rs 45,000. The capital employed in the business is Rs 300,000. The normal rate of return expected in the similar type of business is 12% p.a. Calculate the value of goodwill on the four year's purchase of super profits

- (A) Rs 56,000 (B) Rs 36,000  
(C) Rs 42,000 (D) None of the above

Q16. The average profit before adjustment is Rs 514,000. The profits includes interest at 8% on non trading investment. The cost of these investment is Rs 198,200 while the face value of the investment is Rs 200,000. Expenses amounting to Rs 7,000 per annum are likely to be discontinued in future. The provision of income tax made at 30%. The normal rate of return may be taken at 10%. The average capital employed in the business (including investments) is Rs 18,98,200. Assuming four year's purchase of super profits, what is the value of goodwill?

- (A) Rs 183,500 (B) Rs 150,000  
(C) Rs 200,000 (D) None of the above

Q17. Compute the amount of goodwill based on 3 year's purchase of super profit from the following:

Future maintainable Profit after Tax	Rs 1500,000
Normal pre-tax rate of return	20%
Capital Employed	Rs 60,00,000
Tax Rate	30%
(A) Rs 10,80,000	(B) Rs 19,80,000
(C) Rs 960,000	(D) None of the above

Q18. Find out the goodwill of the company by capitalization of average method:

Total Capital Employed	Rs 30,00,000
Normal Rate of return	10% p.a.
Future maintainable profits	Rs 400,000
(A) Rs 40,00,000	(B) Rs 10,00,000
(C) Rs 70,00,000	(D) None of the above



Q19. Find out the goodwill of the company by capitalization of average method:

Total Capital Employed	Rs 20,00,000
Normal Rate of return	15% p.a.
Future maintainable profits	Rs 600,000
(A) Rs 40,00,000	(B) Rs 20,00,000
(C) Rs 60,00,000	(D) None of the above

Q20. Goodwill possessed by the firm/Company may be due to

- (A) Location of the business enterprises
- (b) Possession of Brand and Trade mark
- (C) Personal reputation of promoters and directors
- (D) All of the above

Q21. Goodwill possessed by the firm/Company may be due to

- (A) Favourable demand of the business products and services
- (b) Possession of Brand and Trade mark
- (C) Advertisement Campaigns
- (D) All of the above

Q22. Which of the following is not a method of valuation of goodwill?

- (A) Average Profit Method
- (B) Super Profit Method
- (C) Capitalisation of Average method
- (D) Intrinsic Value Method

Q23. Weighted average method of calculating goodwill should be followed when:

- (A) Profits show increasing trends
- (B) Profit show decreasing trends
- (C) Profit show no trend
- (D) Both A and B

Q24. To assess whether an self generated intangible asset meet the criteria for recognition, an enterprises classifies the generation of this asset into two phases which are:

- (A) Research Phase and Completed Phase
- (B) Research Phase and development phase
- (C) Starting phase and Development phase
- (D) None of the above

Q25. Expenses on the research phase should be recognized as an\_\_\_\_\_.

- (A) Income
- (B) Expense
- (C) Intangible assets
- (D) Liability

Q26. Expenses on the development phase should be recognized as an\_\_\_\_\_.

- (A) Income
- (B) Expense
- (C) Intangible assets
- (D) Liability

Q27. An intangible asset arising from development phase should be recognized only if:

- (A) the technical feasibility of completing the intangible asset so that it is available for use or sale;
- (B) its intention to complete the intangible asset and use or sell it;
- (C) the availability of adequate control technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- (D) All of the above



Q28. MLtd. Launched a project for producing product A in Nov 2008. The company incurred Rs 30 lakhs towards research and development expenses upto 31<sup>st</sup> March 2010.

Due to unfavorable market conditions the management feels that it is not possible to manufacture and sell the product in the market. The management wants to defer the expenditure. Can management can defer it as per AS 26?

- (A) Yes  
(B) No  
(C) Only for 10 Years  
(D) Only for 20 years

**Use the following information for questions 29 to 32**

U.K. International Ltd. is developing a new production process. During the financial year ending 31<sup>st</sup> March, 2017, the total expenditure incurred was Rs.50 lakhs. This process met the criteria for recognition as an intangible asset on 1<sup>st</sup> December, 2016. Expenditure incurred till this date was Rs. 22 lakhs. Further expenditure incurred on the process for the financial year ending 31<sup>st</sup> March, 2018 was Rs.80 lakhs. As at 31<sup>st</sup> March, 2018, the recoverable amount of know-how embodied in the process is estimated to be Rs. 72 lakhs. Ignore depreciation.

Q29. Calculate the amount to be charged to Profit and Loss A/c for the year ending 31<sup>st</sup> March, 2017

- (A) Rs 50 lakhs  
(B) Rs 28 lakhs  
(C) Rs 22 lakhs  
(D) None of the above

Q30. Calculate the carrying value of intangible as on 31<sup>st</sup> March 2017.

- (A) Rs 50 lakhs  
(B) Rs 28 lakhs  
(C) Rs 22 lakhs  
(D) None of the above

Q31. Calculate the amount to be charged to Profit and Loss A/c for the year ended 31<sup>st</sup> March 2018

- (A) Rs 80 lakhs  
(B) Rs 36 lakhs  
(C) Rs 108 lakhs  
(D) None of the above

Q32. Calculate the carrying value of intangible as on 31<sup>st</sup> March, 2018.

- (A) Rs 108 lakhs  
(B) Rs 130 lakhs  
(C) Rs 72 lakhs  
(D) None of the above

**Use the following information for questions 33 to 36**

Dell International Ltd. is developing a new production process. During the financial Year 31<sup>st</sup> March, 2016, the total expenditure incurred on this process was Rs. 40 lakhs. The production process met the criteria for recognition as an intangible asset on 1<sup>st</sup> December 2015. Expenditure incurred till this date was Rs.16 lakhs.

Further expenditure incurred on the process for the financial year ending 31<sup>st</sup> March 2017 was Rs.70 lakhs. On 31-03-2017, the recoverable amount of know-how embodied in the process is estimated to be Rs. 62 lakhs. (Ignore depreciation for this purpose)

Q33. What is the expenditure to be charged to the Profit and Loss Account for the financial year ended 31<sup>st</sup> March 2016?

- (A) Rs 40 lakhs  
(B) Rs 24 lakhs  
(C) Rs 16 lakhs  
(D) None of the above

Q34. What is the carrying amount of the intangible asset as at 31<sup>st</sup> March 2016?

- (A) Rs 40 lakhs  
(B) Rs 24 lakhs  
(C) Rs 16 lakhs  
(D) None of the above

Q35. What is the expenditure to be charged to the Profit and Loss Account for the financial year ended 31<sup>st</sup> March 2017?

- (A) Rs 50 lakhs  
(B) Rs 32 lakhs  
(C) Rs 94 lakhs  
(D) None of the above

Q36. What is the carrying amount of the intangible asset as on 31st March 2017?

- (A) Rs 50 lakhs (B) Rs 62 lakhs  
(C) Rs 94 lakhs (D) None of the above

Q37. Fox Ltd. is developing a new production process. During the financial year ending 31<sup>st</sup> March 2019, the total expenditure incurred was Rs 50 lakhs. This process met the criteria for recognition as an intangible asset on 1<sup>st</sup> Nov 2018. Expenditure incurred this date was Rs 26 lakhs. What amount to be charged to profit and loss account for the year ended 31<sup>st</sup> March 2019 and carrying value of intangible asset as on that date.

- (A) Rs 50 lakhs and Zero (B) Rs 26 lakhs and Rs 24 lakhs  
(C) Rs 24 lakhs and Rs 26 lakhs (D) None of the above

Q38. Fox Ltd. is developing a new production process. During the financial year ending 31<sup>st</sup> March 2019, the total expenditure incurred was Rs 50 lakhs. This process met the criteria for recognition as an intangible asset on 1<sup>st</sup> Nov 2018. Expenditure incurred this date was Rs 26 lakhs. Further expenditure on the same process for the financial year ending 31<sup>st</sup> March 2020 was Rs 70 lakhs. What carrying value of intangible asset as on that date.

- (A) Rs 70 lakhs (B) Rs 24 lakhs  
(C) Rs 94 lakhs (D) None of the above

Q39. Fox Ltd. is developing a new production process. During the financial year ending 31<sup>st</sup> March 2019, the total expenditure incurred was Rs 50 lakhs. This process met the criteria for recognition as an intangible asset on 1<sup>st</sup> Nov 2018. Expenditure incurred this date was Rs 26 lakhs. Further expenditure on the same process for the financial year ending 31<sup>st</sup> March 2020 was Rs 70 lakhs. As on 31<sup>st</sup> March 2020, the recoverable amount of know how in the process is estimated to be Rs 75 lakhs. What amount to be charged to profit and loss account for the year ended 31<sup>st</sup> March 2020 and carrying value of intangible asset as on that date.

- (A) Nil and Rs 94 lakhs (B) Rs 94 lakhs and Nil  
(C) Rs 19 lakhs and Rs 75 lakhs (D) None of the above

Q40. X purchased business from Y on 30th June 2017. Profit earned by Y for the preceding years ending on 31<sup>st</sup> December every year were- 2014 Rs. 41,000, 2015 Rs. 40,000 and 2016 Rs. 42,000. It was ascertained that profits of 2015 included a non-recurring item of Rs. 1500 and profit of 2016 was reduced by Rs. 2000 due to an extraordinary loss on account of theft. The annual premium was Rs. 200 per annum. X at the time of purchasing the business, was employed with Rama Bros and was getting Rs. 500 p.m. he intends to replace the manager who at the present is getting Rs. 350 p.m. the goodwill is calculated at 2 years purchase of the average profits. Calculate the goodwill of the business.

- (A) Rs 80,000 (B) Rs 78,334  
(C) Rs 39,167 (D) None of the above

Q41. A Pharma Company spent Rs. 33 lakhs during the accounting year ended 31st March, 2016 on a research project to develop a drug to treat "AIDS". Experts are of the view that it may take four years to establish whether the drug will be effective or not and even if found effective it may take two to three more years to produce the medicine, which can be marketed. The company wants to treat the expenditure as deferred revenue expenditure.

- (A) Yes (B) No  
(C) Only for 10 Years (D) Only for 20 years

Q42. Average profit of a firm is Rs. 48,000. The rate of capitalization is 12%. Assets and liabilities of the firm are Rs. 4,00,000 and Rs. 1,70,000 respectively. Calculate goodwill by capitalisation of average method:

- (A) Rs 170,000 (B) Rs 150,000  
(C) Rs 130,000 (D) None of the above



Q43. A firm has a total capital investment of Rs. 2,25,000. The firm earned net profit during the last four years Rs. 35,000 , Rs. 40,000 , Rs. 60,000 , Rs. 50,000. The fair return on the net capital employed is 15%. Find out the value of goodwill if it is based on 3 years' purchase of the average super profits of past four years.

- (A) Rs 37,500  
(C) Rs 32,000

- (B) Rs 50,000  
(D) None of the above

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# ANSWERS

## Valuation of Goodwill

1. B	2. C	3. D	4. B
5. B	6. B	7. -	8. -
9. B	10. C	11. B	12. B
13. A	14. C	15. A	16. A
17. B	18. B	19. B	20. D
21. D	22. D	23. D	24. B
25. C	26. B	27. D	28. B
29. B	30. C	31. B	32. A
33. B	34. C	35. B	36. B
37. C	38. A	39. C	40. B
41. B	42. A	43. A	

## **CHAPTER – 10 | SHARE BASED PAYMENT (IND AS 102)**

Q-1 Which of the following section of the Companies Act, 2013 allows a company to offer shares to employees under a scheme of employees stock option?

- (A) Section 63
- (B) Section 65
- (C) Section 62
- (D) Section 66

Q-2 According to Section 62, a company can offer shares to employees under a scheme of employees stock option by passing

- (A) Ordinary resolution
- (B) Special resolution
- (B) Board resolution
- (D) Unanimous resolution

Q-3 With reference to Ind AS 102, what does SBP stands for?

- (A) Share based payment
- (B) Share based proportion
- (C) Sum based payment
- (D) Shareholder based pricing

Q-4 Which of the following Ind AS deals with share based payments?

- (A) Ind AS 101
- (B) Ind AS 102
- (C) Ind 103
- (D) Ind AS 104

Q-5 SAR stands for

- (A) Share Appreciation Rights
- (B) Share Ascending Rights
- (C) Securities Appreciation Response
- (D) None of the above

Q-6 As per Ind AS 102, share based payment can be:

- (A) Equity settled and Debentures Settled
- (B) Cash Settled and Equity Settled
- (C) Equity settled and Cash Settled
- (D) None of the above

Q-7 Ind AS 102 applies in case of

- (A) Share appreciation rights that entitle employees to cash payments calculated by reference to increase in market price of an entity's shares.
- (B) An external consultant may provide services in return for shares in the entity.
- (C) A supplier may provide goods in return for shares in the entity.
- (D) All of the above

Q-8 The date on which the Company and employees agree to the terms of an employee share-based payment plan is known as .....

- (A) Award date
- (B) Recognition date
- (C) Grant date
- (D) All of the above

Q-9 A Company has its share capital dividend into shares of Rs. 10 each. On 1<sup>st</sup> April 2010, it granted 20,000 employees stock options at Rs. 40, when the market price was Rs. 130. The options were to be exercised between 1<sup>st</sup> January 2011 to 15<sup>th</sup> March 2011. The employees exercised their options for 18,000 shares only, the remaining options lapsed. The company closes its books on 31<sup>st</sup> March every year. How much securities premium is to be credited at the time of issue of shares against options.

- (A) Rs. 22,00,000
- (B) Rs. 21,60,000
- (C) Rs. 19,20,000
- (D) Rs. 9,00,000

Q-10 A Company has its share capital dividend into shares of Rs. 10 each. On 1-4-2010, it granted 5,000 employees stock option at Rs. 50, when the market price was Rs. 140. The options were to be exercised between 1-12-2010 to 28-2-2011. The employees exercised their options for 4,800 shares only; remaining options lapse. The company closes its books of accounts on 31<sup>st</sup> March. How much employee compensation expense will be transferred to profit and Loss account?

- (A) Rs. 48,000  
(C) Rs. 4,32,000

- (B) Rs. 6,24,000  
(D) Rs. 2,40,000

Q-11 A Company has its share capital dividend into shares of Rs. 10 each. On 1<sup>st</sup> April 2014, it granted 5,000 shares as employees stock options at Rs. 40 per share, when the market price was 130 per share. The options were to be exercised between 16<sup>th</sup> December, 2014 and 15<sup>th</sup> March, 2015. The employees exercised their options for 4,500 shares only; the remaining options lapsed. The company closes its books on 31<sup>st</sup> March every year. How much share capital will credited at the time of allotment of shares?

- (A) Rs. 8,00,000  
(C) Rs. 4,05,000

- (B) Rs. 5,40,000  
(D) Rs. 1,80,000

Q-12 On 1<sup>st</sup> January, 2016, Tulip Ltd. Offered 100 shares of Rs. 10 each to each of its 500 employees at Rs. 30 per share. The employees were given time upto 31<sup>st</sup> March, 2016 to accept the offer. The shares issued under ESOP shall be subject to lock-in-period of two years from the grant date. Other details provided are as under:

- i. The market price of shares of the company on the grant date is Rs. 50 per share.
- ii. Due to post vesting restriction on transfer of shares, the fair market value of share is estimated at Rs. 40 per share.
- iii. On 31<sup>st</sup> March, 2016, 400 employees accepted the offer and paid Rs. 30 per share.

Employee compensation expense will be debited by

- (A) Rs. 8,00,000  
(C) Rs. 5,00,000

- (B) Rs. 10,00,000  
(D) Rs. 4,00,000

Q-13 X Ltd. granted 500 stock options to its employees on 1.4.2011 at Rs. 50 per share. The vesting period is 21/2 years and the maximum exercise period is one year. Market price on that date is rs. 140 per share. 50 options were lapsed on 1<sup>st</sup> May 2013. Remaining 450 options were exercised on 30.6.2014. Face value of equity share is Rs. 10 per share. Expense to be recognized in year 2011-12, 2012-13 and 2013-14.

- (A) Rs. 18,000; Rs. 18,000; Rs. 4,500  
(C) Rs. 9,000; Rs. 18,000; Rs. 18,000

- (B) Rs. 18,000; Rs. 9,000; Rs. 18,000  
(D) Rs. 18,000; Rs. 18,000; Rs. 9,000

Q-14 X Ltd. Granted 500 stock options on 1<sup>st</sup> April 2011 at Rs. 50 per share.

Vesting period = 2 ½; Face value of a share is Rs. 10.

Maximum exercise period – one year

Market price on 1<sup>st</sup> April 2011- Rs. 140

60 options were lapsed on 01<sup>st</sup> March 2013.

Remaining options were exercised on 30<sup>th</sup> June 2014.

How much expense to be recognized in 2011-12, 2012-13 and 2013-14?

- (A) Rs. 18,000; Rs. 18,000; Rs.3,600  
(C) Rs. 18,000; Rs. 3,600; Rs. 18,000

- (B) Rs. 18,000;Rs. 13,680; Rs. 7,920  
(D) None of the above

Q-15 X Ltd. granted 500 stock options on 1<sup>st</sup> April 2011 at Rs. 50 per share.

Vesting period = 2 ½; Face value of a share is Rs. 10.

Maximum exercise period – one year

Market price on 1<sup>st</sup> April 2011- Rs. 140

60 options were lapsed on 01<sup>st</sup> March 2013 and another 40 options lapsed on 1<sup>st</sup> May 2013.

Remaining 400 options were exercised on 30<sup>th</sup> June 2014.

How much expense to be recognized in 2011-12, 2012-13 and 2013-14?



- (A) Rs. 18,000; Rs. 18,000; Rs. 3,600  
(C) Rs. 18,000; Rs. 3,600; Rs. 18,000

- (B) Rs. 18,000; Rs. 13,680; Rs. 7,920  
(D) Rs. 18,000; Rs. 13,680; Rs. 4,320

Q-16 A Company grants 500 options on 1/4/1999 at Rs. 40 when the market price is Rs 160, the vesting period is two and a half years, the maximum exercise period is one year. Also suppose that 150 unvested options lapse on 1/5/2001. 350 options are exercised on 30/6/2002. How much amount be transferred to General reserve in the year ended on 31<sup>st</sup> march 2002.

- (A) Rs. 16,000  
(C) Rs. 8,000

- (B) Rs. 24,000  
(D) Rs. 6,000

Q-17 The concept of ESOP is believed to be the brain child of .....

- (A) Louis Kelso  
(C) Adam Smith

- (B) Narayan Murthy  
(D) None of the above

Q-18 Which of the following is an objective of issuing ESOP?

- (A) To provide an incentive to draw, retain and reward employees of the company;  
(B) To motivate employees to contribute to the growth and profitability of the company.  
(C) Both (A) and (B)  
(D) None of the above

Q-19 XYZ Ltd. grants 100 stock options to each of its 500 employees. The law governing the company requires approval of the board / shareholders on any such grant. The company communicates the award to employees first, followed by board's / shareholders approval. What is the grant date of ESOP?

- (A) Date of communication to employees  
(C) Either(A) or (B)

- (B) Board's/ shareholder approval date  
(D) None of the above

Q-20 XYZ Ltd. grants 100 stock options to each of its 500 employees . The law governing the company requires approval of the board/ shareholders on any such grant. Shareholder/ board's approval is obtained first , and later the award is communicated to the employees. What is the grant date of ESOP?

- (A) Date of communication to employees  
(C) Either(A) or (B)

- (B) Board's/ shareholder approval date  
(D) None of the above

Q-21 XYZ Ltd. grants 100 stock options to each of its 500 employees . The law governing the company requires approval of the board/ shareholders on any such grant. The award is communicated to the individual employees, but when it goes to the shareholders/board for approval, the shareholders/board change the original award from how it was initially communicated to employees. The entity then communicates the new terms to employees.

- (A) Date of original communication to the employees  
(B) Board's/shareholder approval date  
(C) Date of subsequent communications to employees  
(D) None of the above

# ANSWERS

## Share based Payment

1. C	2. B	3. A	4. B
5. A	6. C	7. D	8. C
9. B	10. C	11. A	12. D
13. A	14. B	15. D	16. D
17. A	18. C	19. B	20. A
21. C			

# **CHAPTER – 11 | INTRODUCTION TO FINANCIAL ACCOUNTING**

- **Meaning of Accounting:**

“Accounting is the systematic process of recording, classifying and summarising of all the business transactions and events, which are of financial character, also includes analysing & interpreting and communicating the results to the users of accounting.”

- **Process/ Phases/Steps of Accounting**

## **IDENTIFICATION**

Firstly need to identify those business transaction and events which are of a financial character i.e. can be measured and expressed in terms of Money.



## **RECORDING**

Under this step, all the financial transactions and events are recorded in the books of Accounts through "**Journal**" or "**Subsidiary Books**".



## **CLASIFYING**

After recording , all the transactions are classified i.e. making groups of similar nature transactions. Classification is performed through "**Ledger Book**"



## **SUMMARISING**

After classifying, all classified groups are summarised to ascertain financial performance and financial position of Business through

- Trial Balance
- Profit & Loss Account
- Balance Sheet



### **ANALYSING & INTERPRETING**

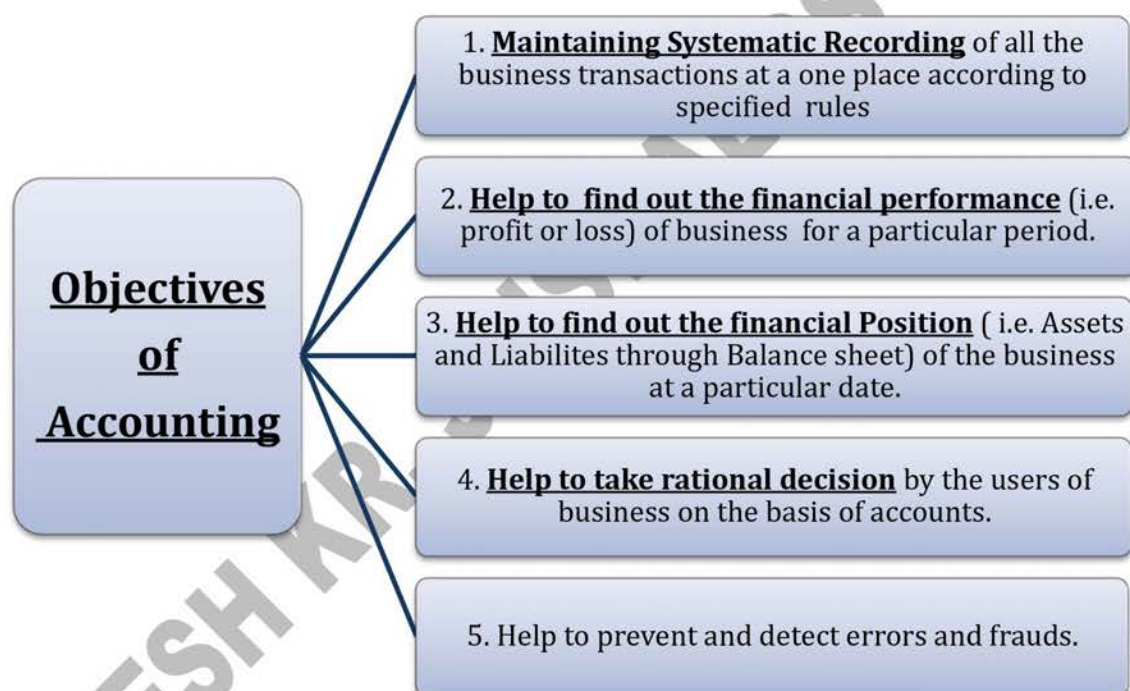
Under this step, financial result and position of business is presented in such manner that users of accounting can have all information about Business.



### **COMMUNICATING**

Under this step, financial results are communicated to users who analyse them as per their requirement.

### **Objectives of Accounting**

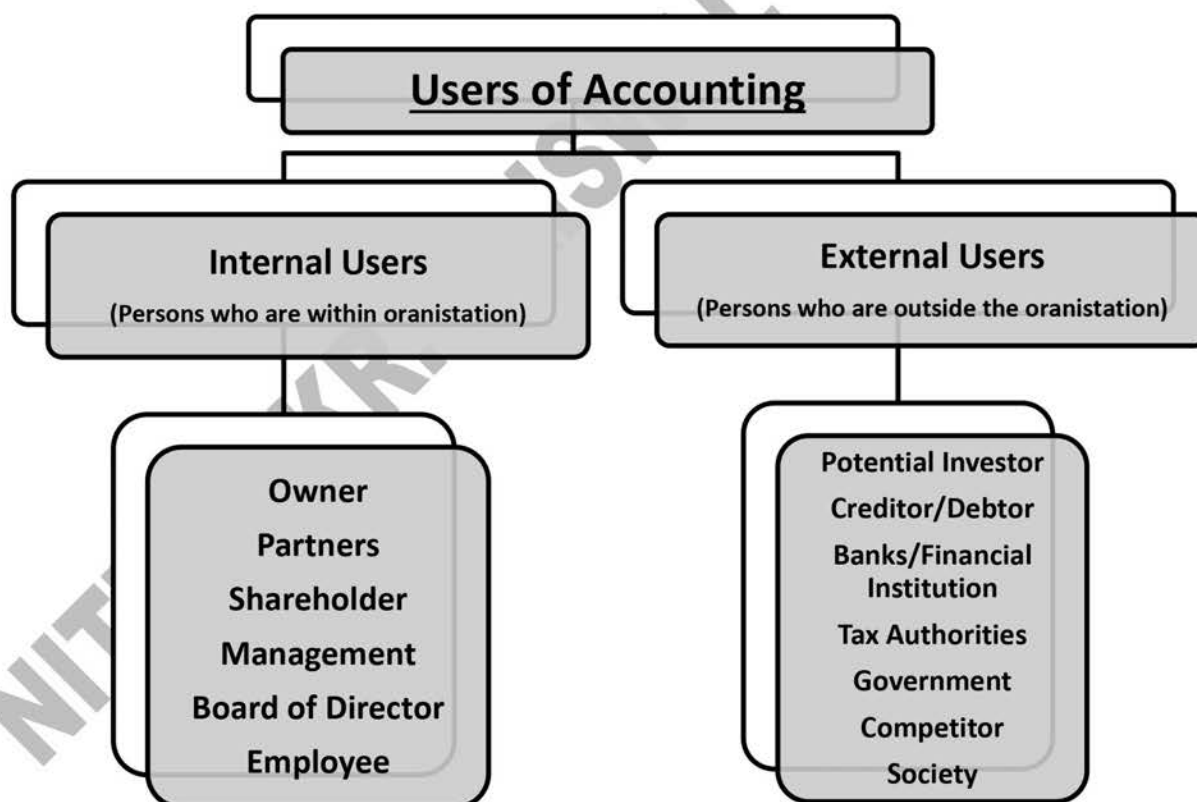


### **Book Keeping**

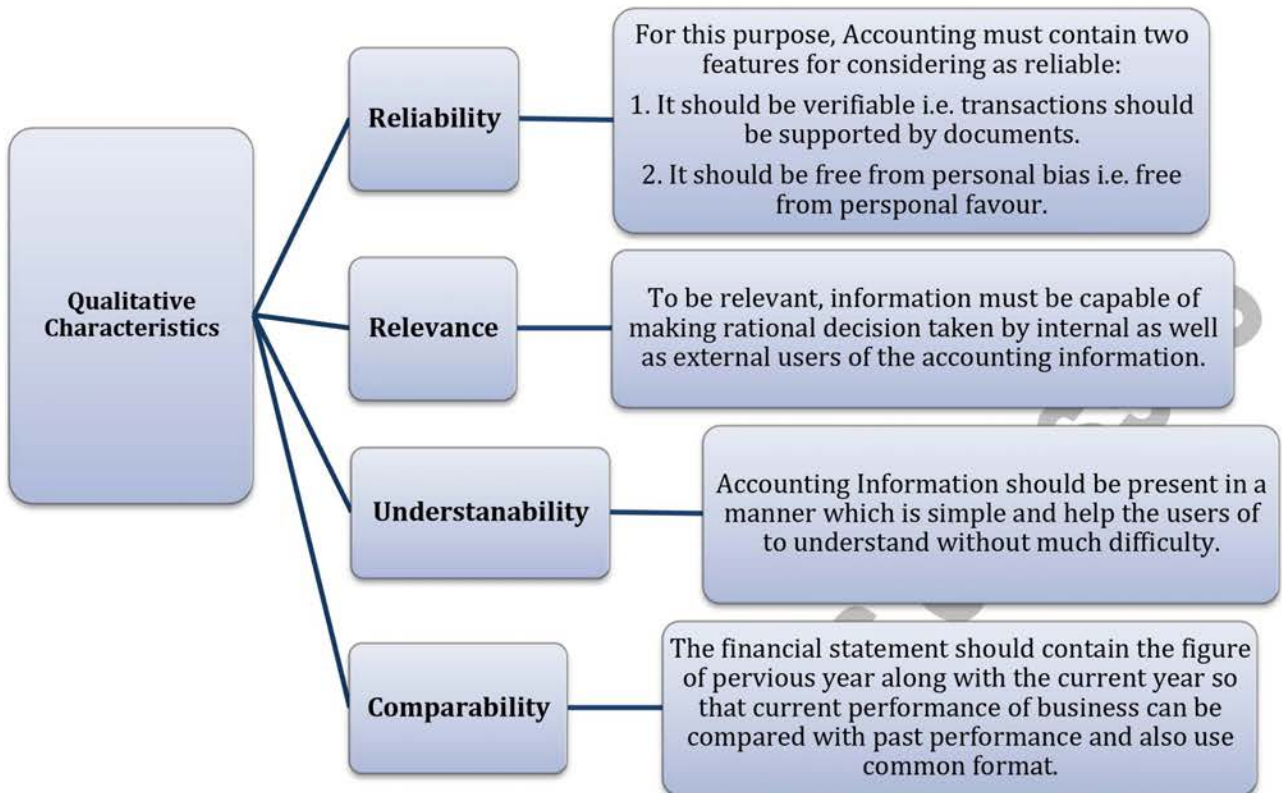
- ✓ Book-keeping is an activity concerned with recording and classifying financial data related to business operation in order of its occurrence.
- ✓ Book-keeping is a mechanical task which involving:
  - Collection of basic financial information
  - Identification of events and transactions with financial character
  - Measurement of economic transactions in terms of money
  - Recording of financial effects of economic transactions in order of its occurrence
  - Classifying effects of economic transactions

<b>Basis of Difference</b>	<b>Book Keeping</b>	<b>Accounting</b>
<b>1. Scope</b>	It includes identification, recording and classifying the transactions.	It include in addition to Book-keeping, summarising, analysing, interpreting and communicating activities.
<b>2. Stage</b>	Primary Stage	Secondary Stage
<b>3. Nature of Job</b>	Routine and Clerical	Analytical & Professional
<b>4. Who performs</b>	Junior Staff	Senior staff
<b>5. Objective</b>	To maintain systematic records of business transactions.	To ascertain financial performance and position of business.
<b>6. Users</b>	Only the Internal users use book keeping.	Both Internal & External users use accounting.

### **Users of Accounting:**



## Qualitative Characteristics of Accounting





## **BASIC ACCOUNTING TERMS**

### **1. Asset:**

- ✓ Asset is a resource owned by a business with the purpose of using it for generating future profits.
- ✓ Assets can be Tangible and Intangible.
- ✓ Tangible Assets are the Capital assets which have some physical existence. They can, therefore, be seen, touched and felt, e.g., plant and machinery, furniture and fittings, land and buildings, books, computers and vehicles.
- ✓ The capital assets which have no physical existence and whose value is limited by the rights and anticipated benefits that possession confers upon the owner are known as Intangible Assets. They cannot be seen or felt although they help to generate revenue in future, e.g., goodwill, patents, trade-marks, copyrights, brand equity, designs
- ✓ and intellectual property, etc.

Assets can also be classified as Current Assets and Non-Current Assets.

**Current Assets** – An asset can be classified as Current if it satisfies any of the following:

- (a) It is expected to be realized 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 due to be realized within 12 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 12 months after the Reporting Date.

**Non-Current Assets** – All other Assets is classified as Non-Current Assets, e.g., Machinery held for long term, etc.

### **2. Liability:**

It is an obligation of financial nature to be settled at a future date. It represents amount of money that the business owes to the other parties.

Liabilities could be further classified into long term or non-current liabilities, and short term or current liabilities.

**Current Liabilities** – A liability is classified as Current when it satisfies any of the following:

- (a) It is expected to be settled in the company's normal Operating Cycle;
- (b) It is held primarily for the purpose of being traded;
- (c) It is due to be settled within 12 months after the Reporting Date; or
- (d) The company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date (Terms of a Liability that, at the option of the counterparty, result in their settlement by the issue of Equity Instruments which do not affect its classification).

**Non-Current Liabilities** – All other liabilities shall be classified as Non-Current Liabilities. For example loan taken for 5 years, Debentures issued etc.

• **Internal Liability:** These represent proprietor's equity, i.e., all those amount which are entitled to the proprietor, like Capital, Reserves and Undistributed Profits

### **3. Contingent Liability:**

- ✓ It represents a potential obligation that could be created depending on the outcome of an event.
- ✓ For example if a supplier of a business files a legal suit, it will not be treated as a liability because no obligation is created immediately. If the verdict of the case is given in favour of the supplier then only the obligation is created. Till that it is treated as a contingent liability.
- ✓ Please note that contingent liability is not recorded in books of account, but disclosed a note through in the financial statements.

### **4. Capital:**

- ✓ Capital is the amount invested in a business by its owners. It may be in the form of cash, goods, or any other asset which the proprietor or partners of business invest in the business activities.
- ✓ From business point of view, capital of owners is a liability which is to be settled only in the event of closure or transfer of the business.
- ✓ Hence, it is not classified as a normal liability.
- ✓ For corporate bodies, capital is normally represented as share capital.

### **5. Drawings:**

- ✓ It represents the amount of cash, goods or any other assets which the owner withdraws from business for his or her personal use, e.g., when in the life insurance premium of the proprietor or a partner of the business is paid from the business cash, it is called drawings.
- ✓ Drawings will result in a reduction in the owners' capital. The concept of drawing is not applicable to the corporate bodies like limited companies.

### **6. Net worth:**

- ✓ It represents the excess of total assets over total liabilities of a business.
- ✓ Technically, this amount is made available to be distributed to the owners in the event of closure of the business after payment of all liabilities.
- ✓ That is why it is also termed as Owner's Equity

### **7. Non-Current Investments:**

- ✓ Non-Current Investments are investments which are held beyond the current period for sale or disposal, like a Fixed Deposit for 5 years.

### **8. Current Investments:**

- ✓ Current investments are investments that are by their nature readily realizable and are intended to be held for not more than one year from the date on which such investment is made.
- ✓ 11 months Commercial Paper is an example of it.

### **9. Debtor:**

- ✓ The sum total or aggregate of the amounts which the customer owes to the business for the purchase of goods on credit or services rendered or in respect of other contractual obligations, is known as Sundry Debtors or Trade Debtors, or Trade Receivable, or Book-Debts or Debtors.

These debtors may again be classified as under:

- (a) **Good Debts:** The debts which are sure to be realized are called good debts.
- (b) **Doubtful Debts:** The debts which may or may not be realized are called doubtful debts.
- (c) **Bad Debts:** The debts which cannot be realized at all are called bad debts.



### **10. Fictitious Assets :**

- ✓ Fictitious assets are not assets at all since they are not represented by any tangible possession. They appear on the asset side simply because of a debit balance in a particular account not yet written off, e.g., provision for discount to creditors, discount on issue of shares, etc.

### **11. Wasting Assets:**

- ✓ Such assets as mines, quarries, etc., that become exhausted or reduce in value by their working are called wasting assets.

### **12. Capital Expenditure:**

- ✓ This represents expenditure incurred for the purpose of acquiring a fixed asset which is intended to be used over long term for earning profits there from, e.g., amount paid to buy a computer for office use is a capital expenditure.
- ✓ At times expenditure may be incurred for enhancing the production capacity of the machine. This will also be a capital expenditure.
- ✓ Capital expenditure forms a part of the Balance Sheet.

### **13. Revenue Expenditure:**

- ✓ This represents expenditure incurred to earn revenue of the current period.
- ✓ The benefits of revenue expenses get exhausted in the year of the incurrence. For example repairs, insurance, salary and wages to employees, travel, etc.
- ✓ The revenue expenditure results in the reduction in profit or surplus.
- ✓ It forms become part of the Income statement.



### **Double Entry System**

- ✓ It was in 1494 that Luca Pacioli, the Italian mathematician, first published his comprehensive treatise on the principles of Double Entry System.
- ✓ The use of principles of double entry system made it possible to record not only cash but also all sorts of mercantile(i.e. credit) transactions.

### **Features of Double Entry System**

- (a) Every transaction has twofold aspects, i.e., one party giving the benefit and the other receiving the benefit.
- (b) Every transaction is divided into two aspects, debit and credit. One account is to be debited and the other account is to be credited.
- (c) Every debit must have its corresponding and equal credit.

## **THE CONCEPTS OF 'ACCOUNT', 'DEBIT' AND 'CREDIT'**



### **The Concept of Account**

- (a) An account is defined as a summarized record of transactions related to a person or a thing, e.g., when the business deals with customers and suppliers, the customer and supplier will each be a separate account.

- (b) Typically, an account is expressed as a statement in form of English letter 'T'. It has two sides. The left hand side is called as the Debit side, and the right hand side is called as the Credit side. The debit is denoted as 'Dr' and the credit as 'Cr'.

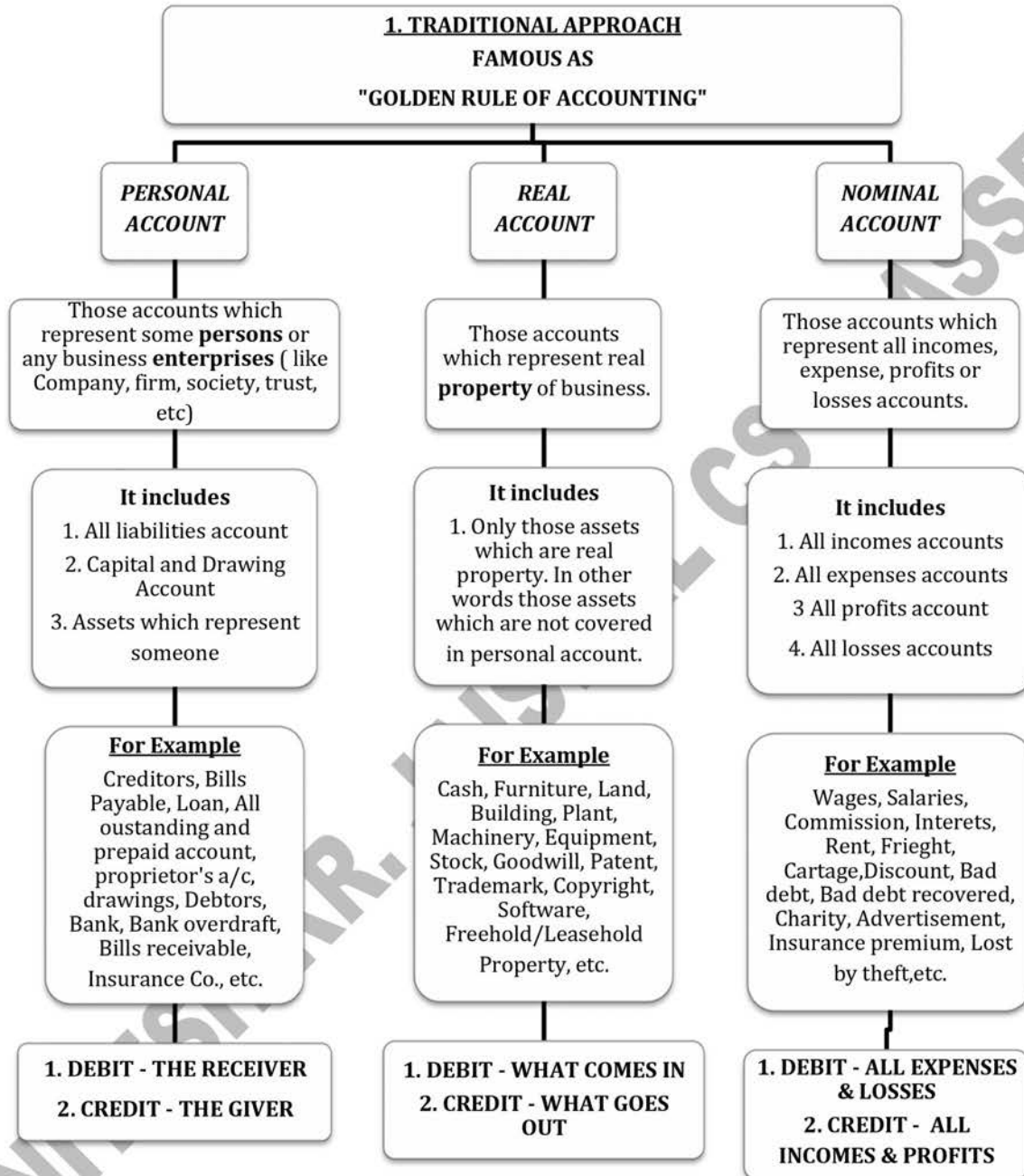




## **Rules of Debit and Credit**

Such rules can be understood with the help of following two approach:

- 1) **Traditional Approach** ( Also known as *British Approach*)
- 2) **Modern Approach** (Also known as *American Approach*)





## **ACCOUNTING PRINCIPLES AND CONCEPTS**

A generally accepted set of rules have been developed and these rules provide guidelines for preparing the accounting statements. Such rules are commonly known as Generally Accepted Accounting Principles (GAAPs). These can be classified mainly into two categories:

### **✚ Accounting Concepts or Assumptions:**

#### **I. Fundamental Accounting Assumptions as per AS-1**

- 1) Going Concern Concept
- 2) Consistency Concept
- 3) Accrual Concept

#### **II. Other Accounting Assumption**

- 4) Business Entity Concept
- 5) Money Measurement Concept
- 6) Cost Concept
- 7) Accounting Period Concept
- 8) Dual Aspect Concept
- 9) Revenue Recognition Concept
- 10) Matching Concept

### **✚ Accounting Conventions**

- 1) Convention of Full Disclosure
- 2) Convention of Materiality
- 3) Convention of Conservatism/Prudence

#### **1) Business Entity Concept:**

- ✓ According to this concept, Business is treated as separate and distinct person from its owner.
- ✓ For legal purposes, a Business entity and its owner are considered to be same, but for accounting purposes they are considered to be two separate entities.
- ✓ Accounting records are made in the books of account from the point of view of business, not the owner.

**Example:** Capital and Drawings accounts are created in the books of accounts as per business entity concept.

#### **2) Money Measurement Concept:**

- ✓ According to this concept, only those business transactions and events are recorded which can be measured or expressed in terms of money.



- ✓ They must be expressed in a common unit of measurement i.e. money.
- ✓ An event, even though it may be very important for the business, will not be recorded in the books of accounts unless it can be expressed or measured in terms of money.

**Example:**

- Does not report strike of labours, Quality of product and management.
- Appointment of an employee of an employee

3) **Accounting Period/Periodicity Concept:**

- ✓ This is also called the concept of definite accounting period.
- ✓ According to this concept, the entire life of the business entity is divided into equal time interval to know financial performance and position of business at regular interval.
- ✓ 12 months period generally adopted for this purpose (In India we follow from 1<sup>st</sup> April to 31<sup>st</sup> March).

4) **Going Concern Concept:**

- ✓ According to this concept, it is assumed that business shall continue for a foreseeable period.
- ✓ It is also assumed that business has neither intention to close the business nor to cut down the business operation significantly.

**Example:**

- The assets & liabilities are classified into Current and Non Current as per going concern concept.

5) **Cost or Historical Cost Concept:**

- ✓ According to this concept, an asset are recorded in the books of accounts at the acquisition price (also known as Original Cost), which includes purchase price, installation, transportation cost and any other expense incurred to make asset ready for use.
- ✓ Hence, Assets are shown in the balance sheet at cost less depreciation.

**Example:**

- A Land purchased for Rs 20 Lacs, after 2 year market value of land increased to Rs 50 Lacs, but Increased value of Land (i.e. Rs 50 lacs) not shown in the books of accounts whereas Land continue to be Rs 20 lacs (i.e. Original cost) as per cost concept.

6) **Dual Aspect Concept:**

- ✓ It is the core of double entry book-keeping system.
- ✓ According to this concept, every transaction has at least two aspects in preparation of books of accounts (i.e. rule of debit and credit).
- ✓ If one account is debited, any other account must be credited.
- ✓ The system of recording transactions based on this principle is called as "Double Entry System".

$$\text{Assets} - \text{Liabilities} = \text{Capital}$$

7) **Consistency:**

- ✓ According to this concept, accounting principles and method should once selected and then follow consistently from one year to another for better comparability of financial performance and position of Business.
- ✓ However, changes can be made in an exceptional case (i.e. required by any law, accounting standard or better presentation).



**Example:**

- Follow Straight Line Method or Written Down Value Method for Depreciation consistently.

**8) Revenue Recognition/ Realisation Concept:**

- ✓ Revenue is earned by sale of goods or by providing a service.
- ✓ According to this concept, revenue is considered to be realised when a transaction has been entered and the right to receive the amount has been established.
- ✓ Revenue is recognized irrespective of cash received or not.

**Example:**

- Goods sold in March 2017 and amount received in April 2017, then revenue is recognised in 2016-17 not 2017-18.
- Credit sales are recorded as revenue at the time of sales are made, not when cash is received from buyer.

**9) Accrual Concept:**

- ✓ According to this concept, a transaction is recorded in the books of account at the time when it is entered into and not when the cash received or paid.
- ✓ In other words, all the incomes and expenses are recorded in the year in which they relates whether cash is received/paid or not.

**Example:**

- Advance received for income is not shown as income
- Salary Outstanding is recorded as expense as per Accrual Concept.

**10) Matching Concept:**

- ✓ According to this concept, to ascertain the correct amount of profit/loss for the business, all expenses should be matched with revenues for the same period.
- ✓ Firstly, revenue should be recorded and then expense incurred for generating such revenue should be recorded.

**Example:**

- Sales commission expense should be reported in the period when the sales were made (and not reported in the period when the commissions were paid).

**11) Convention of Conservatism/Prudence:**

- ✓ According to this, all the anticipated losses should be recorded in books of accounts whereas all the anticipated income should be ignored.
- ✓ It is policy of playing safe.
- ✓ Provision is made for all known liability and losses even amount cannot be ascertained.

**Example:**

- Closing Stock should be valued at lower of cost or Market Value.
- Making provision for Doubtful debts and Discount on debtors
- No provision for discount on creditor is created due to this concept.

**12) Convention of Full disclosure:**

- ✓ According to this convention, all the significant information relating to the business entity should be completely recorded in the financial statement.
- ✓ In other words, there should be sufficient disclosure of all the information for the users of accounting such as proprietor, creditor, etc.

**Example:**

- Reason of low turnover should be disclosed.

- Information about Pending case against business

### 13) **Convention of Materiality:**

- ✓ According to this convention, if the effect of any item should be treated as material if it would influence the decision of an investor.
- ✓ Thus, whether an item is material or not will depend on its nature and amount.
- ✓ It is an exception of full disclosure concept.

#### **Example:**

- Accounting for small items like calculators, books, stationery etc., are treated as expense and not an asset as per Materiality concept.

### **JOURNAL**

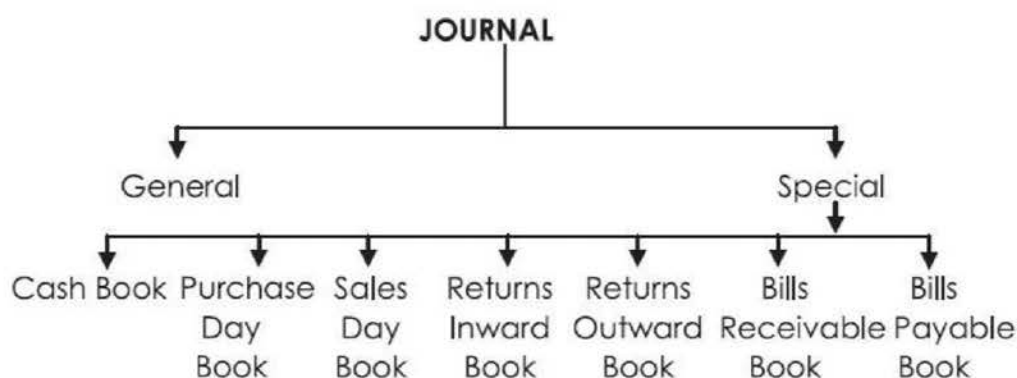
- ✓ Not possible to remember each and every business transactions by the businessman, hence better to record such transactions at one place.
- ✓ So for recording all business transactions in a systematic manner at one place, we prepare "Journal".
- ✓ Journal is also known as "**Books of Original entry or Prime Entry**" because transactions are first of all recorded in the Journal.
- ✓ All the business transactions are recorded in Journal in Chronological order i.e. date wise.
- ✓ Process of recoding transactions in a Journal is known as "**Journalising**".

#### • **Format of Journal**

Date	Particular	Ledger Folio	Amount (Debit)	Amount (Credit)

### **Sub-division of Journals**

Journal is divided into two types -(i) General Journal and (ii) Special Journal.





## **Compound Journal**

- ✓ If for a single transaction, only one account is debited and one account is credited, it is known as **simple journal**.
- ✓ If the transaction requires more than one account to be debited or more than one account to be credited, it is known as **Compound Journal**.

## **SUBSIDIARY BOOKS**

- ✓ Subsidiary Books refers to books meant for specific transactions of similar nature.
- ✓ They Books are also known as Special journals or day books.
- ✓ To overcome shortcoming of the use of the journal only as a book of original entry, the journal is subdivided into specific journals or subsidiary books.
- ✓ All the cash and bank related transactions are recorded in the **Cash Book**, whereas all non cash transactions are recorded in "Other Subsidiary Book".
- ✓ Other Subsidiary books are as follows:
  - 1) **Purchase Book**: This book is used to record all the transactions related to credit purchase of goods.
  - 2) **Sales Book**: This book is used to record all the transactions related to credit sale of goods.
  - 3) **Purchase Return Book**: This book is used to record all the transactions related to return of goods which were purchased on credit. This is also known as Return Outward Book. Entries are made in this book on the basis of Debit Note.
  - 4) **Sales Return Book**: This book is used to record all the transactions related to return of goods which were sold goods to customer on credit. This is also known as Return Inward Book. Entries are made in this book on the basis of Credit Note.
  - 5) **Bills Receivable Book**
  - 6) **Bills Payable Book**
  - 7) **Journal Proper**: All the remaining transactions are recorded here. For Example: Purchase of asset on credit, bad debt, outstanding expense and income, etc.

## **Cash Book**

- ✓ A Cash Book is a special journal which is used for recording all cash receipts and cash payments.
- ✓ Cash Book is a book of original entry since transactions are recorded for the first time from the source documents.
- ✓ The Cash Book is larger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side.
- ✓ **Thus, the Cash Book is both a journal and a ledger.**

## **Types of Cash Book**

There are different types of Cash Book as follows :

### **1. Single Column Cash Book**

- ✓ Single Column Cash book has one amount column on each side.
- ✓ All cash receipts are recorded on the debit side and all cash payments on the payment side; this book is nothing but a Cash Account and there is no need to open separate cash account in the ledger.

### **2. Double Column Cash Book**

- ✓ The Double Column Cash Book has two amounts. Columns on each side are as under:



- Cash and discount columns
- Cash and bank columns
- Bank and discount columns

### **3. Triple Column Cash Book**

- ✓ Triple Column Cash Book has three amount columns, one for cash, one for bank and one for discount on each side.
- ✓ All cash receipts, deposits into book and discounts allowed are recorded on the debit side and all cash payments, withdrawals from bank and discounts received are recorded on the credit side. In fact, a triple-column cash book serves the purpose of both Cash Account and Bank Account.
- ✓ Thus, there is no need to create these two accounts in the ledger.

### **4. The multicolumn cash book**

- ✓ has multiple columns on both the sides of the cash book.

### **5. The petty cash book.**

## **LEDGER**

- ✓ After recording of all the business transactions in the Journal or Subsidiary Book, all the recorded transactions are classified i.e. making groups of similar nature of transactions.
- ✓ Classification process is done through "Ledger".
- ✓ Ledger is the Principle Book of Account which contains all accounts of business enterprise whether Real, Nominal or Personal
- ✓ The ledger is also called the Principal Book. As a result, all the necessary information relating to any account is available from the ledger.
- ✓ This is the most important book of the business and hence is rightly called the "King of All Books". Also Known as Book of Final Entry.

Format of Ledger:

Dr.				Cr.			
Date	Particular	Journal Folio	Amount	Date	Particular	Journal Folio	Amount

### **Rules of Posting in the ledger**

#### **General Rules**

- ✓ Every ledger account is prepared in form of "T" Share i.e. divided into two equal parts.
- ✓ Left hand side of ledger is classified as Debit Side and Right hand side is classified as Credit Side.
- ✓ The word "To" is used before the accounts which appears on the Debit side of ledger account. Similarly, the words "By" is used before the accounts which appears on the Credit side of ledger account
- ✓ It is not necessary to write the word "A/c" after the personal account.

- **Specific Rules for Ledger**

**1) Posting of Opening Balance**

- ✓ All the assets account will be debited as per rules of debit and credit in an opening entry, an account for each asset will be opened in the Ledger and posting will be made on the debit side by writing the words "To Balance b/d".
- ✓ All the liabilities and capital account will be credited as per rules of debit and credit in an opening entry, an account for each asset will be opened in the Ledger and posting will be made on the credit side by writing the words "By Balance b/d".

**2) Posting from Journal Entries in the Ledger**

- ✓ If an account has been debited in the Journal entry, the posting in the ledger should also be made on the debit side of such account. But in the particular column, the name of other account (which has been credited in the Journal) should be appeared.
- ✓ If an account has been credited in the Journal entry, the posting in the ledger should also be made on the credit side of such account. But in the particular column, the name of other account (which has been debited in the Journal) should be appeared.

**3) Posting from Cash Book in the Ledger**

- ✓ Cash Book is treated as subsidiary book as well as principle book.
- ✓ Hence whenever cash book is maintained, there is no need to prepare cash account in the Ledger. Also if we maintained Double column cash book (i.e. cash and bank column), then there is no need to prepare cash account as well as bank account in the ledger.
- ✓ Opening and closing balance of cash book is not entered in the ledger anywhere.

**4) Posting from Purchase Book in the Ledger**

- ✓ Purchase Book is totaled and the total of purchase column will be posted to the debit side of the purchase account by writing the words "To sundries as per Purchase Book".
- ✓ Supplier account from which goods have been purchased on credit will be credited by writing the words "By Purchase A/c".

**5) Posting from Sales Book in the Ledger**

- ✓ Sales Book is totaled and the total of sales column will be posted to the credit side of the sales account by writing the words "By sundries as per sales Book".
- ✓ Customer account to which goods have been sold on credit will be debited by writing the words "To sales A/c".

**6) Posting from Purchase Return Book in the Ledger**

- ✓ Purchase return Book is totaled and the total of purchase return column will be posted to the credit side of the purchase return account by writing the words "By sundries as per Purchase Return Book".



- ✓ Supplier account to which goods have been returned will be debited by writing the words "To Purchase Return A/c".

#### 7) Posting from Sales Return Book in the Ledger

- ✓ Sales Return Book is totaled and the total of sales return column will be posted to the debit side of the sales return account by writing the words "To sundries as per Sales return Book".
- ✓ Customer account by which goods are returned will be credited by writing the words "By sales return A/c".

#### 8) Closing and Balancing of Accounts

- ✓ Balancing of account here means that the debit and credit sides are totaled and difference between two sides is inserted on the shorter balancing side so as to make their total equal.
- ✓ If the debit side exceeds the credit side, balance is known as debit balance.
- ✓ If the credit side exceeds the debit side, balance is known as credit balance.
- ✓ The words "Balance c/d" i.e. balance carried down written in place of difference.
- ✓ Nominal Accounts balance are transferred to Trading and Profit and Loss A/c at the end of accounting year.

### TRIAL BALANCE

- ✓ After classification, all the ledgers are summarised to ascertain the financial performance and financial position of business.
- ✓ At first step of summarising, we need to prepare "**Trial Balance**".
- ✓ **Trial Balance** is a statement in which balances of all the ledger accounts and the cash book are taken to verify the accuracy of posting.
- ✓ Accounts showing debit balances are put on the debit side of the trial Balance and the accounts showing credit balance are put on the credit side of the trial Balance.
- ✓ If the total of debit side and credit side of trial balance is **equal**, then it is presumed that posting to the ledger is accurate i.e. **arithmetically correct**.

#### • Objectives / Need/ Function /Advantages of Trail Balance

- 1) To ascertain the arithmetically accuracy of the Ledger posting.
- 2) To help in locating errors.
- 3) To obtain a summary of the ledger account.
- 4) To help in the preparation of final account.

#### • Format of Trail Balance

Name of Account	Ledger Folio	Debit Balance (Rs.)	Credit Balance (Rs.)



## **Method of Preparation**

- (a) Total Method or Gross Trial Balance.
- (b) Balance Method or Net Trial Balance.
- (c) Compound Method.

### **(a) Total Method or Gross Trial Balance :**

- ✓ Under this method, two sides of the accounts are totaled. The total of the debit side is called the "debit total", and the total of the credit side is called the "credit total".
- ✓ Debit totals are entered on the debit side of the trial balance while the credit total is entered on the credit side of the trial balance.
- ✓ If a particular account has total in one side, it will be entered either in the debit column or the credit column as the case may be.

#### **Advantages:**

- (a) It facilitates arithmetical accuracy of the accounts.
- (b) Extraction of ledger balances is not required at the time of preparation of trial balance.

**Disadvantages:** Preparation of final accounts is not possible.

### **(b) Balance Method or Net Trial Balance:**

- ✓ Under this method, all the ledger accounts are balanced. The balances may be either "debit-balance" or "credit balance".

#### **Advantages:**

- (a) It helps in the easy preparation of final accounts.
- (b) It saves time and labour in preparing a trial balance.

**Disadvantages:** Errors may remain undisclosed irrespective of the agreement of trial balance.

### **(c) Compound Method:**

- ✓ Under this method, totals of both the sides of the accounts are written in the separate columns. Along with this, the balances are also written in the separate columns.
- ✓ Debit balances are written in the debit column and credit balances are written in the credit column of the trial balance.

**Advantages:** It offers the advantage of both the methods.

**Disadvantages:** It is a lengthy process and more time is consumed in the preparation of a trial balance.

## **MCQ FOR PRACTICE**

Q1. "Debit the Receiver and Credit the giver" is the golden rule for which type of account?

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q2. "Debit what comes in and Credit what goes out" is the golden rule for which type of account?

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q3. "Debit all expenses and losses, credit all incomes and profits" is the golden rule for which type of account?

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q4. The two approaches for deciding an account to be debited or credited are:

- (A) American and British Approach
- (B) American and European Approach
- (C) American and Indian Approach
- (D) None of these

Q5. Share allotment Account is a:

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q6. Share application Account is a:

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q7. Capital is a:

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q8. Trade Receivable is a:

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q9. Plant and Machinery is a:

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q10. Bank is a:

- (A) Real Account
- (B) Personal Account
- (C) Nominal Account
- (D) None of these

Q11. Bank Overdraft:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

Q12. Patent and Trademark is a:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

Q13. Wages account is an example of:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

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Q14. Bad Debt is a:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

Q15. Bad Debt recovered:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

Q16. Salary Outstanding is a:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

Q17. Prepaid Rent is a:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

Q18. Accrued Interest is a:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

Q19. Unearned Commission is a:

- (A) Real Account
- (C) Nominal Account

- (B) Personal Account
- (D) None of these

Q20. Which of the following is correct:

- (A)  $\text{Asset} = \text{Liability} - \text{Capital}$
- (B)  $\text{Liabilities} = \text{Asset} + \text{Capital}$
- (C)  $\text{Liabilities} = \text{Capital} - \text{Asset}$
- (D)  $\text{Liabilities} = \text{Asset} - \text{Capital}$

Q21. Journal is known as:

- (A) Original Book
- (C) Both of (A) and (B)

- (B) Primary Book
- (D) None of these



Q22. The process of recording transaction in a journal is called:

- (A) Journalization.
- (B) Ledger Posting
- (C) Both of the above
- (D) None of the above

Q23. If for a single transaction, only one account is debited and one account is credited, it is known as

- (A) Compound journal
- (B) simple journal
- (C) Contra Journal
- (D) None of the above

Q24. If the transaction requires more than one account to be debited or more than one account to be credited, it is known as:

- (A) Compound journal
- (B) simple journal
- (C) Contra Journal
- (D) None of the above

Q25. Journal is divided into two types:

- (A) General Journal and Modern journal
- (B) General Journal and Special Journal
- (C) Ordinary Journal and Special Journal
- (D) None of the above

Q26. Special Journal is also known:

- (A) General Journal
- (B) Subsidiary Journal
- (C) Original Journal
- (D) None of these

Q27. Sales Book is an example of:

- (A) General Journal
- (B) Special Journal
- (C) Ledger
- (D) Financial Statement

Q28. Return Inward Book is an example of:

- (A) General Journal
- (B) Special Journal
- (C) Ledger
- (D) Financial Statement

Q29. Cash Book is an example of:

- (A) General Journal
- (B) Special Journal
- (C) Ledger
- (D) Financial Statement

Q30. Cash book is:

- (A) Subsidiary Book
- (B) Ledger
- (C) Both of the above
- (D) None of the above

Q31. Balance of Petty Cash Book is an:

- (A) Income
- (B) Expense
- (C) Asset
- (D) Liability

Q32. In petty cash book, the system followed:

- (A) Accrual System
- (B) Cash System
- (C) Imprest System
- (D) None of these

Q33. Ledger Book is also known as:

- (A) Original Book
- (B) Subsidiary Book
- (C) Principal Book
- (D) None of the above

Q34. Ledger Book is also known as:

- (A) Kings of all book
- (B) Book of final entry
- (C) Principal Book
- (D) All of the above

Q35. The "balances of the nominal accounts" is closed by transferring to

- (A) Balance sheet
- (B) Trading and Profit & Loss Account
- (C) Trial Balance
- (D) None of the above

Q36. Trial Balance is a:

- (A) Account
- (B) Statement
- (C) Summary
- (D) Ledger

Q37. \_\_\_\_\_ is prepared to ascertain the arithmetical accuracy of posting and balancing.

- (A) Cash Book
- (B) Trial Balance
- (C) Balance Sheet
- (D) Bank reconciliation Statement

Q38. The convention that states that the accounting practice should be followed consistently over the years:

- (A) Consistency
- (B) Conservatism
- (C) Materiality
- (D) Disclosure

Q39. Recording of fixed assets at cost ensures adherences of:

- (A) Consistency Concept
- (B) Conservatism Concept
- (C) Materiality Concept
- (D) Cost Concept

Q40. Human Resources will not appear in the balance sheet according to \_\_\_\_\_ concept:

- (A) Money Measurement Concept
- (B) Going Concern Concept
- (C) Materiality Concept
- (D) Cost Concept

Q41. Which accounting concept treats a business separately from its owner:

- (A) Going Concern Concept
- (B) Accounting Entity Concept
- (C) Money Measurement Concept
- (D) Accounting Period Concept

Q42. Which accounting concept state that Closing stock should be valued at cost or market value, whichever is lower:

- (A) Going Concern Concept
- (B) Accounting Entity Concept
- (C) Money Measurement Concept
- (D) Conservatism Concept

Q43. Assets are held short period are called:

- (A) Fixed Asset
- (B) Current Asset
- (C) Contingent Liabilities
- (D) None of the above

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Q44. The following is not an advantages of Double entry System:

- (A) It prevents and minimizes frauds
- (B) The trial Balances prepared doesn't disclose certain type of error
- (C) It helps in decision making
- (D) Easy for government to calculate tax

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Q45. "Substance of any transaction should be considered while recording them & not only the legal form," is the statement which holds true for:

- (A) Disclosure of accounting policies
- (B) Substance over form
- (C) Both of the above
- (D) None of the above

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Q46. \_\_\_\_\_ is an activity concerned with recording and classifying financial data related to business operation in order of its occurrence.

- (A) Book keeping
- (B) Budgeting
- (C) Costing
- (D) Management Accounting

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Q47. A person who owes money to the business is a \_\_\_\_\_.

- (A) Debtor
- (B) creditor
- (C) Investor
- (D) Promoters

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Q48. The amount set apart from profit for future is known as \_\_\_\_\_.

- (A) Capital Account
- (B) Reserve
- (C) Depreciation
- (D) Cash at Bank

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Q49. Following is not a method of preparation of Trial balance:

- (A) Compound Method
- (B) Balance Method
- (C) Total Method
- (D) fair Value Method

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Q50. Contingent Liabilities must be shown under\_\_\_\_\_.

- (a) Current Liabilities & Provisions
- (b) By way of foot note only
- (c) Miscellaneous Expenditure
- (d) Not shown

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NITESH KR. JAISWAL CS CLASSES

# ANSWERS

## Introduction to Financial Accounting

1. B	2. A	3. C	4. A
5. B	6. B	7. B	8. B
9. A	10. B	11. B	12. A
13. C	14. C	15. C	16. B
17. B	18. B	19. B	20. D
21. C	22. A	23. B	24. C
25. B	26. B	27. B	28. B
29. B	30. C	31. C	32. C
33. C	34. D	35. B	36. B
37. B	38. A	39. D	40. A
41. B	42. D	43. B	44. B
45. B	46. A	47. A	48. B
49. D	50. B		

# CHAPTER – 12 | INTRODUCTION TO CORPORATE ACCOUNTING

## ✚ Section 129 of the Companies Act, 2013

- ✓ governs the preparation and presentation of financial statements of a company.
- ✓ The financial statements shall give a true and fair view of the state of affairs of a company or companies, comply with the accounting standards notified under Section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.
- ✓ The financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose –
  - (a) in the case of an **insurance company**, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
  - (b) in the case of a **banking company**, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
  - (c) in the case of a company engaged in the **generation or supply of electricity**, any matters which are not required to be disclosed by the Electricity Act, 2003;
  - (d) in the case of a company governed **by any other law** for the time being in force, any matters which are not required to be disclosed by that law.

According to the rules for the purposes of Sub-section (1) of Section 129, the class of companies as may be notified by the Central Government from time to time, shall mandatorily file their financial statements in **Extensible Business Reporting Language (XBRL)** format.

## ✚ Schedule III

### GENERAL INSTRUCTIONS

1. Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required (a) narrative descriptions or disaggregations of items recognised in those statements; and (b) information about items that do not qualify for recognition in those statements.

2. Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as given below:—

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

3. 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.



**PART I — BALANCE SHEET**

Name of the Company.....

Balance Sheet as at .....

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
1	2	3	4

**I. EQUITY AND LIABILITIES**

**(1) Shareholders' funds**

- (a) Share capital
- (b) Reserves and surplus
- (c) Money received against share warrants

**(2) Share application money pending allotment**

**(3) Non-current liabilities**

- (a) Long-term borrowings
- (b) Deferred tax liabilities (Net)
- (c) Other Long term liabilities
- (d) Long-term provisions

**(4) Current liabilities**

- (a) Short-term borrowings
- (b) Trade payables
- (c) Other current liabilities
- (d) Short-term provisions

**TOTAL**

**II. ASSETS**

**Non-current assets**

- (1) (a) Fixed assets
  - (i) Tangible assets
  - (ii) Intangible assets
  - (iii) Capital work-in-progress
  - (iv) Intangible assets under development
- (b) Non-current investments
- (c) Deferred tax assets (net)
- (d) Long-term loans and advances
- (e) Other non-current assets

**(2) Current assets**

- (a) Current investments
- (b) Inventories
- (c) Trade receivables
- (d) Cash and cash equivalents
- (e) Short-term loans and advances
- (f) Other current assets

TOTAL

## Notes

### 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. An operating cycle is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration 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 in the company's normal operating cycle;
  - (b) it is held primarily for the purpose of being traded;
  - (c) it is due to be settled within twelve months after the reporting date; or
  - (d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.All other liabilities shall be classified as non-current.
4. A receivable shall be classified as a "trade receivable" if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
5. A payable shall be classified as a "trade payable" if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.
6. 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 shareholder 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) Debit balance of statement of profit and loss shall be shown as a negative figure under the head “Surplus”. Similarly, the balance of “Reserves and Surplus”, after adjusting negative balance of surplus, if any, shall be shown under the head “Reserves and Surplus” even if the resulting figure is in the negative.

## **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 "Other 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.



## **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.

## **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) (a) Secured, considered good;
- (B) Unsecured, considered good;
- (C) Doubtful.

(b) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(c) 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) 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.



## PART II – STATEMENT OF PROFIT AND LOSS

Name of the Company.....

Profit and loss statement for the year ended .....

(Rupees in.....)

	Particulars	Item No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
	1	2	3	4
I	Revenue from operations		xxx	xxx
II	Other income		xxx	xxx
III	Total Revenue (I + II)		xxx	xxx
IV	Expenses: Cost of materials consumed  Purchases of Stock-in-Trade  Changes in inventories of finished goods work-in-progress and Stock-in-Trade  Employee benefits expense Finance costs  Depreciation and amortization expense  Other expenses  Total expenses		Xxx  Xxx  Xxx  xxx      	Xxx  Xxx  Xxx        
V	Profit before exceptional and extraordinary items and tax (III - IV)		xxx	xxx
VI	Exceptional items		xxx	xxx
VII	Profit before extraordinary items and tax (V - VI)		xxx	xxx
VIII	Extraordinary items		xxx	xxx
IX	Profit before tax (VII- VIII)		xxx	xxx
X	Tax expense: (1) Current tax (2) Deferred tax		Xxx Xxx	Xxx Xxx
XI	Profit (Loss) for the period from continuing operations (VII-VIII)		xxx	xxx
XII	Profit/(loss) from discontinuing operations		xxx	xxx
XIII	Tax expense of discontinuing operations		xxx	xxx

XIV	Profit/(loss) from continuing operations (after tax) (XII-XIII)		xxx	xxx
XV	Profit (Loss) for the period (XI + XIV)		xxx	xxx
XVI	Earnings per equity share:			
	(1) Basic		Xxx	Xxx
	(2) Diluted		xxx	xxx

**See accompanying notes to the financial statements.**

**GENERAL INSTRUCTIONS FOR PREPARATION OF STATEMENT OF PROFIT AND LOSS**

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

- (a) Sale of products;
- (b) Sale of services;
- (c) Other operating revenues;
- Less:
- (d) Excise duty.

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

- (a) Interest; and
- (b) Other financial services.

2. Finance costs shall be classified as:

- (a) Interest expense;
- (b) Other borrowing costs;
- (c) Applicable net gain/loss on foreign currency transactions and translation.

3. Other income shall be classified as:

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

**4. Additional Information**

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

- (a) 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].

- (b) Depreciation and amortisation expense;

(c) Any item of income or expenditure which exceeds one per cent. of the revenue from operations or Rs.1,00,000, whichever is higher;

(j) 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;

(k) In case of Companies covered under section 135, amount of expenditure incurred on corporate social responsibility activities;

(l) Details of items of exceptional and extraordinary nature;

(m) Prior period items;

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## **MCQ FOR PRACTICE**

- Q1. Different organisations from same industry should select accounting policies \_\_\_\_\_.  
(a) As per the provisions of the Companies Act  
(b) As per the Auditing & Assurance Standards  
(c) On a uniform basis from one concern to another and from one accounting period to another  
(d) On non-uniform basis from one concern to another and from one accounting period to another
- Q2. The Companies Act, 2013 provides that the Balance Sheet of a Company shall be in the prescribed form given in:  
(a) Part I of Schedule III  
(b) Part II of Schedule III  
(c) Part III of Schedule III  
(d) Part I of Schedule II
- Q3. The Companies Act, 2013 provides that the Profit & loss Account of a Company shall be in the prescribed form given in:  
(a) Part I of Schedule III  
(b) Part II of Schedule III  
(c) Part III of Schedule III  
(d) Part I of Schedule II
- Q4. Section \_\_\_\_ of the Companies Act, 2013 governs the preparation and presentation of financial statements of a company.  
(a) 140  
(b) 135  
(c) 129  
(d) 110
- Q5. A balance sheet has two parts to it, i.e. I. Equity and Liabilities and II. \_\_\_\_\_.  
(a) Shareholder's fund  
(b) Trade receivables  
(c) Inventories  
(d) Assets
- Q6. Reserves and Surplus is a part of :  
(a) Current liabilities  
(b) Shareholders Fund's  
(c) Non-current assets  
(d) Current assets
- Q7. Which of the following would be considered an internal user of the financial statement?  
(a) Shareholder  
(b) Creditor  
(c) Debtor  
(d) Finance Manager

# ANSWERS

## Introduction to Corporate Accounting

1. C	2.A	3. B	4. C
5. D	6. B	7. A	

# CHAPTER – 13 | FINANCIAL STATEMENT INTERPRETATION

## Financial Statement Preparation

Financial statements are reports prepared and issued by company management to give investors and creditors additional information about a company's performance and financial standings. The four general purpose of financial statements include:

- Income Statement
- Balance Sheet
- Statement of Stockholders Equity
- Statement of Cash Flow

## Different Types of Financial Statements

### 1. Interim Statements

Financial statements that are issued for the time periods smaller than one year are called interim statements, because they are used as temporary statements to judge a company's financial position, until the full annual statements are issued.

Interim financial statements are most commonly issued quarterly or semi-annually, but it is not uncommon for companies to issue monthly reports to creditors as part of their loan covenants.

### 2. Annual Statements

The annual financial statement form is prepared once a year and covers a 12-month period of financial performance.

Generally, these statements are issued at the end of a company's fiscal year instead of a calendar year.

## User of Financial Statement

- ✓ Financial statements are mainly prepared for external users.
- ✓ Their users are people who are outside of the company or organization itself and need information about it to base their financial decisions on.
- ✓ These external users typically fall into four main categories:
  - Investors
  - Creditors
  - Competitors
  - Regulators

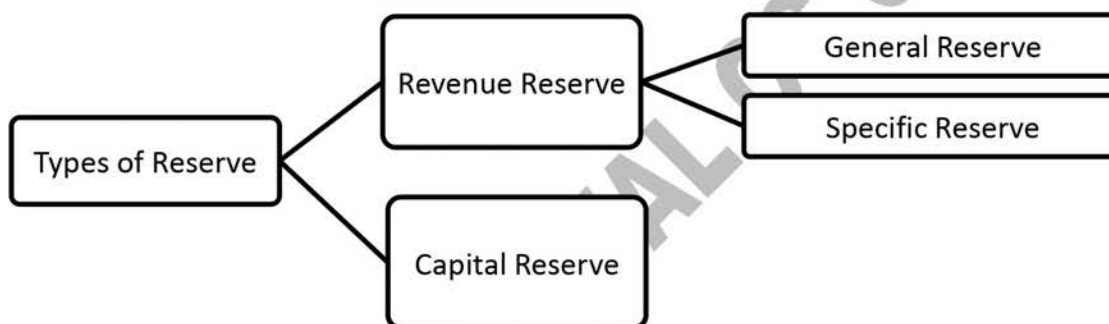
## PROVISIONS

- ✓ Provisions are the amount set aside for a **known liability** but the amount of which **cannot be ascertained** with the complete accuracy.
- ✓ It is a charge against Profit and Loss Account i.e. provision has to be made whether business earned profits or suffered losses.
- ✓ Following are the some examples of Provisions:
  - Provision for depreciation
  - Provision for Doubtful Debts
  - Provision for repairs
  - Provision for Tax
  - Provision for discount on debtors



## • **RESERVES**

- ✓ Reserves are the amount set aside to **strengthen the financial position** of the business.
- ✓ It is an appropriation of Profits i.e. only created when business earned profits not in case of losses.
- ✓ Following are the some examples of Reserves:
  - General Reserve
  - Dividend Equalisation Reserve
  - Capital Reserve
  - Reserve for Expansion, etc.
- ✓ If the amount equal to reserve is invested into outside the business, the reserve will be called "Reserve Fund".
- ✓ Reserve is also known as "Plough Back Profits".
- ✓ Following are the types of reserves:



### **1. Revenue Reserve**

- ✓ These are created out of **revenue profits** and which are available for distribution of dividend among their owners.
- ✓ **Revenue profit** here means profit earned in the course of day to day business operations.
- ✓ Revenue reserve can be classified into two following categories:

#### **a) General Reserve:**

- ✓ General reserve is the amount set aside out of profits for no specific purpose but for any future uncertainty or expansion of business operations.
- ✓ **(Budape ke liye saving)**
- ✓ General Reserve is also known as "Contingency Reserve" or "Free Reserve".
- ✓ Objectives of General reserve:
  - 1) For meeting future uncertain losses.
  - 2) For expansion of business operations.
  - 3) For strengthening of financial position of business.

### **b) Specific Reserve:**

- ✓ Specific reserve is the amount set aside out of profits for some specific purpose and can be used only for that specific purpose.
- ✓ **(Beti ki Shadi ke liye saving)**
- ✓ Following are the examples of Specific reserve:
  - 1) Dividend Equalisation Reserve
  - 2) Capital Redemption Reserve
  - 3) Debenture Redemption Reserve
  - 4) Reserve for replacement of Asset
  - 5) Workmen compensation reserve

### **2. Capital Reserve:**

- ✓ These are created out of **capital profits** and which are not available for distribution of dividend among their owners.
- ✓ **Capital profits** here means profits earned in addition to normal profits.
- ✓ Following are the some example of Capital Profits:
  - 1) Profit on sale of Fixed Assets.
  - 2) Profit on sale of Investment.
  - 3) Profit on the purchase of another running business.
  - 4) Profit on the revaluation of assets and liabilities.
  - 5) Profit on redemption of debentures.
- ✓ Capital reserves are used to write off capital losses and for the issue of fully paid bonus shares.

### **• Secret Reserve**

- ✓ Such reserves are created by showing the assets at a lower figure and liabilities at a higher figure and such reserve is not disclosed by business in the Balance Sheet.
- ✓ It is also called "Hidden Reserve" or "Internal Reserve".
- ✓ Creation of secret reserve is not permitted under "**The Companies Act 2013**".

## **DETERMINATION OF MANAGERIAL REMUNERATION**

Managerial persons implies Managing Director, Whole-time Director, Part-time Directors and managers who shall be paid remuneration subject to and in accordance with the provisions of **Section 197 of the Companies Act, 2013**.

### **Applicability of Provisions to Whom**

- ✓ Section 196 deals with appointment of Managerial Personnel and is applicable to private as well as public companies;
- ✓ Section 197 which deals with remuneration payable to managerial personnel is applicable to public companies only.
- ✓ Schedule V is partly applicable to private companies (i.e., in relation to Part I that deals with appointment) and partly not applicable to private companies (i.e., Part II that deals with remuneration)



## **Remuneration Allowed to Managerial Personnel**

Section 197 of the Companies Act, 2013 provides a way to pay managerial remuneration in case company is having adequate profits.

- A Public Company can pay remuneration to its directors including Managing Directors and Whole-time Directors, and its managers which shall not exceed 11% of the net profit as calculated in a manner laid down in Section 198 of the Companies Act, 2013.
- Wherein a company in which there is one Managing Director; Whole-time Director or manager the remuneration payable shall not exceed 5% of net profits, and where there are more than one such Directors remuneration payable shall not exceed 11 % of the net profit.

### **Maximum Remuneration Payable by a Company to its Managerial Personnel**

If a company wants to pay remuneration in excess of the above payable limit it have to follow Schedule V of the Companies Act, 2013.

Part II of Schedule V (earlier Schedule XIII) – Remuneration payable by a company in case where there is no profit or these is an inadequacy of profit is given below :

#### **Where Effective Capital is Limit of yearly Remuneration payable shall not exceed (Rupees)**

- |  |  |
|--|--|
| i) Negative or less than 5 crore                   | 30 lakhs   |
| ii) 5 Crores and above but less than Rs 100 Crores | 42 lakhs   |
| iii) 100 crores and above but less than 250 crores | 60 lakhs   |
| iv) 250 Crores and above                           | 60 lakhs plus 0.01% the effective capital in excess of Rs. 250 crores. |

A company with inadequate profit may pay to its Managing Director or Whole-Time Director double, i.e., 200% of the above mentioned managerial remuneration, if shareholders have given their approval through a special resolution.

Where a manager person who is not holding Rs. 5 lacs worth of shares or more or an employee or a director of the company not related to any director or promoter at any time during the two years prior to his appointment as a managerial person, the company can pay him upto a maximum of 2.5% of the "current relevant profits", and up to 5% with the approval of shareholders by a special resolution.

### **Penalty Clauses**

If any person contravenes the provisions of the Section 197, he/she shall be punishable with fine, which shall not be less than one lakh rupees and may extend to five lakhs rupees.

If a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made thereunder, the company and every officer of the company who is in default, or any such other person shall be punishable with fine which may extend to ten thousand rupees, and where the contravention is a continuing one, with a further fine which may increase one thousand rupees every day after the first day during which the contravention continues.



## **CORPORATE SOCIAL RESPONSIBILITY (CSR)**

The Companies Act, 2013 requires that every company with

- a) net worth of Rs.500 crore or more, or
- b) turnover of Rs 1,000 crore or more, or
- c) net profit of Rs. 5 crore or more during any financial year

will constitute a CSR committee.

The CSR Rules state that every company, which ceases to be a company covered under the above criteria for three consecutive financial years, will not be required to

- (a) constitute the CSR Committee, and
- (b) comply with other CSR related requirements,

### **Constitution of CSR Committee**

- ✓ The Companies Act, 2013 requires that a company which meets the CSR applicability criteria should constitute a CSR committee comprising **three or more directors**.
- ✓ The Companies Act, 2013 also states that out of these three directors, **at least one director should be an independent director**.
- ✓ The CSR Rules state that a non-listed public company or a private company, which is not required to appoint an independent director as per the 2013 Act/ Directors' Appointment Rules.

### **CSR expenditure**

In accordance with Section 135(5) of the Companies Act, 2013, the Board of each company covered under the CSR requirement needs to ensure that the company spends, in every financial year, **at least 2% of its average net profits made during the three immediately preceding financial years**.

Neither the Companies Act, 2013 nor the CSR Rules prescribe any specific penal provision if a company fails to spend the 2% amount.

## **RELATED PARTY DISCLOSURES – IAS 24**

IAS 24 Related Party Disclosures requires disclosures about transactions and outstanding balances with an entity's related parties.

### **Who are Related Parties?**

A related party is a person or entity related to the entity that is preparing its financial statements.

a) A person or a close member of that person's family is related to a reporting entity if that person:

- Has control or joint control over the reporting entity
- Has significant influence over the reporting entity
- Is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

b) An entity is related to a reporting entity if any of the following conditions applies:

- The entity and the reporting entity are members of the same group.
- One entity is an associate or joint venture of the other entity.
- Both entities are joint ventures of the same party.
- One entity is a joint venture of a third and the other entity is an associate of the third entity.
- The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity, or an entity related to the reporting entity.
- The entity is controlled or jointly controlled by a person identified in (a).
- The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

## **SEGMENT REPORTING ( Accounting Standard 17)**

Segment reporting is the reporting of the operating segments of a company in the disclosures accompanying its financial statements.

Segment reporting is required for publicly held entities, and is not required for privately held ones.

Segment reporting is intended to give information to investors and creditors regarding the financial results and position of the most important operating units of a company, which they can use as the basis for decisions related to the company.

Follow these rules to determine which segments need to be reported:

- Report a segment if it has at least 10% of the revenues, 10% of the profit or loss, or 10% of the combined assets of the entity.
- If the total revenue of the segments you have selected under the preceding criteria comprise less than 75% of the entity's total revenue, then add more segments until you reach that threshold.
- You can add more segments beyond the minimum just noted, but consider a reduction if the total exceeds ten segments.

**Case 1.** A Ltd. had a reportable segment in year 02-03, but for 03-04, that reportable segment does not meet the 10% threshold limit. Should A Ltd. continue or drop the segment for reporting in 03-04?

**Solution:** A segment may have been a reportable segment in the prior period, but does not have reportable segment in the current period, The AS requires A Ltd. to continue the reportable segment of 02-03 also for 03-04, even though its revenue, result and assets no longer meet the 10% threshold limit. Taking a clue about the applicability of Accounting Standards, A Ltd. would be required to disclose for two consecutive years, and thereafter cease reporting that segment which does not meet the threshold criteria.



## **AUDIT QUERY**

An accounting audit is the process of examining a company's entire financial situation, with an emphasis on ensuring compliance with relevant reporting standards, and promoting adequate cash-handling policies and internal controls.

Audit queries are questions asked by an auditor during an investigation. These may be used to gather information to come to a conclusion in the audit.

The following parameters are looked during audit queries:

1. Any questions related to a company which is being audited either by an internal or external auditor.
2. The final touch of the accounts.
3. It is the matter being investigated while examining financial report of a company.
4. Audit queries are questions asked by an auditor during an investigation. These may be used to gather information to come to a conclusion in the audit.
5. An audit query is a explanation that is required by the audit team on certain points that they may have identified during an audit.
6. It is an inquiry from an auditor also known as findings.

## **MCQ FOR PRACTICE**

Q1. The part of share capital which can be called up only on the winding up of a company is called:

- (A) Authorised Capital
- (B) Called Up Capital
- (C) Reserve Capital
- (D) Capital Reserve

Q2. "Unpaid Dividend" is shown in the balance sheet of a company under the head:

- (A) Reserve and Surplus
- (B) Provision
- (C) Current Liability
- (D) Non Current liabilities

Q3. \_\_\_\_\_ and \_\_\_\_\_ of Schedule III of companies Act 2013, deals with presentation of Profit and Loss Account and Balance Sheet:

- (A) Part I and Part II
- (B) Part II and Part I
- (C) Part I and Section 210
- (D) Part II and Section 210

Q4. The Reserve which is created for a particular purpose and which is a charge against revenue is called

- (A) General Reserve
- (B) Secret Reserve
- (C) Specific reserve
- (D) Capital Reserve

Q5. Dividend is to be paid is calculated as a percentages of:

- (A) Authorised Capital
- (B) Called Up Capital
- (C) Paid up Share Capital
- (D) Issued Share Capital

### **Managerial Remuneration**

Q.6 Net profit for the purpose of managerial remuneration has to be calculated as per \_\_

- (a) Section 195
- (b) Section 196
- (c) Section 197
- (d) Section 198

Q.7 Which of the following deals with payment of managerial remuneration ?

- (a) Section 196
- (b) Section 197
- (c) Section 190
- (d) Section 200

Q.8 Net Profit for the purpose of managerial remuneration has to be calculated as per \_\_\_\_

- (a) Section 196
- (b) Section 197
- (c) Section 198
- (d) None of the above

Q.9 Managerial persons includes

- (a) Managing Director
- (b) Whole Time Director
- (c) Part Time Director and mangers
- (d) All of the above

Q.10 Which of the following is not a managerial person for the purpose of Section 197?

- (a) Managing Director
- (b) Manager
- (c) Part Time Director
- (d) None of the above

Q.11 What is the maximum remuneration payable if the company has one Managing Director ?

- (a) 6%                      (b) 10%                      (c) 11%                      (d) 5%

Q.12 How much remuneration will be payable if there are two whole-time directors, a part-time director and a manager.

- (a) 5%                      (b) 10%                      (c) 11%                      (d) 3%

Q.13 What is the maximum remuneration payable if the company has one Managing Director and one whole time director?

- (a) 6%                      (b) 10%                      (c) 11%                      (d) 5%

Q.14 What is the maximum remuneration payable if the company has one Managing Director and two whole time director?

- (a) 6%                      (b) 10%                      (c) 11%                      (d) 5%

Q.15 What is the maximum remuneration payable if the company has one Manager?

- (a) 6%                      (b) 10%                      (c) 11%                      (d) 5%

Q.16 According to Section 197 of the Companies Act, 2013, the total managerial remuneration payable by a public company to its directors, including managing director and whole time director, and its manager in respect of any financial year shall not exceed \_\_\_\_ of the net profits of that company for that financial year except that the remuneration of the directors shall not be deducted from the gross profits.

- (a) 10%                      (b) 11%                      (c) 12%                      (d) 14%

Q.17 A company may pay a sitting fee to a director for attending meetings of the Boards or Committees thereof, such sum as may be decided by the Board of Directors thereof which shall not exceed Rs. \_\_\_\_\_ per meeting of the board.

- (a) One lakh                      (b) Two lakh                      (c) Five Lakh                      (d) Ten lakh

Q.18 If any person contravenes the provisions of the section 197 of the companies Act, 2013, he shall be punishable with fine. What is the minimum fine that people have to pay?

- (a) Ten thousand Rupees                      (b) One Lakh Rupees  
(c) Five Lakh Rupees                      (d) Two lakh Rupees

Q.19 If effective capital of the company is negative, it may pay remuneration to the managerial person not exceeding:

- (a) Rs 84 lakhs                      (b) Rs 120 lakhs                      (c) Rs 60 lakhs                      (d) None of the above

Q.20 If effective capital of the company is 60 crores, it may pay remuneration to the managerial person not exceeding:

- (a) Rs 84 lakhs                      (b) Rs 120 lakhs                      (c) Rs 60 lakhs                      (d) None of the above

Q.21 If effective capital of the company is 100 crores, it may pay remuneration to the managerial person not exceeding:



(a) Rs 84 lakhs  
the above

(b) Rs 120 lakhs

(c) Rs 60 lakhs

(d) None of

Q.22 If effective capital of the company is 250 crores and above, it may pay remuneration to the managerial person not exceeding:

- (a) Rs 120 lakhs plus 0.08% of the effective capital in excess of Rs 250 crore
- (b) Rs 160 lakhs plus 0.01% of the effective capital in excess of Rs 250 crore
- (c) Rs 190 lakhs plus 0.05% of the effective capital in excess of Rs 250 crore
- (d) Rs 120 lakhs plus 0.01% of the effective capital in excess of Rs 250 crore

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# ANSWERS

## Financial Statement Interpretation

1. C	2. C	3. B	4. C
5. C	6. D	7. B	8. C
9. D	10. D	11. D	12. C
13. B	14. B	15. D	16. B
17. A	18. A	19. C	20. A
21. B	22. D		

## **CHAPTER – 14 | CORPORATE FINANCIAL REPORTING**

A company's annual report contains not only the financial statements, notes thereto and significant accounting policies followed in preparing them, but certain other financial reports as well. The most common and statutorily required reports are as under:

1. Auditor's report
2. Directors' report
3. Corporate governance report and within that or separately, management discussion, and analysis report.
4. Report on corporate social responsibility (CSR) activities.

### **Fundamental Accounting Assumption**

If the fundamental accounting assumptions, viz., **Going Concern, Consistency and Accrual** are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

### **Features of Corporate Financial Reporting**

**Relevance:** Information is relevant when it influences the economic decisions of users by helping them to evaluate past, present, and future events to confirm/correct their past evaluations.

**Reliability:** Information should be free from material errors and bias. The key aspects of reliability are faithful representation, priority of substance over form, neutrality, prudence, and completeness.

**Comparability:** Information should be presented in a consistent manner over time, and consistent between entities to enable users to make significant comparisons.

**Understandability:** Information should be readily understandable by users who are expected to have a reasonable knowledge of business, economics and accounting, and a willingness to study the information with reasonable diligence.

### **AUDITOR S REPORT**

#### **Requirements of the Companies Act**

Section 143 of the Companies Act 2013 deals with the auditors report which should fulfill following requirement :

1. The auditor shall make a report to the members of the company on the accounts examined by him, and on every Balance Sheet and Profit and Loss account and on every other document, which is to be a part of or Annexed to the Balance Sheet or Profit and Loss Account.
2. The report shall state whether, in his opinion and to the best of his information and according to the explanations given to him the said accounts.
  - (a) Give the information required by the Companies Act in the manner so required and ;
  - (b) Give a true and fair view ;
3. The auditor's report shall also state:
  - (a) Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit.



(b) Whether, in his opinion, proper books of account as required by law have been kept by the company, and proper returns adequate for the purpose for his audit have been received from branches not visited by him.

(c) Whether the report on the accounts of any branch office audited by a person other than the company's auditor has been forwarded to him, and how he has dealt with the same in preparing the auditor's report.

(d) Whether the company's Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of account and return.

(e) Whether, in his opinion, the Profit and Loss Account and Balance Sheet comply with the accounting standards.

(f) In thick type or in italics the observations or comments of the auditor's which have any adverse effect on the functioning of the company.

(g) Whether any director is disqualified from being appointed as director under Sub-Section (2) of Section 164.

The clause mentioned above disqualifies a person from being appointed as a company director if such person is already a director of a public company which.

– Has not filed the annual accounts and annual returns for any continuous three financial years; or

– Has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend on due date and such failure continues for one year or more.

4. Where any of the matters referred to in 2b or 3a to 3e above is answered in the negative, or with an attribute, the auditor's report shall state the reasons for the answer.

5. The central government may direct that, in the case of such class or description of companies as may be specified, the auditor's report shall also include a statement on such matters as may be specified therein.

## **Companies (Auditors' Report) Order, 2003 or CARO**

*The Central Government had issued 'The Manufacturing and Other Companies (Auditor's Report) Order, 1988 popularly known as MAOCARO. It was replaced in 2003 by a new order known as CARO.*

**Applicability CARO is applicable to all Companies except the following:**

- 1. Banking and Section 25 (not for profit) Companies.**
- 2. A private limited company, which at any point of time during the financial year, complies with the following.**
  - Paid-up capital and reserve not more than rupees fifty lakh.**
  - Loan outstanding not exceeding rupees twenty-five lakh from any bank or financial institution, and**
  - Turnover not exceeding rupees five crore.**

**Matters to be included in the auditor's report :** The auditors' report shall include a statement on the following matters.

### **1. Fixed assets :**

- a. Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets?
- b. Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of accounts? and
- c. If a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern.

### **2. Inventory :**

- a. Whether physical verification of inventory has been conducted at reasonable intervals by the management?
- b. Are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business? If not, the inadequacies in such procedures should be reported?
- c. Whether the company is maintaining proper records of inventory? If any material discrepancies were noticed on physical verification, whether the same have been properly dealt with in the books of account.

### **3. Loans granted to/taken from companies and firms in which directors are interested:**

- a. Has the company granted any loans, secured or unsecured, to companies, firms or other parties covered in the register maintained under Section 301 of the Act? if so, give the number of parties and amount involved in the transactions.
- b. Whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company?
- c. Whether repayment of the principal amount and interest are also regular?
- d. If overdue amount is more than lakhs, whether reasonable steps have been taken by the company for recovery of the principal and interest?
- e. Has the company taken any loans, secured or unsecured, from companies, firm or other parties covered in the register maintained under Section 301 of the Act? if so, give the details of parties and the amount involved in the transactions.
- f. Whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the company?
- g. Whether payment of the principal amount and interest are also regular?



#### **4. Internal control system :**

Is there an adequate internal control system commensurate with the size of the company and the nature of its business for the purchase of inventory, and fixed assets and for the sale of goods and services? Whether there is a continuing failure to correct major weaknesses in internal control system.

#### **5. Transactions (other than loans) with companies and firms in which directors are interested:**

- a. Whether the particulars of contracts or arrangements referred to in Section 301 of the act have been entered in the register required to be maintained under that section?
- b. Whether transactions made in pursuance of such contracts and arrangements have been made at prices which are reasonable with regard to the prevailing market prices at the relevant time? (This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party, and in any one financial year)

#### **6. Public deposits :**

In case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of Section 58A and 58AA or any other relevant provisions of the Act and the rules framed thereunder, where applicable, have been complied with. If not, the nature of contraventions should be stated; if an order has been passed by company law board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal whether the same has been complied with or not?

#### **7. Internal audit system :**

In the case of listed companies and/or other companies having a paid up capital and reserves exceeding Rs.50 lakhs was commitment for the financial year concerned or having an average arrival turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, it is important to see whether the company has an internal audit system commensurate with its size and nature of its business.

#### **8. Cost accounts and records :**

Where maintenance of cost records has been prescribed by the central government under clause (d) of Sub-Section (I) of Section 209 of the Act, whether such accounts and records have been made and maintained.

#### **9. Statutory dues :**

- a. Is the company regular in depositing undisputed statutory dues including provident fund investor education and protection fund, employees state insurance. Income tax. Sales tax. Wealth tax, Service tax, Custom Duty, Excise duty, Cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.
- b. In case dues to income tax/sales tax/service tax/custom duty/excise duty/cess have not been deposited on account of any dispute, then the amounts involved and the from where the dispute is pending may please be mentioned.  
(A mere representation to the department shall not constitute the dispute)

#### **10. Accumulated losses :**

Whether in case of a company which has been registered for a period not less than five years, in accumulated losses at the end of the financial year are not less than fifty per cent of net worth, and whether it has incurred cash losses in such financial year and in the immediately proceeding financial year.



**11. Default in repayment of loans :**

Whether the company has defaulted in repayment of loans to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported.

**12. Loans granted against securities (share etc) :**

Whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities.

If not, the deficiencies to be pointed out.

**13. Chit fund, Nidhi/mutual benefit fund/societies**

Whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of Nidhi/mutual benefit fund/societies :

- a. Whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet;
- b. Whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard/doubtful/loss assets;
- c. Whether the company has adequate procedures for appraisal of credit proposals requests, assessment of credit needs and repayment capacity of the borrowers;
- d. Whether the repayment schedule of various loans granted by the Nidhi is based on the repayment capacity of the borrower.

**14. Companies dealing in securities :**

If the company is dealing or trading in shares, securities, debentures and other investment, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein, also whether the shares, securities, debentures and other investment have been held by the company, in its own name except to the extent of the exemption, if any, granted under Section 49 of the Act.

**15. Third party guarantees :**

Whether the company has given any guarantee for loans taken by others from bank or financial institutions? Whether the terms and conditions whereof are prejudicial to the interest of the company?

**16. Application of loans for the intended purpose :**

Whether term loans were applied for the purpose for which the loans were obtained.

**17. Use of short-term funds for long-term investment :**

Whether the funds raised on short-term basis have been used for long-term investment; if yes, the nature and amount is to be indicated.

**18. Preferential allotment :**

Whether the company has made any preferential allotment of shares to parties and companies covered in the register maintained under Section 301 of the Act, and if so whether the price at which shares have been issued is prejudicial to the interest of the company.

**19. Creation of charge on debentures :**

Whether security or charge has been created in respect of debentures issued?

**20. End use of public issue:**

Whether the management has disclosed the end use of money raised by public issues and the same has been verified.



## 21. Frauds :

Whether any fraud on or by the company has been noticed or reported during the year; if yes, the nature and the amount involved is to be indicated.

## DIRECTOR S REPORT

### Requirements of the Companies Act

Section 134 of the Companies Act, 2013 deals with the director's report and provided as under:

1. There shall be attached to every Balance Sheet laid before a company's general body meeting, a report by its Board of Directors containing the following –

- The state of the company's affairs.
- The amounts, if any, which it proposes to carry to any reserves in the balance sheet.
- The amount, if any, which it recommends should be paid by way of dividend.
- Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year and the date of the report.
- The conservation of energy; technology absorption, foreign exchange earnings and outgoing should be mentioned.

2. The Board's report shall, so far as it is encouraging for the appreciation of the state of the company's affairs by its members, and will not in the board's opinion be harmful to the business of the company, or any of its subsidiaries, deal with any changes which have occurred during the financial year;

- In the nature of the company's business;
- In the company's subsidiaries or in the nature of their business; and
- Generally in the classes of business in which the company has an interest.

3. The Board's report shall also include directors' responsibility statement, indicating therein

- That in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- That the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year, and of the profit or loss of the company for that period;
- That the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- That the directors had prepared the annual accounts on a going concern basis.

4. The board is also bound to give the fullest information and explanations, in its report on every reservation, qualification or adverse remark contained in the auditors report.

5. The board's report has to specify the reasons for the failure, if any, to complete the buy-back within the time specified .

**6. The Board's report shall also include a statement showing the name of every employee of the company who:**

**– If employed throughout the financial year, was in receipt of remuneration for that year which in the aggregate, was not less than the prescribed sum (Rs. 24 lacs per annum with effect from 17.04.2002)**

**– If a director was employed for a part of the financial year and had received remuneration for any part of that year, at a rate, which in the aggregate was not less than the sum, prescribed per month (Rs. 2 lacs per month with effect from 17.04.2002).**

**– If employed throughout the financial year or part thereof, he was in receipt of remuneration in that year which in the aggregate, or as the case may be, at a rate which, in the aggregate, in excess of that drawn by the managing director, or whole time director, or manager who holds by himself or along with his spouse and dependent children, not less than two per cent of the equity shares of the company.**



## **SHAREHOLDER VALUE ADDED**

Shareholder Value Added (SVA) represents the economic profits generated by a business above and beyond the minimum return required by all providers of capital.

The SVA approach is a methodology which recognizes that equity holders as well as debt financiers need to be compensated for the bearing of investment risk.

## **BENEFITS OF ADOPTING SVA**

1. Overall value-based performance measures will result in greater accountability for the investment of new capital, as well as for the use of existing investment
2. Organization will have the opportunity to apply a meaningful private accountability for the investment of performance
3. Managers will be provided with an improved focus on maximizing shareholder value.

## **DRAWBACKS OF ADOPTING SVA**

1. Limitation in the uses of SVA as a performance measure is that, by nature, it is an aggregate measure. In order to analyse the underlying causes of any changes in calculated value between years, it is necessary to fully comprehend the value drivers and activities specific to a given firm.
2. There may be certain enterprises which are subject to any degree of price regulation then it may not be possible for management to adjust output prices to achieve a commercial return in response to upward movements in input prices. Such a situation may result in SVA being reduced even though there may have been no decrease in overall efficiency.
3. Similarly, a reduction in direct Government funding would result in a decrease in SVA.
4. Combined with the use of traditional accounting measures, a thorough knowledge of the value drivers of the business will assist in determining the underlying causes of fluctuation in the value added measure.

### **Market value Added:**

Market value added is the market value of capital employed in the firm less the book value of capital employed.

- Market value added is calculated by summing up the paid up value of equity and preference share capital, retained earnings, long term and short term debts and subtracting this sum from the market value of equity and debt.
- Market value added (MVA) measures cumulatively the performance of corporate entity.
- A high market value added means that the company has created substantial wealth for shareholders.
- On the other hand, negative MVA means that the value of management's actions and investments are less than the value of capital contributed to the company by the capital market or that the wealth and value has been destroyed.

### **Economic value added**

**Concept of Economic Value Added EVA:** EVA is the surplus generated by an organization after meeting an equitable change towards the providers of capital. It is basically a benchmark to measure an organization's earning efficiency.

Shareholders must earn sufficient returns for the risk they have taken in investing their money company's capital. The return generated by the company for shareholders has to be more than the cost of capital to justify risk taken by the shareholders. The excess of returns over cost of capital is simply termed as Economic Value Added (EVA). EVA measures whether the operating profit is sufficient enough to cover cost of capital. If a company's EVA is negative, the firm is destroying shareholders wealth even though it may be reporting positive and growing EPS or return on Capital employed.(ROCE)

Thus, EVA is just away of measuring an operation's real profitability.EVA holds a company accountable for the cost capital it uses to expand and operate its business and show whether a company is creating a real value for its shareholders or not.



## **Calculation of EVA**

EVA is the measure of financial performance. It is the operating profit after tax less a charge for the capital, equity as well as debt, which is used in business.

EVA can be calculated as follows:

$$\text{EVA} = \text{NOPAT} - (\text{TCE} \times \text{WACC})$$

NOPAT = Net operating profit after tax

TCE = Total Capital Employed

WACC = Weighted average cost of capital

While calculation of NOPAT, the non-operating items like dividend, interest on securities invested outside the business, non-operating expenses etc. are not considered. The total capital employed is the sum of shareholders funds as well as loan funds and this does not include investments outside the business.

In calculating WACC, cost of debt is taken as after tax cost of equity is measured on the basis of Capital Asset Pricing Method (CAPM). CAPM is traditionally used by the founders of EVA. Under CAPM, Cost of Equity (K) is given by the following.

$$K = R_f + b (R_m - R_f)$$

Where  $R_f$  = Risk free return

$R_m$  = Expected market rate of return

b = Risk coefficient of particular investment

It should be noted that EVA is expressed in terms of rupee figure and not as a percentage i.e. EVA measures the absolute rupee value of wealth created.

## **Adjustments for calculation of EVA**

### **(1) Adjustment related to NOPAT**

- (i) The NOPAT figure calculated from P & L A/c is adjusted by adding back the R & D expenses and capitalizing them in the B/S.
- (ii) NOPAT is adjusted for the tax actually paid instead of the accounting provision. The reserves for deferred taxes are added to the equity.
- (iii) The depreciation charge if excessive needs adjustments.
- (iv) Operating leases are to be capitalized. The net present value of the lease payments is capitalized.
- (v) Certain marketing expenses like advertising or sales promotion for a new brand launch capitalized and amortized over the period during which benefits will be reaped.
- (vi) Expenses incurred on employee training again will provide benefits over a period so these expenses are also capitalized.
- (vii) Restricting expenses and such other expenses which will benefit the firm in the long run. Capitalized and written-off over a period.
- (viii) provision for gratuity and pension should be recognized and provided for properly.
- (ix) Goodwill of an acquired business, if written off, is capitalized and adjusted in NOPAT and equity.
- (x) Other adjustments like adding back the provision for warranty claims, provisions for bad and doubtful debts are also made. They are accounted for on the cash basis. Similarly other non-book keeping entries are adjusted and accounted for on a cash basis.

### **(2) Adjustment to 'Capital Employed'**

- (i) It is prudent to use the book value figure in the EVA calculation, as this is the amount that has been entrusted to the management to employ in the business. The market value of a firm is the investor's capital and it is not the same as the firm's capital. The capital employed that earns operating profits is the book value of net assets and not the market value of a firm's stock.
- (ii) From the asset side, capital employed is the current assets less the non-interest bearing current liabilities i.e. the net working capital (current assets - non interest bearing current liabilities) the net fixed assets.
- (iii) From the liabilities side it is the sum of interest bearing debt (short-term as well as long term) net worth less any non-operating assets.



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Thus, EVA is just a way of measuring an operation's real profitability. EVA holds a company accountable for the cost of capital it uses to expand and operate its business and show whether a company is creating a real value for its shareholders or not.

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$$K = R_f + b (R_m - R_f)$$

Where  $R_f$  = Risk free return

$R_m$  = Expected market rate of return

b = Risk coefficient of particular investment

It should be noted that EVA is expressed in terms of rupee figure and not as a percentage i.e. EVA measures the absolute rupee value of wealth created.

## **Value Added Statement**

Value added can be defined as the value created by the activities of a firm, that is, sales less the cost of bought in goods and services. The value added statement reports on the calculation of value added and its allocation among the stakeholders. In other words, value added can be defined as wealth generated by the entity through the collective efforts of capital providers, management and employees.

### **Advantages of Value Added Statement :**

- (1) It helps in the comparison of the performance of the company.
- (2) It helps in judging the productivity of the company.
- (3) It provides a better alternative by focusing on other factors rather than just profit.
- (4) It also helps in devising the incentives schemes for the employees.
- (5) It reflects a broader view of the company's objectives and responsibilities.

### **Limitation of Value Added Statement :**

Many inconsistencies are found in practice in both the calculation and presentation of value added in the VAS. These inconsistencies make the statement confusing, non-comparable and unverifiable. The main areas of inconsistencies includes the following :

- (a) The treatments of depreciation resulting in gross and net value added.
- (b) The treatment of taxes like pay-as-you-earn, fringe benefits and other benefits in the employee's share of value added.
- (c) The timing of recognition of value added – production or sales.
- (d) The treatment of taxes such as VAT/GST and deferred tax and
- (e) The treatment of non-operating items.



## Format of 'Value Added Statement'

Value Added Statement for the year ended .....

Particulars		Rs.
<b>Value Added:</b>		
Sales less returns		XXXX
Less:		
- Excise duty	XXXX	
- Purchase	XXXX	
- Decrease in stock	XXXX	
- Manufacturing & other Expenses	XXXX	XXXX
Value added from operations		XXXX
Add:		
- Other Income		XXXX
-		XXXX
<b>Value Applied :</b>		
<b>Towards employees</b>		
- Wages & Salaries	XXXX	
- Salaries and commission to directors	XXXX	XXXX
<b>Towards Government</b>		
- Local tax	XXXX	
- Dividend paid	XXXX	Xxxx
<b>Towards replacement &amp; expansion</b>		
- Depreciation	Xxxx	
- Replacement	XXXX	
- Deferred tax account	XXXX	
- Retained Profit	XXXX	XXXX
		XXXX

## Economic Value Added

The New York based financial advisory **Stern Stewart & Co.** postulated a concept of economic value added. Economic value added measures the excess returns over cost of capital. EVA measures whether the operating profit is sufficient enough to cover cost of capital. If a company's EVA is negative it is destroying shareholders wealth even though it may be reporting positive and growing EPS or return on capital employed.

### How to calculate EVA :

Particulars	Calculations	Rs.
EBIT		XXXX
Less: Interest		(XXX)
EBT		XXXX
Less: Tax		(XXX)
Profit After Tax (PAT)		XXXX
Add: Interest (1-t)		XXXX
Net Operating Profit after Tax (NOPAT)		XXXX
Less: Cost of Capital		XXXX
Economic Value Added		XXXX

**Expressed as a formula :**  $EVA = NOPAT - (Capital\ Employed \times WACC)$

## Advantages of EVA Analysis

Advantages of EVA analysis are as follows :

- (1) In some cases, company pay bonuses to the employees on the basis of EVA generated. Thud, it promotes the employees for working hard for generating higher revenue.
- (2) Using EVA, company can evaluate the projects and hence decide on whether to execute the project or not.
- (3) It helps the company in monitoring the problem areas and hence taking corrective action to resolve those problems.
- (4) EVA presents a better and true picture of the company to the owners, creditors, employees, shareholders and all other interested parties.
- (5) It helps the owners to identify the best way to run the company effectively and efficiently.

However there are some disadvantages of EVA like it is difficult to compute and also it does not take into account inflation into its calculation. Therefore, company should take into account above advantages and disadvantages before deciding whether to implement EVA or not.

## **Market Value Added**

Market value added is the difference between the Company's market and book value of shares. According to **Stern Stewart**, if the total market value of a company is more than the amount of capital invested, the company has managed to create shareholder value. If the market value is less than capital invested, the company has destroyed shareholder value.

**Market Value Added = Company's Market Value – Capital Invested**

With the simplifying assumption that market and book value of debt are equal, this is the same as Market Value Added = Market Value of equity – Book value of equity

Book value of equity refers to all equity equivalent items like reserves, retained earnings and provisions. In other words, in this context, all the items that are not debt (interest bearing or non-interest bearing) are classified as equity.

## **Shareholder Value Added**

Shareholder Value Added (SVA) represents the economic profits generated by a business above and beyond the minimum return required by all providers of capital. "Value" is added when the overall net economic cash flow of the business exceeds the economic cost of all the capital employed to produce the operating profit. Therefore, SVA integrates financial statements of the business (profit and loss, balance sheet and cash flow) into one meaningful measure.

The SVA approach is a methodology which recognizes that equity holders as well as debt financiers need to be compensated for the bearing of investment risk. The SVA methodology is a highly flexible approach to assist management in the decision making process. Its applications include performance monitoring, capital budgeting, output pricing and market valuation of the entity



## **MCQ FOR PRACTICE**

Q1. Which section of companies Act, 2013 deals with auditors report:

- (a) 143 (b) 147 (c) 148 (d) 154

Q2. CARO does not apply on a private company if, during a financial year turnover not exceeding –

- (a) Rs. 3 Crore (b) Rs. 5 Crore (c) Rs. 7 Crore (d) Rs. 10 Crore

Q3. CARO does not apply to

- (a) Banking Companies (b) Not for Profit Companies  
(c) both (a) and (b) (d) None of the above

Q4. CARO come into existence in the year—

- (a) 2000 (b) 2003 (c) 2004 (d) 2005

Q5. Section 134 of the Companies Act, 2013 deals with

- (a) Directors Report (b) Auditors Report (c) Secretary Report (d) Government Report

Q6. To calculate Economic Value Added (EVA) the cost of equity is deducted from—

- (a) Gross Profit (b) Net Profit (c) EBIT (d) Net Operating Profit after tax

Q7. Market Value Added is the difference between—

- (a) Market Value of equity and Book value of equity (b) Gross Profit and Net Profit  
(c) Turnover of two consecutive years (d) None of the above

Q8. In which of the following companies, auditor is required to report on matters specified under CARO, 2016:

- (a) Foreign company. (b) Small Company. (c) One person company (d) None of the above

Q9. A private limited company, In order to be covered under CARO, 2016, must satisfy which of the following conditions:

- (a) total borrowings exceeding rupees ten crores from any bank or financial institution at any point of time during the financial year.  
(b) total borrowings exceeding rupees one crore from any bank or financial institution as on the balance sheet date.  
(c) total borrowings exceeding rupees ten crores from any bank or financial institution as on balance sheet date.  
(d) total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year.

Q10. Astha Pvt. Ltd., which is a subsidiary company of Kiran Pvt. Ltd., has fully paid capital of Rs. 40 lakh. During the year, the company had borrowed Rs. 55 lakh each from a bank and a financial institution independently. It has the turnover of Rs. 175 lakhs.

- (a) CARO is not applicable as Astha Pvt. Ltd., is a small Company.
- (b) CARO is applicable as total borrowings exceeds Rs. 1 Cr.
- (c) CARO is not applicable as Astha Pvt. Ltd., is a subsidiary Company of another Pvt. Ltd.
- (d) CARO is applicable as turnover exceeds Rs. 1 Cr.

Q11. CARO, 2016 is applicable over a private limited company, having paid up capital and reserves and surplus is Rs. 1 crore or more as on the balance sheet date. For this purpose,

- (a) Paid-up share capital would include equity share capital only.
- (b) Amount of calls unpaid should be added to the figure of paid-up capital.
- (c) Amount originally paid-up on forfeited shares should be added to the figure of paid-up capital.
- (d) Share application money received should be considered as part of the paid-up capital.

Q12. When reporting under CARO, 2016, auditor is required to state in case of Nidhi Companies, whether the Nidhi company has complied with:

- (a) Net Owned funds to total debts in the ratio of 1:20
- (b) Net Owned funds to deposits in the ratio of 1:20
- (c) Net Owned funds to total debts in the ratio of 1:10
- (d) Net Owned funds to deposits in the ratio of 1:10

Q13. When reporting under CARO, 2016, auditor is required to state in case of Nidhi Companies, whether the Nidhi Company has complied with Net Owned Funds to Deposits liability in the ratio of 1:20. For this purpose, the deposit liability consists of:

- (a) Fixed Deposits and recurring deposits received from its members.
- (b) Fixed Deposits and saving deposits received from its members.
- (c) Recurring Deposits and Saving deposits received from its members
- (d) Fixed Deposits, recurring deposits and Saving deposits received from its members.

Q14. If a company is not regular in deposit of statutory dues to the appropriate authorities, auditor need to report on arrears of outstanding dues as at the last day of the financial year concerned for a period of:

- (a) more than 90 days from the date they became payable
- (b) more than 6 months from the date they became payable
- (c) more than 90 days from the reporting date
- (d) more than 6 months from the reporting date

Q15. Reporting under CARO, 2016 will be required in case of which companies:

- (a) X Pvt Ltd. which is a subsidiary of ABC Ltd. a listed company
- (b) X Pvt Ltd. which is One-person company, having paid up capital of Rs 105 lacs.
- (c) X Pvt Ltd. which is a Small Company, having outstanding borrowings from banks in excess of Rs 1 Cr.
- (d) All of the above.

Q16. What is the full form of CARO?

- (a) Company Account's Repository Order
- (b) Company Account's Reports Order
- (c) Company Auditor's Report Order
- (d) Company Assets Revaluation Order

Q17. A simplified financial statement that shows how much wealth has been created by a company is called\_\_\_\_\_.

- (a) Economic value added
- (b) Value added statement

- (c) Profit and loss statement
- (d) Income statement

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Q18. SVA stands for:

- (a) Shareholder Value Arrear
- (b) Shareholder Value Added
- (c) Security Value Added
- (d) None of the above

Q19. Requirements of Auditor's report is covered under which section of Companies Act, 2013?

- (a) Section 144
- (b) Section 143
- (c) Section 142
- (d) Section 145

Q20. Financial Statements are used by:

- (a) Investors
- (b) Creditors
- (c) Regulators
- (d) All of the above

Q21. Financial statements that are issues for the time periods smaller than one year are called:

- (a) Annual statements
- (b) Interim statements
- (c) Both of the above
- (d) None of the above
- (d) Ten lakh

Q22. Every company having net worth of Rs. \_\_\_\_\_ shall constitute a Corporate social responsibility committee of the Board.

- (a) Rs. 100 crore or more
- (b) Rs. 200 crore or more
- (c) Rs. 500 crore or more
- (d) Rs. 1000 crore or more

Q23. The Corporate social Responsibility committee shall consist of \_\_\_\_\_ directors, out of which atleast \_\_\_\_\_ director(s) shall be independent director(s).

- (a) three or more; two
- (b) two or more; one
- (c) four or more; two
- (d) three or more; one

Q24. The Board of Directors of the company, who has to form a Corporate Social Responsibility Committee, shall make sure that the company spends in every financial year, minimum \_\_\_\_\_% of the average net profits made during the 3 immediately preceding financial years as per the CSR policy.

- (a) 1
- (b) 2
- (c) 5
- (d) 10

Q25. With respect to CSR Reporting, The board's report referring to any financial year initiating on or after the 1st day of April 2014 shall include \_\_\_\_\_.

- (a) Monthly report on CSR
- (b) Annual report on CSR
- (c) Quarterly report on CSR
- (d) Bi-monthly report on CSR

Q26. As per section 2(76) of the Companies Act, 2013 the term Related party w.r.t public company means: A public company in which a director or manager is a director or holds along with his relative more than \_\_\_\_\_% of his paid up share capital.

- (a) 5%
- (b) 3%
- (c) 2%
- (d) 10%

- Q27. Financial Statements are prepared by transferring the account balances on the adjusted \_\_\_\_\_ to a set of financial statement templates.
- (a) Income Statement
  - (b) Statement of Shareholder's Equity
  - (c) Trial Balance
  - (d) Statement of Cash flow
- Q28. If any person contravenes the provisions of the section 197 of the Companies Act, 2013, he shall be punishable with fine. What is the minimum fine that people have to pay?
- (a) Ten Thousand Rupees
  - (b) One Lakh Rupees
  - (c) Five Lakh Rupees
  - (d) Two Lakh rupees
- Q29. A/An \_\_\_\_\_ is an explanation that is required by the audit team on certain points that they may have identified during an audit.
- (a) Audit query
  - (b) Related party
  - (c) Segment reporting
  - (d) Economic value added
- Q30. Financial Analysis is one of the important tool for investor for analysis. Which of the following statement/s does not support above statement?
- (a) Past performance analysis is a good indicator of future performance
  - (b) Future Trends can always be correctly predicted
  - (c) Investor read financial statement either to study the current situation or to forecast the future performance.
  - (d) None of the above

# ANSWERS

## Corporate Financial Reporting

1. A	2. B	3. B	4. B
5. A	6. D	7. A	8. A
9. D	10. B	11. C	12. B
13. D	14. B	15. A	16. C
17. B	18. B	19. B	20. D
21. B	22. C	23. D	24. B
25. B	26. C	27. C	28. B
29. A	30. B		



## **CHAPTER – 15 | ACCOUNTING STANDARD**

Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements.

### **Accounting Standards deal with the issues of**

- (i) recognition of events and transactions in the financial statements,
- (ii) measurement of these transactions and events,
- (iii) presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader

### **ACCOUNTING STANDARDS SETTING PROCESS**

- The Institute of Chartered Accountants of India (ICAI), being a premier accounting body in the country, took upon itself the leadership role by constituting the Accounting Standards Board (ASB) in 1977.
- The ASB considers the International Accounting Standards (IASs) / International Financial Reporting Standards (IFRSs) while framing Indian Accounting Standards (ASs) and try to integrate them, in the light of the applicable laws, customs, usages and business environment in the country.
- The composition of ASB includes representatives of industries (namely, ASSOCHAM, CII, FICCI), regulators, academicians, government departments, etc.
- Although ASB is a body constituted by the Council of the ICAI, it (ASB) is independent in the formulation of Accounting Standards and Council of the ICAI but ICAI
- is not empowered to make any modifications in the draft of Accounting Standards formulated by ASB without consulting with the ASB.

The standard-setting procedure of Accounting Standards Board (ASB) can be briefly outlined as follows:

1. **Identification of broad areas** by ASB for formulation of AS.
2. **Constitution of study groups** by ASB to consider specific projects and to prepare preliminary drafts of the proposed Accounting Standards. The draft normally includes objective and scope of the standard, definitions of the terms used in the standard, recognition and measurement principles, wherever applicable, and presentation and disclosure requirements.
3. **Consideration of the preliminary draft** prepared by the study group of ASB and revision, if any, of the draft on the basis of deliberations.
4. **Circulation of draft** of Accounting Standard (after revision by ASB) to the Council members of the ICAI and specified outside bodies, such as Department of Company Affairs (DCA), Securities and Exchange Board of India (SEBI), Comptroller and Auditor General of India (C&AG), Central Board of Direct Taxes (CBDT), Standing Conference of Public Enterprises (SCOPE), etc., for comments.
5. **Meeting with the representatives of the specified outside bodies** to ascertain their views on the draft of the proposed Accounting Standard.
6. **Finalization of the exposure draft** of the proposed Accounting Standard and its issuance inviting public comments.

## **Number of Accounting Standards**

- The council of the Institute of Chartered Accountants of India has, so far, issued 32 Accounting Standards.
- However, AS 8 on 'Accounting for Research and Development' has been withdrawn consequent to the issuance of AS 26 on 'Intangible Assets' and AS -6, 30, 31, 32 were deleted.
- Thus effectively, there are 27 Accounting Standards at present.

## **Accounting Standards issued by Council of ICAI**

AS 1 Disclosures of Accounting Policies  
AS 2 Valuation of Inventories  
AS 3 Cash Flow Statement  
AS 4 Contingencies and Events Occurring After the Balance Sheet Date  
AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies  
AS 6 \*Depreciation Accounting  
AS 7 Construction Contracts (revised 2002)  
AS 9 Revenue Recognition  
AS 10 Accounting for Fixed Assets  
AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003)  
AS 12 Accounting for Government Grants  
AS 13 Accounting for Investments  
AS 14 Accounting for Amalgamations  
AS 15 Employee Benefit  
AS 16 Borrowing Costs  
AS 17 Segment Reporting  
AS 18 Related Party Disclosures  
AS 19 Lease  
AS 20 Earning Per Share  
AS 21 Consolidated Financial Statements  
AS 22 Accounting for Taxes on Income  
AS 23 Accounting for Investments in Associates in Consolidated Financial  
AS 24 Discontinuing Operations  
AS 25 Interim financial Reporting  
AS 26 Intangible Assets  
AS 27 Financial Reporting of Interest in Joint Venture  
AS 28 Impairment of Assets  
AS 29 Provisions, Contingent Liabilities & Contingent Assets.  
AS 30 \*Financial Instruments: Recognition and Measurement  
AS 31 \*Financial Instruments: Presentation  
AS 32 \*Financial Instruments: Disclosures

\*In March 2016 withdrawn by ICAI

## **Exemptions or Relaxations for SMCs as defined in the Notification**

(A) Accounting Standards not applicable to SMCs in their entirety:

- AS 3 Cash Flow Statements.
- AS 17 Segment Reporting

(B) Accounting Standards not applicable to SMCs since the relevant Regulations require compliance with them only by certain Non-SMCs:

- AS 21, Consolidated Financial Statements



AS 23, Accounting for Investments in Associates in Consolidated Financial Statements  
AS 27, Financial Reporting of Interests in Joint Ventures (to the extent of requirements relating to Consolidated Financial Statements)

*(C) Accounting Standards in respect of which relaxations from certain requirements have been given to SMCs:*

Accounting Standard (AS) 15, Employee Benefits (revised 2005)  
AS 19, Leases  
AS 20, Earnings Per share  
AS 28, Impairment of Assets  
AS 29, Provisions, Contingent Liabilities and Contingent Assets

### **AS 01. Disclosure of Accounting Policies**

Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements. All significant accounting policies should be disclosed. Such disclosure form part of financial statements. All disclosures should be made at one place. Specific disclosure for the adoption of fundamental accounting assumptions is not required.

### **AS 02. Valuation of Inventories**

Inventories should be valued at the lower of cost and net realizable value.

The cost of inventories should comprise

- (a) All costs of purchase
- (b) Costs of conversion
- (c) Other costs incurred in bringing the inventories to their present location and condition

### **AS 03. Cash Flow Statements**

Cash Flows are inflows and outflows of cash and cash equivalents.

Cash Flow Statement represents the cash flows during the specified period by operating, investing and financing activities.

### **AS 04. Contingencies and Events Occurring After the Balance Sheet Date**

Contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

### **AS 05. Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies**

All items of income and expense, which are recognized in a period, should be included in the determination of net profit or loss for the period, unless an Accounting Standard requires, or permits otherwise.

The net profit or loss for the period comprises the following components, each of them should be disclosed on the face of the statement of profit and loss:

Profit or loss from ordinary activities; and Extraordinary items.

### **AS 07. Construction Contracts**

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

### **AS 09. Revenue Recognition**

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.



### **AS 10. Property Plant and Equipment**

A Fixed Asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business. (It is expected to be used for more than one accounting period.)

### **AS 12. Accounting for Government Grants**

Government Grants are assistance by the government in cash or kind for past or future compliance with certain conditions.

### **AS 13. Accounting for Investments**

Investments are classified as Long-Term Investments and Short-Term Investments. Current Investment is intended to be held for not more than one year and readily realisable. Long-term Investment is an investment other than a current investment. The carrying amount of current investments is lower of cost and fair value.

### **AS 15. Accounting for Retirement Benefits in the financial Statements of Employers**

Retirement Benefits consists of :

1. Provident Fund
2. Superannuation / Pension
3. Gratuity
4. Leave Encashment Benefit
5. Other Retirement Benefits

Accounting treatment under Defined Contribution Scheme/ Provident Fund

Contribution payable by the employer in a year is charged to profit & loss account

Accounting treatment under Defined Benefit Scheme/ Gratuity/ Leave Encashment

Payment of Retirement Benefit out of its own fund

### **AS 16. Borrowing Costs**

Borrowing Costs include:

Interest and commitment charges on borrowings;

Amortization of discounts or premiums relating to borrowings;

Amortization of ancillary costs incurred in connection with the arrangement of borrowings; and Exchange difference arising from borrowings to the extent it amounts to interest costs.

Borrowing costs should be recognized as an expense in the period in which they are incurred.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of that asset.

### **AS 17. Segment Reporting**

A BUSINESS SEGMENT is a distinguishable component of an enterprise engaged in providing an individual product or service or a group of related products or services subject to risks and returns that are different from those of other business segments.

### **AS 18. Related Party Disclosure**

Related party is considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

### **AS 19. Leases**

It should be applied in accounting for all leases other than:

- (a) lease agreements to explore for or use natural resources;
- (b) licensing agreements for items such as plays, manuscripts, patents and copyrights; and

(c) lease agreements to use lands.

### **AS 20. Earning Per Share**

An enterprise should present BASIC & DILUTED EPS on the face of the statement of Profit and Loss Account for each class of equity shares that has different rights to have a share in the net profit for the period. EPS has to be calculated & presented even in the case of losses.

### **AS 21. Consolidated Financial Statements**

1. This standard should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.
2. This Standard should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.
3. In the preparation of consolidated financial statements, other Accounting Standards also apply in the same manner as they apply to the separate financial statements.

### **AS 22. Accounting for Taxes on Income**

Accounting Income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving. (i.e., PBT as per P/L A/c)

### **AS 23. Accounting for Investments in Associates in Consolidated Financial Statements**

The Consolidated Financial Statements include investments in associates accounted on the equity method in accordance with Accounting Standard 23 (Accounting for Investments in Associates in Consolidated Financial Statements) and the jointly controlled entities accounted in accordance with Accounting Standard 27.

### **AS 24. Discontinuing Operations**

A discontinuing operation is a component of an enterprise:

- (a) That the enterprise, pursuant to a single plan, is:  
disposing of substantially in its entirety (example – demerger)  
disposing of piecemeal (selling and settling assets and liabilities one by one)  
terminating through abandonment; and
- (b) That represents a separate major line of business or geographical area of operations; and
- (c) That can be distinguished operationally and for financial reporting purposes.

### **AS 25. Interim Financial Reporting**

The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in a complete or condensed financial statements for an interim period.

### **AS 26. Intangible Assets**

An Intangible assets can be defined as non-monitory assets having no physical substance, held for use in the production or services for rental to others, or for administrative purposes.

- (a) Intangible assets can be sold
- (b) Non-monetary assets are those who sales proceeds using in no money.
- (c) Assets mean resources, under the control of entity and having future economic benefits.
- (d) Non physical substance except storage devices
- (e) Held for use means used in production, administration or can be given for rental.

### **AS 27. Financial Reporting of Interests in Joint Ventures**

1. This Standard should be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.



2. The requirements relating to accounting for joint ventures in consolidated financial statements, contained in this Standard, are applicable only where consolidated financial statements are prepared and presented by the venturer.

### **AS 28. Impairment of Assets**

Impairment of Assets means depreciation in the value of assets. An enterprise should assess at each balance sheet date whether there is any indication that any of its assets are impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.

### **AS 29. Provisions, Contingent Liabilities & Contingent Assets**

A provision is a liability which can be measured only by using a substantial degree of estimation.

## **APPLICABILITY OF Accounting Standards**

### **Level I Entities**

Non-corporate entities, which fall in any one or more of the following categories, at the end of the relevant

accounting period are classified as Level I entities:

- (i) Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.
- (ii) Banks (including cooperative banks), financial institutions or entities carrying on insurance business.
- (iii) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore in the immediately preceding accounting year.
- (iv) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year.
- (v) Holding and subsidiary entities of any one of the above. Level II Entities (SMEs)

Non-corporate entities which are not Level I entities but fall in any one or more of the following categories are **classified as Level II entities**:

- (i) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees one crore but does not exceed rupees fifty crore in the immediately preceding accounting year.
- (ii) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees one crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.
- (iii) Holding and subsidiary entities of any one of the above. Level III Entities (SMEs)

Non-corporate entities which are not covered under Level I and Level II are **considered as Level III entities**.

### **Additional Requirements**

- (1) An SME which does not disclose certain information pursuant to the exemptions or relaxations given to it should disclose (by way of a note to its financial statements) the fact that it is an SME and has complied with the Accounting Standards in so far as they are applicable to entities falling in Level II or Level III, as the case may be.
- (2) Where an entity, being covered in Level II or Level III, had qualified for any exemption or relaxation previously but no longer possesses qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from



the current period and the figures for the corresponding period of the previous accounting period need not be revised

merely by reason of its having ceased to be covered in Level II or Level III, as the case may be. The fact that the entity was covered in Level II or Level III, as the case may be, in the previous period and it had availed of the exemptions or relaxations available to that Level of entities should be disclosed in the notes to the financial statements.

(3) Where an entity has been covered in Level I and subsequently, ceases to be so covered, the entity will not qualify for exemption/relaxation available to Level II entities, until the entity ceases to be covered in Level I for two consecutive years. Similar is the case in respect of an entity, which has been covered in Level I or Level II and subsequently, gets covered under Level III.

(4) If an entity covered in Level II or Level III opts not to avail of the exemptions or relaxations available to that Level of entities in respect of any but not all of the Accounting Standards, it should disclose the Standard(s) in respect of which it has availed the exemption or relaxation.

(5) If an entity covered in Level II or Level III desires to disclose the information not required to be disclosed pursuant to the exemptions or relaxations available to that Level of entities, it should disclose that information in compliance with the relevant Accounting Standard.

(6) An entity covered in Level II or Level III may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in an Accounting Standard: Provided that such a partial exemption or relaxation and disclosure should not be permitted to mislead any person or public.

(7) In respect of Accounting Standard (AS) 15, Employee Benefits, exemptions/ relaxations are available to Level II and Level III entities, under two sub-classifications, viz., (i) entities whose average number of persons employed during the year is 50 or more, and (ii) entities whose average number of persons employed during the year is less than 50. The requirements stated in paragraphs (1) to (6) above, mutatis mutandis, apply to these sub-classifications.

### **Criteria for classification of Companies under the Companies (Accounting Standard) Rules, 2006**

Small-and Medium-Sized Companies (SMC) as defined in Clause 2(f) of the Companies (Accounting Standards) Rules, 2006:

“Small-and Medium-Sized Company” (SMC) means, a company-

- (i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- (ii) which is not a bank, financial institution or an insurance company;
- (iii) whose turnover (excluding other income) did not exceed rupees fifty crore in the immediately preceding accounting year;
- (iv) which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and
- (v) which is not a holding or subsidiary company of a company that is not a small-and medium-sized company.

*Explanation:* For the purposes of clause (f), a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

### **Non-SMCs**

Companies not falling within the definition of SMC are considered as Non- SMCs.

### **Enterprises to which the Accounting Standards Apply**



Accounting Standards apply in respect of any enterprise (whether organised in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, whether or not profit oriented and even if established for charitable or religious purposes. Accounting Standards however, do not apply to enterprises solely carrying on the activities, which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people). Exclusion of an enterprise from the applicability of the Accounting Standards would be permissible only if no part of the activity of such enterprise is commercial, industrial or business in nature. Even if a very small proportion of the activities of an enterprise were considered to be commercial, industrial or business in nature, the Accounting Standards would apply to all its activities including those, which are not commercial, industrial or business in nature.

## **INTERNATIONAL ACCOUNTING STANDARD BOARD**

With a view of achieving these objectives, the London-based group namely the International Accounting Standards Committee (IASC), responsible for developing International Accounting Standards, was established in June, 1973.

It is presently known as International Accounting Standards Board (IASB).

The IASC comprises the professional accountancy bodies of over 75 countries (including the Institute of Chartered Accountants of India).

Primarily, the IASC was established, in the public interest, to formulate and publish, International Accounting Standards to be followed in the presentation of audited financial statements. International Accounting Standards were issued to promote acceptance and observance of International Accounting Standards worldwide.

Between 1973 and 2001, the International Accounting Standards Committee (IASC) released International Accounting Standards (IAS).

Between 1997 and 1999, the IASC restructured their organization, which resulted in the formation of International Accounting Standards Board (IASB). These changes came into effect on 1<sup>st</sup> April, 2001.

Subsequently, IASB issued statements about current and future standards: IASB publishes its Standards in a series of pronouncements called International Financial Reporting Standards (IFRS).

However, IASB has not rejected the standards issued by the IASC. Those pronouncements continue to be designated as "International Accounting Standards" (IAS).

### **International Financial Reporting Standards (IFRS) as Global Standards**

The term IFRS comprises IFRS issued by IASB, IAS issued by International Accounting Standards Committee (IASC), and Interpretations issued by the Standard Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB.

International Financial Reporting Standards (IFRSs) are considered a "principles-based" set of standards.

International Financial Reporting Standards comprise –

- 9-International Financial Reporting Standards (IFRS) – standards issued after 2001 by IASB.
- 29-International Accounting Standards (IAS) – standards issued before 2001 by IASC which are still

valid.

– 16-Interpretations issued by International Financial Reporting Interpretations Committee (IFRIC) after 2001.

– 11-interpretations issued by Standing Interpretations Committee (SIC) before 2001.

#### LIST OF IAS

- IAS-1-Presentation of Financial Statements
- IAS-2- Inventories
- IAS-7- Cash Flow Statements
- IAS-8- Accounting Policies, Change in Accounting estimates and Errors
- IAS-10- Events after balance sheet date
- IAS-11- Construction Contracts
- IAS-12- Income Taxes
- IAS-16-Property, Plant and Equipments
- IAS-17- Leases
- IAS-18- Revenue
- IAS-19- Employee Benefits
- IAS-20-Accounting for Govt Grant and Disclosure of Govt. Assistance
- IAS-21- Effect of Changes in Forex Rates
- IAS-23-Borrowing Costs
- IAS-24- Related Party Disclosures
- IAS-26- Accounting and reporting by retirement benefit plans
- IAS-27- Consolidated and Separate Financial Statements
- IAS-28- Investment in Associates
- IAS-29- Financial Reporting in Hyperinflationary Conditions
- IAS-31- Interest in Joint Ventures
- IAS-32- Financial Instruments- Presentation
- IAS-33- Earning Per Share
- IAS-34- Interim Financial Reporting
- IAS-36- Impairment of Assets
- IAS-37- Provisions, Contingent Liabilities and Contingent Assets
- IAS-38- Intangible Assets
- IAS-39- Financial Instruments: Recognition and Measurement
- IAS-40-Investment Property
- IAS-41- Agriculture
- IFRS-1 First Time Adoption of International Financial Reporting Standard
- IFRS-2 Share Based Payment
- IFRS-3 Business Combination
- IFRS-4 Insurance Contracts
- IFRS-5 Non Current Asset held for sale and Discontinued Operations
- IFRS-6 Exploration for and Evaluation and Mineral resources
- IFRS-7 – Financial Instruments: Disclosures
- IFRS-8 – Operating Segments
- IFRS-9 – Financial Instruments



## **Road Map for the application of Ind AS by MCA**

**Phase 1:** Mandatory for accounting periods beginning on or after 1 April 2016

**A**

- Companies whose equity and/or debt securities are listed, or
- Companies who are in the process of listing on any stock exchange in India or outside India, and
- Companies having a net worth of 500 crore INR or more.

**B**

- Unlisted companies having a net worth of 500 crore INR or more.

**C**

- Holding, subsidiary, joint venture or associate companies of companies covered in (A) and (B).
- Comparative information required for the period ending 31 March 2016 or thereafter.
- The roadmap does not mention the net worth criteria for holding, subsidiary, joint venture or associate companies covered in (C) above. Accordingly, it appears that even smaller sized companies in this category will get covered in phase 1.

**Phase 2:** Mandatory for accounting periods beginning on or after 1 April 2017

**D**

- Companies whose equity and/or debt securities are listed, or
- Companies who are in the process of listing on any stock exchange in India or outside India, and
- Companies having a net worth of less than 500 crore INR.

**E**

- Unlisted companies having a net worth of 250 crore INR or more but less than 500 crore INR and not covered in any of the other categories.

**F**

- Holding, subsidiary, joint venture or associate companies of companies covered in (D) and (E)

## **List of Ind AS**

1. Ind AS 101 First-time Adoption of Indian Accounting Standards
2. Ind AS 102 Share based Payment
3. Ind AS 103 Business Combinations
4. Ind AS 104 Insurance Contracts
5. Ind AS 105 Non-current Assets Held for Sale and Discontinued Operations
6. Ind AS 106 Exploration for and Evaluation of Mineral Resources
7. Ind AS 107 Financial Instruments: Disclosures
8. Ind AS 108 Operating Segments
9. Ind AS 1 Presentation of Financial Statements
10. Ind AS 2 Inventories
11. Ind AS 7 Statement of Cash Flows
12. Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors
13. Ind AS 10 Events after the Reporting Period
14. Ind AS 11 Construction Contracts
15. Ind AS 12 Income Taxes
16. Ind AS 16 Property, Plant and Equipment
17. Ind AS 17 Leases
18. Ind AS 18 Revenue
19. Ind AS 19 Employee Benefits
20. Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance
21. Ind AS 21 The Effects of Changes in Foreign Exchange Rates
22. Ind AS 23 Borrowing Costs
23. Ind AS 24 Related Party Disclosures
24. Ind AS 27 Consolidated and Separate Financial Statements
25. Ind AS 28 Investments in Associates
26. Ind AS 29 Financial Reporting in Hyperinflationary Economies
27. Ind AS 31 Interests in Joint Ventures
28. Ind AS 32 Financial Instruments: Presentation
29. Ind AS 33 Earnings per Share
30. Ind AS 34 Interim Financial Reporting
31. Ind AS 36 Impairment of Assets
32. Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets
33. Ind AS 38 Intangible Assets
34. Ind AS 39 Financial Instruments: Recognition and Measurement
35. Ind AS 40 Investment Property

## **MCQ FOR PRACTICE**

Q1. AS 7 issued by ICAI deals with:

- (A) Disclosure of accounting Policies
- (C) Construction Contracts

- (B) Revenue Recognition
- (D) Government grants

(CS Sampler Paper)

Q2. AS 1 issued by ICAI deals with:

- (A) Disclosure of accounting Policies
- (C) Construction Contracts

- (B) Revenue Recognition
- (D) Government grants

Q3. AS 3 issued by ICAI deals with:

- (A) Disclosure of accounting Policies
- (C) Construction Contracts

- (B) Revenue Recognition
- (D) Cash Flow Statement

Q4. AS 26 issued by ICAI deals with:

- (A) Disclosure of accounting Policies
- (C) Cash Flow Statements

- (B) Intangible Assets
- (D) Government grants

Q5. AS 28 issued by ICAI deals with:

- (A) Impairment of Assets
- (C) Cash Flow Statements

- (B) Intangible Assets
- (D) Government grants

Q6. AS 22 issued by ICAI deals with:

- (A) Disclosure of accounting Policies
- (C) Accounting for Income Tax

- (B) Intangible Assets
- (D) Government grants

Q7. AS 12 issued by ICAI deals with:

- (A) Disclosure of accounting Policies
- (C) Accounting for Income Tax

- (B) Intangible Assets
- (D) Government grants

Q8. AS 20 issued by ICAI deals with:

- (A) Earning Per share
- (C) Accounting for Income Tax

- (B) Intangible Assets
- (D) Government grants

Q9. To determine whether an intangible assets is impaired, an enterprise applies:

- (A) AS 25
- (C) AS 26

- (B) AS 28
- (D) AS 29

Q10. As per Accounting Standard 28, an impairment loss should be recognized whenever the recoverable amount of an asset is less than its-

- (A) Original Cost
- (C) Market Value

- (B) Carrying Value
- (D) None of the above

Q11. Accounting standards are issued by

- (A) Institute of Company Secretaries of India
- (B) Institute of Chartered Accountant of India
- (C) Securities exchange board of India
- (D) Institute of Cost Accountant of India



Q12. Accounting standards are formulated with a view to \_\_\_\_\_ different accounting policies and practices in use in a country.

- (A) Harmonize
- (B) Regulate
- (C) Promote
- (D) None of the above

Q13. Indian Accounting Standards are formulated under the authority of the-

- (A) International Accounting Standards Board
- (B) Council of the Institute of Chartered Accountants of India
- (C) Accounting Standard Board
- (D) National Financial reporting Authority

Q14. Accounting Standards –

- (A) Harmonise accounting standards
- (B) Eliminate the non-comparability of financial statement
- (C) Improve the reliability of financial statements
- (D) All of the above

Q15. AS 13 deals with

- (A) Earning per share
- (B) Financial Instrument Presentation
- (C) Valuation of Investment
- (D) None of the above

Q16. GAAP stands for:

- (a) Generally accepted accounting principles
- (b) Generally accumulated adherence policy
- (c) Generally accounting adherence policy
- (d) Generally assisted accounting principles

**(CS SAMPLE PAPER)**

Q17. \_\_\_\_\_ are set of accounting standards notified by the Ministry of Corporate affairs which are converged with International Financial Reporting Standards.

- (a) International Accounting Standards
- (b) Indian Accounting Standard
- (c) Indian Auditing Standard
- (d) International Auditing Standards

**(CS SAMPLE PAPER)**

Q18. IASB stands for:

- (a) Indian Accounting Standard Board
- (b) International Auditing Standard Board
- (c) International Accounting Standard Board
- (d) International Assurance Service Board

**(CS SAMPLE PAPER)**

Q19. Financial Reporting Council is an organisation of which country?

- (a) The USA
- (b) The UK
- (c) Australia
- (d) Canada

**(CS SAMPLE PAPER)**

Q20. Under Phase IV of adoption of Ind AS, all NBFCs whose net worth is more than or equal to \_\_\_\_\_ but less than \_\_\_\_\_ shall have Ind AS mandatorily applicable to them from April 1, 2019.

- (a) Rs. 250 crore; Rs. 500 crore
- (b) Rs. 300 crore; Rs. 600 crore
- (c) Rs. 100 crore; Rs. 500 crore
- (d) Rs. 400 crore; Rs. 800 crore

**(CS SAMPLE PAPER)**

Q21. Ind AS 113 deals with:

- (a) Fair value Measurement
- (b) Joint arrangements
- (c) Financial Instruments
- (d) Insurance Contract

(CS SAMPLE PAPER)

Q22. International Accounting Standards are issued by \_\_\_\_\_.

- (A) International Accounting Standard Board
- (B) Accounting Standard Board
- (C) Accounting Standard Committee
- (D) None of the above

Q23. Statement 1: Accounting standards are formulated by International Accounting Standard Board.  
Statement 2: AS 19 relates to related party disclosure

- (A) Both the statements are correct
- (B) Both the statements are incorrect
- (C) Statement 1 is correct but statement 2 is incorrect
- (D) Statement 2 is correct but statement 1 is incorrect

Q24. Statement 1: AS-15 deals with earning per share.

Statement 2: As per AS-26, intangible asset arising from research should not be recognized as an asset.

- (A) Both the statements are correct
- (B) Both the statements are incorrect
- (C) Statement 1 is correct but statement 2 is incorrect
- (D) Statement 2 is correct but statement 1 is incorrect

Q25. Ind AS 104 deals with

- |                                     |                        |
|-------------------------------------|------------------------|
| (A) Share based Payment             | (B) Insurance Contract |
| (C) Evaluation of mineral resources | (D) None of the above  |

Q26. Ind AS 106 deals with

- |                                     |                        |
|-------------------------------------|------------------------|
| (A) Financial Investment            | (B) Insurance Contract |
| (C) Evaluation of mineral resources | (D) None of the above  |

Q.27 The Accounting Standards are mandatory for:

- (a) Companies
- (b) Partnership Concerns
- (c) Charitable Organizations
- (d) Sole Proprietorship

Q.28 Accounting Standards refers to specific accounting:

- (a) Principles
- (b) Methods of applying those principles
- (c) Both (a) and (b)
- (d) None

(CS SAMPLE PAPER)

Q.29 Accounting Standards \_\_\_\_\_ the statute:

- (a) can over-ride
- (b) cannot over-ride
- (c) may over-ride
- (d) None

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Q.30 IASB stands for:

- (a) Indian Accounting Standards Board
- (b) Indian Accounting Standards Bulletin
- (c) Indian Accounting Standards Bulletin
- (d) International Accounting Standards Board

Q.31 AS-8 on Accounting for Research and Development:

- (a) Is replaced by AS -26
- (b) Is applicable only to listed companies
- (c) Is mandatory for Research institutions
- (d) Is still in use

Q.32 The purpose of Accounting Standards is to :

- (a) Harmonise accounting policies
- (b) Eliminate the non comparability of financial statements
- (c) Improve reliability of financial statements
- (d) All of the above

Q.33 AS 2 is on:

- (a) Disclosure of Accounting Policies
- (b) Valuation of Inventories
- (c) Revenue Recognition
- (d) Depreciation Accounting

Q.34 An accounting policy may be changed

- (a) To comply with accounting standard
- (b) To ensure more appropriate presentation of the financial statement of the enterprise
- (c) To comply with law
- (d) All of the above

Q.35 FRRP stands for –

- (a) Financial Regulation Review Panel
- (b) Financial Reporting Review Panel
- (c) Financial Reports Regulatory Provision
- (d) None of the above

Q.36 IFRS refers to –

- (a) International Financial Reporting System
- (b) Indian Forest Reserve Service
- (c) International Financial Reporting Standard
- (d) None of the above

Q.37 Professional Oversight Board (POB) is regulatory body situated in –

- (a) USA
- (b) India
- (c) Japan
- (d) UK

Q.38 Accounting and Actuarial Discipline Board (AADB) is a disciplinary body in -

- (a) UK
- (b) USA
- (c) France
- (d) Japan



Q.39 FASB Stands for:-

- (a) Financial Accounting Standard Board
- (b) Financial Accounting System Board
- (c) Financial Accounting Securities Board
- (d) None of the above

Q.40 APB stands for:

- (a) Auditing Professional Board
- (b) Auditing Practices Board
- (c) Auditing Professional Body
- (d) None of the above

Q.41 AASB Stands for

- (a) Australian Accounting Standard Board
- (b) American Accounting Standard Board
- (c) Australian Professional System Board
- (d) None of the above

Q42. IND AS will apply to:

- (A) Both consolidation as well as standalone financial of company.
- (B) Only consolidated Financial Statement
- (C) Only Standalone Financial Statement
- (D) Optional

Q43. The International Accounting Standards Committee was set up in:

- (A) 1976
- (B) 2009
- (C) 1967
- (D) 1982

Q44. Which IND AS is applicable on Investment Property

- (A) Ind AS 34
- (B) Ind AS 38
- (C) Ind AS 39
- (D) Ind AS 40

Q45. Ind AS 36 is related with the following

- (A) Impairment of Asset
- (B) Investment of Property
- (C) Earning Per Share
- (D) None of the above

Q46. Ind AS 2 is related with the following

- (A) Impairment of Asset
- (B) Operating Segment
- (C) Inventories
- (D) None of the above

Q47. Ind AS 108 is related with the following

- (A) Leases
- (B) Operating Segment
- (C) Inventories
- (D) None of the above

Q48. Ind AS 19 is related with the following

- (A) Leases
- (B) Employee Benefit
- (C) Income Tax
- (D) None of the above

Q49. Ind AS 27 is related with the following

- (A) Consolidation of Assets
- (B) Earning per share
- (C) Impairment of assets
- (D) None of the above

Q50. \_\_\_\_\_prescribes the basis for presentation of general purpose financial statement to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities.

- (a) Ind AS 1
- (b) Ind AS 2
- (c) Ind AS 3
- (d) Ind AS 4

# ANSWERS

## Accounting Standards

1. C	2. A	3. D	4. B
5. A	6. C	7. A	8. A
9. B	10. B	11. B	12. A
13. A	14. D	15. C	16. D
17. B	18. C	19. B	20. A
21. A	22. A	23. B	24. D
25. B	26. C	27. A	28. C
29. B	30. D	31. A	32. D
33. B	34. D	35. B	36. C
37. D	38. A	39. A	40. B
41. A	42. A	43. C	44. D
45. A	46. C	47. B	48. B
49. A	50. A		