# 1

# PREPARATION OF FINAL ACCOUNTS OF COMPANIES - I

**Unit Structure:**



## 1.0 OBJECTIVES

After studying this chapter, you will be able to understand

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

## 1.1 INTRODUCTION

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

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

## 1.2 PROVISIONS RELATING TO FINANCIAL STATEMENTS UNDER THE NEW COMPANIES ACT

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

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

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

### 1.2.1 Nature of Financial Statements

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

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

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

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

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

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

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

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

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

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

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

### 1.2.2 Objectives of Financial Statements

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

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

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

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

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

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

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

## 1.3 A S 1 – DISCLOSURE OF ACCOUNTING POLICIES

**AS 1 – Disclosure of Accounting Policies**

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

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

**Nature of Accounting Policies**

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

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

**Areas in which differing Accounting Policies are possible**

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

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

The above list of examples is not exhaustive.

**Considerations in the Selection of Accounting Policies**

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

**Disclosure of Accounting Policies**

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

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

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

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

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

**Remember the following:**

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

## 1.4 ADJUSTMENTS IN PREPARATION OF FINANCIAL STATEMENTS

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

**Need for Adjustments:**

Adjustments are done to:

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

**Important Point to be Noted while passing adjustment entries:**

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

**List of Adjustments in Final Accounts**

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

Note: Adjustments would appear outside the trial balance.

**1. Closing Stock**

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

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

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

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

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

To Trading A/C

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

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

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

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

To Asset A/C

(Charging depreciation on fixed asset)

Profit and Loss A/C Dr

To Depreciation A/C

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

B. When Provision for Depreciation is Maintained

Journal Entry When Provision is Maintained
Depreciation A/C Dr

To Provision for Depreciation A/C

(Being provision for depreciation made)

Step 2
Profit and Loss A/C Dr

To Depreciation A/C

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

**3. Outstanding expenses and income**

**A. Outstanding Expenses**

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

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

**Expenses A/c …Dr.**

**Input CGST A/c …Dr.**

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

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

**B. Accrued Income or Outstanding Income**

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

Journal Entry for Adjustment of Accrued Income in Final Accounts

Accrued Income A/C Dr

To Income A/C

To Output CGST A/C

To Output SGST A/C

To Output IGST A/C

(Recording income earned but not received)

Treatment of Accrued Income Adjustment in Financial Statements

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

**4. Prepaid expenses and Pre-received income**

A. Pre-paid Expenses

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

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

Journal Entry for Adjustment of Prepaid Expenses in Final Accounts

Prepaid Expense A/C Dr

To Expense A/C

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

B. Pre-received Income or Income Received in Advance

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

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

Income A/C Dr

To Income Received in Advance A/C

To Output CGST A/C

To Output SGST A/C

(Recording income received but not earned)

Treatment of Income Received in Advance in Financial Statements

- Trading Account: No effect
- Profit & Loss Account: Show on the credit side (Subtract from the respectiveincome)
- Balance Sheet: Show on the liability side (usually under the head current liabilities)

**5. Proposed Dividend and Unclaimed Dividend**

**Dividends:**

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

**Legal Provisions regarding Dividend**

**A company may pay dividends from any or all of the three following sources:**

(i) Profits of the current year

(ii) Undistributed profits of previous years after providing for depreciation as per Schedule II of the Companies Act, 2013

(iii) Out of both or

(iv) Moneys provided by the Central or any State Government for the payment of dividends in pursuance of a guarantee given by the government concerned.

**Proposed Dividend:**

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

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

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

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

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

**Interim Dividend**

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

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

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

**Unclaimed Dividend**

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

**6. Provision for Tax and Advance Tax**

**A. Provision for Income Tax:**

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

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

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

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

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

**B. Advance Income Tax:**

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

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

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

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

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

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

**Meaning of Bill of Exchange**

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

**ENDORSEMENT OF BILL OF EXCHANGE:**

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

**Journal Entries in the Books of Endorser and Endorsee:**

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

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

**Dishonour of Bill**

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

**Dishonour by Non-Payment**

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

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

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

**8. Capital Expenditure included in Revenue expenditure and vice versa**

**a. Capital Expenditure incorrectly treated as Revenue**

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

For example, furniture purchases may be included in purchases.

**b. Revenue Expenditure incorrectly treated as Capital Expenditure**

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

**9. Unrecorded Sales and Purchases**

**a. Unrecorded Sales**

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

**b. Unrecorded Purchases**

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

**10. Good sold on sale or return basis**

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

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

**11. Managerial remuneration on Net Profit before tax**

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

A. Manager's Commission Payable Before Charging the Commission

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

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

Profit and Loss A/C Dr

To Manager's Commission Payable

(Recording outstanding commission payable to managers)

Treatment of Manager's Commission in Financial Statements

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

B. Manager's Commission Payable After Charging the Commission

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

**Calculation of Net Profit for Managerial Remuneration**

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

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

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

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

**12. Transfer to Reserves**

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

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

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

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

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

**13. Bad debt and Provision for bad debts**

A. Bad Debts

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

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

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

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

Journal Entry for Adjustment of Bad Debts in Final Accounts

Bad Debts A/C Dr

To Debtor's A/C

(Recording bad debts)

Step 2

Profit and Loss A/C Dr

To Bad Debts A/C

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

Treatment of Bad Debts in Financial Statements

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

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

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

Journal Entry for Adjustment of Further Bad Debts in Final Accounts

Bad Debts A/C Dr

To Debtor's A/C

(Recording further bad debts)

B. Provision for Doubtful Debts

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

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

When Provision for Doubtful Debts does not Appear in Trial Balance

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

Profit and Loss A/C Dr

To Provision for Doubtful Debts A/C

(Recording provision for doubtful debts)

Treatment of Provision for Doubtful Debts in Financial Statements

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

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

Provision for Discount on Debtors

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

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

Profit and Loss A/C Dr

To Provision for Discount on Debtors A/C

(Recording provision for discount on debtors)

Treatment of Provision for Discount on Debtors in Financial Statements

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

**14. Calls in Arrears**

Calls in Arrears and Calls in Advance

Calls-In-Arrears

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

Methods of Accounting Treatment of Calls-In-Arrears

Without opening Calls-in-Arrears Account

By opening Calls-in-Arrears Account

Without opening Calls-in-Arrears Account

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

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

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

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

## A. If Goods are Not Insured

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

Profit and Loss A/C Dr

To Trading A/C

To Input CGST A/C

To Input SGST A/C

(Recording total value of abnormal loss)

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

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

## B. If Goods are Insured

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

Accidental Loss A/C Dr

To Trading A/C

To Input CGST A/C

To Input SGST A/C

(Recording total value of abnormal loss)

Step 2

Insurance Claim A/C Dr

Profit and Loss A/C Dr

To Accidental Loss A/C

(Adjusting the insurance claim received)

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

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

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

Balance Sheet: No effect

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

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

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

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

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

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

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

**Presentation of Balance Sheet**

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

**Key features of Balance Sheet**

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

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

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

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

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

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

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

## 1.6 VERTICAL FINANCIAL STATEMENT

**ABC LIMITED**
**Balance Sheet As On 31st March, 2022**

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

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

## GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

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

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

All other assets shall be classified as non-current.

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

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

All other liabilities must be designated as non-current.

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

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

**A. Share Capital**

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

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

**B. Reserves and Surplus**

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

e. Revaluation Reserve;
f. Share Options Outstanding Account;
g. Other Reserves(specify the nature and purpose of each reserve and the amount in respect thereof);
h. Surplus i.e., balance in Statement of Profit and Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/ from reserves, etc.;
(Additions and deductions since last balance sheet to be shown under each of the specified heads);
ii. A reserve specifically represented by earmarked investments shall be termed as a “fund”.
iii. The debit balance of the profit and loss statement must be shown as a negative figure under the heading "Surplus." Similarly, even if the resulting figure is negative, the balance of "Reserves and Surplus," after adjusting for any negative balance of surplus, shall be shown under the heading "Reserves and Surplus."

**C. Long-term Borrowings**

i. Long-term borrowings shall be classified as:
a. Bonds/debentures;
b. Term loans:
A. From banks.
B. From other parties.
c. Deferred payment liabilities;
d. Deposits;
e. Loans and advances from related parties;
f. Long-term maturities of finance lease obligations;
g. Other loans and advances (specify nature).
ii. Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
iii. Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
iv. Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due.
v. Particulars of any redeemed bonds/debentures which the company has power to reissue shall be disclosed.
vi. Terms of repayment of term loans and other loans shall be stated.
vii. Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

**D. Other Long-term Liabilities**

Other Long-term Liabilities shall be classified as:

a. Trade payables;
b. Others.

**E. Long-term provisions**

The amounts shall be classified as:

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

**F. Short-term borrowings**

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

**G. Other current liabilities**

The amounts shall be classified as:

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

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

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

**H. Short-term provisions**

The amounts shall be classified as:

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

**I. Tangible assets**

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

**J. Intangible assets**

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

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

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

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

**K. Non-current investments**

i. Non-current investments shall be classified as trade investments and other investments and further classified as:

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

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

iii. The following shall also be disclosed:

a. Aggregate amount of quoted investments and market value thereof;
b. Aggregate amount of unquoted investments;
c. Aggregate provision for diminution in value of investments.

**L. Long-term loans and advances**

i. Long-term loans and advances shall be classified as:

a. Capital Advances;
b. Security Deposits;
c. Loans and advances to related parties (giving details thereof);
d. Other loans and advances (specify nature).

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

**M. Other non-current assets**

Other non-current assets shall be classified as:

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

**N. Current Investments**

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

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

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

**O. Inventories**

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

**P. Trade Receivables**

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

**Q. Cash and cash equivalents**

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

**R. Short-term loans and advances**

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

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

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

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

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

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

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

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

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

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

## 1.7 STATEMENT OF PROFIT AND LOSS

**Statement of Profit and Loss**

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

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

Salient features of the statement of Profit and Loss:

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

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

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

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

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

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

**GENERAL INSTRUCTIONS FORPREPARATION OF STATEMENT OF PROFIT AND LOSS**

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

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

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

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

- Interest; and
- Other financial services.

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

iii. Finance Costs

Finance costs shall be classified as:

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

iv. Other Income

Other income shall be classified as:

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

v. Additional Information:

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

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

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

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

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

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

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

xi. (a) Dividends from subsidiary companies.

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

**Exercise:**
**Choose the correct alternative:**

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

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

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

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

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

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

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

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

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

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

6. Claims not acknowledged as debts

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

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

| | | | | | |
|---|---|---|---|---|---|
| b. | Loan | c. | Current Liabilities | d. | Contingent Liabilities |

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

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

9. Unclaimed dividend is shown under

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

10. The example of accounting policy is ________.

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

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

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

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

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

Correct Answer:

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

**Short Notes:**

1. Nature of Financial Statements

2. Objectives of Financial Statements

3. Current investment.

4. Operating cycle.

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# 2

# PREPARATION OF FINAL ACCOUNTS OF COMPANIES - II

**Unit Structure:**

2.0 Objectives

2.1 Illustration

2.2 Exercise

## 2.0 OBJECTIVES

After studying this chapter, you will be able to understand

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

## 2.1 ILLUSTRATIONS

**Illustration 01:**

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

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

**Solution 01:**

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

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

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

**Illustration 02:**

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

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

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

**Solution 02:**

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

Working Note:

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

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

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

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

**Illustration 03:**

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

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

Additional Information:

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

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

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

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

**Solution 03:**

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

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

Extract of Balance Sheet as at 31-3-2016

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

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

WN. 1: Calculation of Excess/Shortage Provision

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

WN. 2: Income Tax Payable

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

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

**Illustration 04: (Fixed Assets Schedule)**

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

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

Solution:

Note for Tangible Assets:

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

**Illustration 5:**

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

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



**Further Information:**

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

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

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

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

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

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

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

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

**Solution 05:**

In the Books of Ram Ltd.

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

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

**Notes to Accounts**

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

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

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

**Illustration 6:**

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

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

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

**Additional Information:**

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

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

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

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

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

(f) Income Tax Rate 30%.

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

**Solution 06:**

M Ltd.

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

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

**Notes to Accounts:**

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

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

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

**Illustration 7:**

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

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

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

In the books of Statistics Ltd.

Balance Sheet as on 31st March, 2022

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

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

Notes to Accounts

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

**Illustration 8:**

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

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

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

**Adjustments needed:**

1. Share Capital consist of:

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

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

2. Depreciate assets by ₹ 20,00,000.

Gold Ltd.

Balance Sheet as at 31st March, 2018

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

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

**Notes to Accounts:**

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

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

**Illustration 09:**

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

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

**Additional Information:**

1) On 31st March, 2016, the company issued bonus shares in the ratio of 1 bonus for every 3 Equity Shares held. No entry has been passed for the same.

2) The Authorised Share Capital is 25,000 Equity Shares of ₹ 100 each.

3) Suspense Account of ₹ 20,000 represents cash received for the sale of some part of the machinery on 1st April, 2016. The cost of the machinery was ₹ 50,000 and accumulated depreciation there on being ₹ 40,000.

4) Depreciation is to be provided on Plant and Machinery at 20% p.a. on Reducing Balance Method.

5) It is the policy of the company to write off 1/5th of Share Issue Expenses every year, upto 31st March, 2016, 4/5th of total Share Issue Expenses was written off.

6) Debtors include ₹ 80,000 due for more than 6 months.

7) Provision for Taxation to be made for ₹ 1,20,000.

8) Income Tax Assessment for the Accounting year 2015-16 is completed on 27th March, 2017 resulting with a gross demand of ₹ 3,30,000 but no effect has been given so far.

**Prepare:**

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

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

3. Ignore Previous year's figures.

**Solution 09:**

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

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

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

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

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

Notes to Account

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

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

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

Schedule 04: Tangible Fixed Assets

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

EXERCISE:

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

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

2. Bills Receivable is shown under __________.

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

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

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

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

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

5. Future bad debts are usually estimated as ____________.

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

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

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

7. Bank Balance is shown under ________.

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

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

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

9. Preliminary Expenses are shown under

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

**Solution:**

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

**Unsolved Problems**

**Problem 1:**

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

**Problem 2:**

A company has the following information on 31.03.2017:

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

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

Problem 3

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

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

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

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

4. Salaries outstanding were ₹ 5,000

Prepare the income statement from the given information.

**Problem 4:**

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

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

**Additional Information:**

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

b. Closing stock was ₹ 50,000.

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

d. Income tax to be provided at 40%.

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

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

**Problem 5:**

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

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

**Additional Information:**

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

Prepare Income statement & Balance sheet from the given information.

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# Module II

# 3

# REDEMPTION OF PREFERENCE SHARES

**Unit Structure**

3.0 Objective

3.1 Introduction

3.2 Accounting Procedure

3.3 Questions

## 3.0 OBJECTIVE

After studying this unit students will be able to:

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

## 3.1 INTRODUCTION

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

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

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

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

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

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

   i) Proceeds of fresh issue of shares

   ii) Divisible profits of the company.

5) Only fully paid shares can be redeemed.

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

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

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

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

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

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

## 3.2 ACCOUNTING PROCEDURE

1) Making final calls incasethe shares are partly paid.

   Calls on Preference share A/c or

   To Preference Capital A/c

2) Receiving money on the call

Bank A/c Dr

To calls on Preference share A/c

3) Share forfeiture on non payment

i) Preference Capital A/c Dr.

To Share forfeiture A/c

(Reduction of the shares that are to be forfeited)

ii) Share forfeiture A/c Dr

To Capital Reserve

(Share forfeiture balance transferred)

4) Create the claim of the Preference share holders.

Preference Capital A/c Dr.

Premium on Redemption A/c Dr.

To Preference Share holders A/c

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

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

Profit & Loss A/c Dr.

To Assets A/c

To Profit & Loss A/c

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

6) Issue of shares

Bank A/c Dr.

To Equity Capital A/c

To Security premium A/c

(Where shares are issued at a premium)

7) Payment to preference share holders

Preference share Holders A/c Dr.

To Bank A/c

8) A mortising the premium on redumption

Profit and Loss A/c Dr.

To Premium on Redemption A/c

9) Creating the CRR

Profit and Loss A/c Dr.

General Reserve A/c Dr.

To CRR A/c

10) Declaration of Bonus

Bonus to Equity share holder A/c Dr.

To Equity Capital A/c

11) Capitalising the reserves for Bonus

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

To Bonus to Equity share capital A/c

**Study Note : (A) Bonus**

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

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

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

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

| Eg : | Held | Bonus |
|---|---|---|
| | 5 | 1 |
| | 20,000 | 2 |

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

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

**B) Divisible Profits :**

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

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

**II) Practical Questions :**

Redemption fully out of new issue.

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

Ans. Journal of Salman Ltd.

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

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

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

(Being the claim of Preference Share holders created)

2) Bank A/c Dr. 60,00000

To Equity Capital A/c 50,00,000

To Security Premium A/c 10,00,000

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

3) Profit and Loss A/c Dr 5,00,000

To premium on Redeem A/c 5,00,000

(Being premium on redeem W/off)

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

To Bank A/c 55,00,000

(Being the claim of the preference shares holders settled)

Redemption fully out of the profits

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

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

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

Ans. Journal of Katrina Ltd.

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

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

(Being the claim of the preference share holders created)

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

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

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

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

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

To Bank A/c 5,00,000

(Being Preference share holders claim settled)

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

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

General Reserve ₹2,00,000

Profit & Loss A/c ₹2,00,000

Journalise the transactions.

Ans. Journal of Sharukh Ltd.

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

Premium on Redeem A/c Dr. 30,000

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

(Being Preference share holders claim created)

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

To Equity Capital A/c 3,00,000

To Security Premium A/c 30,000

(Being equity shares issued at a premium)

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

General Reserve A/c Dr 1,00,000

To CRR A/c 3,00,000

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

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

To Premium on Redeem 30,000

(Being premium on Redeem w/off)

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

To Bank A/c 6,30,000

(Being preference share holders claim settled)

**Redemption then bonus - declaration**

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

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

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

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

Journalise all the above transactions.

Ans. Journal of Ranveer Ltd.

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

Premium on Redeem A/c Dr. 25,000

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

(Being the claim of preference share holders created)

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

To Investment A/c 1,00,000

To Profit & Loss A/c 20,000

(Being investments sold at a gain, WN1)

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

To Investment A/c 1,20,000

To Profit & Loss A/c 20,000

(Being equity share issued at par)

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

To CRR A/c 1,30,000

(Being CRR created for redemption)

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

To Premium on Redeem A/c 25,000

(Being premium on redeem w/off)

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

To Bank A/c 2,75,000

(Being preference share holders paid)

7) CRR A/c Dr 51,200

Bonus to Equity share Holders 51,200

(Being bonus shares declared)

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

To Equity Capital A/c 51,200

(Being bonus shares declared)

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

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

Profit = 20% = 20,000

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

WN2 - Calculation of Bonus shares

Total no. of equity share = (before bonus)

Originally issued + Fresh issue

= 50,000 + 1200

= 51,200

| Held | Bonus |
|---|---|
| 10 | 1 |
| 51200 | ? |

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

Redemption with untraceable preference shareholders and Balance sheet.

(Comprehensive question)

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

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

**Adjustments :**

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

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

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

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

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

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

**WN1**

Calculation of extent of issue of equity share

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

NV of equity shares = ₹100 each

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

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

**WN2**

Actual Payment made to PSH

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

Redeem value = 4,40,000

∴ Redeem value / share = 110

No. of share unpaid = 500

Amount unpaid = 500 x 110 = 55,000

∴ Amount paid = 4,40,000 - 55,000

= 3,85,000

**WN3**

Calculation of Bonus

Total no. of Equity shares = 8000 + 1250

= 9250

| Bonus | Held |
|---|---|
| 1 | 25 |
| 2 | 9250 |

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

Journal of Adira Ltd.

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

Premium on Redeem A/c Dr 40,000

To PSH A/c 4,40,000

(Being the claim of PSH created)

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

Profit & Loss A/c Dr 50,000

To CR RA/C 2,50,000

(Being CRR created for redemption of preference share)

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

To Premium on Redeem A/c 40,000

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

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

To Equity Capital A/c 1,25,000

To security premium A/c 25,000

(Being equity shares issued at a premium)

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

To Bank A/c 85,000

(Being PSH Claim settled) 55,000

6) CRR A/c Dr. 37,000

To Bonus to ESH A/c 37,000

(Being bonus declared)

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

To Equity Capital A/c 37,000

(Being bonus shares issued)

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

Capital & Liabilities

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

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

Note 1 : Share Capital

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

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

Note 2 : Reserves & Surplus

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

Note 3 : Current Liabilities

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

Note 4 : Non CA

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

Note 5 : CA

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

WN4 : Calculation of Bank balance

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

## 3.3 QUESTIONS

**I) True or False.**

1) Preference shareholders are also known ordinary shareholders.

2) Partly paid preference shares can not be redeemed

3) Redeemable preference shares can be issued only if authorized by the Company's Articles of Association.

4) Dividends of a preference share are directly paid to the preference shareholders every year.

5) Redemption of preference shares results in the resolution of the issued capital always.

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

**II) Fill in the blanks.**

1) Workmen Compensation Fund is a _______________ profit.

2) Capital Redemption Reserve may be used for issuing _________ shares.

3) Preference shareholders have ___________ rights of repayment at the time of winding up.

4) A company limited by shares can issue preference shares for __________ years.

5) Bonus issue helps in ______________ the profits.

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

**Questions for self Test**

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

2) Sara Ltd. provided the following information

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

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

3) Taimur Ltd. provides the following information to you

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

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

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

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

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

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

Journalise the above transactions and also prepare the Balance sheet.

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

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

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

On the 1st April the Company

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

Journalise the above transactions and prepare the Balance sheet.

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# Module III

# 4

# REDEMPTION OF DEBENTURES

**Unit Structure:**



## 4.0 OBJECTIVE

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

## 4.1 INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**2. Fluctuating Instalment Method**

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

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

## 4.4 METHODS OF WRITING OFF DISCOUNT/LOSS ISSUE OF DEBENTURES

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

**Illustration 1:**

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

Show Loss on Issue of Debentures A/c if:

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

   HK Ltd. follows calendar year as its accounting year.

**Solution:**

1. Such debentures are redeemable after four years.

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

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

Total Loss (a+b) = ₹2,00,000

Term of Debenture = 4 years

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

In the books of HK Ltd.

Loss on Issue of Debentures A/c

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

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

**Discount/Loss to be written off each year**

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

In the books of HK Ltd.

Loss on Issue of Debentures A/c

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

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

**Illustration 2:**

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

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

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

**Solution:**

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

**Discount to be written off each year**

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

In the books of R Ltd.

Loss on Issue of Debentures A/c

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

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

**A. Terms of issue of debentures**

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

**This topic has been dealt in Introduction to Companies Account**

**B. Methods of redemption of debentures**

The different methods of redemption of debentures are:

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

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

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

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

**SOURCES OF REDEMPTION**

**1. Redemption out of Capital**

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

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

**Illustration 3:**

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

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

**Solution:**
**Journal Entries in the books of ITI Ltd.**

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

**2. Redemption out of Profits**

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

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

**A. Creating Debenture Redemption Reserve (DRR)**

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

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

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

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

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

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

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

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

**Illustration 4:**

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

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

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

**Solution:**

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

**Illustration 5:**

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

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

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

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

**Solution:**

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

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

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

**Illustration 6:**

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

**Solution:**

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

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

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

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

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

**Solution:**

Journal Entries in the books of Raman Ltd.

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

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

**Illustration 8:**
Apple Ltd. issued 9,000, 6% debentures of ₹100 each on 1st November, 2011 redeemable at a premium of 7% as under:

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

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

**Solution:**

Journal Entries in the books of Apple Ltd.

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

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

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

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

**Solution:**
Journal entries in the books of Mala Ltd.

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

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

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

**B. Creating Sinking Fund**

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

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

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

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

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

**Model Journal Entries:**

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

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

**Illustration 10:**

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

**Solution:**

Journal Entries in the books of CIT Ltd.

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

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

In the books of CIT Ltd.

Sinking Fund A/c

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

Sinking Fund Investment A/c

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

**Illustration 11:**

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

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

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

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

Prepare the following accounts:

i. Debenture Stock;

ii. Sinking Fund;

iii. Sinking Fund Investments

iv. General Reserve

**Solution:**

In the books of Jani Ltd.

8% Debentures Stock A/c

| Particulars | ₹ | Particulars | ₹ |
|---|---|---|---|
| To Bank a/c<br>To Balance c/d | 3,00,000<br>1,00,000 | By Balance b/d | 4,00,000 |
| **Total** | **4,00,000** | **Total** | **4,00,000** |

Sinking Fund A/c

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

Sinking Fund Investments A/c

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

General Reserve A/c

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

**Working Note:**

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

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

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

**4. Redemption by Conversion**

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

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

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

**Illustration 12:**

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

The Company offered three options to debenture holders as under:

i. 7% preference shares of ₹10 at ₹12

ii. 9% debentures of ₹100 at par

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

The options were accepted as under

i. Option by holders of 1500 Debentures

ii. Option by holders of 1500 Debentures

iii. Option by holders of 2000 Debentures

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

**Solution:**

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

Journal Entries in the books of Alpha Ltd.

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

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

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

**Illustration 13:**

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

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

b) 7% debentures at ₹96 and

c) to have their holdings redeemed for cash

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

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

**Solution:**

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

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

Journal Entries in the books of Tony Ltd.

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

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

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

## 4.5 SUMMARY

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

## 4.6 EXERCISE

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

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

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

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

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

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

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

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

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

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

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

7. Fill in the blanks choosing correct alternative

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

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

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

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

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

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

8. Match the Columns

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

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

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

Give discount on issue of debentures account for five years

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

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

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

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

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

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

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

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

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

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

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

    b) 9% debentures at ₹96 and

    c) To have their holdings redeemed for cash

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

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

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

Pass journal entries in the books of Tetron Ltd.

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

    The Company offered three options to debenture holders as under:

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

    b. 8% debentures of ₹100 at par

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

    The options were accepted as under

a. Option by holders of 3,000 Debentures

b. Option by holders of 3,000 Debentures

c. Option by holders of 4,000 Debentures

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

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

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

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

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

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

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

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

 Pass journal entries in the books of B Ltd.

**Answers:**

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

 False : ii, vi, x, xii, xiii, xiv, xv

7. i.15%, ii.General Reserve, iii. 18, iv. Capital, v. Special, vi. Divisible.

8. 1- e, 2-a, 3- d, 4-c, 5-b

❖❖❖❖

# Module IV

# 5

# ASCERTAINMENT AND TREATMENT OF PROFIT PRIOR TO INCORPORATION

**Unit Structure**



## 5.0 OBJECTIVES

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

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

## 5.1 INTRODUCTION

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

### 5.1.1 Concept-

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

### 5.1.2 Utilisation of Profit prior to incorporation-

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

## 5.2 COMPUTATION OF PROFIT BEFORE INCORPORATION

**Step-1 Calculate the Time ratio and Sales ratio-**

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

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

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

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

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

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

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

Profit and Loss account

For the year ended 31st March 2018

Dr. Cr

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

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

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

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

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

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

**Check your progress**

Calculate time ratio and sales ratio from the following information-

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

Calculation of TIME RATIO

Accounting period –

Date of incorporation-

Pre incorporation period—

Post incorporation period –

TIME RATIO-

Calculation of SALES RATIO

Total sales during the year –

Sales in the pre incorporation period –

Sales in the post incorporation period –

SALES RATIO

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

## 5.3 SOLVED PROBLEMS

**Illustration 1**

**Calculate Time ratio and Sales Ratio from the following information-**

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

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

**Illustration 2-**

**Calculate Time Ratio and Sales Ratio from the following information.**

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

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

**Solution:**

**Time Ratio:**

Accounting period – 1 January to 31st December 2017

Date of Incorporation 1st July 2017

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

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

Time Ratio 1:1

**Sales Ratio**

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

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

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

**Illustration 3**

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

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

**Additional information:**

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

2. Depreciation shown above includes depreciation on furniture worth Rs. 2,40,000 @ 10% and on delivery van worth Rs.90,000 @ 20%. Both these assets were taken over from Small and sons.

3. Big Co. Ltd. settled Purchase consideration on 1st January,2008

4. Audit fees are payable for the whole year.

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

(University of Mumbai- October 2009)

Solution:--

WN - Time ratio-

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

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

Time ratio - 7:5

Sales ratio-

Let monthly sales be-1

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

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

Sales Ratio- 10:8 or 5:4

Interest on purchase consideration-

(payable for 9 months from April to December)

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

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

Specific ratio- 7:2

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

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

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

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

Dr. Cr

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

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

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

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

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

**Illustration 4**

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

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

**Additional Information:**

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

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

**Solution:**

Working Notes –

Time Ratio 5:7

Sales Ratio 5: 13

Basis for Allocating Rent 5:11

Salaries 15:24 or 5:8

Bad Debts Rs. 12,00,000

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

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

Pre incorporation: 2, 77,778

Post Incorporation: 7, 22,222

Total Pre Incorporation Bad Debts Amount:

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

Post Incorporation Bad Debts=722222

Statement of Profit And Loss

For The Year Ended 31$^{ST}$ March 2019

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

**Illustration 5:**

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

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

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

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

You obtained the following additional information :

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

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

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

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

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

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

Working notes-

Time Ratio 1:2

Sales Ratio 4:11

Interest on Purchase Consideration 4: 2 or 2:1

Interest is paid for 6 months from April to September.

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

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

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

Statement of Profit and Loss

For the year ended 31st March 2018

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

**Illustration 6**

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

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

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

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

**Solution-**

WN 1

Time ratio – 1:2

Sales Ratio 1: 5

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

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

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

Therefore SR 1: 5

WN2

Interest to Vendor

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

Rounded off to Rs 6667

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

4 months will be pre incorporation.

From 1st Feb 2013 to 31st May 2013-

4 months will be post incorporation.

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

Statement showing Profit and loss

For the year ended 30th September 2013.

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

**Illustration 7**

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

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

You are informed that –

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

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

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

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

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

(Mumbai University April 2010)

**Solution:**

**Working notes1:**

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

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

**Illustration 8**

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

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



**Additional information-**

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

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

c) Audit fees is for entire year

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

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

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

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

**Solution:**

WN 1-

Time ratio- TR 4: 8 or 1: 2

Sales Ratio- SR 4:12 or 1: 3

WN-2

Bad debts total 24,000 to be allocated as under

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

WN-3

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

WN-4

Salary to Anil as partner

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

Salary to Anil as Managing director –

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

Balance salary

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

Statement Showing Pre and Post Incorporation Profit/ Loss

For The Year Ended 31st March 2018

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

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

## 5.4 EXERCISE

**Practical Problems**

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

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

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

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

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

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

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

**Additional Information-**

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

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

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

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

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

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

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

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

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

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

**Additional Information-**

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

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

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

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

Objective Questions

5. Match the Columns-

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

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

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

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

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

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

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

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

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

5) The Profit before incorporation is to be transferred to General Reserve – False

6) The Profit after corporation is a revenue Profit- True

7) While computing pre and post incorporation profits, Audit fees are allocated on Time basis – True

8) Profit prior to incorporation is available for payment of dividend – False

9) Loss prior to incorporation is debited to Goodwill account- True

10) Preliminary expenses should be debited to pre-incorporation period- False

7. **Multiple Choice Questions**

1) While calculating profit prior to incorporation, the fixed expenses are to be allocated _____
   a) in Sales ratio b) in Time ratio
   c) equally d) none of the above

2) While calculating profit prior to incorporation, the variable expenses are to be allocated _____
   a) in Sales ratio b) in Time ratio
   c) equally d) none of the above

3) While calculating profit prior to incorporation, the Directors fees are to be ______
   a) allocated in sales ratio b) shown as pre incorporation expense
   c) shown as post incorporation expenses d) ignored

4) While calculating profit prior to incorporation, the partners salaries are to be _______
   a) allocated in sales ratio b) shown as pre incorporation expense
   c) shown as post incorporation expenses d) ignored

5) The profit prior to incorporation is transferred to _________
   a) Capital Reserve b) General Reserve
   c) Securities Premium d) Goodwill

6) The share transfer fees are _______
   a) to be shown on the credit side of P&L A/c in the pre-incorporation column
   b) to be allocated equally
   c) to be shown on the debit side of P&L A/c in the pre-incorporation column
   d) to be shown on the credit side of P&L A/c in the post - incorporation column

   (Answer: 1- b, 2- a, 3- c, 4- b, 5- a, 6- d.)

8. **Short Numerical Objective Questions –**

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

a) The turnover for the whole period 1st October 2012 to 30th September 2013 was Rs. 2,40,000 of which 40,000 related to the period from 1st October 2012 to 1st February 2013

b) The Trading account showed a Gross profit of Rs. 96,000

Calculate Time Ratio and Sales Ratio. State how the Gross profit will be allocated between the pre and post incorporation periods.

(Answer- Time ratio 4:8 or 1:2 Sales Ratio 1: 5 Gross profit Rs 96,000 to be allocated in Sales Ratio Pre incorporation amount Rs 16,000 post incorporation Rs 80,000)

2) Friendship Ltd was incorporated on 1st April 2017 to take over business of the partnership firm with effect from 1st January 2017. The company prepared its Profit and Loss a/c for the year ended 31st March 2018. The company was able to double the average monthly sales from 1st April 2017. Calculate Time ratio and Sales ratio

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

3) Indo-Japan Ltd was incorporated on 1st May 2018 to take over a business as a going concern from 1st January of the same year. The total turnover for the year ended 31st December was Rs 2,00,000 namely Rs 60,000 for the first period upto 1st May and Rs 1,40,000for the remaining period. Calculate Time Ratio and Sales Ratio

(Answer Time ratio 4: 8 or 1:2 and Sales ratio 6:14 or 3: 7)

❖❖❖❖

# 6

# FOREIGN BRANCH

**Unit Structure**



## 6.1 INTRODUCTION

A Foreign branch usually maintains a complete set of books under double entry principles. So, the accounting principles of a Foreign Branch will be the same as those applying to an Inland Branch. Before a Trial Balance of the Foreign Branch is incorporated in the

H. O. books, it has to be converted home currency.

## 6.2 RULES FOR CONVERSION

In case of fluctuating rates of exchange, the following rules for conversion are applied:

| No | Nature of Account | Exchange Rate Applicable |
|---|---|---|
| 1. | Fixed Assets | Rates ruling at the time they were acquired. |
| 2. | Fixed Liabilities | Rates ruling as on the date of the Trial Balance. |
| 3. | Current Assets & Liabilities | Rates ruling as on the date of the Trial Balance. |
| 4. | Remittance sent by the branch | At the actual rates at which they were made. |
| 6. | Goods received from H. O. as well as goods returned to H. O. | At the rate ruling on the date of dispatch or the date of receipt. |
| 6. | The Nominal A/c's (except next two) | Average rate ruling during the accounting period. |

| | | |
|---|---|---|
| 7. | Depreciation on Fixed Assets | Rate of conversion applicable in case of the particular asset concerned [as indicated in (a) above]. |
| 8. | Opening and Closing stocks | Rates ruling of on the opening and closing dates respectively. |
| 9. | Balance in H. O. A/c | Value at which the Branch A/c appears in H. O. books on the date. |

## 6.3 BRANCH ACCOUNTING (FOREIGN BRANCH)

**FOREIGN BRANCHES**

When a branch is established abroad it is called as a Foreign Branch. The accounting arrangements for a foreign branch are exactly the same as for any independent branch up to the Trial Balance. But in this case accounts are maintained in foreign currency to correspond with the local conditions the main problem which the Head Office has to face is the restatement of accounts one currency into another. In order to incorporate the Trial Balance of a foreign branch in the books of the head office it must be translated (using appropriate exchange rates) into the currency of the Head Office.

**Rules for conversion of Branch Trial Balance when ExchangeRates are 'Stable'**

Exchange rate is said to be stable, when it does not vary to agreat extent from time to time. In this situation, a fixed exchange rate can be used to convert the branch Trial Balance into thecurrency of the Head Office with the exception of (a) Remittances, and (b) Head office Current Account.

a. Remittances: These are converted at the actual rates at which they were made.

b. Head Office Current Account: The actual figures shown for the Branch Current Account in the books of the Head Office (after taking into consideration in-transit items).

When the foreign branch Trial Balance is converted into localcurrency, a new Trial Balance takes birth known as "Difference on Exchange Account" is opened to make the Trial Balance agree.

Closing of Difference on Exchange Account

**i. For debit entry on trialbalance**

Profit and Loss Account Dr.OR

Exchange Reserve Account Dr. (if any)

To Difference on Exchange Account

**ii. For credit entry on trialbalance**

Difference on Exchange Account Dr. To Exchange Reserve Account Big Differences)

(If the difference is very small, it can credited to Profit & Loss account)

The format of the new Trial Balance of the branch is generally drawn up as follows:

Foreign Branch Converted Trial Balance as at 31st December, 2006

| Sr. No. | Heads of | L. F. | Currency Dr. $ | Currency Cr. $ | Rate of Exchang | Rupee Dr. | Rupee Cr. |
|---|---|---|---|---|---|---|---|
| | | | | | | | |

## 6.4 SOLVED PROBLEMS

**Q.1** ABC Ltd. has a branch in New York as on 31st March 2011 the trial balance of the branch was as follows:

| Particulars | Dr. $ | Cr. $ |
|---|---|---|
| Head office account | - | 8,500 |
| Goods from head office | 44,000 | - |
| Furniture | 9,000 | - |
| Bank Balance | 1,250 | - |
| Cash | 250 | - |
| Rent | 1,200 | - |
| Outstanding Expenses | - | 800 |
| Sundry debtors | 3,150 | - |
| Sales | - | 61,000 |
| Stock – 1.4.2010 | 8,500 | - |
| Salaries | 2,800 | - |
| Insurance | 150 | |
| | **70,300** | **70,300** |

The branch account in head office shows debit balance Rs.2,14,500 and goods sent to branch credit balance of Rs. 13,12,500.

Depreciation furniture @ 10% p.a.

Stock at branch 31st March 2011 was $ 7,500 Furniture was purchased in

1997 when 1$ = Rs. 20Exchange Rates were:

On 1.4.2010 1$= Rs. 28

On 31.3.2011 1$= Rs. 30

Average rate 1$= Rs. 29

You are required to prepare branch trial balance by converting in rupees and prepare branch trading and profit and loss a/c for the year ended 31.3.2011 and balance sheet as on that date.

**Solution:**

**Converted Trial Balance as on 31st March 2011In the Books of Branch**

| Sr. no. | Particulars | Dr. ($) | Cr.($) | Rate | Dr. ($) | Cr. (Rs) |
|---|---|---|---|---|---|---|
| 1 | Head office account | | 8,500 | Actual | - | 214,500 |
| 2 | Sales | | 61,000 | 29 | - | 1,769,000 |
| 3 | Goods from Head Office | 44,000 | - | Actual | 1,312,500 | |
| 4 | Stock on 1-4-10 | 8,500 | - | 28 | 238,000 | |
| 5 | Furniture | 9,000 | - | 20 | 180,000 | |
| 6 | Cash in box | 250 | - | 30 | 7,500 | |
| 7 | Bank Balance | 1,250 | - | 30 | 37,500 | |
| 8 | Salaries | 2,800 | - | 29 | 81,200 | |
| 9 | Rent | 1,200 | - | 29 | 34,800 | |
| 10 | Insurance | 150 | - | 29 | 4,350 | |
| 11 | Outstanding expenses | - | 800 | 29 | | 24,000 |
| 12 | Sundry debtors | 3,150 | - | 30 | 94,500 | - |
| 13 | Difference in Exchange | - | - | 30 | 17,150 | - |
| | | 70,300 | 70,300 | | 2,007,500 | 2,007,500 |

**In the books of Branch, Trading & Loss a/c for the year ended 31st March 2011**

| Particulars | Dr. Amt | Particulars | Cr. Amt |
|---|---|---|---|
| To Opening stock a/c | 238,000 | By Sales | 1,769,000 |
| To Goods from H. O. | 1,312,500 | By Closing stock | 226.000 |
| To Rent | 34,800 | | |
| To Gross profit c/d | 408,700 | | |
| | 1,994,000 | | 1,994,000 |
| To Salaries | 81,200 | By Gross profit b/d | 408.700 |
| To Insurance | 4,350 | | |
| To Depreciation | 18,000 | | |
| To Diff. in exchange | 17,150 | | |
| To Net profit c/d | 288,000 | | |
| | 408.700 | | 408.700 |

**Balance sheet as on 31st March 2011**

| Liabilities | | Amt | Assets | | Amt |
|---|---|---|---|---|---|
| Head office a/c | 2,14,500 | | Furniture | 1,80,000 | |
| Add: Net profit | 2,88,000 | 5,02,500 | Less: Depreciation | 18,000 | 1,62,000 |
| | | | Cash in box | | 7,500 |
| Outstanding expenses | | 24,000 | Bank balance | | 37,500 |
| | | | Sundry debtors | | 94,500 |
| | | | Closing Stock | | 2,25,000 |
| | | 5,26,500 | | | 5,26,500 |

**Q.2** The following balance appeared in the books of Surat branchof firm in London as on 31st December 2010.

| Particular | Dr. Rs. | Cr. Rs. | Particular | Dr. Rs. | Cr. Rs. |
|---|---|---|---|---|---|
| Sales | - | 225,000 | Stock as on 1st Jan 2008 | 25,200 | - |
| Debtors | 78,000 | - | Purchases | 150,000 | - |
| Bills Receivable | 20,800 | - | Wages/salaries | 9,600 | - |
| Head Office account | - | 66,400 | Rent, Rates, Taxes | 7,200 | - |
| Cash at Axis Bank | 57,980 | - | Furniture | 9,820 | 18,200 |
| Miscellaneous Exp | 3,000 | - | Bills payable<br>Creditors | | 52,000 |
| | | | | **361,600** | **361,600** |

Stock on 31st December 2010 was Rs. 65,000. Surat branch a/c in the books of London head office showed a debit balance of Rs. 2.680 on 1st December 2010.

Furniture was purchased from a remittance of Rs. 350 received from London H. O. which exactly covered the cost of the item.

The rates of exchange were:

31.12.2009 Rs. 28/1 pound

31.12.2010 Rs. 26/1 pound

The average rate for 2008 may be taken at Rs. 24 per 1 pound.

Prepare the trading and p&I account and balance sheet of Surat branch in the books of London H. O. assuming the branch operations to be integral to the main operation.Solution:

**Converted Trail Balance as on 31st Dec. 2010**

| Sr. No. | Particulars | Rs. | Rs. | Rate | Pound | Pound |
|---|---|---|---|---|---|---|
| 1 | Stock as on 1.1.10 | 25,200 | - | 28 | 900 | - |
| 2 | Purchases | 1,50,000 | - | 24 | 6,250 | - |
| 3 | Sales | - | 2,25,000 | 24 | - | 9,375 |
| 4 | Debtors | 78,000 | - | 26 | 3,000 | - |
| 5 | Creditors | - | 52,000 | 26 | - | 2,000 |
| 6 | Bills receivable | 20,800 | - | 26 | 800 | - |
| 7 | Bills payable | - | 18,200 | 26 | - | 700 |
| 8 | Wages/Salaries | 9,600 | - | 24 | 400 | - |
| 9 | Rent, rates, taxes | 7,200 | - | 24 | 300 | - |
| 10 | Miscellaneous exp | 3,000 | - | 26 | 115 | - |
| 11 | Furniture | 9,820 | - | - | 350 | - |
| 12 | Cash at Axit Bank | 57,980 | - | 26 | 2,230 | - |
| 13 | Head office a/c | - | 66,400 | | - | 2,680 |
| 14 | Diff. in exchange | - | - | | 410 | - |
| | | | | | 14,755 | 14,755 |

**Trading and profit n Loss a/c for the year ending 31.12.2010**

| Particular | Amt | Particular | Amt |
|---|---|---|---|
| To opening stock a/c | 900 | By sales | 9,375 |
| To purchases | 6,250 | By closing stock | 2,500 |
| To wages/salaries | 400 | | |
| To gross profit c/d | 4,325 | | |
| | 11,875 | | 11,875 |
| | | By gross profit b/d | 4,325 |
| To rent, rates and taxes | 300 | | |
| To difference in exchange | 410 | | |
| To N. P. c/d | 3,615 | | |
| | 4,325 | | 4,325 |

**Balance sheet as on 31st Dec 2010**

| Liabilities | | Amt | Assets | Amt |
|---|---|---|---|---|
| Head office a/c | 2,680 | | Debtors | 3,000 |
| Add: N. P | 3,615 | 6,295 | Bills Receivable | 800 |
| | | | Furniture | 350 |
| Creditors | | 2,000 | Cash at Axis bank | 2,230 |
| Bills payable | | 700 | Closing Stock | 2,500 |
| | | | Miscellaneous Exp | 115 |
| | | 8,995 | | 8,995 |

**Q.3** Kaun Banga Koredpati Computers Ltd. has head office at Mumbai and Branch at California. The branch submits the following trial balance as on 31st Mar. 2011.

| Particulars | Dr. US $ | Cr. US $ | Assets | Dr. US $ | Cr. Us $ |
|---|---|---|---|---|---|
| Head office a/c | - | 11,606 | Salaries | 71,130 | - |
| Goods received | | | Office rent | 44,316 | - |
| From H.O. | 12,725 | | Taxes & insurance | 13,655 | - |
| Purchases & sales | 5,06,323 | 7,87,777 | Debtorsand | 1,17,117 | - |
| Stock (1.4.10) | 13,100 | | creditors | 37,119 | 1,57,617 |
| Plant & machinery | 27,650 | | Printing & stationary | 16,303 | - |
| Furniture & fixtures | 18,220 | | Postage & telegrams | 14,784 | - |
| Cash in hand | 3,233 | | Freight | 14,784 | - |
| Cost atbank | 60,180 | | conveyance | 1,145 | - |

1. The branch a/c in H. O. showed a debit balance of Rs. 5,11,100 and goods sent to branch a/c showed a credit balance of Rs. 5,66,600.
2. Plant & machinery was acquired when US$ Rs. 46. furniture was acquired by branch on 1st Jan'11 when Rs. 100 were equivalent to US $ 2.50 H. O. office charges depreciation on plant & machinery @20% p.a. & on furniture & fixture @10%

p.a. The closing stock as on 31st Mar'11 at branch was US $ 16,550. The exchange rates were as under 1st Apr.'10 US $ 38.50 31st Mar'11 US $ 2.50 Aug US $ 44 convert the branch trial balance into rupees & prepare profit & loss a/c for the year ended 31st Mar'11 prepare balance sheet of California branch of Kaun Banega Karodpati Ltd. as on 31st Mar'11 the foreign operation is in the nature of an integral operation.

**Solution:**

**Converted Trial Balance for the year ending 31st Mar'11**

| Particulars | Dr. ($) | Cr. ($) | Rate | Dr. ₹ | Cr. ₹ |
|---|---|---|---|---|---|
| Head office a/c | - | 11606 | Actual | | 511100 |
| Goods received from H. O. | 12725 | | Actual | 566600 | |
| Purchases & sales | 506323 | 787777 | 44 | 22278212 | 34662188 |
| Stock (1.4.10) | 13100 | | 38.50 | 504350 | |
| Plant & Machinery | 27650 | | 46 | 1271900 | |
| Furn & fixtures | 18220 | | 40 | 728800 | |
| Salaries | 71130 | | 44 | 3129720 | |
| Office rent | 44316 | | 44 | 1949904 | |
| Taxes & insurance | 13655 | | 44 | 600820 | |
| Drs/ & creditors | 117117 | 157617 | 40 | 4684680 | 6304680 |
| Priting & creditors | 37119 | | 44 | 1633236 | |
| Printing & stationery | 37119 | | 44 | 717332 | |
| Postage & telegram | 16303 | | 44 | 650496 | |
| Freight | 14784 | | 44 | 50380 | |
| Conveyance | 1145 | | 44 | 129320 | |
| Cash in hand | 3233 | | 40 | | |
| Diff. in exchanges | | | | 2407200 | |
| Cash at bank | 60180 | | 40 | 175018 | |
| Diff in exchange | | | | 41477968 | 41477968 |

**In the books of branch Trading and Profit & Loss a/c for yearended 31st Mar'11**

| Particulars | Amt | Particulars | Amt |
|---|---|---|---|
| To opening stock | 5,04,350 | By sales | 34662188 |
| To purchases | 2,22,78,212 | | 6,62,000 |
| To goods from H. O. | 5,66,600 | By closing stock (16550 x 40) | |
| To gross profit c/d | 1,19,75,026 | | |
| | 35324188 | | 35324188 |
| To salaries | 31,29,720 | By gross profit b/d | 1,19,75,026 |
| To office rent | 19,49,904 | | |
| To taxes & insurance | 6,00,820 | | |
| To printing & stationery | 16,33,236 | | |
| To postage & telegram | 7,17,332 | | |
| To freight | 650496 | | |
| To conveyance | 50380 | | |
| To depreciation | 327260 | | |
| To diff in exchange | 1,75,018 | | |
| To net profit c/d | 27,40,860 | | |
| | 1,19,75,026 | | 1,19,75,026 |

**Balance sheet as on 31st Mar'11**

| Liabilities | Amt | Amt | Assets | Amt | Amt |
|---|---|---|---|---|---|
| Head office a/c | 5,11,100 | | Plant &mach. | 12,71,900 | |
| (+) Net profit | 2740860 | 3251960 | (-) & fixtures | 2,54,380 | 10,17,520 |
| | | | (-) dep$^{n}$ | 728800 | 6,55,920 |
| creditors | | 63,04,680 | Debtors | 72,880 | 46,84,680 |
| | | | Cash in hand | | 1,29,320 |
| | | | Cash at bank | | 24,07,200 |
| | | | Closing stock | | 6,62,000 |
| | | 9556640 | | | 9556640 |

**Q.5** XY Ltd has a branch in New York. At the end of each year (Dec' 31) a trial balance sent by the branch in dollar currency is converted into rupee currency at the head office. (Bhopal)

The following trial balance for the year has been compiled at the branch as on 31st Dec.'10

| Particulars | Dr. $ | Cr. $ |
|---|---|---|
| Bill receivable | 2,500 | - |
| Sundry debtors | 3,800 | - |
| Sundry creditors | - | 1,100 |
| Purchases | 1,3,500 | - |
| Sales | - | 22,800 |
| Furniture & fixtures | 1,340 | - |
| Stock (1st Jan'10) | 2,000 | - |
| Establishment expenses | 2,000 | - |
| Salaries | 1,400 | - |
| Rent, rates & taxes | 400 | - |
| Sundry expenses | 1,450 | - |
| Depreciation on furniture & fixtures | 128 | - |

| | | |
|---|---|---|
| Remittances to H. O. | 1,502 | - |
| Head office account | - | 6,920 |
| Cash on hand & at bank | 800 | |
| | 30,820 | 30,820 |

The stock in hand on Dec 31st '10 was \$ 2,500 the rates of exchange were:-

Dec 31'09 to June 30'10 1 \$ = 34 July 1st '10 to 31st Dec '10

1\$ = 36.

In the Bhopal books the balance of New York branch a/c & of the remittances from New York branch a/c appear as 1,78,847 & Rs. 37,068 respectively. The original furniture & fixture were boughtwhen the rate of exchange was \$ 1 = Rs. 30. Convest the above trail balance into rupee currency & prepare the final a/c of the branch.

**Solution:**

**Converted trial bal. as on 31st Dec.'10 in bks of brch**

| Particulars | Dr. \$ | Cr.\$ | Rate | Dr.₹ | Cr.₹ |
|---|---|---|---|---|---|
| Bills receivable | 2500 | | 36 | 90,000 | |
| Sundrydebtors | 3,800 | | 36 | 1,36,800 | |
| Sundry creditors | | 1100 | 36 | | 39,600 |
| Purchases & sales | 13500 | 22800 | 35 | 472500 | 798000 |
| Furn & fixtures | 1340 | | 30 | 40,200 | |
| Stock 1st Jan 2010 | 2000 | | 34 | 68,000 | |
| Establishment expenses | 2000 | | 35 | 70,000 | |
| Salaries | 1400 | | 35 | 49,000 | |
| Rent, rates & taxes | 400 | | 35 | 14,000 | |
| Sundry expenses | 1450 | | 35 | 50,750 | |
| Dep. On furn& fixture | 128 | | 30 | 3840 | |

| | | | | | |
|---|---|---|---|---|---|
| Remittance to H. O. | 1502 | | Actual | 37068 | |
| H O. account | | 6920 | Actual | | 178847 |
| Cash on hand& at bank | 800 | | 36 | 28800 | |
| Diff in exchange | | | | | 44511 |
| | | | | 1060958 | 1060958 |

**In the books of XY Ltd Co. Trading & Profit and Loss a/c forthe year ending 31st Dec'10**

| Particulars | ₹ | Particulars | ₹ |
|---|---|---|---|
| To opening stock | 68,000 | By sales | 7,98,000 |
| To purchases | 4,72,500 | By closing stock ($2500x 36) | 90,000 |
| To gross profit b/d | 3,47,500 | | |
| | 8,88,000 | | 8,88,000 |
| To establishment exps | 70,000 | By gross profit b/d | 3,47,500 |
| To salaries | 49,000 | By diff. in exchange | 44511 |
| To rent rates & taxes | 14,000 | | |
| To sundry expenses | 50,750 | | |
| To Dep on furniture | 3,840 | | |
| To net profit c/d | 2,04,421 | | |
| | 3,92,011 | | 3,92,011 |

**Balance sheet as on 31st Dec'10**

| Liabilities | ₹ | ₹ | Assets | ₹ |
|---|---|---|---|---|
| H. O. current a/c | 1,78,847 | | fixture | 40,200 |
| (+) net profit | 2,04,421 | | | |
| | 383268 | | Bills receivable | 90,000 |
| (-) remittance | 37068 | 346200 | Sundry debtors | 1,36,800 |
| Sundry creditors | | 39,600 | cash in hand & at bank | 28800 |
| | | | Closing stock | 90,00 |
| | | 3,85,800 | | 3,85,800 |

## 6.5 EXERCISE

**Q.1** White Coller Ltd have branch in Canada. On 31st December 2010 the trial balance of the branch was as given below.

| Particulars | Dr. $ | Cr. $ |
|---|---|---|
| Stock as on 1.1.2010 | 7,500 | - |
| Head office account | - | 9,000 |
| Sales | - | 81,000 |
| Goods from head office a/c | 45,000 | - |
| Furniture's and fixtures | 10,000 | - |
| Owing for expenses | - | - |
| Rent | 1,000 | - |
| Taxes. Insurance etc | 250 | - |
| Salaries | 13,000 | - |
| Sundry debtors | 12,250 | - |
| Cash in hand | 1,050 | - |
| Cash in bank | 950 | 1,000 |
| | **91,000** | **91,000** |

The branch account in the head office showed a debit balance of Rs. 1,12,500 and goods sent to branch account a credit balance of Rs. 8,07,500.

Furniture and fixtures are acquired on 1.1.2010. 1 pound = Rs. 16. Provide depreciation @ 10% p.a.

The exchange rates were:> January1 pound = Rs. 17.50

December 1 pound = Rs. 18.50

Average 1 pound = Rs. 18.00

The stock at branch on 31st December 2010 were valued at 4500 pounds. Prepare Trading, P & L A/c Balance Sheet of Canadabranch account for the year ended 31.12.2010

**Q.2** Zenith Computers Ltd. has H. O. at Mumbai and branch at Boston U. S. A. The branch submits the following trail branch as on 31st March 2011.

| Particular | Dr. $ | Cr. $ |
|---|---|---|
| H. O. account | - | 12,707 |
| Goods received from H. O. | 11,600 | - |
| Purchases and sales | 387,516 | 610,416 |
| Stock as on 1.4.2010 | 14,316 | - |
| Plant & Machinery | 34,120 | - |
| Furniture and fixtures | 16,316 | -- |
| Cash at bank | 3,816 | - |
| Cash in hand | 1,314 | - |
| Salaries | 68,016 | - |
| Office rent | 42,340 | - |
| Taxes and insurance | 11,672 | - |
| Debtors and creditors | 125,430 | 127,977 |
| Printing and stationary | 12,148 | - |
| Postage and telegram | 11,010 | - |
| Courier charges | 6,316 | - |
| Internet charges | 2,718 | - |
| Legal expenses | 2,452 | - |
| | **751,100** | **751,100** |



The branch account in head office showed a debit balance or Rs. 5,84,222 and goods sent to branch account showed a credit balance of Rs. 5,56,800. Plant & Machinery was acquired by the branch as on 31st December 2010, when 1US $ = Rs. 46. Furniture & fixtures were acquired by the Boston branch on 30th June 2010 when Rs. 100 was equal to US $ 2.50. H. O. provides depreciation on the P&M @ 25 % p.a. and on furniture and fixture @ 10% p.a.

The Boston branch reported closing stock of US$ 15,350 on 31st March 2002. The exchange rates were at under.

| | |
|---|---|
| 1.4.2010 | US $ 1 = 43.50 |
| 31.3.2011 | Rs. 100 = US $ 2.00 |
| Average | US $ 1 = 46.50 |

Convert the branch trial balance into rupees and prepare branch profit and loss a/c for the year ended 31st March 2011. also you are required to prepare balance sheet of Boston branch Zenith Computers Ltd. as on 31st March 2011.

**Q.3** GHCL & Co. has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch furnishes you with its trail balance as on 31st March 2011 and the additional information given thereafter.

| Particulars | Dr. Rs. | Cr. Rs. | Particulars | Dr. Rs. | Cr. Rs. |
|---|---|---|---|---|---|
| Stock on 1.4.2004 | 300 | - | Rent, rates & taxes | 360 | - |
| Purchases and sales | 800 | 1,200 | Sundry charges | 160 | - |
| Sundry debtors | 400 | - | Computers | 240 | - |
| Sundry creditors | - | 300 | Bank balance | 420 | - |
| Bills of exchange | 120 | 240 | New York office a/c | - | 1,620 |
| Wages and salaries | 560 | - | | | |
| | | | | 3,360 | 3,360 |

**Additional Information:**

1. Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.
2. Unsold stock of Mumbai branch was worth Rs. 4,20,000 on 31st march 2011.
3. The rates of exchange may be taken as follows:

   a. On 1.4.2010 @ Rs. 40 per US $

   b. On 31.3.2011 @ 42 per US $

   c. Average exchange rate for the year @ Rs. 41 per US $

   d. Conversion in $ shall be made upto two decimal accuracy.

You are asked to prepare in US $ the revenue statement of the year ended 31st March 2011 and the balance sheet as on that date of Mumbai branch as would appear in the book of New York head office of GHCL & Co.

You are informed that Mumbai branch account showed a debit balance of US $ 39,609.18 on 31.03.2011 in New York books and there were no items pending reconciliation. The foreign operation is in the nature of an integral operation.

**Q.4** The foll. Balance appeared in the books of PQR Branch ofthe firm in Sydney on 31st Dec. 2010.

| Particulars | Dr. Rs. | Cr. Rs. | articulars | Dr. Rs. | Cr. Rs. |
|---|---|---|---|---|---|
| Stock as on 1st Jan '10 | 50,400 | | Wages & salaries | 19,200 | |
| Purchases | 3,00,000 | | Rent rates & taxes | 14,400 | |
| Debtors | 1,56,000 | | Miscellan e ous exp | 6,000 | |
| Bills receivable | 41,600 | | Furniture & fitting | 19,640 | |
| Sales | | 4,50,000 | Cash at bank | 1,15,960 | |
| Creditors | | 1,04,000 | Head office a/c | | 1,32,800 |
| Bills payable | | 36,400 | | | |
| | | | | **7,23,200** | **7,23,200** |

1. Stock as on 31st Dec'10 was Rs. 1,43,000 PQR Branch a/c in the books of Sydney head office showed Dr. balance on £5,360 on 31st Dec'10.
2. Furniture which exactly were purchased from a remittance of £ 700 received from Sydney head office which exactly covered the cost of item.
3. The rates of exchange were: 31st Dec' 09 Rs. 28 per £, 31st Dec'10 Rs. 26 per £. Average rate for year 2010 may be taken at Rs. 24 per £.
4. Prepare trading profit and loss a/c and balance sheet of PQR branch in the books of Sydney head office assuming branch operation to be integral to the main operations.

**Q.5** KBK Ltd has a branch in Sydney, Australia at the end of 31st Mar 2011 the foll. ledger of the Sydney office.

**Sydney (Australia Dollars thousand)**

| Particulars | Dr. A$ | Cr. A$ | Particulars | Dr.A$ | Cr. A$ |
|---|---|---|---|---|---|
| Plant & machinery (cost) | 200 | - | Goods sent to branch | 5 | |
| Prov. For plant & machinery | - | 130 | Wages & salaries | 45 | |
| | | | Rent | 12 | |
| Debtors / creditors | 60 | 30 | Office expenses | 18 | |
| Stock (1.4.10) | 20 | | Commission receipts | | 100 |
| Cash/bank balance | 10 | | Branch H. O. | | |
| Purchases/sales | 20 | 123 | Current a/c | | 7 |
| | | | | 390 | 390 |

**Theory Question**

1. What is Foreign Branch Accounting.
2. Short note on Conversion of Foreign Branch Trial Balance.

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