1

PREPARATION OF FINAL ACCOUNTS OF COMPANIES

Unit Structure:

1.0 OBJECTIVES

After studying this chapter, you will be able to understand

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

1.1 INTRODUCTION

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

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

account, profit and loss account, and balance sheet are all part of the final accounts.

1.2 PROVISIONS RELATING TO FINANCIAL STATEMENTS UNDER THE NEW COMPANIES ACT

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

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

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

1.2.1 Nature of Financial Statements

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

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

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

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

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

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

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

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

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

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

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

1.2.2 Objectives of Financial Statements

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

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

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

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

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

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

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

1.3 A S 1 – DISCLOSURE OF ACCOUNTING POLICIES

AS 1 – Disclosure of Accounting Policies

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

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

Nature of Accounting Policies

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

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

Areas in which differing Accounting Policies are possible

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

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

The above list of examples is not exhaustive.

Considerations in the Selection of Accounting Policies

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

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

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

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

Disclosure of Accounting Policies

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

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

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

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

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

Remember the following:

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

1.4 ADJUSTMENTS IN PREPARATION OF FINANCIAL STATEMENTS

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

Need for Adjustments:

Adjustments are done to:

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

Important Point to be Noted while passing adjustment entries:

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

List of Adjustments in Final Accounts

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

Note: Adjustments would appear outside the trial balance.

1. Closing Stock

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

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

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

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

Journal Entry for Adjustment of Closing Stock in Final Accounts

Closing Stock A/C Dr

To Trading A/C

(Recording ending inventory)

Closing stock is valued at cost or market, whichever is less.

2. Depreciation:

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

The double effect of depreciation is:

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

A. When Provision for Depreciation is Not Maintained

Journal Entry When Provision is Not Maintained

Depreciation A/C Dr

To Asset A/C

(Charging depreciation on fixed asset)

Profit and Loss A/C Dr

To Depreciation A/C

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

B. When Provision for Depreciation is Maintained

Journal Entry When Provision is Maintained
Depreciation A/C Dr

To Provision for Depreciation A/C

(Being provision for depreciation made)

Step 2
Profit and Loss A/C Dr

To Depreciation A/C

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

3. Outstanding expenses and income

A. Outstanding Expenses

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

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

Expenses A/c …Dr.

Input CGST A/c …Dr.

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

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

B. Accrued Income or Outstanding Income

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

Journal Entry for Adjustment of Accrued Income in Final Accounts

Accrued Income A/C Dr

To Income A/C

To Output CGST A/C

To Output SGST A/C

To Output IGST A/C

(Recording income earned but not received)

Treatment of Accrued Income Adjustment in Financial Statements

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

4. Prepaid expenses and Pre-received income

A. Pre-paid Expenses

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

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

Journal Entry for Adjustment of Prepaid Expenses in Final Accounts

Prepaid Expense A/C Dr

To Expense A/C

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

B. Pre-received Income or Income Received in Advance

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

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

Income A/C Dr

To Income Received in Advance A/C

To Output CGST A/C

To Output SGST A/C

(Recording income received but not earned)

Treatment of Income Received in Advance in Financial Statements

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

5. Proposed Dividend and Unclaimed Dividend

Dividends:

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

Legal Provisions regarding Dividend

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

(i) Profits of the current year

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

(iii) Out of both or

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

Proposed Dividend:

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

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

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

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

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

Interim Dividend

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

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

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

Unclaimed Dividend

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

6. Provision for Tax and Advance Tax

A. Provision for Income Tax:

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

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

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

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

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

B. Advance Income Tax:

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

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

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

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

Accounting entry will be as under
: Advance Income Tax paid A/C Dr
To Bank A/C

In case of self-assessment tax also this entry is passed but the narration will be for self-assessment.

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

Meaning of Bill of Exchange

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

ENDORSEMENT OF BILL OF EXCHANGE:

"The person receiving the bill of exchange becomes the endorsee when the bill's holder signs the bill's reverse with the intention of transferring the property it contains (the right to receive money from the acceptor). "Endorsement" is the process through which a bill is moved from one person to another for the payment of debts.

Endorsement of the bill refers to the process by which the creator or holder of the bill transfers the title of the bill in aid of his or her creditors. The person transferring the title is known as the "Endorser," while the person receiving the bill is known as the "Endorsee." Signing at the back of the bill constitutes an endorsement.

Journal Entries in the Books of Endorser and Endorsee:

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

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

Dishonour of Bill

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

Dishonour by Non-Payment

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

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

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

8. Capital Expenditure included in Revenue expenditure and vice versa

a. Capital Expenditure incorrectly treated as Revenue

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

For example, furniture purchases may be included in purchases.

b. Revenue Expenditure incorrectly treated as Capital Expenditure

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

9. Unrecorded Sales and Purchases

a. Unrecorded Sales

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

b. Unrecorded Purchases

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

10. Good sold on sale or return basis

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

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

11. Managerial remuneration on Net Profit before tax

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

A. Manager's Commission Payable Before Charging the Commission

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

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

Profit and Loss A/C Dr

To Manager's Commission Payable

(Recording outstanding commission payable to managers)

Treatment of Manager's Commission in Financial Statements

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

B. Manager's Commission Payable After Charging the Commission

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

Calculation of Net Profit for Managerial Remuneration

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

Profit before tax as per P&L Statement	xxxx
Add the following items if debited to P&L Statement before arriving profit before tax	
Managerial remuneration	xxxx
Provision for Bad doubtful debts	xxxx
Loss on sale/disposal/discarding of assets.	xxxx
Loss on sale of investments	xxxx
Provision for diminution in the value of investments	xxxx
fixed assets written off	xxxx
Fall in the value of foreign currency monetary assets	xxxx
Loss on cancellation of foreign exchange contracts	xxxx
Write off of investments	xxxx
Provision for contingencies and unascertained liabilities	xxxx
Lease premium written off	xxxx
Provision for warranty spares/supplies	xxxx
Infructuous project expenses written off	xxxx
Provision for anticipated loss in case of contracts	xxxx
Loss on sale of undertaking	xxxx
Provision for wealth tax	xxxx
compensation paid under VRS	xxxx
Less the following if credited to P&L statement for arriving at profit before tax:	xxxx
Capital profit on sale/disposal of fixed assets (the same should be added if the co., business comprises of buying & selling any such property or asset) and revenue profit (difference between original cost and WDV should not be deducted)	xxxx
Profit on sale of any undertaking or its part	xxxx
Profit on buy back of shares	xxxx
Profit/discount on redemption of shares or debentures	xxxx

Profit on sale of investments	xxxx
Compensation received on non-compete agreements	xxxx
Write back of provision for doubtful debts	xxxx
Write back of provision for doubtful advances	xxxx
Appreciation in value of any investments	xxxx
Compensation received on surrender of tenancy rights	xxxx
Profit on sale of undertaking	xxxx
Write back of provision for diminution in the value of investments	xxxx
Profit on sale of forfeited shares & shares of subsidiary/associated companies	xxxx

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

12. Transfer to Reserves

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

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

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

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

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

13. Bad debt and Provision for bad debts

A. Bad Debts

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

- **Bad Debts:** It means which are uncollectable or irrecoverable debts.

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

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

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

Journal Entry for Adjustment of Bad Debts in Final Accounts

Bad Debts A/C Dr

To Debtor's A/C

(Recording bad debts)

Step 2

Profit and Loss A/C Dr

To Bad Debts A/C

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

Treatment of Bad Debts in Financial Statements

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

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

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

Journal Entry for Adjustment of Further Bad Debts in Final Accounts

Bad Debts A/C Dr

To Debtor's A/C

(Recording further bad debts)

B. Provision for Doubtful Debts

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

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

When Provision for Doubtful Debts does not Appear in Trial Balance

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

Profit and Loss A/C Dr

To Provision for Doubtful Debts A/C

(Recording provision for doubtful debts)

Treatment of Provision for Doubtful Debts in Financial Statements

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

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

Provision for Discount on Debtors

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

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

Profit and Loss A/C Dr

To Provision for Discount on Debtors A/C

(Recording provision for discount on debtors)

Treatment of Provision for Discount on Debtors in Financial Statements

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

14. Calls in Arrears

Calls in Arrears and Calls in Advance

Calls-In-Arrears

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

Methods of Accounting Treatment of Calls-In-Arrears
Without opening Calls-in-Arrears Account
By opening Calls-in-Arrears Account
Without opening Calls-in-Arrears Account

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

15. Loss by fire (Partly and fully insured goods)
Loss by fire as well as accidental losses or abnormal losses occur when a company experiences any form of loss as a result of a fire, an accident, an earthquake, or another natural disaster.

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

A. If Goods are Not Insured

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

Profit and Loss A/C Dr

To Trading A/C

To Input CGST A/C

To Input SGST A/C

(Recording total value of abnormal loss)

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

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

B. If Goods are Insured

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

Accidental Loss A/C Dr

To Trading A/C

To Input CGST A/C

To Input SGST A/C

(Recording total value of abnormal loss)

Step 2

Insurance Claim A/C Dr

Profit and Loss A/C Dr

To Accidental Loss A/C

(Adjusting the insurance claim received)

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

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

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

Balance Sheet: No effect

16. Goods distributed as free samples:

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

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

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

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

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

Introduction:

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

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

Presentation of Balance Sheet

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

<u>Key features of Balance Sheet</u>

1) The Schedule III permits only Vertical form of presentation.
2) It uses "Equity and Liabilities" and "Assets" as headings.
3) All assets and liabilities classified into current and non-current and presented separately on the face of the Balance Sheet.
4) Number of shares held by each shareholder holding more than 5% shares now needs to be disclosed.
5) Details pertaining to aggregate number and class of shares allotted for consideration other than cash, bonus shares and shares bought back will

need to be disclosed only for a period of five years immediately preceding the Balance Sheet date

6) Any debit balance in the Statement of Profit and Loss will be disclosed under the head "Reserves and surplus." Earlier, any debit balance in Profit and Loss Account carried forward after deduction from uncommitted reserves was required to be shown as the last item on the asset side of the Balance Sheet
7) Specific disclosures are prescribed for Share Application money. The application money not exceeding the capital offered for issuance and to the extent not refundable will be shown separately on the face of the Balance Sheet. The amount in excess of subscription or if the requirements of minimum subscription are not met will be shown under "Other current liabilities."
8) The term "sundry debtors" has been replaced with the term "trade receivables." 'Trade receivables' are defined as dues arising only from goods sold or services rendered in the normal course of business. Hence, amounts due on account of other contractual obligations can no longer be included in the trade receivables.
9) It requires separate disclosure of "trade receivables" outstanding for a period exceeding six months from the date the bill/invoice is due for payment."
10) "Capital advances" are specifically required to be presented separately under the head "Loans & advances" rather than including elsewhere.
11) Tangible assets under lease are required to be separately specified under each class of asset. In the absence of any further clarification, the term "under lease" should be taken to mean assets given on operating lease in the case of lessor and assets held under finance lease in the case of lessee.
12) Under the Schedule III, other commitments also need to be disclosed.

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

Schedule III (See section - 129) GENERAL INSTRUCTION FOR PREPARATION OF BALANCE SHEET AND STATEMENT OF PROFIT AND LOSS OF A COMPANY	
GENERAL INSTRUCTIONS	(1) If compliance with the Act's requirements, including Accounting Standards applicable to companies, necessitates any change in treatment or disclosure, including addition, amendment, substitution, or deletion in the head or sub-head or any changes, in the financial statements or statements forming part thereof, the same shall be made, and the requirements of this Schedule shall be modified accordingly. (2)The disclosure requirements specified in this Schedule supplement, rather than replace, the

disclosure requirements specified in the Accounting Standards prescribed under the Companies Act of 2013. Unless required to be disclosed on the face of the Financial Statements, additional disclosures specified in the Accounting Standards must be made in the notes to accounts or by way of an additional statement. Similarly, in addition to the requirements set out in this Schedule, all other disclosures required by the Companies Act must be made in the notes to accounts.

(3) (i) Notes to accounts must include information in addition to what is presented in the Financial Statements, such as

a) narrative descriptions or disaggregation of items recognised in those statements, and

b) information about items that do not qualify for recognition in those statements.

(ii) Each item on the balance sheet and profit and loss statement must be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements, including the notes to accounts, a balance must be struck between providing excessive detail that may not be useful to users of financial statements and failing to provide important information due to excessive aggregation.

(4) (i) Depending on the company's turnover, the figures in the Financial Statements may be rounded off as shown below:

Turnover	Rounding off
(a) less than one hundred' crore rupees	To the near thousands, lakh decimals thereof
(b) one hundred crore rupees or more	To the nearest or crores, or dec

(ii) Once a unit of measurement is established, it must be used consistently in the Financial Statements.

(5)Except in the case of the first Financial Statements laid before the Company (after its

	incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given. (6) For the purpose of this Schedule, the terms used herein shall be as per the notes applicable
Accounting Standards.	Note:This section of the Schedule specifies the minimum requirements for the Balance Sheet, Statement of Profit and Loss (hereinafter referred to as - Financial Statements for the purposes of this Schedule), and Notes. Line items, sub-line items, and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company's financial position or performance, or to cater to industry/sector-specific disclosure requirements, or when required for compliance with amendments to the Companies Act or under the Accounting Standards.

1.6 VERTICAL FINANCIAL STATEMENT

ABC LIMITED **Balance Sheet As On 31st March, 2022**			
Particulars	**Note No.**	**Figures as at the end of current reporting period** **Rs.**	**Figures as at the end of previous reporting Period** **Rs.**
A EQUITY AND LIABILITIES			
1 Shareholders' funds			
(a) Share capital	1	XX	XX
(b) Reserves and surplus	2	XX	XX
(b) Money Received against share warrants		XX	XX

2	**Share application money pending allotments**		XX	XX
3	**Non-current liabilities**			
	(a) Long-term borrowings	3	XX	XX
	(b) Deferred tax liabilities (net)		XX	XX
	(c) Other Long Term Liabilities		XX	XX
	(d) Long term provision		XX	XX
4	**Current liabilities**			
	(a) Short Term Borrowings	4	XX	XX
	(b) Trade payables	5	XX	XX
	(c) Other current liabilities	6	XX	XX
	(d) Short-term provisions	7	XX	XX
	Total		**XX**	**XX**
B	**ASSETS**			
1	**Non-current assets**			
	(a) Fixed Assets			
	(i) Property, Plant and Equipment	8	XX	-
	(ii) Intangible assets		XX	-
	(iii) Capital Work in progress		XX	-
	(iv) Intangible Assets under Development		XX	-
	(b) Non-current investments	9	XX	-
	(c) Deferred Tax Assets		XX	
	(d) Long term loans and Advances		XX	
	(e) Other Non-Current Assets		XX	
2	**Current assets**			
	(a) Current Investments	10	XX	
	(b) Inventories	11	XX	-
	(c) Trade receivables	12	XX	-
	(d) Cash and cash equivalents	13	XX	-
	(e) Short-term loans and advances	14	XX	-
	(f) Other Current Assets	15	XX	-
	Total		**XX**	**XX**

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

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

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

All other assets shall be classified as non-current.

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

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

All other liabilities must be designated as non-current.

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

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

A. Share Capital

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

a. The number and amount of shares authorised;
b. The number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
c. Par value per share;
d. A reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;

e. The rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;
f. Shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
g. Shares in the company held by each share holder holding more than 5 per cent shares specifying the number of shares held;
h. Shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;
i. For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
A. Aggregate number and class of shares allotted as fully paid-up pursuant to contract(s) without payment being received in cash.
B. Aggregate number and class of shares allotted as fully paid-up by way of bonus shares.
C. Aggregate number and class of shares bought back.
j. Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date;
k. Calls unpaid (showing aggregate value of calls unpaid by directors and officers);
l. Forfeited shares (amount originally paid-up).

B. Reserves and Surplus

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

C. Long-term Borrowings

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

D. Other Long-term Liabilities
Other Long-term Liabilities shall be classified as:

a. Trade payables;
b. Others.

E. Long-term provisions
The amounts shall be classified as:

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

F. Short-term borrowings

i. Short-term borrowings shall be classified as:
a. Loans repayable on demand;
A. From banks.
B. From other parties.
b. Loans and advances from related parties;

c. Deposits;
d. Other loans and advances (specify nature).
ii. Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
iii. Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
iv. Period and amount of default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

G. Other current liabilities

The amounts shall be classified as:

a. Current maturities of long-term debt;
b. Current maturities of finance lease obligations;
c. Interest accrued but not due on borrowings;
d. Interest accrued and due on borrowings;
e. Income received in advance;
f. Unpaid dividends;
g. Application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms and conditions including the number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether the company has sufficient authorised capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable, i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under "Óther current liabilities";
h. Unpaid matured deposits and interest accrued thereon;
i. Unpaid matured debentures and interest accrued thereon;
j. Other payables (specify nature).

H. Short-term provisions

The amounts shall be classified as:

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

I. Tangible assets

i. Classification shall be given as:
a. Land;
b. Buildings;

c. Plant and Equipment;
d. Furniture and Fixtures;
e. Vehicles;
f. Office equipment;
g. Others (specify nature).

ii. Assets under lease shall be separately specified under each class of asset.

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

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

J. Intangible assets

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

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

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

K. Non-current investments

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

L. Long-term loans and advances

i. Long-term loans and advances shall be classified as:
a. Capital Advances;
b. Security Deposits;
c. Loans and advances to related parties (giving details thereof);
d. Other loans and advances (specify nature).
ii. The above shall also be separately sub-classified as:
a. Secured, considered good;
b. Unsecured, considered good;
c. Doubtful.
iii. Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.
iv. Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

M. Other non-current assets

Other non-current assets shall be classified as:

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

N. Current Investments

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

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

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

O. Inventories

i. Inventories shall be classified as:
a. Raw materials;
b. Work-in-progress;
c. Finished goods;
d. Stock-in-trade (in respect of goods acquired for trading);

e. Stores and spares;
f. Loose tools;
g. Others (specify nature).
ii. Goods-in-transit shall be disclosed under the relevant sub-head of inventories.
iii. Mode of valuation shall be stated.

P. Trade Receivables

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

Q. Cash and cash equivalents

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

R. Short-term loans and advances

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

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

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

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

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

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

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

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

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

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

1.7 STATEMENT OF PROFIT AND LOSS

Statement of Profit and Loss

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

	operations			
XV	**Profit/ (Loss) from discontinuing operations**		**XX**	**XX**
XVI	**(Loss) for the Period**		**XX**	**XX**
XVII	**Earning per equity share:**		**XX**	**XX**
	(1) Basic		**XX**	**XX**
	(2) Diluted		**XX**	**XX**

Salient features of the statement of Profit and Loss:

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

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

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

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

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

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

GENERAL INSTRUCTIONS FORPREPARATION OF STATEMENT OF PROFIT AND LOSS

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

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

- Sale of products;
- Sale of services;
- Other operating revenues;
- *Less*:

- Excise duty.

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

- Interest; and
- Other financial services.

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

iii. Finance Costs

Finance costs shall be classified as:

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

iv. Other Income

Other income shall be classified as:

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

v. Additional Information:

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

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

vi. In the case of manufacturing companies:

- Raw materials under broad heads
  - goods purchased under broad heads

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

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

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

- The aggregate, if material, of any amounts withdrawn from such reserves.

ix. (*a*) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.

(*b*) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.

x. Expenditure incurred on each of the following items, separately for each item:—

- Consumption of stores and spare parts;
- Power and fuel;
- Rent;
- Repairs to buildings;
- Repairs to machinery;
- Insurance;
- Rates and taxes, excluding, taxes on income;
- Miscellaneous expenses,

xi. (*a*) Dividends from subsidiary companies.

- Provisions for losses of subsidiary companies.
- The profit and loss account shall also contain by way of a note the following information, viz:
  - Value of imports calculated on C.I.F basis by the company during the financial year in respect of—
  - Raw materials;
    - Components and spare parts;
    - Capital goods;
  - Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;
  - Total value if all imported raw materials, spare parts and components consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;

- The amount remitted during the year in foreign currencies on account of dividends with a specific mention of the total number of non-resident shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related;
- Earnings in foreign exchange classified under the following heads, namely:—
- Export of goods calculated on F.O.B. basis;
- Royalty, know-how, professional and consultation fees;
- Interest and dividend;
- Other income, indicating the nature thereof.

Exercise:
Choose the correct alternative:

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

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

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

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

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

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

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

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

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

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

6. Claims not acknowledged as debts

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

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

b.	Loan	c.	Current Liabilities	d.	Contingent Liabilities

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

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

9. Unclaimed dividend is shown under

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

10. The example of accounting policy is ________.

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

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

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

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

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

Correct Answer:

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

Short Notes:

1. Nature of Financial Statements
2. Objectives of Financial Statements
3. Current investment.
4. Operating cycle.

List of References:-

www.academia.edu

www.accountingcapital.com

www.accountingnotes.net

www.yourarticlelibrary.com

www.linkedin.com

www.tutorialspoint.com.

Bibliography

Financial Accounting,

Jain S.P., Narang K.L., Kalyani Publishers, Delhi.

Fundamentals of Advanced Accounting

R.S.N Pillai Bagavathi, S. Chand Chand Publications

Bibliography Glossary Further Readings Model Question

❖❖❖❖

2

PREPARATION OF FINAL ACCOUNTS OF COMPANIES

Unit Structure:

2.0 OBJECTIVES

After studying this chapter, you will be able to understand

- Application of Various adjustments with respect to the preparation of financial statements

- Preparation of final accounts both under the vertical format as suggested by the Revised Schedule – III

2.1 ILLUSTRATIONS

Illustration 01:

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

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

Solution 01:

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

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

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

Illustration 02:

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

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

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

Solution 02:

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

Working Note:

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

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

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

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

Illustration 03:

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

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

Additional Information:

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

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

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

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

Solution 03:

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

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

Extract of Balance Sheet as at 31-3-2016

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

WN. 1: Calculation of Excess/Shortage Provision

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

WN. 2: Income Tax Payable

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

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

Illustration 04: (Fixed Assets Schedule)

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

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

Solution:

Note for Tangible Assets:

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

Illustration 5:

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

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

Further Information:

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

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

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

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

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

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

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

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

Solution 05:

In the Books of Ram Ltd.

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

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

Notes to Accounts

Particulars	Amount	Amount
1. Revenue from Operations		
Sales		2,40,00,000
Less: Returns		(40,00,000)
Total		2,00,00,000
2. Other Income		
a. Dividend Income		10,00,000
b. Sundry Income	8,00,000	
Add: Income Receivable	50,000	8,50,000
Total		18,50,000
3. Cost of Materials Consumed		
a. Opening Stock	20,00,000	
b. Add : Purchases (Net)	54,00,000	
c. Carriage Inward	60,000	74,60,000
d. Less: Purchase Returns	4,00,000	
e. Less: Material lost by fire	30,000	
f. Less: Closing Stock	10,00,000	(14,30,000)
Total		60,30,000
4. Change in Inventories		
<u>Finished Goods</u>		
Opening Stock	10,00,000	
Less : Closing Stock	(12,00,000)	(2,00,000)
Total		
5. Employee Benefits Expense		
a. Salaries and Wages	8,00,000	
Add: Outstanding	1,00,000	9,00,000
b. Bonus		1,60,000
Total		10,60,000

6. Finance Costs		
Interest on Bank Loans		14,00,000
7. Depreciation and Amortisation		
Depreciation on		
- Plant and Machinery	10,00,000	
- Furniture and Fixtures	6,00,000	
- Motor Vehicle	2,00,000	
Total		18,00,000
8. Other Expenses		
Directors Remuneration		16,00,000
Repairs and Maintenance		1,60,000
Insurance Premium		60,000
Electricity		80,000
Rent, Rates and Taxes		40,000
Audit Fees		1,00,000
Advertisement	2,40,000	
Less: Pre-paid	(40,000)	2,00,000
Sundry Expenses		20,000
Provision for Bad and Doubtful Debts		50,000
Loss by Fire		30,000
Total		23,40,000

Illustration 6:

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

Particulars	₹ in lakhs	Particulars	₹ in lakhs
Excise Duty paid	92.50	Sale of Services	15.00
Net Loss on Sale of Investments	2.00	Trading Commission Received	30.00
Rental Collection Expenses	0.50	Interest Income	10.00
Opening Stock of Materials	42.30	Dividends from Companies	5.00

Opening Stock of WIP	75.00	Rental Income	7.50
Opening Stock of Finished Goods	87.50	Gain on Foreign Currency Transactions and Translation	4.00
Purchases of Materials	477.60	50 lakhs Equity Shares of ₹ 10 each, ₹ 8 paid up	400.00
Salaries and Wages	300.00	60 lakhs Equity Shares of ₹ 10 each	600.00
Contribution to Provident Fund	36.00	Profit and Loss Account [1-4-2016]	226.00
Expense on Employee Stock Option Scheme (ESOP)	14.00	10%, 70 lakhs Preference Shares of ₹ 10 each	700.00
Staff Welfare Expenses	75.00	General Reserve	80.00
Interest Expense	12.00	12% Debentures	100.00
Other Borrowing Costs (Brokerage)	2.00	Provision for Doubtful Debts	1.00
Buildings	200.00	Consumption of Stores and Spares Parts	7.00
Plant and Equipment	100.00	Power and Fuel	8.00
Vehicles	25.00	Rent	5.00
Furniture and Fixtures	30.00	Repairs to Buildings	4.00
Brands	100.00	Repairs to Machinery	3.00
Computer Software	45.00	Insurance	2.00
Prepaid Expenses	1.00	Rates and Taxes	1.00
Interim Dividend Paid	50.00	Miscellaneous Expenses	1.00
Sundry Debtors	40.00		
Payment to the Auditor	16.00		
Sale of Products	1,350.00		

Additional Information:

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

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

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

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

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

(f) Income Tax Rate 30%.

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

Solution 06:

M Ltd.

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

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

Notes to Accounts:

Particulars	₹ in lakhs	₹ in lakhs
1. Revenue from Operations		
a. From Sale of Products		1,350.00
b. From Sale of Services		15.00
c. From Other Operating Revenues [Trading Commission]		30.00
d. Less: Excise Duty		(92.50)
Total		1,302.50
2. Other Income		
a. Interest Income		10.00
b. Dividends from Companies		5.00
c. Net Loss on Sale of Investments		(2.00)
d. Rental Income (7.5 lakhs – 0.5 lakhs Collection Expenses)		7.00
Total		20.00
3. Cost of Materials Consumed		
a. Opening Stock of Materials		42.30
b. Add: Purchases of Materials		477.60
c. Less: Closing Stock of Materials		(19.90)
Total		500.00
4. Change in Inventories		
Work in Progress		
Opening Stock	75.00	
Less : Closing Stock	(100.00)	
Total WIP	**(25.00)**	
Finished Goods		
Opening Stock	87.50	
Less : Closing Stock	(200.00)	
Total FG	**(112.50)**	
Total Changes in inventory		(137.50)
5. Employee Benefits Expense		
a. Salaries and Wages		300
b. Contribution to Provident Fund		36
c. Expense on Employee Stock Option Scheme (ESOP)		14
d. Staff Welfare Expenses		75
Total		425

6. Finance Costs		
a. Interest Expense	12.00	
b. Other Borrowing Costs (Brokerage)	2.00	
c. Gain on Foreign Currency Transactions and Translation	(4.00)	
Total		10.00
7.Depreciation and Amortisation Expense		
a. Buildings [5% of ₹200 lakhs]	10.00	
b. Plant and Equipment [20% of ₹ 100 lakhs]	20.00	
c. Vehicles [20% of ₹ 25 lakhs]	5.00	
d. Furniture and Fixtures [10% of ₹30 lakhs]	3.00	
e. Brands [10% of ₹ 100 lakhs]	10.00	
f. Computer Software [60% of ₹ 45 lakhs]	27.00	
Total		75.00
8. Other Expenses		
a. Consumption of Stores and Spare Parts		7.00
b. Power and Fuel		8.00
c. Rent		5.00
d. Repairs to Buildings		4.00
e. Repairs to Machinery		3.00
f. Insurance		2.00
g. Rates and Taxes		1.00
h. Miscellaneous Expenses		1.00
i. Provision for Doubtful Debts [(10% of ₹40 lakhs) - ₹ 1 lakh]		3.00
j. Payments to the Auditor as:		
(i) Auditor	5.00	
(ii) For Taxation Matters	4.00	
(iii) For Company Law Matters	3.00	
(iv)For Management Services	2.00	
(v)For Other Services	2.00	16.00
Total		50.00
9. Surplus in the Statement of Profit and Loss to be Taken to Balance Sheet		
Opening Balance	226.00	
Add : Profit for the period	280.00	
Less : Transfer to General Reserve @ 5%	(14.00)	
Less : Interim Dividend Paid	(50.00)	
Less : Debenture Redemption Reserve [25% of ₹ 100 lakhs]	(25.00)	
Closing Balance		417.00

Illustration 7:

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

Particulars	Amount (₹)	Particulars	Amount (₹)
Office Equipment	4,80,600	General Reserve	4,15,000
9% Debentures in APCO Ltd.	2,45,000	Creditors for Goods	1,68,500
Loose Tools	1,63,000	Creditors for Expenses	36,000
Plant and Machinery	18,00,000	Cash Credit	75,000
Computer Software	83,250	Mortgage Loan	3,10,000
Debtors for Goods	1,90,000	8% Preference Share Capital	5,50,000
Share Issue Expense (unwritten off)	30,000	Equity Share Capital	15,00,000
Stores and Spares	1,00,200	Staff Welfare Fund	85,000
Interest Accrued on Investment	51,000	Provision for Taxation	26,550
Cash at Bank	23,000		

In the books of Statistics Ltd.

Balance Sheet as on 31st March, 2022

Particulars	Note	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital		
– Equity Share Capital		15,00,000
– Preference Share Capital		5,50,000
b. Reserves and Surplus (General Reserve)		4,15,000
2. Non-Current Liabilities		
a. Long Term Borrowings (Mortgage Loan)		3,10,000
b. Long Term Provisions (Staff Welfare Fund)		85,000
3. Current Liabilities		
a. Short Term Borrowings (Cash Credit)		75,000
b. Trade Payables	1	2,04,500
c. Short Term Provisions (Tax)		26,550
Total		31,66,050

II. ASSETS		
1. Non-Current Assets		
a. Property, Plant and Equipment		
- Tangible Assets	2	22,80,600
- Intangible Assets (Computer Software)		83,250
b. Other Non-Current Assets (Share Issue Expenses)		30,000
2. Current Assets		
a. Current Investments (9% Debentures)		2,45,000
b. Inventories	3	2,63,200
c. Trade Receivables		1,90,000
d. Cash and Cash Equivalents (Bank)		23,000
e. Other Current Assets (Interest Accrued on Investment)		51,000
Total		31,66,050

Notes to Accounts

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

Illustration 8:

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

Particulars	Amount (₹)	Particulars	Amount (₹)
Term Loans (Secured)	40,00,000	Investments (Non-current)	9,00,000
Trade Payables	45,80,000	Profit for the year	32,00,000
Other Advances	14,88,000	Trade Receivables	49,00,000
Cash and Bank Balances	38,40,000	Miscellaneous Expenses	2,32,000
Staff Advances	2,20,000	Loan from Other Parties	8,00,000
Provision for Taxation	10,20,000	Provision for Doubtful Debts	80,000
Securities Premium	19,00,000	Stores	16,00,000
Loose Tools	2,00,000	Fixed Assets (WDV)	2,26,00,000
General Reserve	62,00,000	Finished Goods	30,00,000
Capital Work-in-Progress	8,00,000	Profit and Loss Account	2,00,000

Adjustments needed:

1. Share Capital consist of:

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

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

2. Depreciate assets by ₹ 20,00,000.

Gold Ltd.

Balance Sheet as at 31st March, 2018

Particulars	Note	Amount ₹
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds	1	1,60,00,000
a. Share Capital	2	1,10,68,000
b. Reserves and Surplus		
2. Non-Current Liabilities		40,00,000
Long Term Borrowings - Term Loans (Secured)		
3. Current Liabilities		
a. Trade Payables		45,80,000
b. Other Current Liabilities	3	8,00,000
c. Short-Term Provisions (Provision for Taxation)		10,20,000
Total		3,74,68,000
II. ASSETS		
1. Non-Current Assets		
a. Property, Plant and Equipment	4	2,06,00,000
– Tangible Assets		8,00,000
– Capital WIP		9,00,000
b. Non-Current Investments		
2. Current Assets		
a. Inventories	5	48,00,000
b. Trade Receivables	6	48,20,000
c. Cash and Cash Equivalents		38,40,000
d. Short Term Loans and Advances	7	17,08,000
Total		3,74,68,000

Notes to Accounts:

Particulars	Amount ₹	Amount ₹
1. Share Capital		
Authorised, Issued, Subscribed and Called-up		
1,20,000, Equity Shares of ₹ 100 each		1,20,00,000
40,000, 10% Redeemable Preference Shares of ₹ 100 each		40,00,000
Total		1,60,00,000
2. Reserves and Surplus		
a. Securities Premium Account		19,00,000
b. General Reserve		62,00,000
c. Profit and Loss Account		
Opening Balance	2,00,000	
Add: Profit of the current year	30,00,000	
Less: Miscellaneous Expenditure written off	(2,32,000)	29,68,000
Total		1,10,68,000
3. Other Current Liabilities		
Loan from Other Parties		8,00,000
4. Tangible Assets		
Opening Balance	2,26,00,000	
Less : Depreciation	(20,00,000)	
Total (Closing Balance)		2,06,00,000
5. Inventories		
a. Finished Goods		30,00,000
b. Stores		16,00,000
c. Loose Tools		2,00,000
Total		48,00,000
6. Trade Receivables		49,00,000
Less : Provision for Doubtful Debts		(80,000)
Total		48,20,000
7. Short Term Loans and Advances		
a. Staff Advances		2,20,000
b. Other Advances		14,88,000
Total		17,08,000

Illustration 09:

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

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

Additional Information:

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

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

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

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

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

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

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

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

Prepare:

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

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

3. Ignore Previous year's figures.

Solution 09:

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

Particulars	Note	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
a. Share Capital	1	20,00,000
b. Reserves and Surplus	2	11,50,000
2. Non-Current Liabilities		
Long Term Borrowings	3	10,00,000
3. Current Liabilities		
Trade Payables		2,60,000
Total		44,10,000
II. ASSETS		
1. Non-Current Assets		
a. Property, Plant and Equipment	4	33,00,000
– Tangible Assets		4,80,000
b. Non-Current Investments	5	80,000
c. Other Non-Current Assets		
2. Current Assets		
a. Trade Receivables	6	4,30,000
b. Cash and Cash Equivalents	7	1,00,000
c. Other Current Assets	8	20,000
Total		44,10,000

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

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

Notes to Account

Particulars	Amount (₹)	Amount (₹)
1. Share Capital		
Equity Share Capital		
Authorised Shares (Par Value per Share : ₹ 100)		
25,000 Equity Shares of ₹ 100 each		25,00,000
Issued, subscribed & fully paid Shares		
20,000 Equity Shares of ₹ 100 each		20,00,000
(Of the above, 5,000 Equity shares of ₹ 100 each issued as Bonus Shares)		
Total		20,00,000
2. Reserves and Surplus		
a. Capital Redemption Reserve	6,70,000	
Less: Utilized for Bonus Issue	(5,00,000)	1,70,000
b. Securities Premium Account		2,00,000
c. Profit and Loss Account		
Balance in Statement of Profit & Loss A/c b/d	3,60,000	
Surplus for the year	4,20,000	7,80,000
Total		11,50,000

3. Long Term Borrowings		
10% Debentures		10,00,000
5. Other Non-Current Assets		
Advance Tax		2,00,000
Less : Provision for Tax		(1,20,000)
Total		80,000
6. Trade Receivables		
Unsecured, Considered Good		
- Outstanding for more than 6 months		80,000
- Others		3,50,000
Total		4,30,000
7. Cash and Cash Equivalents		
Bank		1,00,000
8. Other Current Assets		
Tax Refund Due		20,000
9. Revenue From Operations		
Gross Profit		19,00,000
10. Other Income		
Profit on Sale of Machinery		10,000
11. Employee Benefits Expense		
Salaries		3,50,000
12. Finance Costs		
Debenture Interest		1,00,000
13. Other Expenses		
a. Sundry Expenses		1,00,000
b. Selling Expenses		1,50,000
c. Printing and Stationery		1,20,000
d. Share Issue Expenses w/o		20,000
Total		3,90,000

Schedule 04: Tangible Fixed Assets

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

EXERCISE:

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

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

2. Bills Receivable is shown under __________.

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

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

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

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

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

5. Future bad debts are usually estimated as ____________.

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

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

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

7. Bank Balance is shown under ________.

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

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

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

9. Preliminary Expenses are shown under

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

Solution:

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

Unsolved Problems

Problem 1:

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

Problem 2:

A company has the following information on 31.03.2017:

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

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

Problem 3

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

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

1. During the year Directors proposed dividend @ 10% on Capital of ₹ 1,00,00,000.

2. Income Tax is to be provided @ 30%.

3. Closing stock as on 31.03.2022 were as follows:

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

4. Salaries outstanding were ₹ 5,000

Prepare the income statement from the given information.

Problem 4:

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

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

Additional Information:

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

b. Closing stock was ₹ 50,000.

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

d. Income tax to be provided at 40%.

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

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

Problem 5:

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

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

Additional Information:

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

Prepare Income statement & Balance sheet from the given information.

❖❖❖❖

3

INTERNAL RECONSTRUCTION

Unit Structure

3.0OBJECTIVES:

After studying the unit the students will be able to:

- Understand the various types of reconstruction.
- Know the alternation of share capital.
- Explain the procedure of reconstruction.
- Understand the Accounting entries for reconstruction.
- Solve the practical problems on the unit.

3.1 INTRODUCTION:

The term reconstruction refers to reorganising a company's financial structure and reducing the claims of both classes of shareholders and creditors against the company. It is also known as reorganisation, and it allows the existing company to continue. Sick companies (loss-making companies) can be taken over by profit-making companies; however, if huge losses exist and assets are overvalued or undervalued, the company may reduce share capital for reconstruction. External or internal reconstruction is possible.

3.2 TYPES OF RECONTRUCTION:

The Company can be reconstructed internally or externally.

It means two types of reconstruction is possible:

3.2.1 External Reconstruction:

In the case of external reconstruction, a new company is formed to take over the operations of an existing loss-making company that is in a bad financial situation. The vendor company is liquidated, and the new company takes over its operations.

3.2.2 Internal Reconstruction:

In the case of internal reconstruction, the company's capital structure is reorganised in order to breathe new life into the company. It includes the modification, reduction, and reorganisation of the company's share capital.

3.3 ALTERATION OF SHARE CAPITAL:

A limited company if authorized by its Articles of Association can alter the capital clause of its Memorandum of Association. As per Sec. 61 of the Companies Act 2013 a company can alter its share capital. The alteration of share capital may be in following different ways: -

a] Increase in share capital by the issue of new shares. b] Consolidation of shares:

Consolidation refers to conversion of shares of the smaller denomination into shares of larger denomination e.g: 1000 equity shares of Rs . 10 each can be consolidated into 100 shares of Rs. 100 each.

c] Subdivision of shares:

Sub division refers to conversion of shares of the largerdenomination into shares of small denomination e.g: 1000 equity shares of Rs. 100 each can be subdivided into 10000 shares of Rs. 10 each.

d] Conversion of shares into stock:

A corporation's shares can be converted into stock. Stocks can be purchased in fractions, but shares cannot. Conversion of shares into stock requires Central Government approval.

e] Surrender of shares:

In the case of a share surrender, shareholders may be required to surrender a portion of their shareholdings. Such a surrender may be made prior to immediate cancellation or for distribution to some of the company's creditors in satisfaction of their claim.

f] Cancellation of Unissued shares:

There is no need for an accounting entry to be made when a company cancels its unissued shares. The amount of unissued shares now cancelled will be deducted from the company's authorised share capital.

3.4 LEGAL ASPECTS:

Internal reconstruction plans should be based on careful research and proper asset and liability valuation. It entails a compromise or arrangement reached between the company and its members or creditors. However, the following factors should be carefully considered when developing an internal reconstruction strategy:

a] Changes in share capital in any form should be considered in accordance with the provisions of the M/A & A/A, and if necessary, the company should amend the provisions in the M/A & A/A.

b] Within 30 days of passing a resolution, the company must notify the Register of Companies.

c] In some cases, SEBI sanction is required.

d] A Board Resolution is required to make the change.

3.5 CAPITAL REDUCTION: (Section 66)

Reducing capital is necessary for internal reconstruction in order to cancel any paid-up share capital that is lost during business operations and is not equal to the true value of the assets.
The following are some ways that a company can reduce its share capital:
a] writing off capital loss
a] Refunding Surplus paid-up capital.

b] Lowering the members' liability for uncalled capital.

Only after each of the following conditions has been met by the company can it reduce its share capital.

Such a reduction must be permitted by the business' A/A.

The business adopts a special resolution to lower its share capital.

The corporation gets the court's approval.Only when it is approved by the court and registered with the Registrar of Companies will a capital reduction take effect. The company's name may, at its option, have the words "And Reduced" appended for the time period specified.

3.6 ACCOUNTING ENTRIES:

1] When the face value of share is changed:

Share capital A/c (o/d) Dr.

(With paid up value of old shares)To Share Capital A/c (new)

(With paid up value of new shares)

To Capital Reduction A/c(With difference)

2] When any sacrifice is made by the creditors:

Creditors A/c (with sacrifice) Dr.

To Capital Reduction A/c

3] When there is reduction in share capital (face value ofshare is not changed)

Share Capital A/c Dr.

To Capital Reduction A/c

(With the amount of reduction).

4] When the value of any asset is appreciated:

Asset A/c (increase in value) Dr.

To Capital Reduction A/c

5] When any sacrifice is made by the Debenture Holders

Debentures A/c (increase in value) Dr.

To Capital Reduction A/c

6] When shares are consolidated:

Share Capital A/c (say Rs. 10) Dr.

To Share Capital A/c (say Rs. 100)

7] When Shares are subdivided:

Share Capital A/c (say Rs. 100) Dr.

To Share Capital A/c (say Rs. 10)

8] When capital reduction is utilised for writing off fictitious assets, losses and excess value of other assets:

Capital Reduction A/c Dr.

To P/L A/c (Dr.bal)

To Goodwill A/c

To Preliminary Expenses A/c

To Discount on Shares/Debentures A/cTo Other Assets A/c

To Capital Reserve A/c (if any balance is left)

9] When shares are converted into stock:

Share Capital A/c Dr.

To Share Stock A/c

10] When shares are surrendered:

Share Capital A/c Dr.

To Share Surrendered A/c

11] When surrendered shares are converted into preference shares:

Share Surrendered A/c Dr.

To Preference Share Capital A/c

12] When contingent liability/unrecorded liability is paid for:

Capital Reduction A/c Dr.

To Bank A/c

(**Note:** No entry is required for amount foregone against suchliability.)

13] When recorded liability is paid for:

Liability A/c Dr.

To Bank A/c

(**Note:** Any profit or loss should be transferred to Capital ReductionA/c)

14] When recorded assets are disposed off:

Bank A/c Dr.

To Assets A/c

(**Note:** Any profit or loss on sale should be transferred to CapitalReduction A/c)

15] When Reconstruction expenses are paid

Capital Reduction A/c Dr.

To Bank A/c

16] When an unrecorded assets is sold off:

Bank A/c Dr.

To Capital Reduction A/c

17] When finance is raised by issue of shares

Bank A/c Dr.

To Share Capital A/c

18] When arrears of preference dividend are cancelled:No Entry (As it is contigent liability)

19] When new debentures are exchanged for olddebentures:

Old Debentures A/c Dr.

To New Debentures A/c

20] When arrears of preference dividend are settled by issueof deposit certificates cash/shares:

Capital Reduction A/c Dr.

To Deposit Certificates/Cash/Share Certificate A/c

21] When the rate of preference dividend is changed:

Preference Share Capital (old) A/c Dr.

To Preference Share Capital A/c (new)

22] When surrendered shares are issued to creditors:

(a) Surrendered A/c Dr.

To Share Capital A/c

(b) Creditors A/c Dr.

To Capital Reduction A/c

Note: Profit or Loss on scheme to be transferred to capitalReduction A/c.

23] When provision for taxation, Capital Reserve, SecuritiesPremium is utilized:

Provision for Taxation A/c Dr.

Capital Reserve A/c Dr.

Securities Premium A/c Dr.

To Capital Reduction A/c

Capital Reduction Account

It is a nominal account prepared to debit all the losses and fictitious assets , credit all the incomes , surrendered amount by shareholders and appreciation of assets. Balance if any is transferred to capital reserve.

Capital Reduction A/c

Particulars	Rs.	Particulars	Rs.
To P & L A/c (Loss written off)	XX	By Share Capital A/c (Amount of reduction)	XX XX
To Goodwill A/c (Written off)	XX	By Debentures A/c (Amountof Reduction)	XX XX
To Preliminary expenses A/c (Written off)	XX	By Creditors A/c (Amount ofSacrifice)	XX
To Discount on Shares/Debentures (Written off)	XX	By Assets A/c (Increase in value)	
To Assets A/c (Decrease in value)	XX XX	By Bank A/c (sate of unrecorded assets)	
To Bank A/c (payment of unrecorded liability)	XX		
To Bank A/c (payment of Reconstruction Expenses)	XX XX		
To Bank A/c (Refund of DirectorsFees)			
To Capital Reserve (Balancing figure)			
	XXX		**XXX**

3.7SOLVED PROBLEMS:

Illustration– 1

Following is the Balance sheet of M/s. Life Care Ltd. as on 31st March, 2015.

Balance Sheet as on 31st March, 2015.

Liabilities	**Rs.**	**Assets**	**Rs.**
50,000 – 8% Cumulative Preference Shares ofRs.10/- each.	5,00,000	Goodwill	1,00,000
40,000 – Equity Shares of Rs.10/- each.	4,00,000	Freehold Property	1,50,000
Security Premium	8,000	Leasehold Property	2,40,000
9% Debentures	1,00,000	Plant & Machinery	3,00,000
Accrued Debenture Interest	6,000	Furniture	1,00,000
Sundry Creditors	1,00,000	Stock	50,000
Bank Overdraft	1,42,000	Debtors	1,00,000
		Preliminary Exp.	9,000
		Profit & Loss A/c	2,07,000
	12,56,000		12,56,000

Note –

1) Preference dividend was in arrears for 2 years.

2) There was a contingent liability of Rs.50,000/- for workmen compensation.

Following scheme of reconstruction was approved & implemented.

a) The Preference shares were reduced to Rs.7/- per share fully paid & Equity Shares to Rs.4/- per share fully paid.

b) One new Equity share of Rs.10/- each was issued of every Rs.50/- gross preference dividend in arrears.

c) After reduction, both classes of shares were consolidated into Rs.10/- shares.

d) The balance of Securities Premium was utilized.

e) Plant & Machinery was written of down to Rs.2,00,000/-.

f) Furniture was sold at Rs.85,000/-

g) Preliminary expenses debit balance in Profit & Loss A/c, debt of Rs.15,000/- & obsolete stock Rs.18,000/- were to be written off.

h) Contingent liability for which no provision has been made was settled at Rs.25,000/-. However, the amount of Rs.11,000/- was recovered from insurance company.

i) Debenture holders agreed to Forgo principal amount by Rs.60,000/- & accrued debenture interest in full.

Pass journal entries and capital reduction account.

Solution :

Journal of Life Care Ltd.

Date	**Particulars**	**Debit (Rs.)**	**Credit (Rs.)**
1.	8% Preference Share Cap. A/c ....Dr. (50,000X10) To 8% Preference Share Capital A/c (50,000X7) To Capital Reduction A/c (50,000X3) (Being reduction in 8% Preference Capital.)	5,00,000	 3,50,000 1,50,000

2.	8% Preference Share Capital A/c ....Dr. (40,000X8) To 8% Preference Share Capital A/c (32,000X10) (Being consolidation of 8% Preference Shares.)	3,20,000	 3,20,000
3.	Equity Share Capital A/c .... Dr. (40,000X10) To Equity Share Capital A/c (40,000X4) To Capital Reduction A/c (40,000X6) (Being reduction in Equity Share Capital)	4,00,000	 1,60,000 2,40,000
4.	Equity Share Capital A/c ....Dr. (40,000X3) To Equity Share Capital A/c (12,000X10) (Being consolidation of Equity Shares.)	1,20,000	 1,20,000
5.	Capital Reduction A/c ....Dr. To Equity Share Capital A/c (8%X5,00,000X $\frac{3}{50}$ X10) (Being arrears of Preference dividend paid by issue of Equity shares.)	24,000	 24,000
6.	Security Premium A/c ....Dr. To Capital Reduction A/c (Being Security Premium used.)	8,000	 8,000
7.	Bank A/c..Dr. Capital Reduction A/c ....Dr. To Furniture A/c (Being sale of Furniture at a loss of Rs.25,000/-)	85,000 15,000	 1,00,000

8.	Capital Reduction A/c ....Dr. To Bank A/c (Being payment of contingent liability.)	25,000	 25,000
9.	Bank A/c.. Dr. To Capital Reduction A/c (Being recovery of claim from insurance company.)	11,000	 11,000
10.	9% Debentures A/c....................................Dr. Accrued Debenture interest A/c .... Dr. To Capital Reduction A/c	60,000 6,000	 66,000
11.	Capital Reduction A/c ....Dr. To Plant & Machinery A/c (3,00,000 – 2,00,000) To Preliminary Expenses A/cTo Profit & Loss A/c To Sundry Debtors A/cTo Stock A/c To Capital Reserve A/c (Being losses & Assets written off.)	3,91,000	 1,00,000 9,000 2,07,000 25,000 18,000 52,000

Capital Reduction Account

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
To Equity Share Cap. A/c (Preference Dividend) To Furniture To Plant & Machinery A/c To Preliminary Expenses To Profit & Loss A/c To Sundry Debtors A/c To Stock To Bank (Contingent liability) To Capital Reserve	24,000 15,000 1,00,000 9,000 2,07,000 25,000 18,000 25,000 52,000	By 8% Pref. Share Cap. A/c By Equity Share Capital A/c By Security Premium By 9% Debentures By Accrued interest on debentures By Bank (Insurance)	 1,50,000 2,40,000 8,000 60,000 6,000 11,000
	4,55,000		4,75,000

Illustration – 2

Following is the Balance Sheet of Satya Ltd. as on 31st March,2015.

Balance Sheet as on 31st March 2015

Liabilities	Amt.	Assets	Amt.
Share Capital		Goodwill	3,00,000
1,50,000 Equity Shares		Land & Building	2,40,000
of Rs.10/- each fully paid	7,50,000	Equipment	2,10,000
		Sundry Debtors	2,00,970
5,000 6% Preference Shares of Rs.100/- each fully paid	5,00,000	Stock Investment Cash at Bank	3,32,440 44,000 21,000
8% Debentures	3,00,000	Profit & Loss A/c	7,51,590
Bank Overdraft	1,70,000		
Sundry Creditors (including Rs.22,000 int. on Bank Overdraft)	3,80,000		
	21,00,000		21,00,000

Preference dividend is in arrears for Five years.

Following scheme of reconstruction was approved by the court.

1) Equity Shares be reduced to Rs.1.5/- each of then to be consolidated into shares of Rs.10/- each.

2) 6% Preference shares be reduced to Rs.50/- each & then to be subdivided into shares of Rs.10/- each.

3) Interest accrued but not due on 8% debentures. For half year ended 31st March 2015 has not been provided in the above Balance Sheet. The debenture holders have agreed to received 30% of this interest in cash immediately & provision for the balance be made in the books of account.

4) Rs.20,000/- be paid to Preference shareholders in lieu of arrears of Preference dividend.

5) The debenture holders have also agreed to accept equal number of 9% debentures of Rs.60/- each in exchange of 8% debentures of Rs.100/- each.

6) Bank has agreed to take over 50% stock in full satisfaction of its claim including interest. The remaining stock be revalued at Rs.80,000/-.

7) Investment be sold for Rs.39,000/-.

8) Tangible Fixed assets be appreciated by 15% & provision bemade for doubtful debts of Rs.18,000/-.

Give journal entries for the above scheme of reconstruction. Prepare Capital Reduction Account in the books of Satya Ltd. & Balance sheet of the company after reconstruction.

Solution :

Journal of Satya Ltd.

Date	Particulars	Debit (Rs.)	Credit (Rs.)
1.	Equity Shares Capital A/c (5) .... Dr. To Equity Share Capital A/c (1.50) To Capital Reduction A/c (3.5) (Being 1,50,000 Equity Shares of Rs.5/-each reduced to Rs.1.50 each.)	7,50,000	 2,25,000 5,25,000
2.	Equity Share Capital A/c (1.50)................Dr. To Equity Share Capital (10) (Being 1,50,000 Equity shares of Rs.1.50 consolidated into shares of Rs.10/- each.)	2,25,000	 2,25,000
3.	6% Preference Share Capital A/c (100) .. Dr. To 6% Preference Share Capital A/c (50) To Capital Reduction A/c (Being 6% Preference shares of Rs.100/- each reduced to shares of Rs.50/- each.)	5,00,000	 2,50,000 2,50,000
4.	6% Preference Share Capital A/c............... Dr. To 6% Preference Shares Capital A/c (Being 6% Preference shares of Rs.50/- each subdivided into shares of Rs.10/- each.)	2,50,000	 2,50,000
5.	Capital Reduction A/c............................... Dr. To Bank A/c To Interest on Debentures A/c (Being payment of accrued interest on debentures to the extent of 30% & provided for the balance.)	12,000	 3,600 8,400
6.	Capital Reduction A/c............................... Dr. To Bank A/c (Being paid to preference share holders in lieu of arrears of dividend.)	20,000	 20,000

7.	8% Preferences A/c (100) ....Dr. To 9% Debentures A/c (60) To Capital Reduction A/c (Being exchanged 8% debentures by 9% debentures.)	3,00,000	 1,80,000 1,20,000
8.	Bank Overdraft A/c....................................Dr. Sundry Creditors A/c ....Dr. (Interest on Bank Overdraft)To Stock A/c To Capital Reduction A/c (Being taken over 50% of the Stock by the bank in satisfaction of bank overdraft.)	1,70,000 22,000	 1,66,220 25,780
9.	Capital Reduction A/c................................ Dr. To Stock A/c (Being reduction in Stock.)	86,220	 86,220
10.	Bank A/c ....Dr. Capital Reduction A/c................................ Dr. To Investment A/c (Being sale of investment at a loss.)	39,000 5,000	 44,000
11.	Capital Reduction A/c................................ Dr. To Profit & Loss A/c To Provision for doubtful debts A/cTo Capital Reserve A/c (Being written off profit & loss account debit balance, provided for reduction redemption reserve & transferred the remaining amountto Capital Reserve Account.)	8,65,040	 7,51,590 18,000 95,470
12.	Land & Building A/c ....Dr. Equipment A/c ....Dr. To Capital Reduction A/c (Being appreciation in Land & Building & Equipment.)	36,000 31,500	 67,500

Capital Reduction Account

Dr.Cr.

Particulars	Amt.	Particulars	Amt.
To Bank A/c	3,600	By Equity Share Capital A/c	5,25,000
To Int. on debentures	8,400	By 6% Preference Share Capital A/c	2,50,000
To Bank A/c	20,000	By 8% Debentures A/c	1,20,000
To Stock A/c	86,220	By Bank Overdraft & Creditors A/c	25,780
To Investment A/c	5,000	By Land & Building A/c	36,000
To Profit & Loss A/c	7,51,590	By Equipments A/c	31,500
To Provision for doubtful debts.	18,000		
To Capital Reserve	95,470		
	9,88,280		9,88,280

Satya Ltd. (And Reduced) Balance Sheet as on 1st April 2015

Particulars	Notes	Rs.	Rs.
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
a. Share Capital	1	4,75,000	
b. Reserves & Surplus	2	95,470	5,70,470
2. Non-Current Liabilities			
Long Term Borrowings			1,80,000
3. Current Liabilities			
a. Trade Payables			3,58,000
b. Other Current Liabilities	3		8,400
Total			**11,16,870**

II. ASSETS			
1. Non current Assets			
a. Fixed Assets	4		5,17,500
- i. Tangible Assets			
ii. Intangible Assets			3,00,000
(Goodwill)			
2. Current Assets		80,000	
a. Inventories	5	1,82,970	
b. Trade Receivables		36,400	2,99,370
c. Cash & Cash Equivalents			
Total			**11,16,870**

Notes to Accounts

Note – 1 Share Capital	**Number**	**Rs.**
Authorised Share Capital		
Issued, Paid Up Share Capital		
Equity Share Capital	22,500	2,25,000
Equity Shares of Rs. 10/- each Preference Share Capital		
6% Pref. Share of Rs. 10/- each	25,000	2,50,000
		4,75,000

Note – 2 Reserves & Surplus	**Rs.**	**Rs.**
Capital Reserve		95,470
(transf. from Capital Reduction A/c)		

Note – 3 Other Current Liabilities	Rs.	Rs.
Interest payable on Debentures		8,400

Note – 4 Tangible Assets	Rs.	Rs.
Land & Building	2,76,000	
Equipments	2,41,500	5,17,500

Note – 5 Trade Receivables	Rs.	Rs.
S. Debtors	2,00,970	
Less: Prov.for doubtful debts.	18,000	1,82,970

Illustration – 3

Following is the Balance sheet of Damyanti Ltd. as on 31st March,2015.

Liabilities	Amt.	Assets	Amt.
16,000 12% Preference		Goodwill	90,000
Shares of Rs.10/- each fully paid up		Patents	50,000
	1,60,000	Land & Building	1,50,000
		Plant & Machinery	3,00,000
14000 10%		Furniture Investment	35,000
Preference shares of Rs.10/-, Rs.5/- per			85,000
share paid up	70,000	Sundry Debtors	3,00,000
		Bills Receivables	1,20,000

18,000 Equity Share of Rs.10/- each fully paidup	1,80,000	Bank	30,000
		Profit & Loss A/c	71,500
12% Debenture of Rs.100/- each	1,70,000		
11% Debentures of Rs.100/- each	2,80,000		
Interest due ondebenture	21,500		
Sundry Creditors	3,50,000		
	12,31,500		12,31,500

The following scheme of reconstruction was submitted & approved by the court.

1) 12% Preference Shares of the Rs.10/- each fully paid were reduced to 13% Preference Shares of Rs.10/- each, Rs.6/- per share paid up.

2) 10% Preference share of Rs.10/- each, Rs.5/- per share paid up were reduced to 13% Preference shares of Rs.10/- each, Rs.4/- per share paid up.

3) Equity Shares of Rs.10/- each fully paid were reduced to the denomination of Rs.7/- each fully paid.

4) 11% Debenture holders agreed to accept 44,800 Equity Shares of Rs.5/- each in full settlement of their claims.

5) Debentures holders agreed to Forgo the interest due on debentures.

6) Sundry Creditors agreed to Forgo 20% of their claims.

7) The company recovered as damages as sum of Rs.60,000/- which was not recorded in the books.

8) Cost of reconstruction was paid Rs.3,000/-.

9) Assets are to be revalued as under : Land & Buildings Rs.2,05,000/-, Plant & Machinery Rs.2,50,000/-, Furniture Rs.10,000/-, Investment Rs.1,05,000/-, Sundry Debtors Rs.2,77,000/-.

10) All intangible assets & accumulated losses are to be written off.

You are required to –

i) Pass journal entries in the books of Damyanti Ltd.

ii) Prepare Capital Reduction Account & Balance Sheet after reconstruction.

Solution:

Journal of Damyanti Ltd.

Date	Particulars	Debit (Rs.)	Credit (Rs.)
1.	12% Preference Share Capital A/c.............Dr. To 13% Preference Share Capital A/c To Capital Reduction A/c (Being reduction in 12% Preference Capital.)	1,60,000	 96,000 64,000
2.	10% Preference Share Capital A/c.............Dr. To 13% Preference Share Capital A/c To Capital Reduction A/c (Being reduction in 13% Preference Capital.)	70,000	 56,000 14,000
3.	Equity Share Capital A/c ....Dr. To Equity Share Capital A/c To Capital Reduction A/c (Being reduction in Equity Share Capital.)	1,80,000	 1,26,000 54,000
4.	11% Debenture A/c.................................. Dr. To Equity Share Capital A/c To Capital Reduction A/c (Being reduction in debentures.)	2,80,000	 2,24,000 56,000
5.	Interest due on Debenture A/c .... Dr. To Capital Reduction A/c (Being interest dues on debentures cancelled.)	21,500	 21,500
6.	Creditors A/c... Dr. To Capital Reduction A/c (Being Creditors dues reduced.)	70,000	 70,000
7.	Bank A/c ....Dr. To Capital Reduction A/c (Being damages recovered.)	60,000	 60,000
8.	Capital Reduction A/c...............................Dr. To Bank A/c (Being costs of reconstruction paid.)	3,000	 3,000

9.	Land & Building A/c ....Dr. Investment A/c.. Dr. To Capital Reduction A/c (Being increase in valuations.)	55,000 20,000	 75,000
10.	Capital Reduction A/c............................... Dr. To Plant & Machinery A/cTo Furniture A/c To Sundry Debtors A/c	5,01,500	 50,000 25,000 23,000
	To Goodwill A/c To Patents A/c To Profit & Loss A/c To Capital Reserve A/c		90,000 50,000 71,500 102000

Capital Reduction Account

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
To Bank A/c To Plant & Machinery To Furniture A/c To Sundry Debtors A/c To Goodwill A/c To Patents A/c To Profit & Loss A/c To Capital Reserve A/c	3,000 50,000 25,000 23,000 90,000 50,000 71,500 10,2000	By 12% Preference Share Capital A/c By 10% Preference Share Capital A/c By Equity Share Capital A/c By 11% Debenture A/c By Interest due on debentures By Sundry Creditors By Bank A/c By Land & Building A/c By Investment A/c	64,000 14,000 54,000 56,000 21,500 70,000 60,000 55,000 20,000
	4,14,500		4,14,500

Balance Sheet of Damyanti Ltd. (And Reduced)as on 1st April, 2015

Particulars	Notes	Rs.	Rs.
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
a. Share Capital	1	5,02,000	
b. Reserves & Surplus	2	1,02,000	6,04,000
2. Non-Current Liabilities			
Long Term Borrowings			
	3		1,70,000
3. Current Liabilities			
a. Trade Payables			2,80,000
Total			**10,54,000**
II. ASSETS			
1. Non current Assets			
a. Fixed Assets			
- i. Tangible Assets	4		
b. Non -currentInvestments			
3. Current Assets	5		
a. Trade Receivables			4,65,000
b. Cash & Cash Equivalents			
			1,05,000
		3,97,000	
		87,000	
			4,84,000
Total			**10,54,000**

Notes to Accounts

Note – 1 Share Capital	**Number**	**Rs.**
Authorised Share Capital		
Issued, Paid Up Share Capital		
Equity Share Capital		
Equity Shares of Rs. 7/- each	18,000	1,26,000
Equity Shares of Rs. 5/- eachPreference Share Capital	44,800	2,24,000
13 % Pref. Share of Rs. 10/- each Rs.6/- paid up	16,000	96,000
13 % Pref. Share of Rs. 10/- each Rs.4/- paid up	14,000	56,000
		5,02,000

Note – 2 Reserves & Surplus	**Rs.**	**Rs.**
Capital Reserve (transf. from Capital Reduction A/c)		1,02,000

Note – 3 Long Term Borrowings	**Rs.**	**Rs.**
12% Debentures of Rs.100/- each		1,70,000

Note – 4 Tangible Assets	**Rs.**	**Rs.**
Land & Building	2,05,000	
Plant & Machinery	2,50,000	
Furniture	10,000	4,65,000

Note – 5 Non -current Investments	**Rs.**	**Rs.**
Balance:	85,000	
Add: Increase in valuations	20,000	1,05,000

Illustration– 4

M/s. Katrina Ltd. whose Balance Sheet as at 31st March 2015 is as given below.

Liabilities	Rs.	Assets	Rs.
Sources of Funds		Application of Sources Fixed assets 15,50,000	
2,00,000 Equity Shares of Rs.20/- each Rs.10/- paid up		Goodwill 50,000 Investment at cost (Market value 1,00,000)	16,00,000
10% Preference Shares Capital	20,00,000	Current Assets & Loans & Advances	1,10,000
10,000 Shares of Rs.100/- each, Rs.50/- paid up		Current Assets	
Secured Loan	5,00,000	Stock 3,00,000 Debtors 5,00,000	
9% Deb. 7,00,000 (+) O/s int. 1,00,000		B.R. 8,00,000 16,00,000	
Loan from ICICI Ltd. 1,80,000 (+) O/s Int. 30,000	8,00,000	Less : Liab. S. Creditors 2,00,000	14,00,000
	2,10,000	Profit & Loss A/c	4,00,000
	35,10,000		35,10,000

Preference dividend is in arrears for 1 year. Following scheme of reconstruction is approved & agreed upon

1) Preference Shareholders to give up their 50% of claims, dividend to be paid in full

2) Debenture holders agree to give up their claims to receive interest in consideration of their rate of interest being enhanced to 12% henceforth.

3) ICICI Ltd. agree to give up 80% of their interest outstanding in consideration of their claim being paid off at once.

4) Sundry Creditors would like to grant a discount 20% if they wereto be paid off immediately.

5) Balance of Profit & Loss A/c, Goodwill & 50% of the total sundry debtors to by written off.

6) Fixed Assets to be written down by Rs.50,000/-.

7) Investment to be reflected at their market value.

8) Cost of reconstruction is Rs.50,000/-.

9) To the extent required Equity Shareholders suffers on reduction of their rights.

10) The Equity shareholder bring in necessary as against theirpartly paid shares to leave working capital at Rs.30,000/-.

Pass necessary journal entries in the books of the company assuming that scheme has been put through fully & prepare the Balance Sheet after reconstruction. Ignore narration.

Solution:

In the books of Ms. Katrina Ltd.

Date	**Particulars**	**Debit(Rs.)**	**Credit (Rs.)**
Dec. 31 1.	Preference Share Capital A/c................ Dr. To Preference Shareholders A/c To Capital Reduction A/c	5,00,000	 2,50,000 2,50,000
2.	Capital Reduction A/c ....Dr. To Preference Shareholders A/c	50,000	 50,000
3.	9% Debenture A/c ....Dr. Interest o/s on debenture A/c ....Dr. To 12% Debentures A/c To Capital Reduction A/c	7,00,000 1,00,000	 7,00,000 1,00,000
4.	ICICI Loan A/c.................................... Dr. Outstanding interest A/c .... Dr. To Bank A/c To Capital Reduction A/c	1,80,000 30,000	 1,86,000 24,000
5.	Capital Reduction A/c ....Dr. To Profit & Loss A/cTo Goodwill A/c To Investment A/cTo Debtors A/c To Fixed Assets A/c	7,65,000	4,00,000 50,000 10,000 2,50,000 50,000
	To Bank (Expenses) A/c		5,000

6.	Creditors A/c.. Dr. To Bank A/c To Capital Reduction A/c	2,00,000	 1,60,000 40,000
7.	Preference Shareholders A/c ....Dr. To Bank A/c	3,00,000	 3,00,000
8.	Equity Share Capital A/c ....Dr. To Capital Reduction A/c	4,01,000	 4,01,000
9.	Bank A/c .... Dr. To Equity Share Capital A/c	6,81,000	 6,81,000

Working Note:

Bank Account

Dr.Cr.

Particulars	**Amt.**	**Particulars**	**Amt.**
To Equity Share Capital A/c (Bal Figure)	6,81,000	By Creditors A/c By Expenses A/c By Loan Interest A/c By Preference Share Capital A/c By Closing Balance	1,60,000 5,000 1,86,000 3,00,000 30,000
	6,81,000		6,81,000

Capital Reduction Account

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
To Preference Dividend A/c	50,000	By Preference Shareholders A/c	2,50,000
To Sundries A/c	7,65,000	By Debenture Interest A/c	1,00,000
		By Interest A/c	24,000
		By Creditors A/c	40,000
		By Equity Share Capital A/c	4,01,000
	8,15,000		8,15,000

Balance Sheet as on 1st April, 2015

Particulars	Notes	Rs.	Rs.
I. Equity and Liabilities			
1. Shareholders' Funds			
Share Capital	1		22,80,000
2. Non-Current Liabilities			
Long Term Borrowings 12% Debentures			7,00,000
Total			**29,80,000**
II. Assets			
1. Non current Assets			
a. Tangible Assets			15,00,000
b. Non Current Investments			1,00,000
2. Current Assets			
Inventories	2	3,00,000	
Trade Receivables		10,50,000	
Cash & Cash equivalents		30,000	13,80,000
Total			**29,80,000**

Notes to Accounts

Note – 1 Share Capital	Number	Rs.
Authorised Share Capital		
Issued, Paid Up Share Capital		
Equity Share Capital		
200000 Equity Shares of Rs. 20, Rs.11.4 paid up	200000	22,80,000
		22,80,000

Note – 2 Trade Receivables	Rs.	Rs.
Debtors		
Bills Receivables	2,50,000	
	8,00,000	10,50,000
		10,50,000

Illustration 5

The Balance Sheet of Three Idiots Ltd. as at 31st March 2015 was as under

Liabilities	Rs.	Assets	Rs.
10,000 Equity Shares of Rs.50/- each fully paid	5,00,000	Goodwill	1,00,000
10%, 50,000 Debentures of Rs.10/- each	5,00,000	Other Assets	8,00,000
Interest on debenture	20,000	Profit & Loss A/c	3,00,000
Sundry Creditors	1,80,000		
	12,00,000		12,00,000

For the purpose of reconstruction of the company, necessary resolutions are passed on the following lines.

1) The Equity Shares are to be sub divided into Share of Re.1/- each & each shareholder shall re-surrender 80% of his holding.

2) Out of the surrendered shares, 1,00,000 shares will be converted to 8% Preference Shares of Rs.10/- each.

3) Debentures holders will reduced their claims by Rs.2,20,000/- & in consideration they are to get the entire Preference Shares Capital converted from Shares Surrendered.

4) Creditors claims are to be reduced to the extent of Rs.80,000/-& in consideration they are to received Equity Shares of Re.1/- each, amounting to Rs.50,000/- from the Shares surrendered.

5) Goodwill & profit & loss A/c (Dr.) are to be written off fully.

6) The remaining surrendered shares shall be cancelled.

You are required to give the journal entries for the above & prepare Balance sheet of the company after reconstruction.

Journal entries in the books of Three Idiots Ltd.

Date	Particulars	Debit(Rs.)	Credit (Rs.)
1.	Equity Share Capital A/c (50)..................Dr. To Equity Share Capital A/c (1) (Being 10,000 Equity Shares of Rs.50/- each sub-dividend into shares of Re.1/- each.)	5,00,000	 5,00,000
2.	Equity Share Capital A/c .... Dr. To Share Surrendered A/c (Being surrender of 80% of shares.)	4,00,000	 4,00,000
3.	Shares Surrendered A/c .... Dr.	1,00,000	
	To 8% Preference Share Capital A/c (Being converted Rs.1,00,000/- shares surrendered into 80% Preference Shares Capital.)		1,00,000
4.	10% Debentures A/c ....Dr. Interest Debenture A/c .... Dr. To Capital Reduction A/c (Being reduction in the claim of debenture holders.)	2,00,000 20,000	 2,20,000
5.	Share Surrendered A/c .... Dr. To Equity Share Capital A/c (Being issued to Creditors out of surrendered Shares.)	50,000	 50,000

6.	Creditors A/c.. Dr. To Capital Reduction A/c (Being reduced the claim of creditors.)	80,000	 80,000
7.	Capital Reduction A/c.............................Dr. To Goodwill A/c To Profit & Loss A/c (Being written off Goodwill & Profit & LossAccount debit balance.)	4,00,000	 1,00,000 3,00,000
8.	Shares Surrendered A/c .... Dr. To Capital Reduction A/c (Being cancelled remaining Surrendered Shares.)	2,50,000	 2,50,000
9.	Capital Reduction A/c.............................Dr. To Capital Reserve A/c (Being the balance on Capital Reduction transferred to Capital Reserve.)	1,50,000	 1,50,000

Capital Reduction Account

Dr.Cr.

Particulars	Amt.	Particulars	Amt.
To Goodwill A/c To Profit & Loss A/c To Capital Reserve A/c	1,00,000 3,00,000 1,50,000	By 10% Debentures A/c By Interest A/c By Share SurrenderedA/c By Creditors A/c	2,00,000 20,000 2,50,000 80,000
	5,50,000		5,50,000

Three Idiots Ltd. (And reduced) Balance sheet as on 1st April , 2015

Particulars	Notes	Rs.	Rs.
I. Equity and Liabilities			
1. Shareholders' Funds			
a. Share Capital	1	2,50,000	
b. Reserves and Surplus	2	1,50,000	4,00,000
2. Non-Current Liabilities Long Term Borrowings 10% Debentures			3,00,000
3. Current Liabilities			
Trade Payables			1,00,000
Total			**8,00,000**
II. Assets			
1. Non current Assets			
Tangible Assets			8,00,000
Total			**8,00,000**

Notes to Accounts

Note – 1 Share Capital	Number	Rs.
Authorised Share Capital	-	-
Issued, Paid Up Share Capital		
Equity Share Capital	150000	1,50,000
Equity Shares of Re. 1 each Preference Shares of Rs. 10 each	10000	1,00,000
		2,50,000

Note – 2 Reserves & Surplus	Rs.	Rs.
Capital Reserve:		
(transf. from Capital Reduction A/c)		1,50,000

Illustration 6

Following is the balance sheet of Veer Ltd. as on 31st March 2015.

Liabilities	Rs.	Assets	Rs.
10,000 8% Cumulative Preference Shares of Rs.100/- each	10,00,000	GoodwillPatents	90,000
8,000 Equity Shares of Rs.100/- each	8,00,000	Land & Building Pant	30,000
9% Debentures of Rs.100/- each (Secured on Land / Building)	7,00,000	& Machinery	10,00,000
Interest payable to debenture holders	20,000	Investment (at cost)	4,80,000
Loan from Directors	2,00,000	Stock	50,000
Creditors	3,00,000	Debtors : Considered Goods 3,00,000Considered Doubtful 70,000	4,80,000
			3,70,000
		Cash	5,000
UTI Bank Overdraft	2,80,000	Preliminary Expenses	95,000
		Profit & Loss A/c	7,00,000
	33,00,000		33,00,000

Contingent Liabilities:

1) Claims for damages pending in the court totaling Rs.1,00,000/-

2) Arrears of Preference dividend Rs.300000/-.

The board of directors agreed to present the realistic picture of the state of affairs of the company's position & the following scheme of reconstruction was duly approved.

1) The Preference shares were to be reduced to an equal number of fully paid Preference Shares of Rs.50/- each. Equity Share toan equal number of fully paid Equity Shares of Rs.30/- each.

2) All intangible assets, including patents to be written off.

3) Stock to be revalued at Rs.4,00,000/- & debtors considereddoubtful to be written off.

4) Preference Shareholders agreed to waive half of the arrears of dividends & to receive Equity Shares in lieu of the balance.

5) Debenture holder agreed to take over part of the security of the book value of Rs.2,00,000/- for Rs.2,00,000/- in satisfaction of part of their claim & to provide further cash of Rs.1,00,000/- after deducting arrears

of interest due to them on floating charge of the rest of the assets.

6) The contingent liability for claims for damage pending in the court of law materialized to the full extent. However, the company could recover Rs.80,000/- from those who were responsible for such damages & settled the rest by issuingEquity Shares.

7) The Directors agreed to convert the loan into Equity Shares. You are required to prepare –

i) Capital Reduction Account

ii) The Balance sheet after reconstruction

Solution:

In the books of Veer Ltd. Capital Reduction Account

Dr. Cr.

Particulars	**Amt.**	**Particulars**	**Amt.**
To Goodwill A/c To Patents To Preliminary Expenses A/c	90,000 30,000 95,000	By Preference Share Capital A/c By Equity Share Capital A/c	5,00,000 5,60,000
To Profit & Loss A/c To Stock (4,80,000 - 4,00,000) To Debtors To Preference Dividend A/c To Cash A/c (damages) To Damages A/c To Capital Reserve A/c	7,00,000 80,000 70,000 1,50,000 80,000 20,000 60,000	By Cash A/c (claim recovery) By Land & Building A/c (3,00,000 - 2,00,000)	80,000 1,00,000
	12,40,000		12,40,000

Working Note:

1) Equity Shares @ Rs.30/- each

	Nos.	Amount
Original (at Reduced Value)	8,000	2,40,000
Issued against arrears of Preference Dividend	500	15,000
Issued against claim for Damages	666.67	20,000
Loan from Directors converted	6,666.67	2,00,000
Closing Balance	15,833	4,75,000

2) Cash Account

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
To Balance b/d	5,000	By Debenture interest A/c	20,000
To Damages Claim A/c	80,000	By Recovery A/c	80,000
To Debenture holders A/c	1,00,000	By Balance c/d	85,000
	1,85,000		1,85,000

3) It is assumed that the debenture holder brought in gross Rs.1,00,000/- without deducting Rs.20,000/- for arrears of interest.

4) 9% debenture holders

	Amount
Balance	7,00,000
Less : Land / Building taken over	3,00,000
	4,00,000
Add : Further Cash brought in	1,00,000
Closing Balance	5,00,000

Veer Ltd. (And reduced) Balance Sheet as on 1st April 2015

Particulars	Notes	Rs.	Rs.
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
a. Share Capital	1	9,75,000	
b. Reserves & Surplus	2	60,000	10,35,000
2. Non-Current Liabilities			
Long Term Borrowings			5,00,000
(Secured 9% Debentures)			
3. Current Liabilities			
a. Trade Payables			
b. Short -Term Liabilities(UTI Bank Overdraft)		3,00,000	
		2,80,000	5,80,000
Total			**21,15,000**
II. ASSETS			
1. Non current Assets			
a. Fixed Assets			
- i. Tangible Assets	3		12,80,000
b. Non Current Investment			50,000
2. Current Assets			
a. Inventories		4,00,000	
b. Trade Receivables	4	3,00,000	
c. Cash & Cash Equivalents		85,000	7,85,000
Total			**21,15,000**

Notes to Accounts

Note – 1 Share Capital	**Number**	**Rs.**
Authorised Share Capital		
Issued, Paid Up Share Capital		
Equity Share Capital	15,833	4,75,000
Equity Shares of Rs. 30/- each Preference Share Capital		
8 % Pref. Share of Rs. 50/- each	10,000	5,00,000
		9,75,000

Note – 2 Reserves & Surplus	**Rs.**	**Rs.**
Capital Reserve: Balance		60,000
(transf. from Capital Reduction A/c)		

Note – 3 Tangible Assets	**Rs.**	**Rs.**
Land & Building	10,00,000	
Less: Given to Debenture holders	2,00,000	8,00,000
		4,80,000
Plant & Machinery		
		12,80,000

Note – 4 Trade Receivables	**Rs.**	**Rs.**
Balance		3,00,000
(Unsecured, Considered Good)		

Illustration 7

Monaco Ltd. had adverse trading for past few years resulting in accumulated losses & over valued assets. It's Balance Sheet as on 31st March 2015 is as follows.

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital		Goodwill	60,000
(in shares of Rs.10/-		Freehold Property	70,000
each)		Leasehold Property	1,50,000
50,000 Equity Share Capital		Plant Investment Stock Debtors	1,40,000
	5,00,000		80,000
40,000 Preference Share Capital		Profit & Loss A/c	
			1,00,000
Securities Premium 12% Debenture	4,00,000		5,00,000
	30,000		2,00,000
	1,20,000		
Accrued Interest	10,000		
Creditors	1,10,000		
Overdraft	1,30,000		
	13,00,000		13,00,000

Note : Preference dividend is unpaid for past three years.

The shareholders & the court approved the following scheme of reconstruction.

1) The paid – up value of preference shares and Equity shares was to be reduced by 50% & 85% respectively. The face value will remain unchanged.

2) The Preference dividend for one years is to be paid by allotment of Equity shares credited Rs.2/- per share. The remaining amount to be cancelled.

3) The debenture holders took over Freehold property which was mortgaged in their favour. This property realized Rs.1,40,000/-. The balance amount after adjusting principal & interest washanded over to the company.

4) The investments are sold for Rs.1,00,000/-.

5) Obsolete Stock worth Rs.25,000/- & irrecoverable debt worth Rs.15,000/- are to be written off along with goodwill & profit & loss A/c.

6) There was a claim against company not provided to the extent of Rs.1,00,000/-. This was settled for Rs.83,000/-.

7) A call @ Rs.3/- per share on revised Equity & Preference shares was made. This was paid by all shareholders.

8) The authorized capital was suitably revised from Rs.8,00,000/- to Rs.12,00,000/- which was equally divided between Equity & 8% Preference shares.

9) Remaining bank balance to be utilized to pay bank overdraft.

You are required to show journal entries & balance sheet after implementation of the scheme.

Solution:

Journal in the books of Monaco Ltd.

Sr. No.	**Particulars**	**Debit(Rs.)**	**Credit (Rs.)**
1.	8% Preference Share Capital A/c ……Dr. To Capital Reduction A/c (Being reduced Preference share by 50%.)	2,00,000	 2,00,000
2.	Equity Share Capital A/c Dr. To Capital Reduction A/c (Being 50,000 Equity shares of Rs.10/- each reduced by 75%.)	4,25,000	 4,25,000
3.	Capital Reduction A/c .... Dr. To Equity Share Capital A/c (Being 10,667 Equity shares of Rs.3/- each allotted to satisfy the arrears of preference dividend for 1 year.)	32,000	 32,000
4.	12% Debenture A/c ....Dr. Accrued Interest on Debenture A/c … Dr. Bank A/c..Dr. To Freehold Property A/c To Capital Reduction A/c	1,20,000 10,000 10,000	 70,000 70,000

	(Being Freehold property of Rs.70,000/- taken by debenture holders, remaining amount paid by the debenture holders.)		
5.	Bank A/c ....Dr. To Investment A/c To Capital Reduction A/c (Being sold out investments at a profit of Rs.20,000/-.)	1,00,000	 80,000 20,000
6.	Capital Reduction A/c Dr. To Stock A/c To Debtors A/c To Goodwill A/c To Profit & Loss A/c (Being written off Stock, Debtors, Goodwill & Profit and Loss debit balance as agreed upon.)	3,00,000	 25,000 15,000 60,000 2,00,000
7.	Capital Reduction A/c Dr. To Bank A/c (Being settled the claim.)	83,000	 83,000
8.	Preference Share Call A/c ....Dr. To 8% Preference Share Capital A/c (Being made a call on 40,000 Preference Share @ Rs.3/- each.)	1,20,000	 1,20,000
9.	Equity Share Call A/c .... Dr. To Equity Share Capital A/c (Being made a call on 66,000 Equity shares @ Rs.3/- each.)	1,98,000	 1,98,000
10.	Bank A/c ....Dr. To Preference Share Call A/c To Equity Share Call A/c (Being collected call money.)	3,18,000	 1,20,000 1,98,000
11.	Bank overdraft A/c ....Dr. To Bank A/c (Being cleared Bank overdraft.)	1,30,000	 1,30,000
12.	Capital Reduction A/c Dr. To Capital Reserve A/c (Being Capital Reserve account closed)	3,00,000	 3,00,000

Capital Reduction Account

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
To Equity Share Capital A/c To Stock A/c	32,000 25,000	By Preference CapitalA/c By Equity Share Capital	2,00,000
To Debtors A/c To Goodwill A/c To Profit & Loss A/c To Bank A/c To Capital Reserve A/c	15,000 60,000 2,00,000 83,000 3,00,000	A/c By 12% Debenture A/cBy Bank A/c	4,25,000 70,000 20,000
	7,15,000		7,15,000

Bank Account

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
To Freehold Property A/c To Investment A/c To Capital Reduction A/c To Preference Share Capital A/c To Equity Share Capital A/c	 10,000 80,000 20,000 1,20,000 1,98,000	By Capital Reduction A/c By Bank overdraft A/c By Balance c/d	83,000 1,30,000 2,15,000
	4,28,000		4,28,000

Monaco Ltd. (And reduced) Balance Sheet as on 1st April, 2015

Particulars	Notes	Rs.	Rs.
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
a. Share Capital	1	6,25,000	9,55,000
b. Reserves & Surplus	2	3,30,000	
2. Current Liabilities			
a. Trade Payables			1,10,000
Total			**10,65,000**
II. ASSETS			
1. Non current Assets			
a. Fixed Assets			
- i. Tangible Assets	3		2,90,000
2. Current Assets	4	75,000	
a. Inventories	5	4,85,000	
b. Trade Receivables			
c. Cash & Cash Equivalents		2,15,000	7,75,000
Total			**10,65,000**

Note – 1 Share Capital	Number	Rs.
Authorised Share Capital		
Equity Share of Rs.10/- each	60,000	6,00,000
8% Preference share of Rs.10/- each	60,000	6,00,000
	1,20,000	**12,00,000**
Issued, Paid Up Share Capital		
Equity Share Capital		
Equity Shares of Rs. 10/- each Rs.5/- paid up	61,000	3,05,000
Preference Share Capital		
8 % Pref. Share of Rs. 10/- each	32,000	3,20,000
		6,25,000

Note – 2 Reserves & Surplus	Rs.	Rs.
Security Premium: Balance Capital Reserve: (transf. from Capital Reduction A/c)	30,000 3,00,000	 3,30,000

Note – 3 Tangible Assets	Rs.	Rs.
Leasehold Property Plant & Machinery	1,50,000 1,40,000	 2,90,000

Note – 4 Inventories	Rs.	Rs.
Balance Less : written off	1,00,000 -25,000	 75,000

Note – 5 Trade Receivables	Rs.	Rs.
Balance Less : written off	5,00,000 -15,000	 4,85,000

Illustration 9

The paid – up Capital of Fast traler Ltd. amounted to Rs.12,00,000/- consisting of 6,000 – 5% Cumulative Shares ofRs.100/- each and 60,000 Equity Shares of Rs.10/- each. The Preference dividend was in arrears for Rs.80,000/- (Contingent Liability)

The company incurred heavy losses continuously. Therefore, the Directors recommended to the shareholders the following scheme of reconstruction to provide a sum sufficient for the following purpose :

1) To write down the book value of Patents by Rs.2,00,000/-, Plant & Machinery by Rs.24,000/- and Tools & Equipments by Rs.8,000/-.

2) To write off the debit balance of Profit & Loss Account of Rs.2,96,000/-.

3) Any balance made available by the reduction of capital is to be utilized to write off "Experiment & research expenses"

4) The scheme duly approved & authorized provided the following.

i) For every 15, 5% Preference Shares, 8 – 4% Cumulative Preference Shares of Rs.100/- each & 40 Equity shares of Rs.2/- each are to be issued.

ii) For every Rs.20/- of Cumulative Preference Divided; 2 Equity shares of Rs.3/- each are to be issued.

iii) For every 10 old Equity shares, 2 new Equity shares of Rs.2/- each are to be issued.

You are required to:

Pass journal entries in the books of the company to record the above transactions. Prepare Capital Reduction Account.

Solution:

Journal of Fast Traler Ltd.

Date	Particulars	Debit (Rs.)	Credit (Rs.)
1.	5% Preference Share Capital A/c ………Dr. To 4% Cumulative Preference Share Capital A/c To Equity Share Capital A/c To Capital Reduction A/c (Being issued 3200, 4% Preference shares of Rs.100/- each & 24,000 Equity Shares of 5% Preference shares Capital.	6,00,000	 3,20,000 48,000 2,32,000
2.	Capital Reduction A/c..................................Dr. To Equity Share Capital A/c (Being issued 6,000 Equity shares of Rs.3/- each in settlement of arrears of Preference dividend.)	18,000	 18,000

3.	Equity Share Capital A/c .... Dr. To Equity Share Capital A/c To Capital Reduction A/c (Being issued 12,000 Equity share of Rs.2/- each to the existing Equity shareholders.)	6,00,000	24,000 5,76,000
4.	Capital Reduction A/c .... Dr. To Patents A/c To Plant & Machinery A/c To Tools & Equipment A/cTo Profit & Loss A/c To Experiment & Research Expenses A/c (Being written off Patents, Plant & Machinery, Tools & Equipments , Profit & Loss A/c, Debit balance & Experiment & Research Expenses as agreed upon.)	7,96,000	2,00,000 24,000 8,000 2,96,000 2,68,000

Capital Reduction Account

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
To Equity Share Capital A/c To Patents A/c To Plant & Machinery A/c To Tools & Equipment A/c To Profit & Loss A/c To Experiment & Research Expenses A/c	 18,000 2,00,000 24,000 8,000 2,96,000 2,62,000	By 5% Preference Share Capital A/c By Equity Share Capital A/c	2,32,000 5,76,000
	8,08,000		8,08,000

12.2 EXERCISES:

12.2.1 OBJECTIVES QUESTIONS

- **Filling the blanks.**

1) Capital Reduction is implemented per section_____ofCompanies Act.
2) The scheme of Capital reduction is to be approved by_.
3) Fictitious assets are to be transferred to______________________________.
4) Balance in Capital Reduction should be transferred to______.
5) The payment for contingent liability should be debited to_.
6) And reduced words are to be shown as in Balance sheet as per __________required.
7) XYZ Ltd. has on 31st March, 2015 1,00,000 Equity shares at Rs.10/- each. It was decided to reduced share to Rs.6/- each. The reduction is __________.
8) The Preference shareholders agree to Forgo arrears of Preference dividend Rs.1,00,000/-. The amount transferred to Capital Reduction Account is_.
9) Debtors costing of Rs.56,000/- given to Bank for bank loan of Rs30,000/-. The Capital reduction is debited by Rs._.
10) Provision for taxation is Rs.1,62,000/-. The tax liability of the company is settled at Rs.1,40,000/- & it is paid immediately. Amount credited to Capital Reduction is____________________________________.

(Ans – 1) 100, 2) High court, 3) Capital reduction, 4) Capital Reserve,

5) Capital Reduction, 6) Company law, 7) 4,00,000, 8) Nil, 9) 26.000 10)

22,000.)

1) The capital reduction means reduction in_________valueof shares.
2) The sub division of shares does not result in_______ofcapital.
3) The shareholders can surrender shares for ______or________.
4) _________resolution is to be passed by shareholders forapproval of scheme or reconstruction.
5) The Fictitious debit balances are to be transferred to___Account.
6) The full balance of Capital is to be debited, if ____ value is reduced.
7) Shareholders not approving scheme is called _____ shareholders.

8) The expenses for forming & implementing scheme should be debited to__.

9) The scheme of internal reconstruction can be utilized to provide___ __________for the company.

(Ans – 1) Paid-up Value, 2) Reduction, 3) Re-issue, cancellation, 4) Special, 5) Capital Reduction, 6) Face, 7) dissenting, 8) Capital Reduction, 10) Funds.

- **Match the following.**

1)

Group "A"	Group "B"
1) Capital Reduction	a) Profit& loss Ac (Dr.bal)
2) Fictitious Balance	b) Section 100
3) Capital Reduction Scheme	c) No reduction of Capital
4) Consolidation of Share	d) Internal Reconstruction
5) Subdivision of Share	e) No Change in Capital

(Ans : 1 – b, 2 – a, 3 – d, 4 – e, 5 – c.)

2)

Group "A"	Group "B"
1) Surrender of share	a) Credit – Capital reduction
2) Cancellation of surrendered shares	b) Unchanged Capital
3) Surplus on revaluation of assets	c) Transfer to Capital Reserve
4) Loss on revaluation ofassets	d) Transfer to Capital Reduction
5) Credit balance in Capital Reduction	e) Debit Capital Reduction

(Ans : 1 – b, 2 – a, 3 – c, 4 – e, 5 – d.)

3)

Group "A"	Group "B"
1) Balance sheet after reduction	a) Not transferable to Capital Reduction
2) Statutory Reserve	b) Transfer difference to Capital Reserve
3) Expenses of Scheme	c) Cancel present capital, raise new capital & difference toreduction
4) Reduction in paid up value of shares	d) Indicate, & reduced
5) Reduction in face value of debenture	E) Debit capital reduction account

(Ans – 1 – d, 2 – a, 3 – e, 4 – b, 5 – c.)

- **True or False.**

1) Capital Reduction & Internal reconstruction is synonym. – True
2) Consolidation of shares result in profit for a company. – False
3) Sub – division of shares result in gain for a company. – False
4) Provision for unrecorded liability indicates loss to a company. –True
5) Accounting for Internal & External reconstruction is in identical manner. – False
6) Authorised Share Capital is to be reduced to the extent of Capital Reduction. – False
7) Cancellation of contingent liability is treated as profit to thecompany. – False
8) Re – classification of surrendered shares should not beaccounted. – True
9) The requirements of schedule VI is to be complied while preparing account after internal reconstruction. – True
10) Internal reconstruction scheme cannot be prepared to cover capital reconstruction. – False

12.2.2 PROBLEMS FOR PRACTICE

1) Following is the balance sheet of Vinayak Ltd. as on 31st March,2015.

Liabilities	**Rs.**	**Assets**	**Rs.**
60,000 10% Cumulative Preference Share of Rs.10/- each fully paid up 1,50,000 Equity share	6,00,000	Goodwill Land & Building Plant & Machinery Stock Trade Debtors	2,00,000 19,50,000 70,000 4,00,000 2,88,000
of Rs.10/- each, fully paid up Loans Creditors	15,00,000 2,22,000 7,50,000	Bank Balance Profit & Loss A/c	1,26,000 38,000
	30,72,000		30,72,000

Note: Preference dividend was in arrears Rs.1,20,000/-. The Board of Directors of the company decided upon the following scheme of reconstruction, which was approved by all concerned.

1) Paid up value of Equity shares shall be reduced to Rs.5/- per share, face value being Rs.10/-.
2) Preference shares are to be converted into 13% debentures of Rs.100/- each with regard to their 20% of dues (including arrears of Preference dividend) & for the balance (including dividend arrears) prefrence, shares of Rs.10/- each (Rs.5/- paid up shall be issued.)
3) All Equity shareholders agreed to pay the balance amount, making shares full paid up.
4) The Plant & Machinery was revalue at Rs.1,00,000/-.
5) The value of Stock was reduced by Rs.50,000/-.
6) Land & Building shall be written down to Rs.16,50,000/-.
7) Creditors agreed to Forgo their claims by 50%.
8) Loans was fully settled for Rs.2,00,000/-.
9) Goodwill, debit balance of profit & loss Account shall be writtenoff.
10) Cost of reconstruction of Rs.2,000/- was paid. Above resolution was carried out

You are required to:

i) Pass journal entries in the books of the company.

ii) Prepare Capital Reduction Account

iii) Prepare Balance sheet after reconstruction

(Ans : Capital Reserve – Rs.2,000/-, Tally – 30,43,000/-)

2) The ledger balance of ZEE TV Ltd. include Building Rs.6,10,000/-, Furniture Rs.2,00,000/-, Computer Rs.3,00,000/-, Debtors Rs.3,00,000/-, Preliminary Expenses Rs.20,000/-, Cash at Bank Rs.80,000/-, Bills Receivable Rs.2,50,000/-, Stock Rs.40,000/-, 8% Preference Share Capital – 2,000 shares Rs.100/- each, Equity Share Capital – 80,000 shares of Rs.10/- each, 'A' 10% Debentures Rs.4,00,000/-, 'B' 12% Debenture Rs.5,00,000/-, Outstanding Interest for one year on Debentures Rs.1,00,000/-.

Creditors Rs.4,00,000/-, Bills Payable Rs.50,000/-, Outstanding Audit Fees Rs.50,000/-, Profit & Loss Account

The company has incurred heavy losses. The following scheme of reconstruction is agreed upon.

1) 8% Preference shares are to be reduced by Rs.20/- per share, Equity shares be reduced by Rs.5/- per share.

2) To settle the claim of holders of 'A' 10% Debenture by issue of new 11% Debenture of Rs.2,00,000/-, 'A' Debenture holders agree to forgo their interest.

3) To settle the claim of holders of 'B' 12% Debenture by issue of new 13% Debenture of Rs.5,00,000/- outstanding Debenture interest on 'B' 12% Debenture holders be paid.

4) To write off Fictitious assets & debit balance of Profit & Loss Account.

5) Director refund Rs.60,000/- fees previously received by them.

6) Computer was to be written down by Rs.20,000/-.

You are required to show :

a) Journal entries to record the above transactions in books of ZEE Ltd.

b) Balance sheet before reconstruction

c) Balance sheet after reconstruction.

Assume that all the formalities are duly complied.

(Ans : Balance sheet before reconstruction Tally – Rs.25,00,000/-, Balance sheet after reconstruction Tally – Rs.17,60,000/-, Capital Reduction – Rs.7,40,000/-.)

❖❖❖❖

4

BUY BACK OF EQUITY SHARES

Unit Structure

4.0 OBJECTIVES:

After studying the unit the students will able to:

- Distinguish between Redemption of Preference shares and buy back of Equityshares.
- Understand the need and objectives of Buy Back.
- Explain the Legal provision for Buy Back.
- To prepare the balance sheet post buyback

4.1 INTRODUCTION:

When any company buys back its shares from the existing shareholders it is called as buy back of equity shares. Usually shares are bought back at a price higher than its market price.

Buyback is done in order to reduce the number of shares outstanding thereby increasing the share in dividend per share.

4.2 DIFFERENCE BETWEEN BUY BACK AND REDEMPTION OF SHARES:-

- ➢ Buy back is associated with Equity shares whereas redemption is related to Preference Shares and Debentures.
- ➢ Equity is a permanent capital of the company and has no maturity term therefore it cannot be redeemed on the other hand preference shares and debt instruments are issued with a fixed maturity term therefore they are redeemed on maturity.
- ➢ Company cannot buy back its entire equity capital but a company has to redeem the entire amount of preference capital and debt capital on its maturity date.
- ➢ Company has to follow the guidelines of SEBI and section 68 in buying back its Equity shares but the provisions of 68 are not

applicable for redemption of Preference shares or other Debt Instruments.

- Buyback of equity shares results in consolidation of capital but redemption of preference shares and debt instruments results in cancellation of such capital.

Following are the reasons for buy back:-

- To increase the dividend per share-
  Due to decrease in number of shares outstanding after buy back the share in dividend per share increases. Thus the company is able to give better returns to its equity shareholders.

- Optimum utilization of capital-
  Buyback is done using free reserves of the company. Company having sufficient amount of free reserves can only opt for buy back of equity. Company utilizes free reserves to pay off equity shareholders which helps in optimum utilization of funds and mobilization of the idle funds.

- Improve the EPS Ratio-
  Buy back leads to decrease in number of outstanding shares which further leads to improvement in companies Earnings per Share.

- To enhance the consolidation of stake in the company-
  Decrease in number of outstanding shares of a company also leads to consolidation in the stake of company which gives better returns to the remaining shareholders.

- To support the share price -
  If a company’s share is underperforming in the market than buyback of share may help the company in improving its ratios and return to equity shareholders which in turn will attract the attention of investors thereby improving its market price.

- To improve the ratios of the company-
  Buyback helps the company to improve its return on equity, return of capital employed and net worth of the company. Improvement in the ratios depicts a positive image of the company in the eyes of investors and also helps in improving its performance in the market.

Advantages of Buyback:-

- Improves the EPS Ratio-
  Buy back leads to decrease in number of outstanding shares which further leads to improvement in companies Earnings per Share.

- Mode of Internal Reconstruction-
  It is one of the ways a company can use to correct its capital structure without requiring the permissions from the Company Law Board or the Court.

- Improves the ratios of the company-
  Buyback helps the company to improve its return on equity, return of capital employed and net worth of the company. Improvement in the ratios depicts a positive image of the company in the eyes of investors and also helps in improving its performance in the market.

- Increases the dividend per share-
  Due to decrease in number of shares outstanding after buy back the share in dividend per share increases. Thus the company is able to give better returns to its equity shareholders.

- Optimum utilization of capital-
  Buyback is done using free reserves of the company. Company having sufficient amount of free reserves can only opt for buy back of equity. Company utilizes free reserves to pay off equity shareholders which helps in optimum utilization of funds and mobilization of the idle funds.

- Acts as a booster-
  If a company's share is underperforming in the market than buyback of share may help the company in improving its ratios and return to equity shareholders which in turn will attract the attention of investors thereby boosting its market price.

Disadvantages of Buyback:-

- Fake Picture of a company-
  Buyback of share helps in boosting some ratios like EPS, Return on Investments and Return on Equity but this improvement in the ratio is because of the decline in number of outstanding equity shares and not because of the increase in profits of the company thus it depicts a fake picture to the investors of the company.

- Reduces the retained earnings of the company-
  Company has to use its free reserves for the purpose of buy back of shares therefore company pays off its equity shareholders from its retained earnings thereby reducing the funds of the company.

- Miss the opportunity-
  Company may miss some of the immediate market opportunities, even though if they are more profitable and revenue generating projects, due to lack of funds.

Methods of Buy Back:-

Equity shares can be bought back at either Par, Premium or Discount.

- Whenever company buys back the equity shares at a price higher than its face value it is called as buy back at premium.

- When such buy back is done at a price equal to face value it is called as buy back at par and

- When such buy back is done at a price less than the face value of shares it is called as buy back at discount.

4.3 GUIDELINES FOR BUY BACK:-

- **Provisions of Section 68:**
- Articles of Association-
  Articles of Association of the company should authorize such buy back of shares.

- Special Resolution-

Company willing to buy back up to 25 % of aggregate capital and reserves should pass a special resolution in shareholders meeting of the company.

- Board Resolution-

For buy back of shares up to 10% of Paid up capital and free reserves a company needs the approval from its board of directors.

- Fully Paid Shares-

Only fully paid equity shares can be brought back.

- Twelve Months-

The company should complete the process of buyback within a period of twelve months from the date of passing of special resolution.

- Maximum amount of Buy Back-

The amount to be paid in case of buy back of shares shouldnot exceed 25% of Paid up capital + Free reserves of the company

- Maximum Number of shares-

The number of shares to be brought back by the company in any financial year should not exceed 25% of it paid capital.

- Debt-Equity ratio-

Post buy back Debt-Equity ratio should not exceed 2: 1

- Issue of same class of shares-

A company cannot issue the same class of shares which it has brought back with in a period of six months from the date of completion of the buyback process.

- Destroy the shares-

Once the buyback process is complete the company should physically destroy the shares brought back by it.

- Capital Redemption Reserve-

A company should transfer a sum equal to capital value of shares bought back minus the capital value of new issue of shares to the Capital Redemption Reserve Account.

- Use of C.R.R-

Company shall use the balance in Capital Redemption Reserve Account only for the purpose of issue of Bonus Shares.

4.4 JOURNAL ENTRIES FOR BUY BACK OF EQUITY SHARES:-

Date	Particulars	l/f	Debit	Credit
	Conversion of Partly paid shares into fully paid:			
	Share final call A/c Dr		×××	
	To Share Capital A/c			×××
	Cash / Bank A/c Dr		×××	
	To Share final call A/c			×××
	New Issue of Shares:			
	At par			
	Cash / Bank A/c Dr		×××	
	To Share capital A/c			×××
	At Premium			
	Cash / Bank A/c Dr		×××	
	To Share capital A/c			×××
	To Securities Premium A/c			×××
	At Discount			
	Cash / Bank A/c Dr		×××	
	Discount on Issue of Shares A/c Dr		×××	
	To Share capital A/c			×××
	Sale of Investments :			
	At Profit			
	Cash / Bank A/c Dr		×××	
	To Investments A/c			×××
	To Profit & Loss A/c			
	At Loss			
	Cash / Bank A/c		×××	

	Dr Profit & Loss A/c Dr To Investments A/c		×××	 ×××
	Transfer to CRR: Free Reserves A/c Dr To Capital Redemption Reserve A/c		×××	×××
	Buy back of shares: **At par** Equity Share capital A/c Dr To Equity Shareholders A/c **At Premium** Equity Share capital A/c Dr Premium on Buyback A/c Dr To Equity Shareholders A/c **At Discount** Equity Share capital A/c Dr To Equity Shareholders A/c To Securities Premium A/c		××× ××× ××× ×××	××× ××× ××× ×××
	<u>Payment to Equity Shareholders:</u> Equity Shareholders A/c Dr To Cash / Bank A/c		×××	×××
	<u>Closing Premium on Redemption A/c:</u> Securities Premium A/c Dr To Premium on Redemption A/c		×××	×××

Examples of Free Reserves:

- Profit & Loss Account
- General Reserve
- Securities Premium
- Sinking Fund
- Dividend Equalization Reserve

Other Reserves not available for Buy-back:

- Revaluation Reserve
- Capital Redemption Reserve
- Debenture Redemption Reserve
- Forfeited Shares Account
- Capital Reserve
- Statutory Reserve

Practical Sums

Illustration 1:

Amit &Co. Ltd., wishes to buy back 10,000 Equity Shares of ₹ 10 each. For this purpose the company decided to issue equivalent amount of new preference shares of ₹10 each. Assume that the company complies with the buy-back conditions.

Solution:

Journal Entries in the books of Amit & Company Limited for the year ended___.

Particulars	Debit ₹	Credit ₹
Bank Account ……………………..….Dr. To Preference Share Capital A/c [Being 10,000 Preference shares issued at par]	1,00,000	 1,00,000
Equity Share Capital A/c…………………Dr. To Equity Shareholders A/c [Being Equity Shares due for buy-back]	1,00,000	 1,00,000
Equity Shareholders A/c…………………Dr. To Bank A/c [Being satisfied the claim of Equity Shareholders]	1,00,000	 1,00,000

Note:- Transfer to C.R.R = 0.

The entire amount of buyback is supported by way of new issue of Equity Shares.

Illustration 2:

Maruti Ltd., furnishes the following summarized Balance Sheet as at 31st March, 2021.

Particulars	₹ In '000'	₹ In '000'
Equity & Liabilities:		
Issued & Subscribed Capital-		
5,00,000 Equity shares of ₹ 10 each fully paid		5,000
Reserves & Surplus:		
Capital Reserve	20	
Revenue Reserve	8,000	
Securities Premium	1,000	
Profit & Loss Account	2,500	11,520
Non-Current Liabilities- 10% Debentures		400
Current Liabilities & Provisions		40
TOTAL		**16,960**
Assets:		
Fixed Assets	5,750	
Non-Current Investments	6,210	
Current Assets, Loans & Advances	5,000	
(including Cash & Bank balance)		
TOTAL		**16,960**

The company passed a resolution to buy back 20% of its equity capital at a premium of ₹ 5 per share. For this purpose, it sold its investments of ₹30,00,000 for ₹35,00,000.

Solution:

Date	Particulars	Debit ₹ In '000'	Credit ₹ In '000'
1.	Bank A/c…………………………..Dr To Investment A/c To Profit & Loss A/c [Being Sale of Investment at Profit]	3,500	 3,000 500
2.	Equity Share Capital A/c…………..Dr Premium on Buy back A/c…………Dr To Equity Shareholders A/c [Being the amount due on Buy back of 20% Equity Capital]	1,000 500	 1,500
4.	Securities Premium A/c……………Dr To Premium on Buy back A/c [Being Premium on buyback written off with the balance in Securities Premium]	500	 500
4.	Revenue Reserve A/c………………Dr To Capital Redemption Reserve A/c [Being transfer to C.R.R to the extent of buy back]	1,000	 1,000
5.	Equity Shareholders A/c ……….......Dr To Bank A/c [Being Payment made for the buyback of Equity]	1,500	 1,500

Particulars	₹ In ‘000’	₹ In ‘000’
Equity & Liabilities:		
Issued & Subscribed Capital-		
4,00,000 Equity shares of 10 each fully paid		4,000
Reserves & Surplus:		
Capital Reserve	20	
Revenue Reserve	7,000	
Securities Premium	500	
Profit & Loss Account	3,000	
Capital Redemption Reserve	1,000	12,520
Non-Current Liabilities- 10% Debentures		400
Current Liabilities & Provisions		40
TOTAL		**15,960**
Assets:		
Fixed Assets		
Non-Current Investments	5,750	
Current Assets, Loans & Advances	3,210	
(including Cash & Bank balance)	7,000	
TOTAL		
		15,960

Illustration 3:

Following is the summarized Balance sheet of Vishal Ltd. As at 31st March, 2021.

Liabilities	Amount ₹	Assets	Amount ₹
4,00,000 Equity Shares of ₹ 10 each	40,00,000	Fixed Assets	40,00,000
50,000 11.5% Preference Shares of ₹ 10 each	5,00,000	Stock	10,00,000
Revenue Reserve	4,50,000	Debtors	6,00,000
Profit & Loss Account	7,00,000	Bank	7,00,000
Securities Premium	1,50,000		
Creditors	15,00,000		
TOTAL	**73,00,000**	TOTAL	**73,00,000**

The company bought back 1,00,000 Equity Shares at par after complying with the legal formalities.

Solution:

Journal Entries in the books of Vishal Ltd. For the year ended 31st March, 2021.

Particulars	Debit ₹	Credit ₹
Equity Share Capital A/c …………..Dr	10,00,000	
To Equity Shareholders A/c		10,00,000
[Being Equity shares due for buy back at par]		
Revenue Reserve A/c………………Dr	4,50,000	
Profit & Loss A/c…………………..Dr	5,50,000	
To Capital Redemption Reserve A/c		10,00,000
[Being transfer to C.R.R to the extent of buy back]		
Equity shareholders A/c……………Dr	10,00,000	
To Bank A/c		10,00,000
[Being payment made to the Equity Shareholders]		

Illustration 4:

The summarized Balance sheet of Uma Ltd., shows the following balances as at 31st March, 2022.

Amt. ₹.

1,00,000 Equity Shares of ₹ 10 each (₹8 Paid up)	8,00,000
Securities Premium	50,000
General Reserve	1,00,000
Capital Redemption Reserve	1,00,000
Profit & Loss Account	1,50,000

The company decided to purchase 20,000 Equity shares at 10% Discount out of the reserve. The Company made a final call for the purpose of buyback and call money was duly received. The company incurred ₹ 5,000 worth of buyback expenses. Check if the company's decision is within the frame work of section 68 and pass necessary journal entries in the books of the company.

Solution:

Journal Entries in the books of Uma Ltd., for the year ended 31st March, 2022.

Particulars	**Debit ₹**	**Credit ₹**
Equity Share Final Call A/c…………….Dr	2,00,000	
To Equity Share Capital A/c		2,00,000
[Being Final Call made for ₹ 2 per share]		
Bank A/c………………………………..Dr	2,00,000	
To Equity Share Final Call A/c		2,00,000
[Being Final Call money received]		
Equity Share Capital A/c……………….Dr	2,00,000	
To Discount on Buyback A/c		20,000
To Equity Shareholders A/c		1,80,000
Discount on Buyback A/c………………Dr	1,00,000	
To Capital Reserve A/c		1,00,000
[Being transfer of balance in Discount A/c]		
General Reserve A/c……………………Dr	1,00,000	

Profit & Loss A/c………………………Dr To Capital Redemption Reserve A/c [Being transfer of Buyback amount to C.R.R. A/c]	1,00,000	2,00,000
Equity Shareholders A/c………………..Dr To Bank A/c [Being payment made for buyback of Equity share]	1,80,000	1,80,000
Buyback Expenses A/c…………………Dr To Bank A/c [Being Buyback expenses incurred & paid]	5,000	5,000

Working Notes:

1. Maximum Number of Shares that can be bought back Under Section 68:

25 % of No. of Equity Shares outstanding in the market

= 1,00,000 *25%

= 25,000 shares

Since company decided to buyback 20,000 Equity shares, this condition is fulfilled by the company.

2. Maximum Amount Payable on Buy back= 25% of Capital + Reserves

Equity Capital - 10,00,000

Securities Premium- 50,000

General Reserve- 1,00,000

Profit & Loss A/c- 1,50,000

TOTAL Own Fund = 13,00,000

25% =₹3,25,000.

Since Company is paying ₹. 1,80,000. The amount paid by the company on buyback is within the range of section 68.

4. Post Buy Back Debt Equity Ratio should not exceed 2:1:

Since the company does not have any Debt Capital nor does it issues any debt instrument during buyback therefore there is no question of exceeding the Debt –Equity Ratio.

Therefore buyback is completely within the limits of Section 68.

Illustration 5:

The Balance sheet of Asians Ltd. As at 31.04.21 was as follows:

Liabilities	Amount₹	Assets	Amount₹
Equity shares of Rs.10 each	6,00,000	Fixed Assets	10,00,000
Securities Premium	1,45,000	Investments	4,00,000
General Reserve	1,00,000	Current assets	4,00,000
Profit & Loss A/c	1,50,000		
Debenture	7,00,000		
Current Liabilities	1,05,000		
TOTAL	**18,00,000**	**TOTAL**	**18,00,000**

Calculate the maximum number of number of shares to be bought back and the offer price to be paid on buy back. Assuming that the buyback is done pass necessary journal entries in the books of the company.

Solution:

Particulars	Debit ₹	Credit ₹
Equity Share Capital A/c…………..Dr Premium on Buy back A/c…………Dr To Equity Shareholders A/c [Being the amount due on Buy back of 20% Equity Capital]	1,50,000 98,750	 2,48,750
Securities Premium A/c……………Dr To Premium on Buy back A/c [Being Premium on buyback written off with the balance in Securities Premium]	98,750	 98,750
Profit & Loss A/c…………………..Dr To Capital Redemption Reserve A/c [Being transfer to C.R.R to the extent of buy back]	1,50,000	 1,50,000
Equity Shareholders A/c ……….....Dr To Bank A/c [Being Payment made for the buyback of Equity]	2,48,750	 2,48,750

Working Note:

1.Maximum No. of Shares that can be bought back:

25% of Equity Shares outstanding in the Market

= 25% of 60,000

= 15,000 Shares.

2. Maximum Amount to be paid for buy back:

25% of Own Fund

Equity Capital	6,00,000	
Securities Premium		1,45,000
General Reserve	1,00,000	
Profit & Loss A/c		1,50,000
Total Own Fund	9,95,000	
25% of 9,95,000 =		**2,48,750**

4. Post Buyback Debt –Equity Ratio**:**

Debt 7,00,000

Therefore minimum Own Fund Post Buy back Should be at least half of Debt i.e ₹ 3,50,000

Amount available for buy back = 9,95,000 – 3,50,000 = **6,45,000/-**

4. Determination of Offer Price:

Total amount payable on buyback shall be Minimum of working not no. 2 and 3 above

= ₹ 2,48,750

Offer price per share = Amount Payable on Buyback /Maximum no. of Shares to be bought back

= 2,48,750 / 15,000

= ₹ 16.58/- per share

Illustration 6:

Zoomba Ltd. resolved to buy back 3,00,000 fully paid equity shares of ₹10 each at ₹13 per share. For the purpose, it issued 10,000 13% preference shares of ₹100 each at par, the total sum being payable with applications. The company uses ₹ 9,50,000 of its balance in Securities Premium Account apart from its adequate balance in General Reserve Account to fulfill the legal requirements regarding buy-back.

Pass journal entries for all the transactions involved in the buy-back.

Solution:

Journal Entries in the books of Zoomba Ltd., for the year ended 31st March, ____.

Particulars	**Debit ₹**	**Credit₹**
Bank A/c…………………………......Dr To 13% Preference Share Capital A/c [Being issue of Preference shares at par]	10,00,000	 10,00,000
Equity Share Capital A/c……………..Dr Premium on Buy back A/c……………Dr To Equity Shareholders A/c [Being the amount due on Buy back of 20% Equity Capital]	30,00,000 9,00,000	 39,00,000
Securities Premium A/c……………….Dr To Premium on Buy back A/c [Being Premium on buyback written off with the balance in Securities Premium]	9,00,000	 9,00,000
General Reserve A/c…………………..Dr To Capital Redemption Reserve A/c [Being transfer to C.R.R to the extent of buy back]	20,00,000	 20,00,000
Equity Shareholders A/c ……….........Dr To Bank A/c [Being Payment made for the buyback of Equity]	39,00,000	 39,00,000

Working Note:

1. Transfer to Capital Redemption Reserve A/c.

= Capital Value of Buy back - Capital value of New Issue of Shares

= 30,00,000 – 10,00,000

= 20,00,000

Illustration 7:

Sanjivani Ltd., a private company, had issued capital of ₹ 40 lakh divided into equity shares of ₹ 10 each. The balance in the Security Premium Account was ₹ 2 lakh and General Reserve ₹ 6 lakh. The company decided to buy-back 1,00,000 shares of ₹ 10 each at ₹ 8 per share. The company had issued 50,000, 10% Preference Shares ₹ 10 each 3 months back for the purpose of buy-back of equity shares. Record the transaction in the Journal of the company.

Solution:

Journal Entries in the books of Sanjivani Ltd., for the year ended 31st March, ____.

Particulars	**Debit ₹**	**Credit ₹**
Bank A/c…………………………......Dr To 10% Preference Share Capital A/c [Being issue of Preference shares at par]	5,00,000	 5,00,000
Equity Share Capital A/c……………..Dr To Discount on buy back A/c ………Dr To Equity Shareholders A/c [Being the amount due on Buy back of Equity Capital at discount]	10,00,000	 1,00,000 9,00,000
Discount on buy back A/c …………….Dr To Capital Reserve A/c [Being Discount on buyback written off]	1,00,000	 1,00,000
General Reserve A/c…………………..Dr To Capital Redemption Reserve A/c [Being transfer to C.R.R to the extent of buy back]	5,00,000	 5,00,000
Equity Shareholders A/c …………..........Dr To Bank A/c [Being Payment made for the buyback of Equity]	9,00,000	 9,00,000

Working Note:

1. Transfer to Capital Redemption Reserve A/c.

= Capital Value of Buy back - Capital value of New Issue of Shares

= 10,00,000 – 5,00,000

= 5,00,000

Illustration 8:

Sea Ltd., furnishes the following summarized Balance Sheet as at 31st March, 2021.

Particulars	Amount ₹	Amount ₹
Equity & Liabilities:		
3,50,000 Equity shares of ₹ 10 each	35,00,000	
2,000 12% Preference Shares of ₹100 each	2,00,000	
Reserves & Surplus:		
Capital Reserve	5,00,000	
Revenue Reserve	35,00,000	
Securities Premium	20,00,000	
Profit & Loss Account	30,00,000	
Current Liabilities & Provisions	14,00,000	
TOTAL		**1,41,00,000**
Assets:		
Fixed Assets	95,00,000	
Investments	31,00,000	
Current Assets	15,00,000	
TOTAL		**1,41,00,000**

The company passed a resolution to buy back 20% of its equity capital @ ₹. 40 per share.

In accordance to support this buyback, company sold all its investments for ₹ 25,00,000.

You are required to pass necessary journal entries in the books of the company also prepare the Vertical Balance Sheet post buyback.

Solution:

Journal Entries in the books of Sea Ltd., for the year ended 31st March, 2021.

Particulars	Debit ₹	Credit ₹
Bank A/c…………………………......Dr Profit & Loss A/c……………………..Dr To Investment A/c [Being sale of investment at loss]	25,00,000 6,00,000	 31,00,000
Equity Share Capital A/c……………..Dr Premium on Buy back A/c……………Dr To Equity Shareholders A/c [Being the amount due on Buy back of 20% Equity Capital]	7,00,000 21,00,000	 28,00,000
Securities Premium A/c……………….Dr Profit & Loss A/c……………………...Dr To Premium on Buy back A/c [Being Premium on buyback written off]	20,00,000 1,00,000	 21,00,000
Profit & Loss A/c……………………...Dr To Capital Redemption Reserve A/c [Being transfer to C.R.R to the extent of buy back]	7,00,000	 7,00,000
Equity Shareholders A/c ……….........Dr To Bank A/c [Being Payment made for the buyback of Equity]	28,00,000	 28,00,000

Post buyback Balance sheet of Sea Ltd., as at 31st March, 2021.

Particulars	Amount ₹	Amount ₹
Equity & Liabilities:		
2,80,000 Equity shares of ₹ 10 each	28,00,000	
2,000 12% Preference Shares of ₹100 each	2,00,000	
Reserves & Surplus:		
Capital Reserve	5,00,000	
Revenue Reserve	35,00,000	
Securities Premium	NIL	
Profit & Loss Account	16,00,000	
Capital Redemption Reserve	7,00,000	
Current Liabilities & Provisions	14,00,000	
TOTAL		**1,07,00,000**
Assets:		
Fixed Assets	95,00,000	
Investments	NIL	
Current Assets	12,00,000	
TOTAL		**1,07,00,000**

I. SELF-PRACTICE

Illustration 1:

The Balance sheet of Ram Ltd. as at 31-3-2022 is as follows.

Liabilities	Amount ₹	Assets	Amount ₹
SHARE CAPITAL:		Fixed Assets	80,00,000
Equity shares of Rs.10 each	50,00,000	Investments	50,00,000
RESERVES & SURPLUS:		Current assets	60,00,000
Securities Premium	5,00,000		
General Reserve	25,00,000		
Profit and loss account	20,00,000		
SECURED LOANS:			
Debentures	40,00,000		
CURRENT LIABILITIES & PROVISIONS:	50,00,000		
TOTAL	1,90,00,000	TOTAL	1,90,00,000

Keeping in view all the legal requirements, ascertain the maximum no. of equity shares that 0 Victory Ltd. can buy back if price settled is Rs.20 per share. Assume that the buy-back is carried out actually at the legally permissible terms, record the entries in the journal of Victory Ltd. and prepare its balance sheet thereafter.

Illustration 2:

The summarized Balance Sheet of Somnath Ltd. As on 1st March 2021 is as Follows:-

Particulars	**Amount ₹**
Equity & Liabilities:	
6,00,000 Equity shares of Rs. 10Each Fully Paid	60,00,000
Securities Premium	4,00,000
Profit and Loss Account	20,00,000
13% Debentures	18,00,000
Creditors	20,00,000
TOTAL	1,22,00,000
Assets:	
Fixed Assets	70,00,000
Investments	25,00,000
Current Assets	27,00,000
TOTAL	1,22,00,000

Ascertain the maximum number of equity shares the company can buyback at the maximum possible price under the law as on 31st March, 2021. Assuming the buyback is actually carried out, record the journal entries in the books of Somnath Ltd. Also prepare Notes to accounts with respect to share Capital and Reserve & Surplus as they would appear in Notes to accounts Forming part of the Balance Sheet of Somnath Ltd. As on 31st March, 2021.

Illustration 3:

The Balance sheet of Green Tea Ltd. as on 31-3-2022 is as follows:

Liabilities	**Amount₹**	**Assets**	**Amount₹**
SHARE CAPITAL:		FIXED ASSETS:	
Equity shares of Rs.10 each	4,00,000	Net block	9,00,000
Preference Shares of Rs.100 each.	1,00,000	Investments	2,00,000
RESERVES & SURPLUS:		CURRENT ASSETS:	
Securities Premium A/c	1,50,000	Current Assets	6,50,000
General Reserve	1,00,000		
Profit and Loss account	1,00,000		
SECURED LOANS:			
Debentures	7,00,000		
CURRENT LIABILITIES:			
Current liabilities Provisions	2,00,000		
TOTAL	17,50,000	TOTAL	17,50,000

Keeping in view all the legal requirements, ascertain the maximum no of equity shares that Green Tea Ltd can buy back @ Rs.25 per share, being the current market price. Assume that the buy-back is carried out actually on the changed terms and accordingly record the entries in the journal of GreenTea Ltd and prepare its balance sheet thereafter.

II. Multiple Choice Questions

i. Equity share capital (Rs.10) Rs.10, 00,000
General reserve Rs.12, 00,000
Profit and loss account Rs. 1, 00,000
Securities premium Rs. 2, 00,000
The maximum buyback is ________.

a) Rs.45, 00,000
b) Rs. 6, 25,000
c) Rs.5, 50,000
d) Rs.3, 00,000

Answer: Rs. 6, 25,000

ii. Company can buy back________.

a) Preference shares
b) Equity shares
c) Debentures
d) Capital

Answer: Equity shares

iii. Buyback of shares can be out of________.

a) Profits only
b) Proceeds of fresh issue only
c) Capital profit only
d) Free reserve or securities Premium for proceeds of shares

Answer: Free reserve or securities Premium for proceeds of shares

iv. Which of the following is a free reserve for the purpose of buyback of shares?

a) workmen compensation fund
b) capital redemption reserve
c) debenture redemption reserve
d) forfeited shares account

Answer: forfeited shares account

v. In case of equity shares are brought back out of to reserve, amount equal to face value of equity shares bought back should be transferred to________.

a) general reserve account
b) development rebate reserve
c) sinking fund account
d) capital redemption reserve account

Answer: capital redemption reserve account

III. State Whether True or False

i. The buyback of equity shares should be authorized by Articles of Association.
ii. Buyback of equity shares can be made out of proceeds of an earlier issue of preference shares.
iii. Partly paid equity shares can be bought back.
iv. Buy back of shares increases the Earnings per Share of the company.
v. Due to buyback of shares there is reduction in the share capital.

❖❖❖❖

5

INVESTMENT ACCOUNTING (W.R.T ACCOUNTING STANDARD -13)

Unit structure

5.0 OBJECTIVES

After studying this module, the student will be able to –

- Understand the different types of Investment
- Calculate cost of acquisition on purchase of investment and ascertain profit/loss on sale of investment
- Understand the quotation prices – cum-interest and ex- interest price
- Prepare and maintain Investment ledger in columnar form.

This module will help learner
1) Understand the various terms used in Investment Accounting
2) Prepare working notes – calculate accrued interest and determine profit/loss on sale
3) Pass journal entries in the books of investor
4) Post transactions in investment a/c – to be prepared in columnar format

The student will learn and understand the meaning of the various terms used in investment accounting – short term investment, long term investment, cost of investment , net receipts on sale of investment, profit or loss on sale of investment , ex- interest and cum- interest quotations , carrying cost of investment, weighted average method, Bonus shares and right shares received .

Expected outcomes –

The student will remember and understand the different types of Investments

The student will learn to apply the provisions of AS -13 in accounting for Investments

The student will learn to analyze the impact of Investment related transactions on the Profit and loss a/c

The student will be able to evaluate the different Investment options relating to purchase and sale of Investments

With the above knowledge, the student should feel empowered to suggest investment options to others and make the appropriate investment decisions

5.1 INTRODUCTION

Investment is an asset which is made with the expectation of appreciation and getting returns. The surplus financial resources are profitably channelized and invested based on an individual's risk appetite. The factors which influence the investment decision making are-

- Liquidity
- Security
- Profitability

AS-13 defines Investments as assets held for earning income by way of dividends, interest and rentals for capital appreciation or for other benefit to the investor.

5.2 TYPES OF INVESTMENTS

AS-13 classifies investments as under

- Government and Trust Securities issued by Government and local authorities
- Bonds and Debentures issued by companies
- Shares issued by Companies
- Deposits with Companies or Banks
- Immoveable property
- Others- jewellery, Insurance policies

On the basis of period of Holding - Long term and current investments

Current Investments is an investment readily realizable and intended to be held for not more than one year from the date on which such investment is made. Current investments are also known as short term investments.

Long term investments are investments other than short term investment.

On the basis of nature of Return -Variable earning securities and fixed earning securities

Variable earning securities refer to securities on which return varies from period to period .For example Investment in Equity shares. Dividend on Equity shares is variable in nature.

Fixed earning securities refer to the securities on which the rate of return is fixed and it is payable on a certain date. For example- Investment in 10% Debentures interest payable on 1st November and 1st May every year. Investment in Bonds also fall under this category.

5.3 TERMS USED IN INVESTMENT ACCOUNTING

a)Cost of investment –

`Cost of Investment' includes purchase price and acquisition charges which refers to the expenses related to the purchase of Investments like brokerage, commission, fees, stamp duty .

Cost of Investment	Purchase Price	xxxx
	Add Brokerage	xxxx
	Add Fees/commission	xxxx
	Add Stamp duty	xxxx
	Total cost of Investment	xxxx

Brokerage is always calculated on the quotation price whether cum-interest or ex- interest

b) Disposal of investment- cost of investment sold

When an Investment is sold off, the profit /loss has to be computed. The net sale proceeds are compared with carrying amount to ascertain profit/ loss.

Net proceeds= Gross proceeds- expenses related to sales

Net Proceeds	xxx
Less carrying amount of investment sold	xxx
PROFIT/LOSS	

c) Carrying amount of Investment

Carrying amount means the value at which Investments are carried in the books of accounts and shown in Final accounts. It is the book value of Investments.

Long Term Investments should be carried in the financial statements at cost.

Current Investments are carried in the financial statements at the lower of cost and fair value,

d) Cum- interest and ex- interest quotations

Cum-Interest and ex- interest are quotation terms used in purchase or sale of Investments (Debentures)

Cum- interest refers to cumulative or inclusive of interest

Ex-interest refers to exclusive or without interest.

e) Calculation of cost and accrued interest

Step 1 – Calculate the period between the date of last interest paid and the date of purchase of securities For example---- interest is payable on 1 April and 1 October every year . On 1 June, 600 12% debentures of fv Rs 100 were purchased. In the above case the last interest was paid on 1 April. Accrued interest is to be calculated for two months ---April and May

Step 2—Calculate accrued interest using the formula-

Rate of Interest x period (months) /12 months x Face value of securities

12/100 x2/12 x (600xRs 100) =60000x2/12x12/100=1200

Step 3 –Calculate cost - (cum interest price x no. of securities) - accrued interest as per step 2

f) Weighted Average cost –to ascertain profit/loss

AS-13 prescribes weighted average method. When investments are purchased at different dates at different rates or cost and a part of Investment is sold, weighed average method is used to calculate the cost of such investment sold.

41200 shares purchased at different dates at a total cost of Rs 534400 out of which 1000 shares are sold .The cost of 1000 shares sold is calculated as under

1000x534400/41200= 12971

The cost of investment sold is compared with selling price to compute profit/loss on sale of investment.

g) Rights shares

It is an issue of shares in which the existing shareholders have a pre-emptive right to subscribe for the new shares. The existing shareholder has a right to exercise the option to buy or sell to third parties. The rights shares are to be recorded on the debit side of Investment a/c in the Nominal value column and cost recorded in the capital column.

h) Sale of entitlement rights-

The shareholder may decide to sell the right shares or part of right shares. As per AS -13, profit on sale of right entitlement is directly credited to Profit and loss a/c

i) Bonus shares –

Issue of Bonus shares is called conversion of profit into share capital or capitalisation of profits. Bonus shares are issued to existing shareholders free of cost. Bonus shares could be issued only as fully paid new shares. The bonus shares issued are to be recorded on the debit side of investment account and entered in the Nominal value column only.

For example –On 1st August 2018, one Equity share was issued as bonus for every six shares held by the shareholders. On 1st April 2018, Mr.Rajat had an opening balance of 50,000 shares and on 1st June2018 he purchased 10,000 additional shares. Thus he had a total of 60,000 shares (50000+10000) and is entitled to 60000/6 =10,000 bonus shares. The nominal value of 10000 shares received as bonus is to be recorded in the debit side of Investment a/c in face value or nominal value column only. As it is free of cost, no amount will be entered in the cost column.

Explain the difference between Ex- interest and Cum- interest transactions in Investment accounting giving suitable examples

Cum- Interest and Ex- Interest Price

Cum - interest means 'with 'or 'cumulative of interest'. Ex interest means 'without' or 'exclusive of interest'.

Cum interest (inclusive of interest) price covers the cost of investment and interest accrued up to the date of purchase. When interest becomes due, it would be the right of the buyer to claim it.

Ex interest (exclusive of interest) price covers only the cost of the investments and the buyer is liable to pay additional amount as interest accrued up to the date of purchase of investments. Note- In case of Government securities and debentures, the price quoted is Ex-interest unless otherwise specified. In case of non- government securities and debentures, it is cum- interest unless otherwise specified.

Accounting in the books - Cum- interest purchase – Investment account will be debited with the cost only and interest account will be debited with accrued interest (from the date of last interest paid to the date of purchase). Bank account will be credited with quotation price.

Example On 1st April 2015, 2000 12% debentures of Rs 100 each @Rs 98 cum- interest were purchased. Interest is payable half- yearly on 30 June and 31 December. Accounts are closed on 31st December.

Journal entry –

Debentures a/c Dr	190,000
Accrued interest a/c Dr	6,000
To Bank a/c	196,000

(Being debentures purchased cum- interest)

Note- Here accrued interest is calculated on 2,00,000@12% for 3 months (April, May, June)

(200,000x12% x3/12=6,000) The cum interest price (2000x98=196000) includes this interest amount and hence cost is 196000-6000=190000

Accounting in the books – Ex- interest purchase – Investment account is debited with quotation price (plus brokerage) .Interest account is debited with accrued interest and the bank account is credited with quotation price plus accrued interest.

Example - On 31st March 2014 Rs 1,00,000 6% Government bonds (face value Rs 100 each) were purchased at Rs 95 ex- interest. Interest is payable on 30th June and 31st December every year.

Journal entry would be-

6% Government Bonds a/c Dr	95,000
Accrued interest a/c Dr	1,500
To Bank a/c	96,500

(Being 6% Bonds purchased at Rs 95 ex- interest)

In the above example, the interest is worked out for 3 months January, February and March (100000x6%x3/12=1,500)

This interest amount is not included in quotation price (1000 bonds @Rs 95 ex interest) and hence the cost is 95000+ 1500= 96,500

In the case of sale of investments Ex interest or cum interest

Journal entry

Ex - interest sales	Cum- interest sales
Bank a/c Dr (ex interest price + interest accrued) To Investment a/c (ex-interest price) To Interest (Accrued interest)	Bank a/c Dr (cum- interest price) To Investment a/c (cum interest price –accrued interest) To Interest a/c (Accrued interest)

In case of Cum- interest sale or ex- interest sales, the Profit or loss on sale is calculated as net sale price less weighted average cost

5.4 JOURNAL ENTRIES

JOURNAL ENTRIES IN THE BOOKS OF THE BUYER – purchase – sales – cum interest – ex interest

Cum –interest purchase Investment a/c dr (cost)

Interest a/c dr (accrued interest)

To bank a/c (cum- interest price)

On 1 April 2018, 2000 12% debentures of Rs 100 each were purchased at Rs 98 cum interest interest is payable on 30 June and 31 Dec .

Face value of debentures purchased- 2000 deb x Rs 100=200000

Cum interest price at Rs 98 = 2000 debx Rs 98= 196000

Accrued interest for three months- 12/100x200000x3/12= 6000

Cost of debentures= cum interest price-accrued interest = 196000-6000=190000

Journal entry	12% debentures a/c dr	190000	
	Accrued interest a/c dr	6000	
	To bank		196000

Ex interest purchase Investment a/c dr (ex interest price)

Interest a/c dr (accrued interest)

To bank (ex interest price+ accrued interest)

On 31st March 2014, Rs 100,000 6% Govt bonds (face value Rs 100 each) were purchased at Rs 95 ex interest. Interest is payable on 30 June and 31 December every year. Pass journal entries

1000 6% Govt bonds of rs 100 each 100000 face value

Ex interest price 1000x rs 95=95000

Accrued interest for three months =6/100x100000x3/12=1500

Note always calculate interest on face value of investments

Journal entry- 6% Govt bonds a/c dr 95000

Accrued Interest a/c dr 1500

To Bank 96500

Bank a/c dr 6000

To interest a/c 6000 (6/100x100000 interest amount)

Cum interest sales-

Bank a/c dr (cum interest price)

To investment a/c (cum interest price- accrued interest)

To interest (accrued interest)

On 1st April 2017, X Ltd had Rs 100000 6% Govt bonds at Rs 94 each (face value Rs 100) Interest is payable on 31 March and 30 September. The company sold Rs 30,000 bonds at Rs 95 cum-interest on 1st June 2017

Working note last interest was paid in March accrued interest will be for April, May 2 months

6/100x 30000x2/12= 300 accrued interest

Rs 30000 bonds were sold 300 bonds of fv rs 100 each sold at rs 95 cum interest on 1 June 2017

Sale cum interest 300 bonds at 95=300x95=	28500
Less accrued interest	300
Cost	28200

Journal entry Bank a/c dr 28500

To 6% Govt bonds 28200

To accrued interest 300

Ex- interest sales –

Bank a/c dr (ex interest price +accrued interest)

To investment (ex- interest price)

To interest (accrued interest)

On 1st April 2018, Y Ltd had Rs 100000 6% Govt bonds at Rs 94 each (face value Rs 100) Interest is payable on 31 March and 30 September. The company sold Rs 30,000 bonds at Rs 95 cum-interest on 1st June 2018.

Ex interest price 300 bonds x 95
28500

Add accrued interest for 2 months 6/100x30000x2/12
300

Total
28800

Bank a/c dr	28800
To 6% Govt bonds	28500
To accrued interest	300

Important points to be noted-

Any brokerage on sale of investments should be deducted from sale proceeds

As per AS-13, weighted average cost is to be used for ascertaining profit or loss on sale of investment.

Carrying amount of investments – at cost or fair value (market value) whichever is lower

In case investments are purchased at different dates at different costs and some part of investment is sold, the carrying amount of investment sold should be ascertained by using FIFO or weighted average method. **AS- 13 prescribes weighted average method**

5.5 INVESTMENT ACCOUNT

The Investment ledger shows the details of investment. Investment Account is prepared in columnar form showing details of face value or nominal value of investment, the income (interest/ dividend) and the last column showing the capital/cost column on both the debit side and credit side of the account.

Proforma of Investment account -10% Debentures

Date	Part	NV	Income	Cost	Date	Part	NV	Income	Cost
1 /4/20	To bal	Xxx	xxx	xxx		By bank	xxx	xxx	xxx
	To Bank	Xxx	xxx	xxx		By p&l	----	-----	xxx
	To p&l	-------	-------	xxx		By bank	----	xxx	---
31/3/21	To p&l	-------	xxx	----	31/3/21	By bal	----	xxx	---
					31/3/21	By bal	----	----	xxx
					31/3/21	By p&l	----	-----	xx
		Xxx	xxx	xxx			xxx	xxx	xxx

NV- Nominal value or face value of Investments

Income – Incase investments are in bonds/ debentures it is interest, in case of investment in shares it refers to dividend

The following transactions are recorded on the debit side of Investment Account

Opening balance of Investments – Purchase of Investments –Bonus shares and rights shares issued (in case of Investment in shares)-Profit on sale of Investment –Transfer of Interest/ dividend to Profit and loss a/c at the end of the year.

The following transactions are recorded on the credit side of Investment a/c

Sale of Investments –Loss on sale-interest received- Accrued interest at the end of the year – closing balance of investments at the end of the year. Loss on valuation transferred to P&L a/c –

Solved Problems -

1)On 1st January 2013, 1,000 -**12 percent** Debentures of Rs 100 each of Shiva Ltd. were held as investment by Mr Dharmesh at a cost of Rs 91,000. **Interest is payable on 31st December**.

On 1st April 2013, Rs 20,000 of such debentures were purchased by Dharmesh at Rs 98 cum-Interest.

On 1st September 2013, Rs 30,000 of such debentures were sold at Rs 96 ex-Interest.

On 1st December 2013, Rs 50,000 of such debentures were sold at Rs 99 cum-interest.

Interest is received on due date.

Prepare investment account for 12 percent debentures of Shiva Ltd. in the books of Mr Dharmesh valuing closing stock as on 31st December 2013 applying AS-13. The debentures were quoted at **Rs 93** on 31st December 2013

In the books Mr Dharmesh

Investment in 12 percent Debentures of Shiva Ltd a/c

Date	Particulars	W/N no	NV	Int	Cost	Date	Particulars	WN no	NV	Int	Cost
2013 Jan 1	To balance b/d		100,000	-	91000	2013 Sep 1	By bank a/c	3	30000	2400	28800
April1	To bank a/c	2	20,000	600	19,000	Dec 1	By bank a/c	5	50000	5500	44000
Sept 1	To P & L a/c [profit]	4	-	-	1300	Dec 1	By P & L a/c [Loss]	6	-	-	1833
Dec 31	To P & L a/c [bal.fig]		-	12100	-	Dec 31	By bank a/c [interest]	7	-	4800	-
						Dec 31	By bal c/d		40000	-	36667
			120,000	12700	111,300				120000	12700	111300

W/N: 1 : Cost structure

Particulars	Units	Nominal value	Cost
Opening balance	1000	100,000	91,000
Add: Purchase	200	20000	19,000
Less: Sale	1200 [300]	120000 [30000]	110,000 [27500]
Less: Sale	900 500	90,000 [50000]	82,500 [45,833]
	400	40,000	36,667

2] Cum Interest purchase price [200 X 98]	19600
Less: Interest [20000 X 12/100 X 3/12]	[600]
Cost	19000

3] Interest on ex-interest sales price

30,000 X 12/100 X 8/12	2400

4] Profit/Loss on ex-interest sale

Sale price	28800
Less: Weighted average cost	[27500]
Profit	1300

5] Sale price [cum- interest] [500 X 99]	49500
Less: Interest [50000 X 12/100 X 11/12]	[5500]
Proceeds [cost]	44000

6] Profit/Loss on sale

Sales price	44000
Less: weighted average cost	[45833]
Loss	1833

7] Interest on due date

40,000 X 12/100 X 12/12	4800

8] Valuation of stock

Cost price [closing balance]	36,667
Market price [400 X 93]	37,200

Therefore, valuation at cost as per AS 13; cost or market price whichever is less.

2)Mr. Ram Nene held on **1-1-2013** Rs 60,000 of **12 percent** Government securities [Tax Free] of Rs 100 each of Rs 56,500.

On **1-6-2013**, he purchased a further of Rs 40,000 of the security at **Rs 97 cum-interest**.

On 31-7-2013 Rs 50,000 of the security was sold at Rs 94 **ex-interest**.

On 1-12-2013 Rs 20,000 of the security was again sold at **Rs 96 cum-interest.**

Interest on the security was paid each year on 31st March and 30th September and was credited by the bank on 3rd April and 4th October respectively. The price of the security on **31/12/2013** was **Rs 96.**

Mr Nene closes his books on **31st December each year.**

Draw investment account in the books of Mr. Nene.

In the books of Mr Ram Nene

Investment a/c in 12 % Government Securities a/c [**Due Date: 31st March and 30th September**]

Date	Particulars	WN	NV	Int	Cost	Date	Particulars	WN	NV	Int	Cost
1-1-2013	To balance b/d	2	60,000	1800	56,500	3-4-13	By bank [Int on Due date]	3	-	3600	-
1-6-2013	To bank a/c	4	40,000	800	38,000	31-7-13	By bank [500 X 94]	5	50000	2000	47000
31-12-13	To P & L a/c [bal.fig]			**7300**		31-7-13	By P & L a/c [Loss]	6	-	-	250
						4/10/13	By bank [Int on due date]	7	-	3000	-
						1/12/13	By bank	8	20000	400	18800
						1/12/13	By P & L a/c [Loss]	9	-	-	100
						31/12/13	By bal c/d		30,000	900	**28350**
			100000	9900	94500				100000	9900	94500

Working notes 1] Cost Structure

Particulars	Units	Nominal value	Cost
Opening balance Add: Purchase	600 400	60,000 40,000	56,500 38,000
 Less: Sales	1000 [500]	100,000 [50000]	94,500 47,250
 Less: Sales	500 200	50000 [20000]	47,250 [18900]
	300	30000	**28,350**

2] Outstanding Interest on Opening Balance [Oct/Nov/Dec]

60,000 X 12/100 X 3/12 1800

3] Interest on due-date [31st March] : 60,000 X 12% X 6/12 3600

4] Cum Interest purchase price [400 X 97] 38,800

Less: Interest [40000 X 12/100 X 2/12] [April/May] [800]

Cost (38800-800) 38,000

5] Interest on ex-interest sale [50000 X 12/100 X 4/12] 2000

6] Profit/Loss on ex-interest sale

Sales price [500 X 94] 47,000

Less: Weighted average cost

[50000 X 94500/100,000] [47,250]

Loss 250

7] Interest on due date [30th Sept] 50,000 X 12/100 X 6/12 3,000

8] Cum Interest sales price [200 X 96] 19,200

Less: Interest [20000 X 12/100 X 2/12] [Oct/Nov] [400]

Sales price (19200-400) 18,800

9] Profit/Loss on Cum Interest sales

Sales price 18800

Less: Weighted average cost	[18900]
[47250 X 20000/50000]	
Loss	100
10] Accrued Interest on closing balance	
30000 X 12% X 3/12 [Oct/Nov/Dec]	900
11] Valuation of closing balance	
Cost value [as per closing balance]	**28350**
Market value [300 X 96]	28,800

Valuation of securities is cost value or market value, whichever is less as per AS-13

Therefore, valuation of securities is as per cost value Rs 28350

3)Miss Bhagawati entered into the following transactions of purchase and sales of **12 percent** Debentures of **Rs 100** each of Mansi Ltd. **Interest is payable on 30th June and 31st December every year.** Transactions are as under:

Date	No of Debentures	Terms
1-04-2012	800	Opening balance at the cost of Rs 76,000
1-06-2012	300	Sold at Rs 105 each cum-interest
1-09-2012	700	Purchased at Rs 98 each Ex-Interest
1-12-2012	400	Purchased at Rs 108 each Cum-Interest
1-02-2013	900	Sold at Rs 97 each Ex-Interest

Prepare Investment Account of 12 percent debentures in the books of Bhagawati for the year ended **31st March, 2013**. The market value on 31st March, 2013 was Rs **67,500** of the said investment. Apply As-13.
Solution:

In the books of Miss Bhagawati

Investment on 12 % Debentures in Mansi Ltd account **[Due date: 30th June and 31st December]**

In the books of Miss Bhagawati
Investment on 12 % Debentures in Mansi Ltd account **[Due date: 30th June and 31st December]**

Date	Particulars	W/n	NV	Int	Cost	Date	Particulars	W/n	NV	Int	Cost
1-4-12	To balance b/d	2	80000	2400	76000	1-6-12	By bank a/c	3	30000	1500	30,000
1 Jun	To P & L a/c [profit]	4	-	-	1500	30 Jun	By bank a/c [Int on due date]	5	-	3000	-
1 Sept	To bank a/c [700 X 98]	6	70000	1400	68600	31 Dec	By bank a/c [Int on due date]	8		9600	
1 Dec 2013	To bank a/c	7	40000	2000	41200	1-2-13	By bank a/c [900 X 97]	9	90000	900	87300
31 Mar	To P & L a/c [bal.fig]			**11300**		1 Feb 2013	By P & L a/c [Loss]	10	-	-	1181
						31 March 2013	By P & L a/c [Loss on valuation]	11			1319
							By balance c/d	12	**70000**	2100	**67500**
			190000	17100	187300				190000	17100	187300

Working Notes:

1] Cost Structure:

Particulars	Units	Nominal value	Cost
Opening balance	800	80,000	76,000
Less: Sales	[300]	[30,000]	[28500]
	500	50000	47,500
Add: Purchase	700	70000	68600
	1200	120000	116,100
Add: Purchase	400	40000	41200
	1600	160000	157300
Less: Sale	[900]	[90000]	[88481]
	700	70000	**68819**

2] Outstanding Interest on Opening balance [Jan/Feb/Mar]

80,000 X 12% X 3/12 2400

3] Cum Interest Sales price [300 X 105] 31500

Less: Interest [30000 X 12% X 5/12] [Jan- May] [1500]
Sales price 30,000

4] Profit/Loss on sales
Sales price 30,000
Less: Weighted Average cost [30000 X76000/80000] [28500]
Profit 1500

5] Interest on Due date [30th June]

50,000 X 12% X 6/12 3000

6] Interest on ex-interest purchase [July/Aug]

70000 X 12% X 2/12 1400

7] Cum Interest purchase price [400 X 108] 43,200

Less: Interest [40000 X 12% X 5/12] [Jul- Nov] [2000]
Cost 41200

8] Interest on due date [31st Dec]

160000 X 12% X 6/12 9600

9] Interest on ex- interest sales [90000 X 12% X 1/12] [Jan] 900

10] Profit/Loss on sales

Sales price 87300
Less: Weighted average cost [157300 X 90000/160000] 88481
Loss 1181
11] Valuation of securities
Cost value [From the cost structure] 68,819
Market value [given] **67,500**

Loss on valuation [68819 – 67500] Rs 1319

12] Accrued Interest on closing balance [Jan/Feb/Mar]

70000 X 12% X 3/12 2100

4) On 1st April, 2012, 200; 6 percent Debentures of Rs 100 each of Excellent Ltd. were held as investment by Mr. Tushar at a cost of **Rs 18,200.**

Excellent Ltd. pays interest **on 1st May and 1st November every year.**

The following other transactions were entered by him during the year ended 31st March, 2013 in regard to these Debentures.

Date	No Of Debentures	Transaction	Rate
1st April, 2012	100	Sale	Rs 98 cum interest
1st Oct, 2012	100	Purchase	Rs 104 ex-Interest
1st Dec, 2012	200	Purchase	Rs 97 cum-Interest
1st Feb, 2013	100	Sale	Rs 97 ex-interest

You are required to prepare investment in **6 percent** Debentures in Excellent Ltd. account for the year ended 31st March, 2013 as it would appear in the books of Mr Tushar (Apply AS 13)
In the books of Mr Tushar

Investment in 6 percent Debentures in Excellent Ltd. a/c [**Due date: 1st May and 1st Nov**]

Date	Particulars	W/n	NV	Int	Cost	Date	Particulars	W/n	NV	Int	Cost
2012 1st April	To balance b/d	2	20000	500	18200	2012 1st April	By bank	3	10,000	250	9550
	To P & L a/c	4			450	1st May	By bank [Int on due date]	5	-	300	-
1st Oct	To bank [100 X 104]	6	-	250	10,400	1st Nov	By bank [Int on due date]	7	-	600	-
1st Dec	To bank	8	10,000	100	19300	2013 1st Feb	By bank [100 X 97]	9	10000	150	9700
2013 31st Mar	To P & L a/c [bal.fig]		20,000	**1200**		31st Mar	By balance c/d		**30,000**	750	**29,100**
			50,000	2050	48,350				50,000	2050	48,350

Working Notes:

Jan	Feb	Mar	April	**May**	June	Jul	Aug	Sep	Oct	**Nov**	Dec

1] Cost Structure:

Particulars	Units	Nominal value	Cost
Opening Balance Less: Sales	200 [100]	20000 [10000]	18200 [9100]
 Add: Purchase	100 100	10000 10000	9100 10400
 Add: Purchase	200 200	20000 20000	19,500 19,300
 Less: sale	400 [100]	40000 [10000]	38,800 [9700]
	300	30000	29,100

2] Outstanding Interest on Opening balance [Nov- Mar]

20,000 X 6% X 5/12 500

3] Cum Interest sales price [98 X 100] 9800

Less: Interest [10000 X 6% X 5/12] [250]

Cost 9550

4] Calculation of Profit/Loss on cum Interest sales

Sales price 9550

Less: Weighted average cost [10,000 X 18200/20000] [9100]

Profit 450

5] Interest on Due date [1st May]

10,000 X 6% X 6/12 300

6] Interest on ex – Interest purchase

10,000 X 6% X 5/12 250

7] Interest on due date [1st Nov]

20,000 X 6% X 6/12 600

8] Cum Interest Purchase price [200 X 97] 19400

Less: Interest [20000 X 6% X 1/12] [Nov] [100]

Cost 19300

9] Interest on ex Interest sale

10000 X 6% X 3/12 [Nov- Jan] 150

10] Calculation of profit/Loss

Sales price 9700

Less: Weighted average cost [10000 X 38800/40000] [9700]

Profit/Loss Nil

11] Calculation of Accrued Interest on closing balance

30,000 X 6% X 5/12 750

5. The following transactions of Miss Naina took place during the year ended 31-3-2014

Date	Transactions
12-4-2013	Purchased 1,00,000 Equity Shares of Rs 10 each in "ABC" Ltd for **Rs 50,00,000**
15-5-2013	ABC Ltd made a bonus issue of 3 equity shares for every 2 shares held
30-6-2013	Naina sold 1,25,000 Bonus shares for Rs 20 each

Prepare Equity Shares in ABC Ltd account in the books of Miss Naina for the year ended **31-3-2015.**

Solution:

In the books of Miss Naina

Investment a/c in Equity shares of ABC Ltd

Date	Particulars	w/n	N.V	Cost	Date	Particulars	w/n	N.V	Cost
12-4-13 15-5-13	To bank a/c To Bonus shares	 2	1000,000 1500,000	5000,000 -	30-6-13 31-3-14	By bank a/c By balance c/d		1250,000 1250,000	2500,000 2500,000
			2500,000	5000,000				2500,000	5000,000

Working note:

1] Cost structure

Particulars	Units	Nominal value	Cost
Purchases Add: Bonus shares	100,000 150,000	10,00,000 15,00,000	50,00,000 Nil
 Less: sales	250,000 [125,000]	2500,000 [1250,000]	50,00,000 [2500,000]
	125,000	1250,000	2500,000

2] Calculation of Bonus shares

3 Bonus shares	:	2 equity shares held
?	:	100,000

[100,000 X 3/2] 150,000 Bonus shares of Rs 10 each= Rs 1500,000

3] Calculation of Profit/Loss on sale

Sales price	2500,000
Less: Weighted average cost	2500,000
[1250,000 X 5000,000/2500,000]	
Profit/Loss	NIL

6) Universal Plastics Traders acquired 5,000 shares of Maruti Ltd. at Rs 80.40 each on 15th July, 2012. On 1st December, 2012 Maruti Ltd. issued **Right Shares** in the ratio of 2:5 at Rs 98 per share. Universal Plastics Traders exercised their option for 50 percent of Right shares and applied for the same. On 20th March, 2013 Universal Plastics Traders sold 1600 shares of Maruti Ltd at Rs 99.50 per share.

Calculate Profit/Loss on sale of shares on 20th March 2013.

In the books of Universal Traders
Investment in Equity shares of Maruti Ltd.

Date	Particulars	W/N	Cost	Date	Particulars	W/N	Cost
2012				2013	By bank a/c		159,200
15th Jul	To bank a/c		4,02,000	20th Mar			
1st Dec	To bank a/c		98,000				
2013 20th Mar	To P & L a/c [Profit]		25,867	31st Mar	By balance c/d		3,66,667
			5,25,867				5,25,867

Working note:

1] Cost structure

Particulars	Units	Cost
Purchase Add: Right shares	5,000 1,000	4,02,000 98,000
Less: sales	6,000 [1600]	5,00,000 [133,333]
	4,400	366,667

2] Right shares

Ratio given:
5 equity shares held : 2 right shares
5000 : ? [5000 X 2/5] 2000 right shares
[2000 X 50% = 1000 right shares at Rs 98 each = Rs 98,000]

3] Calculation of Profit/Loss on sale of 1600 equity shares

Sales price [1600 X 99.50]	159,200
Less: Weighted Average cost [1600 X 500,000/6,000]	[133,333]
Profit	**25,867**

4) On 1/4/2010 Aditya had 50,000 equity shares in T Ltd. The face value of the shares were Rs 10 each but their book value was Rs 24 per share.

On 2-6-2010, Aditya purchased 10,000 equity shares in T Ltd at a premium of Rs 6 per share.

On 1-7-2010, the directors of T Ltd. issued bonus shares at the rate of one share for every three shares held.

On 1-1-2011, Aditya purchased 5000 right shares in T ltd of Rs 10 each at Rs 15 per share.

On 31-1-2011, he sold 20,000 equity shares in T Ltd of Rs 10 each at Rs 30 per share. Show investment account as it would appear in the books of Aditya for the year ended 31-3-2011

Solution:

In the books of Aditya

Investment a/c in Equity shares of T Ltd for the year ended 31-3-2011

Date	Particulars	WN	NV	Cost	Date	Particulars	WN	NV	Cost
1/4/10	To balance b/d		500,000	1200000	31/1/11	By bank a/c		200,000	600,000
2/6/10	To bank a/c		100,000	160,000					
1/7/10	To Bonus shares	2	200,000	- ---------					
1/1/11	To bank a/c		50,000	75,000	31/3/11	**By balance c/d**		**650,000**	**10,97,353**
31/1/11	To P & L a/c [Profit]			262,353					
			850,000	16,97,353				850,000	16,97,353

Working note:

1. Cost structure

Particulars	Units	Nominal value	Cost
Opening balance Add: Purchase	50,000 10,000	500,000 100,000	12,00,000 1,60,000
 Add: Bonus shares	60,000 20,000	600,000 200,000	13,60,000 -
 Add: Right shares	80,000 5,000	800,000 50,000	13,60,000 75,000
 Less: Sales	85,000 [20,000]	850,000 [200,000]	14,35,000 [337,647]
	65,000	650,000	10,97,353

2] Calculation of Bonus shares

3 equity shares held : 1 Bonus share

60,000 : [60000 X 1/3] 20,000 Bonus shares of Rs 10 each = Rs 200,000

3] Calculation of Profit/Loss

Sales price 600,000

Less: weighted average cost [200,000 X 1435000/850000] [337,647]

Profit 262,353

8. On 1st April, 2012 Sundar held 25,000 fully paid equity shares of Rs 10 each in X Ltd, at book value of Rs 15 per share. **On 20th June**, 2012 he purchased another lot of 5,000 shares of the company at Rs 16 per share. Afterwards X Ltd. announced a bonus issue and right issue, the following being the terms:

Bonus issue in the ratio of 1:6 [record date 16-8-2012]

Right issue in the ratio of 3:7 [record date 31-8-2012]

The rights shares were issued at **Rs 15** per share and the full amount was payable by 30th September, 2012. Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold one third of this entitlement to another person for a consideration of Rs 2 per share on 5th September, 2012. After becoming ex-rights, the market price of the shares was Rs 15.

Dividends for the year ended **31st March, 2012** at 20 percent were declared by X Ltd. and received by Sundar on 31st October, 2012. Dividends for shares **acquired by Sundar on 20th June, 2012 were adjusted against the cost of purchase**. On 15th November, 2012 Sundar sold 25,000 shares at Rs 15 per share.

You are required to prepare Investment in equity shares in X Ltd account in the books of Sundar.

In the books of Sundar
Investment in equity shares of X Ltd account

Date	Particulars	WN	NV	Dividend	Cost	Date	Particulars	WN	NV	Dividend	Cost
2012						2012					
1-4	To bal b/d		250000	-	375000	31-10	By c/bank	4		50,000	10,000
20-6	To c/bank		50000		80,000	15-11	By c/bank		250000		375000
16-8	To Bonus shares	2	50,000		-	2013					
30/9	To c/bank	3	100000		150,000						
15-11	To P & L a/c	5			44,444						
2013 31-3	To P & L a/c [bal.fig]			**50,000**		31-3	By bal c/d		**200000**		**264,444**
			450000	50,000	649,444				450,000	50,000	649,444

Working note
1] cost structure

Particulars	Units	Nominal value	Cost
Opening balance Add: Purchase	**25000** 5000	250000 50,000	375000 **80,000**
 Add: Bonus shares	**30000** 5000	**300,000** 50,000	455,000 -
 Add: Right shares	35000 10,000	350,000 100,000	455,000 1,50,000
 Less: Adjustment against cost	45,000	450,000	6,05,000 [10,000]
Less: sale	45,000 [25,000]	450,000 [250,000]	5,95,000 [3,30,556]
	20,000	200,000	264,444

2] Calculation of Bonus shares

1 bonus shares	:	6 equity shares
?	:	30,000 equity shares

[30000 X 1/6]5000 bonus shares of Rs 10 each Rs 50,000

3] Calculation of Right shares

3 Right shares	:	7 equity shares
?	:	35,000 equity shares

[35000 X 3/7] 15,000 right shares of Rs 10 issued at Rs 15 per share

He sold 1/3 of the right shares [15000 X 1/3] = 5000 shares were sold

Therefore, he retained [15000 – 5000] 10,000 right shares of Rs 10 issued at Rs 15 = Rs 150,000

4] Calculation of Dividend

Opening balance [25000 shares] 250,000 X 20% = Rs 50,000

Purchase on 20th June [5000 shares] 50,000 X 20% = **Rs 10,000**

5] Calculation of Profit/Loss

Sales price	375,000	
Less: weighted average cost [250000 X 595000/450000]		330,556
Profit	44,444	

9) On 1st April 2012, Mr Vinay had 40,000 Equity shares of Rs 10 each of Spectrum Ltd. purchased at a cost of Rs 15 per share.

On 1st May 2012, he purchased 10,000 equity share of Satyam Ltd [face value Rs 10 each] at Rs 25 per share. On the same day he also purchased 20000 Equity shares of Spectrum Ltd. at Rs 12 each.

On 1st July, 2012 he sold 2000 equity shares of Satyam Ltd at 22 per share. Board of directors of Spectrum Ltd announced right shares of equity shares in ratio of one share for every three shares held at Rs 20 each, full amount was payable by 31st August 2012. Shareholders were allowed to renounce their right either in part or full to the outsiders. Mr Vinay renounced 40 percent of his rights at Rs 5 per share and subscribed for the balance. On 1st December 2012 Mr Vinay sold 5000 equity shares of Spectrum Ltd and 2000 equity shares of Satyam Ltd at Rs 30 and Rs 27 per share respectively.

You are required to prepare:

1. Investment in equity shares of Spectrum Ltd a/c and

2. Investment in Equity shares of Satyam Ltd a/c in the books of Mr Vinay for the year ended 31st March 2013

In the books of Mr Vinay
Investment in equity shares of Spectrum Ltd a/c

Date	Particulars	WN	NV	Cost	Date	Particulars	WN	NV	Cost
1-4-12	To balance b/d		400,000	600000	1-12-12	By bank		50000	150,000
1-5-12	To bank	4	200,000	240000	31-3-13	By bal c/d	1	**670,000**	**10,05,000**
31-8-12	To bank	5	120,000	240000					
1-12-12	To P & L a/c		-	75,000					
			720,000	1155000				720,000	1155000

Investment in Equity shares of Satyam Ltd a/c

Date	Particulars	WN	NV	Cost	Date	Particulars	WN	NV	Cost
1-5-12	To bank a/c		100000	250000	1-7-12	By bank		20000	44,000
1-12-12	To P & L a/c		-		1-7-12	By P&L	3	-	6,000
		6		4,000	1-12-12	By bank	2	20000	54,000
					31-3-13	By bal c/d		60,000	150,000
			100,000	254000				100,000	254000

Working notes

1] Cost structure [Spectrum ltd]

Particulars	Units	Nominal value	Cost
Opening balance Add: Purchase	40000 20000	400,000 200,000	600,000 240,000
Add: Right shares	60,000 12,000	600,000 120,000	8,40,000 2,40,000
Less: sales	72,000 [5000]	7,20,000 [50,000]	10,80,000 [75,000]
	67,000	670,000	10,05,000

2] Cost structure [Satyam Ltd]

Particulars	Units	Nominal value	Cost
Purchase Less: sales	10,000 2000	100,000 20,000	250,000 50,000
 Less: sales	8,000 2,000	80,000 20,000	200,000 50,000
	6,000	60,000	150,000

3] Profit/Loss on sale of 2000 shares of Satyam ltd
Sales price 44,000
Less: weighted average cost [20000 X 250000/100000] 50,000
Loss 6000

4] Calculation of Right shares
1 Right share : 3 equity shares held
? : 60,000 equity shares
[60000 X 1/3] 20,000 right shares of Rs 10 each issued at Rs 20 each
[20000 X 60%] 12000 right shares of Rs 10 at Rs 20 [Subscribed]

5] Calculation of Profit/Loss on sale of 5000 shares of Spectrum ltd

Sales price 150,000
Less: weighted average cost [50000 X 1080000/720,000] 75,000
Profit 75,000

6] Calculation of Profit/Loss on sale of 2000 shares of Satyam Ltd
Sales price 54,000
Less: Weighted average cost [20000 X 200,000/80,000] 50,000
Profit 4,000

7) Mr Arvind entered into following transactions of purchase and sale of Equity shares of Aspi Ltd. The shares have paid up value of Rs 10 per share

Date	No of shares	Terms
01-01-12	600	Buy at Rs 20 per share
15-03-12	900	Buy at Rs 25 per share
20-05-12	1000	Buy at Rs 22 per share
25-07-12	2500	Bonus shares received
20-12-12	1500	Sale at Rs 22 per share
01-02-13	1000	Sale at Rs 24 per share

Additional Information:

1. On 15th September, 2012, **dividend at Rs 3 per share** was received for the year ended **31st March, 2012**
2. On 12th November 2012, the company made a rights issue of equity shares in the ratio of one share for five shares held on payment of Rs 20 per share. **He subscribed to 60% of the shares** and renounced the remaining shares on receipt of premium of Rs 3 per share.
3. Shares are to be valued on weighted average cost basis.

You are required to prepare Investment Account for the years ended **31-3-2012** and 31-3-2013.

Solution:

In the books of Mr Arvind

Investment in equity shares of Aspi Ltd account

Date	Particulars	WN	NV	Dividend	Cost	Date	Particulars	WN	NV	Dividend	Cost
1-1-12	To bank		6000		12,000	**2012**					
15-3-12	To bank		9000		22,500	**31-3**	By bal c/d		15000		34500
			15000		34500				15000		34500
1-4-12	To bal b/d		15000		34500	2012					
20-5-12	To bank		10000		22,000	15-9	By bank	2		4500	3000
25-7-12	To bonus Shares		25000		Nil	20-12	By bank		15000		33,000
12-11-12	To bank	3	6000		12000	2013	By bank		10000		24000
20-12-12	To P & L a/c	4			15455	1-02					
1-02-13	To P & L a/c				12304	31/3	By bal c/d		**31000**		**36259**
31-3-13	To P & L a/c			**4500**							
			56000	4500	96259				56000	4500	96259

Working notes

1] Cost structure

Particulars	Units	Nominal value	Cost
Purchase Add: Purchase	600 900	6000 9000	12000 22500
 Add: Purchase	**1500** 1000	**15,000** 10,000	**34,500** 22,000
 Add: Bonus shares	2500 **2500**	25000 25000	56,500 -
	5000	50,000	56,500

Less: Pre-acquisition dividend			[3000]
Add: Right shares	5000 600	50,000 6000	53,500 12,000
Less: sale	5600 [1500]	56000 [15000]	65,500 [17545]
Less: sale	4100 [1000]	41000 [10000]	47955 [11696]
	3100	31000	36259

2] Calculation of Dividend

On 31st March 2012: Mr Arvind had 1500 equity shares : Dividend = 1500 X 3 = **Rs 4500**

Remaining shares [2500 – 1500] 1000 shares purchased on 20-5-2012, Dividend = 1000 X 3 = Rs 3000

3] Calculation of Right shares

1 right share : 5 equity shares held

? : 5000 equity shares

[5000 X 1/5 = 1000 right shares of Rs 10 each issued at Rs 20]

Mr Arvind subscribed for 60% shares [1000 X 60%] = 600 right shares of Rs 10 each at Rs 20

4] Calculation of profit/loss

Sales price 33,000

Less: Weighted average cost [15000 X 65500/56000] [17,545]

Profit 15,455

5] Calculation of profit/loss

Sales price 24000

Less: weighted average price [10000 X 47955/41000] [11696]

Profit 12304

5.6 SUMMARY

- Investments are the assets held for earning income by way of dividend or interest
- As per AS-13, there are different types of investments. Investments may be classified as long term and current investment, fixed income bearing securities and variable income bearing securities
- Cost of investment includes cost of purchase and all related acquisition charges like brokerage /commission, stamp duty.
- Interest is always calculated on the face value of investment
- Investments may be purchased or sold on cum- interest quotation price or ex- interest quotation price
- Brokerage is calculated on the purchase or sale of Investments. Brokerage is always calculated on the quotation price whether cum-interest or ex- interest. Any brokerage on purchase of Investments is to be added to purchase price and in case of sale of investments, it should be deducted from sale proceeds
- Carrying amount of investments – at cost or fair value (market value) whichever is lower.
- Investments held as long term is valued at cost at the end of the year
- As per AS-13, weighted average cost is to be used for ascertaining profit or loss on sale of investment.
- In case investments are purchased at different dates at different costs and some part of investment is sold, the carrying amount of investment sold should be ascertained by using FIFO or weighted average method. AS 13 prescribes weighted average method
- Profit/ loss on sale of investment is to be calculated and transferred to P&L A/C

5.7 EXERCISES

1) On 1st April 2016 Mr. Manish holds 10,000 Equity Shares of Rs. 10 each in Glenmark Ltd., at cost price of Rs.15 each. On 1st August he Sold 3,000 shares at cost price of Rs. 18 each. On 30th September Company has announced a bonus issue of two shares for every seven shares held as on 30th September. On 10th January 2017 he purchased Right issue announced by Company of one shares for every three held as on 10th January 2017 at the rate of Rs. 18 each. On 21st February 2017 he purchased 2,500 additional shares of the same Company at cost price of Rs. 20 each.

Prepare Equity Shares in Glenmark Ltd A/c in the books of Mr. Manish

2) Mr. Yash holds 10,000 – 10% Bonds of Rs. 10 each in NIVEA Ltd. as on 1st April, 2016 at a cost of Rs. 130000. Transactions for the year are as follow:

Date	Particulars	Quantity	Rate	Quotation
01/05/2016	Purchased	3000	12	Ex Interest
01/09/2016	Purchased	6000	15	Cum Interest
01/01/2017	Sold	5000	13	Ex Interest
01/03/2017	Purchased	1000	16	Ex Interest

Interest is payable half yearly on 30th June and 31st December every year. The Accounting year ends on 31st March. Prepare 10% Bonds Account for the year ending 31/03/2017.

3) On 1st April 2016 Mr. Rajesh holds 20,000 Equity Shares of Rs. 10 each in Hindustan Unilever Ltd., at total cost of Rs. 300000. On 1st July he purchased 4,000 additional shares of the same Company at total cost of Rs. 64,000. On 1st October Company has announced a bonus issue of one share for every six shares held as on that date. On 1st January 2017 he purchased Right issue, announced by Company of two shares for every five held as on that date at the rate of Rs. 12 each. On 31st January 2017 he purchased 2,000 additional shares of the same Company at total cost of Rs. 36,000. On 1st February 2017 he sold 1000 shares for Rs. 20 each.

Prepare Equity Shares in Hindustan Unilever Ltd. in the books of Mr. Rajesh.

4)Mr. Shivam holds 1,000 – 10% Debentures of Rs. 100 each in Tech Mahindra Ltd. as on 1st April, 2016 at a cost of Rs. 1,20,000. Interest is payable half yearly on 30th September and 31st March every year. Transactions for the year are as follow:

Date	Particulars	Quantity	Rate	Quotation
30/6/2016	Purchased	500	102	Cum Interest
1/10/2016	Purchased	500	97	Ex Interest
31/12/2016	Sold	700	110	Cum Interest
1/2/2017	Sold	300	98	Ex Interest
1/3/2017	Purchased	200	105	Cum Interest

The Accounting year ends on 31st March. Prepare 10% Debenture Account for the year ending 31/03/2017.

5) Mr. Bharat holds 20,000 – 12% Bonds of Rs. 10 each in NIPPO India Ltd. as on 1st April, 2016 at a cost of Rs. 300000. Transactions for the year are as follow:

Date	Particulars	Quantity	Rate	Quotation
01/05/2016	Purchased	4000	20	Cum Interest
01/09/2016	Purchased	5000	22	Cum Interest
01/01/2017	Sold	6000	24	Ex Interest
01/03/2017	Purchased	2000	21	Cum Interest

Interest is payable half yearly on 30th June and 31st December every year. The Accounting year ends on 31st March. Prepare 12% Bonds Account for the year ending 31/03/2017

6) On 1st January 2013, 1,500 **-12 percent** Debentures of Rs 100 each of Shikha Ltd. were held as investment by Mr Saroj at a cost of Rs 145,000. Interest is payable on 30th June and 31st December.

On 1st April 2013, Rs 30,000 of such debentures were purchased by Saroj at Rs 98 cum-Interest.

On 1st September 2013, Rs 50,000 of such debentures were sold at Rs 96 ex-Interest.

On 1st December 2013, Rs 80,000 of such debentures were sold at Rs 99 cum-interest.

Interest is received on due date.

Prepare investment account for 12 percent debentures of Shikha Ltd. in the books of Mr Saroj valuing closing stock as on 31st December 2013 applying AS-13. The debentures were quoted at **Rs 93** on 31st December 2013.

5.8 OBJECTIVE QUESTIONS –TEST YOUR UNDERSTANDING

MATCH THE GROUPS

GROUP A	GROUP B
1) Debentures	A) AS-13
2) IInvestment a/c	B) Securities with fixed income
3) SShares	C) Held for not more than one year
4) CCost of investment	D) No fixed income
5) CCurrent investment	E) Weighted average method
Answer-1-B 2-A 3- D 4- E 5-C	

Group A	Group B
1) Investment for over 12 months	A) Current investment
2) Investment to be traded	B) Face value
3) Cum-interest price	C) No cost shares
4) Interest calculation	D) Long term
5) Bonus shares	E) Includes interest
6) Ex- interest price	F) Without or exclusive of interest
Answer-1-D 2-A 3-E 4-B 5-C 6-F	
1) Rights shares	A) Is transferred to p&l a/c
2) Interest is calculated	B) are valued at cost or MV whichever is less
3) Profit on sale of investment	C) Credited to p&l a/c
4) Current investment	D) On face value of securities
5) Sale of rights shares	E)Is debited to p&l a/c
6) loss on sale of investment	F) increase fv of investment
7) bonus shares issued	G) issued to existing shareholders
8)AS -13	H)deals with accounting for investment I) AS-14 J) Cost of investment
Ans-1-G 2-D 3-A 4-B 5-C 6-E 7-F 8-H	
GROUP A	GROUP B
1) Current investment	A) Investments held for less than 12 months
2) Long term investment	B) Investments held for more than 12 months
3) Variable income bearing securities	C) Equity shares
4) Fair value	D) includes purchase price and brokerage
5) Acquisition cost	E)value at which asset could be exchanged
1-A 2-B 3- C 4- E 5-D	

1)Personal investment accounting	a) debit side face value/ nominal value column
2)Equity shares	b) fixed income bearing security
3)Government bonds	c) debit side nominal value and capital/cost column
4) ex- interest price	d) exclusive of interest
5)Cum- interest price of investment	e) AS 13
6) Bonus shares received	f) variable income bearing securities
7) Rights shares	g) includes interest h) liquidity
1-e 2- f 3- b 4- d 5-g 6-a 7-c	

MULTIPLE CHOICE QUESTIONS

1) Accounting for investments is specified in ______

A)AS-14 B)AS-11 C)AS-13 D)AS-2
ANS **AS-13**

2) Long term investments are shown in balance sheet at ______
A) Market value B) cost C) average cost
D) cost or market value whichever is lower

ANS - **COST**

3) Short term investments are shown in balance sheet at ______
A) Market value B) cost C) average cost
D) cost or market value whichever is lower
ANS–**COST OR MARKET VALUE WHICHEVER IS LOWER**

4) The cost of Investment sold is to be calculated as per ______________
A) method FIFO B) LIFO C) Weighted Average
D) simple average
ANS **WEIGHTED AVERAGE**

5) Loss on sale of Investment is
A) Debited to Investment a/c B) debited to Profit and loss a/c
C) credited to P&LA/C ignored
ANS-**DEBITED TO PROFIT AND LOSS A/C**

5) Cost of Investment includes _____________
A) Purchase price B) stamp duty C) brokerage D) all of the above
ANS –ALL OF THE ABOVE

6) Interests on bonds is to be calculated on

A) Cost B) face value C) number of bonds D) market value

ANS **FACE VALUE**

7) Bonus shares received increases

A) Nominal value of shares held B) cost of shares sold C) market value of shares held D) None of the above

ANS – **NOMINAL VALUE OF SHARES HELD**

STATE WHETHER THE FOLLOWING STATEMENTS ARE TRUE OR FALSE

1) Cost of Investment includes expenses incidental to purchase like brokerage, stamp duty and Taxes **TRUE**
2) In the case of Bonus issue, only nominal value is entered in nominal value column of the Investment account **TRUE**
3) Sale of Right shares is credited to Investment a/c - **FALSE**
4) Cum- interest price excludes interest accrued – **FALSE**
5) Investments held for more than 12 months are long term investments – **TRUE**
6) Current Investments are valued at cost- **FALSE**
7) Interest is always calculated on face value of securities – **TRUE**
8) Equity shares is a fixed income bearing security- **FALSE**

NUMERICAL OBJECTIVE QUESTIONS –

1)The purchase price of investment is Rs 100000 brokerage 15000 stamp duty 10000 what is the acquisition cost of investment?

Ans -Cost of investment is	purchase price	100000
	Plus brokerage	15000
	Plus stamp duty	10000
	Total cost	125000

2)1000 shares were purchased at Rs 120 per share and brokerage was paid at 2% .what is the cost of acquisition?

Ans 1000 shares x Rs 120=120000 brokerage at 2%=2/100x120000=2400 total cost of acquisition is 120000+2400=122400

3) Mr.Rajat purchased 2000 shares of Excel Ltd @Rs 95 and paid brokerage @2% and stamp duty Rs 20000. Out of these shares, 1000 shares are sold out @Rs 110 and brokerage @2% .Calculate cost of Investment sold and the resulting profit/loss.

2000 shares purchased @ Rs 95=190000 add 2% brokerage 2/100x190000=3800 add stamp duty 20000 total cost of acquisition = 190000+3800+20000=213800

1000 shares sold @Rs 110=110000 less brokerage @2% 2/100x110000=2200 net sale proceeds 110000-2200= 107800

Cost of acquisition of 2000 shares =213800

Cost of acquisition of 1000 shares= 213800/2= 106900

Cost of 1000 shares 106900 sale proceeds of 1000 shares 107800 therefore profit on sale is 107800-106900= Rs 900

4) X purchased 1000 10% debentures of RS 100 each on 1 April 2015 at 96 cum- interest the previous interest date being 31 December 2015. Compute cost of Investment

Total amount payable 1000 x Rs 96= 96000

Less Interest included in the above for 3 months January February and March

100000x10%x3/12=100000x10/100x3/12=2500

Cost of Investment = 96000-2500=93500

5.9 EXERCISES – problems for practice

1) On 1st April 2014, Mr. Manish has 50,000 Equity Shares of P Ltd .at a book value of Rs 15 per share (face value Rs. 10 each)He provides you the following information-

i) On 20 June 2014 he purchased another 10000 shares of P Ltd at Rs 16 per share

ii) On 1 August 2014, P Ltd issued one Equity bonus share for every six shares held by the shareholders.

iii) On 31 October 2014, the Directors of P Ltd announced a rights issue which entitled the holders to subscribe to three shares for every seven shares at Rs 15 per share. Shareholders can transfer their rights in full or in part.

Manish sold 1/3 rd of entitlement to Umang for a consideration of Rs 2 per share and subscribe the rest on 5 November 2015.

You are required to prepare investment a/c in the books of Manish for the year ending 31 March 2015

(Ans Bonus shares 10000 shares rights sold 10000 shares at Rs 2 per share=20000 rights subscribed 20000 shares at Rs 15 per share=300000 closing balance 31 March 2015 90000 shares Rs 1210000)

2)Following transactions appear in the books of Mr Joshi for 12% Government bonds of Rs 100 each. Transactions during the year ended 31 March 2016 are as follows- On 1st April 2015, opening balance of 2400 bonds at a cost of Rs 228000

Date	Particulars	Quantity	Rate	Quotation
01/06/2015	sold	900	105	Cum Interest
01/09/2015	Purchased	2100	98	Ex- Interest
01/12/2015	Purchased	1200	108	cum Interest
01/02/2016	sold	2700	97	Ex Interest

Interest is payable half yearly on 30th June and 31st December every year. The Accounting year ends on 31st March. Prepare 12% Bonds Account for the year ending 31/03/2016.Market value of the above investment as on 31 March 2016 was Rs 203456

(Ans- Interest transferred to P&L as on 31 March 2016 Rs 33900 Balance as on 31/3/16 NV 210000 cost 203456 1/6/2015 Profit on sale 4500 1/2/2016 Loss on sale 3544 Interest accrued on 31 March 2016 Rs 6300)

3) On 1st April 2016 Mr. Rajesh holds 20,000 Equity Shares of Rs. 10 each in Hindustan Unilever Ltd., at total cost of Rs. 300000. On 1st July he purchased 4,000 additional shares of the same Company at total cost of Rs. 64,000. On 1st October Company has announced a bonus issue of one shares for every six shares held as on that date. On 1st January 2017 he purchased Right issue, announced by Company of two shares for every five held as on that date at the rate of Rs. 12 each. On 31st January 2017 he purchased 2,000 additional shares of the same Company at total cost of Rs. 36,000. On 1st February 2017 he sold 1000 shares for Rs. 20 each.

Prepare Equity Shares in Hindustan Unilever Ltd. in the books of Mr. Rajesh.

(Ans- profit on sale 7029 balance as on 31 March 2017 40200 shares at Rs 521429)

4)Mr. Shivam holds 1,000 – 10% Debentures of Rs. 100 each in Tech Mahindra Ltd. as on 1st April, 2016 at a cost of Rs. 1,20,000. Interest is payable half yearly on 30th September and 31st March every year. Transactions for the year are as follow:

Date	Particulars	Quantity	Rate	Quotation
30/6/2016	Purchased	500	102	Cum Interest
1/10/2016	Purchased	500	97	Ex Interest
31/12/2016	Sold	700	110	Cum Interest
1/2/2017	Sold	300	98	Ex Interest
1/3/2017	Purchased	200	105	Cum Interest

The Accounting year ends on 31st March. Prepare 10% Debenture Account for the year ending 31/03/2017.

(Ans –loss on sale 31-12-2016 Rs 1138 and loss on sale 1/2/2017 Rs 3337 closing balance as on 31/3/17 face value 120000 cost 129292 interest transferred to P&L a/c 14167)

❖❖❖❖

6

ETHICAL BEHAVIOUR AND IMPLICATIONS FOR ACCOUNTANTS

Unit Structure

Learning outcome

The main purpose of this chapter is for the students to have an awareness of the need for ethical behaviour by accountant and to complement the various accounting and audit standards issued by the governing bodies.

By the end of this chapter, the pupils should be able to:

- discuss the meaning of ethical behaviour;
- understand why accountants need to apply a high level of ethical behaviour to their regular, routine as well as additional activities;
- appreciate how approaches to standard setting, laws and cultures influence our ethical standards;
- describe the various techniques to facilitate whistle-blowing when there are genuine breaches of appropriate legal and moral standards.

6.1 INTRODUCTION

During the past few decades, multiple financial reporting scandals around the globe have brought the issue of ethics in accounting into the forefront. Individuals in an organization irrespective of their position have their own ethical guidelines which may vary from person to person. Thus these scandals took place due to the malicious intentions of few such employees, entrepreneurs and accountants that led to the collapse of the organisations and the investor's wealth being wiped out tremendously.

The fraudulent activities, in the financial set-up, occur when accountants and managers along with few other stake holders[like creditors/ debtors/banks etc.] do not adhere to the standards of earnings management ethics. In such cases, managers and accountants alter financial information. This alteration usually entails the representation of predetermined results in the financial statements, which gives different results than the actual ones ususlly a better one.

Hence to promote integrity among their employees and gain trust from key stakeholders, such as investors and consumers every stakeholder of the company should maintain and follow standards of acceptable behavior. As a result following ethics are vital for an organization. The domain that deals with moral ideologies that govern a person's behaviour or the conducting of an activityis called as ethics. Ethics in accounting are concerned with how to make good and moral choices in regard to the preparation, presentation and disclosure of financial information.

6.2 MEANING OF ETHICAL BEHAVIOUR

An ethical behavior is the application of moral principles in a given situation. It means to behave according to the moral standards set by the society which we live in or working as per the rules or standards set by the organization.

Ethical behaviour is characterized by the qualities of honesty, fairness and equity in interpersonal, professional and academic relationships and in every facet of work life . Ethical behaviour respects the dignity, diversity and rights of the stakeholders in the company as well as the society or country at large.

It evaluates the moral implications of actions being taken on each of the previously mentioned contexts. An ethical behavior is essential for a company to function properly. Individuals who behave unethically will normally lose other people's confidence and their unethical behavior when revealed may attract punitive action or dismissal.

On the other hand, ethical behaviours can also be evidenced in work relationships. Colleagues should maintain an ethical standard between each other to ensure a healthy work environment. This behavior is evidenced by certain values and principles maintained within the relationships, such as integrity, transparency, honesty or fairness. These are ethical standards that should be respected between the parties to maintain an ethical environment.

6.3 FINANCIAL REPORTS & LINK BETWEEN LAW, CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY

6.3.1 Concepts Of Law, Corporate Governance And Corporate Social Responsibility

Corporate governance is the combination of rules, processes or laws by which businesses are operated, regulated or controlled. The term encompasses the internal and external factors that affect the interests of a company's stakeholders, including shareholders, customers, suppliers, government regulators and management.

Corporate Law includes the rules, practices and regulations that govern the formation as well as the operation of corporate firms. In India currently The Companies Act 2013 and the amendments made subsequently are applicable.

Corporate social responsibility (CSR) is a self-regulating business model that helps a company be socially accountable—to itself, its stakeholders, and the public.India became the first country that legislated and made companies adopt and undertake CSR activities . Also the corporates are required to mandatorily report CSR initiatives under the new Companies Act 2013. Thus now companies with a particular turnover, networth, and net profit are required to spend 2% of their average net profit on corporate social responsibility [Section 135 of the Companies Act, 2013].

Financial statements (or financial reports) are formal records of the financial activities and position of a business, person, or other entity. According to S. 2(40) of the companies act 2013 financial statement in relation to a company, includes—

(i) a balance sheet as at the end of the financial year;

(ii) a profit and loss account, or in case of a company carrying on any activity not for profit , an income and expenditure account for the financial year;

(iii) cash flow statement for the financial year; and (iv) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause

(iv) However, the financial statement, with respect to one person company, small company and dormant company (S. 455) may not include cash flow statement.

6.3.2 Relationship Of Company Law, Corporate Governance And Corporate Social Responsibility

Financial statements are the statements that present an actual view of the financial performance through the profits and asset &liabilities of an organization at the end of a financial year. It represents a formal record of financial transactions taking place in an organization. These statements help the users of the information in determining the financial position, liquidity and performance of the organization. The financial statements provide enormous information about a company's revenue, expenses, profitability, debt position, and the ability to meet its short-term and long-term financial obligations.

Corporate law provides pertinent information about the formation and the activities of corporations, while corporate governance regulates the balancing of interests among a business's different stakeholders. Corporate law and governance therefore directly shapes what businesses do and how they do it.

The Companies Act 2013 introduced a new Section on Corporate Social Responsibility (CSR), Section 135, making CSR mandatory for all companies operating in India. The companies should use CSR to integrate economic, environmental and social objectives with the company's operations and its growth. 2% CSR spending would be computed as 2% of the average net profits made by a company during the preceding three financial years.It not only promotes sustainable development of the company's products in the market but also help in reducing the problems faced by the society.

Hence the financial report help in decision making as well as presents the financial wellbeing of the companies as per the provisions laid down in the company act, the governance along with CSR facilitates the companies to focus on the ethical practices in the business and the responsiveness of an organisation to its stakeholders and the environment in which it operates.

6.4 ACCOUNTING BEHAVIOR IN ACCOUNTING PROFESSION

6.4.1 TYPES OF ACCOUNTANTS

The accountant's competency has two dimensions – technical proficiency and ethical sensibility.

Technical Proficiencyis the abilityto apply the technical knowledge and skills required in the specialist and professional job role and responsibilities in order to achieve the expected outputs.

Ethical sensitivity is defined as an "attention to the ethical values involved in a conflict-laden situation and a self-awareness of one's own role and responsibility in a situation.

Assuming this: a given accountant may be technically proficient or not and may be ethically sensible or not. Based on these 2 aspects we get the following four types of accountants based on the degree to which the accountant is technically proficient and ethically sensible.

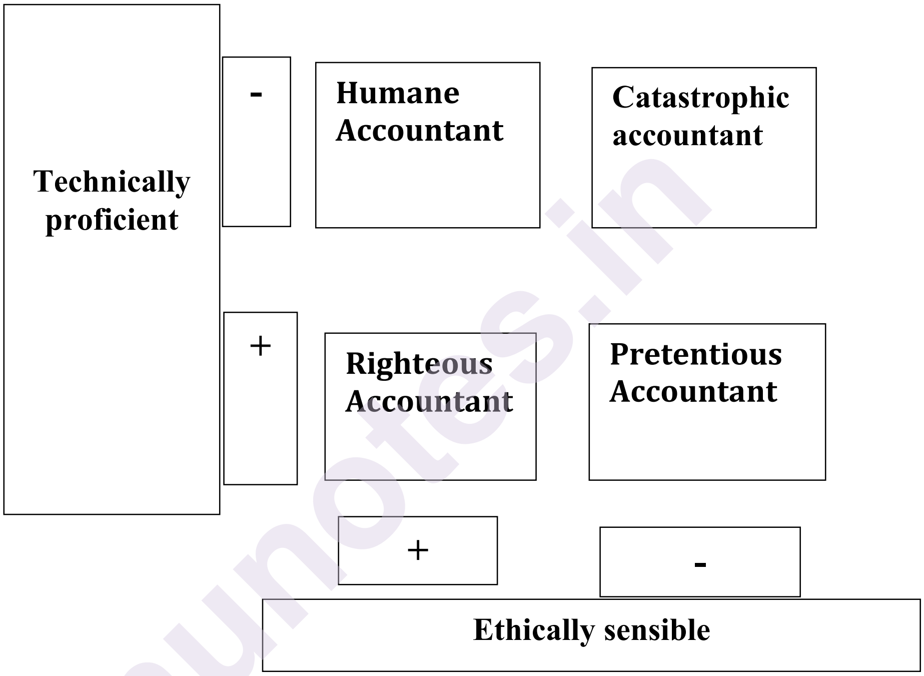
Consider the diagram below, the Y axis reflects the holding [+] or lack [-] of technical proficiency and theX axis the holding [+] or lack [-] of ethical sensibility of the accountants

1.The Catastrophic Accountant

2.The Humane Accountant

3.The Pretentious Accountant

4.The Righteous Accountant



These types are elaborated here under:

The Catastrophic Accountant is an accountant who lacks both technical and ethical competence. If such an accountant enters the practice, he or she is surely the opposite of what accounting education aims to produce. Such an accountant is neither able nor willing to act in accordance with accounting standards.

The Humane Accountant is characterized by ethical sensibility, but lacks technical competence. Such an accountant is essentially well meaning, but has a knowledge problem, in the sense that he or she is not able to act in accordance with standards. This problem can be overcome by increasing the accountant's knowledge and skill in applying the accounting standards.

The pretentious Accountant is characterized by being technically proficient while not being ethically sensible. This means that he knows the standards well enough to use them well, but he is willing and able to exploit loopholes to benefit himself or those whom he favors. Such accountants are in a narrow sense competent, but they have a motivation problem, in the sense that they do not place the common good ahead of their own self- interest. This is a problem that can be addressed either by strengthening the moral character of the accountant, or by putting control measures in place that will hinder him from acting unethically.

The Righteous Accountant is characterized by being technically proficient and ethically sensible. This means that he or she integrates technical and ethical knowledge in accounting decisions. Such an accountant will follow standards and act to promote the common good.

6.4.2 TYPES OF ACCOUNTING FRAUDS

Fraudulent Financial Reporting

Most accounting scandals over the last two decades have centered on fraudulent financial reporting. Fraudulent financial reporting is the misstatement of the financial statements by company management. Usually, this is carried out with the intent of misleading investors and maintaining the company's share price.

While the effects of misleading financial reporting may boost the company's stock price in the short-term, there are almost always ill effects in the long run. This short-term focus on company finances is sometimes known as "myopic management."

Misappropriation of Assets

On an individual employee level, the most common ethical issue in accounting is the misappropriation of assets. Misappropriation of assets is the use of company assets for any other purpose than company interests. Otherwise known as stealing or embezzlement, misappropriation of assets can occur at nearly any level of the company and to nearly any degree.

For example, a director may charge a family dinner to the company as a business promotion expense. At the same time, an administrative employee may take home office supplies for personal use. In both cases, misappropriation of assets has occurred.

Disclosure Violations

Disclosure violations are errors of ethical omission. It usually pertains to the failure to disclose information to investors that could change their decisions about investing in the company. Company executives must walk a fine line; it is important for management to protect the company's proprietary information. However, if this information relates to a significant event, it may not be ethical to keep this information from the investors.

Unethical accounting practices are usually motivated by management pressure, bonus incentives, greed, and more. However, these actions typically result in short-term gains, but long-term negative consequences. Thus they are neither desireable nor acceptable to any stakeholder of an entity.

6.4.3 DESIRED BEHAVIOUR BY THE ACCOUNTANTS

A professional accountant thus shall comply with the principle of professional behavior, which requires an accountant to comply with relevant **laws** and regulations and avoid any conduct that the accountant knows or should know might discredit the profession.To attend theabove-mentionedchallenges along with issues of harmonization of accounting practice and to improve the quality of financial reporting, accountants are needed to look beyond accounting decisions-making.

The good financial performance of the company depends, largely on, the proper estimation, analysis and use that the accountant made of financial information. In the most successful way the accountants have to handle administrative decision-making, these accounting professionals have to check and produce specific reports, they must be able to prepare, analyze and interpret all the financial information of the company and thus there collaborate with the process of decision-making by management.

6.5 IMPLICATIONS OF ETHICAL VALUESFOR PRINCIPLES V. RULE BASED APPROACHES TO ACCOUNTING STANDARDS

Accounting standardsplays a vital role in financial accounting and reporting in order for investors to make good decisions. Rules-based accounting is generally a list of detailed rules that must be followed whena concern is preparing its financial statements. Principle based standards are derived from a conceptual framework that provides for broad ‘principles’ to be adopted within standards and also requires professional and managerial judgment in relevance to particular transactions and events.

Principles-based accounting standards are based on an abstractoutline. Such standards require a clear hierarchy of predominant concepts, principles that reflect these concepts and limited further guidance. The principles-based deliver a comprehensive way in preparing the financial statement yet has the flexibility to overcome any situations.

The main differences between accounting standards developed under a principles-based approach and existing accounting standards are

(1) the principles would apply more broadly than under existing standards, thereby providing few, if any, exceptions to the principles and

(2) there would be less interpretive and implementation guidance for applying the standards.

Principle based approach are anticipated to help and protect the long term interests of the investors and other stakeholders and will help the management team of the companies to make an appropriate professional judgement in selecting and applying the most suitable accounting policies.

Six high-quality characteristics of principles-based accounting standard include; faithful presentation of economic reality, responsive to users’ needs for clarity and transparency, consistency with a clear Conceptual Framework, based on a defined scope that addresses a broad area of accounting, written in a clear and understandable language and use of appropriate judgment. The principles-based tend to have more professional judgement and to give a true and fair view of the financial results.

The fundamental advantage of principles-based accounting is that its broad guidelines can be practical for a variety of circumstances. Precise requirements can sometimes compel managers to manipulate the statements to fit what is compulsory.

6.6 PRINCIPAL BASED APPROACH AND ETHICS

There are five fundamental principles in the code of ethics, and these are pillars uponwhich the code is built. A professional accountant shall comply with the followingfundamental principles:

1. Integrity- Integrity means to be straightforward, trustworthy , gracious and honest in all professionaland business relationships. Honesty and transparency are important virtues in allprofessional practice. Acting with integrity means staying true to the values of theprofession and not attempting to mislead the client.

Eg. Ms. Radhika was facing problem in timely completion of a project. Her colleague Mr. Shyam noticed that and offered some useful tips that enabled her to complete it. Later, at the team meeting, Radhika told everyone that she could not have done it without him and thanked him for his help.

This illustration displays Radhika's Integrity at workplace of being honest and giving due credit to the colleague.

2. Objectivity- Objectivity means not allowing bias, conflict of interest or undue influence of any person, agency or organisation to override professional or business judgments. Objectivity is absolutely desirable and clearly displayed in the code of ethics for accountants so that equal treatment is steered out. Objective decision making means acting in a manner that does not unduly prioritize some stakeholders over others unless there is a valid reason to do so.

Eg. Mr. Prince, an accountant, of Balloons &Gifts Ltd that is trying to get financing for an extra plant expansion, but the company's bank wants to see a copy of its financial statements before it willprovide a loan to the company. Mr. Prince provides the link of the previous statements on the companies website and a memorandum statement with due permission from his seniors for the current period to the bank without any window dressing creation. Mr. Prince is thus very objective in his work.

3. Professional competence and due care- Professional competence and due care means maintaining professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation, and techniques. This principle advocates acting diligently and in accordance with applicable technical and professional standards. A cornerstone of any professional relationship is the expectation that the professional will act in line with the bestavailable knowledge and practice of the profession.

Eg. Mr. Emperor regularly attends seminars and conferences in his company as well as in many professional organisations thereby enhancing personal competence through Continuing Professional Development shows his efforts to stay competent in his job role.

4. Confidentiality- All accountants and auditors should respect the confidentiality of the information acquired as a result of professional and business relationships and not disclose any such information to third parties without proper and specific authority (unless there is a legal or professional right or duty to disclose). Nor should the accountant use the information for personal advantage for himself or for third parties. The duty to maintain confidentiality is very strict, but there are exceptions in cases where the client releases the accountant from confidentiality or in cases where regulatory bodies compel the accountant in order to disclose confidential information.

Eg. Mrs Queen has marked confidential information clearly while preparing a project report for a sensitive project and ensured that additional paper copies were duly shredded. This reflects her quality of maintaining confidentiality in her work.

6. Professional behaviour- Professional behavior is expected of accountants. This means complying withrelevant laws and regulations and avoiding any action that discredits the profession. This principle directly relates to the conduct of the accountant, and has a compliancedimension as well as a reputational dimension. Thus, it deals with the responsibilityfor acting in accordance with the laws and regulations that govern and act in a manner that is compatible with maintaining thereputation and legitimacy of the accountancy profession in the eyes of the generalpublic.

Eg A colleague Mr King treats you in a aggressive manner, you should not resort to the same type of behavior or be vindictive towards him show your high level of professional behaviour.

6.7 INTERNATIONAL FEDERATIONOF ACCOUNTANTS (IFAC) CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

A professional accountant is required to comply with the following fundamental principles: [these principles have been elaborated in 6.6 hence summed up here]

(a) Integrity - A professional accountant should be straightforward and honest in all professional and business relationships.

(b) Objectivity A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

(c) Professional Competence and Due Care- A professional accountant has a unending duty to maintain professional knowledge and skill and also act meticulously and in accordance with applicable technical and professional standards when providing professional services.

(d) Confidentiality- A professional accountant should respect the confidentiality of information acquired during the course of work and maintain secrecy unless otherwise called for revelation by any law

(e) Professional Behavior- A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:

(a) **Self-interest threats**, which may occur as a result of the financial or other interests of a professional accountant or of an immediate or close family member;

Eg Mr Somin promotes his client ABC Ltd consciously to get a job for his son in the firm ABC Ltd is a self interest threat.

(b) **Self-review threats**, which may occur when a previous judgment needs to be re-evaluated by the professional accountant responsible for that judgment;

Eg. Mr Royal an accountant has not appropriately evaluated the results of the current year but has given his opinion based on previous judgments made is an illustration of self review threat.

(c) **Advocacy threats**, which may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised;

Eg Mr. Yash acts as an advocate for a client in a dispute with third parties irrespective of the merit of the case reflects advocacy threat.

(d) **Familiarity threats**, which may occur when, because of a close relationship, a professional accountant becomes too sympathetic to the interests of others;

Eg. Ms Rashi a professional accountant accepted gifts and preferential treatment from a client, the value was not trivial or inconsequential. This was because of having a long association with the client she violated the code of conduct and accepted the gifts that were of a high value. This is an example of a familiarity threat.

(f) **Intimidation threats**, which may occur when a professional accountant may be deterred from acting objectively by threats that may be actual or perceived.

Eg. Mr. Shyam an accountant is deterred from acting objectively because of actual or perceived time pressures by the management. This is an intimidation threat. However in this case it is very much possible that the management takes a holistic view and extends the time for the completion of the work depending of its crucial nature. Alternatively, an employee Mr. Prince may be threatened of removal from his job by his supervisor Mr. King incase an assignment is not completed as desired by him. This also reflects an intimidation threat.

As these threats are presents in the function ing of the organisations, suitable precautionary measures must also be laid in the systems to avoid such circumstances. Safeguards that may eliminate or reduce such threats to an acceptable level fall into two broad categories:

(a) Safeguards created by the profession, legislation or regulation; and

(b) Safeguards in the work environment.

Safeguards created by the profession, legislation or regulation include, but are not restricted to:

- Educational, training and experience requirements for entry into the profession.
- Continuing professional development requirements.
- Corporate governance regulations.
- Professional standards.
- Professional or regulatory monitoring and disciplinary procedures
- External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.
- Ethical Conflict Resolution

In evaluating compliance with the fundamental principles, a professional accountant may be required to resolve a conflict in the application of fundamental principles

When initiating either a formal or informal conflict resolution process, a professional accountant should consider the following, either individually or together with others, as part of the resolution process:

(a) Relevant facts;

(b) Ethical issues involved;

(c) Fundamental principles related to the matter in question;

(d) Established internal procedures; and

(e) Alternative courses of action.

Having considered these issues, a professional accountant should determine the suitable course of action that is consistent with the fundamental principles acknowledged. The professional accountant should also evaluate the consequences of each possible course of action. If the matter remains unanswered, the professional accountant should consult with other appropriate persons within the firm i.e. authorized personnel or by employing a proficient expert for help in addressing or solving the problem.

Where a matter involves a conflict with, or within, an organization, a professional accountant should also consider referring with those charged with governance of the organization, such as the board of directors or the audit committee. It may be in the best interests of the professional accountant to document the severity of the issue and details of any discussions held or decisions taken, regarding that issue.

If a noteworthy conflict cannot be resolved, a professional accountant may wish to obtain professional advice from the relevant professional body or legal advisors, and thereby obtain guidance on ethical issues without breaching confidentiality. For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant should consider obtaining legal advice to determine whether there is a requirement to report.

If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant should, where possible, refuse to remain associated with the matter creating the conflict.

The professional accountant may determine that, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the engagement, the firm or the employing organization.

6.8 ETHICS IN ACCOUNTING WORK ENVIRONMENT

Accountants deal with the financial details of the organizations. Such power involves the potential and possibility of exploitation of such information for self-gain or to deceive the interest of any or all the stakeholders. As a result Accounting ethics are of paramount importance so that falsification or manipulations of records as well as other challenges are avoided.

Ethical codes are thus the fundamental principles that accounting professionals choose to abide by to enhance their profession, maintain public trust, and demonstrate honesty and fairness.

Accounting Decision-making doesn't always come down to "yes" or "no." The fine line between the two is subject to interpretation and will make up the bulk of the encounters that an accountant faces during his or her career.

Ethics in accounting includes both strict adherence to guidelines and careful assessment of unique situations where professional judgment is necessary. Understanding the ethical frameworks for independence, integrity, confidentiality and professional competence can guide decision-making and help preserve the reputation of the field.

6.9 IMPLICATIONS OF UNETHICAL BEHAVIOUR IN FINANCIAL REPORTS

The financial statements are used by investors, market analysts, creditors and many stakeholders to evaluate a company's financial health and earnings potential. It aids them in decision making. Accounting rules, standards and regulations are very crucial in preparing a correct statement. Incase unethical practices have crept in these statements, the basic objective of providing a true and fair picture to the readers is completely hampered.

Lack of personal and professional ethics can lead to negative financial results. Also, the company have raised risky loans putting the firms in a perilous position. The consequences of which for the company may be financial losses, legal wrangling from aggrieved clients, investors, or others affected by the activities, prosecution and penalties to name a few.

For employees in a such an organisation employment growth will be hindered considerably. The firms may even shred employees, reduce pay or increments in an attempt to stay afloat. The employees found engaged in such unethical activities may face faced fines and penalties, loss of jobs or be implicated in law suits. It may as well result in jail sentences. Thus such employees may even be posed with a threat of potential employability with the spread of such an information.

6.10 COMPANY CODE OF ETHICS

A code of ethics in business is a set of guiding principles intended to ensure that abusiness and its employees act with honesty and integrity in all facets of its day-to-day operations. It also promotes all stakeholders to engage only in acts that promote a benefit to society.

A company code of conduct is a document prepared by a company in which it sets out a set of principles that it commits itself to follow, or requires its employees to file. Writing a great code of conduct requires a thorough understanding of the company, its culture and vision. But no matter the company, all great codes of conduct share certain characteristics.

These characteristics are

- **Beneficence** that means the act of doing good to others, concern for well-being and safety of clients.
- **Non maleficence** refers to refraining from causing intentional harm to clients or depriving or deceiving them from their dues.
- **Autonomy/Confidentiality**-Autonomy is the basis for informed consent, truth-telling, and confidentiality means keeping an information discreet.
- To respect client's rights and opinions.
- To do Social Justice by providing services in a fair and equitable manner.
- To ensure and maintain systems such that Procedural Justice is automatically served.
- To preserve Veracity or reliability in all activities in the organisation
- To sustain Loyalty and fidelity by all the stakeholders always.

A great code of conduct is hence:

- **Written for the reader.** It is easy to understand and doesn't include any technical or legal jargon.
- **Comprehensive.** It covers all important details that may impact the daily lives of employees and answers common questions that arise.
- **Supported by leadership.** It has been acknowledged and approved by the company's senior management team. This is often demonstrated in the form of a foreword written by the Chairman or CEO or President or any other authority.
- **Accessible.** It is available to all employees, current investors and potential investors.
- **Visually appealing.** It follows a style that is clean and reflective of the organization.

An extract of the code of conduct of HUL is represented below:

CODE OF CONDUCT

The Company has adopted a Code of Conduct specifically for the members of the Board of Directors and / or members of the Senior Management of the Company, which sets out as follows:

- To act in the best interests of, and fulfill fiduciary obligations to the Company; act honestly, fairly, ethically and with integrity, conduct themselves in professional, courteous and respectful manner and not take improper advantage of the position of Director;
- To comply with all applicable laws, rules and regulations;
- To act in good faith, responsibly, with due care, competence and diligence, without allowing their independent judgement to be subordinated;
- To act in a manner to enhance and maintain the reputation of the Company;
- To disclose any personal interest that they may have regarding any matters that may come before the Board and abstain from discussion, voting or otherwise influencing decision on any matter in which the concerned Director has or may have such interest;
- To respect the confidentiality of information relating to the affairs of the Company acquired in the course of their service as Directors, while continuing as such a director and even after ceasing to be such a director, for a reasonable period of say two years, except when authorised or legally required to disclose such information;
- Restrain from using the Company's property or position for personal gain;

Retrieved from:https://assets.unilever.com/files/92ui5egz/production/ccbf4bfab375b742b988600d47af917cab792a79.pdf/code-of-conduct-tcm1255-469194-en.pdf

6.11 INCREASING ROLE OF WHISTLE BLOWING

Whistleblowing is the term used when a person passes on information concerning any wrongdoing in an organization or agency etc. The person is generally closely allied with the organisation, often an employee, but also sometimes a supplier or a customer. They become a whistleblower when they observe behaviour or actions that they believe to be misconduct, illegal and not in line with the company's Code of Conduct, and report that suspicion as a whistleblowing matter.

Organisational whistleblowing: This is a preventive tool for organisations to reduce the risks of malpractice and irregularities. Empowering employees and other relevant stakeholders to blow the whistle increases the chances of managers obtaining information on irregularities that should be acted upon at an early stage. Organisations that take their Code of Conduct seriously will therefore put in place mechanisms to enable organisational whistleblowing, such as a secure corporate whistleblowing system or hotline and a whistleblowing policy or guidelines.

Public whistleblowing: In organisations where trust is lowor compliance mechanisms are not in place, or there is no possibility to be an anonymous whistleblower, the person may be more inclined to blow the whistle publicly. This may include reporting to the police, media or through online social channels, which of course brings a greater risk of reputational damage for organisations. In some instances, though, there is a duty to blow the whistle to a professional body or regulator.

Whistle blowing thus generally includes the following

- a criminal offence, e.g. fraud or corruption
- a person's health and safety is in danger
- risk or actual damage to the environment
- a miscarriage of justice
- serious forms of discrimination or harassment
- the company is breaking the law, e.g. does not have the right insurance
- there is suspicion that someone is covering up wrongdoing

In order to mandate the implementation of whistleblowing systems, and to set up adequate and appropriate whistleblowing channels to better manage issues internally and to ensure compliance various nodal agencies have been very proactive in setting upof suitable structures. Accordingly the Government of India enacted **Whistle Blowers Protection Act, 2011** to promote disclosure of information about any corruption or other misconduct.

It was renamed as **Whistle Blowers Protection Act, 2014** by the second schedule of the Repealing and Amending Act, 2015 which provides a mechanism to investigate alleged corruption and misuse of power by public servants and also protect anyone who exposes alleged wrongdoing in government bodies, projects and offices. The wrongdoing might take the form of fraud, corruption or mismanagement. The Act will also ensure punishment for false or frivolous complaints.

The Act was approved by the Cabinet of India as part of a drive to eliminate corruption in the country's bureaucracy. The Act seeks to protect whistle blowers, i.e. persons making a public interest disclosure related to an act of corruption, misuse of power, or criminal offense by a public servant.

6.12 STUDENTS NEED TO LEARN ETHICS

1. Studying ethics can deepen the reflection on the accounting problems or issue faced. The study of ethics helps the accountant to look at the accounting problem critically and to evaluate the actions or choicesand rationalize or them.As a result in depth understanding is possible.

2. Ethics is anticipated to assist in making better judgments, think logically and reasonably and to handle such issues with greater clarity.

3. The increased emphasis on ethical education exposes students to ethical dilemmas that will allow them to develop their own ethical decision-making process. This exposure arms students with the skills and knowledge needed for them to make ethical decisions in their own careers.

4. Ethical studies and discussions not only expose students to contrasting ethical opinions, they also provide an opportunity to understand the reasons behind the differences. As a result, students are able to expand their understanding of ethics, sometimes even changing their own values and ethical decision-making process.

5. Case studies and articles presenting ethical scenarios introduce students to both precise and improper ethical decisions and allow them to learn personally the intricacy of ethics. Such instructional methods can "demonstratethe students what first-rate reasoning about ethics actually looks like.

6. Skills related to ethical decision-making, such as critical thinking and leadership, are regarded as top attributes in problem solving and task completion.

7. The development of ethical decision-making skills gives students an opportunity to leverage a competitive advantage into a great job and prepares them to become future business leaders.

Self appraisal

MCQ

1. _____________ "is the ability to do the right thing, at the right time, for the company

a. **Practical wisdom**

b. Ethical language and practice

c. professional ethics

d. Unethical accounting practices

2. _________ is a person, who could be an employee of a company, or a government agency, disclosing information to the public or some higher authority about any wrongdoing, which could be in the form of fraud, corruption, etc.

a. **A whistleblower**

b. Students

c. Ministers

d. Corporators

3. An auditor qualifies his opinion about a director's embezzlement in return for a gain of Rs 50000. This is__________

a. **Self-interest threats**

b.Self-review threats

c.Advocacy threats

d. Intimidation threats.

4. If a company fails to comply with the CSR obligations, the penalty levied is not less than __________
   a. Rs 20000
   b. Rs 30000
   c. Rs 50000
   d. Rs 75000

5. _______________ is a self-interest threat.
   a. Auditor has a close family member who is a director or officer of the client.
   b.Potential employment with the client
   c. Acting as the client's advocate in a legal proceeding.
   d. When the auditor was previously a director or officer of the assurance client.

6. The fraudulent activities, in the financial set-up, do not occur when accountants and managers do not adhere to____________
   a**. Ethics**
   b. A. S.
   c. Concepts
   d. Conventions

7. Accountants should respect the confidentiality of information acquired as a result of professional and business relationships and not disclose any such information to third parties without proper and specific authority____________
a. Integrity
b. Objectivity
c. Professional competence and due care
d**. Confidentiality**

8.___________ is to be straightforward and honest in all professional and business relationships.
a. Integrity
b. **Objectivity**
c. Professional competence and due care
d.Confidentiality

9. ______________ in accounting are concerned with how to make good and moral choices in regard to the preparation, presentation and disclosure of financial information.

a**. Ethics**

b. Accounting Standards

c. Concepts

d. Conventions

10. _________ refer to threats that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior.

a. **Self-interest threats**

b. Self-review threats

c. Advocacy threats

d. Familiarity threats

True or false

1. Ethical education exposes students to ethical dilemmas
2. Whistle blowing isinformation concerning any wrongdoing in a Company.
3. A company code of conduct is a document prepared by a company's shareholders.
4. Advocacy threatoccurs when a previous judgment needs to be re-evaluated and used.
5. Competency means complying with relevant laws and regulations and avoiding any action that discredits the profession.
6. Maintaining professional knowledge and skill at the level required refers to professionalism.
7. Misappropriation of assets is the use of company assets for any other purpose than company interests.
8. Ethical behaviour is characterized by the qualities of honesty and fairness.
9. Corporates are required to mandatorily report CSR initiatives under the new Companies Act 2013.
10. **Financial statements** are formal records of the financial activities and position of an entity.

Answers True:1, 2,7,8,9,10

False:3, 4,5,6

CASE STUDY

1. A marketing personnel has just returned to work after taking special leave to care for her elderly dependent parents. For financial reasons she needs to work full-time. She has been having difficulties with her domestic home care arrangements, causing her to miss a number of team meetings (which usually take place at the beginning of each day) and to leave work early. She is very competent in her work but her absences are putting pressure on her and her overworked colleagues. You are her manager, and you are aware that the flow of work through the practice is coming under pressure. Discuss

ANS:**TYPES OF ACCOUNTANT-** The junior member is stated to be very competent in her work so she is a VIRTUOUS ACCOUNTANT who will follow standards and act to promote the common good.

FUNDAMENTAL PRINCIPLES

Professional competence and due care- Although competent in her work but her absences are putting pressure on her and her overworked colleagues. This may result in pressure upon the colleagues which may result in all of them not being able to act diligently and in accordance with applicable technical and professional standards i.e. due care may not be taken in completion of the work.

Professional behaviour- Till now all the team members arecomplying with relevant laws and regulations and avoiding any action that discredits the profession but they are overworked creating pressures on them.

THREATS

1. Self-interest threats- As a result of this any of the team member may try to take advantage of the situation and negotiate with the management for a higher salary/ remuneration or promotion or any other favour in any form.

2. **Self-review threats-** Due to lack of time and overworking all the team members including this staff member may base their decisions on previous judgements and not current scenario resulting in self review threats.

3. **Familiarity threats-** As all the team members are aware of the staff's domestic situation they face familiarity threat that may occur through helping her all the time.

4. **Intimidation threats**.- All the team members may be deterred from acting objectively because of actual pressures of work causing intimidation threats.

TYPES OF FRAUDS-

1. **Unethical practices** -Due to tremendous work pressure, the team members may unavoidably get into unethical practices due to greed, frustration, stress or any other human factor.

2. **Misappropriation of assets**-If the self interest threats of the employees are not resolved, they may use the company assets for any other purpose than company interests to make a gain for themselves.

3.**disclosure violation & fradulent reporting** -If on a continuous basis all the threats exists then employee frustrations may lead them to not disclose properly or report fraudulently all the requisites. This may be deliberately done so that the company is affected either monetarily or its goodwill/ branding/ public image is not maintained at the same previous level (revenge seeking option by the employees).

Conclusion

Although the employee is competent but as the pressures of work has created multiple threats on the organisation which may result in an ethical problem, it has to be resolved at the earliest. Accordingly, the junior employee may be asked and given time to settle the domestic issues in the most appropriate manner. Other provisions like work from home, staggered timings etc can be looked into however despite all these if still the problem persists then she may be moved to a department where work can be done individually and not in teams.

The team members till the time the problem is not fully arrested should all be motivated enough to overcome all the threats that have been discussed above and maintain the fundamental principles.

TRY YOURSELF [HINTS GIVEN]

2. Ms. Priti is one of three partners in a firm of accountants. Five years ago the firm was appointed as external accountants to a young, successful and fast-growing LLP, engaged to prepare year end accounts and tax returns. The business had started trading with a handful of employees but now has a workforce of 200, while still remaining below the size of LLP requiring a statutory audit. Due to her close relationship with the directors of the company and several of its staff, she became aware that staff purchases of goods manufactured by the company are authorised by production managers, and then processed outside the accounting system. The proceeds from these sales are used to fund the firm's Diwali party.

Hints A.to prepare year end accounts and tax returns- accountant + Auditor- identify type of accountant

B. remaining below the size of LLPrequiring a statutory audit- audited reports are not to be published]- FUNDAMENTAL PRINCIPLES

c. to your close relationship with the directors of the company, aware that staff purchases – threats, FUNDAMENTAL PRINCIPLES

d. processed outside the accounting system, proceeds from these sales are used to outside the org.- **TYPES OF FRAUDS**

3. Mr. Samir cleared his CA final exam in his attempt. Owing to his meritorious background he landed a job immediately with Kabir & Shyam enterprises as General Manager - Finance. At the same time he has decided to take certificate of practice to commence with his practice. In the light of the above statement,

1. identify the type of account he is

2. The threats that he poses to Kabir & Shyam enterprises

3. The fundamental code of ethics that he needs to follow.

<u>HINTS:</u> 1.Virtuous Accountant
2. self interest threat
3. refer 6.6

<u>Theoretical questions</u>

1.Write a brief note on ethical behaviour

2. Explain the link between law corporate governance and corporate social responsibility

3. Write a short note on accounting behavior in the accounting profession

4. Briefly discuss the implications of ethical valuesfor principles v. rule based approaches to accounting standards

6. Explain IFAC code of ethics for professional accountants

6. Briefly discuss the increasing role of whistle blowing

7. Why do students need to learn ethics?

❖❖❖❖