Module I

1

INTRODUCTION TO COMPANY ACCOUNTS - I

Unit structure

2.0 OBJECTIVES

After studying the unit students will be able to:

- Know the meaning, features and types of company
- Understand the procedure of Formation of the company.
- Discuss about the meaning, types of shares.
- Know the meaning and classification of share capital.
- Explain the Balance sheet of the company
- Understand the meaning of forfeiture of shares

2.1 INTRODUCTION

- **Meaning and Definition**

Company is a type of commercial organisation, Lord Justice Hanay had said company is an artificial person created by law having perpetual succession and a common seal. It is owned by shareholders and managed by directors.

Definition: Sec 2(20) of the Companies Act 2013 states that, “A company means a company formed and registered under that Act or under any previous Companies Act.”

- **Features of Company:**

From above meaning and definition we can identify following features of the company:

i. **Registered / Incorporation**: The company need to be formed and registered under the Companies Act, this process is known as Incorporation of the company. Without such incorporation company cannot come into existence.

ii. **Artificial Person**: The Company is considered as artificial person so it has power to acquire, hold and sale all types of properties, it can enter into legal agreements, it can file a case or case can be filed against the company.

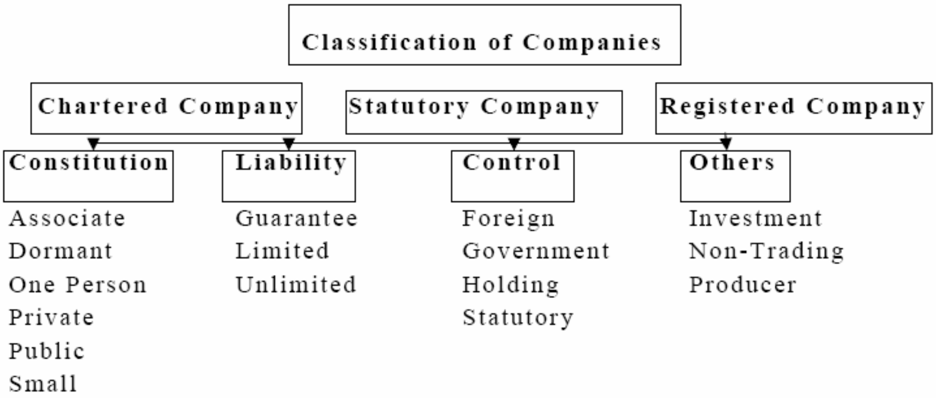
iii. **Separate Legal Entity:** A company is considered as separate legal entity hence its existence is not affected due death, insolvency of its members or transfer of shares by the members. A member of company is not liable for act of the company and vice versa.

iv. **Perpetual Succession:** A company is created by following process of law and it cease to exist only upon the process of law. It enjoys perpetual (permanent) existence. Companies existence is independent of death, insolvency or changes in membership of the company.

v. **Common Seal:** It is the most important property, common seal act as signature of company and use to authenticate the documents. If the common seal if affixed on any document by the authorised person it becomes a legal document

- **Types of Companies**

There are various types of companies which are described in following diagram.



Companies are basically classified as Chartered Company, Statutory Company and Registered Company.

1. Chartered Companies: These companies come into existence by Royal Charter which is issued by Head of State. For eg. East India Company.

2. Statutory Companies: These are formed under special statute of the parliament or the state legislature. These are public undertakings and form with main objective to serve social need not earn profit. For eg. RBI, LIC, SBI UTI etc.

3. Registered Companies: These are the companies which are registered under Indian Companies Act 2013, or any other previous Indian Companies Act. These companies are divided on the basis of Constitution Control and Other Liability.

- **On the basis of Constitution**

a) **Associate Company S2(6):** A company is said to be associate company of other, if other company had control on 20% of total voting power in the company or have control over business decisions of the company under an agreement. However an Associate Company is not subsidiary company.

b) **Dormant Company S455:** Where a company is formed for future projects or to hold an asset or intellectual property and do not have significant financial transactions for atleast 2 years may obtain status of Dormant Company by applying to Registrar.

c) **One Person Company S2 (62):** It is a new type of company introduced in the Companies Act 2013. It can be formed with only one member and have only one director. However the Act prescribed maximum in respect of amount of Share Capital and Turnover if One Person Company is exceeding that limit it need to be converted into Private or Public Company.

d) **Private Company :** It is a types of company which is formed with minimum two shareholders and two directors, Another crucial condition of a private limited company is that it by its articles of association restricts the right to transfer its shares & also prohibits any invitation to the public to subscribe for any securities of the company. A private company is exempted from various provisions of the Companies Act 2013 in comparison with the public company.

e) **Public Company S2 (71):** A company which is not a Private Company is a Public Company. A Public Company had minimum 7 members; there is no any restriction for minimum paid up capital for Public Company. Its shares are freely transferable. It can also invite public to subscribe its shares.

f) **Small Company S2(85):** Small company means a company other than a public company and should fulfil the following criteria:

a. Paid-up share capital of which does not exceed 50 Lakh Rupees or anything higher than that as may be prescribed will not be more than five crore rupees, and;

b. Turnover of last profit and loss statement should not exceed 2 Crore Rupees or such higher amount as may be prescribed.

- **On the basis of Liability:**

a) **Company Limited by Guarantee S2(21):** Each member promises to pay a fixed sum of money, specified in Memorandum of Association in the event of liquidation or payment of debt. This promised amount is called as guarantee. If a company insert such clause in its Memorandum the said company is Limited by Guarantee.

b) **Limited Company:** In these types of companies shareholders are bound to pay a fixed amount per share i.e. face value of shares either at the time of subscription or in instalments.

c) **Unlimited Liability Company:** If a company does not have any limit for liability of its members then such company is called as unlimited company. In this case members are liable to pay full amount of debt at the time of winding up of the company.

- **On the basis of Control**

a) **Foreign Company:** It is a company which is incorporated outside India and having its place of business in India has a place of business in India whether by itself or through an agent, physically or through electronic mode; and conducts any business activity in India in any other manner.

b) **Government Company:** It is the company whose minimum 51% paid up capital is held by government, i.e. State or Central Government or subsidiary of Government Company.

c) **Holding Company:** It is the company which has control over other company. If any company held more than 51% of the share capital of another company then it is called as holding company.

d) **Subsidiary Company:** It is the company which is controlled by another company i.e. Holding Company.

- **Other Companies:**

a) **Investment Company:** It is the company whose main business is to acquire shares, debentures, or other securities.

b) **Non Trading Company:** This is also called “association not for profit or charitable companies” These companies are registered under special license issued by government. The object of the company is to promote arts, science, sports, education, research, social welfare, religion etc.

c) **Producer Company:** In generic terms, producer companies can be said to be a way to improve the standard of living of those involved in the agricultural sector. Such companies are deemed to possess the goodness of co-operatives and the dynamicity of companies. A producer company is a company incorporated under Companies Act 2013 (formerly the Companies Act 1956) and shall carry on prescribed activities as mentioned in Section 581B of Companies Act 1956, to name few, Production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the Members or import goods for their benefit. Processing including preserving, drying, distilling, brewing, venting, canning and packaging of produce of its members. Manufacture, sale or supply of machinery, equipment or consumables mainly to its Members. Promoting mutual assistance, financial services and welfare measures of producers or their primary produce.

2.2 FORMATION OF COMPANY

Company is generally formed by the promoters. Promoter is a person who conceives a business idea and to bring it into reality he take initiative to Form and Register the company.

- **Steps in formation**

Following Steps are taken in respect of registration of company.

1. **Name:** The promoter may propose name of the company for registration, they can propose up to six names. If name is available further process is carried out.

2. **Memorandum of Association and Articles of Association**: Promoter should prepare Memorandum of Association and Articles of Association. Promoters should sign both and submit it to Registrar of Companies.

3. **Filling of Documents**: Following documents need to be filled with registrar for the purpose of registration

a) Memorandum of Association and Articles of Association

b) A declaration by advocate or practicing professional (CA, CS etc) regarding compliance.

c) Affidavit from each subscriber from each person named as first director.

d) Address for correspondence till its registered office is not established

e) Details of each subscriber

f) Details of first director

g) Required amount of registration fees and any other document if required

4. **Incorporation Certificate:** Once all these required documents are received Registrar of the company will issue Incorporation Certificate for the company.

2.3 SHARES

- **Meaning & Definition:**

Share is the smallest part of the share capital of the company. As per section 2(84) of the Companies Act "A Share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied."

Shares are considered as movable property and can be transferred as per procedure laid down in Articles of the company. Each and every share has a predetermined value which is called as face value.

- **Shareholder:**

The owner of the shares is called as shareholder. Company issues a share certificate to the holder having his name along with other details such as no of shares and their distinct no. The share holders are co-owners of the company he has right to attend meeting and to receive dividend. He has right to receive back his capital at the time of winding up of the company.

- **Stock:**

Stock is a bundle of fully paid shares. A limited can company can convert its fully paid shares into stock. Stock can be divided into any fractions and subdivisions regards to the face value.

- **Types of Shares**

There are two types of shares, 1. Equity Shares, 2. Preference Shares

1. **Equity Shares:** Explanation to section 43 It is that part of share capital which is not preference share capital.

Equity shares are of two types:

a) **With voting rights:** These are normal equity shares having equal rights regards to voting at meeting, dividend and same rights in each and every aspect.

b) **With differential voting rights:** Company can issue equity shares with differential rights as to dividend, voting rights etc. However such must can be done subject to Rule 4 of Companies (Share Capital and Debentures) Rules 2014.

2. **Preference Shares:** These are the shares having preferential rights in respect of dividend and receiving back their capital at the time of

winding up of the company. Preference Shares will receive dividend at fix rate before any dividend is paid to equity shares and receive back their capital before equity shares.

Types of Preference Shares:

a) **Cumulative and Non-cumulative Preference Shares:** If any year company does not pay dividend Cumulative preference shares will receive dividend for that year from the profits of following year. However Non-cumulative preference shares do not enjoy such benefits.

b) **Participating and Non-participating Preference Shares:** Participating Preference Shares are entitled to participate in surplus profits remaining after payment of dividend of both types of shares.

c) **Convertible and Non-convertible Preference Shares:** Convertible Preference Shares can be converted into equity shares whereas non-convertible preference shares are not converted into equity shares.

d) **Redeemable and Non-redeemable Preference Shares:** Redeemable preference shares are redeemed (paid back) during life time of the company whereas Non-redeemable Preference shares are not redeemed during life time of the company they are redeemed at the winding up of the company.

2.4 SHARE CAPITAL

Capital of the company is collected by issue of shares, there is no any limit for maximum no of members / shareholders of the company and shares are freely transferable so it's impossible to have separate capital account for each shareholder. The company maintain a share capital account in its books representing amount collected from all shareholders.

- **Classification of Share Capital**

1. **Authorised Capital:** Authorised Capital or Nominal Capital is capital which is mentioned in memorandum and company cannot issue shares exceeding this amount.

2. **Issued Capital:** It is the no shares issued by the company for subscription. Company can issue full or part of its authorised capital.

3. **Subscribed Capital:** It is the part of issued capital, it refers to the no of shares actually subscribed or taken u by general public.

4. **Called up Capital:** Called up capital is the amount of subscribed capital which is actually called by the company. (demanded by the company)

5. **Paid up Capital:** Paid up capital is the amount received against called up capital amount by the company.

6. **Reserve Capital:** It is the uncalled amount of share subscribed capital which company will demand at the time of emergency or liquidation of company.

- **Dividend**

Dividend is part of profit distributed among shareholders by the company. Dividend can be classified as final dividend and Interim dividend. The dividend can be paid as % of paid up capital or at a fixed amount per share.

1. **Final Dividend:** Final dividend is proposed by directors and declared at annual general meeting of the company. It should be noted that proposed dividend will be considered as contingent liability and will not be recorded in balance sheet. Once the dividend is declared it will be considered as liability and should be paid off in stipulated time.

2. **Interim Dividend:** Interim dividend is declared by board of directors in between two annual general meetings. Any dividend declared over and above the final dividend will be considered as Interim dividend.

2.5 FORMAT OF BALANCE SHEET

The company need to prepare its financial statements i.e. Profit & Loss A/c and Balance Sheet in the format prescribed by Companies Act 2013. Schedule 3 of Companies Act provide format for the financial statements. Any requirement of Accounting Standard will override the requirements of the schedule 3 of the Companies Act.

The balance sheet needs to be prepared in vertical format along with notes to accounts.

Part I – Form of Balance Sheet

Name of the Company:- ______________________________

Balance Sheet as at:- ________________________________

(Rupees in _________)

Particulars	Note No	Figures as at the end of the current reporting period	Figures as at the end of the previous reporting period
EQUITY AND LIABILITIES			
Shareholders Fund			
Share Capital			
Reserves Surplus			
Money Received against Share Warrants			
Share Application Money Pending Allotment			
Non Current Liabilities			
Long Term Borrowings			
Differed Tax Liabilities (Net)			
Other Long Term Liabilities			
Long Term Provisions			
Current Liabilities			
Short Term Borrowings			
Trade Payable			
Other Current Liabilities			
Short Term Provisions			
Total			
ASSETS			
Non-Current Assets			
Fixed Assets			
Tangible Assets Intangible Assets Capital work in Progress Intangible Assets under developments			
Non-Current Liabilities			
Differed Tax Assets (Net)			
Long Term Loans and Advances			

Other Long Term Assets			
Current Assets			
Current Investments			
Inventories			
Trade Receivables			
Cash and Cash Equivalents			
Short Term Loans and Advances			
Other Current Assets			
Total			

The balance sheet of the company is presented along with relevant notes to accounts providing detailed information regarding the particular item. The notes accounts are presented as follows.

Notes to accounts	**Rs.**
A. Share Capital	
• Authorised shares (Par Value per Share : Rs…..)	
• Issued, subscribed, called up & fully paid shares	
• Subscribed but not fully paid shares	
Less : Calls unpaid	
– By Directors	
– By Officers	
– By Others	
• Forfeited Shares	
• Forfeited Shares reissued	
• Reconciliation of Shares Outstanding	
B. Reserves and Surplus	
a. Capital Reserves	
b. Capital Redemption Reserve	
c. Securities premium	
d. Debenture Redemption Reserve	
e. Revaluation Reserve	
f. Share Options Outstanding Account	
g. Other Reserves	
h. General Reserves	
i. Surplus	

– Balance b/d
Add : Profit for Year
Less : Appropriations

C. Long Term Borrowings

a. Bonds / Debentures
b. Term Loans
i. Term Loans from Banks
ii. Term Loans from Other Parties
c. Deferred Payment Liabilities
d. Deposits
i. Public Deposits (GN)
ii. Inter-Corporate Deposits (GN)
e. Loans and Advances from Related Parties
f. Long Term Maturities of Finance Lease Obligations
g. Other Loans and Advances

D. Other Long Term Liabilities

a. Trade Payables
b. Other Payables
i. Trade Deposits (GN)
ii. Security Deposits (GN)

E. Long Term Provisions

a. Provision for Employee Benefits
b. Others
– Provision for Warranties (GN)

F. Short Term Borrowings

a. Loans Repayable on Demand
i. From Banks
ii. From Other Parties
b. Loans and Advances from Related Parties
c. Deposits
d. Other Loans and Advances

G. Other Current Liabilities

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

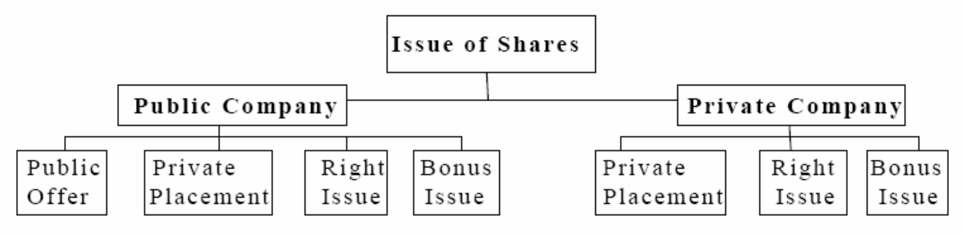
e. Income Received in Advance f. Unpaid Dividends g. Application Money Refund and Interest Due h. Unpaid Matured Deposits and Interest Accrued thereon i. Unpaid Matured Debentures and Interest Accrued thereon j. Other Payables – Calls-in-Advance (GN) – Non-Trade Payables (GN) – Taxes Payable (GN) **H. Short Term Provisions** a. Provisions for Employee Benefits b. Others –Provision for Tax (Net of tax payments) (FAQ) **I. Tangible Assets** a. Land b. Buildings c. Plant and Equipment d. Furniture and Fixtures e. Vehicles f. Office Equipment g. Others (specify nature) **J. Intangible Assets** a. Goodwill b. Brands / Trademarks c. Computer Software d. Mastheads and Publishing Titles e. Mining Rights f. Copyrights, Patents, etc. g. Recipes, Formulae, Models, Designs and Prototypes h. Licenses and Franchise i. Others (specify nature) **K. Non-Current Investments** a. Investments in Property b. Investment 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	
L. Long Term Loans and Advances	
a. Capital Advances	
b. Security Deposits	
c. Loans and Advances to Related Parties	
d. Other Loans and Advances	
– Advances Tax (Net of provision) (FAQ)	
– CENVAT Credit Receivable (GN)	
– VAT Credit Receivable (GN)	
– Service Tax Credit Receivable (GN)	
M. Other Non Current Assets	
a. Long Term Trade Receivables	
b. Others	
N. Current Investments	
a. Investments in Equity Instruments	
b. Investments 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	
O. Inventories	
a. Raw Materials	
b. Work-in-progress	
c. Finished Goods	
d. Stock-in-Trade	
e. Stores and Spares	
f. Loose Tools	
g. Others	
P. Trade Receivables	
a. Secured, Considered Good	
b. Unsecured, Considered Good	

i. More than 6 months	
ii. Other	
c. Doubtful	
Less : Provision for Bad and Doubtful Debts	
Q. Cash and Cash Equivalents	
a. Balances with Banks	
b. Cheques, Drafts on Hand	
c. Cash on Hand	
d. Others (specify nature)	
– Other Bank Balances	
– Earmarked (Unpaid Dividend A/c)	
– Margin Money Deposit	
– Deposits Maturing After 12 Months	
R. Short Term Loans and Advances	
a. Loans and Advances to Related Parties	
b. Others	
– Prepaid Expenses (GN)	
– Tax Refund Receivable vide A.O. (FAQ)	
S. Other Current Assets	
• Non-Trade Receivables (GN)	
• Unamortized Expenditure (GN)	
• Unbilled Revenue (GN)	

2.6 ISSUE OF SHARES

Company issue shares for formation of its on capital. There are several modes for issue of shares such as public offer, private placement, right issue etc. However regulations of Companies Act lay don guidelines in respect of these modes. Depending upon type of company modes of issue will be applicable for issue of shares.



Issue of Shares

1. Public Offer: In this case company offer shares to general public for subscription it need to follow a prescribed procedure laid down by companies act and rules in respect of the issue of shares. Public offers are classified as follows.

a) Initial Public Offer (IPO): When company offer its shares to public for subscription through prospectus for the first time it is called as initial public offer. Generally such offer is made by unlisted companies. This enables listing and trading of companies shares at stock exchange.

b) Further Public Offer (FPO): When an existing listed company makes a fresh issue of securities to the public through an offer document it is called as Further Public Offer.

c) Offer for Sale of Securities (OFS): Offer for sale of securities is different from IPO and FPO. It is used to reduce promoters holding or to provide exit route to venture capitalist. In this case shares offered to public are shares held by promoters of the company. In this case balance sheet of the company is not affected as new shares are not issued.

2. Private Placement: In case of private placement company does not offer its shares to general public instead it offers its shares to selected group of persons. Such offer is made through issue of a private placement offer letter. However company need to satisfy various conditions mentioned in section 42 of the Companies Act 2013.

3. Right Issue: Right Issue referrers to offer given by company to its existing equity shares to subscribe for additional shares. However such offer will be given to the shareholder for limited no of shares in proportion to shares already held by him. Section 62(1) (a) of the Companies Act 2013 provide guidelines for right issue.

4. Bonus Shares: Bonus shares are free gift given by company to its existing equity share holders. In this case company allot fully paid shares to its existing equity share holders for free increasing their shareholding and companies share capital. Company can issue bonus shares by utilising its free reserves, securities premium or capital redemption reserve. Section 63 of the Companies Act provides guidelines for issue of bonus shares.

2.7 ISSUE OF SHARES ON PREFERENTIAL BASIS

Section 62(1)(c) of the Companies Act and Rule 13 of Companies (Share Capital and Debentures) Rule 2014 enable the company to issue shares on preferential basis. However the company need to comply with section 42 of the Companies Act while issuing shares on preferential basis. Apart from compliance of various provisions of Companies Act, a special resolution is also required for issue of shares on preferential basis

Meaning: "PREFERENTIAL ALLOTMENT" means an issue of shares or other securities, by a Company to any select person or group of persons on preferential basis and does not include shares or other securities offered through a public issue, right issue, employee stock option scheme, employee stock purchase scheme or an sweet equity issue or bonus issue or depository receipts issued in a country outside India or foreign securities.

Price: The price of shares or other securities to be issued on preferential basis shall be determined on the basis of valuation report of a registered valuer or Independent Valuer having 10 year of experience.

Consideration other than Cash: Company can issue shares on preferential basis as consideration for other than cash. However valuation of such consideration shall be done by registered valuer who need to submit a valuation report to the company giving justification for the valuation.

2.8 EMPLOYEE STOCK OPTION (ESO)

Meaning

Section 2(37) of the Companies Act, 2013 Employees Stock Option means the option given to the directors, officers, or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers nor employees the benefit or right to purchase or to subscribe for the shares of the company at a future date at a predetermined price.

Section 62(1)(b) of the Companies Act enable the company to offer shares to its employees through Employee Stock Option. A special resolution is required for such issue and company also need to comply with Rule 12 of Companies (Share Capital and Debentures) rules 2014.

For this purpose employee means

1. A permanent employee of the company
2. A director of the company excluding independent director
3. A employee (1 or 2 mentioned above) in subsidiary company of Indian Holding Company.

Employee does not include following

1. An employee who is promoter of the company or belonging to promoter group
2. A director himself or through his relative hold directly or indirectly more than 10% of share capital of the company.

Following are important point in respect of Employee Stock Option

1. Company can offer these shares at any price to its employees
2. There should be time gap of atleast 1 year between granting of option and vesting of option.

3. Option granted to employee is non transferable
4. The company need to maintain a separate register for Employee Stock Option in prescribed form.
5. If company is listed on any recognised stock exchange, then Employee Stock Option Scheme shall be issued in accordance with the regulations made by SEBI.

2.9 SWEAT EQUITY SHARES

- **Meaning**

According to Section 2(88) of the Companies Act 2013, SWEAT equity shares means such equity shares issued by a company to its directors, or employees at a discount or for consideration other than cash, for providing their knowhow or making available rights in the nature of intellectual property or value additions, by whatever name called. It should be noted that SWEAT Equity is different from Employee Stock Option Scheme and Employee Stock Purchase Scheme.

- **Conditions to be fulfilled by the company**

Section 54 of the Companies Act prescribed conditions to be fulfilled by the company for issue of SWEAT Equity Shares which are as follows

1. A special resolution is required for issue of SWEAT Equity Shares.
2. The resolution must specify no. of shares, market price, consideration and details of directors or employees to whom such shares are issued.
3. The Company must have started its business for at least 1 year not less than that.
4. If the equity shares of the company is listed on recognised stock exchange issue of SWEAT Equity Shares will be done as per guidelines issued by SEBI. If company is not listed it will be issued as per Chapter IV of the Companies Act 2013.

2.10 ESCROW ACCOUNT

- **Meaning**

Escrow means depositing funds with third party to be used latter on compliance of certain conditions. Company use this system at the time of IPO, it is used to put Share Application Money received at the time of receiving applications from public for an IPO.

Escrow account is the dedicated bank account, it is opened with Escrow Collections Bank which is used for collection of application money at the time of public offer. The company need to enter into escrow agreement.

Escrow Agreement is an agreement between issuer company, registrar of issue, and escrow collection bank for collection of application money and its refund whenever applicable.

- **Escrow Mechanism**

1. Company open one or more escrow account with Escrow Collections Bank for collection of application money. Application money received from public along with applications is deposited in escrow account. The company also open Public Issue Account and Refund Account with Bankers of Issue.
2. The money received will be held by the Escrow Collection Bank on behalf of issuing company till date of allotment.
3. On date of allotment money as per size and terms of issue will be transferred from escrow account to Public Issue Account.
4. The balance left in escrow account will be transferred to refund account. The amount will be refunded to all unsuccessful applicants, and applicants who have paid excess application money after adjusting for allotment money within 15 days from closing date of issue. If it fails to repay on time, company need to pay 15% interest on the amount to the applicants.

2.11 ISSUE OF SHARES AT PAR, AT PREMIUM AND AT DISCOUNT

The company can issue shares at any price. It can issue shares at Par, at Premium or at Discount.

a. At par: When shares are issued at its face value, they are said to be issued at par.

b. At premium: When shares are issued at a price more than its face value, they are said to be issued at premium.

c. At Discount: When shares are issued at price less than its face value, they are said to be issued at discount.

- **Oversubscription and Under subscription**

Public Company issue shares to general public, for this purpose it invites applications from interested investors by issuing prospectus. Interested investors need to subscribe for the shares as per procedure described in prospectus. Oversubscription or Under subscription relates to the response received from general public for companies offer for issue of shares.

Under subscription:

It is the situation in which number of shares subscribed by public is less than no of shares offered by company. In this case shares can be allotted only when minimum subscription received. However applications are received more than minimum subscription shares can be allotted.

Oversubscription:

When no of applications received are more than shares offered by company then it is called as oversubscription. In case of oversubscription shares can be allotted in following ways:

i. **Partial Allotment:** The directors may decide to fully accept some applications and reject remaining excess applications.

ii. **Pro-rata Allotment:** Pro-rata allotment means proportionate distribution of shares available for allotment among the applicants for the shares.

iii. **Combination:** Company can combine both the above methods where it rejects few applications and allots shares on prorate basis among remaining applicants.

- **Issue of Shares for Consideration Other than Cash**

A company can issue shares for consideration other than cash. Such issue can be at par, at premium or at discount. Following are some of the cases in which company can issue shares for consideration other than cash.

Vendors: The vendors may be an individual, a firm or company whose business is taken over by the company. The purchasing company may issue its shares to vendors from whom their business is purchased.

Promoters: Shares may be issued to promoters of the company as remuneration for the services rendered for the formation of the company.

Underwriters: Shares may be issued to underwriters in lieu of underwriting commission payable to them.

Directors or Employees: A company can SWEAT Equity Shares to its directors or employees as consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions.

- **Forfeiture and Re-Issue of Forfeited Shares**

On issue of shares company can collect entire money at the time of application or it can collect it in instalments, at the time of application, allotment and balance in calls. If any shareholder fails to pay allotment or call money, company can forfeit his shares, i.e. take back his shares without paying any compensation.

Forfeiture of Shares

Forfeiture of shares can be referred as compulsory termination of membership of shareholder by the company die to non-payment of allotment or call money. In this case shareholder ceases to be member of company and company take back its shares and confiscate any amount paid by the shareholder against those shares. Company need to follow the procedure laid down by Articles of Association of the company to forfeit the shares of any shareholder.

Re-Issue of Forfeited Shares

A company can re-issue the forfeited shares. Re-issue of shares though called as re-issue it is 'sale' of shares not 'issue' of shares. Company need to follow the procedure laid down in its Articles of Association in respect of re-issue of shares. The company can re-issue the forfeited shares at par, at premium or at discount; however re-issue of shares cannot have allotment, calls etc.

2.12 EXERCISE

Descriptive Questions

1. What is mean by Company? Explain its features
2. Describe different type of companies.
3. Define Shares? Explain different types of Shares
4. Explain different types of Preference Shares
5. Explain Share Capital
6. Explain different modes for issue of shares.
7. Explain Equity & Liabilities of Balance Sheet as per Schedule-III of Companies Act 2013.
8. Explain Forfeiture and re-issue of forfeited shares.

Short Notes

1. One Person Company
2. Private Company
3. Public Company
4. SWEAT Equity
5. ESCROW Account
6. Share
7. Bonus Shares
8. Right Shares

Objective Questions

1) Fill in Blanks.

1. A Public company may be formed by _______ or more persons.
2. One Person company may have _____ person as director.
3. ___________ Preference Shares are converted into equity shares.
4. Profit distributed by the company among shareholders is called as ___

5. Preference Shareholders are entitled to receive dividend at _______ rate.
6. Inventories appear under ___________ in Balance Sheet.
7. Creditors are recorded under ___________ in Balance Sheet.
8. Forfeiture of shares results in __________ termination of membership.
9. SWEAT Equity shares can be issued to directors & _______ of the company.
10. A share denotes a ______ part of company's share capital.

(seven, one, Redeemable, dividend, fixed, Current Assets, Trade Payable, compulsory, employees, smallest)

2. Match Pairs

Group A	**Group B**
Authorised Capital	Creditors of the company
One Person Company	Receive dividend at fixed rate
Debenture holders	Can be formed with only 1 member.
Preference Shares	Compulsory termination of membership
Forfeiture of shares	Minimum 7 members
Public Company	Shares issued to vendor for purchase of its business.
Shares issued for consideration other than cash	Memorandum of Association

(a – 7, b – 3, c – 1, d – 2, e – 4, f – 5, g – 6)

3. True or False

1. Only a natural person can form one person company.
2. A stock can be transferred in any fractions.
3. Right issue is made to existing shareholders only.
4. Forfeited shares cannot be reissued.
5. Company can issue bonus shares out of capital reserve.
6. Company has perpetual life.
7. ESCROW is a special bank account used specifically for public offer.
8. Offer for Sale of securities is not fresh issue of shares.

(True – 1, 2, 3, 6, 7, 8) (False – 4, 5)

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2

INTRODUCTION TO COMPANY ACCOUNTS

ISSUE OF DEBENTURES

Unit Structure:

2.0 OBJECTIVE

After studying the unit students will be able to

- Understand the provisions regarding issue of debentures under the Companies Act, 2013
- Explain the accounting treatment for the same.

2.1 INTRODUCTION

- **Meaning:**

Section 2(30) of the Companies Act, 2013 defines a as *'Debenture' includes debenture stock, bonds or any other securities of a company evidencing a debt whether constituting a charge on the company's assets or not*. In other words, a debenture is a borrowing or a loan. Schedule III of the Companies Act, 2013 classifies debenture as a Long Term Borrowing. Debentures are issued by the company only if it is authorised by the Articles of Association of the Company. It is in the form of a certificate issued under the common seal of the company and it creates or acknowledges a debt. Debentures are normally secured against the assets of the company and interest is payable on them which is calculated on the nominal value of the debentures issued by the company. The debenture certificate specifies the date of redemption of the debenture. The persons to whom the debentures are allotted are known as debenture holders

- **Features of Debentures:**

a. It is a document which creates or acknowledges debt.

b. It is in the form of certificate issued by company under its common seal.

c. The certificate will show rate of interest payable.

d. Normally debentures are secured against assets of the company.

2.2 TYPES OF DEBENTURES

Debentures are classified as follows:

1. Secured debentures and Unsecured debentures:

A. Secured debentures: The debentures which have a charge (security) on the assets of the company are called secured debentures. The charge may be fixed charge or floating charge. The charge is on all assets of the company in general.

i) **Fixed Charge:** In case of fixed charged the debentures are secured on specific assets of the company like Land & Building, Plant & machinery etc. The company cannot sell such assets until the debenture holders are repaid. In this case the debenture holder can recover their dues out of the specific asset of the company which is identified in mortgage deed.

ii) **Floating Charge:** In this case debenture holders do not have charge on specific asset of the company. The charge may be on current assets such as stock, debtors etc. of the company. It is very difficult to pinpoint an asset as value of the current assets keeps changing. Hence company can use these assets for normal business operations however the floating charge become fixed in the event of default by company in respect of interest or redemption of debentures.

B. Unsecured debentures are also known as 'simple' or 'naked' debentures. The debentures which do not have a charge (security) on the assets of the company are called unsecured debentures. In the event of the winding up of company, such debentures are treated as unsecured creditors.

2. Registered debentures and Bearer debentures:

A. Registered debenture must be compulsorily registered with the company and the details of these debentures are recorded by the company in the Register of Debenture holders which is kept by the company.

B. **Bearer debentures** are not registered with the company. They are transferred by mere delivery.

3. **Redeemable debentures and Irredeemable Debentures:**
   A. **Redeemable debentures** are redeemed after a specified period of time in future. The date on which the debenture would be redeemed is mentioned on the debenture certificate.

   B. **Irredeemable debentures** are redeemed only when the company is liquidated. They continue to remain in existence as long as the company exists.

2.3 ISSUE OF DEBENTURES

- **Issue of debentures at Par, Premium and Discount**
  A. **Issue of debentures at Par**: Debentures are said to be issued at par when their issue price is equal to their nominal value. For example debentures of nominal value of ₹100 is issued at ₹ 100.

  B. **Issue of debentures at Premium:** Debentures are said to be issued at a premium when their issue price is greater than their nominal value. For example debentures of nominal value of ₹100is issued at ₹ 101 or more. In this case ₹1 is the premium and would be credited to securities premium account.

  C. **Issue of debentures at Discount:** Debentures are said to be issued at a discount when their issue price is less than their nominal value. For example debentures of nominal value of ₹100 is issued at ₹99 or less. In this case ₹1 is the discount and would be debited to discount on issue of debentures account.

- **Issue of Debentures with consideration of Redemption**

Debentures may be issued with consideration of redemption. Debentures can be redeemed (repaid) at par, premium or discount.

  A. If debentures are redeemed at an amount equal to their face, they are redeemable at par.

  B. If debentures are redeemed at an amount greater than their 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.

  C. If debentures are redeemed at an amount less than their face value, they are said to be redeemable at a discount. Such discount on redemption is a capital profit for the company.

- **Issue of debentures for cash receivable in instalments or at a time issue of debentures for consideration other than cash**

A. Debentures can be issued for cash or for consideration other than cash. In both these cases, debentures can be issued at par, premium or at a discount. When debentures are issued for cash, the cash may be received in instalments such as application, on allotment and balance in calls. The premium or discount, if any, is adjusted at the time of allotment itself.

B. Debentures issued for consideration other than cash means that the company issues debenture without receiving money for the debentures issued.

   Examples: Debentures issued to vendors for purchase of business, debentures issued to suppliers for purchase of machinery.

C. Debentures can also be issued to the lender as a collateral security. Collateral security means an additional or parallel security. Such debentures are in the nature of contingent liability. The lender will be the custodian of the debentures. There is no accounting entry (journal entry) passed in the books of accounts of the company for debentures issued as a collateral security, since there is no immediate liability created by the company. Only a note in the balance Sheet has to be given to that effect

2.4 PROVISIONS OF THE COMPANIES ACT, 2013 REGARDING ISSUE OF DEBENTURES

Section 71 of the Companies Act, 2013 provides the manner in which debentures are to be issued by the Company. The features of the provisions are:

1. A company cannot issue any debentures carrying voting rights.

2. A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. Such an issue must be approved by a special resolution at a general meeting.

3. A company shall pay interest and redeem debentures as per the terms and conditions of the issue.

4. Secured debentures shall be issued by a company as per the terms and conditions prescribed in Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014

5. The company shall create a Debenture Redemption Reserve account (DRR A/c) out of company's profits available for dividend and the amount appropriated to DRR account shall be utilised by the company only for redemption of debentures.

6. A debenture trustee shall ensure the protection of Debenture holders' interest and redress their grievances as prescribed by the rules.

7. The debenture trustee can approach the Tribunal for an order, if the assets of the company become insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due.

8. If the company fails to redeem the debentures on due date or it fails to pay the interest on debentures on due date, then the tribunal can direct, by order, the company to redeem the debentures forth with on payment of principal and interest due thereon.

9. If the company fails to comply the tribunal's order, then every officer of the company who is in default shall be punishable with imprisonment upto three years or a fine of at least rupees two lakhs which can be extended to Rupees five lakhs or with both.

10. The Central Government may prescribe procedure for securing the issue of debentures, the form of trust deed and its inspection and to obtain its copies, the amount of DRR to be created and such other matters.

11. Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 provides that a company shall issue secured debentures on the following terms and conditions:

   i. Secured debentures can be issued provided its date of redemption shall not exceed ten years from the date of it issue.

   ii. The following classes of companies can issue secured debentures for a period exceeding ten years but not exceeding thirty years

      a) Companies who are engaged in setting up infrastructure projects
      b) Infrastructure Finance Companies
      c) Infrastructure Debt Fund Non-Banking Financial Companies

   iii. There shall be a creation of charge on the issue of such debentures.

   iv. The company shall appoint a debenture trustee before issue of prospectus or offer letter for subscription of debentures.

   v. The charge or mortgage shall be created in favour of the debenture trustee on any specified movable or immovable property.

2.5 DISTINCTION BETWEEN SHARE AND DEBENTURE

	Share	Debenture
1.	It is an owned capital.	It is a borrowed capital.
2.	A person who holds share is known as shareholder.	A person who holds debenture is known as debenture holder
3.	The shareholder is the owner of the company.	The debenture holder is the creditor of the company.
4.	Earnings on share are in the form of dividend.	Earnings on debentures are in the form of interest.
5.	The rate of dividend fluctuates in case of equity shares	The rate of interest is fixed.
6.	Shares do not have any security. They are unsecured.	Debentures may have security. They are secured.
7.	Shareholders enjoy voting rights	Debenture holders do not have voting rights
8.	Equity shares can never be converted	Debentures can be converted
9.	Share Trust Deed is not required to be executed.	Debenture Trust Deed is required to be executed.
10.	Section 53 of the Companies Act 2013 prohibits issue of shares at a discount.	There are no restrictions in the Companies Act on issue of debenture at discount

2.6 MODEL JOURNAL ENTRIES ON ISSUE OF DEBENTURES

	Nature of Transaction	Journal Entry	Amount
1.	When debentures are issued at par and redeemable at par	Bank A/c Dr. To Debentures A/c	Amount Received
2.	When debentures are issued at a premium and redeemable at par	Bank A/c Dr. To Debentures A/c To Securities Premium A/c	Amount Received NV of Debentures Amount of Premium
3.	When debentures are issued at a discount and redeemable at par	Bank A/c Dr. Discount on issue of Debentures A/c Dr. To Debentures A/c	Amount Received Amount of discount NV of Debentures

4.	When debentures are issued at par and redeemable at premium	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Premium on redemption of debentures A/c	Amount Received Premium on redemption NV of Debentures Premium on redemption
5.	When debentures are issued at a discount and redeemable at premium	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Premium on redemption of debentures A/c	Amount Received Disc. allowed & POR NV of Debentures Premium on redemption
6.	When debentures are issued at a premium and redeemable at premium	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Securities Premium A/c To Premium on redemption of debentures A/c	Amount Received Premium on redemption NV of Debentures Amount of Premium Premium on redemption

NV = Nominal Value

POR = Premium on Redemption

2.7 ILLUSTRATION:

Ajay Ltd. issues 2,000 8% debentures of □100 each

You are asked to give journal entries on issue if:

a. the debentures are issued at par and redeemable at par
b. they are issued at a premium of 5% but redeemable at par
c. they are issued at a discount of 5% but redeemable at par
d. they are issued at par but redeemable at a premium of 10%
e. they are issued at a discount of 10% but redeemable at a premium of 5%
f. they are issued at a premium of 5% but redeemable at a premium of 10%

Solution:

Working Note

	On date of Issue ₹	**On date of Redemption** ₹
a. NV 2,000 x of □100 (at par)	2,00,000	2,00,000
b. NV + Premium on issue 5%	2,00,000 +10,000	2,00,000 -
c. NV - Discount on issue 5%	2,00,000 -10,000	2,00,000 -
d. NV + Premium on redemption 10%	2,00,000 -	2,00,000 +20,000
e. NV - Discount on issue 5% + Premium on redemption 10%	2,00,000 -20,000 -	2,00,000 - +10,000
f. NV + Premium on issue 5% + Premium on redemption 10%	2,00,000 +10,000 -	2,00,000 - +20,000

Journal entries in the books of Ajay on Issue of Debentures

	Nature of Transaction	**Journal Entry**	**Debit ₹**	**Credit ₹**
a.	When issued at par and redeemable at par	Bank A/c Dr. To Debentures A/c	2,00,000	 2,00,000
b.	When debentures are issued at a premium and redeemable at par	Bank A/c Dr. To Debentures A/c To Securities Premium A/c	2,10,000	 2,00,000 10,000
c.	When debentures are issued at a discount and redeemable at par	Bank A/c Dr. Disc. on issue of Deb. A/c Dr. To Debentures A/c	1,90,000 10,000	 2,00,000
d.	When debentures are issued at par and redeemable at premium	Bank A/c Dr. Loss on issue of Deb. A/c Dr. To Debentures A/c To Prem. on redemption of deb. A/c	2,00,000 20,000	 2,00,000 20,000

e.	When debentures are issued at a discount and redeemable at premium	Bank A/c Dr. Disc. on issue of Deb. A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Prem on redemption of deb. A/c	1,80,000 20,000 10,000	2,00,000 10,000
f.	When debentures are issued at a premium and redeemable at premium	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Securities Premium A/c To Prem. on redemption of deb. A/c	2,10,000 20,000	2,00,000 10,000 20,000

2.9 SUMMARY:

1. Debenture is acknowledged as a debt
2. Debenture is a long term borrowing
3. It is given in the form of a certificate under the common seal of the company
4. The terms of issue and redemption of debentures are mentioned in the certificate
5. Debenture can be issued at par, premium or discount
6. Debentures can be issued for consideration other than cash.
7. Debenture can be offered as a collateral security
8. Debentures can be secured or unsecured.
9. Interest is payable on nominal value of debentures.
10. Debentures do not carry voting rights

2.10 EXERCISE:

1. Distinguish between a share and debenture?
2. Explain the different types of debentures?
3. What are the provisions of the Companies Act regarding issue of debentures?
4. Write Short Notes on:

   i. Meaning and features of debentures.

   ii. Types of Debentures

iii. Simple debentures

iv. Fixed charge and floating charge on debentures

v. Secured debentures and redeemable debentures

vi. Issue of debentures

vii. Issue of debentures other than cash

viii. Issue of debentures as a collateral security

Objective types questions

A. State whether the following statements are True or False

i. Debenture is a short term borrowing

ii. Debenture holders are creditors of the company

iii. Interest on debentures is calculated on the cost of the debentures

iv. Debentures can be issued as a collateral security

v. Debentures can be issued for consideration other than cash

vi. Debentures cannot be issued at a discount

vii. A charge on all the assets of the company is a fixed charge

viii. Unsecured debentures are simple debentures

ix. Bearer debentures are registered with the company

x. A company cannot issue secured debentures

xi. Debentures carry voting rights.

Answers:
True : ii, iv, v, viii
False : i, iii, vi, vii, ix, x, xi

B. Fill in the blanks choosing correct alternative

i. Debenture holders are the _________of the company (Owners/Creditors)

ii. Naked debentures are also known as _______ debentures. (Secured/Unsecured)

iii. Debenture is a ________________capital (Borrowed/Owned)

iv. Interest is calculated on the ___________ of the debentures (Nominal Value/Cost Price)

v. A charge on specific assets of the company is a ________ charge. (Fixed/Floating)

vi. Collateral security is a ____________ security (Lateral/Parallel)

vii. The rate of interest on debenture is________ (Fixed/Fluctuating)

viii. The maximum tenure for debentures issued by Companies engaged in setting up infrastructure project is _______ years (10/30)

ix. When debentures of the face value of ₹100 are issued at ₹105, the issue is said to be at______ (Discount/Premium)

x. Issue of debentures must be authorised by __________ of Association (Memorandum/Articles)

Answers:

i. Creditors, ii. Unsecured, iii. Borrowed, iv. Nominal Value,
v. Fixed, vi. Parallel, vii. Fixed, viii 30 ix. Premium, x. Articles

C. Match the Columns

Column A	**Column B**
1. Debenture holders are	a. Simple debentures
2. Unsecured Debentures	b. Collateral Security
3. Bearer Debentures	c. Charge on the assets of the company
4. Secured Debentures	d. Creditors of the company
5. Parallel Security	e. Transfer by mere delivery

Answers:

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

Illustration

Varun Ltd. issues 1,000 7% debentures of ₹100 each

You are asked to give journal entries on issue if:

i. the debentures are issued at par and redeemable at par

ii. they are issued at a discount of 5% but redeemable at par

iii. they are issued at a premium of 5% but redeemable at par

iv. they are issued at a discount of 10% but redeemable at a premium of 5%

v. they are issued at par but redeemable at a premium of 10%

vi. they are issued at a premium of 5% but redeemable at a premium of 10%

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Module II

3

REDEMPTION OF PREFERENCE SHARES

Unit Structure

3.0 OBJECTIVE

After studying this unit students will be able to:

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

3.1INTRODUCTION

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.

3.2ACCOUNTING 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

$\therefore$ 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

$\therefore$ Redeem value / share = 110

No. of share unpaid = 500

Amount unpaid = 500 x 110 = 55,000

$\therefore$ Amount paid = 4,40,000 - 55,000

= 3,85,000

WN3

Calculation of Bonus

Total no. of Equity shares = 8000 + 1250

= 9250

Bonus	Held
1	25
2	9250

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

Journal of Adira Ltd.

1) 9% preference Capital A/c Dr. 4,00,000
   Premium on Redeem A/c Dr 40,000
   To PSH A/c 4,40,000
   (Being the claim of PSH created)

2) General Reserve A/c Dr. 2,00,000
   Profit & Loss A/c Dr 50,000
   To CR RA/C 2,50,000
   (Being CRR created for redemption of preference share)

3) Profit and Loss A/c Dr. 40,000
   To Premium on Redeem A/c 40,000
   (Being the premium on redemption amountised through profit and loss A/c)

4) Bank A/c Dr 1,50,000
   To Equity Capital A/c 1,25,000
   To security premium A/c 25,000
   (Being equity shares issued at a premium)

5) PSH A/c Dr. 4,40,000
   To Bank A/c 85,000
   (Being PSH Claim settled) 55,000

6) CRR A/c Dr.	37,000	
To Bonus to ESH A/c	37,000	
(Being bonus declared)		
7) Bonus to ESH A/c Dr.	37,000	
To Equity Capital A/c	37,000	
(Being bonus shares issued)		

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

Capital & Liabilities			
1	Shareholders funds		
a	Share Capital	1	9,62,000
b	Reserves & Surplus	2	3,16,000
2	Non Current Liabilities		Nil
3	Current Liabilities	3	10,42,000
	Total		23,20,000
Assets			
1	Non Current Assets	4	17,60,000
2	Current assets	5	5,60,000
	Total		23,20,000

Note 1 : Share Capital

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

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

Note 2 : Reserves & Surplus

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

Note 3 : Current Liabilities

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

Note 4 : Non CA

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

Note 5 : CA

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

WN4 : Calculation of Bank balance

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

3.3 QUESTIONS :

I) True or False.

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

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

II) Fill in the blanks.

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

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

Questions for self Test

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

2) Sara Ltd. provided the following information

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

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

3) Taimur Ltd. provides the following information to you

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

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

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

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

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

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

Journalise the above transactions and also prepare the Balance sheet.

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

Equity share of ₹100 each	15,00,000
10% preference share of ₹100 each	6,00,000
Profit & Loss A/c	6,00,000
Current Liabilities	5,00,000
	32,00,000
Fixed Assets	10,00,000
Investments	5,00,000
Bank	3,00,000
Other Current assets	14,00,000
	32,00,000

On the 1st April the Company

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

Journalise the above transactions and prepare the Balance sheet.

❖❖❖❖

Module III

4

REDEMPTION OF DEBENTURES

Unit Structure:

I. Introduction
II. Provisions of Section 71 (1) and (4) of the Companies Act, 2013
Creation and investment of DRR including The Companies (Share Capital and Debentures) Rules, 2014
III. Methods of writing off discount/loss issue of debentures
IV. Terms of issue of debentures
V. Methods of redemption of debentures
VI. Summary
VII. Exercise

Unit II

Objective of the Unit:

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

Unit III

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.

Unit IV

A. 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.

B. 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.

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

Illustration 1:

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

Show Loss on Issue of Debentures A/c if:

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

   HK Ltd. follows calendar year as its accounting year.

Solution:

1. Such debentures are redeemable after four years.

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

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

Total Loss (a+b) = ₹2,00,000

Term of Debenture = 4 years

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

In the books of HK Ltd.

Loss on Issue of Debentures A/c

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

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

Discount/Loss to be written off each year

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

In the books of HK Ltd.

Loss on Issue of Debentures A/c

Date	**Particulars**	**₹**	**Date**	**Particulars**	**₹**
1-1-2015	To 15% debentures a/c	2,00,000	31-12-2015	By P&L a/c By Balance c/d	80,000 1,20,000
	Total	**2,00,000**		**Total**	**2,00,000**
1-1-2016	To Balance b/d	1,20,000	31-12-2016	By P&L a/c By Balance c/d	60,000 60,000
	Total	**1,20,000**		**Total**	**1,20,000**
1-1-2017	To Balance b/d	60,000	31-12-2017	By P&L a/c By Balance c/d	40,000 20,000
	Total	**60,000**		**Total**	**60,000**
1-1-2108	To Balance b/d	20,000	31-12-2018	By P&L a/c	20,000
	Total	**20,000**		**Total**	**20,000**

Illustration 2:

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

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

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

Solution:

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

Discount to be written off each year

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

In the books of R Ltd.

Loss on Issue of Debentures A/c

Date	Particulars	₹	Date	Particulars	₹
1-1-2015	To 7% debentures a/c	3,00,000	31-12-2015	By P&L a/c By Balance c/d	1,00,000 2,00,000
	Total	**3,00,000**		**Total**	**3,00,000**
1-1-2016	To Balance b/d	2,00,000	31-12-2016	By P&L a/c By Balance c/d	90,000 1,10,000
	Total	**2,00,000**		**Total**	**2,00,000**
1-1-2017	To Balance b/d	1,10,000	31-12-2017	By P&L a/c By Balance c/d	70,000 40,000
	Total	**1,10,000**		**Total**	**1,10,000**
1-1-2108	To Balance b/d	40,000	31-12-2018	By P&L a/c	40,000
	Total	**40,000**		**Total**	**40,000**

C. 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

D. Methods of redemption of debentures

The different methods of redemption of debentures are:

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

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

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

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

SOURCES OF REDEMPTION

1. Redemption out of Capital

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

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

Illustration 3:

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

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

Solution:

Journal Entries in the books of ITI Ltd.

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

31-3-2019	6% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To6% Debentureholders A/c (Being amount due to debentureholders on redemption)	8,00,000 40,000	8,40,000
31-3-2019	6% Debentureholders A/c Dr. To Bank A/c (Being debentureholders paid off)	8,40,000	8,40,000

2. Redemption out of Profits

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

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

A. Creating Debenture Redemption Reserve (DRR)

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

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

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

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

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

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

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

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

Illustration 4:

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

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

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

Solution:

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

Illustration 5:

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

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

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

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

Solution:

Journal Entries in the books of Prakash Ltd.

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

29-4-2018	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be redeemed)	60,000	60,000
31-3-2019	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits equal to 25% of the nominal value of debentures issued)	1,00,000	1,00,000
31-3-2019	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	60,000	60,000
31-3-2019	8% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To 8% Debentureholders A/c (Being amount due to debentureholders on redemption)	4,00,000 40,000	4,40,000
31-3-2019	8% Debentureholders A/c Dr. To Bank A/c (Being debentureholders paid off)	4,40,000	4,40,000
31-3-2019	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being transfer of balance in DRR a/c to general reserve a/c on redemption of debentures)	4,00,000	4,00,000

Illustration 6:

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

Solution:

Journal Entries in the books of Kajal Ltd.

Date	Particulars	Debit (₹)	Credit (₹)
30-4-2015	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be on 31st March 2016)	45,000	45,000
31-3-2016	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	45,000	45,000
31-3-2016	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c, 25% ₹3,00,000 = ₹75,000 – ₹70,000)	5,000	5,000
31-3-2016	9% Debentures A/c Dr. To 9% Debenture holders A/c (Being 1/4th amount due to debenture holders on redemption)	300,000	3,00,000
31-3-2016	9% Debenture holders A/c Dr. To Bank A/c (Being 1/4thdebentureholders paid off)	3,00,000	3,00,000
30-4-2016	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be redeemed on 31st March 2017))	45,000	45,000
31-3-2017	Bank A/c Dr. To Debenture Redemption Investment A/c (Being investments encashed)	45,000	45,000
31-3-2017	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c @ 25% of the nominal value of debentures to be redeemed)	75,000	75,000

31-3-2017	9% Debentures A/c Dr. To 9% Debentureholders A/c (Being 1/4th amount due to debentureholders on redemption)	300,000	3,00,000
31-3-2017	9% Debentureholders A/c Dr. To Bank A/c (Being 1/4thdebentureholders paid off)	3,00,000	3,00,000
30-4-2017	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be on 31st March 2018)	45,000	45,000
31-3-2018	Bank A/c Dr. To Debenture Redemption Investment A/c (Being investments encashed)	45,000	45,000
31-3-2018	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c @ 25% of the nominal value of debentures to be redeemed)	75,000	75,000
31-3-2018	9% Debentures A/c Dr. To 9% Debentureholders A/c (Being 1/4th amount due to debentureholders on redemption)	300,000	3,00,000
31-3-2018	9% Debentureholders A/c Dr. To Bank A/c (Being 1/4thdebentureholders paid off)	3,00,000	3,00,000
30-4-2018	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of the nominal value of debentures to be on 31st March 2019)	45,000	45,000
31-3-2019	Bank A/c Dr. To Debenture Redemption Investment A/c (Being investments encashed)	45,000	45,000

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

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

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

Date	Particulars	Debit (₹)	Credit (₹)
1-9-2011	Bank A/c Dr. To 7% Debentures A/c (Being 21,000 7% debentures issued at par)	21,00,000	21,00,000
31-3-2012	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c)	50,000	50,000
31-3-2013	Profit & Loss A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits to DRR A/c)	4,00,000	4,00,000

31-3-2014	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of balance required profits to DRR A/c, 25% of ₹21,00,000 – ₹50,000 -₹4,00,000)	75,000	75,000
30-4-2014	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹7,00,000)	1,05,000	1,05,000
31-3-2015	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	1,05,000	1,05,000
31-3-2015	7% Debentures A/c Dr. To 7% Debentureholders A/c (Being 1st instalment due to debentureholders on redemption, ₹21,00,000/3)	7,00,000	7,00,000
31-3-2015	7% Debentureholders A/c Dr. To Bank A/c (Being 1st instalment paid to debentureholders)	7,00,000	7,00,000
30-4-2015	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹7,00,000)	1,05,000	1,05,000
31-3-2016	Bank A/c Dr. To Debenture Redemption Investment A/c (Being Investments encashed)	1,05,000	1,05,000
31-3-2016	7% Debentures A/c Dr. To 7% Debentureholders A/c (Being 2nd instalment due to debentureholders on redemption)	7,00,000	7,00,000
31-3-2016	7% Debentureholders A/c Dr. To Bank A/c (Being 2nd instalment paid to debentureholders)	7,00,000	7,00,000

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

Illustration 8:

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

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

The Board of directors decides to transfer to the required amount to Debenture Redemption Reserve A/c in four equal annual instalments starting with 31st March, 2013. Ignore entries for payment of interest and write off of loss on issue of debentures. Investments as required by law are made by the Company in bank fixed deposits. Pass necessary journal entries.

Solution:

Journal Entries in the books of Apple Ltd.

Date	Particulars	Debit (₹)	Credit (₹)
1-11-2011	Bank A/c Dr. Loss on issue of debentures A/c Dr. To 6% Debentures A/c To Premium on redemption of debentures A/c (Being 9,000 6% debentures issued at a par, redeemable at 7% premium)	9,00,000 63,000	 9,00,000 63,000
31-3-2013	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of 1st instalment of profits to DRR A/c, 25% of 9,00,000 = 2,25,000/4)	56,250	56,250
31-3-2014	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of 2nd instalment of profits to DRR A/c)	56,250	56,250
31-3-2015	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of 3rd instalment of profits to DRR A/c)	56,250	56,250
31-3-2016	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of 4th instalment of profits to DRR A/c)	56,250	56,250
30-4-2016	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹3,00,000)	45,000	45,000
31-3-2017	Bank A/c Dr. To Debenture Redemption Investment A/c	45,000	45,000

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

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

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

Solution:
Journal entries in the books of Mala Ltd.

30-4-2019	Debenture Redemption Investment A/c Dr. To Bank A/c (Being investment made @ 15% of ₹25,00,000)	3,75,000	3,75,000
30-6-2019	Bank A/c Dr. To Debenture Redemption Investment A/c (Being investments encashed)	3,75,000	3,75,000
30-6-2019	Debenture Interest A/c Dr. To 10% Debentureholders A/c (Being half year debenture interest due, `25,00,000 x 10/100 x 6/12 months)	1,25,000	1,25,000
30-6-2019	10% Debentures A/c Dr. Premium on redemption of debentures A/c Dr. To 10% Debentureholders A/c (Being amount due to debentureholders on redemption)	25,00,000 2,50,000	27,50,000

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

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

B. Creating Sinking Fund

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

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

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

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

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

Model Journal Entries:

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

Illustration 10:

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

Solution:

Journal Entries in the books of CIT Ltd.

Date	Particulars	Debit (₹)	Credit (₹)
1-4-2016	Bank A/c Dr. To 6% Debentures A/c (Being 1,100 6% debentures ₹100 each issued at par, redeemable at par)	1,10,000	 1,10,000
31-3-2017	Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c (Being amount appropriated out of profits and transferred to SF A/c)	34,893	 34,893
31-3-2017	Sinking Fund Investment A/c Dr. To Bank A/c (Being amount invested out of SF A/c)	34,893	 34,893
31-3-2018	Bank A/c Dr. To Sinking Fund A/c (Being interest received on SF investments @ 5% on ₹34,893)	1,745	 1,745
31-3-2018	Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c (Being amount appropriated out of profits and transferred to SF A/c)	34,893	 34,893
31-3-2018	Sinking Fund Investment A/c Dr. To Bank A/c (Being amount invested out of SF A/c + interest)	36,638	 36,638
31-3-2019	Bank A/c Dr. To Sinking Fund A/c (Being interest received on SF investments @ 5% on ₹71,531)	3,577	 3,577
31-3-2019	Profit & Loss Appropriation A/c Dr. To Sinking Fund A/c (Being amount appropriated out of	34,893	 34,893

	profits and transferred to SF A/c)		
31-3-2019	Bank A/c Dr. To Sinking Fund Investment A/c To Sinking Fund A/c (Being SF investments sold at a profit)	71,580	 71,531 49
31-3-2019	6% Debentures A/c Dr. To 6% Debentureholders A/c (Being amount due to debentureholders on redemption)	1,10,000	 1,10,000
31-3-2019	6% Debentureholders A/c Dr. To Bank A/c (Being 1/4th debentureholders paid off)	1,10,000	 1,10,000
31-3-2019	Sinking Fund A/c Dr. To General Reserve A/c (Being transfer of balance in SF a/c to general reserve a/c on redemption of debentures)	1,10,050	 1,10,050

In the books of CIT Ltd.

Sinking Fund A/c

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

Sinking Fund Investment A/c

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

Illustration 11:

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

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

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

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

Prepare the following accounts:

i. Debenture Stock;

ii. Sinking Fund;

iii. Sinking Fund Investments

iv. General Reserve

Solution:

In the books of Jani Ltd.

8% Debentures Stock A/c

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

Sinking Fund A/c

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

Sinking Fund Investments A/c

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

General Reserve A/c

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

Working Note:

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

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

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

3. Redemption by Conversion

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

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

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

Illustration 12:

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

The Company offered three options to debenture holders as under:

i. 7% preference shares of ₹10 at ₹12
ii. 9% debentures of ₹100 at par
iii. Redemption in cash (assume redemption out of capital only)

The options were accepted as under

i. Option by holders of 1500 Debentures
ii. Option by holders of 1500 Debentures
iii. Option by holders of 2000 Debentures

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

Solution:

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

Journal Entries in the books of Alpha Ltd.

Sr. No.	Particulars	Debit (₹)	Credit (₹)
1.	8% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 8% Debentureholders A/c (Being amount due to debentureholders on redemption against option i)	1,50,000 7,500	1,57,500
2.	8% Debentureholders A/c To 7% Preference Share Capital A/c, To Securities Premium A/c (Being 1,500 8% debentures converted into 13,125 7% preference shares of ₹10 each issued at premium of ₹2 per share)	1,57,500	1,31,250 26,250
3.	8% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 8% Debentureholders A/c (Being amount due to debentureholders on redemption against option ii)	1,50,000 7,500	1,57,500
4.	8% Debentureholders A/c To 9% Debentures A/c (Being 1,500 8% debentures converted into 1,5759% debentures of `100 each issued at par)	1,57,500	1,57,500
5.	8% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 8% Debentureholders A/c (Being amount due to debentureholders on redemption against option iii)	2,00,000 10,000	2,10,000
6.	8% Debentureholders A/c To Bank A/c (Being 2,000 8% debentures paid in cash)	2,10,000	2,10,000
7.	Securities Premium A/c Dr. To Premium on redemption of debentures a/c (Being premium on redemption of debentures written off)	25,000	25,000

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

Illustration 13:

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

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

b) 7% debentures at ₹96 and

c) to have their holdings redeemed for cash

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

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

Solution:

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

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

Journal Entries in the books of Tony Ltd.

Sr. No.	Particulars	Debit (₹)	Credit (₹)
1.	7% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 7% Debentureholders A/c (Being amount due to debentureholders on redemption against option i)	1,71,000 3,420	1,74,420
2.	8% Debentureholders A/c To 5% cumulative preference Share Capital a/c To Securities Premium A/c (Being 7% debentures of NV ₹1,71,000 converted into 7,7525% cumulative preference shares of ₹20 each issued at premium of ₹2.50 per share)	1,74,420	1,55,040 19,380
3.	7% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 7% Debentureholders A/c (Being amount due to debentureholders on redemption against option ii)	1,44,000 2,880	1,46,880
4.	7% Debentureholders A/c Discount on issue of debentures A/c Dr. To 6% Debentures (New) A/c (Being 7% debentures of NV ₹1,44,000 converted into 1,530 new 6% debentures of `100 each issued at `96 per debenture)	1,46,880 6,120	1,53,000
5.	7% Debentures A/c Dr. Premium on redemption of debentures a/c Dr. To 7% Debentureholders A/c (Being amount due to debentureholders on redemption against option iii)	85,000 1,700	86,700

6.	7% Debentureholders A/c To Bank A/c (Being balance 7% debentures paid in cash)	86,700	86,700
7.	Securities Premium A/c Dr. To Premium on redemption of debentures a/c (Being prem on redemption of deb written off)	8,000	8,000
8.	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being transfer of profits equal to 25% of the nominal value of debentures redeemed in cash, 25% of 85,000)	21,250	21,250
9.	Debenture Redemption Reserve A/c Dr. To General Reserve A/c (Being transfer of balance in DRR a/c to general reserve a/c on redemption of debentures in cash)	21,250	21,250

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

Unit V

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

Unit VI

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

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

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

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

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

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

vi. 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

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.

4.1.1 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.

4.1.2 Utilisation of Profit prior to incorporation-

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

5.2 COMPUTATION OF PROFIT BEFORE INCORPORATION

Step-1 Calculate the Time ratio and Sales ratio-

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

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

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

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

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

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

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

Profit and Loss account

For the year ended 31st March 2018

Dr. Cr

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

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

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

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

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

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

Check your progress

Calculate time ratio and sales ratio from the following information-

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

Calculation of TIME RATIO

Accounting period –

Date of incorporation-

Pre incorporation period—

Post incorporation period –

TIME RATIO-

Calculation of SALES RATIO

Total sales during the year –

Sales in the pre incorporation period –

Sales in the post incorporation period –

SALES RATIO

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

5.3 SOLVED PROBLEMS

Illustration 1

Calculate Time ratio and Sales Ratio from the following information-

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

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

Illustration 2-

Calculate Time Ratio and Sales Ratio from the following information.

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

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

Solution:

Time Ratio:

Accounting period – 1 January to 31st December 2017

Date of Incorporation 1st July 2017

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

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

Time Ratio 1:1

Sales Ratio

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

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

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

Illustration 3

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

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

Additional information:

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

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

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

4. Audit fees are payable for the whole year.

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

(University of Mumbai- October 2009)

Solution:--

WN - Time ratio-

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

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

Time ratio - 7:5

Sales ratio-

Let monthly sales be-1

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

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

Sales Ratio- 10:8 or 5:4

Interest on purchase consideration-

(payable for 9 months from April to December)

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

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

Specific ratio- 7:2

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

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

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

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

Dr. Cr

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salaries	Time	1,40,000	1,00,000	By Gross profit	Sales	7,00,000	5,60,000
To Rent and taxes	Time	1,05,000	75,000				
To Printing &Stationery	Time	56,000	40,000				
To Audit fees	Time	17,500	12,500				
To Sundry expenses	Time	14,000	10,000				
To Carriage outward	Sales	50,000	40,000				
To Advertising	Sales	35,000	28,000				
To Electricity charges	Time	42,000	30,000				
To Commission on sales	Sales	60,000	48,000				
To Debenture interest	Post	----------	28,000				
To Depreciation	Time	24,500	17,500				
To Interest on purchase consideration	7:2	21,000	6,000				
To Capital Reserve (bal fig)		1,35,000	-----------				
To Net Profit (bal fig)		-----------	1,25,000				
Total		7,00,000	5,60,000	Total		7,00,000	5,60,000

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

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

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

Illustration 4

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

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

Additional Information:

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

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

Solution:

Working Notes –

Time Ratio 5:7

Sales Ratio 5: 13

Basis for Allocating Rent 5:11

Salaries 15:24 or 5:8

Bad Debts Rs. 12,00,000

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

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

Pre incorporation: 2, 77,778

Post Incorporation: 7, 22,222

Total Pre Incorporation Bad Debts Amount:

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

Post Incorporation Bad Debts=722222

Statement of Profit And Loss

For The Year Ended 31ST March 2019

	Pre-Incorporation	Post-Incorporation
INCOMES		
Gross profit (SR)	47,22,222	122,77,778
Interest on FD (TR)	+ 5,00,000	+ 7,00,000
Total Income (A)	52,22,222	129,77,778
EXPENSES		
Printing and Stationery (TR)	1,00,000	1,40,000
Salaries (5:8)	15,00,000	24,00,000
Directors Fees (Post)	-------------	5,00,000
Selling Expenses (SR)	6,75,000	17,55,000
Debenture Interest (Post)	--------------	5,80,000
Auditors fees (TR)	41,667	58,333
Rent and Taxes (5:11)	3,00,000	6,60,000
Office Expenses (TR)	2,50,000	3,50,000

Bad Debts (WN)	4,77,778	7,22,222
Preliminary expenses (Post)	------------	10,00,000
Total expenses (B)	33,44,445	81,65,555
Capital Reserve (A-B) (bal.fig)	18,77,777	
Net Profit (A-B) (bal.fig)		48,12,223

Illustration 5:

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

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

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

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

You obtained the following additional information :

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

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

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

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

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

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

Working notes-

Time Ratio 1:2

Sales Ratio 4:11

Interest on Purchase Consideration 4: 2 or 2:1

Interest is paid for 6 months from April to September.

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

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

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

Statement of Profit and Loss

For the year ended 31st March 2018

	Pre-Incorporation	Post-Incorporation
Incomes		
Gross Profit (SR)	32,00,000	88,00,000
Profit on Investment (Post)	--------------	+20,00,000
Total Income (A)	32,00,000	1,08,00,000
Expenses		
Office Salaries(TR)	12,00,000	24,00,000
Bad Debts(Pre)	5,00,000	----------
Depreciation (TR)	6,00,000	12,00,000
Office Rent(WN)	2,00,000	7,00,000
Commission on Sales (SR)	4,00,000	11,00,000
Debenture Interest(Post)	------------	8,00,000

Directors Fees(Post)	-------------	8,00,000
Interest on Purchase consideration (2:1)	4,00,000	2,00,000
Total Expenses (B)	33,00,000	72,00,000
Loss(A-B) Less Vendors share 60% Loss transferred to Goodwill	1,00,000 (60,000) 40,000	
Net Profit (A-B)		36,00,000

Illustration 6

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

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

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

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

Solution-

WN 1

Time ratio – 1:2

Sales Ratio 1: 5

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

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

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

Therefore SR 1: 5

WN2

Interest to Vendor

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

Rounded off to Rs 6667

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

4 months will be pre incorporation.

From 1st Feb 2013 to 31st May 2013-

4 months will be post incorporation.

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

Statement showing Profit and loss

For the year ended 30th September 2013.

Particulars	Basis	Pre-Incorporation		Post-Incorporation	
		Debit	Credit	Debit	Credit
Gross Profit –SR	Turnover		16,000		80,000
Expenses					
Directors fees	Post			1,500	
Auditors fees –TR	1:2	250		500	
Rent , Rates	1:2	1600		3200	
Bad Debts	Given	700		1300	
Salaries	1:2	4000		8000	
Debenture Interest	Post			6000	
Depreciation	1:2	1200		2400	
Preliminary expenses	Post			2400	
General expenses	1:2	600		1200	

Commission on sales	1:5	600		3000	
Printing and Stationery	1:2	800		1600	
Advertising	1:5	700		3500	
Travellers Salary	1:5	1400		7000	
Interest to vendor	4:4	3333		3334	
Total of expenses		15183		44934	
Capital Reserve (Bal. fig)		817			
Net Profit (Bal Fig)				35066	
Total		16,000	16,000	80000	80,000

Illustration 7

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

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

You are informed that –

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

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

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

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

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

(Mumbai University April 2010)

Solution:

Working notes1:

Pre incorporation period 1st May 2017 to 1 Feb 2018 = 9 months
post incorporation 1st Feb. 2018 to 31st Mar. 2018 = 2 months
Time ratio (TR) 9:2 and
Sales ratio (SR) 33:2
WN-2 Salaries
Pre incorporation Rs 6,000x 9 months = 54,000
Post incorporation Rs 9,000x 2 months = 18,000
WN- 3 Rent received
Pre incorporation 4000 x 2 months = 8,000
Post incorporation 4,000 x 2 months= 8,000
WN-4 Rent paid
Pre incorporation 5,000x 9 months =45,000 post incorporation 5,000x 2 months =10,000
WN-4 Audit fees to be allocated in the Time ratio 9:2

In the books of Sunderam Ltd –
Profit and Loss a/c
For the period 1st May 2017 to 31st March 2018
Dr. Cr.

Particulars	Pre	Post	Particulars	Pre	Post
To Salaries – WN1	54,000	18,000	By Gross Profit -SR	6,60,000	40,000
To Rent –WN 3	45,000	10,000	By Rent received	8,000	8,000
To Delivery van expenses –SR	13,200	800	By Discount – SR	6,600	400
To General	18,000	4,000	By Net Loss		90,000

Expenses –TR			(Bal. Fig)		
To Advertisement expenses - SR	3,30,000	20,000			
To Bad debts written off – SR	13,200	800			
To Debenture Interest- Post		70,000			
To Directors meeting fees- Post		10,000			
To Preliminary expenses –Post		4,000			
To Audit - TR	3,600	800			
To Capital Reserve (Bal Fig)	1,97,600				
	6,74,600	1,38,400		6,74,600	1,38,400

Illustration 8

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

Particulars	Amt Rs	Amt Rs
Gross Profit		19,20,000
Less Expenses		
Directors Fees	98,000	
Rent	1,71,000	
Bad debts	24,000	
Salaries	3,66,000	
Interest on Debentures	45,000	
Depreciation	1,32,000	
Preliminary expenses written off	87,000	
General Expenses	98,400	
Commission on Sales	72,000	
Printing and Stationery	1,86,000	
Advertisement Expenses	2,41,000	

Audit Fees	1,17,200	
Carriage Outward	1,45,600	
Electricity charges	88,800	
Insurance Premium	48,000	
Net Profit	NIL	
	19,20,000	19,20,000

Additional information-

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

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

c) Audit fees is for entire year

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

e) Mr Anil was a working partner in the firm entitled to a remuneration of Rs 24,000 per month From 1st August 2017, he was made the Managing Director of the company and was entitled to salary Rs 30,000 per month. The remaining salary is to two clerks employed during the period from 1st July 2017 to 31November 2017.

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

Solution:

WN 1-

Time ratio- TR 4: 8 or 1: 2

Sales Ratio- SR 4:12 or 1: 3

WN-2

Bad debts total 24,000 to be allocated as under

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

WN-3

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

WN-4

Salary to Anil as partner

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

Salary to Anil as Managing director –

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

Balance salary

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

Statement Showing Pre and Post Incorporation Profit/ Loss

For The Year Ended 31st March 2018

Particulars	Basis	Pre	Post
Gross Profit	SR(1:3)	4,80,000	14,40,000
Less Expenses			
Directors fees	POST		98,000
Rent	WN 2 (1:4)	34,200	1,36,800
Bad debts	WN 1	9,000	15,000
Salary--- Anil	WN 3	96,000	2,40,000
Clerks	WN 3 (1:4)	6,000	24,000
Interest on Debentures	POST		45,000
Depreciation	TR (1:2)	44,000	88,000
Preliminary expenses written off	POST		87,000
General expenses	TR(1:2)	32,800	65,600
Commission on sales	SR	18,000	54,000
Printing and stationery	TR	62,000	1,24,000
Advertising expenses	SR	60,250	1,80,750
Auditors fees	TR	39,066	78,134
Carriage outward	SR	36,400	1,09,200
Electricity charges	TR	29,600	59,200
Insurance premium	TR	16,000	32,000
Total expenses		4,83,316	14,36,684
Loss transferred to Goodwill (Bal. Fig)		3,316	
Net Profit (Bal. Fig)			3,316

5.4 EXERCISE

Practical Problems

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

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

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

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

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

Particulars	Amt (Rs)	Amt (Rs)
Gross Profit		37,80,000
Less Expenses		
Salaries	7,20,000	
Rates and Insurance	5,40,000	
Printing and Stationery	2,88,000	
Audit Fees	90,000	
Directors Fees	72,000	
Carriage Outward	2,70,000	
Advertising	1,89,000	
Electricity charges	2,16,000	
Commission on sales	3,24,000	
Debenture Interest	84,000	
Depreciation	1,26,000	
Interest on Purchase consideration	81,000	30,00,000
NET PROFIT		7,80,000

Additional Information-

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

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

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

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

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

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

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

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

Particulars	Amt (Rs)	Particulars	Amt(Rs)
To Directors Fees	49,000	By Gross Profit	9,60,000
To Rent	85,500		
To Bad Debts	12,000		
To Salaries	1,83,000		
To Interest on Debentures	24,000		
To Depreciation	66,000		
To Preliminary expenses	42,000		
To General Expenses	49,200		
To Commission on Sales	36,000		
To Printing and Stationery	93,000		
To Advertising	1,20,000		
To Audit Fees	58,600		
To Carriage Outward	72,800		
To Electricity charges	44,400		
To Insurance Premium	24,000		
Total	9,60,000	Total	9,60,000

Additional Information-

1) Rent is paid on the basis of floor space occupied. The floor space was doubled in the post incorporation period.
2) Sales for each month of December 2017 to March 2018 were double the monthly sales of April to November 2017.
3) Bad Debts Rs 2,000 were in respect of sales effected two years ago.

4) Mr Amit was working partner in the firm entitled to a remuneration @ Rs 12,000 p.m from 1st August 2017. He was Managing Director of a company entitled to salary @Rs 15,000 p.m . The remaining salary is to two clerks employed during the period 1st July to 30th November 2017.You are required to prepare Statement of Profit and Loss for the year ended 31st March 2018 and show the Pre and post incorporation profit or Loss .

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

- Bad debts Rs 12,000 Rs 2000 old bad debts to be shown in pre incorporation and balance (12000-2000=10,000) to be allocated in the sales ratio 1: 3 Allocation of Bad debts in -Pre incorporation period (2000+ 2500) 4500 and Post incorporation 7500.

- Rent to be allocated in 4: 16 ratio

- Salaries a) Amit pre incorporation 12000x4 months =48,000 post incorporation From August2017 to March 2018 8 months @ 15,000 per month 15000x8= 1,20,000 Total Salary as per P&L a/c Rs 1,83,000 Total salary to Amit (48000+ 120000) 1,68,000 Therefore balance amount to clerks for 5 months July to November is 183000-168000=15000

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

Objective Questions

5. Match the Columns-

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

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

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

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

6. State whether the following statements are True or False

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

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

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

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

5) The Profit before incorporation is to be transferred to General Reserve – False

6) The Profit after corporation is a revenue Profit- True

7) While computing pre and post incorporation profits, Audit fees are allocated on Time basis – True

8) Profit prior to incorporation is available for payment of dividend – False

9) Loss prior to incorporation is debited to Goodwill account- True

10) Preliminary expenses should be debited to pre-incorporation period- False

7. Multiple Choice Questions

1) While calculating profit prior to incorporation, the fixed expenses are to be allocated _____
a) in Sales ratio b) in Time ratio
c) equally d) none of the above

2) While calculating profit prior to incorporation, the variable expenses are to be allocated _____
a) in Sales ratio b) in Time ratio
c) equally d) none of the above

3) While calculating profit prior to incorporation, the Directors fees are to be ______
a) allocated in sales ratio b) shown as pre incorporation expense
c) shown as post incorporation expenses d) ignored

4) While calculating profit prior to incorporation, the partners salaries are to be _______
a) allocated in sales ratio b) shown as pre incorporation expense
c) shown as post incorporation expenses d) ignored

5) The profit prior to incorporation is transferred to _________
a) Capital Reserve b) General Reserve
c) Securities Premium d) Goodwill

6) The share transfer fees are _______
a) to be shown on the credit side of P&L A/c in the pre-incorporation column
b) to be allocated equally
c) to be shown on the debit side of P&L A/c in the pre-incorporation column
d) to be shown on the credit side of P&L A/c in the post - incorporation column
(Answer: 1- b, 2- a, 3- c, 4- b, 5- a, 6- d.)

8. Short Numerical Objective Questions –

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

a) The turnover for the whole period 1st October 2012 to 30th September 2013 was Rs. 2,40,000 of which 40,000 related to the period from 1st October 2012 to 1st February 2013

b) The Trading account showed a Gross profit of Rs. 96,000

Calculate Time Ratio and Sales Ratio. State how the Gross profit will be allocated between the pre and post incorporation periods.

(Answer- Time ratio 4:8 or 1:2 Sales Ratio 1: 5 Gross profit Rs 96,000 to be allocated in Sales Ratio Pre incorporation amount Rs 16,000 post incorporation Rs 80,000)

2) Friendship Ltd was incorporated on 1st April 2017 to take over business of the partnership firm with effect from 1st January 2017. The company prepared its Profit and Loss a/c for the year ended 31st March 2018 . The company was able to double the average monthly sales from 1st April 2017. Calculate Time ratio and Sales ratio

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

3) Indo-Japan Ltd was incorporated on 1st May 2018 to take over a business as a going concern from 1st January of the same year. The total turnover for the year ended 31st December was Rs 2,00,000 namely Rs 60,000 for the first period upto 1st May and Rs 1,40,000for the remaining period. Calculate Time Ratio and Sales Ratio

(Answer Time ratio 4: 8 or 1:2 and Sales ratio 6:14 or 3: 7)

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