SHIVAJI UNIVERSITY, KOLHAPUR

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Corporate Accounting

Paper-I and II

For

B. Com. Part-II

Semester-III and IV

(In accordance with National Education Policy 2020)
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Preface

In the modern age of business, a corporate entity has significant role in the economy because of its own identical features. Hence, corporate accounting becomes important part of accounting discipline. From formation of company to winding-up of a company, accounting requires important place in the businesses. Corporate accounting revolves around keeping a company's financial records in order to ensure that the directed rules are compliance effectively and working procedures are held within the limits of the company's rules regulations and policies. It is useful to various stakeholders of company. Corporate accounting not only benefits the company but also enables the executives in making financial decisions.

We hope that this book will prove to be useful to the students of B. Com. Part-II. The text of this book has been divided into eight chapters as four chapters for Semester-III and another four chapters for Semester-IV.

The first part of this book is divided into four units. The first unit covers the Issue of bonus shares, right shares and Swat equity. The second unit describes the accounting process for the Issue and Redemption of Debentures. The third unit focuses on the accounting of Profit or Loss prior to incorporation. The fourth unit introduces the practical approach of Fundamental Computerized Accounting with Tally.

The second part of this book is also divided into four units. The first unit emphasis on accounting for redemption of preference shares. The second unit highlights the valuation of shares. The third unit focuses process of preparation of Final Accounts of Companies. The fourth unit covers store accounting with practical using Tally.

We are thankful to Prof. (Dr.) D. T. Shirke, Hon. Vice-Chancellor and Dr. D. K. More, Director, The Centre for Distance and Online Education for giving us an opportunity to contribute the knowledge in the form of this book. Suggestions for improvement in the book are welcome from stakeholders of all corners.

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B. Com Part-II

Semester III and IV

SIM IN CORPORATE ACCOUNTING PAPER I AND II

INDEX

Each Unit begins with the section 'Objectives' -

Objectives are directive and indicative of :

1. What has been presented in the Unit and
2. What is expected from you
3. What you are expected to know pertaining to the specific Unit once you have completed working on the Unit.

The self check exercises with possible answers will help you to understand the Unit in the right perspective. Go through the possible answer only after you write your answers. These exercises are not to be submitted to us for evaluation. These are provided to you as Study Tools to help keep you in the right track as you study the Unit.

Semester-III
Unit-1
Issue of Bonus Shares, Right Shares and Sweat Equity

Index :

1.0 Objectives

After studying this unit you will be able to –

- Understand the meaning and nature of Bonus Shares, Right Shares and Sweat Equity
- Explain advantages and disadvantages of bonus issue, right shares and sweat equity, SEBI Guidelines, valuation of rights, conditions for sweat equity and related information.
- Pass accounting entries regarding bonus issue and value of rights

1.1 Introduction

In this unit we will discuss in detail issue of bonus shares, right shares and sweat equity. In section 1, we will study bonus shares. In this part you will understand the meaning and nature of bonus shares, advantages and disadvantages, SEBI Guidelines, Prerequisites, Circumstances and Sources of Bonus Shares. We will also learn accounting treatment of bonus issue. In section 2, right shares are discussed. It contains meaning and nature of right shares, Advantages, Valuation of Rights and Accounting Entries. You will learn sweat equity in section 3. Here you will learn Meaning and Definitions, Legal Provisions or Conditions, for and Significance of Sweat Equity Shares

1.2 Issue of Bonus Shares

1.2.1 Introduction

Bonus shares are the shares issued by a company free of charge to its existing shareholders on a pro-rata basis. Bonus Shares are the **supplementary or extra shares distributed to the current stakeholders of the company** without taking any extra amount from them, and these shares are issued out of free reserves created from the profits earned by the company. The companies having substantial reserves sometimes decide to capitalise a part of such reserves by issuing bonus shares to their existing shareholders. Shareholders need not pay anything for such shares. They get the shares free of cost. All the existing shareholders, at the time of issue, will be entitled to receive bonus shares. When the company declares the issue of bonus shares, it also declares the date on which the issue will take place, commonly known as the **record date**. And so, the investors who are the shareholders on the record date will receive bonus issues.

Reserves cannot be distributed to shareholders as dividend because of legal restrictions and financial prudence. So, the successful companies having huge amount of accumulated reserves increase their capital base by issuing bonus shares at free to their existing shareholders from the reserves.

Issue of bonus share is not a source of funds. It is just conversion of reserves and retained earnings into capital. Issue of bonus shares do not affect on the size of the company, assets of the company and total of the balance sheet. It changes only the liabilities side of the balance sheet. Amount of reserves and retained earnings are reduced and capital is increased with the same amount. It is just capitalisation of reserves which are otherwise not available for dividend.

In the short period of time, it is not beneficial to the shareholders, though they are getting additional shares of the company free of cost, because, the size of the company does not change and in the initial period, market value of shares drop. However, in the long run, shareholders may get benefitted. Bonus shares are not taxable at the time of issue in the hands of shareholders, but the shareholders are required to pay capital gains tax, at the time of selling.

1.2.2 Objects / Reasons / Purposes of Issue of Bonus Shares

Companies issue bonus shares mainly for the following reasons.

1. Bonus shares may be issued to make up paid up capital correspond to the capital actually employed in the business.
2. Issue of bonus shares reduces the chance of take-over bids.
3. Issue of bonus shares indicates company's prosperity in front of their investors and brightens the company's image. Maintain a respectable position in the eyes of the investing community. Enhance possibilities of additional funds.
4. It is an inexpensive method of raising capital base of the company. Cash resources of the company are conserved.
5. They are issued to shorten the market price per share by raising shares distribution.

1.2.3 Advantages of Issue of Bonus Shares

1. Shareholders get share in the reserves in the form of shares.
2. As shareholders get additional shares, the value of their investment increases and in the long run they get more dividends.
3. A company can make happy their shareholders without disturbing their liquidity position.
4. As the capital base increases, security of the creditors and financers increases.
5. Issue of bonus share raises the overall share capital of the company, which reflects a good impression over the investors and increases the image of the company in the market.
6. Bonus Shares are issued free of cost to the existent stakeholders of the company out of the free reserves created out of profit which increases stakeholder's wealth as well as saleability of shares in the market.
7. Stakeholders can save the tax on Long-Term Capital Gain by keeping a share for more than one year.

1.2.4 Disadvantages of Issue of Bonus Shares

1. After the issue of bonus shares, market price of shares will drop initially.

2. As the number of shares and amount of capital increases, the rate of dividend will decline in future.
3. For issue of bonus shares, approval of SEBI is essential. Delay in approval delay the issue of shares.
4. When there is a bonus issue, the shareholders do not gain at all.

1.2.5 SEBI Guidelines for Issue of Bonus Issues

A listed company proposing to issue bonus shares shall comply with the following:

1. No company shall issue any shares by way of bonus unless similar benefit is extended to the holders of fully or partly convertible debentures, through reservation of shares in proportion to such convertible part of debentures. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the bonus issues were made.
2. The bonus issue shall be made out of free reserves built out of the genuine profits or share premium collected in cash only.
3. Reserves created by revaluation of fixed assets are not capitalised.
4. The declaration of bonus issue, in lieu of dividend, is not made.
5. The bonus issue is not made unless the partly-paid shares, if any existing, are made fully paid-up.
6. The Company -
   (a) has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof and
   (b) has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.
7. A company which announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of six months from the date of such approval and shall not have the option of changing the decision.

8. The Articles of Association of the company shall contain a provision for capitalisation of reserves, etc. If there is no such provision in the Articles the company shall pass a Resolution at its general body meeting making provisions in the Articles of Associations for capitalisation.
9. Consequent to the issue of Bonus shares if the subscribed and paid-up capitals exceed the authorised share capital, a Resolution shall be passed by the company at its general body meeting for increasing the authorised Capital.
10. Statutory dues of the employees such as provident funds, pension funds, gratuity payment should be made before issuing bonus shares.
11. Bonus shares and dividends can never be adjusted with each other. Bonus shares will always be given in the form of equity shares.
12. Bonus shares cannot be issued within twelve months after any public issue or right issue.

The conditions or guidelines given by SEBI do not apply to bonus issues made by private companies and unlisted public companies.

1.2.6 Prerequisites for Issue of Bonus Shares

1. It should be authorized by the articles of association of the company.
2. It has been authorized in the general meeting of the company after the recommendation of the Board of Directors.
3. The company must have sufficient undistributed profits.
4. Prior approval of the Securities and Exchange Board of India (SEBI) has been received.

1.2.7 Circumstances in which bonus shares are issued

1. When the cash resource of the company is not adequate, for the payment of cash dividend.
2. When the company wants to accumulate cash resources for the purpose of expansion or for the repayment of liability.
3. When the company has accumulated large reserves and wants to indicate the actual earning capacity to its stakeholders.

1.2.8 Sources of Bonus Shares

A company can make an issue of fully paid-up bonus shares from-

1. General Reserves
2. Capital Reserves
3. Securities or Share Premium Account
4. Capital Redemption Reserve Account
5. Balance in Profit and Loss Account
6. Balance in Sinking Fund after redemption of debentures.

1.2.9 Journal Entries

To record the issue of bonus shares in the books of the company, the following accounting entries are passed.

1. For provision made for issue of bonus shares

   Share Premium A/c   Dr

   To Bonus to Equity Shareholders A/c

2. For issue of bonus share

   Bonus to Equity Shareholders A/c   Dr

   To Equity Share Capital A/c

1.2.10 Illustrations

Illustration 1. The following is the balance sheet of Amitabh Ltd. as on 31st March 2023.

Liabilities	₹	Assets	₹
4000 Equity Shares of ₹100 each	4,00,000	Fixed Assets	4,00,000
Share Premium	1,40,000	Investments	3,00,000
General Reserve	70,000	Current Assets	2,00,000
Profit & Loss A/c	1,20,000		
Outside Liabilities	1,70,000		
	9,00,000		9,00,000

The company issued one bonus share for every five fully paid shares on 1st April 2023. For the purpose share premium account is utilised. Show journal entries.

Solution

Calculation of number and amount of bonus shares issued.

4000 / 5 = 800 x 100 = 80,000

Journal

Date	Particulars	L/F	Dr. ₹	Cr. ₹
1/4/2023	Share Premium A/c Dr		80,000	
	To Bonus Equity Shareholders A/c			80,000
	(Being provision made for issue of bonus shares)			
	--			
1/4/2023	Bonus to Equity Shareholders A/c Dr		80,000	
	To Equity Share Capital A/c			80,000
	(Being 1bonus share is issued for every 5 shares)			

Illustration 2. Abhishek Ltd. presents the following balance sheet.

Balance Sheet as on 31/3/2023

Particulars	Schedule No.	₹
Equity and Liabilities		
1. Shareholders' Fund		
a) Share Capital	1	9,00,000
b) Reserves and Surplus	2	7,05,000
2. Current Liabilities		1,25,000
Total		17,30,000
Assets		
1. Non-current Assets	3	9,80,000
2. Current Assets	4	7,50,000
Total		17,30,000

Schedule 1 - Share Capital

	₹
Authorised Capital	20,00,000
Issued, Subscribed and Paid up Capital	
300 10% Preference Shares of ₹ 1000 each fully paid	3,00,000
600 Equity Shares of ₹1000 each fully paid	6,00,000
	9,00,000

Schedule 2 – Reserves and Surplus

	₹
Capital Reserve	1,50,000
Securities Premium	70,000
General Reserve	3,60,000
Profit & Loss A/c	1,25,000
	7,05,000

Schedule 3 – Non-current Assets

	₹
Plant and Machinery	6,50,000
Furniture and Fixtures	1,70,000
Other fixed assets	1,60,000
	9,80,000

Schedule 3 – Current Assets

	₹
Inventories	2,50,000
Trade Receivables	2,70,000
Cash at Bank	1,30,000
Cash in hand	1,00,000
	7,50,000

On 1/4/2023, the company issued one fully paid bonus equity share of ₹ 1000 each for every three equity shares held to its equity shareholders. For this purpose, the balances in Profit & Loss Account and General Reserve are used to the necessary extent.

You are required to pass journal entries for the above transaction.

Solution

Calculation of number and amount of bonus shares issued.

600 / 3 = 200 x 1000 = 2,00,000

Journal

Date	Particulars	L/F	Dr. ₹	Cr. ₹
1/4/2023	Profit & Loss A/c Dr		1,25,000	
	General Reserve A/c Dr		75,000	
	To Bonus to Equity Shareholders A/c			2,00,000
	(Being provision made for issue of bonus shares)			
	--			
1/4/2023	Bonus to Equity Shareholders A/c Dr		2,00,000	
	To Equity Share Capital A/c			2,00,000
	(Being 1bonus share is issued for every 5 shares)			

Illustration 3. Following is the extract from the draft Balance Sheet of Aishwarya Ltd. as on 31^{st} March 2023.

	₹
Authorised Capital	10,00,000

Issued, Subscribed and Paid up Capital	
5000 Equity Shares of ₹100 each fully paid	5,00,000

Reserve Fund	1,00,000
Profit & Loss A/c	80,000

On 31st March 2023, a resolution was passed declaring the issue of bonus shares of 25% on equity share capital to be provided as to ₹ 50,000 from Profit & Loss A/c and remaining from Reserve Fund. The bonus shares will be fully paid.

You are required to set out journal entries to give effect to the resolution.

Solution

Calculation of amount of bonus shares issued.

25% of 5,00,000 = 1,25,000

Provision –	from Profit & Loss A/c	50,000	
from Reserve Fund		**75,000**	1,25,000

Journal

Date	Particulars	L/F	Dr. ₹	Cr. ₹
31/3/2023	Profit & Loss A/c Dr		50,000	
	General Reserve A/c Dr		75,000	
	To Bonus to Equity Shareholders A/c			1,25,000
	(Being provision made for issue of bonus shares)			
31/3/2023	Bonus to Equity Shareholders A/c Dr		1,25,000	
	To Equity Share Capital A/c			1,25,000
	(Being 1bonus share is issued for every 5 shares)			

Illustration 4. Following is the Balance Sheet of Jaya Ltd. as on 31st March 2023.

Balance Sheet as on 31/3/2023

Particulars	Schedule No.	₹
Equity and Liabilities		
1. Shareholders' Fund		
a) Share Capital	1	9,00,000
b) Reserves and Surplus	2	9,35,000
2. Current Liabilities		1,95,000
Total		20,30,000

Assets		
1. Non-current Assets	3	12,10,000
2. Current Assets	4	8,20,000
Total		20,30,000

Schedule 1 - Share Capital

	₹
Authorised Capital	20,00,000
Issued, Subscribed and Paid up Capital	
3000 Equity Shares of ₹ 100 each fully paid	3,00,000
6000 10% Preference Shares of ₹100 each fully paid	6,00,000
	9,00,000

Schedule 2 – Reserves and Surplus

	₹
Capital Reserve	1,50,000
Capital Redemption Reserve	1,70,000
Securities Premium	3,60,000
General Reserve	1,25,000
Profit & Loss A/c	1,30,000
	9,35,000

Schedule 3 – Non-current Assets

	₹
Plant and Machinery	6,50,000
Furniture and Fixtures	2,00,000
Other fixed assets	3,60,000
	12,10,000

Schedule 3 – Current Assets

	₹
Inventories	3,10,000
Trade Receivables	2,20,000
Cash at Bank	1,90,000
Cash in hand	1,00,000
	8,20,000

The company decided to issue bonus shares at 40% of existing equity share capital to the shareholders. For this purpose required provision will be made as from,

Capital Reserve – 20%, Capital Redemption Reserve - 20%, Securities Premium - 40%, General Reserve - 10%, Profit & Loss A/c - 10%.

The appropriate resolution was passed and the above transactions were duly completed.

You are required to show journal entries to record the transactions in the books of the company.

Solution

Calculation of amount of bonus shares issued - 40% of 3,00,000 = 1,20,000

Provisions

	₹
Capital Reserve - 20% of 1,20,000	24,000
Capital Redemption Reserve - 20% of 1,20,000	24,000
Securities Premium - 40% of 1,20,000	48,000
General Reserve - 10% of 1,20,000	12,000
Profit & Loss A/c - 10% of 1,20,000	12,000
	1,20,000

Journal

Date	Particulars	L/F	Dr. ₹	Cr. ₹
31/3/2023	Capital Reserve Dr		24,000	
	Capital Redemption Reserve Dr		24,000	
	Securities Premium Dr		48,000	
	General Reserve A/c Dr		12,000	
	Profit & Loss A/c Dr		12,000	
	To Bonus to Equity Shareholders A/c			1,20,000
	(Being provision made for issue of bonus shares)			
	--			
31/3/2023	Bonus to Equity Shareholders A/c Dr		1,20,000	
	To Equity Share Capital A/c			1,20,000
	(Being 1bonus share is issued for every 5 shares)			

Illustration 5. Following are the Schedules of Financial Statement of Aaradhya Ltd. as on 31st March 2023.

Schedule 1 - Share Capital

	₹
Authorised Capital	25,00,000
Issued, Subscribed and Paid up Capital	
8000 10% Preference Shares of ₹ 100 each fully paid	8,00,000
2000 Equity Shares of ₹100 each fully paid	2,00,000
	10,00,000

Schedule 2 – Reserves and Surplus

	₹
Capital Reserve	1,80,000
General Reserve	2,80,000
Profit & Loss A/c	1,25,000
	5,85,000

On 1st July 2023, the company in its general meeting resolved that, bonus shares are to be issued on the basis of one share to one share. For issuing bonus shares, capital reserve will be used fully and remaining portion from general reserve.

Accordingly, bonus shares were issued on 15/7/2023.

Prepare Equity Share Capital A/c, Capital Reserve A/c, General Reserve A/c and Bonus to Equity Shareholders A/c in the books of the company.

Solution

Calculation of Bonus Share Capital **-** one share to one share – equal - 2,00,000

Dr Equity Share Capital A/c Cr

Date	Particulars	₹	Date	Particulars	₹
			1/4/2023	By Balance b/d	2,00,000
15/7/2023	To Balance c/d	4,00,000	15/7/2023	By Bonus to Equity Shareholders A/c	2,00,000
		4,00,000			4,00,000

Dr Capital Reserve A/c Cr

Date	Particulars	₹	Date	Particulars	₹
15/7/2023	To Bonus to Equity Shareholders A/c	1,80,000	1/4/2023	By Balance b/d	1,80,000
		1,80,000			1,80,000

Dr General Reserve A/c Cr

Date	Particulars	₹	Date	Particulars	₹
15/7/2023	To Bonus to Equity Shareholders A/c	20,000	1/4/2023	By Balance b/d	2,80,000
15/7/2023	To Balance c/d	2,60,000			
		2,80,000			2,80,000

Dr Bonus to Equity Shareholders A/c Cr

Date	Particulars	₹	Date	Particulars	₹
15/7/2023	To Equity Share Capital A/c	2,00,000	15/7/2023	By Capital Res. A/c By Gen. Reserve A/c	1,80,000 20,000
		4,00,000			4,00,000

Check your progress - 1

Choose correct alternative given below to fill in the blanks and rewrite the sentence

1. ---------- shares are the shares issued by a company free of charge to its existing shareholders on a pro-rata basis.

   a) Bonus b) Right c) Sweat d) Preference

2. ---------- at the time of issue, will be entitled to receive bonus shares.

   a) All the members of Board of Directors,

   b) All the existing shareholders,

   c) All the Preference Shareholders

   d) All the investors

3. Bonus shares are issued ----------

   a) at premium b) at discount c) free of cost d) at par

4. Issue of ---------- share is not a source of funds.

   a) Preference b) Right c) Sweat d) Bonus

5. Issue of bonus shares is ---------- method of raising capital base of the company.

   a) an inexpensive b) an expensive

   c) highly expensive d) income generating

6. Issue of bonus share raises the overall ---------- of the company.

   a) Loan Capital b) Share Capital c) Reserves & Surplus d) Assets

7. For issue of bonus shares, approval of ---------- is essential.

   a) RBI b) Central Government

c) SEBI d) State Government

8. Bonus Shares are issued only to ------------------

   a) fully paid preference shares b) partly paid preference shares

   c) partly paid equity shares d) fully paid equity shares

9. A company which announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of ---------- months from the date of such approval

   a) six b) three c) nine d) twelve

10. Issue of bonus shares must be authorised by ____________

    a) debtors and creditors

    b) Articles of Association and General Meeting

    c) investors and suppliers

    d) Central and State Government

11. Bonus shares are issued when the company is having **-------**

    a) huge cash and bank balance

    b) excessive current assets

    c) large balance of accumulated reserves

    d) large amount of share capital

12. ---------- is not the source of bonus shares

    a) General Reserves b) Capital Reserves

    c) Share Premium A/c d) cash and bank balance

1.3 Right Shares or Right Issue

1.3.1 Introduction

In case of Joint Stock Companies, generally the shareholders are given the pre-emptive right either by their Articles or by the Act applicable to them. This pre-emptive right gives existing shareholders the first option to purchase additional issues of equity shares. Right is the preference to existing shareholders in subscribing equity shares in all further issues. It means, whenever a company will offer new or fresh issue of shares it should give first option or preference to existing shareholders. Thus, subsequent issue of shares by an existing company to existing shareholders is known as right issues.

In right issue of shares, no prospectus is issued or offer for sale of shares is made. Instead, existing equity shareholders are given 'rights certificates' in proportion to the existing holding which entails them to take up a specified number of shares at a specified price. The price of the shares so offered is usually below listed price to make the offer attractive and to encourage existing shareholders to subscribe for extra shares. If any existing shareholder does not wish to exercise any or all of the rights is at liberty to sell them to third parties who can purchase such shares at a specified price.

As per Section 62 of the Companies Act 2013, where at any time a company having a share capital proposes to increase it subscribed capital by the issue of further shares then –

a) Such further shares shall be offered to the persons who on that date are the holders of equity shares of the company proportionately to their equity holdings on that date subject to the following conditions –

    i. The offer shall be made by a notice specifying the number of shares offered and limiting a time not being less than 15 days and not exceeding 30 days from the date of the offer, within which the offer, if not accepted, will be deemed to have been declined.

    ii. Unless the Articles of Association of the company otherwise specify, the offer shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person, and the notice referred to in clause (i) shall contain a statement of this right.

    iii. After expiry of the time specified in the notice referred to above or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may proceed to dispose of such shares offered in such manner as they consider most beneficial to the company.

b) Such further shares can also be offered to employees under a scheme of employees' sock option, subject to special resolution passed by the company and subject to such conditions as may be prescribed, or to any person, if it is authorised by a special resolution either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

Thus, when a company which has already issued shares want to make a further issue of shares, it is under a legal obligation to first offer the fresh issue to the existing shareholders unless the company has resolved otherwise by a special resolution. It means, the existing shareholders have right to buy shares first when the company offers further issues of shares. However, this right is transferable. It means, a shareholder has choice to buy or not to buy.

Issue of right shares preserves the power of control of the present shareholders. In the absence of this right, the company may issue large number of shares to outsiders and the existing shareholders may lose their controlling power. It also prevents the loss to the existing shareholders on account of dilution of the value of their share holdings. In other words, offering new equity shares below market value results in the decrease in the value of present equity shares. This loss can be compensated by the right value.

Generally, a company offers shares to the existing shareholders at the price lower than market price. Because, the company wants to give some advantage to the existing shareholders considering their continued association with the company and it wants to make the right issue success taking into account the possible fall in the market value of the company's shares due to further issue.

In the case of right issue, the existing shareholders have the privilege of either applying for the shares offered within the specific period or to renounce their right to apply for these shares in favour of some other person. As the right shares are issued at concessional price, an existing shareholder can make a profit by selling his right to apply for the new shares. Existing shareholder may sell this right with or without selling his / her existing shareholdings. So, the price of right shares may be cum-right price or ex-right price. The cum-right price gives the right to apply for new shares in addition to the shares already held, while, ex-right price gives no right to apply for additional shares offered by the company. But the ownership of the existing shares is continued. Hence, generally ex-right price is quoted either after the right shares have already been allotted fully by the company or after expiry of the period given for application for right shares.

If the market price of the shares is higher than the amount at which the company has offered new shares or ex-right price, the existing shareholders have right to buy shares from the company at lower price. The difference between these two is called as right value.

1.3.2 Advantages of Right Issue

Following are the advantages of Issue of Right Shares

1. Control of the company is retained in the hands of the existing shareholders. Right shares are offered to those who are equity shareholders on the date of right issue in the proportion of their shareholdings. It does not disturb existing established equilibrium of shareholdings.
2. The existing shareholders do not suffer loss on account of dilution in the value of their holdings. Due to fresh issue, value of shares is likely to fall. This decrease in the value of shares is compensated by getting right shares at a price lower than the market price.
3. As the shares are issued to the existing shareholders, expenses to be incurred on issue of share to general public are avoided.
4. As the existing shareholders get new shares at lower price, they remain satisfied. It better the image of the company in the minds of the shareholders and automatically in the market.
5. The right issue gives more certainty of getting fresh capital. Issue of shares to the general public has no certainty of getting required amount of capital.
6. In right issue, shares are offered proportionately to the existing shareholders according to their existing holdings. Obviously, the directors or other authorities cannot misuse the opportunity of issuing new shares to their friends and relatives at lower price and retaining more control in their hands.

1.3.3 Valuation of Rights

There are three ways of valuation of rights.

a) Value of Right Share = Market Price – Average Price (MP – AP)

Steps for calculation of Value of Right Share

1. Find Market Value of each share held - If shares are of cum-dividend, deduct the amount of dividend per share from the market value of per share to get market value of cum-right shares.
2. Calculate Market Value of existing shareholdings – No. of shares held x Market value per share
3. Add (to the above) price paid for the fresh shares
4. Calculate total value of all shares (2+3)
5. Calculate Average Price of shareholdings i.e. ex-right value

$$\frac{\text{Total Value}}{\text{No.of Shares}}$$

6. Calculate value of Right share - Deduct Average Price per share from Market Price per share – (1-5)

OR

b) Value of Right Share = $\frac{\text{Market Price – Subscription Price}}{\text{No.of old shares required to purchase one new share +1}}$ =R= $\frac{\text{M} - \text{S}}{\text{N} + 1}$

OR

c) Value of Right Share = $\frac{\text{New Shares}}{\text{Total Shares}}$ x(cum-right price–New Issue Price) = $\frac{\text{NS}}{\text{TS}}$ x (RP–IP)

Valuation of ex-right Value

$$\text{ex-right Value} = \frac{\begin{array}{c}(\text{Cum}-\text{market price x no.of old shares entitling purchase one share})\\ + \text{ subscription price for a new share}\end{array}}{\text{no.of old shares entitling purchase one share } + 1}$$

Note – Students can directly calculate ex-right price by using above formula or they can calculate Right value and then calculate ex-right value by using following formula.

ex-right Value = Cum-market price – Right Value

1.3.4 Accounting Entries

The accounting entries in the books of the company for a rights issue of shares are the same as those are required for new issue of shares to the public. In general, the value of right shares is collected in single instalment at the time of application. The following journal entries are passed for the purpose.

1. On receipt of price of the shares along with application.

Entry	Amount
Bank A/c Dr To Rights Share Application A/c OR To Equity Share Application A/c (Being application money for ----- rights shares @ ₹ ---- each is received)	No. of shares applied for x Issue Price of one equity share

2. On transfer of application money to share capital account and share premium account.

Entry	Amount
Rights Share Application A/c Dr OR Equity Share Application A/c Dr To Equity Share Capital A/c To Equity Share Premium A/c (Being application money of rights shares transferred to share capital account and share premium account)	No. of shares applied for x Issue Price of one equity share No. of shares applied for x face value of equity share No. of shares applied for x amount of premium

1.3.5 Illustrations

Illustration 1. Anna Company offers to its equity share holders the right to buy one equity share of ₹1000 each at ₹1200 for every four equity shares of ₹1000 each held.

The market value of one equity share is ₹ 1800. Calculate value of Right and ex-right value.

Solution –

Calculation of Value of Right

Particulars	Calculations	₹
Market Value per equity share		1800
Market Value of 4 equity shares	1800 x 4	7200
Issue Price of one equity share		1200
Total Price of 5 equity shares	7200 + 1200	8400
Average Price per equity share i.e. ex-right value	8400 / 5	1680
Value of Right	1800-1680	120

OR

b) Value of Right Share = $\frac{\text{Market Price – Subscription Price}}{\text{No.of old shares required to purchase one new share + 1}}$ = R= $\frac{M - S}{N + 1}$

$$= \frac{1800 - 1200}{4 + 1} = 120 ₹$$

OR

Value of Right Share = $\frac{\text{New Shares}}{\text{Total Shares}}$ x (cum-right price – New Issue Price) = $\frac{NS}{TS}$ x (RP – IP)

$$= \frac{1}{5} \text{ x } (1800 - 1200) = 120₹$$

Note – Students can know that any method gives the same answer. So, you can use any one method as per your choice.

Calculation of ex-right value

$$\text{ex-right Value } = \frac{\text{(Cum−market price x no.of old shares entitling purchase one share)} + \text{subscription price for a new share}}{\text{no.of old shares entitling purchase one share } + 1}$$

$$\text{ex-right Value } = \frac{(1800 \text{ x } 4) + 1200}{4 + 1} = 1680$$

OR

ex-right Value = Cum-market price – Right Value = 1800 – 120 = 1680

Illustration 2. Dada Co. Ltd. has a share capital of 10,000 equity shares of ₹100 each having a market value of ₹160 per share. The company wants to raise additional funds or ₹ 2,40,000 and offers to the existing shareholders the right to apply for new share at ₹130 for every five shares held.

You are required to calculate the Value of Right and ex-right value

Solution -

Calculation of Value of Right

Particulars	Calculations	₹
Market Value per equity share		160
Market Value of 4 equity shares	160 x 5	800
Issue Price of one equity share		130
Total Price of 5 equity shares	800 + 130	930
Average Price per equity share i.e. ex-right value	930 / 6	155
Value of Right	160-155	5

OR

b) Value of Right Share = $\frac{\text{Market Price – Subscription Price}}{\text{No.of old shares required to purchase one new share + 1}} = R = \frac{M-S}{N+1}$

$= \frac{160 - 130}{5 + 1} = 5$ ₹

OR

Value of Right Share = $\frac{\text{New Shares}}{\text{Total Shares}}$ x (cum-right price – New Issue Price) = $\frac{NS}{TS}$ x (RP – IP)

$= \frac{1}{6}$ x (160 – 130) = 5 ₹

Calculation of ex-right value

$$\text{ex-right Value} = \frac{(\text{Cum}-\text{marke price x no.of old shares entitling purchase one share}) + \text{subscription price for a new share}}{\text{no.of old shares entitling purchase one share} + 1}$$

$$\text{ex-right Value} = \frac{(160 \text{ x } 5) + 130}{5 + 1} = 155$$

OR

ex-right Value = Cum-market price – Right Value = 160 – 5 = 155

Illustration 3. Baba Co. Ltd. offers to its shareholders the right to buy one share of ₹ 200 each at ₹ 410 for every 2 shares held. The company declared a dividend of ₹ 30 last year. On the declaration of dividend and recommendation of the right, the shares are quoted at a price of ₹ 530 cum-dividend and cum-right.

Calculate the value of the right and ex-right value.

Solution

Calculation of Value of Right

Particulars	Calculations	₹
Market Value per equity share (cum-dividend)		530
Less - Dividend		30
Market Value per equity share		500
Market Value of 2 equity shares	500 x 2	1000
Issue Price of one equity share		410
Total Price of 5 equity shares	1000 + 410	1410
Average Price per equity share – ex-right value	1410 / 3	470
Value of Right	500-470	30

Illustration 4. Kaka Co. Ltd. decided to make a right issue in the proportion of one new share of ₹1000 each at a premium of ₹250 each to the shareholders for every three existing shares. The market value of the shares at the time of announcement of rights issue is ₹2500.

Calculate the value of right and ex-right value of a share.

Solution –

Subscription price = face value + premium = 1000 + 250 = 1250

Value of Right Share = $\frac{\text{Market Price – Subscription Price}}{\text{No.of old shares required to purchase one new share + 1}} = R = \frac{M - S}{N + 1}$

$$= \frac{2500 - 1250}{3 + 1} = 312.50 \text{ ₹}$$

Calculation of ex-right value

$$\text{ex-right Value } = \frac{\text{(Cum−marke price x no.of old shares entitling purchase one share)} + \text{subscription price for a new share}}{\text{no.of old shares entitling purchase one share } + 1}$$

$$\text{ex-right Value } = \frac{(2500 \text{ x } 3) + 1250}{3 + 1} = 2187.50$$

Illustration 5. Mama Co. Ltd. is planning to raise funds by making right issue of equity shares to finance its expansion. The face value of its shares is ₹100 and the market price is `400. The following are the alternatives under consideration before the management for making right issue.

A) 4 new shares for 5 old shares at par

B) 3 new shares for 5 old shares at ₹150

C) 2 new shares for 5 old shares at ₹200

D) 1 new share for 5 old shares at ₹250

You are required to calculate ex-right value and right value for each of the above alternatives.

Solution

Calculation of Value of Right

Particulars	Alternative A ₹	Alternative B ₹	Alternative C ₹	Alternative D ₹
Market Value per equity share (5x400)	2000	2000	2000	2000
Market Value of entitling equity shares	4 x 100 = 400	3 x 150 = 450	2 x 200 = 400	1 x 250 = 250
Total Issue Price	2400	2450	2400	2250
Total No. of shares after right issue	5 + 4 = 9	5 + 3 = 8	5 + 2 = 7	5 + 1 = 6
Average Price per equity share – ex-right value	2400/9 = 266.67	2450/8 = 306.25	2400/7 = 342.86	2250/6= 375.00
Value of Right	400 -	400 -	400 -	400-

(market price – ex-right price)	266.67= 133.33	306.25 = 93.75	342.86 = 57.14	375.00= 25.00

Check your progress-2

1. Whenever a company will offer new or fresh issue of shares it should give -------- option or preference to existing shareholders.

   a) first b) second c) third d) no

2. Preferential issue of shares to existing shareholders in subsequent issues is known as -------- issues.

   a) bonus b) right c) sweat equity d) preference

3. The price of the shares in right issue of shares is usually --------

   a) more than listed price b) free of cost

   c) below listed price d) less than face value

4. As per Section -------- of the Companies Act 2013, where at any time a company proposes to increase it subscribed capital by the issue of further shares then such further shares shall be offered to the persons, who are the holders of equity shares of the company in proportion to their equity holdings on that date

   a) 32 b) 42 c) 52 d) 62

5. The time limit given to existing shareholders for selecting the option of right shares is --------

   a) 15 to 30 days b) 1to15 days c) 30 to 45 days d) 45 to 60 days

6. Issue of -------- shares preserves the power of control of the present shareholders.

   a) bonus b) right c) sweat d) preference

7. The -------- price gives the right to apply for new shares in addition to the shares already held

   a) ex-right b) de-right c) cum-right d) in-right

8. Generally -------- price is quoted either after the right shares have already been allotted fully by the company or after expiry of the period given for application for right shares.

a) in-right b) de-right c) cum-right d) ex-right

9. In the case of issue of -------- shares, the existing shareholders do not suffer loss on account of dilution in the value of their holdings due to fresh issue.

a) right b) bonus c) sweat d) preference

10. In right issue, shares are offered --------

a) dis-proportionately to the existing shareholders according to their existing holdings.

b) proportionately to the existing shareholders according to their existing holdings.

c) proportionately to the existing shareholders according to their past holdings.

d) proportionately to the existing shareholders according to their future holdings.

11. Value of Right Share = $\frac{\text{------ Price – Subscription Price}}{\text{No.of old shares required to purchase one new share} + 1}$

a) Premium b) discount c) Market d) Par

12. --------Value = $\frac{(\text{Cum}-\text{marke price x no.of old shares entitling purchase one share}) + \text{subscription price for a new share}}{\text{no.of old shares entitling purchase one share} + 1}$

a) in-right b) de-right c) cum-right d) ex-right

1.4 Sweat Equity Shares

1.4.1 Meaning and Definitions

Sweat Equity Shares means equity shares issued at a discount or for consideration other than cash for providing know how or making available rights in the nature in intellectual property rights or value additions by whatever name called.

The term sweat equity refers to a company's contribution toward a business venture or other project. Sweat equity is generally not monetary and in most cases, comes in the form of physical labour, mental effort, and time. Sweat equity is commonly found in real estate and the construction industry, as well as in the corporate world, especially, in start-ups.

Sweat equity shares are discounted shares issued by a company to its employees or directors. The shares are given in exchange for a value-add by an employee or director.

The term "Sweat Equity Shares" refers to share that a company issues to its directors or workers in exchange for contributing intellectual property rights, know-how, or any other kind of value addition in exchange for non-cash consideration or at a discount.

According to Section 2(88) of the Companies Act, 2013, sweat equity shares are shares that are distributed to certain employees of a given company when they have made exceptional contributions to the successful completion of a project or assignment, when an employee has demonstrated expert technical skill in a particular subject or when an employee has contributed significantly to the company and earned intellectual property rights.

Sweat Equity shares is a reward given to the employees for their contribution towards fulfilling the objectives of the Company. It encourages the employee to work more for the development of the Company.

Sweat equity is often used in the context of startups or small businesses, where the founders or early employees are compensated for their work with equity in the company rather than a salary. Startups in the initial stages have low capital or profits to pay employee salaries or provide profits to the promoters extensively. Hence, they pay by providing company equity to motivate them to contribute and ensure success.

Sweat equity describes the contribution of physical and mental labour without monetary benefits. Today, most corporate entities offer such equities to ensure they have the best people to run their operations and make the business successful. The equity motivates them to add value to the startup, increasing the company's valuation. Sweat equity can also refer to the value added to a property or real estate investment through improvements or renovations made by the owner rather than a financial investment.

The sweat equity shares shall be issued to the following category of employees:-

- Permanent employee of the Company whether working in India or outside India;
- Director of the Company, whether a whole-time Director or not;
- Employee or Director as mentioned above of a Subsidiary in India or outside India, or of a Holding Company of the Company.

1.4.2 Legal Provisions or Conditions for Issue of Sweat Equity Shares

- Section 53 of the Companies Act, 2013 prescribes that Company shall not issue shares on discount. Any shares issued by the Company at a discount shall be void. However, a Company can issue shares at a discount in the case of Issue of Sweat Equity Shares.
- Section 54 of the Companies Act 2013 allows a company to issue type of equity shares called Sweat Equity Shares.
- Notwithstanding anything contained in section 53 of the Companies Act 2013, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled. –
    i. The issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting.
    ii. The resolution specifies the number of shares, current market price, the consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued.
    iii. not less than one year has, at the time of issue, elapsed since the date on which the company was entitled to commence business.

iv. The sweat equity shares of the company, whose equity shares are listed in a stock exchange, are issued in accordance with the regulations made by the SEBI in this behalf. But in the case of company whose equity shares are not dealt on any stock exchange, the sweat equity shares are issued in accordance with such rules as may be prescribed.

- Under Section 2(88) of the Companies Act of 2013, employees covered by this plan include directors and employees.
- Rule 8(1) of the Companies (Share Capital and Debentures) Rules, 2014 defines that an "Employee" is someone who has been employed by the organisation permanently or at least a year from outside India or a director of the corporation, whether or not such director serves full-time or an employee or director of the holding company or a subsidiary of the entity in or outside of India.

1.4.3 Significance / Advantages of Sweat Equity Shares

1. Offering sweat equity shares to employees is a way to appreciate their hard work and dedication and contribution to the company through work. Such appreciation creates loyalty in the minds of the employees and encourages them to remain with the company for a longer period.
2. Most startups in the early stages cannot give their staff cash bonuses or other financial incentives due to financial constraints. At such time, rewarding employees with sweat equity shares makes them happy.
3. At the time of wage reductions due to one or other reason, sweat equity shares can be issued to compensate. Employees and directors generally agree to a lower salary in return for the shares in the company.
4. It also helps in attraction and retention of employees, especially in the early stage when the company's growth is uncertain.
5. Such shares offer employees a sense of business because, they become owner and are eligible to vote and get dividends.
6. Lock in period of these shares is three years. During this period these shares are non transferable. This makes the strategy effective for a longer period.
7. A company can issue sweat equity shares to an exceptional director who goes above and beyond for the business expansion and development as an award. It is

a reward to the efforts of such exceptional directors. It maintains their interest in the engagement for the foreseeable future.

8. In its initial stages, a company may not have sufficient capital to pay high salaries to experts. Companies can pay them by providing sweat equity shares, the value of which may rise significantly as the company expands.

9. A business may run out of cash because of regular losses or may suffer a temporary cash shortage during the business cycle. Such a cash flow problem can create a financial burden on the company to pay employees' salaries or compensate the directors for their contributions.

In such a case, companies can use sweat equity to compensate employees and directors.

10. This type of equity can be an effective tool for companies to retain talented employees or service providers. They can have company shares which may rise in value based on their contributions. The hope for high profits in the long term ensures lower employee turnover.

11. Sweat equity can give employees or service providers a sense of ownership and pride in the company's success. This can foster a strong culture of teamwork and collaboration and create a sense of shared purpose and vision.

1.4.4 Issue of Sweat Equity Shares

For issue of sweat equity shares, Listed Company shall comply with the provisions of Securities and Exchange Board of India (SEBI) Regulations on Sweat Equity and the Company other than listed company shall comply with the provisions of Section 54 of the Companies Act, 2013 and Rule 8 of Companies (Share Capital and Debentures) Rules, 2014.

The various conditions for the issue of Sweat Equity Shares by Unlisted Companies are:

1. Quantum of issue of Sweat Equity Shares For One time - The Company shall not issue Sweat Equity Shares for more than 15% of existing paid-up share capital or issue value of shares ₹ Five Crores, whichever is higher. For lifetime: The Company shall not issue Sweat Equity shares for more than 25% of the paid-up Equity Capital at any time. Further the limit for issuance of Sweat

Equity Shares for Start-up Company shall not exceed 50% of its paid-up capital up to 5 years from the date of its incorporation or registration.

2. Price of Sweat Equity Shares - The price of the Sweat equity shares shall be determined by the 'Registered valuer' by providing valuation report as the fair price giving justification for such valuation.
3. Convene a Board Meeting - The Board of Directors of the Company shall call, hold and conduct Board meeting and discuss the matter in respect of issue of sweat equity shares and the Board of Directors may pass board resolution in favour of the same.
4. Confirm the Provisions in Articles of Association - Before consideration of issuance of Sweat Equity shares, the Company first ensures that (AOA) of the Company contains the provision for sweat equity shares and if not then take necessary steps for alteration of AOA.
5. Confirm Limit of Authorised Capital – It is also necessary to ensure the proposed issue of sweat equity shares shall be within the limit of the authorised share capital, and if not take necessary steps for increase in the authorised share capital
6. Convene Extra-Ordinary General Meeting - The Company shall hold General meeting and get approval from members by passing special resolution. The Special resolution shall specify Number of issued Shares, Current Market Price of the shares, Consideration, if any, Name of the Directors or Employees to whom such shares has been issued.
7. Filing of form MGT-14 - Company shall have to file MGT-14 to Registrar of Companies within 30 days from the date of passing of special resolution in the Extra-Ordinary General Meeting.
8. Allotment of Shares - The allotment of sweat equity shares shall be made within a period of 12 months for the date of passing of Special Resolution.
9. Filing of form PAS-3 - The Company shall file form PAS-3 to the Registrar within a period of 30 days from the date of allotment of sweat equity shares.
10. Issue of Share Certificate - The Company shall issue share Certificate in form SH-1 within a period of 2 months from the date of allotment of shares and also

pay the stamp duty in accordance with the provisions of Indian Stamp Act, 1899.

11. Disclosure in Board's Report - The Board Report for the year shall disclose the issue of sweat equity shares and provided the required details

12. Lock-in Period -The shares are non-transferable and are in lock-in period for a period of 3 years from the date of allotment and the share certificate shall also specifies the lock-in period on the same.

13. Register of Sweat Equity Shares - The Company shall maintain register of Sweat Equity in Form SH-3 and fill all the particulars as mentioned therein.

In India, sweat equity shares are subject to taxation under the Income Tax Act 1961. The Indian government treats the difference between the fair market value of the shares and the price at which the company issues the shares as income for the employee or service provider. Furthermore, TDS also applies to the value of the shares issued to the employee or service provider.

Check your progress-3

1. ------ Equity Shares means equity shares issued at a discount or for consideration other than cash for providing know how or making available rights in the nature in intellectual property rights or value additions by whatever name called.

   a) Sweat b) Right c) Bonus d) Preference

2. ------ equity is commonly found in real estate and the construction industry, as well as in the corporate world, especially, in start-ups.

   a) Right b) Sweat c) Bonus d) Preference

3. ------ equity shares are discounted shares issued by a company to its employees or directors.

   a) Right b) Bonus c) Sweat d) Preference

4. The sweat equity shares shall be issued to -------- employees whether working in India or outside India

   a) temporary b) daily wages c) seasonal d) permanent

5. The sweat equity shares shall be issued to --------

a) Director of the Company b) Director of the other Company

c) Investor of the Company d) Debtors of the Company

6. Section --- of the Companies Act 2013 allows a company to issue type of equity shares called Sweat Equity Shares.

   a) 34 b) 44 c) 54 d) 64

7. The sweat shares are issued to those employees and directors who are working in the company --------

   a) not less than three years b) not less than two years

   c) not less than one year d) not less than six months

8. Under Section ---- of the Companies Act of 2013, employees covered sweat equity include directors and employees.

   a) 2 (77) b) 3(77) c) 3(88) d) 2(88)

9. Lock in period of sweat shares is ---- years. During this period these shares are non transferable.

   a) three b) two c) one d) four

10. For issue of sweat equity shares, Listed Company shall comply with the provisions of ----- Regulations on Sweat Equity.

    a) RBI b) SEBI c) SBI d) TBF

11. In the case of non listed company, quantum of issue of Sweat Equity Shares for one time should ------

    a) not more than 20% of existing paid-up share capital or issue value of shares ₹ Five Crores, whichever is higher.

    b) not more than 15% of existing paid-up share capital or issue value of shares ₹ Ten Crores, whichever is higher.

    c) not more than 15% of existing paid-up share capital or issue value of shares ₹ Five Crores, whichever is higher.

    d) not more than 25% of existing paid-up share capital or issue value of shares ₹ Five Crores, whichever is higher.

1.5 Summary

In this unit we studied bonus issue of shares, right issue of shares and sweat equity. The companies having substantial reserves sometimes decide to capitalise a part of such reserves by issuing bonus shares to their existing shareholders. Shareholders need to pay nothing for such shares. They get the shares free of cost. All the existing shareholders, at the time of issue, are entitled to receive bonus shares. Issue of bonus shares indicates company's prosperity in front of their investors and brightens the company's image, maintain a respectable position in the eyes of the investing community and enhances possibilities of additional funds. Such issue should be authorized by the articles of association of the company and the general meeting of the company after the recommendation of the Board of Directors and prior approval of the Securities and Exchange Board of India (SEBI).

When a company which has already issued shares want to make a further issue of shares, it is under a legal obligation, the existing shareholders have right to buy shares first However, this right is transferable i.e. a shareholder has choice to buy or not to buy. Issue of right shares preserves the power of control of the present shareholders. It also prevents the loss to the existing shareholders on account of dilution of the value of their share holdings. A company offers shares to the existing shareholders at the price lower than market price considering their continued association with the company

The existing shareholders have the privilege of either applying for the shares offered within the specific period or to renounce their right to apply for these shares in favour of some other person. As the right shares are issued at concessional price, an existing shareholder can make a profit by selling his right to apply for the new shares. The price of right shares may be cum-right price or ex-right price. The cum-right price gives the right to apply for new shares in addition to the shares already held, while, ex-right price gives no right to apply for additional shares offered by the company. But the ownership of the existing shares is continued. Hence, generally ex-right price is quoted either after the right shares have already been allotted fully by the company or after expiry of the period given for application for right shares.

According to Section 2(88) of the Companies Act, 2013, sweat equity shares are shares that are distributed to certain employees of a given company when they have made exceptional contributions to the successful completion of a project or assignment, when an employee has demonstrated expert technical skill in a particular subject or when an employee has contributed significantly to the company and earned intellectual property rights. Sweat equity is often used in the context of startups or small businesses, where the founders or early employees are compensated for their work with equity in the company rather than a salary. It describes the contribution of physical and mental labour without monetary benefits. Today, most corporate entities offer such equities to ensure that, they have the best people to run their operations and make the business successful.

1.6 Terms to remember

- Bonus shares - Bonus shares are the shares issued by a company free of charge to its existing shareholders on a pro-rata basis. Bonus Shares are the **supplementary or extra shares distributed to the current stakeholders of the company** without taking any extra amount from them, and these shares are issued out of free reserves created from the profits earned by the company.
- Right Issue of Shares - Subsequent issue of shares by an existing company to existing shareholders is known as Right Issues or Right Issue of Shares.
- The term “Sweat Equity Shares” refers to share that a company issues to its directors or workers in exchange for contributing intellectual property rights, know-how, or any other kind of value addition in exchange for non-cash consideration or at a discount.

1.7 Answers to check your progress

Check Your Progress-1

1. a) Bonus
2. b) All the existing shareholders,
3. c) free of cost
4. d) Bonus
5. a) an inexpensive
6. b) Share Capital
7. c) SEBI
8. d) fully paid equity shares
9. a) six
10. b) Articles of Association and General Meeting
11. c) large balance of accumulated reserves

12. d) cash and bank balance

Check Your Progress-2

1. a) first	2. b) right	3. c) below listed price
4. d) 62	5. a) 15 to 30 days	6. b) right
7. c) cum-right	8. d) ex-right	9. a) right

10. b) proportionately to the existing shareholders according to their existing holdings.

11. c) Market 12. d) ex-right

Check your progress-3

1. a) Sweat	2. b) Sweat	3. c) Sweat	4. d) permanent
5. a) Director of the Company		6. b) 44	
7. c) not less than one year		8. d) 2(88)	9. a) three

10. b) SEBI

11. c) not more than 15% of existing paid-up share capital or issue value of shares ` Five Crores, whichever is higher.

1.8 Exercise

Write Short Notes

1. Meaning and purpose of issue of bonus shares
2. Advantages and disadvantages of issue of bonus shares
3. SEBI Guidelines for Issue of Bonus Issues
4. Meaning and Prerequisites for Issue of Bonus Shares
5. Meaning and Circumstances in which bonus shares are issued
6. Meaning and Sources of Bonus Shares
7. Meaning and definitions of Rights Issue
8. Advantages of Rights Issue
9. Valuation of Rights

10. Meaning and Definitions of Sweat Equity Shares
11. Legal Provisions or Conditions for Issue of Sweat Equity Shares
12. Significance / Advantages of Sweat Equity Shares
13. Issue of Sweat Equity Shares

Practical Problems

Problem 1. The following are the extracts from the Balance Sheet of Sangeet Ltd.

Authorised Capital – 10,000 equity shares of ₹100 each

Issued and Subscribed Capital - 5,000 equity shares of ₹100 each fully paid

General Reserve – ₹3,50,000

Profit & Loss A/c – ₹1,00,000

A resolution was passed to issue 1,000 shares of ₹100 each by providing `50,000 from Profit & Loss A/c and the balance from the General Reserve.

Pass journal entries to give effect to the resolution.

Problem 2. The following are the extracts from the Balance Sheet of Geet Ltd.

Authorised Capital – 1,00,000 equity shares of ₹100 each

Issued and Paid up Capital - 80,000 equity shares of ₹100 each

General Reserve – ₹35,00,000

Share Premium – ₹10,00,000

Profit & Loss A/c – ₹25,00,000

A resolution was passed declaring one bonus share for four shares held. Provision should be made from Profit & Loss A/c.

Problem 3. The Authorised Capital of a company is ₹12,00,000 divided into12,000 Equity Shares of ₹100 each. Out of which 8,000 shares have been subscribed. The company has the following undisposed off balances-

a) ₹2,30,000 (Cr) in the Profit & Loss A/c and

b) ₹2,85,000 in the General Reserve.

The company has decided in General Meeting to capitalise the necessary part of the above balance by issuing 1,000 fully paid equity shares at par as bonus at the rate of one fully paid share for eight shares held. The balance of the Profit & Loss A/c is first to be exhausted and then the General Reserve is to be drawn upon.

Give Journal Entries to give effect to the above transaction.

1.8 Reference for Further Study

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Unit-2

Issue of Debentures, Interest on Debentures, Amortisation of Discount and Loss on Issue of Debentures and Redemption of Debentures (Sinking Fund Method only)

Index :

2.0 Objectives

After studying this unit you will be able to –

- Understand the meaning and nature of Issue of Debentures, Interest on Debentures and amortization of Discount and Loss on Issue of Debentures.
- Understand the meaning, nature and methods of Redemption of Debentures
- Pass accounting entries regarding issue of debentures.
- Pass accounting entries regarding interest on debentures and amortization of discount and loss on issue of debentures.
- Pass accounting entries and ledger accounts regarding redemption of debentures under Sinking Fund Method

2.1 Introduction

In the first unit we studied issue of bonus shares, issue of right shares and issue of sweat equity. In this unit, we are going to study issue of debentures, interest on debentures and also the redemption of debentures. As you know, there are two types of capital i.e. own capital and loan capital. In the first unit we discussed some sources of own capital and in this unit we will discuss one of the major sources of loan capital i.e. debentures. As like shares, debentures can be issued to raise capital for long period of time. However, it is a loan. So, it should be repaid during or after specific period of time, which is called as redemption of debentures. Here, we will study all aspects of debentures, particularly issue, interest, amortisation of discount and loss on issue and redemption together with their accounting entries in the books of the company.

2.2 Issue of Debentures

2.2.1 Meaning and Definitions

A company needs money for the purposes of growth, expansion, extension, development etc. Every time it will not be suitable to finance for these only by issue of shares. Therefore, a company may turn to the debt financing. Issue of debentures is one of the sources of debt financing for business activities. Debt financing helps in making appropriate capital structure and it also reduces the cost of capital.

Section 2 (30) of the Companies Act, 2013 defines the term Debentures as "debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not".

A debenture is a bond issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.

Debenture is a debt acknowledged by a company whether constituting a charge on the assets of the company or not, whether convertible into shares at a later stage or not, which ensures payment of interest at the fixed rate and repayment of money raised after the expiry of the stipulated period. As Debentures are in the form of debt, they don't carry voting rights. According to **Section 71, a** company may issue debentures with an option to convert into shares, wholly or partly, at the time of redemption but cannot issue debentures with voting rights.

2.2.2 Features of Debentures

1. It is a written instrument which evidences a loan taken by a company from public.
2. It is a fixed interest-bearing security where interest falls due on specific dates.
3. Interest on debentures is payable regardless of the level of profit or loss.
4. The principal amount is repaid on a specified date or it may be converted into shares or new debentures.
5. It may be secured by any asset or may have floating charge on all assets or it may be unsecured.
6. It can generally be traded through the stock exchange at a price prevailing in the market.

2.2.3 Types of Debentures

Debentures can be classified from different points of view as,

1. Security; (2) Convertibility; (3) Permanence; (4) Negotiability; and (5) Priority.

1. On the basis of Security

a) Secured Debentures: These debentures are secured by a charge upon some or all assets of the company. There are two types of charges: (i) Fixed charge; and (ii) Floating charge.

A fixed charge is a mortgage on specific assets. These assets cannot be sold without the consent of the debenture holders. The sale proceeds of these assets are utilized first for repaying debenture holders. A floating charge generally covers all the assets of the company including future one.

b) Unsecured or "Naked" Debentures: These debentures are not secured by any charge upon any assets. A company merely promises to pay interest on due dates and to repay the amount due on maturity date. These types of debentures are very risky from the view point of investors.

2. On the basis of Convertibility

a) Convertible Debentures: These are debentures which will be converted into equity shares (either at par or premium or discount) after a certain period of time from the date of its issue. These debentures may be fully or partly convertible. In future, these debenture holders get a chance to become the shareholders of the company.

b) Non-Convertible Debentures: These are debentures which cannot be converted into shares in future. As per the terms of issue, these debentures are redeemed.

3. On the basis of Permanence

a) Redeemable Debentures: These debentures are repayable as per the terms of issue, for example, after 10 years from the date of issue.

b) Irredeemable Debentures: These debentures are not repayable during the life time of the company. These are also called perpetual debentures. These are repaid only at the time of liquidation.

4. On the basis of Negotiability

a) Registered Debentures: Register of Debenture holders is maintained in which the details of debenture holders such as name, address etc. are recorded. These are not easily transferable. The provisions of the Companies Act, 2013 are to be complied with for effecting transfer of these debentures. Debenture interest is paid either to the registered holder as or the bearer of the interest coupons.

b) Bearer Debentures: These debentures are transferable by delivery. These are negotiable instruments payable to the bearer. No kind of record is kept by the company in respect of the holders of such debentures. Therefore, the interest on it is paid to the holder irrespective of any identity. No transfer deed is required for transfer of such debentures.

5. On the basis of Priority

a) First Mortgage Debentures: These debentures are having first charge on the secured asset and payable first out of the property.

b) Second Mortgage Debentures: These debentures are having second charge on the secured assets and payable after satisfying the first mortgage.

2.2.4 Difference between Debentures and Shares

Debentures	Shares
A person owing the debentures is called as Debenture holder	A person owing the shares is called as share holder
Debenture holder is a creditor of the company. In the balance sheet of the company, debentures are shown under the heading 'Secured Loans'	Share holder is the owner of the company. In the balance sheet of the company, shares are shown under the heading 'Share Capital'
Debenture holder cannot take part in the management of the company	Share holder can take part in the management of the company
Debenture holder has no voting rights	Share holder has voting rights
Debenture holders get interest periodically at a fixed rate irrespective to the profit or loss	Share holder get dividend only in the case of profit. The rate of dividend is not fixed but, it changes according to the profit.
Interest on debentures is an expense of	Dividend is an appropriation of profit. It

the company and deductible in determining taxable profit	is not deductible in determining taxable profit.
Debentures are redeemed after stipulated period	Shares not repaid after specific period but are repaid only in the case of liquidation and only if there is surplus money
Debenture holders have priority in the repayment in the case of liquidation	Share holders have no priority for the repayment in the case of liquidation. Share capital is repaid only after repayment of all liabilities if there is surplus money.
Debentures may be converted into shares	Shares cannot be converted into debentures

2.2.5 Important Points

The following points are to be considered in this regard.

1. The value of debentures may be called in single instalment or in two or more instalments,
2. The debentures may be issued at par or at discount or at premium, and
3. The debentures may be redeemed at par or at premium (very rarely at discount).

A) When total value of debentures is called at the time of application (single instalment), considering the terms of issue and redemption of debentures, one of the following cases may arise.

1. Debentures issued at par repayable at par
2. Debentures issued at par repayable at premium
3. Debentures issued at discount repayable at par
4. Debentures issued at discount repayable at premium
5. Debentures issued at premium repayable at par
6. Debentures issued at premium repayable at premium

Note - Redemption of debentures at discount is very rare in practice, hence not considered.

2.2.6 Accounting / Journal Entries for Issue of Debentures

A) When debentures are issued at single payment

1. Debentures issued at par repayable at par

Journal Entry	Amount
Bank A/c Dr To Debentures A/c (Being debentures issued at par repayable at par)	No. of debentures x face value

2. Debentures issued at par repayable at premium

Journal Entry	Amount
Bank A/c Dr Loss on Issue of Debentures A/c Dr To Debentures A/c To Premium on Redemption of Debentures A/c (Being debentures issued at par repayable at premium)	No. of debentures x face value No. of debentures x premium amount No. of debentures x face value No. of debentures x premium amount

3. Debentures issued at discount repayable at par

Journal Entry	Amount
Bank A/c Dr Discount on Issue of Debentures A/c Dr To Debentures A/c (Being debentures issued at discount repayable at par)	No. of debentures x amount received No. of debentures x discount amount No. of debentures x face value

4. Debentures issued at discount repayable at premium

Journal Entry	Amount
Bank A/c Dr Discount on Issue of Debentures A/c Dr Loss on Issue of Debentures A/c Dr	No. of debentures x amount received No. of debentures x discount amount No. of debentures x premium amount

To Debentures A/c To Premium on Redemption of Debentures A/c (Being debentures issued at discount repayable at premium)	No. of debentures x face value No. of debentures x premium amount

5. Debentures issued at premium repayable at par

Journal Entry	Amount
Bank A/c Dr To Debentures A/c To Premium on Issue of Debentures A/c (Being debentures issued at par repayable at premium)	No. of debentures x amount received No. of debentures x face value No. of debentures x premium amount

6. Debentures issued at premium repayable at premium

Journal Entry	Amount
Bank A/c Dr Loss on Issue of Debentures A/c Dr To Debentures A/c To Premium on Issue of Debentures A/c To Premium on Redemption of Debentures A/c (Being debentures issued at premium repayable at premium)	No. of debentures x amount received No. of deben. x redemption premium amount No. of debentures x face value No. of debentures x issue premium amount No. of deben. x redemption premium amount

B) When the value of debentures is called in instalments – A company may call money on debentures as per requirements in instalments. Just like shares, the instalments are called as Application Money, Allotment Money, First Call Money etc. Accounting entries are also similar to that of issue of shares.

A) Application

1. On receipt of application money

Journal Entry	Amount
Bank A/c Dr To Debentures Application A/c (Being debenture applications received)	No. of debentures applied x application money

2. For transfer of application money to debentures account

a) If debentures are issued at par

Journal Entry	Amount
Debentures Application A/c Dr To Debentures A/c (Being debenture application money transferred to debentures account)	No. of debentures issued x application money

b) If debentures are issued at premium and application money includes premium

Journal Entry	Amount
Debentures Application A/c Dr To Debentures A/c To Premium on Issue of Debentures A/c (Being debenture application money transferred to debentures account and premium on issue of debentures account)	No. of debentures issued x application money No. of debentures issued x debenture amount No. of debentures issued x premium amount

B) Allotment

1. For allotment money due

a) If debentures are issued at par

Journal Entry	Amount
Debentures Allotment A/c Dr To Debentures A/c (Being debenture allotment money due)	No. of debentures issued x allotment money

b) If debentures are issued at discount

Journal Entry	Amount
Debentures Allotment A/c Dr Discount on Issue of Debentures A/c Dr To Debentures A/c (Being debenture allotment money due and discount adjusted)	No. of debentures issued x debenture amount No. of debentures issued x discount amount The total of above two

c) If debentures are issued at premium and allotment money includes premium

Journal Entry	Amount
Debentures Allotment A/c Dr To Debentures A/c To Premium on issue of Debentures A/c (Being debenture allotment money due and premium adjusted)	No. of debentures issued x allotment money No. of debentures issued x debenture amount No. of debentures issued x premium amount

2. On receipt of allotment money

a) When total amount of allotment money is received after demand

Journal Entry	Amount
Bank A/c Dr To Debentures Allotment A/c (Being debenture allotment money received)	No. of debentures issued x allotment money

b) When excess application money is adjusted and remaining amount is received

Journal Entry	Amount
Bank A/c Dr Debentures Application A/c Dr To Debentures Allotment A/c (Being debenture allotment money received and excess application money adjusted)	allotment money–application money to be adjusted application money to be adjusted No. of debentures issued x allotment money

c) When excess application money is refunded

Journal Entry	Amount
Debentures Application A/c Dr To Bank A/c (Being excess application money refunded)	application money to be refunded

C) First Call

a) For first call money due

Journal Entry	Amount
Debentures First Call A/c Dr To Debentures A/c (Being debenture first call money due)	No. of debentures issued x first call money

b) On receipt of first call money

Journal Entry	Amount
Bank A/c Dr To Debentures First Call A/c (Being debenture first call money received)	No. of debentures issued x first call money

Note – If there are further calls, journal entries are passed on the same lines that are passed for the first call.

2.3 Discount and Premium on Issue and Redemption of Debentures

- Discount on Issue of Debentures - Discount on Issue of Debentures is capital loss and is shown to the Assets side of the Balance Sheet under the heading 'Miscellaneous Expenditures and Losses'. Proportionate amount from it is written off every year by passing the following entry every year till it is fully amortised.

Entry	Amount
Profit & Loss A/c. To Discount on Issue of Debentures	Proportionate amount of Discount on Issue of Debentures to be written off

- Premium on Issue of Debentures - Premium on Issue of Debentures is a capital profit and is shown to the Liabilities side of the Balance Sheet under the heading 'Reserves & Surplus'.
- Premium on Redemption of Debentures - Premium on Redemption of Debentures is a liability and is shown to the Liabilities side of the Balance Sheet along with Debentures till the debentures are redeemed.
- Loss on Issue of Debentures - Premium on Redemption of Debentures is treated as a Loss on Issue of Debentures. It is capital loss and is shown to the Assets side of the Balance Sheet under the heading 'Miscellaneous Expenditures and Losses'. Proportionate amount from this is written off every year by passing the following entry every year till it is fully amortised.

Entry	Amount
Profit & Loss A/c. To Loss on Issue of Debentures	Proportionate amount of Loss on Issue of Debentures to be written off

2.4 Interest on Debentures - Accounting Entries

Debenture interest is paid at regular intervals at a fixed percentage of the face value. As per Income Tax Act 1961, a company is required to deduct tax at source at the prevailing rate before payment of interest on debentures, if it exceeds certain limit.

Accounting / Journal Entries for Interest on Debentures

1. When interest falls due

Journal Entry	Amount
Interest on Debentures A/c Dr To Tax Deducted at Source A/c To Debenture holders A/c (Being interest on debenture is due)	Face value of debentures x rate of interest (1) Income Tax to be deducted (2) Interest amount – income tax (1 - 2)

2. On payment of interest on debentures

Journal Entry	Amount
Debenture holders A/c Dr To Bank A/c (Being interest on debenture paid)	Interest amount – income tax (as above)

3. On payment of Income Tax

Journal Entry	Amount
Tax Deducted at Source A/c Dr To Bank A/c (Being income tax deducted at source paid)	Amount of income tax

4. To transfer balance of Interest on Debentures A/c to Profit & Loss A/c

Journal Entry	Amount
Profit & Loss A/c Dr To Interest on Debentures A/c (Being income tax deducted at source paid)	Face value of debentures x rate of interest

2.5 Redemption of Debentures

2.5.1 Meaning and Nature

Redemption of Debentures refers to repayment of liability on account of debentures. In respect of redemption of debentures, the following points need to be considered.

1. Time of Redemption – Every time debentures are not redeemed at the expiry of the given period but, they may be redeemed before the expiry of the given period.

2. Mode of Redemption – Every time debentures are not redeemed by making payment through bank to debenture holders. But, the company may purchase its own debentures in the open market or they may be converted into other debentures or shares.

3. Amount to be paid on Redemption – The debentures may be redeemed at par or at premium or in exceptional case may be at discount. When the debentures are purchased in the open market, the price to be paid depends on the market conditions. In the case of conversion of debentures either in other debentures or shares, the price is determined as per the conditions of conversion. It means the amount of to be paid on redemption changes according to method of redemption.

4. Sources of Finance for Redemption – The debentures may be redeemed out of profits or out of capital or out of provisions or they may be converted into shares or new debentures or may be combination of these.

2.5.2 Methods of Redemption of Debentures

The methods of redemption of debentures can broadly be divided under two headings –

A) When Sinking Fund or Debenture Redemption Fund is created

B) When Sinking Fund or Debenture Redemption Fund is not created – at such time debentures are redeemed by applying any one of the following methods.

   1. Redemption by payment in lump sum
   2. Redemption by payment in instalments
   3. Redemption by Conversion

4. Insurance Policy Method
5. Purchase of own Debentures

Note - As the syllabus includes only Sinking Fund method, Redemption of Debentures when Sinking Fund or Debenture Redemption Fund is not created and the methods under this are not discussed in this unit.

2.5.3 Sinking Fund or Debenture Redemption Fund Method

2.5.3.1 Meaning and Nature

A Sinking Fund is a fund created for the repayment of a particular liability. Here, Sinking Fund refers to the fund created for the redemption of debentures. So, here Sinking Fund and Debenture Redemption Fund are used interchangeably. Debentures are issued for specific period of time. After expiry of the period they are to be redeemed. To avoid liquidity crisis at the time of repayment, many companies create sinking fund by transferring proportionate amount from profit and invest equal amount in outside securities. Interest received on such investment is also reinvested as and when it is received. At the time of maturity, the investment is realised and the proceeds is utilized for repayment of debentures.

2.5.3.2 Accounting / Journal Entries for Redemption of Debentures

Journal entries for issue of debentures are passed as per the information given in the problem considering the entries given for issue of debentures above, if the entries for first year are required.

A) At the end of first year i.e. the year in which debentures are issued

1. To make provision for redemption of debentures

Journal Entry	Amount
Profit & Loss Appropriation A/c Dr To Sinking Fund A/c (Being proportionate amount set aside from profit)	Amount of Debentures / No. of years

2. For investing the amount set aside

Journal Entry	Amount
Sinking Fund Investment A/c Dr To Bank A/c (Being proportionate amount set aside invested)	Provision as per the first entry

B) At the end of second and subsequent years

1. On receipt of interest on investment

Journal Entry	Amount
Bank A/c Dr To Interest on Sinking Fund Investment A/c (Being interest on sinking fund investment received)	Amount of interest as calculated at given rate on the investment of the previous years (as explained in the following table)

2. To transfer the interest on sinking fund investment account to sinking fund account

Journal Entry	Amount
Interest on Sinking Fund Investment A/c Dr To Sinking Fund A/c (Being interest on sinking fund investment transferred to sinking fund account)	Interest received as calculated above

3.To make provision for redemption of debentures

Journal Entry	Amount
Profit & Loss Appropriation A/c Dr To Sinking Fund A/c (Being proportionate amount set aside from profit)	Amount of Debentures / No. of years

Note – These three entries are repeated for all the subsequent years (including last year) from second year

4. For investing the amount set aside and interest received

Journal Entry	Amount
Sinking Fund Investment A/c Dr To Bank A/c (Being proportionate amount set aside and interest invested)	As per the above entry + interest received

Note – This entry is repeated for all the subsequent years from second year except last year i.e. the year in which debentures are matured and repayment is to be made.

C) At the end of last year i.e. the year in which the debentures are matured for repayment

1. For realisation of sinking fund investments

Journal Entry	Amount
Bank A/c Dr To Sinking Fund Investment A/c (Being sinking fund investments sold out)	Amount realised by selling investments

5. If there is profit on sale of investments

Journal Entry	Amount
Sinking Fund Investment A/c Dr To Sinking Fund A/c (Being profit on sale of investments transferred to sinking fund account)	Amount realised – balance of sinking fund investment account

OR

If there is loss on sale of investments

Journal Entry	Amount
Sinking Fund A/c Dr To Sinking Fund Investment A/c (Being loss on sale of investments transferred to sinking fund account)	Balance of sinking fund investment account – Amount realised

6. To transfer balance of debentures account to debenture holders account

Journal Entry	Amount
Debentures A/c Dr Premium on Redemption of Debentures A/c Dr To Debenture holders A/c (Being balance of debentures account transferred to debenture holders account)	Total balance of debentures account Premium, **if any**, on redemption Total of the above two

7. For payment to debenture holders

Journal Entry	Amount
Debenture holders A/c Dr To Bank A/c (Being payment made to debenture holders)	Amount credited in the above entry

8. To transfer premium on redemption of debentures to sinking fund account

Journal Entry	Amount
Sinking Fund A/c Dr To Premium on Redemption of Debentures A/c (Being premium on redemption of debentures account transferred to sinking fund account)	Premium on redemption

9. To transfer balance of sinking fund account to general reserve account

Journal Entry	Amount
Sinking Fund A/c Dr To General Reserve A/c (Being balance of sinking fund account transferred to general reserve account)	Balance of sinking fund account

Note - Students can use the title 'Debenture Redemption Fund' in place of 'Sinking Fund' in all the entries passed above.

2.5.3.3 Calculation of interest

At the end of	Interest calculation	Total investment
1	**2**	**3**
First year	Nil	1st year's provision
Second year	Amount as shown in column 3 in the **first** year's row x Rate =	1st and 2nd years provision + interest as calculated in previous column OR Amount as shown in column 3 in the **first**

	Interest	year's row + current year's provision + interest
Third year	Amount as shown in column 3 in the **second** year's row x Rate = Interest	1st, 2nd and 3rd years provision + interest as calculated in previous column OR Amount as shown in column 3 in the **second** year's row + current year's provision + interest
Forth year	Amount as shown in column 3 in the **third** year's row x Rate = Interest	1st, 2nd, 3rd and 4th years provision + interest as calculated in previous column OR Amount as shown in column 3 in the **third** year's row + current year's provision + interest
Fifth year	Amount as shown in column 3 in the **forth** year's row x Rate = Interest	1st, 2nd, 3rd,4th and 5th years provision + interest as calculated in previous column OR Amount as shown in column 3 in the **forth** year's row + current year's provision + interest
Last year	Amount as shown in column 3 in the **previous** year's row x Rate = Interest	Amount as shown in column 3 in the **previous** year's row will be realised

The table can be extended for further years on the same line

2.6 Check Your Progress

A) Multiple Choice questions

1. Issue of ------ is one of the sources of debt financing for business activities.

   a) debentures b) equity shares c) preference shares d) ordinary shares

2. ------------ of the Companies Act, 2013 defines the term Debentures as "debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not".

   a) Section 1 (30) b) Section 2 (30)

   c) Section 2 (31) d) Section 3 (30)

3. A --------- is a bond issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.

a) preference share b) equity share

c) debenture d) ordinary share

4. **-----------** is a debt acknowledged by a company whether constituting a charge on the assets of the company or not, whether convertible into shares at a later stage or not, which ensures payment of interest at the fixed rate and repayment of money raised after the expiry of the stipulated period.

a) Preference Share b) Equity Share

c) Ordinary Share d) Debenture

5. Debentures don't carry -------- rights.

a) voting b) interest

c) principal repayment d) both interest and principal repayment

6. According to**, --------** a company may issue debentures with an option to convert into shares, wholly or partly, at the time of redemption.

a) Section 70 b) Section 71 c) Section 72 d) Section 73

7) ------ is a written instrument which evidences a loan taken by a company from public.

a) Preference Share b) Equity Share

c) Debenture d) Ordinary Share

8) ----- is a fixed interest-bearing security

a) Preference Share b) Equity Share

c) Ordinary Share d) Debenture

9) --------- is payable regardless of the level of profit or loss.

a) Interest on debentures

b) Dividend on equity share capital

c) Dividend on equity share capital

d) Dividend on Debentures

10) Debentures of a Public Limited Co. --------------------------.

a) cannot be traded in the Stock Market

b) can be traded in the Stock Market

c) banned by SEBI for trading in the Stock Market

d) banned by Companies Act 2013 for trading in the Stock Market

11) ------- Debentures are secured by a charge upon some or all assets of the company.

a) Convertible b) Negotiable c) Secured d) Permanent

12) ------- Debentures can be converted into equity shares after a certain period of time from the date of its issue.

a) Permanent b) Negotiable c) Secured d) Convertible

13) -------- debentures are repaid only at the time of liquidation.

a) Perpetual b) Negotiable c) Secured d) Convertible

14) -------- debentures are transferable by delivery.

a) Perpetual b) Bearer c) Secured d) Convertible

15) Debenture holder is a ------- of the company.

a) owner b) debtor c) creditor d) supplier

16) Debenture holder ------------.

a) can take part in the management of the company.

b) can become director of the company on the basis of holding of debentures.

c) can participate in the General Meeting of the company.

d) cannot take part in the management of the company

17) Interest on debentures is ------ of the company.

a) expense b) income

c) asset d) appropriation of profit

18) A person owing the debentures is called as --------

a) share holder b) Debenture holder

c) debtor d) supplier

19) Debentures are shown to the --------------------.

a) debit side of the Profit & Loss A/c

b) credit side of the Profit & Loss A/c

c) Liabilities side of the Balance Sheet

d) assets side of the Balance Sheet

20) Generally, Debentures are ----------------------

a) not redeemed after stipulated period.

b) written off every year proportionately.

c) considered as an asset after stipulated period.

d) redeemed after stipulated period.

2.7 Illustrations

Types of Problems

1. Issue of Debentures at single payment – various combinations – Journal Entries
2. Issue of Debentures in instalments – various combinations – Journal Entries
3. Treatment of Interest on Debentures - various combinations - – Journal Entries
4. Treatment of amortisation of Discount and Loss on issue of Debentures - various combinations along with interest - Journal Entries and Ledger Accounts
5. Redemption of Debentures - When sinking fund account is created - various combinations along with Interest on Debentures and Discount and Loss on issue of Debentures - Journal Entries and Ledger Accounts

2.7.1 Issue of Debentures

a) When debentures are issued at single payment

1. Debentures issued at par repayable at par and at premium and Debentures issued at discount repayable at par and at premium.

Problem 1. Rohit Bat Producing Co. Ltd. issued the following debentures during the year 2022-23.

1. On 1/7/2022, 2000 12% debentures of ₹200 each issued at 10% discount repayable at par at the end of 12^{th} year
2. On 30/9/2022, 4000 9% debentures of ₹500 each issued at 5% discount repayable at 12% Premium at the end of 15^{th} year

3. On 1/1/2023, 500 10% debentures of ₹1000 each issued at par repayable at par after 5 years.
4. On 31/3/2023, 1000 9% debentures of ₹500 each issued at par repayable at 10% premium after 7 years.

Please, enter the above transactions in the journal of the company.

Solution – In the books of Rohit Bat Producing Co. Ltd.

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/7/2022	Bank A/c Dr		3,60,000	
	Discount on Issue of 12% Debentures A/c Dr		40,000	
	To 12% Debentures A/c			4,00,000
	(Being debentures issued at 10% discount repayable at par)			
	--			
30/9/2022	Bank A/c Dr		19,00,000	
	Discount on Issue of 9% Debentures A/c Dr		1,00,000	
	Loss on Issue of 9% Debentures A/c Dr		2,40,000	
	To 9% Debentures A/c			20,00,000
	To Premium on Redem. of 9% Debent. A/c			2,40,000
	(Being 9% debentures issued at 5% discount repayable at 12% premium)			
	--			
1/1/2023	Bank A/c Dr		5,00,000	
	To 10% Debentures A/c			5,00,000
	(Being debentures issued at par repayable at par)			
31/3/2023	--			
	Bank A/c Dr		5,00,000	
	Loss on Issue of 9% Debentures A/c Dr		50,000	
	To 9% Debentures A/c			5,00,000
	To Premium on Redem. of 9% Debent. A/c			50,000
	(Being debentures issued at par repayable at 10% premium)			

2. Debentures issued at discount repayable at premium and Debentures issued at premium repayable at par and at premium.

Problem 2. Rahul Stumps Producing Co. issued following debentures during the financial year 2022-23. On issued at repayable at.

Date	Debentures	Issued at	Repayable at
30/4/2022	10000 11% debentures of ₹100 each	2% discount	Par at the end of 4th year
30/9/2022	2000 9% debentures of ₹100 each	5% discount	10% Premium at the end of 5th year
31/12/2022	7000 7% debentures of ₹100 each	7% premium	Par at the end of 8th year
31/3/2023	5000 15% debentures of ₹200 each	15% premium	15% Premium at the end of 15th year

You are requested to pass journal entries in the books of the company.

Solution – In the books of Rahul Stumps Producing Co.

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
30/4/2022	Bank A/c Dr		9,80,000	
	Discount on Issue of 11% Debentures A/c Dr		20,000	10,00,000
	To 11% Debentures A/c			
	(Being 11% debentures issued at 2% discount repayable at par)			
30/9/2022	Bank A/c Dr		1,90,000	
	Discount on Issue of 9% Debentures A/c Dr		10,000	
	Loss on Issue of 9% Debentures A/c Dr		20,000	
	To 9% Debentures A/c			2,00,000
	To Premium on Redem. of 9% Debent. A/c			20,000
	(Being 9% debentures issued at 5% discount repayable at 10% premium)			

31/12/2022	Bank A/c Dr		7,49,000	
	To 7% Debentures A/c			7,00,000
	To Premium on Issue of 7% Debent. A/c			49,000
	(Being 7% debentures issued at 7% premium repayable at par)			
	--			
31/3/2023	Bank A/c Dr		11,50,000	
	Loss on Issue of 15% Debentures A/c Dr		1,50,000	
	To 15% Debentures A/c			10,00,000
	To Premium on Issue of 15% Deben. A/c			1,50,000
	To Premium on Redem. of 15% Debent. A/c			1,50,000
	(Being 15% debentures issued at 15% premium repayable at 15% premium)			

3. Debentures issued at par, discount and premium and repayable at premium

Problem 3. Ashwin Ball Producing Co. issued following debentures during the financial year 2022-23.

Date	Debentures	Issued at	Repayable at
30/6/2022	1000 8% debentures of ₹100 each	Par	9% Premium at the end of 7th year
31/10/2022	5000 6% debentures of ₹100 each	7% discount	10% Premium at the end of 10th year
31/1/2023	8000 12% debentures of ₹100 each	14% premium	15% Premium at the end of 12th year

You are requested to pass journal entries in the books of the company.

Solution – In the books of Ashwin Ball Producing Co.

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
30/6/2022	Bank A/c Dr		1,00,000	
	Loss on Issue of 8% Debentures A/c Dr		9,000	
	To 8% Debentures A/c			1,00,000
	To Premium on Redem. of 8% Debent. A/c			9,000
	(Being 8% debentures issued at par repayable at 9% premium)			
	--			
	Bank A/c Dr			
31/10/2022	Discount on Issue of 6% Debentures A/c Dr		4,65,000	
	Loss on Issue of 6% Debentures A/c Dr		35,000	
	To 6% Debentures A/c		50,000	
	To Premium on Redem. of 6% Debent. A/c			5,00,000
	(Being 6% debentures issued at 7% discount repayable at 10% premium)			50,000

	Bank A/c Dr			
	Loss on Issue of 12% Debentures A/c Dr			
31/1/2023	To 12% Debentures A/c		9,12,,000	8,00,000
	To Premium on Issue of 12% Deben. A/c		1,20,000	1,12,000
	To Premium on Redem. of 12% Debent. A/c			1,20,000
	(Being 12% debentures issued at 14% premium repayable at 15% premium)			

4. Debentures issued at discount, par and premium repayable at par and issued at par and premium repayable at premium.

Problem 4. Mahendra Pitch Preparing Co. issued following debentures during the financial year 2022-23.

1. On 31/5/2022, issued 1000 7% debentures of ₹1000 each at 4% discount repayable at par.
2. On 31/7/2022, issued 2000 8% debentures of ₹1000 each at par repayable at par.

3. On 30/9/2022, issued 30000 6% debentures of ₹100 each at 5% premium repayable at par
4. On 30/11/2022, issued 1000 7% debentures of ₹2500 each at par repayable at 4% premium.
5. On 31/1/2023, issued 40000 5% debentures of ₹100 each at 5% premium repayable at 5% premium

You are requested to pass journal entries in the books of the company.

Solution – In the books of Ravi Cricket Pad Producing Co.

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
31/5/2022	Bank A/c Dr		9,60,000	
	Discount on Issue of 7% Debentures A/c Dr		40,000	
	To 7% Debentures A/c			10,00,000
	(Being 7% debentures issued at 4% discount repayable at par)			
	--			
31/7/2022	Bank A/c Dr		20,00,000	
	To 8% Debentures A/c			20,00,000
	(Being 8% debentures issued at par repayable at par)			
	--			
30/9/2022	Bank A/c Dr		31,50,000	
	To 6% Debentures A/c			30,00,000
	To Premium on Issue of 6% Debent. A/c			1,50,000
	(Being 6% debentures issued at 5% premium repayable at par)			
	--			
	Bank A/c Dr		25,00,000	
30/11/2022	Loss on Issue of 7% Debentures A/c Dr		1,00,000	
	To 7% Debentures A/c			25,00,000
	To Premium on Redem. of 7% Debent. A/c			1.00,000
	(Being 7% debentures issued at par			

	repayable at 4% premium)			
	--			
	Bank A/c Dr		42,00,000	
	Loss on Issue of 5% Debentures A/c Dr		2,00,000	
31/1/2023	To 5% Debentures A/c			40,00,000
	To Premium on issue of 5% Debent. A/c			2,00,000
	To Premium on Redem. of 5% Debent. A/c			2,00,000
	(Being 5% debentures issued at par repayable at 5% premium)			

5. Debentures issued at discount repayable at premium, issued at par repayable at par and premium and issued at premium repayable at premium.

Problem 5. Ravi Cricket Pad Producing Co. issued following debentures during the financial year 2022-23.

1. On 31/7/2022 issued 11000 12% debentures of ₹100 each at 3% discount repayable at 4% premium.
2. On 31/10/2022 issued 12000 13% debentures of ₹100 each at par repayable at par.
3. On 31/12/2022 issued 13000 14% debentures of ₹100 each at par repayable at 12% premium
4. On 28/2/2023 issued 14000 15% debentures of ₹100 each at 5% premium repayable at 11% premium

You are requested to pass journal entries in the books of the company.

Solution – In the books of Ravi Cricket Pad Producing Co.

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
31/7/2022	Bank A/c Dr		10,67,000	
	Discount on Issue of 12% Debentures A/cDr		33,000	
	Loss on Issue of 12% Debentures A/c Dr		44,000	
	To 12% Debentures A/c			11,00,000
	To Premium on Redem. of 12% Debent. A/c			44,000
	(Being 12% debentures issued at 3% discount repayable at 4% premium)			
	--			
	Bank A/c Dr		12,00,000	
31/10/2022	To 13% Debentures A/c			12,00,000
	(Being 13% debentures issued at par repayable at par)			
	--			
	Bank A/c Dr		13,00,000	
31/12/2022	Loss on Issue of 14% Debentures A/c Dr		1,56,000	
	To 14% Debentures A/c			13,00,000
	To Premium on Redem. of 14% Debent. A/c			1,56,000
	(Being 14% debentures issued at par repayable at 12% premium)			
	--			
	Bank A/c Dr		14,70,000	
	Loss on Issue of 15% Debentures A/c Dr		1,54,000	
28/2/2023	To 15% Debentures A/c			14,00,000
	To Premium on issue of 15% Debent. A/c			70,000
	To Premium on Redem. of 15% Debent. A/c			1,54,000
	(Being 15% debentures issued at 5% premium repayable at 11% premium)			

b) When value of debentures is called in instalments

1) Debentures issued at par repayable at par

Problem 6. Panchganga Irrigation Co. issued 2000 10% debentures of ₹ 1,000 each at par repayable at the option of the company after 6 years at par. The price of the debenture is called as, on application ₹ 500, on allotment ₹ 300 and ₹ 200 on first call.

Will you please pass journal entries for issue of debentures?

Solution – In the books of Panchganga Irrigation Co.

Journal

Sr	Particulars	L/F	Dr ₹	Cr ₹
1	Bank A/c Dr To 10% Debentures Application A/c (Being applications received for 10% debentures)		10,00,000	 10,00,000
2	10% Debentures Application A/c Dr To 10% Debentures A/c (Being application money transferred to10% debentures account)		 10,00,000	 10,00,000
3	10% Debentures Allotment A/c Dr To 10% Debentures A/c (Being 10% Debentures allotment money due)		6,00,000	 6,00,000
4	Bank A/c Dr To 10% Debentures Allotment A/c (Being 10% Debentures allotment money received)		6,00,000	 6,00,000
5	10% Debentures First Call A/c Dr To 10% Debentures A/c (Being 10% Debentures first call money due)		4,00,000	 4,00,000
6	Bank A/c Dr To 10% Debentures First Call A/c (Being 10% Debentures first call money received)		4,00,000	 4,00,000

2) Debentures issued at par repayable at premium

Problem 7. Ganga Irrigation Co. issued 4000 9% debentures of ₹ 500 each at par repayable at the option of the company after 7 years at 6% premium. The price of the debenture is called as, on application ₹ 200, on allotment ₹ 100 and ₹ 200 on first call.

Will you please pass journal entries for issue of debentures?

Solution – In the books of Ganga Irrigation Co.

Journal

Sr	Particulars	L/F	Dr ₹	Cr ₹
1	Bank A/c Dr		8,00,000	
	To 9% Debentures Application A/c			8,00,000
	(Being applications received for 9% debentures)			
2	9% Debentures Application A/c Dr		8,00,000	
	To 9% Debentures A/c			8,00,000
	(Being application money transferred to9% debentures account)			
3	9% Debentures Allotment A/c Dr		4,00,000	
	Loss on issue of 9% Debentures A/c Dr		1,20,000	
	To 9% Debentures A/c			4,00,000
	To Prem. on Redem. of 9% Debentures A/c			1,20,000
	(Being 9% Debentures allotment money due and premium on redemption adjusted)			
4	Bank A/c Dr		4,00,000	
	To 9% Debentures Allotment A/c			4,00,000
	(Being 9% Debentures allotment money received)			
5	9% Debentures First Call A/c Dr		8,00,000	
	To 9% Debentures A/c			8,00,000
	(Being 9% Debentures first call money due)			

6	Bank A/c Dr To 9% Debentures First Call A/c (Being 9% Debentures first call money received)		8,00,000	 8,00,000

3) Debentures issued at discount repayable at par

Problem 8. Koyana Irrigation Co. issued 6000 14% debentures of ₹ 1000 each at a discount of ₹ 100 repayable at the option of the company after 5 years at par. The price of the debenture is called as, on application ₹ 400, on allotment ₹ 300 and ₹ 200 on first call.

Will you please pass journal entries for issue of debentures?

Solution – In the books of Koyana Irrigation Co.

Journal

Sr	Particulars	L/F	Dr ₹	Cr ₹
1	Bank A/c Dr To 14% Debentures Application A/c (Being applications received for 14% debentures repayable at par) --		24,00,000	 24,00,000
2	14% Debentures Application A/c Dr To 14% Debentures A/c (Being application money transferred to14% debentures account) --		24,00,000	 24,00,000
3	14% Debentures Allotment A/c Dr Discount on Issue of 14% Debentures A/c Dr To 14% Debentures A/c (Being 14% Debentures allotment money due and discount on issue adjusted) --		18,00,000 6,00,000	 24,00,000
4	Bank A/c Dr To 14% Debentures Allotment A/c (Being 14% Debentures allotment money received)		18,00,000	 18,00,000

	--			
5	14% Debentures First Call A/c Dr		12,00,000	
	To 14% Debentures A/c			12,00,000
	(Being 14% Debentures first call money due)			
	--			
6	Bank A/c Dr		12,00,000	
	To 14% Debentures First Call A/c			12,00,000
	(Being 14% Debentures first call money received)			

4) Debentures issued at discount repayable at premium

Problem 9. Krishna Irrigation Co. issued 3000 7% debentures of ₹ 1000 each at a discount of ₹ 100 repayable at the option of the company after 5 years at 5% premium. The price of the debenture is called as, on application ₹ 400, on allotment ₹ 300 and ₹ 200 on first call.

Will you please pass journal entries for issue of debentures?

Solution – In the books of Krishna Irrigation Co.

Journal

Sr	Particulars	L/F	Dr ₹	Cr ₹
1	Bank A/c Dr		12,00,000	
	To 7% Debentures Application A/c			12,00,000
	(Being applications received for 7% debentures repayable at par)			
	--			
2	7% Debentures Application A/c Dr		12,00,000	
	To 7% Debentures A/c			12,00,000
	(Being application money transferred to7% debentures account)			
	--			
3	7% Debentures Allotment A/c Dr		9,00,000	
	Discount on Issue of 7% Debentures A/c Dr		3,00,000	
	Loss on Issue of 7% Debentures A/c Dr		1,50,000	

	To 7% Debentures A/c To Prem. on Redem. of 7% Deben. A/c (Being 7% Debentures allotment money due and discount on issue and premium on redemption adjusted) --			12,00,000 1,50,000
4	Bank A/c Dr To 7% Debentures Allotment A/c (Being 7% Debentures allotment money received) --		9,00,000	9,00,000
5	7% Debentures First Call A/c Dr To 7% Debentures A/c (Being 7% Debentures first call money due) --		6,00,000	6,00,000
6	Bank A/c Dr To 7% Debentures First Call A/c (Being 7% Debentures first call money received)		6,00,000	6,00,000

5) Debentures issued at premium repayable at premium

Problem 10. Kaveri Ice Cream Co. issued 3000 12% debentures of ₹ 1000 each at a premium of ₹ 200 repayable at the option of the company after 7 years at a premium of 15%. The price of the debenture is called as, on application ₹ 500, on allotment ₹ 400 including premium and ₹ 300 on first call.

Pass journal entries for issue of debentures.

Solution – In the books of Kaveri Ice Cream Co.

Journal

Sr	Particulars	L/F	Dr ₹	Cr ₹
1	Bank A/c Dr To 12% Debentures Application A/c (Being applications received for 12% debentures repayable at premium)		15,00,000	15,00,000

2	12% Debentures Application A/c Dr		15,00,000	
	To 12% Debentures A/c			15,00,000
	(Being application money transferred to14% debentures account)			
3	12% Debentures Allotment A/c Dr		12,00,000	
	Loss on Issue of 12% Debentures A/c Dr		4,50,000	
	To 12% Debentures A/c			6,00,000
	To Prem. on Issue of 12% Deben. A/c			6,00,000
	To Prem. on Red. of 12% Deben. A/c			4,50,000
	(Being 12% Debentures allotment money due including premium)			
4	Bank A/c Dr		12,00,000	
	To 12% Debentures Allotment A/c			12,00,000
	(Being 12% Debentures allotment money received)			
5	12% Debentures First Call A/c Dr		9,00,000	
	To 12% Debentures A/c			9,00,000
	(Being 12% Debentures first call money due)			
6	Bank A/c Dr		9,00,000	
	To 12% Debentures First Call A/c			9,00,000
	(Being 12% Debentures first call money received)			

2.7.2 Interest on Debentures

1) When Interest on Debentures is paid annually

Problem 11. On 1st April 2020 Godawari Dam Ltd. issued 2,000 12% Debentures of ₹ 1000 each, repayable at par at the option of the company after 5 years. Under the terms of issue of debentures, interest is payable annually.

Pass journal entries for the first 3 years.

Solution – In the books of Godawari Dam Ltd.

Calculation of Interest – 12% on (2,000 x 1000) = 2,40,000

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2020	Bank A/c Dr		20,00,000	
	To 12% Debentures A/c			20,00,000
	(Being debentures issued repayable at par)			
31/3/2021	Debenture Interest A/c Dr		2,40,000	
	To 12% Debenture holders A/c			2,40,000
	(Being interest on 12% debentures is due)			
31/3/2021	12% Debenture holders A/c Dr		2,40,000	
	To Bank A/c			2,40,000
	(Being interest on 12% debentures paid)			
31/3/2021	Profit & Loss A/c Dr		2,40,000	
	To Debenture Interest A/c			2,40,000
	(Being balance of debenture interest account transferred to profit & loss account)			
31/3/2022	Debenture Interest A/c Dr		2,40,000	
	To 12% Debenture holders A/c			2,40,000
	(Being interest on 12% debentures is due)			
31/3/2022	12% Debenture holders A/c Dr		2,40,000	
	To Bank A/c			2,40,000
	(Being interest on 12% debentures paid)			
31/3/2022	Profit & Loss A/c Dr		2,40,000	
	To Debenture Interest A/c			2,40,000
	(Being balance of debenture interest account transferred to profit & loss account)			

	--			
31/3/2023	Debenture Interest A/c Dr		2,40,000	
	To 12% Debenture holders A/c			2,40,000
	(Being interest on 12% debentures is due)			
	--			
31/3/2023	12% Debenture holders A/c Dr		2,40,000	
	To Bank A/c			2,40,000
	(Being interest on 12% debentures paid)			

31/3/2023	Profit & Loss A/c Dr		2,40,000	
	To Debenture Interest A/c			2,40,000
	(Being balance of debenture interest account transferred to profit & loss account)			

2) When Interest on Debentures is paid half yearly

Problem 12. Narmada Dam Ltd. issued 12,000 12% Debentures of ₹ 100 each, repayable at par at the end of 5 years on 1st April 2021. Under the terms of issue of debentures, interest is payable half yearly.

Pass journal entries for the first two years only.

Solution – In the books of Narmada Dam Ltd.

Calculation of Interest – 12% on (12,000 x 100) for half year = 12,00,000/100 x 12 x ½ = 72,000

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2021	Bank A/c Dr		12,00,000	
	To 12% Debentures A/c			
	(Being debentures issued repayable at par)			12,00,000

30/9/2021	Debenture Interest A/c Dr		72,000	
	To 12% Debenture holders A/c			72,000
	(Being interest on 12% debentures is due for first half of the year)			

30/9/2021	12% Debenture holders A/c Dr		72,000	
	To Bank A/c			72,000
	(Being interest on 12% debentures paid for first half of the year)			

31/3/2022	Debenture Interest A/c Dr		72,000	
	To 12% Debenture holders A/c			72,000
	(Being interest on 12% debentures is due for second half of the year)			

31/3/2022	12% Debenture holders A/c Dr		72,000	
	To Bank A/c			72,000
	(Being interest on 12% debentures paid for second half of the year)			

31/3/2022	Profit & Loss A/c Dr		1,44,000	
	To Debenture Interest A/c			1,44,000
	(Being balance of debenture interest account transferred to profit & loss account)			

30/9/2022	Debenture Interest A/c Dr		72,000	
	To 12% Debenture holders A/c			72,000
	(Being interest on 12% debentures is due for first half of the year)			

30/9/2022	12% Debenture holders A/c Dr		72,000	
	To Bank A/c			72,000
	(Being interest on 12% debentures paid for first half of the year)			

31/3/2023	Debenture Interest A/c Dr		72,000	
	To 12% Debenture holders A/c			72,000
	(Being interest on 12% debentures is due for			

	second half of the year) ---			
31/3/2023	12% Debenture holders A/c Dr To Bank A/c (Being interest on 12% debentures paid for second half of the year) ---		72,000	72,000
31/3/2023	Profit & Loss A/c Dr To Debenture Interest A/c (Being balance of debenture interest account transferred to profit & loss account)		1,44,000	1,44,000

A direct entry can be passed for each payment of interest on debentures as

Debentures Interest A/c Dr 72,000

To Bank A/c 72,000

(Being debenture interest paid)

2.7.3 Interest on Debentures and Amortisation of Discount and Loss on Issue of Debentures

1) When Interest on Debentures is paid annually and discount on issue of debentures is written off.

Problem 13. On 1st April 2021 Sharayu Industries Ltd. issued 11,000 15% Debentures of ₹ 500 each at ₹ 450, repayable at par at the end of 5 years. Interest on debentures is payable annually. The company decided to write off the discount on debentures in five years in equal proportion.

Pass journal entries for first two years.

Solution – In the books of Sharayu Industries Ltd.

Calculation of Interest – 15% on (11000 x 500) = 8,25,000

Calculation of discount to be amortised every year – (11,000 x 50) / 5 = 5,50,000/5 = 1,10,000

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2021	Bank A/c Dr		49,50,000	
	Discount on Issue of 15% Debentures A/c		5,50,000	
	To 15% Debentures A/c			55,00,000
	(Being debentures issued at discount repayable at par)			
31/3/2022	Debenture Interest A/c Dr		8,25,000	
	To 15% Debenture holders A/c			8,25,000
	(Being interest on 15% debentures is due)			
31/3/2022	15% Debenture holders A/c Dr		8,25,000	
	To Bank A/c			8,25,000
	(Being interest on 15% debentures paid)			
31/3/2022	Profit & Loss A/c Dr		9,35,000	
	To Debenture Interest A/c			8,25,000
	To Discount on Issue of Debentures A/c			1,10,000
	(Being interest on debentures and proportionate amount of discount on issue of debentures written off)			
31/3/2023	Debenture Interest A/c Dr		8,25,000	
	To 15% Debenture holders A/c			8,25,000
	(Being interest on 15% debentures is due)			
31/3/2023	15% Debenture holders A/c Dr		8,25,000	
	To Bank A/c			8,25,000
	(Being interest on 15% debentures paid)			
31/3/2023	Profit & Loss A/c Dr		9,35,000	
	To Debenture Interest A/c			8,25,000
	To Discount on Issue of Debentures A/c			1,10,000

	(Being interest on debentures and proportionate amount of discount on issue of debentures written off)			

2) When Interest on Debentures is paid annually and loss on issue of debentures is written off.

Problem 14. On 1st April 2021 Saraswati Industries Ltd. issued 12,000 12% Debentures of ₹ 100 each at par, repayable at 12% premium at the end of 5 years. Interest on debentures is payable annually. The company decided to write off the loss on issue of debentures in five equal annual instalments.

Pass journal entries for first two years.

Solution – In the books of Sharayu Industries Ltd.

Calculation of Interest – 12% on (12000 x 100) = 1,44,000

Calculation of loss on issue of debentures to be amortised every year –

12% on (12000 x 100) = 1,44,000 / 5 = 28,800

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2021	Bank A/c Dr		12,00,000	
	Loss on Issue of 12% Debentures A/c Dr		1,44,000	
	To 12% Debentures A/c			12,00,000
	To Prem. on Redem. of 12% Debentures A/c			1,44,000
	(Being debentures issued at par repayable at 12% premium)			
	--			
	Debenture Interest A/c Dr		1,44,000	
31/3/2022	To 12% Debenture holders A/c			1,44,000
	(Being interest on 12% debentures is due)			
	--			
	12% Debenture holders A/c Dr		1,44,000	
31/3/2022	To Bank A/c			1,44,000
	(Being interest on 12% debentures paid)			
	--			

31/3/2022	Profit & Loss A/c Dr To Debenture Interest A/c To Loss on Issue of Debentures A/c (Being interest on debentures and proportionate amount of loss on issue of debentures written off)		1,72,800	 1,44,000 28,800
31/3/2023	Debenture Interest A/c Dr To 12% Debenture holders A/c (Being interest on 12% debentures is due)		1,44,000	 1,44,000
31/3/2023	12% Debenture holders A/c Dr To Bank A/c (Being interest on 12% debentures paid)		1,44,000	 1,44,000
31/3/2023	Profit & Loss A/c Dr To Debenture Interest A/c To Loss on Issue of 12% Debentures A/c (Being interest on debentures and proportionate amount of loss on issue of debentures written off)		1,72,800	 1,44,000 28,800

3) When Interest on Debentures is paid annually and discount and loss on issue of debentures are written off.

Problem 15. On 1st April 2022 Chandrabhaga Industries Ltd. issued 15,000 11% Debentures of ₹ 100 each at 10% discount, repayable at 7% premium at the end of 10 years. Interest on debentures is payable annually. The company decided to write off the discount and loss on issue of debentures in equal annual instalments.

Pass journal entries for first year only

Solution – In the books of Chandrabhaga Industries Ltd.

Calculation of Interest – 11% on (15000 x 100) = 1,65,000

Calculation of discount on issue of debentures to be amortised every year –

10% on (15000 x 100) = 1,50,000 / 10 =15,000

Calculation of loss on issue of debentures to be amortised every year –

7% on (15000 x 100) = 1,05,000 / 10 = 10,500

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2022	Bank A/c Dr		13,50,000	
	Discount on Issue of 11% Debentures A/cDr		1,50,000	
	Loss on Issue of 11% Debentures A/c Dr		1,05,000	
	To 11% Debentures A/c			15,00,000
	To Prem. on Redem. of 11% Debentures A/c			1,05,000
	(Being debentures issued at 10% discount repayable at 7% premium)			
	Debenture Interest A/c Dr		1,65,000	
31/3/2023	To 11% Debenture holders A/c			1,65,000
	(Being interest on 11% debentures is due)			
	11% Debenture holders A/c Dr		1,65,000	
31/3/2023	To Bank A/c			1,65,000
	(Being interest on 11% debentures paid)			
	Profit & Loss A/c Dr		1,90,500	
31/3/2023	To Debenture Interest A/c			1,65,000
	To Discount on Issue of 11% Debentures A/c			15,000
	To Loss on Issue of 11% Debentures A/c			10,500
	(Being interest on debentures and proportionate amount of discount and loss on issue of debentures written off)			

Problem 16. On 1st Oct. 2021 Warana Industries Ltd. issued 5,000 13% Debentures of ₹ 1,000 each at 6% discount, repayable at 8% premium at the end of 10 years. Interest on debentures is payable on 31st March every year. The company decided to write off the discount and loss on issue of debentures in 10 equal annual instalments starting from 31st March 2022.

Pass journal entries for first two years only

Solution – In the books of Warana Industries Ltd.

Calculation of Interest – 13% on (5,000 x 1,000) = 6,50,000 for a year.

For half year 6,50,000 / 2 = 3,25,000

Calculation of discount on issue of debentures to be amortised every year –

6% on (5,000 x 1,000) = 3,00,000 / 10 =30,000

Calculation of loss on issue of debentures to be amortised every year –

8% on (5,000 x 1,000) = 4,00,000 / 10 = 40,000

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/10/2021	Bank A/c Dr		47,00,000	
	Discount on Issue of 13% Debentures A/c Dr		3,00,000	
	Loss on Issue of 13% Debentures A/c Dr		4,00,000	
	To 13% Debentures A/c			50,00,000
	To Prem. on Redem. of 13% Debentures A/c			4,00,000
	(Being debentures issued at 6% discount repayable at 8% premium)			
	Debenture Interest A/c Dr		3,25,000	
31/3/2022	To 13% Debenture holders A/c			3,25,000
	(Being interest on 13% debentures is due)			
	13% Debenture holders A/c Dr		3,25,000	
31/3/2022	To Bank A/c			3,25,000
	(Being interest on 13% debentures paid)			
	Profit & Loss A/c Dr		1,90,500	
31/3/2022	To Debenture Interest A/c			3,25,000
	To Discount on Issue of 13% Debentures A/c			30,000
	To Loss on Issue of 13% Debentures A/c			40,000
	(Being interest on debentures and proportionate amount of discount and loss			

	on issue of debentures written off)			
	--			
	Debenture Interest A/c Dr		6,50,000	
	To 13% Debenture holders A/c			6,50,000
	(Being interest on 13% debentures is due)			
	--			
31/3/2023	13% Debenture holders A/c Dr		6,50,000	
	To Bank A/c			6,50,000
	(Being interest on 13% debentures paid)			
	--			
31/3/2023	Profit & Loss A/c Dr		7,20,000	
	To Debenture Interest A/c			6,50,000
	To Discount on Issue of 13% Debentures A/c			30,000
	To Loss on Issue of 13%Debentures A/c			40,000
31/3/2023	(Being interest on debentures and proportionate amount of discount and loss on issue of debentures written off)			

4) Preparation of Discount on Issue of Debentures A/c

Problem 17. Vedganga Waterproof Furniture Co. issued on 1/4/2014 9% Debentures of ₹16,00,000 at 8% discount and repayable at the end of 8th year at par. It was decided to write off discount on issue of debentures in the equal proportion during the period till the debentures are redeemed.

You are asked to prepare Discount on Issue of Debentures A/c for all the years.

Solution – In the books of Vedganga Waterproof Furniture Co

Calculation of Discount on Issue of Debentures to be written off every year –

8% on 16,00,000 = 1,28,000 / 8 = 16,000

Dr Discount on Issue of 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2015	To 8% Debentures A/c	1,28,000	31/3/2016	By Profit & Loss A/c	16,000
			31/3/2016	By Balance c/d	1,12,000
		1,28,000			1,28,000

1/4/2016	To Balance b/d	1,12,000	31/3/2017	By Profit & Loss A/c	16,000
			31/3/2017	By Balance c/d	96,000
		1,12,000			1,12,000
1/4/2017	To Balance b/d	96,000	31/3/2018	By Profit & Loss A/c	16,000
			31/3/2018	By Balance c/d	80,000
		96,000			96,000
1/4/2018	To Balance b/d	80,000	31/3/2019	By Profit & Loss A/c	16,000
			31/3/2019	By Balance c/d	64,000
		80,000			80,000
1/4/2019	To Balance b/d	64,000	31/3/2020	By Profit & Loss A/c	16,000
			31/3/2020	By Balance c/d	48,000
		64,000			64,000
1/4/2020	To Balance b/d	48000	31/3/2021	By Profit & Loss A/c	16,000
			31/3/2021	By Balance c/d	32,000
		48,000			48,000
1/4/2021	To Balance b/d	32,000	31/3/2022	By Profit & Loss A/c	16,000
			31/3/2022	By Balance c/d	16,000
		32,000			32,000
1/4/2022	To Balance b/d	16,000	31/3/2023	By Profit & Loss A/c	16,000
		16,000			16,000

5) Preparation of Loss on Issue of Debentures A/c

Problem 18. Mulamutha Waterproof Furniture Co. issued on 1/4/2014 9% Debentures of ₹24,00,000 at par repayable at the end of 8^{th} year at 12% premium. It was decided to write off loss on issue of debentures in the equal proportion during the period till the debentures are redeemed.

You are asked to prepare Loss on Issue of Debentures A/c for all the years.

Solution – In the books of Mulamutha Waterproof Furniture Co

Calculation of Loss on Issue of Debentures to be written off every year –

12% on 24,00,000 = 2,88,000 / 8 = 36,000

Dr Discount on Issue of 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2015	To Premium on Redemption of 9% Debentures A/c	2,88,000	31/3/2016	By Profit & Loss A/c	36,000
			31/3/2016	By Balance c/d	2,52,000
		2,88,000			2,88,000
1/4/2016	To Balance b/d	2,52,000	31/3/2017	By Profit & Loss A/c	36,000
			31/3/2017	By Balance c/d	2,16,000
		2,52,000			2,52,000
1/4/2017	To Balance b/d	2,16,000	31/3/2018	By Profit & Loss A/c	36,000
			31/3/2018	By Balance c/d	1,80,000
		2,16,000			2,16,000
1/4/2018	To Balance b/d	1,80,000	31/3/2019	By Profit & Loss A/c	36,000
			31/3/2019	By Balance c/d	1,44,000
		1,80,000			180,000
1/4/2019	To Balance b/d	1,44,000	31/3/2020	By Profit & Loss A/c	36,000
			31/3/2020	By Balance c/d	1,08,000
		1,44,000			1,44,000
1/4/2020	To Balance b/d	1,08,000	31/3/2021	By Profit & Loss A/c	36,000
			31/3/2021	By Balance c/d	72,000
		1,08,000			1,08,000
1/4/2021	To Balance b/d	72,000	31/3/2022	By Profit & Loss A/c	36,000
			31/3/2022	By Balance c/d	36,000
		72,000			72,000
1/4/2022	To Balance b/d	36,000	31/3/2023	By Profit & Loss A/c	36,000
		36,000			36,000

6) Preparation of Discount and Loss on Issue of Debentures A/c

Problem 19. Satlaj Waterproof Furniture Co. issued on 1/4/2018 8% Debentures of ₹15,00,000 at 5% discount and repayable at the end of 5th year at a premium of 7%. It was decided to write off discount and loss on issue of debentures in the equal proportion during these five years.

You are asked to prepare Discount on Issue of Debentures A/c and Loss on Issue of Debentures A/c for all the years.

Solution – In the books of Satlaj Waterproof Furniture Co

Dr Discount on Issue of 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2018	To 8% Debentures A/c	75,000	31/3/2019	By Profit & Loss A/c	15,000
			31/3/2019	By Balance c/d	60,000
		75,000			75,000
1/4/2019	To Balance b/d	60,000	31/3/2020	By Profit & Loss A/c	15,000
			31/3/2020	By Balance c/d	45,000
		60,000			60,000
1/4/2020	To Balance b/d	45000	31/3/2021	By Profit & Loss A/c	15,000
			31/3/2021	By Balance c/d	30,000
		45,000			45,000
1/4/2021	To Balance b/d	30,000	31/3/2022	By Profit & Loss A/c	15,000
			31/3/2022	By Balance c/d	15,000
		30,000			30,000
1/4/2022	To Balance b/d	15,000	31/3/2023	By Profit & Loss A/c	15,000
		15,000			15,000

Dr Loss on Issue of 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2018	To Prem. On Red. of 8% Debentures A/c	1,05,000	31/3/2019	By Profit & Loss A/c	21,000
			31/3/2019	By Balance c/d	84,000
		1,05,000			1,05,000
1/4/2019	To Balance b/d	84,000	31/3/2020	By Profit & Loss A/c	21,000
			31/3/2020	By Balance c/d	63,000
		84,000			84,000
1/4/2020	To Balance b/d	63000	31/3/2021	By Profit & Loss A/c	21,000
			31/3/2021	By Balance c/d	42,000
		63,000			63,000
1/4/2021	To Balance b/d	42,000	31/3/2022	By Profit & Loss A/c	21,000
			31/3/2022	By Balance c/d	21,000
		42,000			42,000
1/4/2022	To Balance b/d	21,000	31/3/2023	By Profit & Loss A/c	21,000
		21,000			21,000

7) Preparation of Interest on Debentures A/c, Debentures A/c and Loss on Issue of Debentures A/c

Problem 20. Patalganga Fishing Co. issued on 1/4/2019, 2,500 11% Debentures of ₹ 1,000 each at a premium of 8% repayable at a premium of 9% at the end of 4^{th} year.

Please, prepare Interest on 11% Debentures A/c, 11% Debentures A/c and Loss on Issue of 11% Debentures A/c in the books of the company for all the years.

Solution – In the books of Patalganga Fishing Co.

Calculation of amount of Premium on redemption of debentures i.e. Loss on issue of debentures to be written off every year – 9% on (2500 x 1000) = 2,25,000 / 4 = 56250

Calculation of Interest on Debentures to be paid every year - 11% on (2500 x 1000) = 2,75,000

Dr Interest on 11% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2020	To Bank	2,75,000	31/3/2020	By Profit & Loss A/c	2,75,000
		2,75,000			2,75,000
31/3/2021	To Bank	2,75,000	31/3/2021	By Profit & Loss A/c	2,75,000
		2,75,000			2,75,000
31/3/2022	To Bank	2,75,000	31/3/2022	By Profit & Loss A/c	2,75,000
		2,75,000			2,75,000
31/3/2023	To Bank	2,75,000	31/3/2023	By Profit & Loss A/c	2,75,000
		2,75,000			2,75,000

Dr 11% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2020	To Balance c/d	25,00,000	1/4/2019	By Bank	25,00,000
		25,00,000			25,00,000
31/3/2021	To Balance c/d	25,00,000	1/4/2020	By Balance b/d	25,00,000
		25,00,000			25,00,000
31/3/2022	To Balance c/d	25,00,000	1/4/2021	By Balance b/d	25,00,000
		25,00,000			25,00,000
31/3/2023	To Bank	25,00,000	1/4/2022	By Balance b/d	25,00,000
		25,00,000			25,00,000

Dr Loss on Issue of 11% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2019	To Prem. On Red. of 8% Debentures A/c	2,25,000	31/3/2020	By Profit & Loss A/c	56,250
			31/3/2020	By Balance c/d	1,68,750
		2,25,000			2,25,000
1/4/2020	To Balance b/d	1,68,750	31/3/2021	By Profit & Loss A/c	56,250
			31/3/2021	By Balance c/d	1,12,500
		1,68,750			1,68,750
1/4/2021	To Balance b/d	1,12,500	31/3/2022	By Profit & Loss A/c	56,250
			31/3/2022	By Balance c/d	56,250
		1,12,500			1,12,500
1/4/2022	To Balance b/d	56,250	31/3/2023	By Profit & Loss A/c	56,250
		56,250			56,250

8) Preparation of Interest on Debentures A/c, Debentures A/c and Discount on Issue of Debentures A/c

Problem 21. Kumbhi Fishing Co. issued on 1/4/2019, 5,000 12% Debentures of ₹ 100 each at a discount of 9% repayable at par at the end of 4th year.

Please, prepare Interest on 12% Debentures A/c, 12% Debentures A/c and Discount on Issue of 12% Debentures A/c in the books of the company for all the years.

Solution – In the books of Patalganga Fishing Co.

Calculation of amount of discount on issue of debentures to be written off every year – 9% on (5,000 x 100) = 45,000 / 4 = 11250

Calculation of Interest on Debentures to be paid every year - 12% on (5,000 x 100) = 60,000

Dr Interest on 12% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2020	To Bank	60,000	31/3/2020	By Profit & Loss A/c	60,000
		60,000			60,000
31/3/2021	To Bank	60,000	31/3/2021	By Profit & Loss A/c	60,000
		60,000			60,000

31/3/2022	To Bank	60,000	31/3/2022	By Profit & Loss A/c	60,000
		60,000			60,000
31/3/2023	To Bank	60,000	31/3/2023	By Profit & Loss A/c	60,000
		60,000			60,000

Dr 12% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2020	To Balance c/d	5,00,000	1/4/2019	By Bank	5,00,000
		5,00,000			5,00,000
31/3/2021	To Balance c/d	5,00,000	1/4/2020	By Balance b/d	5,00,000
		5,00,000			5,00,000
31/3/2022	To Balance c/d	5,00,000	1/4/2021	By Balance b/d	5,00,000
		5,00,000			5,00,000
31/3/2023	To Bank	5,00,000	1/4/2022	By Balance b/d	5,00,000
		5,00,000			5,00,000

Dr Discount on Issue of 12% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2019	To 12% Debent. A/c	45,000	31/3/2020	By Profit & Loss A/c	11,250
			31/3/2020	By Balance c/d	33,750
		45,000			45,000
1/4/2020	To Balance b/d	33,750	31/3/2021	By Profit & Loss A/c	11,250
			31/3/2021	By Balance c/d	22,500
		33,750			33,750
1/4/2021	To Balance b/d	22,500	31/3/2022	By Profit & Loss A/c	11,250
			31/3/2022	By Balance c/d	11,250
		22,500			22,500
1/4/2022	To Balance b/d	11,250	31/3/2023	By Profit & Loss A/c	11,250
		11,250			11,250

9) Preparation of Interest on Debentures A/c, Debentures A/c and Discount and Loss on Issue of Debentures A/c

Problem 22. Kasari Fishing Co. issued on 1/4/2020, 6,000 7% Debentures of 200 each at a discount of 8% repayable at 6% premium at the end of 3rd year.

Please, prepare Interest on 7% Debentures A/c, 7% Debentures A/c, Discount on Issue of 7% Debentures A/c and Loss on Issue of 7% Debentures A/c in the books of the company for all the years.

Solution – In the books of Patalganga Fishing Co.

Calculation of amount of discount on issue of debentures to be written off every year – 8% on (6,000 x 200) = 96,000 / 3 = 32,000

Calculation of Interest on Debentures to be paid every year - 7% on (6,000 x 200) = 84,000

Calculation of amount of loss on issue of debentures to be written off every year –

6% on (6,000 x 200) = 72,000 / 3 = 24,000

Dr Interest on 7% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2021	To Bank	84,000	31/3/2021	By Profit & Loss A/c	84,000
		84,000			84,000
31/3/2022	To Bank	84,000	31/3/2022	By Profit & Loss A/c	84,000
		84,000			84,000
31/3/2023	To Bank	84,000	31/3/2023	By Profit & Loss A/c	84,000
		84,000			84,000

Dr 7% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2021	To Balance c/d	12,00,000	1/4/2020	By Bank	12,00,000
		12,00,000			12,00,000
31/3/2022	To Balance c/d	12,00,000	1/4/2021	By Balance b/d	12,00,000
		12,00,000			12,00,000
31/3/2023	To Bank	12,00,000	1/4/2022	By Balance b/d	12,00,000
		12,00,000			12,00,000

Dr Discount on Issue of 7% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2020	To 7% Debent. A/c	96,000	31/3/2021	By Profit & Loss A/c	32,000
			31/3/2021	By Balance c/d	64,000
		96,000			96,000
1/4/2021	To Balance b/d	64,000	31/3/2022	By Profit & Loss A/c	32,000
			31/3/2022	By Balance c/d	32,000
		64,000			64,000
1/4/2022	To Balance b/d	32,000	31/3/2023	By Profit & Loss A/c	32,000
		32,000			32,000

Dr Loss on Issue of 7% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2020	To Prem. On Red. of 7% Debentures A/c	72,000	31/3/2021	By Profit & Loss A/c	24,000
			31/3/2021	By Balance c/d	48,000
		72,000			72,000
1/4/2021	To Balance b/d	48,000	31/3/2022	By Profit & Loss A/c	24,000
			31/3/2022	By Balance c/d	24,000
		48,000			48,000
1/4/2022	To Balance b/d	24,000	31/3/2023	By Profit & Loss A/c	24,000
		24,000			24,000

2.7.4 Redemption of Debentures

1) Issue of Debentures, Interest on Debentures, Amortisation of Discount and Loss on Issue of Debentures, Creation of Sinking Fund and Investment of the Fund – Journal Entries for first year

Problem 23. Vainganga Industries Ltd. issued 8% Debentures of ₹ 50,00,000 on 1/4/2022 at a discount of 2%, repayable at 3% premium after 5 years. It was decided to create a sinking fund by transfer of ₹10,00,000 every year from profit &loss appropriation account. An equal amount is to be invested in 9% Government securities at the end of every year. Interest on Government securities is to be invested in the same securities. The interest on debentures is payable at the end of each year. It was also decided to write off discount and loss on issue of debentures in the same period of debentures in equal proportion.

Give journal entries in the books of the company for first year only

Solution – In the books of Vainganga Industries Ltd.

Calculation of Discount on Issue of Debentures – 2% on 50,00,000 = 1,00,000

Calculation of Premium on Redemption of Debentures – 3% on 50,00,000 = 1,50,000

Calculation of Discount on Issue of Debentures written off every year – 1,00,000 / 5 = 20,000

Calculation of Loss on Issue of Debentures written off every year – 1,50,000 / 5 = 30,000

Calculation of Interest on Debentures payable every year – 8% on 50,00,000 = 4,00,000

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2022	Bank A/c Dr		49,00,000	
	Discount on Issue of 8% Debentures A/c Dr		1,00,000	
	Loss on Issue of 8% Debentures A/c Dr		1,50,000	
	To 8% Debentures A/c			50,00,000
	To Premium on Redem. of 8% Debent. A/c			1,50,000
	(Being 8% debentures issued at 2% discount repayable at 3% premium)			
	--			
	Interest on Debentures A/c Dr		4,00,000	
31/3/2023	To Bank A/c			4,00,000
	(Being interest on debentures account)			
	--			
	Profit & Loss Appropriation A/c Dr		10,00,000	
31/3/2023	To Sinking Fund A/c			10,00,000
	(Being proportionate amount transferred to sinking fund)			
	--			
	Sinking Fund Investment A/c Dr		10,00,000	
31/3/2023	To Bank A/c			10,00,000

	(Being amount provided invested in Govt. Securities) --			
31/3/2023	Profit & Loss A/c Dr To Discount on Issue of 8% Deben. A/c To Loss on Issue of 8% Deben. A/c To Interest on Debentures A/c (Being proportionate amount of discount and loss on issue of shares written off and interest on debentures transferred to profit and loss account)		4,50,000	 20,000 30,000 4,00,000

2) Issue of Debentures, Interest on Debentures, Amortisation of Discount and Loss on Issue of Debentures, Creation of Sinking Fund and Investment of the Fund – Journal Entries for second year

Problem 24. Yamuna Finance Co. Ltd. issued 11% Debentures of ₹ 40,00,000 on 1/4/2021 at a discount of 5%, repayable at 7% premium after 8 years. It was decided to create a sinking fund by transfer of proportionate amount every year from profit &loss appropriation account. An equal amount is to be invested in 12% Government securities at the end of every year. Interest on Government securities will also be reinvested.

The interest on debentures is payable yearly on 31st March each year. It was also decided to write off discount and loss on issue of debentures in the same period of debentures in equal proportion.

Give journal entries in the books of the company for the year 2022-23 only.

Solution – In the books of Yamuna Industries Ltd.

Calculation of Discount on Issue of Debentures – 5% on 40,00,000 = 2,00,000

Calculation of Premium on Redemption of Debentures – 7% on 40,00,000 = 2,80,000

Calculation of Discount on Issue of Debentures written off every year – 2,00,000 / 8 = 25,000

Calculation of Loss on Issue of Debentures written off every year – 2,80,000 / 8 = 35,000

Calculation of Interest on Debentures payable yearly – 11% on 40,00,000 = 4,40,000

Calculation of provision to be made for the sinking fund every year – 40,00,000 / 8 = 5,00,000

Calculation of Interest on Government Securities -

Year	Calculation of Interest	Investment at the end of the year
2021-22	NIL	5,00,000
2022-23	12 % on 5,00,000= 60,000	

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
31/3/2023	Interest on Debentures A/c Dr To Bank A/c (Being yearly interest on debentures paid)		4,40,000	 4,40,000
31/3/2023	Bank A/c Dr To Interest on Sinking Fund Investment A/c (Being interest on government securities received)		60,000	 60,000
31/3/2023	Interest on Sinking Fund Investment A/c Dr To Sinking Fund A/c (Being interest on sinking fund investment transferred to sinking fund account)		60,000	 60,000
31/3/2023	Profit & Loss Appropriation A/c Dr To Sinking Fund A/c (Being proportionate amount transferred to sinking fund)		5,00,000	 5,00,000
	Sinking Fund Investment A/c Dr To Bank A/c		5,60,000	 5,60,000

31/3/2023	(Being amount provided and interest received invested in Govt. Securities)			

31/3/2023	Profit & Loss A/c Dr		5,00,000	
	To Discount on Issue of 8% Deben. A/c			25,000
	To Loss on Issue of 8% Deben. A/c			35,000
	To Interest on Debentures A/c			4,40,000
	(Being proportionate amount of discount and loss on issue of shares written off and interest on debentures transferred to profit and loss account)			

3) Calculation of Interest on Sinking Fund Investment

Problem 25. Sindhu Co. Ltd. issued on 1/4/2013, ₹15,00,000 8% Debentures at par and repayable at the end of 10^{th} year at a premium of 5%. It was decide to create sinking fund by transferring ₹1,50,000 from profit every year and investing it in 10% Government Securities. Interest on securities is also invested in the same securities.

Calculate Interest received on Government Securities for all the years.

Solution – In the books of Sindhu Co. Ltd.

Calculation of Interest

At the end of the year	Interest calculation	Total investment
2013-14	Nil	1,50,000
2014-15	10 / 100 x 1,50,000 = 15,000	1,50,000 + 1,50,000 + 15,000 = 3,15,000
2015-16	10 / 100 x 3,15,000 = 31,500	3,15,000 + 1,50,000 + 31,500 = 4,96,500
2016-17	10 / 100 x 4,96,500 = 49,650	4,96,500 + 1,50,000 + 49,650 = 6,96,150
2017-18	10 / 100 x 6,96,150 = 69,615	6,96,150 + 1,50,000 + 69,615 = 9,15,765
2018-19	10 / 100 x 9,15,765 = 91,576	9,15,765 + 1,50,000 + 91,576 = 11,57,341
2019-20	10 / 100 x 11,57,341 = 1,15,734	11,57,341 + 1,50,000 + 1,15,734 = 14,23,075
2020-21	10 / 100 x 14,23,075 = 1,42,308	14,23,075 + 1,50,000 + 1,42,308 = 17,15,383
2021-22	10 / 100 x 17,15,383 = 1,71,538	17,15,383 + 1,50,000 + 1,71,538 = 20,36,921
2022-23	10 / 100 x 20,36,921 = 2,03,692	

4) Issue of Debentures, Interest on Debentures, Creation of Sinking Fund and Investment of the Fund – Journal Entries for first two years

Problem 26. On 1/4/2021 Painganga Construction Ltd. issued 6000 10% Debentures of ₹ 100 each at par repayable at the end of the 6^{th} year at par. It was decided to create a Debenture Redemption Fund by transferring proportionate amount from profit. The amount so provided is to be invested in 11% Government Bonds and interest received thereon will also be reinvested in the same bonds. The interest on debentures is payable and interest on government bonds is receivable annually on 31^{st} March every year.

You are required to pass journal entries for the first two financial years

Solution – In the books of Kaveri Construction Ltd.

Calculation of proportionate amount provided for Debentures Redemption Fund every year

= 6000 x 100 / 6 = 1,00,000

Calculation of interest on debentures payable yearly = 10% (6000 x 100) = 60,000

Calculation of Interest on Government Bonds

Year	Calculation of Interest	Investment at the end of the year
2021-22	NIL	1,00,000
2022-23	11% on 1,00,000 = 11,000	

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2021	Bank A/c Dr		6,00,000	
	To 11% Debentures A/c			6,00,000
	(Being 11% Debentures issued at par repayable at par)			

31/3/2022	Interest on Debentures A/c Dr		60,000	
	To Bank A/c			60,000
	(Being interest on debentures paid)			

31/3/2022	Profit & Loss A/c Dr		1,60,000	
	To Interest on Debentures A/c			60,000
	To Sinking Fund A/c			1,00,000
	(Being Interest on Debentures transferred to Profit & Loss A/c and proportionate amount provided for sinking fund)			

31/3/2022	Sinking Fund Investment A/c Dr		1,00,000	
	To Bank A/c			1,00,000
	(Being amount provided for sinking fund invested in Govt. Securities)			

31/3/2023	Interest on Debentures A/c Dr		60,000	
	To Bank A/c			60,000
	(Being interest on debentures paid)			

31/3/2023	Bank A/c Dr		11,000	
	To Interest on Sinking Fund Investment A/c			11,000
	(Being interest on Sinking Fund Investment received)			

	Profit & Loss A/c Dr		1,60,000	
31/3/2023	To Interest on Debentures A/c			60,000
	To Sinking Fund A/c			1,00,000
	(Being Interest on Debentures transferred to Profit & Loss A/c and proportionate amount provided for sinking fund)			

	Sinking Fund Investment A/c Dr		1,11,000	
31/3/2023	To Bank A/c			1,11,000
	(Being amount provided for sinking fund and interest received on sinking fund investment invested in Govt. Securities)			

31/3/2023	Interest on Sinking Fund Investment A/c Dr To Sinking Fund A/c (Being interest on sinking fund investment transferred to sinking fund account)		11,000	11,000

5) Interest on Debentures, Creation of Sinking Fund and Investment of the Fund – Journal Entries for third year

Problem 27. Kaveri Construction Ltd. issued 3000 10% Debentures of ₹ 1000 each at par repayable at the end of the 6th year at par on 1/4/2020. It was decided to create a Debenture Redemption Fund by transferring proportionate amount from profit. The amount so provided is to be invested in 11% Government Bonds and interest received thereon will also be reinvested in the same bonds. The interest on debentures is payable half yearly on 30th Sept. and 31st March every year and interest on government bonds is receivable annually on 31st March.

You are required to pass journal entries for the financial year 2022-23

Solution – In the books of Kaveri Construction Ltd.

Calculation of proportionate amount provided for Debentures Redemption Fund every year

= 3000 x 1000 / 6 = 5,00,000

Calculation of interest on debentures payable half yearly = 10% (3000 x 1000) /2 = 1,50,000

Calculation of Interest on Government Bonds

Year	Calculation of Interest	Investment at the end of the year
2020-21	NIL	5,00,000
2021-22	11% on 5,00,000 = 55,000	5,00,000 + 5,00,000 + 55,000 = 10,55,000
2022-23	11% on 10,55,000 = 1,16,050	

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
30/9/2022	Interest on Debentures A/c Dr To Bank A/c (Being half yearly interest on debentures paid)		1,50,000	1,50,000
31/3/2023	Interest on Debentures A/c Dr To Bank A/c (Being half yearly interest on debentures paid)		1,50,000	1,50,000
31/3/2023	Bank A/c Dr To Interest on Sinking Fund Investment A/c (Being interest on government securities received)		1,16,050	1,16,050
31/3/2023	Interest on Sinking Fund Investment A/c Dr To Sinking Fund A/c (Being interest on sinking fund investment transferred to sinking fund account)		1,16,050	1,16,050
31/3/2023	Profit & Loss Appropriation A/c Dr To Sinking Fund A/c (Being proportionate amount transferred to sinking fund)		5,00,000	5,00,000
31/3/2023	Sinking Fund Investment A/c Dr To Bank A/c (Being amount provided and interest received invested in Govt. Securities)		6,16,050	6,16,050
31/3/2023	Profit & Loss A/c Dr To Interest on Debentures A/c (Being interest on debentures transferred to profit and loss account)		3,00,000	3,00,000

6) Interest on Debentures, Creation of Sinking Fund and Investment of the Fund – Journal Entries for last year

Problem 28. On 1st April 2017, Bramhaputra Bridge Construction Co. issued 18,000 11% Debentures of ₹100 each at par repayable at par at the end of 6th year from its issue. The company has the following balances on 31st March 2022.

1. 11% Debentures A/c ₹ 18,00,000
2. 11% Sinking Fund A/c ₹ 19,05,854
3. 12% Government of India Loan (Debentures Redemption Fund Investment) ₹ 19,05,854

The company used to transfer ₹ 3,00,000 every year from profit to the redemption fund. On 31st March 2023, the investments were sold for ₹ 19,10,000 and the debentures were redeemed. Interest on debentures is payable annually on 31st March every year.

Pass journal entries for the year 2022-23.

Solution – In the books of Bramhaputra Bridge Construction Co.

Calculation of interest on Govt. Loans – 12% on 19,05,854 = 2,28,702

Calculation of profit on sale of investments = 19,10,000 – 19,05,854 = 4146

Calculation of balance of sinking fund account transferred to general reserve account

Sinking Fund A/c

Particulars	₹	Particulars	₹
To General Reserve A/c	24,38,702	By Balance b/d	19,05,854
		By Int. on S. F. Invest. A/c	2,28,702
		By Profit & Loss Appro. A/c	3,00,000
		By S. F. Investment A/c	4,146
	24,38,702		24,38,702

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
31/3/2023	Interest on 11% Debentures A/c Dr To Bank A/c (Being yearly interest on debentures paid) --		1,98,000	 1,98,000
31/3/2023	Profit & Loss A/c Dr To Interest on 11% Debentures A/c (Being interest on debentures transferred to profit and loss account) --		1,98,000	 1,98,000
31/3/2023	Bank A/c Dr To Interest on Sinking Fund Investment A/c (Being interest on government loans received) --		2,28702	 2,28,702
31/3/2023	Interest on Sinking Fund Investment A/c Dr To Sinking Fund A/c (Being interest on sinking fund investment transferred to sinking fund account) --		2,28702	 2,28702
31/3/2023	Profit & Loss Appropriation A/c Dr To Sinking Fund A/c (Being proportionate amount transferred to sinking fund) --		3,00,000	 3,00,000
31/3/2023	Bank A/c Dr To Sinking Fund Investment A/c (Being Sinking Fund Investments realised) --		19,10,000	 19,10,000
31/3/2023	Sinking Fund Investment A/c Dr To Sinking Fund A/c (Being profit on realisation of sinking fund investment transferred to sinking fund		4146	 4146

	account)			
31/3/2023	11% Debentures A/c Dr To 11% Debenture holders A/c (Being balance of Debentures transferred to Debenture holders account)		18,00,000	18,00,000
31/3/2023	11% Debenture holders A/c Dr To Bank A/c (Being payment made to debenture holders)		18,00,000	18,00,000
31/3/2023	Sinking Fund A/c Dr To General Reserve A/c (Being balance of sinking fund account transferred to general reserve account)		24,38,702	24,38,702

7) Preparation of Sinking Fund A/c and Sinking Fund Investment for first two years

Problem 29. Dudhaganga Purified Water Co. issued on 1/4/2020, 800 8% Debentures of ₹ 1000 each repayable at the end of 8th year at a premium of 10%. The debentures redemption fund was created by transferring ₹ 1,00,000 from profit and it was invested in 9% Government Bonds.

Prepare Debenture Redemption Fund A/c and Debenture Redemption Fund Investment A/c for the first two years.

Solution – In the books of Dudhaganga Purified Water Co.

Calculation of Interest on Government Bonds

Year	Calculation of Interest	Investment at the end of the year
2020-21	NIL	1,00,000
2021-22	9% on 1,00,000 = 9,000	1,00,000 + 1,00,000 + 9,000 = 2,09,000
2022-23	9% on 2,09,000 = 18810	2,09,000 +1,00,000 + 18810 = 3,27810

Dr Sinking Fund A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2021	To Balance c/d	1,00,000	31/3/2021	By Profit & Loss Appro.	1,00,000
		1,00,000			1,00,000
31/3/2022	To Balance c/d	2,09,000	1/4/2021	By Balance b/d	1,00,000
			31/3/2022	By Int. on D. R. F. Inve.	9,000
			31/3/2022	By Profit & Loss Appro.	1,00,000
		2,09,000			2,09,000
31/3/2022	To Balance c/d	3,27810	1/4/2022	By Balance b/d	2,09,000
			31/3/2023	By Int. on D. R. F. Inve.	18810
			31/3/2023	By Profit & Loss Appro	1,00,000
		3,27810			3,27810

Dr Sinking Fund Investment A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2021	To Bank A/c	1,00,000	31/3/2021	By Balance c/d	1,00,000
		1,00,000			1,00,000
1/4/2021	To Balance b/d	1,00,000	31/3/2022	By Balance c/d	2,09,000
31/3/2022	To Bank A/c	1,09,000			
		2,09,000			2,09,000
1/4/2022	To Balance b/d	2,09,000	31/3/2023	By Balance c/d	3,27810
31/3/2023	To Bank A/c	1,18,810			
		3,27810			3,27810

8) Calculation of Interest and Preparation of Sinking Fund A/c for all years

Problem 30. Jamuna Water Supply Co. has issued on 1/4/2018 7% Debentures of ₹ 5,00,000 at par repayable at a premium of 5% after 5 years. The company created a Debenture Redemption Fund by transfer of ₹ 1,00,000 every year from Profit & Loss Appropriation A/c. An equal amount and interest thereon were to be invested in 8% Government approved bonds at the end of every year. On 31st March 2023, the investments were sold for ₹ 4,55,000.

Calculate profit or loss on sale of investment and prepare Debenture Redemption Fund A/c for all the years.

Solution – In the books of Jamuna Water Supply Co.

Calculation of Interest on Government Bonds

Year	Calculation of Interest	Investment at the end of the year
2018-19	NIL	1,00,000
2019-20	8% on 1,00,000 = 8,000	1,00,000 + 1,00,000 + 8,000 = 2,08,000
2020-21	8% on 2,08,000 = 16,640	2,08,000 + 1,00,000 + 16,640 = 3,24,640
2021-22	8% on 3,24,640 = 25,971	3,24,640 + 1,00,000 + 25,971 = 4,50,611
2022-23	8% on 4,50,611 = 36049	

Calculation of profit on sale of investments – 4,55,000 - 4,50,611 = 4389

Dr Debenture Redemption Fund A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2019	To Balance c/d	1,00,000	31/3/2019	By Profit & Loss Appro.	1,00,000
		1,00,000			1,00,000
31/3/2020	To Balance c/d	2,08,000	1/4/2019	By Balance b/d	1,00,000
			31/3/2020	By Int. on D. R. F. Inve.	8,000
			31/3/2020	By Profit & Loss Appro.	1,00,000
		2,08,000			2,08,000
31/3/2021	To Balance c/d	3,24,640	1/4/2020	By Balance b/d	2,08,000
			31/3/2021	By Int. on D. R. F. Inve.	16,640
			31/3/2021	By Profit & Loss Appro.	1,00,000
		3,24,640			3,24,640
31/3/2022	To Balance c/d	4,50,611	1/4/2021	By Balance b/d	3,24,640
			31/3/2022	By Int. on D. R. F. Inve.	25,971
			31/3/2022	By Profit & Loss Appro.	1,00,000
		4,50,611			4,50,611
31/3/2023	To General Rese. A/c	5,91,049	1/4/2022	By Balance b/d	4,50,611
			31/3/2023	By Int. on D. R. F. Inve.	36049
			31/3/2023	By Profit & Loss Appro	1,00,000
			31/3/2023	By D. R. F. Invest. A/c	4389
		5,91,049			5,91,049

9) Calculation of Interest and Preparation of Sinking Fund Investment A/c for all years

Problem 31. Tapi Water Co. has issued on 1/4/2018 11% Debentures of ₹ 15,00,000 at a premium of 5% repayable at par of after 5 years. The company created a

Debenture Redemption Fund by transfer of ₹ 3,00,000 every year from Profit & Loss Appropriation A/c. An equal amount and interest thereon were to be invested in 15% Government Bonds at the end of every year. On 31st March 2023, the investments were sold for ₹ 15,00,000.

Prepare Debenture Redemption Fund Investment A/c for all the years.

Solution – In the books of Tapi Water Supply Co.

Calculation of Interest on 15% Government Bonds

Year	Calculation of Interest	Investment at the end of the year
2018-19	NIL	3,00,000
2019-20	15% on 3,00,000 = 45,000	3,00,000 + 3,00,000 + 45,000 = 6,45,000
2020-21	15% on 6,45,000 = 96,750	6,45,000 + 3,00,000 + 96,750 = 10,41,750
2021-22	15% on 10,41,750 = 1,56,263	10,41,750 + 3,00,000 + 1,56,263 = 14,98,013
2022-23	15% on 14,98,013 = 2,24,702	

Dr Debenture Redemption Fund Investment A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2019	To Bank A/c	3,00,000	31/3/2019	By Balance c/d	3,00,000
		3,00,000			3,00,000
1/4/2019	To Balance b/d	3,00,000	31/3/2020	By Balance c/d	6,45,000
31/3/2020	To Bank A/c	3,45,000			
		6,45,000			6,45,000
1/4/2020	To Balance b/d	6,45,000	31/3/2021	By Balance c/d	10,41,750
31/3/2021	To Bank A/c	3,96,750			
		10,41,750			10,41,750
1/4/2021	To Balance b/d	10,41,750	31/3/2022	By Balance c/d	14,98,013
31/3/2022	To Bank A/c	4,56,263			
		14,98,013			14,98,013
1/4/2022	To Balance b/d	14,98,013	31/3/2023	By Bank A/c	15,00,000
31/3/2023	To D. R. F. A/c	1987			
		15,00,000			15,00,000

10) Various calculations including Interest and Preparation of Debentures A/c and Interest on Sinking Fund Investment A/c for all years

Problem 32. Bhogawati Fishing Co. issued on 1/4/2018, 2,500 11% Debentures of ₹ 500 each at par repayable at par at the end of 5th year. It was decided to create sinking fund for the purpose by transferring 1/5th of the amount of debentures every year from profit & loss appropriation account. The amount set aside is to be invested in 10% Government Securities. The interest received on these securities is also to be reinvested in the same securities.

Please, prepare Interest on 11% Debentures A/c, Interest on 10% Government Securities A/c in the books of the company for all the years.

Solution – In the books of Bhogawati Fishing Co.

Calculation of amount to be set aside as sinking fund = (2500 x 500) / 5 = 2,50,000

Calculation of interest on 11% Debentures – 11% on (2500 x 500) =1,37,500

Calculation of Interest on 10% Government Bonds

Year	Calculation of Interest	Investment at the end of the year
2018-19	NIL	2,50,000
2019-20	10% on 2,50,000= 25,000	2,50,000 + 2,50,000 + 25,000 = 5,25,000
2020-21	10% on 5,25,000 = 52,500	5,25,000 + 2,50,000 + 52,500 = 8,27,500
2021-22	10% on 8,27,500 = 82,750	8,27,500 + 2,50,000 + 82,750 = 11,60,250
2022-23	10% on 11,60,250 = 1,16,025	

Dr Interest on 11% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2019	To Bank	1,37,500	31/3/2019	By Profit & Loss A/c	1,37,500
		1,37,500			1,37,500
31/3/2020	To Bank	1,37,500	31/3/2020	By Profit & Loss A/c	1,37,500
		1,37,500			1,37,500
31/3/2021	To Bank	1,37,500	31/3/2021	By Profit & Loss A/c	1,37,500
		1,37,500			1,37,500
31/3/2022	To Bank	1,37,500	31/3/2022	By Profit & Loss A/c	1,37,500

		1,37,500			1,37,500
31/3/2023	To Bank	1,37,500	31/3/2023	By Profit & Loss A/c	1,37,500
		1,37,500			1,37,500

Dr Interest on 10% Government Securities A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2020	To Sink. Fund A/c	25,000	31/3/2020	By Bank A/c	25,000
		25,000			25,000
31/3/2021	To Sink. Fund A/c	52,500	31/3/2021	By Bank A/c	52,500
		52,500			52,500
31/3/2022	To Sink. Fund A/c	82,750	31/3/2022	By Bank A/c	82,750
		82,750			82,750
31/3/2023	To Sink. Fund A/c	1,16,025	31/3/2023	By Bank A/c	1,16,025
		1,16,025			1,16,025

11) Calculation of Interest and Preparation of Interest on Sinking Fund Investment A/c and Sinking Fund Investment A/c for all years

Problem 33. Tulashi Water Supply Co. issued on 1/4/2018, 2,000 10% Debentures of ₹ 200 each at par repayable at par at the end of 5^{th} year. It was decided to create sinking fund for the purpose by transferring $1/5^{th}$ of the amount of debentures every year from profit & loss appropriation account. The amount set aside is to be invested in 11% Government Bonds. The interest received on these securities is also to be reinvested in the same securities. On 31/3/ 2023, 11% Government Bonds realised ₹ 4,00,000.

Please, prepare Interest on 11% Government Bonds A/c and 11% Government Bonds A/c in the books of the company for all the years.

Solution – In the books of Tulashi Water Supply Co.

Calculation of amount to be set aside as sinking fund = (2000 x 200) / 5 = 80,000

Calculation of Interest on 11% Government Bonds

Year	Calculation of Interest	Investment at the end of the year
2018-19	NIL	80,000
2019-20	11% on 80,000= 8,800	80,000 + 80,000+ 8,800 = 168,800

2020-21	11% on 1,68,800 = 18,568	1,68,800 + 80,000+ 18,568 = 2,67,368
2021-22	11% on 2,67,368 = 29,410	2,67,368 + 80,000+ 29,410 = 3,76,778
2022-23	11% on 3,76,778 = 41,446	

Dr Interest on 11% Government Bonds A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2020	To Sink. Fund A/c	8,800	31/3/2020	By Bank A/c	8,800
		8,800			8,800
31/3/2021	To Sink. Fund A/c	18,568	31/3/2021	By Bank A/c	18,568
		18,568			18,568
31/3/2022	To Sink. Fund A/c	29,410	31/3/2022	By Bank A/c	29,410
		29,410			29,410
31/3/2023	To Sink. Fund A/c	41,446	31/3/2023	By Bank A/c	41,446
		41,446			41,446

Dr 11% Government Bonds A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2019	To Bank A/c	80,000	31/3/2019	By Balance c/d	80,000
		80,000			80,000
1/4/2019	To Balance b/d	80,000	31/3/2020	By Balance c/d	1,68,800
31/3/2020	To Bank A/c	88,800			
		1,68,800			1,68,800
1/4/2020	To Balance b/d	1,68,800	31/3/2021	By Balance c/d	2,67,368
31/3/2021	To Bank A/c	98,568			
		2,67,368			2,67,368
1/4/2021	To Balance b/d	2,67,368	31/3/2022	By Balance c/d	3,76,778
31/3/2022	To Bank A/c	1,09,410			
		3,76,778			3,76,778
1/4/2022	To Balance b/d	3,76,778			
31/3/2023	To D. R. F. A/c	23,222	31/3/2023	By Bank A/c	4,00,000
		4,00,000			4,00,000

12) Calculation of Interest and Preparation of Interest on Sinking Fund Investment A/c and Sinking Fund A/c for all years

Problem 34. Dhamani Water Supply Co. issued on 1/4/2018, 4,000 8% Debentures of ₹ 250 each at par repayable at par at the end of 5th year. It was decided to create sinking fund for the purpose by transferring 1/5th of the amount of debentures every year from profit & loss appropriation account. The amount set aside is to be invested in 9% Government Bonds. The interest received on these securities is also to be reinvested in the same securities. On 31/3/ 2023, 9% Government Bonds realised ₹ 9,20,000.

Please, prepare Interest on 9% Government Bonds A/c and Sinking Fund A/c in the books of the company for all the years.

Solution – In the books of Dhamani Water Supply Co.

Calculation of amount to be set aside as sinking fund = (4000 x 250) / 5 = 2,00,000

Calculation of Interest on 9% Government Bonds

Year	Calculation of Interest	Investment at the end of the year
2018-19	NIL	2,00,000
2019-20	9% on 2,00,000 = 18,000	2,00,000 + 2,00,000 + 18,000 = 4,18,000
2020-21	9% on 4,18,000 = 37,620	4,18,000 + 2,00,000 + 37,620 = 6,55,620
2021-22	9% on 6,55,620 = 59,006	6,55,620 + 2,00,000 + 59,006 = 9,14,626
2022-23	9% on 9,14,626 = 82,316	

Calculation of Profit on sale of 9% Government Bonds – 9,20,000 - 9,14,626 = 5,374

Dr Interest on 9% Government Bonds A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2020	To Sink. Fund A/c	18,000	31/3/2020	By Bank A/c	18,000
		18,000			18,000
31/3/2021	To Sink. Fund A/c	37,620	31/3/2021	By Bank A/c	37,620
		37,620			37,620
31/3/2022	To Sink. Fund A/c	59,006	31/3/2022	By Bank A/c	59,006
		59,006			59,006
31/3/2023	To Sink. Fund A/c	82,316	31/3/2023	By Bank A/c	82,316
		82,316			82,316

Dr Sinking Fund A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2019	To Balance c/d	2,00,000	31/3/2019	By Profit & Loss Appro.	2,00,000
		2,00,000			2,00,000
31/3/2020	To Balance c/d	4,18,000	1/4/2019	By Balance b/d	2,00,000
			31/3/2020	By Int. on D. R. F. Inve.	18,000
			31/3/2020	By Profit & Loss Appro.	2,00,000
		4,18,000			4,18,000
31/3/2021	To Balance c/d	6,55,620	1/4/2020	By Balance b/d	4,18,000
			31/3/2021	By Int. on D. R. F. Inve.	37,620
			31/3/2021	By Profit & Loss Appro.	2,00,000
		6,55,620			6,55,620
31/3/2022	To Balance c/d	9,14,626	1/4/2021	By Balance b/d	6,55,620
			31/3/2022	By Int. on D. R. F. Inve.	59,006
			31/3/2022	By Profit & Loss Appro.	2,00,000
		9,14,626			9,14,626
31/3/2023	To General Rese. A/c	12,02,316	1/4/2022	By Balance b/d	9,14,626
			31/3/2023	By Int. on D. R. F. Inve.	82,316
			31/3/2023	By Profit & Loss Appro	2,00,000
			31/3/2023	By D. R. F. Invest. A/c	5,374
		12,02,316			12,02,316

13) Calculation of Interest and Preparation of Sinking Fund Investment A/c and Sinking Fund A/c for all years

Problem 35. Bhima Water Supply Co. issued on 1/4/2020, 300 8% Debentures of ₹ 300 each at par repayable at par at the end of 3rd year. It was decided to create sinking fund for the purpose by transferring proportionate amount of debentures every year from profit & loss appropriation account. The amount set aside is to be invested in 9% Preference Shares of Vithoba Co. Ltd. The dividend received on these shares is also to be reinvested in the same shares. On 31/3/2023, 9% Preference Shares realised ₹ 65,000.

Please, prepare Sinking Fund A/c and 9% Preference Shares in Vithoba Co. Ltd. A/c in the books of the company for all the years.

Solution – In the books of Bhima Water Supply Co.

Calculation of amount to be set aside as sinking fund = (300 x 300) / 3 = 30,000

Calculation of Profit on sale of 9% Preference Shares in Vithoba Co. Ltd.

65,000 – 62,700 = 2,300

Calculation of Dividend on 9% Preference Shares

Year	Calculation of Interest	Investment at the end of the year
2020-21	NIL	30,000
2021-22	9% on 30,000= 2,700	30,000 + 30,000 + 2,700 = 62,700
2022-23	9% on 62,700 = 5,643	

Dr Sinking Fund A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2021	To Balance c/d	30,000	31/3/2021	By Profit & Loss Appro.	30,000
		30,000			30,000
31/3/2022	To Balance c/d	62,700	1/4/2021	By Balance b/d	30,000
			31/3/2022	By Dividend on P. S.	2,700
			31/3/2022	By Profit & Loss Appro.	30,000
		62,700			62,700
31/3/2023	To General Rese. A/c	1,00,643	1/4/2022	By Balance b/d	62,700
			31/3/2023	By Dividend on P. S.	5,643
			31/3/2023	By Profit & Loss Appro	30,000
			31/3/2023	By 9% Pref. Sha. A/c	2,300
		1,00,643			1,00,643

Dr 9% Preference Shares in Vithoba Ltd. A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2021	To Bank A/c	30,000	31/3/2021	By Balance c/d	30,000
		30,000			30,000
1/4/2021	To Balance b/d	30,000	31/3/2022	By Balance c/d	62,700
31/3/2022	To Bank A/c	32,700			
		62,700			62,700
1/4/2022	To Balance b/d	62,700	31/3/2023	By Bank A/c	65,000
31/3/2023	To Sink. Fund A/c	2,300			
		65,000			65,000

14) Various calculations including Interest and Preparation of Sinking Fund A/c, Sinking Fund Investment A/c, Interest on Debentures A/c, Discount on Issue of Debentures A/c and Loss on Issue of Debentures A/c for first two years

Problem 36. Tungbhadra Water Purifier Co. issued on 1/4/2021, 1400 8% Debentures of ₹ 500 each at 6% discount repayable at 7% premium at the end of 10th year. It was decided to create sinking fund for the purpose by transferring proportionate amount of debentures every year from profit & loss appropriation account. The amount set aside is to be invested in 9% Preference Shares of Kartik Co. Ltd. The dividend received on these shares is also to be reinvested in the same shares.

Please, prepare Sinking Fund A/c, 9% Preference Shares in Kartik Co. Ltd. A/c, Interest on 8% Debentures A/c, Discount on Issue of 8% Debentures A/c and Loss on Issue of 8% Debentures A/c in the books of the company for first two years

Solution – In the books of Tungbhadra Water Purifier Co.

Calculation of amount to be set aside as sinking fund = (1400 x 500) / 10 = 70,000

Calculation of annual interest on debentures – 8% of (1400 x 500) = 56,000

Calculation of discount on debentures to be written off every year-

6% of (1400 x 500) / 10 = 4200

Calculation of discount on debentures to be written off every year-

7% of (1400 x 500) / 10 = 4900

Calculation of Dividend on 9% Preference Shares

Year	Calculation of Interest	Investment at the end of the year
2021-22	NIL	70,000
2022-23	9% on 70,000= 6,300	70,000 + 70,000 = 6,300 = 1,46,300

Dr Sinking Fund A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2022	To Balance c/d	70,000	31/3/2022	By Profit & Loss Appro.	70,000
		70,000			70,000
31/3/2023	To Balance c/d	1,46,300	1/4/2022		70,000
			31/3/2023	By Balance b/d	6,300
			31/3/2023	By Dividend on P. S.	70,000
		1,46,300		By Profit & Loss Appro.	1,46,300

Dr 9% Preference Shares in Vithoba Ltd. A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2022	To Bank A/c	70,000	31/3/2022	By Balance c/d	70,000
		70,000			70,000
1/4/2022	To Balance b/d	70,000	31/3/2022	By Balance c/d	1,46,300
31/3/2022	To Bank A/c	76,300			
		1,46,300			1,46,300

Dr Interest on 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2022	To Bank	56,000	31/3/2022	By Profit & Loss A/c	56,000
		56,000			56,000
31/3/2023	To Bank	56,000	31/3/2023	By Profit & Loss A/c	56,000
		56,000			56,000

Dr Discount on Issue of 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2021	To 8% Debent. A/c	42,000	31/3/2022	By Profit & Loss A/c	4,200
			31/3/2022	By Balance c/d	37,800
		42,000			42,000
1/4/2022	To Balance b/d	37,800	31/3/2023	By Profit & Loss A/c	4,200
			31/3/2023	By Balance c/d	33,600
		37,800			37,800

Dr Loss on Issue of 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2021	To Prem. On Red. of 8% Debentures A/c	49,000	31/3/2022	By Profit & Loss A/c	4,900
			31/3/2022	By Balance c/d	44,100
		49,000			49,000
1/4/2022	To Balance b/d	44,100	31/3/2023	By Profit & Loss A/c	4,900
			31/3/2023	By Balance c/d	39,200
		44,100			44,100

15) Various calculations including Interest and Preparation of Sinking Fund A/c, Sinking Fund Investment A/c, Interest on Debentures A/c, Discount on Issue of Debentures A/c and Loss on Issue of Debentures A/c and Interest on Sinking Fund Investment A/c for first Last year

Problem 37. Tungbhadra Water Purifier Co. issued on 1/4/2013, 1400 8% Debentures of ₹ 500 each at 6% discount repayable at 7% premium at the end of 10^{th} year. It was decided to create sinking fund for the purpose by transferring proportionate amount of debentures every year from profit & loss appropriation account. The amount set aside is to be invested in 9% Preference Shares of Kartik Co. Ltd. The dividend received on these shares is also to be reinvested in the same shares.

On 1/4/2022 the balance on Sinking Fund A/c and 9% Preference Shares of Kartik Co. Ltd. A/c was ₹ 9,11,473. Dividend received for the year 2022-23 on 31/3/2023 on 9% Preference Shares of Kartik Co. Ltd. ₹ 82,033. 9% Preference Shares of Kartik Co. Ltd. sold on 31/3/2023 in the Stock Market for 9,15, 000.

Please, prepare Sinking Fund A/c, 9% Preference Shares in Kartik Co. Ltd. A/c, Interest on 8% Debentures A/c, Discount on Issue of 8% Debentures A/c, Loss on Issue of 8% Debentures A/c and Dividend on 9% Preference Shares in Kartik Co. Ltd. A/c in the books of the company for last year.

Solution – In the books of Tungbhadra Water Purifier Co.

Calculation of amount to be set aside as sinking fund = (1400 x 500) / 10 = 70,000

Calculation of annual interest on debentures – 8% of (1400 x 500) = 56,000

Calculation of discount on debentures to be written off every year-

6% of (1400 x 500) / 10 = 4200

Calculation of discount on debentures to be written off every year-

7% of (1400 x 500) / 10 = 4900

Dr Sinking Fund A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2023	To General Reserve A/c	10,67,033	1/4/2022	By Balance b/d	9,11,473
			31/3/2023	By Dividend on P. S.	82,033
			31/3/2023	By Profit & Loss Appro.	70,000
			31/3/2023	By 9% Pref. Sha. A/c	3,527
		10,67,033			10,67,033

Dr 9% Preference Shares in Kartik Co. Ltd. A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2022	To Balance b/d	9,11,473	31/3/2023	By Bank A/c	9,15,000
31/3/2023	To Sink. Fund A/c	3,527			
		9,15,000			9,15,000

Dr Interest on 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2023	To Bank	56,000	31/3/2023	By Profit & Loss A/c	56,000
		56,000			56,000

Dr Discount on Issue of 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2022	To Balance b/d	4,200	31/3/2023	By Profit & Loss A/c	4,200
		4,200			4,200

Dr Loss on Issue of 8% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
1/4/2022	To Balance b/d	4,900	31/3/2023	By Profit & Loss A/c	4,900
		4,900			4,900

Dr Dividend on 9% Preference Shares in Kartik Co. Ltd. A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2023	To Sink. Fund A/c	82,033	31/3/2023	By Bank A/c	82,033
		82,033			82,033

2.8 Summary

A company needs money for the purposes of growth, expansion, extension, development etc. Issue of debentures is one of the sources of debt financing for business activities. Debenture is a debt acknowledged by a company whether constituting a charge on the assets of the company or not, whether convertible into shares at a later stage or not, which ensures payment of interest at the fixed rate and repayment of money raised after the expiry of the stipulated period. Debentures can be classified from different points of view such as, Security, Convertibility, Permanence, Negotiability and Priority.

Debentures may be issued at par, at discount and at premium. In the same way, debentures may be redeemed at par or at premium. The price of the debenture may be called in single instalment or in more instalments. Interest on debentures is paid periodically. Loss on issue of debentures means premium on redemption of debentures. This loss and discount are amortised proportionately every year. Redemption of Debentures refers to repayment of liability on account of debentures.

The methods of redemption of debentures can broadly be divided under two headings, Sinking Fund Method and methods other than Sinking Fund Method. In other methods debentures are redeemed in lump sum or in instalments or by conversion or by taking insurance policy or by purchase of own debentures. Sinking Fund Method is more popular and mostly used by companies. A Sinking Fund is a fund created for the redemption of debentures. To avoid liquidity crisis at the time of repayment, many companies create sinking fund by transferring proportionate amount from profit and invest equal amount in outside securities. Interest received on such investment is also reinvested as and when it is received. At the time of maturity, the investment is realised and the proceeds is utilized for repayment of debentures.

2.9 Terms to remember

1. **Debentures :** A debenture is a bond issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.
2. **Secured Debentures:** These debentures are secured by a charge upon some or all assets of the company.

3. **Unsecured or “Naked” Debentures:** These debentures are not secured by any charge upon any assets.
4. **Convertible Debentures:** These are debentures which will be converted into equity shares after a certain period of time from the date of its issue.
5. **Non-Convertible Debentures:** These are debentures which cannot be converted into shares in future.
6. **Redeemable Debentures:** These debentures are repayable as per the terms of issue, for example, after 10 years from the date of issue.
7. **Irredeemable Debentures or Perpetual Debentures:** These debentures are not repayable during the life time of the company but, are repaid only at the time of liquidation.
8. **Registered Debentures:** These debentures are registered in the Register of Debenture holders maintained by the company.
9. **Bearer Debentures:** These debentures are transferable by delivery. These are negotiable instruments payable to the bearer. No kind of record is kept by the company in respect of the holders of such debentures.
10. **First Mortgage Debentures:** These debentures are having first charge on the secured asset and payable first out of the property.
11. **Second Mortgage Debentures:** These debentures are having second charge on the secured assets and payable after satisfying the first mortgage.
12. a) The value of debentures may be called in single instalment or more instalments,
    b) The debentures may be issued at par or at discount or at premium, and
    c) The debentures may be redeemed at par or at premium (very rarely at discount).
13. **Discount on Issue of Debentures :** Discount on Issue of Debentures is capital loss and is shown to the Assets side of the Balance Sheet under the heading ‘Miscellaneous Expenditures and Losses’. Proportionate amount from it is written off every year till it is fully amortized.
14. **Premium on Issue of Debentures :** Premium on Issue of Debentures is a capital profit and is shown to the Liabilities side of the Balance Sheet under the heading ‘Reserves & Surplus’.

15. **Premium on Redemption of Debentures :** Premium on Redemption of Debentures is a liability and is shown to the Liabilities side of the Balance Sheet along with Debentures till the debentures are redeemed.
16. **Loss on Issue of Debentures :** Premium on Redemption of Debentures is treated as a Loss on Issue of Debentures. It is capital loss and is shown to the Assets side of the Balance Sheet under the heading 'Miscellaneous Expenditures and Losses'. Proportionate amount from this is written off every year till it is fully amortized.
17. **Redemption of Debentures :** It refers to repayment of liability on account of debentures.
18. **Sinking Fund :** It is a fund created for the repayment of debentures.

2.10 Answers to check your progress

Multiple Choice questions

1. a) debentures	2. b) Section 2 (30)		3. c) debenture
4. d) Debenture	5. a) voting	6. b) Section 71	**7)** c) Debenture
8) d) Debenture		9) a) Interest on debentures	
10) b) can be traded in the Stock Market		11) c) Secured	
12) d) Convertible	13) a) Perpetual	14) b) Bearer	15) c) creditor

16) d) cannot take part in the management of the company

17) a) expense 18) b) Debenture holder

19) c) Liabilities side of the Balance Sheet

20) d) redeemed after stipulated period.

2.11 Exercise

Write Short Notes

1. Definition of Debenture and its features.
2. Types of debentures.
3. Difference between Debentures and Shares.
4. Interest on Debentures with example and journal entries.
5. Discount on Issue of Debentures with example and journal entries.
6. Loss on Issue of Debentures with example and journal entries.

7. Redemption of Debentures. Points that are to be considered in Redemption of Debentures

8. Sinking Fund Method of redemption of debentures.

Practical Questions

1. Mohite Milk Producing Co. Ltd. issued the following debentures during the year 2018-19.

On 30/9/2018, 1500 10% debentures of ₹100 each issued at par repayable at par after 5 years.

On 31/3/2019, 2000 9% debentures of ₹ 200 each issued at par repayable at 7% premium after 7 year

Please, enter the above transactions in the journal of the company.

Problem 2. Mandar Furniture Producing Co. issued the following debentures during the financial year 2018-19.

Date	Debentures	Issued at	Repayable at
1/7/2018	2500 11% debentures of ₹100 each	10% discount	Par at the end of 10th year
1/1/2019	5000 9% debentures of ₹ 200 each	5% discount	10% Premium at the end of 5th year

You are requested to journalise the transactions in the books of the company.

Problem 3. Shital Paper Producing Co. issued following debentures during the financial year 2018-19.

Date	Debentures	Issued at	Repayable at
31/12/2018	6000 6% debentures of ₹100 each	6% premium	Par at the end of 10th year
31/3/2019	7000 12% debentures of ₹200 each	12% premium	10% Premium at the end of 10th year

You are requested to pass journal entries in the books of the company.

Problem 4. Kokan Irrigation Co. issued 5000 12% debentures of ₹ 1000 each at a discount of ₹100 repayable at the option of the company after 5 years at par. The price of the debenture is called as, on application ₹ 400, on allotment ₹ 300 and ₹ 200 on first call.

Will you please pass journal entries for issue of debentures?

Problem 5. Sharaveri Ice Cream Co. issued 4000 11% debentures of ₹ 1000 each at a premium of ₹ 100 repayable at the option of the company after 7 years at a premium of 14%. The price of the debenture is called as, on application ₹ 500, on allotment ₹ 400 including premium and ₹ 200 on first call.

Pass journal entries for issue of debentures.

Problem 6. Nirmala Ltd. issued 14,000 11% Debentures of ₹ 100 each, repayable at par at the end of 5 years on 1st April 2018. Under the terms of issue of debentures, interest is payable half yearly.

Pass journal entries for the first year only.

Problem 7. Shreya Industries Ltd. issued 12,000 13% Debentures of ₹ 500 each at ₹ 450, repayable at par at the end of 5 years on 1st April 2014. The company decided to write off the discount on debentures in five years in equal proportion.

Pass journal entries for issue of debentures and amortisation of discount.

Problem 8. Bindu Co. Ltd. issued on 1/4/2014, 12,00,000 9% Debentures at par and repayable at the end of 10th year at a premium of 7%. It was decide to create sinking fund by transferring 1,20,000 from profit every year and investing it in 10% Government Securities. Interest on securities is also invested in the same securities.

Calculate Interest received on Government Securities for first five years.

Problem 9. Ranga Colours Ltd. issued 10% Debentures of ₹ 25,00,000 on 1/4/2018 at a discount of 3%, repayable at 4% premium after 5 years. It was decided to create a sinking fund by transfer of ₹5,00,000 every year from profit &loss appropriation account. An equal amount is to be invested in 11% Government securities at the end of every year. Interest on Government securities is to be invested in the same securities. The interest on debentures is payable at the end of each year. It was also decided to write off discount and loss on issue of debentures in the same period of debentures in equal proportion.

Give journal entries in the books of the company for first year only

Problem 10. Munnabhai Finance Co. Ltd. issued 9% Debentures of ₹ 30,00,000 on 1/4/2017 at a discount of 5%, repayable at 7% premium after 6 years. It was decided to create a sinking fund by transfer of proportionate amount every year from profit &loss appropriation account. An equal amount is to be invested in 12%

Government securities at the end of every year. Interest on Government securities will also be reinvested. The interest on debentures is payable yearly on 31st March each year. It was also decided to write off discount and loss on issue of debentures in the same period of debentures in equal proportion.

Give journal entries in the books of the company for the year 2018-19 only.

Problem 11. Krishnamai Construction Ltd. issued 15000 10% Debentures of ₹ 100 each at par repayable at the end of the 6th year at par on 1/4/2016. It was decided to create a Debenture Redemption Fund by transferring proportionate amount from profit. The amount so provided is to be invested in 11% Government Bonds and interest received thereon will also be reinvested in the same bonds. The interest on debentures is payable half yearly on 30th Sept. and 31st March every year and interest on government bonds is receivable annually on 31st March.

You are required to pass journal entries for the financial year 2018-19

Problem 12. On 1st April 2013, Bramha Construction Co. issued 9,000 11% Debentures of ₹100 each at par repayable at par at the end of 6th year from its issue. The company has the following balances on 31st March 2018.

1. 11% Debentures A/c ₹ 9,00,000
2. 11% Sinking Fund A/c ₹ 9,52,927
3. 12% Government of India Loan (Debentures Redemption Fund Investment) ₹ 9,52,927

The company used to transfer ₹ 1,50,000 every year from profit to the redemption fund. On 31st March 2019, the investments were sold for ₹ 9,55,000 and the debentures were redeemed. Interest on debentures is payable annually on 31st March every year.

Pass journal entries for the year 2018-19.

Problem 13. Swati Stationery Co. issued on 1/4/2017, 1600 8% Debentures of ₹ 1000 each repayable at the end of 8th year at a premium of 10%. The debentures redemption fund was created by transferring ₹ 2,00,000 from profit and it was invested in 9% Government Bonds.

Prepare Debenture Redemption Fund A/c and Debenture Redemption Fund Investment A/c for the first two years.

Problem 14. Jammu Tourist Co. has issued on 1/4/2015 7% Debentures of ₹ 8,00,000 at par repayable at a premium of 5% after 8 years. The company created a Debenture Redemption Fund by transfer of ₹ 2,00,000 every year from Profit & Loss Appropriation A/c. An equal amount and interest thereon were to be invested in 8% Government approved bonds at the end of every year. The interest on debentures is payable annually on 31st March every year. On 31st March 2019, the investments were sold for ₹ 6,80,000. The company was having sufficient bank balance including the proceeds from sale of investments to make repayment of debentures with premium. The debentures were redeemed on the date of maturity.

Calculate profit or loss on sale of investment and prepare Debenture Redemption Fund A/c for all the years.

Problem 15. Trupti Hotels Ltd. has issued on 1/4/2015 12% Debentures of ₹ 18,00,000 at a premium of 6% repayable at par of after 4 years. The company created a Debenture Redemption Fund by transfer of ₹ 4,50,000 every year from Profit & Loss Appropriation A/c. An equal amount and interest thereon were to be invested in 15% Government Bonds at the end of every year. The interest on debentures is payable annually on 31st March every year. On 31st March 2019, the investments were sold for ₹ 15,75,000. The company was having sufficient bank balance including the proceeds from sale of investments to make repayment of debentures with premium. The debentures were redeemed on the date of maturity.

Calculate profit or loss on sale of investment and prepare Debenture Redemption Fund Investment A/c for all the years.

Problem 16. Satyajeet Furniture Co. issued on 1/4/2014 6% Debentures of ₹20,00,000 at 5% discount and repayable at the end of 5th year at a premium of 7%. It was decided to write off discount and loss on issue of debentures in the equal proportion during these five years.

You are asked to pass journal entry for issue of debentures and prepare Discount on Issue of Debentures A/c and Loss on Issue of Debentures A/c for all the years.

Problem 17. Dudhari Sword Co. issued on 1/4/2014, 5,000 12% Debentures of 500 each at a premium of 8% repayable at a premium of 9% at the end of 5th year. It was decided to create sinking fund for the purpose by transferring 1/5th of the amount of debentures every year from profit & loss appropriation account. The amount set aside is to be invested in 10% Government Securities. The interest received on these securities is also to be reinvested in the same securities.

Please, pass journal entry for issue of debentures and prepare Interest on 10% Government Securities A/c in the books of the company for all the years.

Problem 18. Hem Kiran Co. issued 1000 12% Debentures of ₹ 500 each at 96% on 1st April 2016, repayable at par at the end of 3rd year. Debenture interest is annually payable on 31st March every year. Discount on debenture is to be written off in equal proportion in these 3 years. On 31st March 2019 the company was having sufficient bank balance to repay the debentures and accordingly the debentures were redeemed.

It is kind request of the company to pass journal entries for the transactions from issue to redemption of debentures.

Problem 19. Nargis Film Co. issued 1200 10% Debentures of ₹ 500 each at par on 1st April 2016, repayable at 4% premium at the end of 3rd year. Debenture interest is annually payable on 31st March every year. Loss on debenture is to be written off in equal proportion in these 3 years. On 31st March 2019 the company was having sufficient bank balance to repay the debentures and accordingly the debentures were redeemed.

Please, pass journal entries for the transactions from issue to redemption of debentures.

Problem 20. Jayaprabha Studios Ltd. issued 3000 9% Debentures of ₹ 200 each at 3% discount on 1st April 2016, repayable at 6% premium at the end of 3rd year. Debenture interest is annually payable on 31st March every year. Discount and Loss on issue of debenture is to be written off in equal proportion in these 3 years. On 31st March 2019 the company was having sufficient bank balance to repay the debentures and accordingly the debentures were redeemed.

You are required to prepare 9% Debentures A/c, Discount on Issue of 9% Debentures A/c, Loss on Issue of 9% Debentures A/c and Interest on 9% Debentures A/c for all the years

Problem 21. Rakhi Music Co. issued 9000 12% Debentures of ₹ 200 each at par on 1st April 2016. Debentures are repayable at 6% premium in 3 equal annual instalments by lottery starting from 31st March 2017.

Show, 12% Debentures A/c, 12% Debenture Holders A/c and Premium on Redemption of 12% Debentures A/c

2.12 Reference for Further Study

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Unit-3
Profit or Loss Prior to and After Incorporation
(in Vertical Form only)

Index :

3.0 Objectives

After studying this unit you will be able to –

- Understand the meaning and nature of Profit or Loss Prior to and After Incorporation
- Understand how to calculate Profit or Loss Prior to and After Incorporation
- Prepare Profit and Loss Account for the first year of the company showing profit or loss prior to and after incorporation.

3.1 Introduction

In the previous unit, the entire process from issue of debentures to their redemption is discussed thoroughly. In this unit, we will discuss how to prepare profit and loss account for the very first year of the life of the company which is established by taking over running business and continued the business even before the incorporation of the company. As the company has carried out the business before its registration, the profit or loss for the first year of the company need to be separated in the two periods i.e. before the incorporation and after incorporation. Because, the company was not legally in existence in the period prior to incorporation but, it has carried out the business in that period and earned profit or suffered loss, which cannot be considered as revenue profit or loss of the company available for dividend. In the following lines, theory of profit or loss prior to and after incorporation is discussed in detail followed by practical problems.

3.2 Meaning and Nature

When a running business is taken over by a company from a date prior to its incorporation, the profit earned or loss suffered from the date of purchase to the date of incorporation is known as Pre-incorporation Profit or Loss and the profit earned or loss suffered from the date of incorporation to the date of first year ending is known as Profit or Loss After Incorporation. Profit or loss pertaining to the period before incorporation is treated as capital profit or loss and the profit or loss pertaining to the period after incorporation is treated as revenue profit or loss.

For example, suppose, X Ltd. was incorporated on 1st July 2022 by taking over a running business of Y Ltd., from 1st April 2022 and it closed its accounts on 31st March 2023, any profit/loss made from 1st April 2022 to 1st July 2022 is known as "Profit / Loss Prior to Incorporation". If there is profit, it is treated as a capital profit and the same cannot be distributed by way of dividend. But is transferred to Capital Reserve or may be adjusted against Goodwill. If there is loss, it is treated as a capital loss and is shown under the head "Miscellaneous Expenditure" or added to Goodwill Account in the assets side of the Balance Sheet. The profit earned during post period i.e., in the above example, from 1st July 2022 to 31st March 2023, is treated as a revenue profit and is available for dividend.

A private company can commence its business soon after its incorporation, while a public company can commence business only after obtaining the Certificate of Commencement of Business. Any profit earned or loss suffered by private company before incorporation and by a public company before the commencement of business, should be taken as a capital profit or loss. However, in the case, when a public company is started with purchase of existing business and continues its business, the date of incorporation is taken into consideration for calculating profit or loss prior to incorporation and not the date of commencement of business.

3.3 Ways of Computing Profits/Loss Prior to and After Incorporation

As the profits earned prior to incorporation are not available for dividend, it is necessary to separate it from total profits for the first year. Profit or loss prior to incorporation and after incorporation can be ascertained by the following two ways –

a) Separate Profit and Loss Accounts are prepared for the pre-incorporation period (i.e. the period from the date of purchase to the date of incorporation) and post-incorporation period (i.e. the period from the date incorporation to the date of first year ending).

b) A Profit & Loss Account for the first year in columnar form is prepared by allocating expenses and income between the two periods, prior to and after incorporation.

In practice, generally, the second way is followed.

3.4 Steps in ascertaining profit or loss prior to and after incorporation

Step I : Define the period prior to and after incorporation.

(i) The period from the date of purchase to the date of incorporation is called as pre-incorporation period and

(ii) The period from the date of incorporation to the closing of the first accounting year is called as post-incorporation period.

Step II : Find out Gross Profit

A Trading Account is to be prepared for the first year, i.e., from the date of purchase to the date of year ending, in order to calculate the amount of gross profit. In other words, one trading account is prepared for the whole period without considering the date of incorporation to arrive at figure of the gross profit for the entire period.

Step III : Calculate the following two ratios:

(i) **Sales Ratio:** Ratio of amount of sales pertaining to the pre-incorporation period to that of post-incorporation period.

(ii) **Time Ratio:** Ratio of the period from the date of purchase of business to the date of incorporation to the period from date incorporation to the date of year ending.

Step IV: Determine the items which are to be divided in Sales Ratio

Gross profit and variable expenses and expenses connected with sales are allocated between the two periods on the basis of sales ratio. List of Expenses which are allocated on the basis of Sales / Turnover

(a) Selling Expenses (b) Advertisement

(c) Carriage Outwards (d) Godown Rent

(e) Discount Allowed (f) Salesmen's Salaries

(g) Commission to Salesmen (h) Sales Promotion Expenses

(i) Variable Portion of Distributions Expenses (j) Free Samples given

(k) Expenses incurred for After-Sale Service (l) Delivery Van Expenses,

(m) Bad Debts (n) Packaging

(p) Cartage (q) Storage etc.

Step V : Determine the items which are to be divided in Time Ratio

Expenses of fixed nature and expenses which incurs on the basis of time are allocated between the two periods on the basis of time ratio. List of expenses which are allocated on the basis of Time / Period -

(a) Office and Administrative Expenses (b) Salaries to Office Staff

(c) Rent, Rates and Taxes (d) Depreciation on Fixed Assets

(e) Printing and Stationery (f) Insurance

(g) Miscellaneous / Sundry / General Expenses (h) Repairs

(i) Fixed Portion of Distribution Expenses

(j) Travelling Expenses (not related to sales)

(k) Postage & Telegrams

(l) Other Expenses of Fixed Nature

Step VI : Interest on Purchase Price or Interest to Vendors

A separate ratio is to be calculated to distribute the interest on purchase price considering the date of payment of purchase price. Calculate the ratio of the period from the date of purchase of business to the date of incorporation (prior period) to the period from the date incorporation to the date of payment and distribute the interest in this special ratio.

Step VII : Audit Fees - Audit Fees are treated as below

a) If it is mentioned as Audit Fees - It is distributed in Time Ratio

b) If it is mentioned as Company's Audit Fee or Audit Fees under Companies Act - It is charged to Post-incorporation period

c) If it is mentioned as Tax Audit Fees or Audit Fees under Income tax Act, 1961 - It is distributed in Sales Ratio

(In some books audit fees are charged to after incorporation period, assuming that it is for audit under Company's Act)

Step VIII: Determine the items which are to be charged to Prior Period only

Certain expenses are not apportioned since they relate to a particular period. Find out the items such as partners' salary, interest on capital etc. which are to be charged to prior period only.

Step IX: Determine the items which are to be charged to After Period only

Find out the items which are to be charged to after period only. The following expenses are charged to after period –

(a) Directors' fees, salary and remuneration

(b) Preliminary expenses written off

(c) Interest on debentures,

(d) Provision for doubtful debts

(e) Underwriting Commission

(f) Non-business expenses

(g) Provision for Taxation

(h) Proposed Dividend etc.

Step X: Determine other items which need to be allocated separately

If there are some items for which separate information is provided, such items are distributed considering the information provided in the problem.

3.5 Accounting Treatment of Profit / Loss Prior to and After Incorporation:

Since Profit or Loss prior to incorporation is a Capital Profit / Loss, it is transferred to Capital Reserve or written off against Goodwill Account. Profit or Loss after incorporation is revenue profit or loss. If there is profit it is available for appropriation and if there is loss it will be carried forward and shown under the heading Profit & Loss A/c to the assets side of the Balance Sheet.

3.6 Check your progress

Multiple Choice Questions

1. When a running business is taken over by a company from a date prior to its incorporation, the profit earned or loss suffered from the date of purchase to the date of incorporation is known as ------------------ Profit or Loss.

a) Pre-incorporation　　b) After Incorporation

c) Post Incorporation　　d) Post Registration

2. When a running business is taken over by a company from a date prior to its incorporation, the profit earned or loss suffered from the date of incorporation to the date of first year ending is known as Profit or Loss ---------.

a) Pre-incorporation　　b) After Incorporation

c) Post Incorporation　　d) Post Registration

3. Profit or loss pertaining to the period before incorporation is treated as ------ profit or loss.

a) internal　　b) trading　　c) capital　　d) revenue

4. The profit or loss pertaining to the period after incorporation is treated as -------- profit or loss.

a) internal　　b) trading　　c) capital　　d) revenue

5. The profit earned --------- is not available for dividend.

a) prior to incorporation b) after incorporation

c) post incorporation d) post registration

6. The period from the date of purchase to the date of incorporation is called as ------- period.

a) after incorporation b) pre-incorporation

c) post incorporation d) post registration

7. The period from the date of incorporation to the closing of the first accounting year is called as ----------- period.

a) prior to incorporation b) pre registration

c) post incorporation d) non-cooperation

8. A ----------- can be prepared for the first year, i.e., from the date of purchase to the date of year ending, in order to calculate the amount of gross profit.

a) Profit & Loss A/c b) Cash A/c

c) Trial Balance d) Trading A/c

9. Generally, Gross profit is allocated between the two periods on the basis of ------- ratio.

a) sales b) time c) period d) expenses

10. Generally, variable expenses are allocated between the two periods on the basis of ------ ratio.

a) time b) sales c) period d) expenses

11. Generally, expenses of fixed nature are allocated between the two periods on the basis of ----- ratio.

a) turnover b) sales c) period d) income

12. Tax Audit Fees is distributed in ------- ratio

a) time b) period c) sales d) income

13. Preliminary expenses written off is ---------------------.

a) divided in time ratio b) divided in sales ratio

c) charged to pre incorporation period d) charged to post incorporation period.

14. Provision for doubtful debts is ---------------------------.

    a) charged to post incorporation period b) divided in sales ratio

    c) charged to pre incorporation period d) divided in time ratio

15. The Companies Act 2013 prescribed -------- Form for preparation of Final Accounts of a company.

    a) Horizontal b) Vertical c) Traditional d) Crosscut

3.7 Illustrations

The provision in the Companies Act 2013 regarding preparation of Final Account states that the Profit and Loss Account is to be prepared in **Vertical Form**. So, all the problems are solved in Vertical Form. **Students are advised to use Vertical Form only even though the account given in the problem is in horizontal form**.

Students can use any one of the following ways for distribution of expenses.

1. Expenses which are to be divided in specific ratio can be grouped and distributed individually.
2. Expenses which are to be divided in specific ratio can be grouped and distributed in aggregate.
3. Expenses are taken as they appear in the given problem and distributed individually with addition of one more column for stating the name of ratio.

A) Shivaji University Problems (Dates are revised)

Illustration 1. (Dec. 2018) Ajinkya Ltd. incorporated on 1st August 2022 to take over the running business of Prasad from 1st April 2022. The Profit & Loss Account for the year ended 31st March 2023 is as follows –

Profit & Loss A/c

Particulars	₹	Particulars	₹
To Rent & Taxes	24,000	By Gross Profit	3,10,000
To Insurance	6,000		
To Salaries	94,800		

To Directors' Fees	9,200		
To Commission	1,20,000		
To Advertisement	21,000		
To Preliminary Expenses	13,000		
To Bad Debts	4,000		
To Net Profit	18,000		
	3,10,000		3,10,000

The total turnover for the year ending on 31st March 2023 was ₹10,00,000 divided into ₹3,00,000 for the period up to 1st August 2022 and ₹ 7,00,000 for the remaining period.

Prepare a statement showing profit prior to and after incorporation of Ajinkya Ltd.

Solution – (Expenses which are to be divided in specific ratio are grouped but distributed individually.)

Working Notes

1. Time Ratio – Prior period – 1/4/2022 to 1/8/2022 – 4 months

   Post period – 1/8/2022 to 31/3/2023 – 8 months   Time Ratio = 4:8 = 1:2

2. Sales Ratio – 300000 : 700000 = 3:7

Profit & Loss A/c for the year ending on 31st March 2023

Particulars	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
Gross Profit (sales ratio – 3:7)	310000	93000	217000
Less:			
a) Expenses divided in time ratio (1:2)			
Rent & Taxes	24000	8000	16000
Insurance	6000	2000	4000
Salaries	94800	31600	63200
b) Expenses divided in sales ratio (3:7)			
Commission	120000	36000	84000
Advertisement	21000	6300	14700
Bad Debts	4000	1200	2800
c) Expenses charged post incorporation			
Directors' fee	9200		9200
Preliminary Expenses	13000		13000

Total Expenses	292000	85100	206900
Net profit	18000	7900	10100

Illustration 2. (Nov. 2017) Neha Ltd. was registered on 1st July 2022 to take over business of M/s Asha and Lata as from 1st April 2022. The company received its certificate for commencement of business on 1st August 2022. The accounts of the company prepared for the year ending 31st March 2023 showed the following.

1. Total turnover for the year amounting to ₹ 240000 of which ₹ 40000 relating to the period from 1st April 2022 to 1st August 2022.
2. Trading Account showed gross profit of ₹ 96000
3. Following expenses were debited to P. & L. A/c

Particulars	₹
Salary	21000
Advertising	12600
Bad Debts (500 related to debtors taken from vendors)	1500
Directors fees	10800
Depreciation	3600
Commission on sales	3600
Interest to Vendors (up to 31st Dec. 2022)	4000

Find out profit made by the company prior to and after incorporation

Solution – (Expenses which are to be divided in specific ratio are grouped and distributed in aggregate)

Note – when the date of incorporation and date of receipt of certificate for commencement of business, both are given date of incorporation is considered.

1. Time Ratio – Prior period – 1/4/2022 to 1/7/2022 – 3 months

   Post period – 1/7/2022 to 31/3/2023 – 9 months Time Ratio = 3:9 = 1:3

2. Sales Ratio – assuming sales are taken place evenly from 1/4/2022 to1/8/2022

   Prior period - 1/4/2022 to 1/7/2022 – 40000 /4 x 3 = 30000

   Post period – 1/7/2022 to 1/8/2022 - 40000 /4 x 1 = 10000

   1/8/2022 to 31/3/2023 – 240000 – 40000 = 200000

Total post period – 10000 + 200000 = 210000   Ratio – 30000 : 210000 = 1:7

3. Ratio for interest to vendors - Prior period – 1/4/2022 to 1/7/2022 – 3 months

   Post period – 1/7/2022 to 31/12/2022 – 6 months   Ratio = 3:6 = 1:2

4. Bad debts related to debtors taken over from vendors are charged to prior period and remaining to the after period.

Profit & Loss A/c for the year ending on 31st March 2023

Particulars	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
Gross Profit (sales ratio – 1:7)	96,000	12,000	84,000
Less –			
Expenses divided in Time Ratio (1:3)			
Salary	21,000		
Depreciation	3,600		
	24,600	6,150	18,450
Expenses divided in Sales Ratio (1:7)			
Advertising	12,600		
Commission on sales	3,600		
	16,200	2,025	14,175
Expenses divided specially			
Bad Debts (Given)	1,500	500	1,000
Interest to Vendors (1:2)	4,000	1,333	2,667
Expenses charged to post period			
Directors fees	10,800	---	10,800
Total Expenses	57,100	10,008	47,092
Net profit	38,900	1,992	36,908

Illustration 3. (Dec. 2015) XYZ Ltd. was formed on 1/7/2022 to take over business of partnership as from 1/4/2022. The following is Profit & Loss A/c of the company for the year ending on 31/3/2023

Profit & Loss A/c

Particulars	₹	Particulars	₹
To Salary	18,000	By Gross Profit	1,80,000

To Printing & Stationery	6,000		
To Bad Debts	18,000		
To Depreciation	36,000		
To Preliminary Expenses	9,000		
To Interest to Vendors (up to 31/8/2022)	7,500		
To Provision for Bad Debts	24,000		
To Advertising	15,000		
To Net Profit	46,500		
	1,80,000		1,80,000

Out of Bad Debts ₹4500 related to the debtors taken over from partnership. The sales for the period up to 1/7/2022 were 2/3rd of the sales for remaining period.

Compute the profit or loss made by the company prior to and after incorporation.

Solution –

Note – Individual items of expenses are divided in appropriate ratio, taking the same order as they appear in the given Profit and Loss Account, stating the name of the ratio in the separate column.

Working Notes

1. Time Ratio – Prior period – 1/4/2022 to 1/7/2022 – 3 months

   Post period – 1/7/2022 to 31/3/2023 – 9 months Time Ratio = 3:9 = 1:3

2. Sales Ratio – if the sales for the post incorporation period are 3, then for pre incorporation period – 3 x 2/3 = 2. Thus the ratio = 2:3

3. Ratio for interest to vendors - Prior period – 1/4/2022 to 1/7/2022 – 3 months

   Post period – 1/7/2022 to 31/8/2023 – 2 months Ratio = 3:2

4. Bad debts related to debtors taken over from partnership firm are charged to prior period and remaining to the after period.

Profit & Loss A/c for the year ending on 31st March 2023

Particulars	Ratio	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
Gross Profit	Sales	1,80,000	72,000	1,08,000
Less: Expenses				
Salary	Time	18,000	4,500	13,500
Printing & Stationery	Time	6,000	1,500	4,500
Bad Debts	Given	18,000	4,500	13,500
Depreciation	Time	36,000	9,000	27,000
Preliminary Expenses		9,000	---	9,000
Interest to Vendors	3:2	7,500	4,500	3,000
Provision for Bad Debts		24,000	---	24,000
Advertising	Sales	15,000	6,000	9,000
Total Expenses		1,33,500	30,000	1,03,500
Net profit		46,500	42,000	45,00

Illustration 4. (April 2017) Modern Co. Ltd. was registered on 1st July 2022 to take over a business of a firm with effect from 1st April 2022. The company received certificate of commencement of business on 1st Oct. 2022. The accounts of the company prepared for the year ending 31st March 2023 showed the following.

1. Total turnover for the year amounted to ₹ 8,00,000 of which turnover up to 1st July 2018 was ₹ 3,00,000.
2. Gross Profit for the year was ₹ 2,40,000.
3. Following expenses were debited to Profit & Loss Account.

Expenses	₹
Salary	18,000
Interest on Debentures	6,000
Depreciation	36,000
Discount allowed to Debtors	4,800
Office expenses	2,400

Advertising	20,000
Interest to vendors (up to 30th Sept. 2022)	5,000
Bad debts (₹ 500 relate to debtors taken over from firm)	2,500

Ascertain the profits earned prior to and after incorporation.

Solution –

Note – when the date of incorporation and date of receipt of certificate for commencement of business, both are given, date of incorporation is considered.

1. Time Ratio – Prior period – 1/4/2022 to 1/7/2022 – 3 months

   Post period – 1/7/2022 to 31/3/2023 – 9 months Time Ratio = 3:9 = 1:3

2. Sales Ratio –

   Prior period - 1/4/2022 to 1/7/2022 – 30000

   Post period – 1/7/2022 to 31/3/2023 – 800000 – 300000 = 500000

   Ratio – 300000 : 500000 = 3:5

3. Ratio for interest to vendors - Prior period – 1/4/2022 to 1/7/2022 – 3 months

   Post period – 1/7/2022 to 30/9/2022 – 3 months Ratio = 3:3 = Equal

4. Bad debts related to debtors taken over from firm are charged to prior period and remaining to the after period.

Profit & Loss A/c for the year ending on 31st March 2023

Particulars	Ratio	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
Gross Profit	Sales	2,40,000	90,000	1,50,000
Less: Expenses				
Salary	Time	18,000	4,500	13,500
Interest on Debentures	Post	6,000	---	6,000
Depreciation	Time	36,000	9,000	27,000
Discount allowed to Debtors	Sales	4,800	1,800	3,000
Office expenses	Time	2,400	600	1,800
Advertising	Sales	20,000	7,500	12,500
Interest to vendors	Post	5,000	---	5,000

Bad debts	Given	2,500	500	2,000
Total Expenses		94,700	23,900	70,800
Net profit		1,45,300	66,100	79,200

Illustration 5. (Nov. 2016 and April 2004) Anil Ltd. was formed on 1 July, 2022 to take over Business of partnership as from 1 April, 2022. The following is Profit and Loss Account of the company for the year ending 31 March, 2023.

Profit and Loss A/c

Particulars	₹	Particulars	₹
To Printing & stationery	30,000	By Gross Profit	9,00,000
To Bad Debts	90,000		
To Depreciation	1,80,000		
To Salary	90,000		
To Preliminary expenses	45,000		
To Interest to vendor			
(up to 31-8-2022)	37,500		
To Provision for bad debts	1,20,000		
To Advertising	75,000		
To Net Profit	2,32,500		
	9,00,000		9,00,000

Out of Bad Debts ₹ 22,500 related to the Debtors taken over from partnership. The sales for the period up to 1-7-2022 were 2/3 of the sales for the remaining period. The salary was evenly paid throughout the year.

Compute the Profit or Loss made by the company prior to and after incorporation.

Solution

1. Time Ratio – Prior period – 1/4/2022 to 1/7/2022 – 3 months

   Post period – 1/7/2022 to 31/3/2023 – 9 months Time Ratio = 3:9 = 1:3

2. Sales Ratio – if the sales for the post incorporation period are 3, then for pre incorporation period – 3 x 2/3 = 2. Thus the ratio = 2:3

3. Ratio for interest to vendors - Prior period – 1/4/2022 to 1/7/2022 – 3 months

   Post period – 1/7/2022 to 31/8/2022 – 2 months Ratio = 3:2

4. Bad debts related to debtors taken over from partnership are charged to prior period and remaining to the after period.

Profit & Loss A/c for the year ending on 31st March 2023

Particulars	Ratio	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
Gross Profit	Sales	9,00,000	3,60,000	5,40,000
Less: Expenses				
Printing & stationery	Time	30,000	7,500	22,500
Bad Debts	Given	90,000	22,500	67,500
Depreciation	Time	1,80,000	45,000	1,35,000
Salary	Time	90,000	22,500	67,500
Preliminary expenses	Post	45,000		45,000
Interest to vendor	3:2	37,500	22,500	15,000
Provision for bad debts	Post	1,20,000		1,20,000
Advertising	Sales	75,000	30,000	45,000
Total Expenses		6,67,500	1,50,000	5,17,500
Net profit		2,32,500	2,10,000	22,500

B) Miscellaneous Illustrations

Illustration 6 Lion Ltd. was incorporated on 1/8/2022 to take over the running business of M/s Tiger with effect from 1/4/2022. The accounts of the company were closed on 31/3/2023.

The average monthly sales during the first four months of the year 2022-23 were twice the average monthly sales during each of the remaining eight months.

Purchase price which was fixed at ₹ 12,00,000 was paid on 1/10/2022 with interest @ 6% p.a.

Calculate – a) Time Ratio b) Sales Ratio

c) Interest on Purchase Price and

d) Ratio to distribute Interest on Purchase Price

Solution – a) Time ratio:

Pre-incorporation period (1/4/2022 to 1/8/2022) = 4 months

Post incorporation period (1/8/2022 to 31/3/2023) = 8 months

Time ratio = 4 : 8 or 1 : 2

b) Sales ratio:

If average sale for each post-incorporation month is 1, then for each month of Pre-incorporation period will be 2, Thus, Pre-incorporation period = 4 months x 2 (as twice) = 8

Post incorporation period = 8 months x 1 = 8 Sales Ratio = 8 : 8 or Equal

c) Interest on Purchase Price – 6% on 12,00,000 for 6 months = 36,000

d) Ratio for Interest on Purchase Price –

Pre-incorporation period (1/4/2022 to 1/8/2022) = 4 months

Post incorporation period (1/8/2022 to 1/10/2022) = 2 months

Prior 4 months and after 2 months - 4:2 or 2:1

Illustration 7: Moon Ltd., which was incorporated on 1st September 2022, took over the business of Narendra, a proprietary concern, from 1st April 2022, for ₹ 10,00,000 on the condition that all profits earned from 1/4/2022 shall belong to the company. Following data is extracted from the Profit and Loss Account for the year ended 31st March 2023:

a) Gross Profit for the year was ₹ 2,00,000.

b) Sales for first six months amounted to ₹ 10,00,000, rate of gross profit being 12% on sales. In the second six months, rate of gross profit was 8% on sales.

c) Interest was payable on purchase consideration @ 12%. Purchase price was unpaid till the end of the year.

d) Commission on sales was at 1.5% throughout the year.

Calculate -

1. Gross Profit for pre-incorporation and post-incorporation periods
2. Sales for the year
3. Commission on sales
4. Time Ratio

Solution - 1. Calculation of Gross profit for the pre and post incorporation period

a) Gross profit for the first half of the year – 12% of ₹ 10, 00,000 = ₹ 1, 20,000

b) Gross profit for the second half of the year – 2,00,000 – 1,20,000 = 80,000

c) Gross Profit for Pre incorporation period –

1/4/2022 to 1/9/2022 – 120000/6 x 5 = 100000

d) Gross Profit for Post incorporation period –

1/9/2022 to 30/9/2022 – 120000/6 x 1 = 20000

1/10/2022 to 31/3/2023 – 80000

20000 + 80000 = 100000

2. Calculation of Sales

   a) Calculation of sales for the second half of the year on the basis of gross profit –

   $\frac{100}{8}$ x 80,000 = 10,00,000

   b) Calculation of total sales for the year – 10,00,000 + 10,00,000 = 20,00,000

3. Calculation of Commission on Sales – 1.5% on 20,00,000 = 30,000

4. Calculation of Time Ratio –

   Pre incorporation period – 1/4/2018 to 1/9/2018 –5 months

   Post incorporation period –1/9/2018 to 31/3/2019 – 7 months

   Time Ratio - 5: 7

Illustration 8: Star Ltd., which was incorporated on 1st September 2022, took over the business of Surendra, a proprietary concern, from 1st April 2022, for ₹ 10,00,000 on the condition that all profits earned from 1/4/2022 shall belong to the company. Following data is extracted from the Profit and Loss Account for the year ended 31st March 2023:

a) Sales for first six months amounted to ₹ 12,00,000; rate of gross profit being 12% on sales. In the second six months, sales were ₹ 10,00,000, rate of gross profit was 8% on sales.

b) Interest was payable on purchase consideration @ 12%. Purchase price was unpaid till the end of the year.

c) Commission on sales at 1% for pre and post-incorporation periods.

Calculate –

1. Time Ratio
2. Gross Profit for pre and post-incorporation periods
3. Sales Ratio
4. Interest on Purchase Consideration
5. Commission for pre and post incorporation periods

Solution -

1. Calculation of Time Ratio –

   Pre incorporation period – 1/4/2018 to 1/9/2018 –5 months

   Post incorporation period –1/9/2018 to 31/3/2019 – 7 months Time Ratio - 5: 7

2. Calculation of Gross profit for the pre and post incorporation period

   a) Gross profit for the first half of the year – 12% of ₹ 12, 00,000 = ₹ 1,44,000

   b) Gross profit for the second half of the year – 8% of ₹ 10, 00,000 = ₹ 80,000

   c) Gross Profit for Pre incorporation period – 1/4/2022 to 1/9/2022 – 144000/6 x 5 = 120000

   d) Gross Profit for Post incorporation period –

      1/9/2022 to 30/9/2022 – 144000/6 x 1 = 24000

      1/10/2022 to 31/3/2023 – 80000 24000 + 80000 = 104000

3. Calculation of Sales Ratio

   1/4/2022 to 1/9/2022 – 1200000/6 x 5 = 1000000

   1/9/2022 to 30/9/2022 – 1200000/6 x 1 = 200000

   1/10/2022 to 31/3/2023 –1000000 = 1200000 1000000 : 1200000 = 5 : 6

4. Calculation of Interest on Purchase Consideration – 12% on 1000000 = 120000. Purchase consideration was unpaid till the end of the year, so, interest is calculated for complete year.

5. Calculation of commission for pre and post incorporation periods.

   Pre-incorporation period = 1% on 1000000 = 10000

   Post incorporation period = 1% on 1200000 = 12000

Illustration 9: Mr. Stephen formed a private limited company with his relatives under the name and style of Jesus Pvt. Ltd. to take over his own existing business as from 1st April 2022 but the company was not incorporated till 1st July 2022. No entries relating to transfer of the business was entered in the books, which were carried on without a break till 31st March 2023.The following balances were extracted from the books as on 31st March 2023:

Trial Balance as on 31/3/2023

Particulars	Dr ₹	Cr ₹
Opening Stock	43,000	
Purchases	1,89,000	
Carriage inwards	3,300	
Sales		2,78,000
Selling commission	7,500	
Salaries	21,000	
Administrative expenses	20,000	
Rent and rates	12,000	
Directors' fees	18,000	
Capital		1,38,000
Fixed assets	1,00,000	
Current assets (other than stock)	34,000	
Preliminary expenses	5,200	
Current liabilities		37,000
	4,53,000	4,53,000

You are also given:

(a) Stock on 31st March 2023 amounted to ₹ 44,000.

(b) The Gross Profit Ratio is constant and monthly sales in April 2022, February and March 2023 are double of the average monthly sales of the year.

(c) The Preliminary Expenses are to be written-off.

(d) Depreciation shall be provided at 25% p.a. on Fixed Assets.

You are required to -

1. Compute Gross Profit
2. Compute Sales Ratio
3. Find the items which are not to be considered while preparing Profit & Loss A/c.

Solution - 1. Calculation of Gross Profit

Dr Trading A/c for the year ending on 31/3/2023 Cr

Particulars	₹	Particulars	₹
To Opening stock	43,000	By Sales	2,78,000
To Purchases	1,89,000	By Closing Stock	44,000
To Carriage inward	3,300		
To Gross Profit	86,700		
	3,22,000		3,22,000

2. Sales Ratio – if average sales per month are 1,

   Pre incorporation period- April -2 and May & June each 1 = 4

   Post incorporation period – July to Jan. 1 each and Feb. & March each 2 = 11

   Thus, Sales Ratio is 4 : 11.

3. The items which are not to be considered

   a) Opening Stock b) Purchases c) Carriage inwards d) Sales

   e) Capital f) Fixed assets g) Current assets h) Current liabilities

   i) Closing Stock

Illustration 10: Mr. Sitaram formed a private limited company with his relatives under the name and style of Hindu Pvt. Ltd. to take over his own existing business as from 1st April 2022 but the company was incorporated on 1st July 2022. The following balances were extracted from the books as on 31st March 2023:

Trial Balance as on 31/3/2023

Particulars	Dr ₹	Cr ₹
Gross Profit		86,700
Selling commission	7,500	
Salaries	21,000	
Administrative expenses	20,000	
Rent and rates	12,000	
Directors' fees	18,000	
Capital		1,38,000
Fixed assets	1,00,000	
Current assets	78,000	
Preliminary expenses	5,200	
Current liabilities		37,000
	2,61,700	2,61,700

You are also given:

(a) Monthly sales in April 2022, February and March 2023 are double of the average monthly sales of the year.

(b) The Preliminary Expenses are to be written-off.

(c) Depreciation shall be provided at 25% p.a. on Fixed Assets.

You are required to prepare Profit and Loss Account for the year ended on 31st March 2023 apportioning the profit or loss of the periods before and after incorporation.

Solution - Working Notes –

1. Time Ratio – Pre incorporation period – 1/4/2018 to 1/7/2018 – 3 months

   Post incorporation period – 1/7/2018 to 31/3/2019 – 9 months Ratio 3:9 = 1:3

2. Sales Ratio – if average sales per month are 1,

Pre incorporation period- April -2 and May & June each 1 = 4

Post incorporation period – July to Jan. 1 each and Feb. & March each 2 = 11

Thus, Sales Ratio is 4 : 11.

3. Depreciation – 25% on 100000 = 25000
4. Ignored the items which appears to the balance sheet

Profit & Loss A/c for the year ending on 31st March 2023

Particulars	Ratio	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
Gross Profit	Sales	86,700	23,120	63,580
Less: Expenses				
Selling commission	Sales	7,500	2,000	5,500
Salaries	Time	21,000		
Administrative expenses	Time	20,000		
Rent and rates	Time	12,000		
Depreciation	Time	25,000		
		78,000	19,500	58,500
Directors' fees	After	18,000		
Preliminary Expenses	After	5,200		
		23,200		23,200
Total Expenses		1,08,700	21,500	87,200
Net profit / loss		-22,000	1,620	- 23,620

Illustration 11: New Ventures Ltd. was incorporated on 1st January 2023, with an authorised capital consisting of 5,000 Equity Shares of Rs. 100 each, to take-over the running business of Roshan Bros, as from 1st April 2022. The following is the summarised Profit and Loss Account for the year ended 31st March 2023.

Profit & Loss A/c

Particular	₹	₹
Sales – 1/4/2022 to 31/12/2022	1,90,000	
1/1/2023 to 31/3/2023	60,000	2,50,000
Less – Cost of Sales		1,60,000

Gross Profit		90,000
Less – Expenses		
Administrative Expenses	17,680	
Selling Commission	8,750	
Goodwill written off	2,000	
Interest to Vendors (up to 1/2/ 2023)	3,730	
Distribution Expenses (60% variable)	12,500	
Preliminary Expenses	3,300	
Debenture Interest	3,200	
Depreciation	4,440	
Directors' Fees	1,000	56,600
Net Profit		33,400

You are required to apportion the net profit amount between pre-incorporation and post- incorporation periods showing the basis of apportionment.

Solution:

Working Notes

1. Time Ratio – Pre incorporation period - 1/4/2022 to 31/12/2022 – 9 months

   Post incorporation period 1/1/2023 to 31/3/2023 – 3 months   Ratio = 9:3 = 3:1

2. Sales Ratio - Pre incorporation period - 190000

   Post incorporation period – 60000   Ratio - 19:6

3. Interest to Vendors - Pre incorporation period - 1/4/2022 to 31/12/2022 – 9 months

   Post incorporation period 1/1/2023 to 1/2/2023 – 1 months   Ratio = 9:1

4. Out of distribution expenses 60% are variable; it means remaining 40% are fixed. Hence they are distributed in Time Ratio.

Profit & Loss A/c for the year ending on 31st March 2023

Particulars	Ratio	Total Amt ₹	₹ Pre-incorpo.	₹ Post-incorpo
Gross Profit	Sales	90,000	68,400	21,600
Less: Expenses				
Administrative Expenses	Time	17680	13260	4420
Selling Commission	Sales	8750	6650	2100
Goodwill written off	After	2000		2000
Interest to Vendors (up to 1/2/2019)	Time	3730	3357	373
Distribution Expenses (60% variable)	Sales	7500	5700	1800
Distribution Expenses (40% fixed)	Time	5000	3750	1250
Preliminary Expenses	After	3300		3300
Debenture Interest	After	3200		3200
Depreciation	Time	4440	3330	1110
Directors' Fees	After	1000		1000
Total Expenses		56600	36047	20553
Net profit		33400	32353	1047

Illustration 12. Rama Industries Limited was incorporated on 1st August 2022. It had acquired a running business of Seeta & Co. with effect from 1st April, 2022. During the year 2022-23, the total sales were ₹ 36,00,000. The sales per month in the first half year were half of what they were in the later half year.

The net profit of the company, ₹ 2,00,000 was worked out after charging the following expenses:

(i) Depreciation ₹ 1,23,000, (ii) Directors' fees ₹ 50,000,

(iii) Preliminary expenses ₹ 12,000, (iv) Office expenses ₹ 78,000,

(v) Selling expenses ₹ 72,000 and (vi) Interest to vendors upto 31/8/ 2018 ₹ 5,000.

You are required to Calculate – 1. Sales Ratio, 2. Time Ratio,

3. Ratio for interest to vendors 4. Gross profit

Solution – 1. Sales ratio

The sales per month in the first half year were half of what they were in the latter half of the year. If in the later half year, sales per month is 2 then it should be 1 per month in the first half year.

So, Sales for the prior period, from 1st April, 2022 to 31st July, 2022 i.e. 4 months will be 4 × 1 = 4

Sales for the after period, from 1st August, 2022 to 30th Sept., 2022 i.e. 2 months 2 x 1 = 2 and

From 30th Sept., 2022 to 31st March, 2023 i.e. 6 months 6 × 2 = 12. Thus, 2 + 12 = 14

Sales ratio is 4 : 14 or 2:7.

2. Time ratio

Prior period - 1st April, 2022 to 31st July, 2022 : 4 months

After period - 1st August, 2022 to 31st March, 2023 : 8 months

= 4: 8 or 1:2.

3. Ratio for interest to vendors

Prior period - 1st April, 2022 to 31st July, 2022 : 4 months

After period - 1st August, 2022 to 31st August, 2022 : 1 month = 4: 1

4. Gross profit

Gross profit = Net profit + All expenses

= 2,00,000 + (1,23,000+50,000+12,000+78,000+72,000+5,000)

= 2,00,000 + 3,40,000 = 5,40,000.

Illustration 13. The promoters of Gouree Ltd. took over on behalf of the company a running business of Mrs. Parvatee with effect from 1st April, 2022. The company get incorporated on 1st July, 2022. The annual accounts were made up to 31st March, 2023 which revealed that the sales for the whole year totalled ₹ 160 lakh, out of which sales till 1st July, 2022 were for ₹ 40 lakh. Gross profit ratio was 25%. The expenses from 1st April 2022 to 31st March, 2023 were as follows:

Expenses	₹
Salaries	6,90,000
Sundry Office Expenses	6,60,000
Discount Allowed	1,20,000
Directors' Fee	2,50,000
Depreciation on Tangible Assets	1,20,000
Rent, Rates and Insurance	2,40,000
Travellers' Commission	1,60,000
Bad Debts	40,000
Tax Audit Fee	90,000
Debenture Interest	1,10,000

Prepare Profit and Loss Account for the year ending 31st March 2023, showing Profit for the pre-incorporation and post-incorporation periods

Solution - Working Notes: Sales Ratio

	(₹in lakh)
Sales for the whole year	160
Sales up to 1st July, 2022	40
Sales for the period from 1st July, 2022 to 31st March, 2023	**120**

Thus, Sale Ratio= 40:120 = 1:3

Time Ratio - 1st April, 2022 to 1st July, 2022 **:** 1st July, 2022 to 31st March, 2023

= 3 months: 9 months = 1:3

Profit & Loss A/c for the year ending on 31st March 2023

Particulars	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
Gross Profit (25% of 1,60,00,000)	40,00,000	10,00,000	30,00,000
Less:			
a) Expenses divided in time ratio			
Salaries	6,90,000	1,72,500	5,17,500
Rent, rates and Insurance	2,40,000	60,000	1,80,000
Sundry office expenses	6,60,000	1,65,000	4,95,000
Depreciation on tangible assets	1,20,000	30,000	90,000
b) Expenses divided in sales ratio			
Travellers' commission	1,60,000	40,000	1,20,000
Discount allowed	1,20,000	30,000	90,000
Bad debts	40,000	10,000	30,000
Tax Audit Fees	90,000	22,500	67,500
c) Expenses charged post incorporation			
Directors' fee	2,50,000	-	2,50,000
Debenture interest	1,10,000	-	1,10,000
Total Expenses	24,80,000	5,30,000	19,50,000
Net profit	15,20,000	4,70,000	10,50,000

Illustration 14. Brahma and Vishnu, working in partnership registered a joint stock company under the name of Hawai Travellers Ltd. on August 31, 2022 to take over their existing business. It was agreed that they would take over the assets of the partnership from April 1st, 2022 for a sum of ₹ 30,00,000 and that until the amount was discharged they would pay interest on the amount at the rate of 6% per annum. The amount was paid on September 30, 2022. To discharge the purchase consideration and for having working capital, the company issued 20,000 equity shares of ₹ 100 each at a premium of ₹ 10 each and allotted 7% Debentures of the face value of ₹ 15,00,000 at par.

Trading and Profit & Loss Account for the year ended 31st March, 2023

Particulars	₹	Particulars	₹
To Purchase	14,00,000	By Sales:	
To Freight and carriage	50,000	1st April. to 31st Aug. 22	6,00,000
To Gross Profit c/d	6,00,000	1st Sept. 22 to 31st Mar.23	12,00,000
		By Inventory in hand	2,50,000
	20,50,000		20,50,000
To Salaries and Wages	1,00,000	By Gross profit b/d	6,00,000
To Debenture Interest	52,500		
To Depreciation	10,000		
To Interest on purchase Consideration	90,000		
To Selling commission	90,000		
To Directors' Fee	6,000		
To Preliminary expenses	9,000		
To Provision for taxes	60,000		
To Dividend paid on equity shares @ 5%	50,000		
To Net Profit c/d	1,32,500		
	6,00,000		6,00,000

Prepare statement apportioning the expenses and calculate profits/losses for the 'post' and 'pre-incorporation' periods.

Solution – In the books of Hawai Travellers Ltd.

Time Ratio

Pre incorporation period = 1^{st} April 2022 to 31^{st} August 2022 = 5 months

Post incorporation period = 1^{st} Sept. 22 to 31^{st} March 2023 = 7 months-

Time ratio = 5:7

Sales Ratio

Sales in pre incorporation period = ₹ 6,00,000

Sales in post incorporation period = ₹ 12,00,000   Sales ratio = 1:2

Ratio for Interest on Purchase Price

Pre incorporation period = 1st April 2022 to 31st August 2022 = 5 months

Post incorporation period = 1st September to 30th September 2022 = 1 month- Ratio = 5:1

Dividend on Equity Shares is not considered as it is an appropriation of profit.

Profit & Loss A/c for the year ending 31st March 2023

		Ratio	Pre-incorpo. ₹	Post-incorpo. ₹
Gross profit allocated in sales ratio		1:2	2,00,000	4,00,000
Less: a) Expenses allocated in time ratio				
Salaries and wages	1,00,000			
Depreciation	10,000			
	1,10,000	5:7	45,830	64,170
b) Expenses allocated on sales ratio				
Selling Commission	90,000	1:2	30,000	60,000
c) Interest on Purchase Price	90,000	5:1	75,000	15,000
d) Expenses charged to Post-incorporation period				
Debenture Interest	52,500			
Director's Fee	6,000			
Preliminary expenses	9,000			
Provision for taxes	60,000			
	1,27,500			1,27,500
Total			830 1,50,830	2,66,670
Net Profit			**49,170**	**1,33,330**

Illustration 15: The partners of M/s Dosti Enterprises decided to convert the partnership into a private limited company called Maitree (P) Ltd. with effect from 1st April 2022. The purchase consideration was agreed at ₹ 11,70,000 based on the firm's Balance Sheet as at 31st March 2022. However, due to some procedural difficulties, the company get incorporated on 1st July 2022. Meanwhile the business was continued on behalf of the company.

The same books of accounts were continued by the company which closed its account for the first time on 31st March, 2023 and provided you the following information.

1. On the date of incorporation, the company borrowed loan from bank of ₹ 5,00,000 at 12% p.a. to pay the purchase consideration due to the firm and the consideration was settled on that day with interest at 12% per annum. Bank loan was repaid on the date of year ending.
2. The company doubled the average monthly sales of the firm from 1st July, 2022 but the salaries are tripled from that date.
3. It had to occupy additional space from 1st October, 2022 for which rent was paid ₹ 30,000 per month. Total office & show room rent ₹ 7,20,000

   You are required to –

   a) Calculate Sales Ratio

   b) Calculate Interest and its division between pre and post incorporation period

   c) Ratio for division of salaries between pre and post incorporation period

   d) Division of office & show room rent between pre and post incorporation period

Solution

1. Calculation of Sales Ratio: If the average sales per month in pre-incorporation period are 1, then the average sales in post-incorporation period are 2.

   Sales in pre incorporation period = 1st April 2022 to 1st July 2022 = 3 months = 3 x 1 = 3

Sales in post incorporation period = 1st July 2022 to 31st March 2023 = 9 months = 9 x 2 = 18

Ratio = 3 : 18 or 1:6

2. Calculation of Interest for pre and post incorporation period

   a) Interest on Purchase price= 12% on 11,70,000 for 3 months = 35,100 for pre incorporation period

   b) Interest on bank loan = 12% on 5,00,000 for 9 months = 45,000 for post incorporation period

3. Ratio for division of Salaries between pre and post incorporation period

If average monthly salary for pre-incorporation period is 1, then for after incorporation period will be

3. Pre-incorporation period - 3 months = 3 x 1= 3 and

   Post incorporation period – 9 months=9 x 3 = 27 Ratio = 3:27 = 1:9

4. Division of office & show room rent between pre and post incorporation period

Total Rent	7,20,000
Additional rent for 6 months (From 1st Oct. 2022 to 31st March, 2023) = 30,000 x 6	- 1,80,000
Rent for old office and show room	5,40,000

Rent per month for old office and show room = 540000 /12 = 45000

Pre incorporation period = 1st April 2022 to 1st July 2022 = 3 months = 45000 x 3 = 135000

Post incorporation period = 1st July 2022 to 30th Sept. 2022 = 3 months= 45000 x 3 = 135000

1st Oct. 2022 to 31st March 2023 = 6 months = (45000 + 30000) x 6 = 450000

Thus, 135000 + 450000 = 585000

Illustration 16. Aakash Ltd. took over a running business with effect from 1/4/2022. The company was incorporated on 1/8/2022. The following summarised Profit and Loss Account has been prepared for the year ended 31/3/2023.

	₹		₹
To Rent of office building	26,400	By Gross profit	3,20,000
To Expenses of fixed nature	121200		
To Tax Audit fee	6,000		
To Expenses of variable nature	60400		
To Interest paid to vendor	4,200		
To Director's fee	11,200		
To Debenture interest	3,000		
To Net profit	87,600		
	3,20,000		3,20,000

Additional information:

a) Total sales for the year, which amounted to ₹ 19,20,000 out of which ₹ 4,80,000 are related to the prior incorporation period.

b) Rent of office building was paid @ ₹ 2,000 per month up to the end of September, 2022 and thereafter it was increased by ₹ 400 per month.

c) Purchase consideration was discharged by the company on 30th September, 2022 by issuing equity shares of ₹ 100 each.

Prepare Profit and Loss A/c in columnar form showing profit or loss of pre and post incorporation periods.

Solution - Working Notes:

1. Time Ratio

   Pre incorporation period is 1/4/2022 to 1/8/ 2022 i.e. 4 months

   Post incorporation period is 1/8/ 2022 to 31/3/2023 i.e. 8 months

   Time ratio is 4 : 8 = 1: 2.

2. Sales Ratio

Pre incorporation period	4,80,000
Post incorporation period	14,40,000
Total	19,20,000

Sales ratio is 480000 : 1440000 = 1 :3

3. Rent

		₹
Rent for pre-incorporation period (₹ 2,000 x 4) Rent for post incorporation period		8,000
August & September, 2022 (₹ 2,000 x 2)	4,000	
October, 2022 to March, 2023 (₹ 2,400 x 6)	14,400	18,400

4. Interest on Purchase Consideration

Pre incorporation period is 1/4/2022 to 1/8/ 2022 i.e. 4 months

Post incorporation period is 1/8/ 2022 to 30/9/2023 i.e. 2 months

Time ratio is 4 : 2 = 2:1.

Profit & Loss A/c for the year ended 31/3/2023

Particulars	Ratio	Total	Pre-Incorpo. ₹	Post-incorpo. ₹
Gross Profit	Sales	3,20,000	80,000	2,40,000
Less - Expenses				
Rent of office building	W.N. 3	26,400	8,000	18,400
Expenses of fixed nature	Time	1,21,200	40,400	80,800
Tax Audit fee	Sales	6,000	1,500	4,500
Expenses of variable nature	Sales	60,400	15,100	45,300
Interest paid to vendor	2 : 1	4,200	2,800	1,400
Director's fee		11,200		11,200
Debenture interest		3,000		3,000
Total		2,32,400	67,800	1,64,600
Net profit		87,600	12,200	75,400

Illustration 17. Ashok Ltd. was incorporated on 1.6.2022 to take over the business of Dileep & Co. from 1.4.2022. The summarised Profit and Loss Account as given by Ashok Ltd. for the year ending 31.3.2023 is as under:

Profit and Loss Account for the year ending 31.3.2023

	₹		₹
To Rent and Taxes	90,000	By Gross Profit	10,66,000
To Salaries including manager's salary of ₹ 88,000	3,31,000		
To Carriage Outwards	14,000		
To Printing and Stationery	18,000		
To Interest on Debentures	25,000		
To Sales Commission	30,800		
To Bad Debts	91,000		
To Underwriting Commission	26,000		
To Preliminary Expenses	28,000		
To Audit Fees	45,000		
To Net Profit	3,67,200		
	10,66,000		10,66,000

Prepare Profit & Loss A/c for the year ended on 31/3/2023, showing allocation of expenses and calculations of pre- incorporation and post-incorporation profits after considering the following information:

1. Sales for Nov. and Dec. were 1½ times the average monthly sales while sales for January, February and March were twice the average monthly sales.
2. Manager's salary was increased by ₹ 2,000 p.m. from 1.8.2022.
3. The audit fees are paid for the audit under Companies Act

Solution - Working Notes :

1. Sales Ratio – Suppose the average monthly sales is 1

April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
1	1	1	1	1	1	1	1.5	1.5	2	2	2
2		14									

Sales ratio – 2:14 = 1:7

2. Manager's Salary

Total Salary of the manager 88000

- Additional Salary from 1/8/22 – 8 months x 2000 = <u>16000</u>

Original salary 72000

Original Salary per month 72000 / 12 = 6000

Prior period – 1/4/2022 to 1/6/2022 – 2 months x 6000 = 12000

After period - 1/6/2022 to 31/3/2023 – 10 months = 88000 – 12000 = 76000

3. Time Ratio

Prior period – 1/4/2022 to 1/6/2022 – 2 months

After period - 1/6/2022 to 31/3/2023 – 10 months Time ratio – 2:10 = 1:5

Profit & Loss A/c for the year ended 31/3/2023

Particulars	Ratio	Total	Pre-Incorpo. ₹	Post-incorpo. ₹
Gross Profit	Sales	10,66,000	1,33,250	9,32,750
Less – Expenses				
Rent and Taxes	Time	90,000	15,000	75,000
Salaries (331000 – 88000)	Time	243000	40,500	2,02,500
Manager's salary	W.N. 2	88000	12,000	76,000
Carriage Outwards	Sales	14,000	1,750	12,250
Printing and Stationery	Time	18,000	3,000	15,000
Interest on Debentures	Post	25,000	---	25,000
Sales Commission	Sales	30,800	3,850	26,950
Bad Debts	Sales	91,000	11,375	79,625
Underwriting Commission	Post	26,000		26,000
Preliminary Expenses	Post	28,000		28,000
Audit Fees	Post	45,000		45,000
Total		6,98,800	85,475	6,11,325
Net profit		3,67,200	47,775	3,21,425

3.8 Summary

When a running business is taken over by a company from a date prior to its incorporation, the profit earned or loss suffered from the date of purchase to the date of incorporation is known as Pre-incorporation Profit or Loss and the profit earned or loss suffered from the date of incorporation to the date of first year ending is known as Profit or Loss After Incorporation. Profit or loss pertaining to the period before incorporation is treated as capital profit or loss. If there is profit, it is transferred to Capital Reserve or may be adjusted against Goodwill. If there is loss, it is shown under the head "Miscellaneous Expenditure" or added to Goodwill Account. The profit or loss pertaining to the period after incorporation is treated as revenue profit or loss. If there is profit, it is available for dividend. If there is loss, it is carried forward.

Profit or loss prior to and after incorporation is ascertained as below

1. Define the period prior to and after incorporation.
2. Find out Gross Profit, if it is not given in the problem
3. Calculate the Sales Ratio and Time Ratio
4. Determine the items which are to be divided in Sales Ratio
5. Determine the items which are to be divided in Time Ratio
6. Calculate ratio to divide Interest on Purchase Price or Interest to Vendors
7. Distribute Audit Fees considering the nature
8. Determine the items which are to be charged to Prior Period only
9. Determine the items which are to be charged to After Period only
10. Determine other items which need to be allocated separately considering the information provided in the problem.

3.9 Terms to remember

1. **Pre-incorporation Profit or Loss :** When a running business is taken over by a company from a date prior to its incorporation, the profit earned or loss suffered from the date of purchase to the date of incorporation is known as Pre-incorporation Profit or Loss.
2. **Profit or Loss After Incorporation :**When a running business is taken over by a company from a date prior to its incorporation, the profit earned or loss suffered from the date of incorporation to the date of first year ending is known as Profit or Loss After Incorporation.

3. **Pre-incorporation period :**The period from the date of purchase to the date of incorporation is called as pre-incorporation period and

4. **Post-incorporation period** : The period from the date of incorporation to the closing of the first accounting year is called as post-incorporation period.

5. **Sales Ratio:** Ratio of amount of sales pertaining to the pre-incorporation period to that of post-incorporation period.

6. **Time Ratio:** Ratio of the period from the date of purchase of business to the date of incorporation to the period from date incorporation to the date of year ending.

7. **The items which are to be divided in Sales Ratio** : Gross profit, variable expenses and expenses connected with sales are allocated between the two periods on the basis of sales ratio.

8. **The items which are to be divided in Time Ratio :** Expenses of fixed nature and which incurs on the basis of time are allocated between the two periods on the basis of time ratio.

9. **Ratio for Interest on Purchase Price or Interest to Vendors :** Ratio of the periods from the date of purchase of business to the date of incorporation to the period from date incorporation to the date of payment of purchase price

3.10 Answers to check your progress

1.a) Pre-incorporation	2. b) After Incorporation	3. c) capital
4. d) revenue	5. a) prior to incorporation	6. b) pre-incorporation
7. c) post incorporation	8. d) Trading A/c	9. a) sales
10. b) sales	11. c) period	12. c) sales
13. d) charged to post incorporation period.		
14. a) charged to post incorporation period		15. b) Vertical

3.11 Exercise

Write Short Notes

1. Profit Prior to and After Incorporation

2. Steps used to calculate profit prior to and after incorporation

3. List at least 8 expenses which are divided in Time Ratio.

4. List at least 8 expenses which are divided in Sales Ratio.

5. List at least 8 expenses which are not divided in Time Ratio.

6. List at least 8 expenses which are not divided in Sales Ratio.

7. List at least 8 expenses which are charged to post incorporation period.

8. Treatment of Interest on Purchase Price and Audit Fees in calculation of profit prior to and after incorporation.

Practical Questions

1. Tiger Ltd. was incorporated on 1/8/2022 to take over the running business of M/s Monkey Traders from 1/4/2022. The accounts of the company were closed on 31/3/2023.

The average monthly sales during the first four months of the year 2022-23 were one and half times of the average monthly sales during the remaining eight months.

Purchase price which was fixed at ₹ 14,00,000 was paid on 1/10/2022 with the interest @ 6% p.a.

Calculate – a) Time Ratio b) Sales Ratio

c) Interest on Purchase Price and

d) Ratio to distribute Interest on Purchase Price

2. The partners of M/s Prem Enterprises decided to convert the partnership into a private limited company called Priya (P) Ltd. with effect from 1st April 2022. The purchase consideration was agreed at ₹ 11,00,000 based on the firm's Balance Sheet as at 31st March 2022. However, due to some procedural difficulties, the company get incorporated on 1st August 2018. Meanwhile the business was continued on behalf of the company.

The same books of account were continued by the company and closed for the first time on 31st March, 2023 and provided you the following information.

1. On the date of incorporation, the company borrowed loan from bank of ₹ 10,00,000 at 12% p.a. to pay the purchase consideration due to the firm and the

consideration was settled on that day with interest at 12% p.a. The first instalment of bank loan was payable on 31/3/2023.

2. The company showed 50% increase in the average monthly sales of the firm from 1st August, 2022 as compared to the sales before that date. But, the salaries are doubled from that date.

3. It had to occupy additional space from 1st October, 2022 for which rent was paid ₹ 20,000 per month. Total office & show room rent ₹ 6,60,000

You are required to –

a) Calculate Sales Ratio

b) Calculate Interest and its division between pre and post incorporation period

c) Ratio for division of salaries between pre and post incorporation period

d) Division of office & show room rent between pre and post incorporation period

3. Aniket Ltd. incorporated on 1st July 2022 to take over the running business of Pramod from 1st April 2022. The Profit & Loss Account for the year ended 31st March 2023 is as follows –

Profit & Loss A/c

Particulars	₹	Particulars	₹
To Rent of building	79,200	By Gross Profit	10,23,000
To Fire insurance	19,800		
To Salaries of staff	3,12,840		
To Directors' Fees	30,360		
To Commission for sales	3,96,000		
To Advertisement	69,300		
To Preliminary expenses	42,900		
To Bad debts	13,200		
To Net Profit	59,400		
	10,23,000		10,23,000

The total turnover for the year ending on 31st March 2023 was ₹3300000, out of this ₹660000 are related to the period up to 1st July 2022.

Prepare a statement showing profit prior to and after incorporation of Aniket Ltd.

4. Rana Ltd. was formed on 1/8/2022 to take over business of partnership as from 1/4/2022. The following is Profit & Loss A/c of the company for the year ending on 31/3/2023

Profit & Loss A/c

Particulars	₹	Particulars	₹
To Salary	37,800	By Gross Profit	3,78,000
To Printing & Stationery	12,600		
To Bad Debts	37,800		
To Depreciation	75,600		
To Preliminary Expenses	18,900		
To Interest to Vendors (up to 31/8/2018)	15,750		
To Provision for Bad Debts	50,400		
To Advertising	31,500		
To Net Profit	97650		
	3,78,000		3,78,000

Out of Bad Debts ₹ 9450 related to the debtors taken over from partnership. The sales for the period up to 1/8/2022 were 1/3rd of the sales for remaining period.

Compute the profit or loss made by the company prior to and after incorporation.

5. Sneha Ltd. was registered on 1st July 2022 to take over business of M/s Kiran and Sonu as from 1st April 2022. The company received its certificate for commencement of business on 1st August 2022. The accounts of the company prepared for the year ending 31st March 2023 showed the following.

1. Total turnover for the year amounting to ₹ 504000 of which ₹ 48000 relating to the period from 1st April 2022 to 1st August 2022.
2. Trading Account showed gross profit of ₹ 115200
3. Following expenses were debited to P. & L. A/c

Particulars	₹
Office & Administrative Expenses	25,200
Commission to Salesmen	15,120

Bad Debts (500 related to debtors taken from vendors)	1,800
Directors fees	12,960
Depreciation	4,320
Selling Expenses	4,320
Interest to Vendors (up to 31st Dec. 2022)	4,800

Find out profit made by the company prior to and after incorporation

6. Mohan Co. Ltd. was registered on 1st June 2022 to take over a business of a firm with effect from 1st April 2022. The company received certificate of commencement of business on 1st Oct. 2022. The accounts of the company prepared for the year ending 31st March 2023 showed the following.

1. Turnover for the first half of the year is ¾ of the turnover in the second half of the year. Total turnover of the year was amounted to ₹ 21,00,000.
2. Gross Profit for the year was ₹ 4,90,000.
3. Following expenses were debited to Profit & Loss Account.

Expenses	₹
Salary to staff	36,000
Interest on Debentures	12,000
Depreciation	6,000
Discount allowed to Debtors	8,400
Office expenses	24,000
Selling Expenses	35,000
Interest to vendors (up to 30th Sept. 2022)	9,000
Bad debts (₹ 1,000 relate to debtors taken over from firm)	5,000

Ascertain the profits earned prior to and after incorporation.

7. Anita Ltd. was formed on 1 Oct. 2022 to take over Business of partnership as from 1 April, 2022. The following is Profit and Loss Account of the company for the year ending 31 March, 2023.

Profit and Loss A/c

Particulars	₹	Particulars	₹
To Printing & stationery	1,11,000	By Gross Profit	33,30,000
To Bad Debts	3,33,000		
To Depreciation	6,66,000		
To Salary	3,33,000		
To Preliminary expenses	1,66,500		
To Interest to vendor	1,38,750		
(up to 31-8-2022)	4,44,000		
To Provision for bad debts	2,77,500		
To Advertising	8,60,250		
To Net Profit	33,30,000		33,30,000

Out of Bad Debts ₹ 83,250 related to the Debtors taken over from partnership. The sales for the period up to 1-7-2022 were 2/3 of the sales for the remaining period. Total sales for the year were ₹ 83,25,000. Sales are taken place evenly in the period from 1/7/2022 till the end of the year.

Compute the Profit or Loss made by the company prior to and after incorporation.

8. Sharad Ltd., which was incorporated on 1st Oct 2022, took over the business of Devendra, a proprietary concern, from 1st April 2022, for ₹ 15,00,000 on condition that all profits earned from 1.4.2022 shall belong to the company. Following data is extracted from the Profit and Loss Account for the year ended 31st March 2023:

a) Gross Profit for the year was ₹ 3,00,000;

b) Sales for first six months amounted to ₹ 12,00,000; rate of gross profit being 10% on sales. In the second six months, rate of gross profit was 9% on sales.

c) Expenses for the year were

Expenses of fixed nature other than rent ₹ 72000

Expenses of variable nature other than commission ₹ 45000

Rent ₹ 1,000 per month up to 1/7/2022, afterwards it increased to 150%
Preliminary Expenses written off ₹ 13,000;

Directors' fees ₹ 5,000;

Managing Directors' Remuneration ₹ 3000 per month;

Commission on sales was at 2% throughout the year.

Prepare Profit and Loss Account for pre-incorporation and post-incorporation periods in columnar form stating against each item the basis of segregation.

9. Mr. Husen formed a private limited company with his relatives under the name and style of Moula Pvt. Ltd. to take over his own existing business as from 1st April 2022 but the company was not incorporated till 1st July 2022. No entries relating to transfer of the business was entered in the books, which were carried on without a break till 31st March 2023.The following balances were extracted from the books as on 31st March 2023:

Trial Balance as on 31/3/2023

Particulars	Dr ₹	Cr ₹
Opening Stock	1,63,400	
Purchases	7,18,200	
Carriage inwards	12,540	
Sales		10,56,400
Selling Expenses	28,500	
Salaries	79,800	
Office expenses	76,000	
Rent and rates	45,600	
Directors' fees	68,400	
Capital		5,24,400
Fixed assets	3,80,000	
Current assets (other than stock)	1,29,200	
Preliminary expenses	19,760	
Current liabilities		1,40,600
	17,21,400	17,21,400

You are also given:

(a) Stock on 31st March 2023 amounted to Rs. 1,67,200.

(b) The Gross Profit Ratio is constant and monthly sales in April & May 2022 is one and half times and January, February & March 2023 are double of the average monthly sales of the year.

(c) 50% of the Preliminary Expenses are to be written-off.

(d) Depreciation shall be provided at 20% p.a. on Fixed Assets.

You are required to prepare the Trading Account and the Profit and Loss Account for the year ended on 31st March 2023 apportioning the profit or loss of the periods before and after incorporation.

10. New York Ltd. was incorporated on 1st January 2023, with an authorised capital consisting of 10,000 Equity Shares of Rs. 100 each, to take-over the running business of New Delhi Stores, as from 1st April 2022. The following is the summary of sales and expenses for the year ended 31st March 2023.

Particular	₹	₹
Sales – 1/4/2022 to 31/12/2022	4,00,000	
1/1/2023 to 31/3/2023	1,00,000	5,00,000
Cost of goods sold		3,20,000
Expenses		
Administrative Expenses		35,000
Discount on issue of shares written off		4,000
Interest to Vendors (up to 31/3/2023)		7,200
Distribution Expenses (60% variable)		24,000
Debenture Interest		6,500
Directors' Fees		5,000

1. Selling commission @ 2.5% is paid to agents.
2. Total preliminary expenses are ₹ 50000. It is decided to write off it in 5 years dividing equally
3. Total value of fixed assets taken over from the New Delhi Stores is ₹180000. Depreciation is charged at 5%.

You are required to calculate the net profit of pre-incorporation and post-incorporation periods showing the basis of apportionment.

11. Ramesh Industries Limited was incorporated on 1st July 2022. It had acquired a running business of Himesh & Co. with effect from 1st April, 2022. During the year 2022-23, the total sales were ₹ 36,00,000. The sales per month in the first quarter were half of what they were in the rest of the year.

The net profit of the company, ₹ 3,00,000 was worked out after charging the following expenses:

(i) Depreciation ₹ 1,80,000, (ii) Directors' fees ₹ 75,000,

(iii) Preliminary expenses ₹ 18,000, (iv) Office expenses ₹ 1,60,000,

(v) Selling expenses ₹ 1,05,000 and (vi) Interest to vendors upto 30/9/2022 ₹ 8,000.

You are required to Calculate – 1. Sales Ratio, 2. Time Ratio,

3. Ratio for interest to vendors 4. Gross profit

12. The promoters of Ganga Ltd. took over on behalf of the company a running business of Mrs. Parvatee with effect from 1st April, 2022. The company get incorporated on 1st August, 2022. The annual accounts were made up to 31st March, 2023 which revealed that the sales for the whole year totalled ₹ 32 lakh, out of which sales till 1st August, 2022 were for ₹ 12 lakh. Gross profit ratio was 30%. The expenses from 1st April 2022 to 31st March, 2023 were as follows:

Expenses	₹
Salaries	1,02,000
Wages	36,000
Printing and Stationery	42000
Office Expenses	90,000
Discount Allowed	16,000
Allowances to Debtors	8,000
Directors' Fee	50,000
Depreciation	24,000
Rent & Rates	44,000
Insurance	4,000
Selling Commission	32,000

Carriage Outward	10,000
Tax Audit Fee	20,000
Debenture Interest	25,000

Prepare Profit and Loss Account for the year ending 31st March 2019, showing Profit for the pre-incorporation and post-incorporation periods

13. Kartik and Ganesh, who were working in partnership, registered a joint stock company under the name of Pavan Travellers Ltd. on Sept.1st, 2022 to take over their existing business. It was agreed that they would take over the assets of the partnership from April 1st, 2022 for a sum of ₹ 27,00,000 and that until the amount was discharged they would pay interest on the amount at the rate of 6% per annum. The amount was paid on September 30, 2022. To discharge the purchase consideration and for having working capital, the company issued 4,000 equity shares of ₹ 500 each at a premium of ₹ 50 each and allotted 7% Debentures of ₹1000 of the face value of ₹ 15,00,000 at par.

Profit and Loss Account for the year ended 31st March, 2023

Particulars	₹	Particulars	₹
To Purchase	12,60,000	By Sales:	
To Freight and carriage	45,000	1st Jan. to 31st Aug. 18	5,40,000
To Gross Profit c/d	5,40,000	1st Sept. to 31st Mar.19	10,80,000
		By Closing Stock	2,25,000
	18,45,000		18,45,000
To Salaries and Wages	90,000	By Gross profit b/d	5,40,000
To Debenture Interest	47,250		
To Depreciation	9,000		
To Interest on purchase Price	81,000		
To Selling commission	75,600		
To Directors' Fee	10,800		
To Preliminary expenses	8,100		
To Provision for taxes	54,000		
To Dividend on equity shares	45,000		
To Net Profit c/d	1,19,250		
	5,40,000		5,40,000

The accountant of the company forgot to record following expenses.

1. The business was continued in the premises of Kartik & Ganesh till the date of incorporation, for which the company paid rent of ₹ 5000 per month. On the date of incorporation the business was shifted to the newly constructed building of the company.
2. Unclaimed dividend of ₹ 55,000.
3. Outstanding selling commission of ₹ 5400.

Prepare statement apportioning the expenses and calculate profits/losses for the 'post' and 'pre-incorporation' periods.

14. Anuja Ltd. took over a running business with effect from 1/4/2022. The company was incorporated on 1/8/2022. The following summarised Profit and Loss Account has been prepared for the year ended 31/3/2023.

	₹		₹
To Rent of office building	2,11,200	By Gross profit	25,60,000
To Expenses of fixed nature	9,69,600		
To Tax Audit fee	48,000		
To Expenses of variable nature	4,83,200		
To Interest paid to vendor	33,600		
To Director's fee	89,600		
To Debenture interest	24,000		
To Bad Debts	75,000		
To Net profit	6,25,800		
	25,60,000		25,60,000

Additional information:

a) Total sales for the year, which amounted to ₹ 1,53,60,000 out of which ₹ 38,40,000 are related to the prior incorporation period.

b) Rent of office building was paid @ ₹ 16,000 per month up to the end of September, 2022 and thereafter it was increased by ₹ 3200 per month.

c) Purchase consideration was discharged by the company on 30th September, 2018 by issuing equity shares of ₹ 1000 each.

Prepare Profit and Loss A/c in columnar form showing profit or loss of pre and post incorporation periods.

15. Alok Ltd. was incorporated on 1.6.2022 to take over the business of Dileep & Co. from 1.4.2022. The summarised Profit and Loss Account as given by Alok Ltd. for the year ending 31.3.2023 is as under:

Profit and Loss Account for the year ending 31.3.2023

	₹		₹
To Rent and Taxes	1,08,000	By Gross Profit	12,79,200
To Salaries including Managing Director's salary of ₹ 1,05,600	3,97,200		
To Carriage Outwards	16,800		
To Printing and Stationery	21,600		
To Interest on Debentures	30,000		
To Sales Commission	36,960		
To Bad Debts	65520		
To Reserve for Bad Debts	43680		
To Underwriting Commission	31,200		
To Preliminary Expenses	33,600		
To Audit Fees	54,000		
To Delivery Van Expenses	1,70,250		
To Net Profit	2,70,390		
	12,79,200		12,79,200

Prepare Profit & Loss A/c for the year ended on 31/3/2023, showing allocation of expenses and calculations of pre-incorporation and post-incorporation profits after considering the following information:

1. The company is doing the business which is slightly seasonal. The period of season is from February to April every year when the sales are twice the average monthly sales.
2. Managing Director's salary is increased by ₹ 2,400 p.m. from 1.8.2022.
3. The audit fees are paid for audit under Companies Act.

3.12 Reference for further study

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Unit-4

Practical of Fundamental Computerised Accounting (with Tally)

Index :

4.0 Objectives:

This unit teaches you:

1. Theoretical aspects of Tally software
2. Creation of company and entering accounting transactions on Tally
3. Generation of Accounting Reports using Tally

4.1 Introduction

Modern age is the age of computers. Speed is the watchword of the present world. The job that requires a number of persons to work for several hours or days to complete can be done by a computer within few minutes and that too with sharp accuracy. *Computer is a programmable electronic device that can store, retrieve and process data. It is a machine that can be programmed to accept data (input), process it into useful information (output) and store it in its memory or secondary device for later use.* The processing of input to output is directed by the programme instructions (called software) but performed by the physical parts of computer (called hardware). Speed, accuracy, diligence, versatility and storage capacity are the main features of computers. As a result they are being used in every walk of our life.

In industrial and business organisations computers are playing an important role. With the help of computers each and every business transaction can be recorded. Computers can maintain the accounting record of an organisation with speed and accuracy. Once the business transactions are recorded correctly with the computer on the basis of bills and vouchers by using a proper accounting software (like Tally) the computer can on its own generate, display and print the various kinds of bills, vouchers, statements of accounts, daybook summaries, cash and bank summary, petty cash book, trial balance, final accounts, reports, funds flow and cash flow statement, purchase and sales registers, reminder letters to debtors for overdue balances, stock ledger, pay roll and what not. This helps the management to take important business decisions and carry out the compliances of business towards the government and tax authorities, banks, debtors, creditors etc. Computers can hold the data in their memories and can reproduce, whenever required and in a format needed. Computers help in pay roll accounting, inventory control, costing and budgetary control, filing of tax returns etc.

The functions of computers can be stated in brief as under :-

(1) They store and read the information entered into them,

(2) Then can perform the arithmetical, accounting and scientific operations of all types on the information.

(3) They can analyze and interpret the result of processing done on the information entered.

(4) They can reproduce, display and print the information in any format whenever needed.

4.2 Presentation of Subject Matter

4.2.1 Introduction to Tally :

Tally is the most popular and widely used computerised accounting software package. It provides financial accounting and inventory management system. It is a package with vast application with lots of features aimed for a large section of users of various trade and industry, each having its own kind of requirements. The tally accounting has been refined from time to time hence number of versions of tally have come from time to time such as Tally 4.5, Tally 5.4, Tally 7.1, Tally 8.1, Tally 9.4 and so on.

4.2.1.1 Technological Advantages of Tally :

Tally has achieved great success account of its unique features and technological advantages as under :

(1) A leading accounting Package : The first version of Tally was released in ***1988*** and since then it has undergone continuous development. Today it is recognized as one of the leading accounting packages across the world. Tally's market share in computerised accounting is more than 90%.

(2) Simple Installation : Tally is very simple to install. It gets installed instantly without any problem on any operating system.

(3) Codeless System : Normally accounting packages use numeric coding system. But Tally is a codeless accounting package. You have freedom to allocate meaningful names in simple English to your data items in the system.

(4) **Complete Business Solution :** Tally provides a comprehensive solution to the accounting and inventory needs of business. By using Tally you can maintain a complete set of accounts and inventory record for any kind of business. You can also extract various kind of information and reports such as Trial Balance, Final Accounts, Cash Flow and Funds Flow statements, Accounting Ratios etc.

(5) **Accounting with and without inventory :** While working on Tally you can decide which part of the system to use; Only accounting or accounting with inventory. If accounting with inventory is used whether it should be integrated or not. In *accounting with inventory* simultaneously while doing financial accounting the stock record is indirectly maintained. When accounting entry for purchase or sale of goods is passed you have to fill the details of items of goods purchased and sold, as a result of which the stock of those items is up-dated automatically.

(6) **Receivables and Payable :** Tally helps you to obtain the various reports on Receivables and Payables in different formats. *Ageing analysis* of Receivables and Payables as per your specification can also be obtained. For example, you can obtain a report on district-wise debtors whose amounts are due or overdue for *8 days and above* or *15 days and above* or *one month and above* etc. You may also print reminders to such debtors requesting them to pay such due or overdue bills. The text of reminder may be prepared in your own fashion.

(7) **Multi-location stock control :** Tally has a facility to maintain single location as well as multi-location stocks of the firm. Some business houses having many godowns may use multi-location stock option.

(8) **Multiple units of measurement :** Tally allows you to use multiple units of measure for each item. For example, if you are a wholesale dealer in sarees but occasionally you sell some sarees in retail, you may use *dozen sarees* as unit of measurement of sarees for regular wholesale transactions and *number of sarees* as a unit for retail transactions.

(9) **Unlimited firms :** By using Tally accounting package you can maintain the accounts of any number of firms at the same time. You can even compare or consolidate the financial statements of the firms whose accounts you have maintained. To get consolidated report of a group of companies you may create a Group company of several constituent companies.

(10) Multiple Names : Tally allows you to assign multiple names to stock items or account heads. An item may be identified by Name, Code, Part number, Catalogue number or any other unique identifier.

(11) Multiple Currency accounting : Tally allows the use of multiple currencies while recording business transactions. It does the automatic conversion to base currency as per prevailing exchange rates. This helps the importers, exporters as well as multinationals.

(12) Interest Calculation : Tally provides flexible and wide range of interest computation methods and options.

(13) Printing : Tally does the online printing of quotations, orders, invoices, vouchers, cheques etc.

(14) Single Mode Voucher Entry : Tally allows the recording of business transactions by a person without the knowledge of accounting principles, debits and credits. You may use *Single Mode Voucher Entry Screen* and enter the voucher details and Tally gives all the double effects of the transaction on its own and generates the financial statements and reports needed by your business.

(15) Versatility : Tally is suitable for a wide range of organisations from small grocery stores to large multinational corporations.

(16) User-defined Security levels : Tally offers high levels of security. The user can define multiple levels of security according to his requirements. Every authorized user in the company can have individual passwords with rights to use specific features only. The user with the administrator level password will have full access and can set controls for other users.

(17) Tally Audit : The Tally audit features provides the user with administrative rights, a capacity to check the correctness of the entries made by the authorized users and alter these entries, if necessary. Once the entries are audited, Tally displays the altered entries, if any, along with the name of the user who has altered the entry and the date and time of alteration.

(18) No needs of closing accounts : Tally directly prepares final accounts from regular business vouchers . Once the accounting voucher entries are made you can directly view the final accounts and get print outs. There is no need to pass *year-end closing entries* for the preparation of final accounts as in case of manual accounting.

(19) Income and Expenditure Account : Voluntary and Non-Profit Organisations can prepare Income and Expenditure Statement instead of Profit & Loss Account with the help of Tally.

(20) Columnar day books : Apart from regular day book reports, Tally can on its own create columnar Day books like Petty Cash Book, Sales Register, Purchase Register, Employee Pay Register etc. in a very compact form.

(21) Cost Centres and Cost Categories : Like account groups you may even create cost centres for various levels of cost analysis of accounting data.

(22) Interest & Calculations : Tally provides various options and methods for interest calculation on specified transactions.

(23) Bank Reconciliation : Tally provides you a facility to track unclear cheques and get your bank accounts reconciled with cash book.

(24) Import / Export of Data : Any transactions can be exported to and imported from other software after suitable alteration of the current structures.

(25) Graphical Analysis of data : Tally has a facility to make graphical presentation of accounting data you can generate graphical analysis reports of sales register, purchase register, stock register, cash flow, funds flow etc. This helps in reporting to

(26) GST and TDS : The recent versions of Tally prepare all the reports required by the government agencies in respect of Goods and Service Tax and Income Tax Deducted at Source. It prints all the certificates, challans and returns under these Acts.

4.2.1.2 Accounts organisation :

To work on Tally you should install Tally package on your computer. Then you may begin as under :-

(i) Click on Start > Programs > Tally > Tally 9 or

(ii) Double click on the Tally 9 icon. (if it is on desktop)

Tally Screen : Tally screen has 3 areas, namely,

(a) Work area : Where you can work on menus, Masters, Reports etc.

(b) Calculator : to make necessary calculations, and

(c) Buttons : To perform various functions and easy navigation. These buttons provide quick access to options. Many buttons have under secured or underlined character (e.g. New Column) indicating that you have to press such character simultaneously with <Alt> key. Some buttons have a character double underlined (e.g. As Voucher) indicating that you have to press the character along with <control> key

<table>
<tr><td>Work Area</td><td rowspan="2">B
U
T
T
O
N
S</td></tr>
<tr><td>Calculator</td></tr>
</table>

Common buttons on every screen are :

F11 : Features : This button is used to change the accounting features and inventory features of the company (or firm) you are currently working with. These changes are company specific. It means they do not affect the features of other companies which you work with the software.

F12 : Configure : This button enables us to select the style of reporting from the various options. It is used to configure settings for various applications available in Tally.

4.2.2 Getting Functional with Tally ERP.9

After successful installation of Tally.ERP 9 on your computer we have to make use of Tally Software to do the accounting assignments. The initial procedure to activate the Tally is referred to as Getting Functional with Tally ERP.9. It can be done in any of the following two ways:

1. After starting the computer, move the cursor to START button on the screen and click on it. (***Click*** means press and release the left button of a mouse). Then move the cursor on *All Programs* to display all the programs installed in your computer. Take the cursor on Tally. ERP9 and click it and the Tally ERP9 will get selected then press enter key on your keyboard for once to get functional or after taking cursor on Tally. ERP symbol double click left button to get functional.

   Note: Hence forth (Symbol **>** will be used to mean ***Select and Press Enter Key on your computer)***

2. In case Tally. ERP 9 short cut is saved on your desktop the Tally short cut Icon will be appearing on your computer or laptop. In that case simply select and double click the icon to get functional with tally.

In short: to get functional with tally *Click on start button > All Programs > Tally. ERP 9* or *Double Click Tally. ERP 9 icon on your desktop*.

When you start Tally ERP 9 first of all the welcome screen "Tally – Power of Simplicity" will be displayed on your screen and within few seconds the following screen will appear on your screen.

4.2.2.1 Mouse / Key Board Conventions:

While working with Tally the following mouse and key board conventions should be understood by you.

Action	Meaning
Click	Press the left button of the mouse
Double Click	Press and release the left button of the mouse twice without moving the position of the pointer.
Select	Bring the cursor on desired option and click the left button of the mouse (Denoted by symbol >).
(Key board) Fn	Press the function key (Key on the letter shown in the capital).
Fn (Capital) Letter Function button with Single underline	Press Alt. + Function key combination
Fn (Capital) Letter Function button with Double underline	Press Ctrl + Function key combination

4.2.2.2 Switching between Screen Areas:

When Tally ERP.9 is installed and opened " Gateway of Tally" is the first screen is displayed. To switch between the main screen, calculator area, and information area of the screen the following combinations of the keys on the keyboard can be used.

To use Calculator	Press: Crtl + N
To return to the main screen	Press: Crtl + M
To move to configuration information screen	Press: Crtl + Alt + F
To open screen showing Product Version Features	Press: Crtl + Alt + T
To move to License and Service Details	Press: Crtl + Alt + L
To select a company	Press : F1 or Right Click F1 button
To alter date	Press: F2 or Right Click F1 button
To move to previous screen	Press: Esc
To move to next screen	Press: Enter

4.2.2.3 Quitting Tally ERP.9:

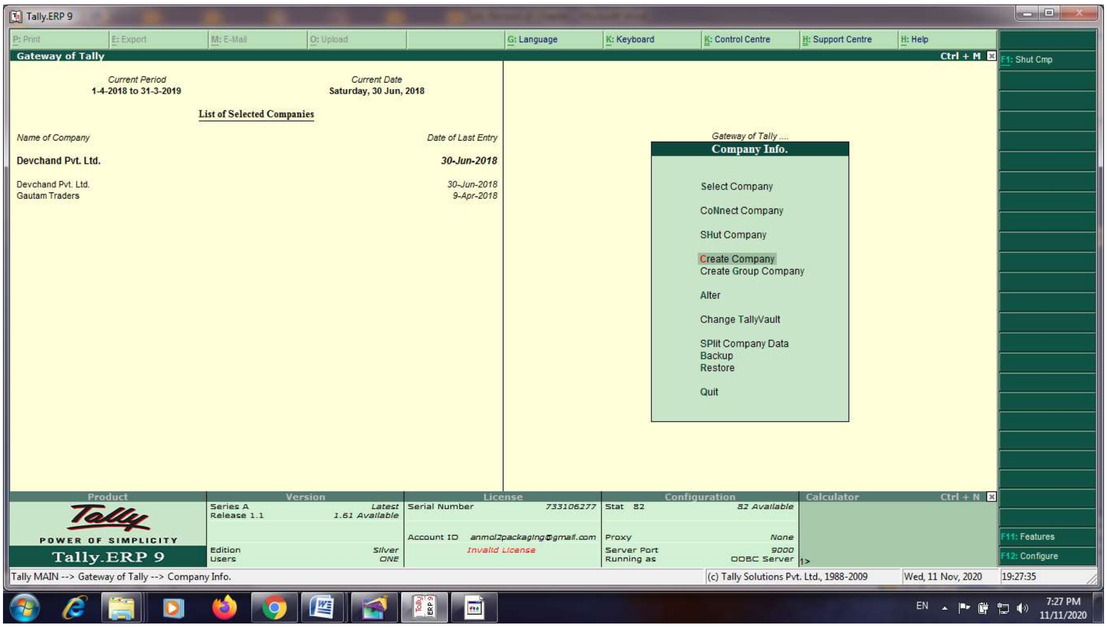
You can quit or exit from any program (Screen and Function) by pressing Quit option given at the end of all functions or press esc key on key board till the message 'Quit' Yes or No appears on the screen. Then press Y key or Enter key on your key Crtl + Q.

4.2.3 Setting up of Company in Tally ERP.9

While using Tally the term company is used to refer to an organization whose accounts are to be maintained under Tally. Such an organization may be a Limited Company, a Private Limited Company, a Partnership firm, a Proprietary concern, a Cooperative Society or any other kind of organization. To maintain the accounts such an organization under a specific name is called setting up a company in Tally ERP. Such an organization or entity whose accounts are maintained under tally is called Accounting Unit.

4.2.3.1 Gate way to Tally: (Main Menu):

After downloading the Tally software or after opening the Tally software any time for accounting work the following opening screen appears which is called GATEWAY to Tally or Main Menu. The screen looks as under:



In the above screen it is seen that accounts of two firms Devchand Pvt. Ltd. and Gautam Traders are already existing with Tally of which Devchand Private Ltd. is in active mode. You can continue your accounting work with this company or select any of the firms from the existing list by pressing select company button. And commence its accounting work by selecting the other company in the given list.

4.2.3.2 How to Create a New Company ? (Company Creation)

If you want to maintain your company's accounts in Tally, first of all you have to create the company or firm whose accounts are to be maintained by you in tally.

To create a new firm whose accounts are to be maintained you have to follow following steps.

Go to Gateway of Tally > Company Info > Create Company

Important Note: Hereafter we shall be using the symbol > to denote ***Select & Press Enter Key***

Then the company creation screen appears as shown below in which you have to fill firm's details such as name, address, sales tax number, Income tax number, VAT Number, E-mail Address, Accounting year, Currency etc.

i) **Directory** ': It asks you for the path where you intend to create your company. The default data directory is C:\TALLY\DATA

ii) **Name** ': Type the name of the company. This name will be displayed in the language in which the company is being created.

iii) **Mailing Name & Address** ': Type the full address of your company. This will appear on all the reports.

iv) **Statutory Compliance for** ': The countries are selected from the given list of countries. The statutory features and Base Currency Symbol are enabled in accordance with the country selected.

v) **State** ': Select the state from the drop down list of Indian state.

vi) **PIN Code** ': Type the Postal Index Number.

vii) **Telephone Number** ': Type office Telephone No.

viii) **E-mail Address** ': Type the E-mail address of the company.

ix) **Currency Symbol** ': type Rs. For India.

x) **Maintain** ': A window with two options pops up. These are :

   a) *Accounts only*: ': Where businesses do not deal with Inventory e.g. Professional.

   b) *Accounts with Inventory* ' It maintains both Financial accounts as well as Inventory.

   Select the appropriate option as per your requirement.

xi) **Financial Year From** ': Type the starting date of the financial year. Tally considers 12 months from the given date e.g. 01/04/2020

xii) **Books Beginning From** ': The date from actual transactions started but this date should be later than the starting date of Financial Year.

xiii) **Tally Vault Password (if any)** ': If you wish to maintain company data in encrypted form.

xiv) **Use security Control** ': This feature of Tally sets up authority levels that decides the right of the user for data manipulation.

xv) **Use Tally Audit features** ': If set to 'yes' the changes in transactions or ledger masters can be tracked.

xvi) Base Currency Information ':

   a) Base currency symbol ': Rs.

   b) Formal name ': Indian Rupees

   c) Number of Decimal Places ': 2

   d) Show Amounts in Millions? ': No

Step 2: Press Enter and accept the screen. Now the company gets created which can be loaded from the Company Info. Menu as and when desired.

4.2.3.3 Select a Company

On creation and selection of a company, Gateway appears which is the ***Main Menu*** of the software from where various accounting activities begin. For selecting the company whose accounts are to be maintained from the gate way you can follow the following route.

Go to Gateway of Tally > Company Info > Select Company

From the list of companies displayed you may select your company by using arrow keys on the key board.

4.2.3.4 Altering / Modifying Existing Company ':

You can modify, at any time, any information given whilst creating the company by Alt + F3 ' Enter.

In case you want to alter the information of the existing company you have to follow the following route:

Go to Gateway of Tally > Company Info > Alter Company

From the list of companies displayed you may select your company by using arrow keys on the key board. The information of the company will be displayed in alter mode. By using enter keys to move ahead to the next fields and back spaces to revert to the earlier fields you may reach the field where you want and make necessary changes in the information therein.

A company can be DELETED only in the alter mode by pressing Alt + D.

4.2.3.5 Shutting a Company ': It means unloading it. If you are in the main menu called Gate of Tally, you can see that there is *F1 : Shut Cmp* button on vertical button bar on the right hand side. If you select this button and click it with the mouse which will help you to leave the screen of the company you are working with. Alternatively you may Press [Alt + F1] on your key board to shut the working of the current company.

4.2.4 Creating Accounting Masters in Tally ERP.9

4.2.4.1 Chart of Accounts

A chart of Accounts in Tally.ERP9 refers to a list of accounts displaying the all the transactions of an organization using Tally for accounting. Such a chart includes the Groups and Ledgers created and used for the accounting of an organization. To view such chart of Groups and Accounts following route is followed:

To view groups: *Gateway > Accounts Info > Groups > Display*

To view ledgers: *Gateway > Accounts Info > Legers > Display*

In Tally Accounting Package, the data can be divided into two types, namely,

(a) Masters and (b) Transactions.

(a) Masters : The master information means the information which will be stored only once but will be used frequently by the computer. This information is more of a static nature and changes in this are not required to be done so frequently. Masters include :

(i) Groups, (ii) Ledger Accounts, and (iii) Customer Master.

(i) Groups : Groups are the masters which do the function of holding the various sub groups (or ledger accounts) together. In Tally, at the time of creation of a Ledger Account, you have to place such ledger under appropriate Account Group. Such Account Groups help you to make proper and meaningful classification of Ledger Accounts so as to get the ultimate Accounting Reports in properly classified manner.

Tally provides you the facility to organise Accounts Ledgers and Groups in a versatile manner. Any number of ledgers can be placed under a sub group and any number of sub groups can be placed under a group. Following example shows the hierarchial structure of Account Groups and Ledger.

Group	**Expenditure Account**
Sub-Group	Employee Expenses
Sub-Group	-Salaries and Wages
Sub-Group	Salaries
Ledger Account	*Managerial Salaries*
Ledger Account	*Technical Staff Salaries*
Sub-Group	Wages
Ledger Account	*Permanent Workers Wages*
Ledger Account	*Temporary Workers Wages*
Sub-Group	- Bonus
Ledger Account	*Statutory Bonus*
Ledger Account	*Ex-gratia Bonus*
Sub-Group	- Incentive
Ledger Account	*Production Incentive*
Ledger Account	*Attendance Incentive*
Sub-Group	Administrative Expenses

Sub-Group - Rent

Ledger Account *Office Rent*

Ledger Account *Factory Rent*

Ledger Account *Godown Rent*

Thus you should plan the arrangement of Groups, Subgroups and Ledger Accounts and establish the link at the time of Group creation and Ledger Creation in order to maintain proper link among them. This helps you to obtain organised reports with control totals. In the above example while you get the total of Expenditure Account, you also get break up into Employee Expenses and Administrative Expenses, again split employee expenditure into Salaries and Wages, Bonus an Incentives. Further total of salaries as well as wages are instantly available along with next level breakup into Permanent workers and Temporary workers wages. Thus proper grouping of accounts help in preparation of Detail as well as Consolidated Accounting Statements and Reports.

4.2.4.2 Ledger Accounts : Ledger account do the function of holding the transaction of a similar nature together. All financial entries are made using ledger account heads. All the expenses on managerial salaries will be shown in the ledger account named, "Managerial Salaries". Similarly All the expenses pertaining to office rent will be shown in the ledger account named "Office Rent Account".

4.2.4.3 Customer Master : Customer master keeps the record of the following information pertaining to the customers.

****Full Name * Postal Address * Sales Tax Registration No * VAT No * Income Tax Permanent Account Number (PAN) * Credit Period to be allowed * Credit rating * Maximum credit to be allowed.***

4.2.4.4 Pre-defined Groups of Accounts

Tally automatically provides a set of **28** predefined groups under which ledgers can be classified. These are :

* Primary Group - **15**

* Sub-Groups - **13**

Out of the 15 predefined primary groups :

* **9** - Primary groups appear in Balance Sheet. These are capital in nature.

* **6** - Primary groups appear in Profit & Loss A/c. These are revenue in nature.

All the 13 Subgroups are classified under the **nine** primary groups that are capital in nature and they appear in the Balance Sheet.

Tally also has two predefined ledgers that are most essential for any kind of business. They are

(1) Cash A/c.

(2) Profit & Loss A/c.

These predefined groups and ledgers for each company already existing in Tally are called *Reserved Groups*. They cannot be deleted or altered except the name. These Reserve Groups are normally sufficient for most of the organisations. However, if the user needs some additional groups to meet the special needs of his organisation he is free to create any number of additional groups. He can create primary group or subgroup. The Reserve Primary Groups and Subgroups are as under :

4.2.5 Groups-

Groups are the masters which do the function of holding the various sub groups (or ledger accounts) together. In Tally, at the time of creation of a Ledger Account, you have to place such ledger under appropriate Account Group. Such Account Groups help you to make proper and meaningful classification of Ledger Accounts so as to get the ultimate Accounting Reports in properly classified manner.

4.2.5.1 Creating Single Group:

For creating a single group you have to follow the following procedure:

Gateway > Accounts Info.> Groups > Single Group Create

Then a group creation window will appear in which you have to fill up the name of group and fill up the other necessary details

4.2.5.2 Creating Multiple Group ;

For creating many groups simultaneously you have to follow the following procedure:

Gateway > Accounts Info.> Groups > Multiple Group > Create

Then a multiple group creation window will appear in which you have to select names of pre existing groups under which your multiple groups will appear. For example you may a group of debtors within the state and debtors outside the state under the group Sundry Debtors.

4.2.5.3 Displaying Group:

For displaying a group you have to follow the following procedure:

Gateway > Accounts Info.> Groups > Single Group Display

Then a list of pre-existing groups will be displayed on your screen.

4.2.5.4 Altering Group:

For altering a group you have to follow the following procedure:

Gateway > Accounts Info.> Groups > Single Group Alter

Then a list groups will be displayed on your screen from which you have to select the group which you want to alter and enter. The group data window will appear on your screen in which you may carry on the necessary alterations.

4.2.6 Ledgers

Ledger account do the function of holding the transaction of a similar nature together. All financial entries are made using ledger account heads. All the expenses on managerial salaries will be shown in the ledger account named, "Managerial Salaries". Similarly all the expenses pertaining to office rent will be shown in the ledger account named "Office Rent Account".

4.2.6.1 Creating Single Ledger:

For creating a single ledger you have to follow the following procedure:

Gateway > Accounts Info.> Ledgers > Single Ledger - Create

Then a ledger creation window will appear in which you have to fill up the name of ledger and specify the group under which the new ledger should appear and fill up the other necessary details. For example if you want to create the ledger of a customer its group will be sundry debtors then you have to fill up his address, GST no etc in the field reserved.

4.2.6.2 Creating Multiple Ledger

For creating many ledgers simultaneously you have to follow the following procedure:

Gateway > Accounts Info.> Ledgers > Multiple Ledgers - Create

Then a multiple ledger creation window will appear in which you have to select names of pre existing groups under which your multiple ledgers will appear. For example you may a ledgers of many customers under the group of Sundry Debtors or you may create ledgers of several expenses under the group indirect expenses.

4.2.6.3 Displaying Ledger:

For displaying a ledger you have to follow the following procedure:

Gateway > Accounts Info.> Ledgers > Single Ledger Display

Then a list of pre-existing ledgers will be displayed on your screen.

4.2.6.4 Altering Ledger:

For altering a group you have to follow the following procedure:

Gateway > Accounts Info.> Ledgers > Single Ledgers Alter

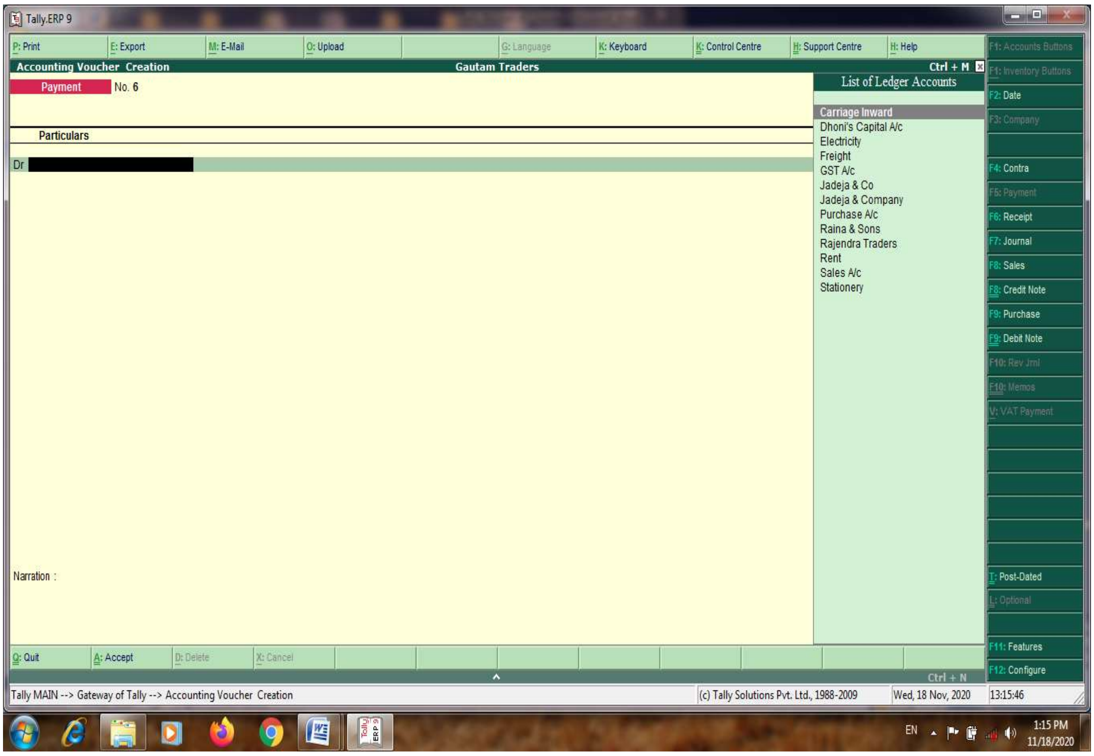
Then a list Ledgers will be displayed on your screen from which you have to select the ledger which you want to alter and enter. The ledger data window will appear on your screen in which you may carry on the necessary alterations.

4.2.7 Voucher Entry in Tally ERP.9s

Day to day transactions are entered in Tally through making proper accounting vouchers in the formats provided by the tally. To make an entry in the desired voucher following steps should be followed:

Gateway to Tally > Accounting Vouchers

Then you will come across the following screen:



Then you have to take the cursor to the kind of voucher you want to make from the dark green color vertical list on the extreme right hand or you have to press proper key such as F4 for Contra voucher, F5 for Payment Voucher, F6 for Receipt Voucher and so on. The concerned voucher will appear on the screen in which you have to enter transaction details as explained in the following pages.

4.2.7.1 Accounting Vouchers-

Voucher is a document containing the details of a transaction. For every transaction you have to make a voucher. The voucher entry option at the Gateway enables you to make day-to-day entries.

Tally already contain a set of standard vouchers essential for any business. They are :

4.2.7.2 Contra Voucher (F4)

Contra entry is a transaction indicating transfer of funds from :

* Cash account to Bank account.

* Bank account to Cash account.

* One Bank account to another Bank account.

* Cash given to or received back from Petty Cash.

To create contra voucher the following route is followed :

Gateway to Tally > Accounting Voucher > F4 : Contra

It displays contra voucher wherein you have to enter voucher details such as Voucher No, Date; Ledger Accounts, Ledger Amount, Narration etc. The entries in contra voucher follow the following rule :

Particulars	**Debit**	**Credit**
Cr. Source of Funds	*(Amount)*	
Dr. Destination of Funds		*(Amount)*

(Narration)

The sample of Contra Voucher for Cash deposit of Rs. 5,25,000 in Bank of India will be as under :

Accounting Voucher Creation	**ABC & Co.**	**Ctrl + M**
Contra No 3		3 Apr,2018
Particulars	**Debit**	**Credit**
Cr. Cash		5,25,000
Cur. Bal. 65,000		
Dr. Bank of India A/c No. 62580654	5,25,000	
Cur. Bal. 5,25,000		
	5,25,000	**5,25,000**
Narration :		
Deposited Cash into Bank of India Current Account.		
		Accept ?
		Yes or No

Note : The above entry will be reversed for the Cash withdrawals from bank.

4.2.7.3 Payment Voucher (F5)

Payment Voucher : Transactions involving payment of money by cash, cheque, bank transfer etc. are entered in payment voucher. To make a payment voucher the following route is followed

Gateway to Tally > Accounting Vouchers > F5 : Payment

It displays payment voucher wherein you have to enter payment details such as voucher Number, Date ; Ledger Account, Ledger Amount, Narration etc. The entry follows this rule :

Particulars	**Debit**	Credit
Dr. Ledger Account (paid to)	*(Amount)*	
Cr. Cash / Bank Account		*(Amount)*
(Narration)		

The sample to payment voucher for the payment of commission amounting to Rs. 10,000 is as under :

Accounting Voucher creation	**ABC & Co.**	**Control + M**
Payment No 1		2 April, 2018
Particulars	**Debit**	**Credit**
Dr. Commission A/c.	1,00,000	
Cr. Cash A/c.		1,00,000
	1,00,000	1,00,000
Narration :		
Received capital from the partners in cash to start the business.		
		Accept ?
		Yes or No

4.2.7.4 Receipt Voucher (F6)

Receipt Voucher : Transactions involving receipts of money by cash, cheque, bank transfer etc. are entered in receipt voucher. To enter receipts voucher the following route is followed :

Go to Gateway of Tally > Accounting Vouchers > F 6 :Receipts

This displays receipt voucher wherein you have to enter receipt details such as voucher number, date, ledger account, ledger amount, narration etc.

The entry follows this rule :

Particulars	**Credit**	**Debit**
Cr. Ledger A/c (from which cash received)	*(Amount)*	
Dr. Cash/Bank Account		*(Amount)*

(Narration)

The sample of receipt voucher for the receipt of capital from owners of business is as under:

Accounting Voucher creation	**ABC & Co.**	**Control + M**
Receipt No 1		1April, 2018
Particulars	**Debit**	**Credit**
Cr. Ashok's Capital A/c.		3,00,000
Cr. Babulal's Capital A/c.		2,00,000
Cr. Chandrakant's Capital A/c.		1,00,000
Dr. Cash	6,00,000	
	6,00,000	6,00,000
Narration : Received capital from the partners in cash to start the business.		
		Accept ? **Yes or No**

4.2.7.5 Journal Voucher (F7)

Journal is used for non cash transactions involving adjustment between the ledger accounts. Journal Voucher is adjustment voucher. The adjustment can be between the two parties (if you are not using debit note or credit note) or between any other account. The examples of transactions where journal voucher may be used are :

(a) Charging of depreciation on fixed assets.

(b) Transfer of an expenditure to Profit & Loss account.

(c) Purchase of a stationary on credit from a party.

(d) Rectification entry for the wrong posting.

Normally Cash a bank transactions are not entered in journal voucher. To create journal voucher the following route is followed :

Gateway to Tally > Accounting Vouchers > F7 : Journal.

It displays journal voucher wherein you may enter voucher details such as Voucher No., Date, Ledger Accounts, Amount, Narration etc. The first entry must be Debit. Later accounts may be either Debit or Credit.

The sample of journal voucher for depreciation on Building and Machinery amounting to Rs. 25,000 and Rs. 15,000 respectively will be as shown ahead :

Accounting Voucher Creation ABC & Co.	**Ctrl + M**	
Journal No 1	5 Apr. 2018	
Particulars	**Debit**	**Credit**
Dr. Depreciation	40,000	
Cr. Building		25,000
Cr. Machinery		15,000
	40,000	**40,000**
Narration : Depreciation charged on machinery and Building for the year.		
		Accept ? **Yes or No**

4.2.7.6 Purchase (F9)

All purchase transactions (including cash purchase) are entered in purchase voucher. To make a purchase voucher the following route is followed :

Gateway to Tally > Accounting Vouchers > F9 Function key (or click F9 : Purchase Button)

The entry follows following rule :

Particulars	**Debit**	**Credit**
Cr. Name of Vender		*(Amount)*
Dr. Purchase Account	*(Amount)*	

(Narration)

In a purchase voucher, first entry should always be a credit involving any Creditor (or Debtor or Branch / Division) or Cash / Bank and Second entry should be a debit to a ledger placed under Purchase Account group. Rest of the accounts may be any Revenue account (except sales) or any account under the Group current Liabilities (other than Sundry Creditors). This you can include Duties & Taxes from third entry onwards.

A sample Purchase Voucher for the Purchase of goods worth Rs. 25,000 from Rajaram Bros. Sholapur is shown below.

Accounting Voucher Creation	**ABC & Co**	**Ctrl + M**
Purchase No 1		6 Apr. 2018 Sunday
Particulars	**Debit**	**Credit**
Cr. Rajaram Bros. Sholapur		25,000
Dr. Purchase Account	25,000	
	25,000	**25,000**

Narration :

Purchased goods worth Rs. 25,000 vide bill no 105 from Rajaram Bros., Sholapur.

Accept ?

Yes or No

4.2.7.7 Sales (F8)

All sales transactions (including cash sales) are entered in Sales Voucher. Cash sales entry in Sales Voucher would automatically appear both in Sales Register and in Cash (or Bank) book. To create sales voucher at Gateway to Tally main menu select Accounting vouchers creation screen and press F8 Function key (or click F8 : Sales button). This provides you sales voucher entry screen.

In sales voucher entry screen you can make simple sale entry as follows :

Particulars	Debit	Credit
Dr. Name of the Buyer	*(Amount)*	
Cr. Sales Account		*(Amount)*

(Narration)

You can also enter Sales Voucher involving several billing terms as under :

Particulars	Debit	Credit
Dr. Name of the Buyer	*(Total Bill Amt.)*	
Cr. Sales Account		*(Net Sales Amt)*
Cr. Duty / Tax		*(Tax Amt.)*
Cr. Packing Charges		*(Expenses Amt.)*
Dr. Discount	*(Disc. Amt.)*	

Entry Rules : The first entry must be a debit involving any Debtor (or creditor or Branch or Division) / Cash / Bank Account and second should be a credit to ledger placed under Sales Account group. Rest of the accounts may be any Revenue Account (except purchase) or any account under the group current Liabilities (other than sundry creditors). Thus you can include Duties and Taxes from 3rd entry onwards.

A sample of Sales Voucher for a Sale of Rs. 52,000 (including VAT of Rs. 2,000) to M/s. Bholaram & Co. is as given ahead :

Accounting Voucher Creation	ABC & Co	Ctrl + M	
Sales No 1		5 Apr. 2018 Saturday	
Particulars		**Debit**	**Credit**
Dr. Bholaram & Co, Pune		52,000	
Cr. Sales Account			50,000
Cr. VAT			2,000
		52,000	**52,000**
Narration :			
Sales of goods to Bholaram & Co vide invoice no 1			
		Accept ? Yes or No	

4.2.7.8 Debit Note (Ctrl + F9)

A Debit Note is entered to give a debit to Party Account. Generally a debit note is issued when the goods purchased are returned to the vendor (Purchase Return) or to charge a customer extra for rate difference. The buyer raises a debit note in respect of a credit note issued by the vendor for rebate, discount etc.

The entry for a debit note is as under :

Particulars	**Debit**	**Credit**
Dr. Party Account (Supplier)	*(Amount)*	
Cr. Purchase Return (Purchase)		*(Amount)*
(Narration)		

A route to create debit note is :

At Gateway select *Accounting Vouchers* to get accounting voucher creation screen. *Press Crtl + F9* Function key (or click F9 : Debit Note button) to get Debit Note entry screen.

While making debit note the first entry must be a Debit involving any party (Debtor/Creditor/Branch/Division) or Cash or Bank Account.

A sample of Debit Note for discount on purchase offered by the supplier is as under:

Accounting Voucher Creation	**ABC & Co**	**Crtl + M**
Debit Note No 3 Ref Wednesday		2 April 2018
Particulars	**Debit**	**Credit**
Dr. Raj & Company	500.00	
Cr. Discount on Purchase		500.00
	500.00	**500.00**
Narration : Debit Note issued in respect of discount receivable from Raj & Co.		Accept ? Yes or No

4.2.7.9 Credit Note (Ctrl + F8)

A Credit Note is entered to give a credit to party Account. Generally credit note is issued when a buyer returns some goods that are sold to him (i.e. Sales Return) or when we grant him credit due to rate difference or discount or rebate in his favor. A credit note entry may be made as under :

Particulars	**Debit**	**Credit**
Cr. Party Account (Customer)		*(Amount)*
Dr. Sales Returns (Sales) / Discount	*(Amount)*	

The route to make credit note is as follows.

Gateway to Tally > Accounting Voucher > Ctrl + F8 key

(or click F8 : credit Note button) to get credit note entry screen.

While making credit note the first entry must be a credit involving any party (Debtor or Creditor or Branch or Division) or bank or cash A/c.

A sample of Credit note is as under:

Accounting Voucher Creation	**ABC & Co**	**Ctrl + M**
Credit Note No 1		1 April 2018
Ref		Tuesday
Particulars	**Debit**	**Credit**
Cr. B.D.Sales Corporation		700.00
Dr. Sales	700.00	
Narration	700.00	700.00
Credit note issued towards rate		Accept?
Difference in Bill No 12584		Yes or No.

4.2.8 Financial Statements-

After preparing the necessary groups, ledgers and preparing all the voucher entries related to the transactions of the enterprise tally automatically keeps ready all the financial statements on its own. These financial statements can be viewed any time through a short procedure explained below.

4.2.8.1 Drill Down and Trace back: To view any report on screen , select the report from the respective menu. From any on-screen report, press enter at any record to drill down step-by-step, level-by-level to view the intermediary reports and vouchers constituting the Report. At the lowest level, you get voucher in Alteration mode where you may carry out Insertions/ Alteration / Deletion/ Cancellation of voucher. Press Esc key to trace back to the higher level report in the same path through which you drilled down.

To view the detailed or consolidated version click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.8.2 Balance Sheet:

To view the Balance Sheet the following route is to be followed:

Gateway of Tally > Reports: Balance Sheet >

The balance Sheet will be displayed on the screen. To view the detailed or consolidated Balance Sheet click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions of Balance Sheet. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.8.3 Profit & Loss A/c.

To view the Profit & Loss A/c the following route is to be followed:

Gateway of Tally > Reports: Profit & Loss A/c.>

The Profit & Loss A/c will be displayed on the screen. To view the detailed or consolidated Profit & Loss A/c click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions of Profit and Loss A/c. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.8.4 Trial Balance:

To view the Trial Balance the following route is to be followed:

Gateway of Tally > Reports: Display > Trial Balance >

The Trial Balance will be displayed on the screen. To view the detailed or consolidated Trial Balance click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions of Profit and Loss A/c. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.9 Accounting Books and Registers-

After preparing the necessary groups, ledgers and preparing all the voucher entries related to the transactions of the enterprise tally automatically keeps ready all the accounting books and registers on its own. These accounting books and registers can be viewed any time through a short procedure explained below:

4.2.9.1 Cash Book:

To view the Cash Book the following route is to be followed:

Gateway of Tally > Reports: Display > Day Book > Account Books > Cash / Bank Books

To view the detailed or consolidated version click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.9.2 Purchase Register

To view the Purchase Register the following route is to be followed:

Gateway of Tally > Reports: Display > Day Book > Account Books > Purchase Register

To view the detailed or consolidated version click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.9.3 Sales Register:

To view the Sales Register the following route is to be followed:

Gateway of Tally > Reports: Display > Day Book > Account Books > Sales Register

To view the detailed or consolidated version click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.9.4 Journal Register:

To view the Journal Register the following route is to be followed:

Gateway of Tally > Reports: Display > Day Book > Account Books > Journal Register

To view the detailed or consolidated version click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.9.5 Debit Note:

A Debit Note is entered to give a debit to Party Account. Generally a debit note is issued when the goods purchased are returned to the vendor (Purchase Return) or to charge a customer extra for rate difference. The buyer raises a debit note in respect of a credit note issued by the vendor for rebate, discount etc.

The entry for a debit note is as under :

Particulars	Debit	Credit
Dr. Party Account (Supplier)	*(Amount)*	
Cr. Purchase Return (Purchase)		*(Amount)*
(Narration)		

A route to create debit note is :

At Gateway select *Accounting Vouchers* to get accounting voucher creation screen. *Press Crtl + F9* Function key (or click F9 : Debit Note button) to get Debit Note entry screen.

While making debit note the first entry must be a Debit involving any party (Debtor/Creditor/Branch/Division) or Cash or Bank Account.

A sample of Debit Note for discount on purchase offered by the supplier is as under :

Accounting Voucher Creation	**ABC & Co**	**Crtl + M**
Debit Note No 3 Ref Wednesday		2 April 2018
Particulars	**Debit**	**Credit**
Dr. Raj & Company	500.00	
Cr. Discount on Purchase		500.00
	500.00	**500.00**
Narration : Debit Note issued in respect of discount receivable from Raj & Co.		Accept ? Yes or No

4.2.9.6 Credit Note:

A Credit Note is entered to give a credit to party Account. Generally credit note is issued when a buyer returns some goods that are sold to him (i.e. Sales Return) or when we grant him credit due to rate difference or discount or rebate in his favor. A credit note entry may be made as under :

Particulars	Debit	Credit
Cr. Party Account (Customer)		*(Amount)*
Dr. Sales Returns (Sales) / Discount	*(Amount)*	

The route to make credit note is as follows.

Gateway to Tally > Accounting Voucher > Ctrl + F8 key

(or click F8 : credit Note button) to get credit note entry screen.

While making credit note the first entry must be a credit involving any party (Debtor or Creditor or Branch or Division) or bank or cash A/c.

A sample of Credit note is as under:

Accounting Voucher Creation	**ABC & Co**	**Ctrl + M**
Credit Note No 1		1 April 2018
Ref		Tuesday
Particulars	**Debit**	**Credit**
Cr. B.D.Sales Corporation		700.00
Dr. Sales	700.00	
Narration	700.00	700.00
Credit note issued towards rate		Accept?
Difference in Bill No 12584		Yes or No.

4.2.9.7 Day Book

To view the Day Book the following route is to be followed:

Gateway of Tally > Reports: Display > Day Book >

To view the detailed or consolidated version click at **F1: Detailed** key on the extreme right on screen. And toggle the key for consolidated and detailed versions. Alternatively, you may press Alt + F1 to achieve the same result.

4.2.10 Special Function Keys

A) FUNCTION KEY

Sl.	No. Key	Functionality	Availability
1	F2	To change the date	At almost all screens in Tally.
2	F4	To select the contra voucher.	At accounting voucher creation and alteration screens.
		To view the list of groups	At the trial balance, cash/bank summary, group summary and group vouchers screens.
		To view the list of ledgers.	At the ledger voucher screen.
		To change voucher type.	At the journal register and daybook screens.
3	F5	To select the payment voucher.	At accounting voucher creation and alteration screens.
		To switch between grouped and ledger-wise display.	At the trial balance, cash/bank summary and group summary screens.
4	F6	To select the receipt voucher	At accounting voucher creation and alteration screens.
5	F7	To select the journal voucher.	At accounting creation and alteration screens.
		To view the monthly summary	At the ledger voucher screen.
		To switch between group summary and group vouchers.	At the group summary and group voucher screens.
6	F10	Navigate between accounting reports.	At the reports screens, Trial Balance, account books and daybook screens.
7	F11	To select the features screen.	At almost all screens in Tally.

8	F12	To select the configure screen.	At almost all screens in Tally.

SPECIAL FUNCTION KEY COMBINATION

Sl.	No. Key	Functionality	Availability
1	Alt+F1	To close a company.	At all menu screens.
		To view a detailed report.	At almost all report screens.
		To explore a line into its details.	At almost all screens.
2	Alt+F2	To change period.	At almost all screens.
3	Alt+F3	To select the company info menu.	At Gateway of Tally screen.
		To create/alter/shut a company.	
4	Alt+C	To create a ledger at a voucher screen.	At accounting voucher and alteration screens, at a field where you have to select a ledger from a list. If the required ledger account has not been created earlier, use this key combination to create the ledger without quitting from the accounting voucher screen.
		To add a new column to reports.	At all the reports, trial balance, cash/bank book (s), group summary and journal register screens.
5	Alt+N	To add multiple columns to a report (Auto column).	At all the reports, trail balance, cash/bank (s), group summary and journal register screens.
6	Alt+P	To print reports.	At all reports screens.
7	Ctrl+Q	To quit a screen -wherever you use this key combination, it quits that screen without making any	At almost all screens.

		changes. It does not ask for confirmation from the user before quitting.	

KEY COMBINATION USED FOR NAVIGATION

Sl	No. Key	Functionality	Availability
1	Enter	To accept anything you type into a field. To accept voucher or master. To get a report with further of an item in a report	You have to use this key in most areas in Tally.
2	Esc	To remove what typed into a field. To come out of a screen. To indicate that you do not want to accept a voucher or ledger.	At almost all screens.
3	Shift-Enter	To view the next level of details and condense the next level of details.	At the balance sheet, profit and loss account, trial balance, cash/bank book(s), group summary, group vouchers, voucher register, daybook and list of accounts screens.

Check Your Progress

(A) Select the most appropriate answer for each of the following questions :

(1) Source code of software means :

(a) Hard disk *(b) Pen drive*

(c) Machine language *(d) Original copy of software.*

(2) The first version of Tally was released in the year ....

(a) 1975 *(b) 1988* *(c) 1960* *(d) 1992*

(3) Tally provides for .... predefined primary groups of accounts.

(a) 28 *(b) 15* *(c) 13* *(d) 25*

(4) To change between the main menu area and the calculator area at the button of the screen you should press .... key.

(a) Ctrl+M / Ctrl+N *(b) Ctrl+C*

(c) Ctrl+A *(d) Ctrl+Esc.*

(5) To quite working on Tally you should press

(a) Ctrl+Q *(b) Ctrl+R* *(c) Ctrl+Esc* *(d) Ctrl+A*

(6) Function key to modify the various features of a company are :

(a) F1 *(b) F11* *(c) F1 + Esc* *(d) F12*

(7) To make receipt voucher you have to press .... key at Accounting Vouchers Screen.

(a) F1 *(b) F4* *(c) F5* *(d) F6*

(8) On Tally you can maintain the accounts of ....firm.

(a) One *(b) Four* *(c) Six* *(d) Unlimited*

(B) Say TRUE or FALSE :

(1) Tally cannot maintain the accounts of non-trading organisations like educational institute or clubs.

(2) Tally is users friendly accounting package.

(3) Tally is an accounting system with coding system.

(4) Tally allows the use of multiple currencies while recording the business transactions.

(5) Tally has the provision of making graphical presentation of accounting data.

(6) Tally does not accept voucher entry unless the account to be debited or credited are already there in the memory.

(7) While using Tally you need not have to follow special procedure to prepare final accounts after making voucher entries.

(8) In tally you have to press F4 to change the voucher date.

(C) Fill in the blanks

(1) .... is the most popular and widely used accounting package.

(2) .... vouchers are prepared to record a transaction indicating transfer of funds from cash to bank or vice versa.

(3) Tally provides a set of .... predefined groups under which ledgers can be classified.

(4) Function key used to prepare sales voucher is ....

(5) Function key used to create a payment voucher under Tally is ....

(6) Tally has only 2 predefined ledgers for .... and ....

4.3 Summary

Tally is the most popular and widely used computerized accounting software package with vast application with lots of features aimed for a large section of users of various trade and industry, each having its own kind of requirements. It is refined from time to time hence many of versions of tally have emerged from time to time. Tally has achieved great success account of its unique features and technological advantages. After successful installation of Tally.ERP 9 on your computer an opening screen appears which is called GATEWAY to Tally or Main Menu. Then first of all you have to create the company or firm whose accounts are to be maintained by you in tally as per the procedure explained in the unit. If you are maintain the accounts of company already enlisted in Tally you have to select the company and commence accounting work. Tally has 28 predefined groups and two ledger accounts namely, Cash A/c and Profit and Loss A/c. You can create new groups, if necessary, and ledger accounts you need by entering Groups Creation mode or Ledger Creation mode through the Company Information option given in the main screen. Once the required groups and ledgers are ready you have to make necessary accounting voucher entries representing the day to day business transactions. On making proper entries Tally makes the necessary ledger entries and prepares the Financial Statements ,Day Books and other business reports on its own which can be displayed on the screen and printed as well. There exists provision for alteration of Company information, ledger details and voucher details through alteration mode. Once the accounting work is over you may shut the company. All the procedures of accounting through tally software are explained elaborately in the chapter. The students can understand and master the Tally Accounting through proper practical training and rigorous practice.

4.4 Terms to Remember

1. **Masters :** The master information means the information which will be stored only once but will be used frequently by the computer. This information is more of a static nature and changes in this are not required to be done so frequently. Masters include :

   (i) Groups, (ii) Ledger Accounts, and (iii) Customer Master.

2. **Groups-**

   Groups are the masters which do the function of holding the various sub groups (or ledger accounts) together. In Tally, at the time of creation of a Ledger Account, you have to place such ledger under appropriate Account Group. Such Account Groups help you to make proper and meaningful classification of Ledger Accounts so as to get the ultimate Accounting Reports in properly classified manner.

3. **Drill Down and Trace back**: To view any report on screen , select the report from the respective menu. From any on-screen report, press enter at any record to drill down step-by-step, level-by-level to view the intermediary reports and vouchers constituting the Report. At the lowest level, you get voucher in Alteration mode where you may carry out Insertions/ Alteration / Deletion/ Cancellation of voucher. Press Esc key to trace back to the higher level report in the same path through which you drilled down.

4.5 Answers to Check Your Progress

I. (A) - 1-d, 2-b, 3-b, 4-a, 5-a, 6-b, 7-d, 8-d

(B) TRUE - 2,4,5,6,7 **FALSE** - 1,3,8

(C) 1- Tally, 2- Contra, 3-28, 4- F8, 5-F5, 6-Cash and Profit & Loss A/c.)

4.6 Exercise

(1) Explain the problems of Manual Accounting System in comparison to computerised accounting?

(2) Explain in brief the benefits derived by a business firm by computerising the accounting function.

(3) Explain the hardware and software aspects to be considered while installing a computerised accounting system for a business.

(4) What do you mean by *Single User* and *Multi-User Accounting Package* ?

(5) What is Tally ? Explain the features of Tally accounting for its great success.

(6) Explain the procedure for creating (i) Receipt vouchers (ii) Payment Vouchers (iii) Journal Vouchers (iv) Sales vouchers and (v) Contra Vouchers.

(7) Write a note on predefined Accounting groups under Tally.

(8) How the Reports of various kind are generated under Tally ?

(9) Write short Notes on :

(a) Company creation under Tally.

(b) F : 11 Features and F:12 configure under Tally.

(c) Memorandum Voucher under Tally

(d) Voucher Alteration, Deletion, and Cancellation under Tally

(10) Enter the following transactions by using Tally Accounting Package.

(a) 1.4.2018 Mr. Rajendra Patil started a business by Name Patil & Co by bringing in cash of Rs. 3,00,000.

(b) 2.4.2018 Mr. Patil paid Rs. 22,500 in cash to purchase a computer with pre-loaded Tally 9. The computer does not have any disposable value at the end of its useful of four years. All the assets are to be depreciated using straight-line method.

(c) 3.4.2018 Mr. Patil opened a Bank account with ICICI Bank, Pune for the firm by depositing cash of Rs. 1,50,000.

(d) 4.4.2018 Mr. Patil rented an office space for Rs. 2,500 per month from 1st April by paying a security deposit of Rs. 25,000 by cheque.

(e) 5.4.2018 Mr. Patil hire Mr. Ravindra H. as a manager on a monthly salary of Rs. 7,500. He also hired Ms. Dipika Naik as an office assistant on a monthly salary of Rs. 4,500.

(f) 10.4.2018 Mr. Patil made an arrangement with Imperial computers so that they will provide all the computer services whenever needed.

(g) 15.4.2018 Mr. Patil issued cheques and purchased the following fixed assets.

(i) A cell phone for office usage for Rs. 6,000 (useful life, 5 years).

(ii) Furniture for Rs. 20,000 (useful life 8 years)

(iii) An Air conditioner for Rs. 20,000 (useful life, 6 years)

(iv) Electrical Fittings for Rs. 15,000 (useful life, 10 years)

All these assets do not have any disposable value at the end of useful life.

(h) 16.4.2018 Mr. Patil obtained a mobile phone subscription with planet Telecommunications Ltd. by paying a deposit of Rs. 3,000 in cash.

(i) 20.4.2018 Mr. Patil purchased stationary worth Rs. 12,500 from Global House on Credit.

(j) 21.4.2018 Mr. Patil entered into a contract with Silver services for providing consultancy services at an agreed price of Rs.75,000. He received an advance of Rs. 25,000 by cheque.

(k) 25.4.2018 Mr. Patil received an invoice for Rs. 6,000 raised by M/s P.G.Gunde & Sons. for printing office stationary.

(l) 27.4.2018 Mr. Patil withdraw Rs. 7,500 cash for personal use.

(m) 30.4.2018 Mr. Patil paid Rs. 750 cash towards office maintenance charges for April, 2018.

(11) **(This Problem should be solved by manual accounting and then entered on Tally to understand basic Accounting Concepts before working on Tally Software)**

Rajesh Traders, Nana Peth, Pune is running a business from 1.4.2018 and keeps his books of accounts in Tally with accounts only. Following are the details of transactions during the month of April 2018:

1.4.2018 Received capital from proprietor Mr. M.S.Dhoni Rs. 2,50,000 vide ICICI Bank Cheque No. 58974 and cash Rs. 50,000 and issued Receipt no. 001 to him.

2.4.2018 Above cheque deposited in Bank of India, Tilak Road, Pune Branch in newly opened Current Account No. 2016256897

2.4.2018	Credit purchases from Raina & Co. Pune as per Invoice no. 1259 Rs. 1,00,000 at a trade discount of 20% and GST @ 5% 4,000.
3.4.2018	Purchased goods from Jadeja & Co., Mumbai vide their invoice no. 325 for Rs. 74,000 (including GST Rs. 3,500 and freight Rs. 500) and paid Rs. 20,000 vide cheque no. 123001 drawn on Bank of India.
3.4.2018	Bought goods from Ashwin & Co. vide cash memo no. 568 for Rs. 36,800 (includes G ST Rs.1,750 and Freight Rs.50)
4.4.2018	Purchased stationery from P.G.Gunde & Sons vide cash memo no. 5987 Rs. 1,255
5.4.2018	Purchased goods from Rohit Brothers, Mumbai vide their invoice no. 658 for Rs.52,500 (including GST 2,500).
5.4.2018	Paid transportation charges on above consignment Rs. 815 vide VRL Transport Goods Consignment Note No. 1458
6.4.2018	Purchase a computer and printer from Imperial Systems, Bangalore for Rs.52,500 (including GST 2,500) vide their invoice no 897
6.4.2018	Paid freight on above consignment from Bangalore Rs. 500 vide Konduskar Road Lines transport receipt no. 2568
7.4.2018	Withdrew from bank for office use Rs. 10,000 vide self cheque no. 123002
8.4.2018	Purchase return to Raina & Co goods worth Rs. 8,400 (GST Rs. 400) vide our debit note no. 001 and their credit no 32
9.4.2018	Sold goods to Shane Warn & Co Rs. 26,250 (GST Rs. 1250) vide Invoice No. 1001 and to Gale & Co. Rs. 31,500 (GST Rs. 1,500) vide Invoice No. 1002
10.4.2018	Paid electricity deposit Rs. 15,000 vide MSEB receipt no. 1245
10.4.2018	Sold goods worth Rs. 42,000 (GST 2,000) to Watson Bros. vide cash memo no. 2001 and of Rs. 33,600 (GST Rs. 1,600) to Sammy & Sons vide cash memo no 2002
11.4.2018	Deposited in bank Rs. 70,000

11.4.2018	Returns from Gale & Co. goods worth Rs. 2,100 (GST Rs. 100) vide our credit no. 1001 and their Dr. Note No. 256.
11.4.2018	Paid Rs, 50,000 to Raina & Co vide cheque no. 123003 and Rs. 25,000 to Jadeja & co. vide cheque no. 123004
12.4.2018	Received a cheque no. 5689702 of Rs. 26,250 drawn on Syndicate Bank from Shane Worn & Co.in full settlement of their account which was deposited in bank
13.4.2018	Received Rs. 20,000 vide cheque no. 3658974 drawn on HDFC Bank from Gale & co. which was deposited into bank on the next day.
13.4.2018	Purchased goods worth Rs. 36,750 (GST Rs. 1750) from Raina & Co. vide their invoice no 1345
14.4.2018	Paid Rs. 40,000 vide cheque no. 123005 to Imperial Systems Bangalore and received their receipt no. 4578
15.4.2018	Withdrew from bank for office expenses vide self cheque no. 123006 Rs. 50,000
15.4.2018	made the following payments:
	(1) Education fees of son of Mr. Dhoni Rs.15,000
	(2) Paid rent of the shop Rs. 10,000 for two months up to 31.5.2018
	(3) Advertisement expenses to daily Sakal Rs. 2,500
	(4) Advance against salary to Manager Rs. 5,000
	(5) Fire Insurance annual premium Rs. 2,000 vide cheque no. 123007
15.4.2018	Following expenses of the business were outstanding:
	(1) Telephone bills Rs. 300, (2) A stationery bill no. 6231 of P.G Gunde & Sons Rs. 700

Closing Stock of goods was Rs. 1,85,800.

A) Enter these transactions in the proper subsidiary books, post those into the ledger accounts and prepare final accounts. Give effect to the following adjustments in the final accounts.

1. Prepaid Expenses are: fire insurance Rs. 2,000, shop rent Rs. 7,500 & Manager's Salary Rs. 2,500.

2. Staff Salary Outstanding Rs. 3,000.

B) Prepare the following accounting vouchers:

(1) Receipt No. 1 issued to Mr. M.S.Dhoni on 1.4.2018.

(2) Invoice no. 1259 received from Raina & Co. Pune on 2.4.2018

(3) VRL Transport Goods Consignment Note No. 1458 received on 5.4.2018

(4) Invoice No. 1001 issued to Shane Warn & Co on 9.4.2018

4.7 Reference for Further Study

1. Tally 9.4 Manual
2. M.G. Patkar and U.A. Sarkhot Financial Accounting with Tally 9.0 Phadke Prakashan
3. M.G.Patkar Corporate Accounting Sem. III Phadke Prakashan
4. Principles of Management Accounting – Man Mohan & Goyal, publisher Sahitya Bhavan, Agra.
5. Materials Management: An Integrated Approach – Gopalkrishnan & Sundaresan, publisher Prentice-Hall of India, New Delhi.
6. Cost Accounting : Methods and Problems– B. K. Bhar, publisher Acedemic Publishers, 700073, India.
7. Theory & Practice of Computer Accounting Volume II – Rajan B. Chougale, Modern Publications, c/o Modern School of Computers, 645, E, Shahupuri, Kolhapur. 416 001.

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Semester-IV
Unit-1
Redemption of Preference of Shares

Index

1.0 Objectives:

1. To understand the meaning of preference shares.
2. To explain, procedure of redemption of preference shares.
3. To understand the accounting of redemption of preference shares.

1.1 Introduction:

A joint stock company is one of the form of organizations. Firstly, see what is a company. It is identical because of its feature of 'share capital'. The capital of a company is called share capital which is divided into shares. Company means an association of persons formed for the economic gain of the members. However, by law, company can be for any legal object not necessary only for economic gain. The Companies Act 2013 defines a company as "a company incorporated under this Act or an existing company." 'An existing company means a company formed and registered under any of the former Companies Act. The characteristics of a company includes (a) it is voluntary association, (b) it is independent legal entity, (c) it has perpetual succession, (d) company being artificial entity, has common seal, (e) liability of members is generally limited and (f) shares of company are freely transferable.

1.2 Presentation of Subject Matter:

Now we are going to learn main points. It is core part of this unit which is redemption of preference shares. We have to learn the meaning of redeemable preference shares, redemption of preference shares and accounting treatment for redemption of preference shares.

1.2.1 Share:

Share capital of a company is divided into parts having equal value is called share. A share has a nominal value or face value. It bears a distinct number. A share is ownership security. Share is a part of share capital which has equal value. A share is one unit of share capital in which share capital is divided. According to Section 2 (84) of Companies Act 2013, a share means "share in the share capital of a company and includes stock".

1.2.2 Types of Shares:

Shares can be classified in different types as shown below:

1) Preference Shares:
2) Equity Shares:
   A) With uniform rights

B) With differential rights

1.2.3 Preference Shares:

Preference shares are those which carry the following preferential rights over other classes of shares:

(a) A preferential right in respect of a fixed dividend- it may consist of a fixed amount (say Rs.30,000 p.a.) or a fixed rate (say 13% p.a.)

(b) A preferential right as to repayment of the capital in the event of company's winding up.

1.2.4 Types of Preference Shares:

Preference shares are categorized in the following types:

A) On the basis of Dividend:

  i) Cumulative Preference Shares

  ii) Non-cumulative Preference Shares

B) On the basis of Participation:

  i) Participatory Preference Shares

  ii) Non-participatory Preference Shares

C) On the basis of Redemption:

  i) Redeemable Preference Shares

  ii) Non-redeemable Preference Shares

D) On the basis of Convertibility:

  i) Convertible Preference Shares

  ii) Non-convertible Preference Shares

1.2.4.1 Cumulative Preference Shares: The preference shares in case of which the arrears of dividend are accumulated till they are paid. As per the inherent feature of preference shares, before paying anything else, preference dividend is paid. Preference shares are always cumulative unless otherwise expressly stated in the company's articles.

Suppose, a company has 5,000, 11% preference shares of Rs.100 each. The company has not paid dividend to its preference shareholders for the year 2014-15, 2015-16, 2016-17 and 2017-18. In 2018-19, the company earns adequate profits. In this case the company shall pay dividend for 4 years (including arrears of last 3 years) amounting to Rs.2,20,000 (Rs.55,000 per annum) before paying any dividend to the equity shareholders.

1.2.4.2 Non-cumulative Preference Shares: The preference shares is which case, the dividend is not allowed to accumulate. In case of such preference shares, the right to claim dividend will lapse if there are not sufficient profits in a particular year.

Suppose, if a company has 5,000, 11% non-cumulative preference shares of Rs.100 each. The company has not paid dividend to its preference shareholders for the year 2014-15, 2015-16, 2016-17 and 2017-18. In 2018-19, the company earns adequate profits. In this case the company shall pay dividend only for one year amounting to Rs.55,000 before paying any dividend to the equity shareholders.

1.2.4.3 Participating Preference Shares: The participating preference shareholders who are entitled to (i) a fixed dividend and (ii) a share in the surplus profits, remaining after paying dividend to the equity shareholders upto a certain limit.

1.2.4.4 Non-participatory Preference Shares: The non-participating preference shareholders who are entitled not to share in extra earnings or surplus assets during the liquidation of a company.

1.2.4.5 Redeemable Preference Shares: Preference shares must be redeemed within 20 years of their issuance and are called redeemable preference shares.

1.2.4.5 Irredeemable Preference Shares: Preference shares which cannot be redeemed from the company at any time. However, Indian companies cannot issue irredeemable preference shares according Companies Act 2013.

Check your progress-1:

State whether the following statement is 'True' or 'False':

(a) Share capital of a company is divided into parts having equal value is called share.

(b) A share has a nominal value and bears a same number.

(c) Shares may be issued generally at par or premium and at discount only in certain cases.

1.2.5 Redemption of Preference Shares:

Share capital of a company is lifetime capital. However, a company can issue redeemable preference shares which are redeemed after its term. The redemption of preference shares means the process of repaying the amount of capital to preference share capital after its term.

1.2.6 Legal Provisions:

As per the provisions of Section 55 of Companies Act 2013, company can issue shares called "Redeemable Preference Shares" which company can redeem during the lifetime of a company. The legal provisions regarding redeemable preference shares given in Section 55 of Companies Act 2013 are as follows:

1. After commencement of this Act, company limited by shares cannot issue irredeemable preference shares.
2. The issue of redeemable preference shares must be authorized by the Articles of Association.
3. A company can issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue. However, company may issue redeemable preference shares for a period exceeding twenty years for infrastructure projects subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the opinion of such preference shareholders.
4. Such shares cannot be redeemed unless they are fully paid.
5. These shares can be redeemed subject to the terms and manners laid down by the Articles and only (a) out of the profits of the company which would otherwise be available for dividend or (b) out of the proceeds of a fresh issue of shares made for the purpose of redemption.
6. Where such shares are proposed to be redeemed out of the profits of the company, the sum equal to nominal amount of the shares to be redeemed, is transferred to Capital Redemption Reserve from undistributed profits. This reserve is utilized for the redemption of such preference shares.

7. When preference shares are redeemed at a premium, the premium shall be provided for out of the profits of the company or out of company's securities premium account.

8. When company is not able to redeem any preference shares or to pay dividend, if any on such shares, in

9. The capital redemption reserve account may, notwithstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

1.2.7 Accounting Treatment for Redemption of Preference Shares:

Now we have to learn accounting entries to be passed for the purpose of the redemption of preference shares.

Model journal entries which are being passed for the redemption of preference shares, are given below:

Date	Particulars	L. F.	Debit Rs.	Credit Rs.
1	***For making party paid up shares fully paid up:*** (a) For making final call: Redeemable Preference Share Final Call A/c. Dr. To Redeemable Preference Share Capital A/c. (Being made final call.)			
	(b) On receipt of final call money: Bank A/c. Dr. To Redeemable Preference Share Final Call Dr. A/c. (Being received final call money)			
2	***For redemption out of profits:*** Profit & Loss A/c. or Revenue Reserve A/c. Dr. To Capital Redemption Reserve A/c. (Being provided for the reserve)			
3	***For a fresh issue of shares:*** Bank A/c. Dr. To Share Capital A/c.			

	(Being issued fresh shares)			
4	***For making provision for payment of premium on redemption of preference shares:*** Securities Premium A/c. or Dr. Profit & Loss A/c. or Dr. Revenue/ Capital Reserve A/c. Dr. To Premium on Redemption of Pref. Shares A/c. (Being made provision for premium on redemption)			
5	***For money due to redeemable preference shareholders:*** Redeemable Preference Share Capital A/c. Dr. Premium on Redemption of Pref. Shares A/ Dr. To Redeemable Preference Shareholders A/c. (Being money due to shareholders on redemption)			
6	***For payment of redeemable preference shareholders:*** Redeemable Preference Shareholders A/c. Dr. To Bank A/c. (Being redeemed preference shares)			
7	***For issue of bonus shares:*** (a) Capital Redemption Reserve A/c. or Dr. Securities Premium A/c. or Dr. Revenue Reserve A/c. Dr. To Bonus Payable A/c. (Being due as bonus)			
	(b) Bonus Payable A/c. Dr. To Share Capital A/c. (Being issued bonus shares)			

Now we will see how practically the accounting is made for the redemption of preference shares in the next part.

Illustration-1:

Bombay Burma Ltd. issued on 1st July 2007, 10,000 redeemable preference shares of Rs.10 each. Such shares were redeemable at a premium of 10%.

Two-fifth of this issue was redeemed out of profits on 20th January 2012.

On 20th December 2019, the company issued 20,000 equity shares of Rs.10 each at premium of Rs.4 per share. Out of the proceeds of such issue, the balance of redeemable preference shares was redeemed.

Give necessary journal entries.

Solution:

Working notes:

First Redemption out of profits (20th January 2012)	Two-fifth of shares = (2/5) x 10,000 = 4,000 shares	40,000
	Add: Premium on redemption 10% of 40,000	4,000
		44,000
Second Redemption out of fresh issue of shares (20th December 2012)	Three-fifth of shares = (3/5) x 10,000 = 6,000 shares	60,000
	Add: Premium on redemption 10% of 60,000	6,000
		66,000

Journal Entries in the books of Bombay Burma Ltd.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
1.7.2007	Bank A/c. Dr.		1,00,000	
	To Redeemable Preference Share Capital A/c.			1,00,000
	(Being issued 10,000 redeemable preference shares of Rs.10 each, at par)			
20.1.2012	Profit & Loss A/c. Dr.		4,000	
	To Premium on Redemption A/c.			4,000

	(Being made provision for premium on redemption)			
	Profit & Loss A/c. Dr. To Capital Redemption Reserve A/c. (Being made provision for capital redemption reserve)		40,000	 40,000
	Redeemable Preference Share Capital A/c. Dr. Premium on Redemption A/c. Dr. To Redeemable Preference Shareholders A/c. (Being amount due to shareholders on redemption)		40,000 4,000	 44,000
	Redeemable Preference Shareholders A/c. Dr. To Bank A/c. (Being redeemed 4,000 shares at a premium of 10%)		44,000	 44,000
20.12.2019	Bank A/c. Dr. To Equity Share Capital A/c. To Securities Premium A/c. (Being issued 20,000 equity shares of Rs.10 each at a premium of Rs.4 per share)		2,80,000	 2,00,000 80,000
	Securities Premium A/c. Dr. To Premium on Redemption A/c. (Being provided premium on redemption out of share premium)		6,000	 6,000
	Redeemable Preference Share Capital A/c. Dr. Premium on Redemption A/c. Dr. To Redeemable Preference Shareholders A/c.		60,000 6,000	 66,000

	(Being amount due to shareholders on redemption)			
	Redeemable Preference Shareholders A/c. To Bank A/c. (Being redeemed 6,000 preference shares at a premium of 10%)		66,000	66,000

Illustration-2:

Extract of ledger balances of Kalpana Ltd. as on 31st March 2015 includes the following:

	Rs.
2,000, 12% Preference Shares of Rs.100 each, fully paid	2,00,000
Surplus	40,000
Securities Premium	12,000

Under the terms of issue, the preference shares are redeemable on 31st March, 2015 at a premium of 10%. The directors desire to make a minimum fresh issue of equity shares of Rs.10 each at a premium of 5% for redemption purpose.

You are required to ascertain the amount of fresh issue to be made and pass necessary journal entries in the books of the company. (CS Executive, June 2016).

Solution:

Calculation of amount of fresh issue to be made:

(a) Amount required for redemption = 2,00,000 + (10%) = 2,00,000 + 20,000 = 2,20,000

(b) The redemption can be made out of profits, reserves and share premium available, such amount available = 40,000 + 12,000 = 52,000

(c) Amount required - Amount available = Amount to raised by fresh issue 2,20,000 - 52,000 = 1,68,000

(d) As per the information given, the fresh issue will be made of shares of Rs.10 each at a premium of 5%.

It means issue price = 10 + (5% of 10) = 10.50 per share

(e) Hence, number of shares to be issued = 1,68,000/10.50 = 16,000

Journal entries in the books of a company

Date	Particulars		L. F.	Debit Rs.	Credit Rs.
1	Preference Share Capital A/c.	Dr.		2,00,000	
	Premium on Redemption A/c.	Dr.		20,000	
	To Preference Shareholders A/c.				2,20,000
	(Being redeemed 2,000 preference shares at a premium of 10%)				
2	Bank A/c.	Dr.		1,68,000	
	To Equity Share Capital A/c.				1,60,000
	To Securities Premium A/c.				8,000
	(Being issued 16,000 shares of Rs.10 each at a premium of 5% for the purpose of redemption of preference shares)				
3	Securities Premium A/c.	Dr.		20,000	
	To Premium on Redemption A/c.				20,000
	(Being utilization of security premium for writing of premium on redemption)				
4	Profit & Loss A/c.	Dr.		40,000	
	To Capital Redemption Reserve A/c.				40,000
	(Being utilized profits for redemption)				
5	Preference Shareholders A/c.	Dr.		2,20,000	
	To Bank A/c.				2,20,000
	(Being made redemption)				

Illustration-3:

Steel Company Ltd. issued 50,000 Redeemable Preference Shares of Rs.10 each on 1st January 2012, redeemable at the option of the company on or after 31st March 2015, in whole or in part.

The following redemptions were made out of profits:

On 31st March 2016	Rs.1,00,000
On 31st March 2017	Rs.1,50,000

On 31st March 2018 the company issued 40,000 equity shares of Rs.10 each at a premium of Rs.2 per share and redeemed the balance of the preference shares.

Pass journal entries to record the above transactions.

Solution:

Working notes:

1) Issue of Redeemable Preference Shares:

   50,000 x 10 =5,00,000

2) Issue of Equity Shares:

   Share Capital = 40,000 x 10 = 4,00,000

   Share Premium = 40,000 x 2 = 80,000

Journal entries in the books of Steel Company Ltd.

Date	Particulars	L. F.	Debit Rs.	Credit Rs.
1.1.2012	Bank A/c. Dr. To Redeemable Preference Share Capital A/c. (Being issued 50,000 redeemable preference shares of Rs.10 each, at par)		5,00,000	5,00,000
31.3.2016	Profit & Loss A/c. Dr. To Capital Redemption Reserve A/c. (Being made provision for capital redemption reserve)		1,00,000	1,00,000
	Redeemable Preference Share Capital A/c. Dr. To Redeemable Preference Shareholders A/c. (Being amount due to shareholders on redemption)		1,00,000	1,00,000

	Redeemable Preference Shareholders A/c. Dr. To Bank A/c. (Being redeemed preference shares at par)		1,00,000	 1,00,000
31.3.2017	Profit & Loss A/c. Dr. To Capital Redemption Reserve A/c. (Being made provision for capital redemption reserve)		1,50,000	 1,50,000
	Redeemable Preference Share Capital A/c. Dr. To Redeemable Preference Shareholders A/c. (Being amount due to shareholders on redemption)		1,50,000	 1,50,000
	Redeemable Preference Shareholders A/c. Dr. To Bank A/c. (Being redeemed preference shares at par)		1,50,000	 1,50,000
31.3.2018	Bank A/c. Dr. To Equity Share Capital A/c. To Securities Premium A/c. (Being issued 40,000 equity shares of Rs.10 each at a premium of Rs.2 per share)		4,80,000	 4,00,000 80,000
	Redeemable Preference Share Capital A/c. Dr. To Redeemable Preference Shareholders A/c. (Being amount due to shareholders on redemption)		2,50,000	 2,50,000
	Redeemable Preference Shareholders A/c. Dr.		2,50,000	

	To Bank A/c. (Being redeemed preference shares at par)			2,50,000

Illustration-4:

The following balances were extracted from the books of Rohit Ltd. As on 30 June 2016:

	2000 8% Redeemable Preference Shares of Rs.100 each fully called up	Rs.2,00,000
Less:	Calls in arrear at Rs.20 per share on 300 shares	Rs.6,000
		Rs.1,94,000
	General Reserve	Rs.50,000
	Capital Reserve	Rs.10,000

The preference shares were redeemed on 1 July 2016 at a premium of Rs.5 per share. The company issued such further equity shares of Rs.10 each- as were necessary for the purpose of redeeming preference shares- which were fully subscribed and duly allotted.

You are required to show the journal entries showing the transactions relating to the redemption of preference shares and the relevant extracts in the liabilities side of the Balance Sheet, after such redemption.

Solution:

Journal Entries in the books of Rohit Ltd.

Date	Particulars	L. F.	Debit Rs.	Credit Rs.
	General Reserve A/c. Dr. To Premium on Redemption of Pref. Shares A/c. To Preference Share Redemption Suspense A/c.* (Being the premium of Rs.5 per share		10,000	 8,500 1,500

	payable on redemption of 1,700 shares, that on 300 shares not yet redeemable put to suspense to be used later when necessary)			
	Bank A/c. Dr. To Equity Share Capital A/c. (Being the amount received on issue of equity shares of Rs.10 each)		1,60,000	 1,60,000
	General Reserve A/c. Dr. To Pref. Shares Redemption Reserve A/c. To Capital Redemption Reserve A/c. (Being the amount of profit utilized for redemption of preference shares transferred to capital redemption reserve A/c. and that relating to 300 shares not yet redeemable put to suspense A/c. to be used when necessary)		40,000	 30,000 10,000
	8% Redeemable Preference Share Capital A/c. Dr. Premium on Redemption of Pref. Shares A/c. Dr. To Pref. Shares Redemption A/c. (Being the amount of preference share capital due to be redeemed)		1,70,000 8,500	 1,78,500
	Preference Share Redemption A/c. Dr. To Bank A/c. (Being amount paid to pref. shareholders on redemption)		1,78,500	 1,78,500

* Alternatively, the amount of Rs.31,500 could have been allowed to remain in the General Reserve.

Balance Sheet (Extracts) of Rohit Ltd.

(after redemption on 1^{st} July 2016)

	Equity and Liabilities	Rs.	Rs.
Shareholders' Funds:			
1.	***Share Capital:***		
	Issued, Subscribed and paid up		
	300, 8% Redeemable Preference shares of Rs.100 each		
	fully called up	30,000	
	Less: Calls in arrear	6,000	24000
	(redeemable after the calls in arrear are collected)		
	16,000 Equity Shares of Rs.10 each fully called up		1,60,000
			1,84,000
2.	***Reserve & Surplus:***		
	Capital Reserve	10,000	
	Capital Redemption Reserve	10,000	20,000
3.	***Current Liabilities:***		
	Other Current Liabilities		
	Preference Shares Redemption Suspense A/c.		31,500

Note:

(a) Capital Reserve is not used to provide for premium on redemption as it may include unrealized appreciation in fixed assets.

(b) Since 300 shares not yet redeemed because of calls in arrears. They would be redeemable as soon as the calls are collected so, it is considered prudent to transfer Rs.31,500 from General Reserve to Preference Shares Redemption Suspense Account. On redemption of such preference shares Rs.30,000 would be transferred to Capital Redemption Reserve. Balance of Rs.1,500 represents the premium payable on redemption of such shares.

Alternatively, the company could have provided only for redemption of 1,700 shares. However, it would not be a sound and safe policy.

(c) The amount in respect of 300 Preference shares is being shown as "Redeemable Preference Share Capital." Alternatively, the amount could have been transferred to "Redeemable Pref. Share Capital Suspense Account." Of course, it would have continued to be shown under the head "Share Capital" in the Balance Sheet.

Illustration-5:

Oxford India Co. Ltd. has an authorized equity share capital of Rs.20 lakhs into shares of Rs.100 each. The paid-up capital was Rs.12,50,000. Besides this, the company had 9% Redeemable Cumulative Preference Shares of Rs.10 each for Rs.2,50,000. Balances on other accounts were Share Premium, Rs.18,000, Profit and Loss Account Rs.72,000 and General Reserve Rs.3,40,000. Included in Sundry Assets were investments of the face value of Rs.30,000 carried in the books at a cost of Rs.34,000.

The company decided to redeem the Cumulative Preference Shares at 10% premium, partly by the issue of equity shares of the face value of Rs.1,20,000 at a premium of 10%. Investments were sold at 105% of their face value. All preference share holders were paid off except 3 holders holding 250 shares.

After redemption of the Cumulative Preference Shares, fully paid bonus shares were issued in the ratio of 1:4.

Give the necessary journal entries bearing in mind that the Directors wanted a minimum reduction in free reserves, while effecting the above transactions. Working should form part of your answer.

Solution:

Journal Entries in the books of Oxford India Co. Ltd.

Date	Particulars	L. F.	Debit Rs.	Credit Rs.
	Bank A/c. Dr.		1,32,000	
	To Equity Share Capital A/c.			1,20,000
	To Share Premium A/c. Dr.			12,000
	(Being issued and allotted 1,200 equity shares of Rs.100 each fully paid at a premium of 10%)			
	Bank A/c. Dr.		31,500	
	Profit and Loss A/c. Dr.		2,500	

	To Investments A/c. (Being investment of Rs.30,000 face value sold at 105 against the cost of Rs.34,000; loss on sale debited to Profit and Loss A/c.)			34,000
	Share Premium A/c. Dr. To Premium on Redemption of Pref. Shares A/c. (Being premium payable on redemption of preference shares @10% charged to share premium account)		25,000	25,000
	General Reserve A/c. Dr. To Capital Redemption Reserve A/c. (Being amount transferred to capital redemption reserve to provide for redemption of preference shares: Shares redeemed face value 2,50,000 – Face value of new shares issued 1,20,000 = 1,30,000)		1,30,000	1,30,000
	9% Redeemable Cum. Pref. Share Capital A/c. Dr. Premium on Redemption of Pref. Shares A/c. To Preference Shares Redemption A/c. (Being amount payable on redemption transferred to preference share redemption account)		2,50,000 25,000	2,75,000
	Preference Share Redemption A/c. Dr. To Bank A/c. (Being amount paid to preference shareholder holding 24,750 shares including premium payable on redemption)		2,72,250	2,72,250
	Capital Redemption Reserve A/c. Dr.		1,30,000	

	Share Premium A/c. Dr.		5,000	
	General Reserve A/c. Dr.		2,07,500	
	To Bonus to Equity shareholders A/c.			3,42,500
	(Being decision to issue bonus shares in the ratio of 1:4 to 13,700 shareholders out of capital redemption reserve, Share premium A/c. and the balance out of General Reserve)			
	Bonus to Equity shareholders A/c. Dr.		3,24,500	
	To Equity Share Capital A/c.			3,24,500
	(Being issue of the bonus shares to the equity shareholders)			

Check your progress-2:

Fill in the blanks:

(a) The issue of redeemable preference shares must be authorized by the......................

(b) ....means the process of repaying the amount of capital to preference share capital after its term.

(c) A company can issue preference shares which are liable to be redeemed within a period not exceeding ....years from the date of their issue.

(d) The redeemable preference shares cannot be redeemed unless they are ....paid.

(e) Where such shares are proposed to be redeemed out of the profits of the company, the sum equal to nominal amount of the shares to be redeemed, is transferred to .... from undistributed profits.

1.3 Summary:

At the beginning of this unit, we have seen what is company and what are its characteristics. In short, we also touched upon types of companies. In the core part of the unit, we have covered shares, types of preference shares and redemption of preference shares. In initial state of subject matter, we try to understand the meaning and essential features of share and types of preference shares. Main two types of shares are defined which are equity shares and preference shares. The types of preference shares include a) Cumulative Preference Shares, b) Non-cumulative Preference Shares, c) Participatory Preference Shares, d) Non-participatory Preference Shares, e) Redeemable Preference Shares, f) Non-redeemable Preference Shares, g) Convertible Preference Shares and h) Non-convertible Preference Shares. The redemption of preference shares means the process of repaying the amount of capital to preference share capital after its term.

1.4 Terms to Remember:

1. **Company:** Company means an association of persons formed for the economic gain of the members. The characteristics of a company includes (a) it is voluntary association, (b) it is independent legal entity, (c) it has perpetual succession, (d) company being artificial entity, has common seal, (e) liability of members is generally limited and (f) shares of company are freely transferable.
2. **Shares:** Share is a part of share capital which has equal value. According to Section 2 (84) of Companies Act 2013, a share means "share in the share capital of a company and includes stock".
3. **Preference Shares:** Preference shares are those which carry the following preferential rights over other classes of shares: (a) a preferential right in respect of a fixed dividend and (b) a preferential right as to repayment of the capital in the event of company's winding up.
4. **Redemption of Preference Shares:** The redemption of preference shares means the process of repaying the amount of capital to preference share capital after its term.

1.5 Answers to Check your progress:

Check your progress-1:

Answer: (a) True, (b) False and (c) True.

Check your progress-2:

Answer: (a) Articles of Association, (b) The redemption of preference shares, (c) twenty, (d) fully and (e) Capital Redemption Reserve

1.6 Exercise:

1. What are different types of preference shares? Explain the concept of redeemable preference shares.

2. What is redemption of preference shares? What are the legal provisions regarding the redemption of preference shares.

3. Write short note on:

(a) Preference Shares

(b) Capital Redemption Reserve

(c) Redemption of preference shares

Problems on Redemption of Preference Shares:

1. 15,000, 9% Redeemable Preference Shares of Rs.100 each of World-Star Customer Care Ltd., repayable at a premium of 12% are now due for redemption. The company has accumulated reserves the amount of which is much in excess the sum required for redemption. In addition, there is a large balance lying securities premium account which is available for payment of premium on redemption.

2. The Dhanpal Ltd. has as a part of share capital, 500 Redeemable Preference Shares of Rs.100 each fully paid up & these have become due for redemption. The company having Rs.45,000 to its Reserve Fund, issued Equity Shares of the face value of Rs.30,000 at a premium of 5% specially for the purpose of such redemption and received cash for the full amount of the issue. The redeemable preference shares are then paid out of the proceeds of the new issue, the balance having been met out the balance to the credit of Reserve Fund. Pass journal entries.

3. X Co. decided to redeem its 40,000 6% Redeemable Preference Shares of Rs.10 each on which Rs.7 per share have been called up & paid up. The redemption was carried out of profits. Journalize.

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Unit-2

Valuation of Shares

Index :

2.0 Objectives :

After studying this unit you should be able to understand :

- Meaning and need for valuation of Shares.
- Identify the factors affecting the value of Shares.
- Explain the different methods of valuations of Shares.
- Explain the meaning of Key terms.
- Compute the valuation of shares under different method

2.1 Introduction :

According to the companies Act 2013 share means share in the share capital of a company. Though the company fixes the value of its shares, which is termed as face value, the actual price may be different and therefore, it becomes necessary to value the shares. The shares, which are included in the list of stock exchange, are quoted in the newspaper but the shares which are not quoted are valued and their value is found out by various methods. On many occasions, even the value of quoted share is also found out.

When a company is floated, it mentions its total capital in the Capital Clause of the Memorandum of Association and also mentions the total number of shares in which total capital of the company is divided. The value of each share is also mentioned in it. Suppose the total share capital of a company is Rs. 10,00,000 which is divided into 1,00,000 shares then value of one share will be Rs. 10. It is called face value or par value of the share and this value is shown in the balance sheet of the company whether the market price of the share is differing. This market price comes through the stock exchange. But sometimes these prices are not realizable because these prices fluctuate due to demand and supply of the shares in the market. As a result the market price does not show the true value of the share

2.2 Presentation of Subject Matter

2.2.1 Necessity of valuation of shares :

In the following cases, valuation of share is necessary.

1. For amalgamation, absorption & reconstruction of companies.
2. For the purpose of Estate Duty, wealth Tax and Gift Tax.

3. For sale of unquoted shares of investors.
4. For raising of loans on lien of shares.
5. For conversion of one class of shares into another class.
6. For sale of business.

2.2.2 Factors affecting the value of shares

Following are the factors affecting the valuation of shares

1. ***Earning capacity of the company*** affects the value of shares of the company.
2. ***Dividends declared by the company*** in the previous years also affect the value of shares. If dividend rate fluctuates in the previous years that has a negative impact on the investors.
3. ***Rate of return from other companies of the same nature*** also affects the value of shares in which the investors take interest.
4. ***Net tangible assets*** of the company also attracts the investors.
5. ***Restrictions on the transferability of shares*** would adversely affect the value of shares.
6. ***Capital employed*** of the company in relation to the profits earned would affect the value of shares.
7. ***Qualification, experience and capacity of the management*** of a company would affect the price of the shares of a company.
8. If some incentives are given by the ***government in its policy*** to a particular business, there will be good chances that the value of its shares may go up.
9. ***Demand and supply*** of the shares of a company also affect the value of shares.
10. There would be an ***impact of the political, economical and social conditions*** on the value of a particular company.
11. ***Nature of competition*** in the business also affect the value of the shares. If there is monopoly in the business, value of its shares will be high.
12. ***Goodwill*** of the company has its own impact on the value of shares.

2.2.3 Methods of valuation of shares :

2.2.3.1 Net Asset Method Or Intrinsic Value Method Or Asset Backing Method

In this method, the net assets of the company are determined and then the figure is divided by the number of shares. The Net Assets include value of Goodwill and non trading assets but excludes fictitious assets and accumulated losses in the Balance sheet. If there are preference shares, the preference capital will be deducted and only the remainder will be available for equity shareholders. According to this method the value of each equity share is ascertained by using following formula –

$$Intrinsic\ Value\ of\ each\ share = \frac{\text{Net Assets} - \text{ preference shares capital}}{Number\ of\ equity\ shares}$$

2.2.3.2 Yield or market value method

Under this method, the valuation depends upon the comparison of the company's earning capacity and the normal rate of profit or dividend that is prevailing in the market. Here, the profit means, profit available for equity dividend. It may be termed as average profit or maintainable profit or expected profit. Under this method, shares are valued on the basis of expected earning and normal rate of return.

There are two different methods when using the Yield Method -

i) Capitalization of Profits :

Capitalization of profits is the use of a corporation's retained earnings to pay a bonus to shareholders in the form of dividends or additional stock shares. It is a reward to shareholders, distributed in proportion to the number of share each owns. The capitalization of profits by issuing additional shares has no impact on a corporation's book value. It merely transfers funds from retained earnings, or profits, to assets for shareholders. In that sense, the company is using money but not losing it.

ii) Dividend Basis :

Whether Profit Basis or Dividend Basis method is followed for ascertaining the value of shares depends on the shares that are held by the respective shareholders. In other words, the shareholders holding minimum number of shares (i.e., minority holding) may determine the value of his shares on dividend basis since he has to satisfy himself having the rate of dividend which is recommended by the Board of Directors, i.e., he has no such power to control the affairs of the company.

2.2.3.3 Fair Value Method :

Fair value of share is simply the average of intrinsic value and market value of shares. Total of Intrinsic value of share and yield value of share is found out and this total is divided by two in order to find out fair value, Intrinsic value gives consideration to net assets backing but ignores profitability of concern. Yield value takes into account profitability of concern but neglects solvency of business. Fair value is the mean of both i.e. intrinsic value and yield value of share.

$$Fair\ value\ of\ share = \frac{\text{Intrinsic Value + Market or yield value}}{2}$$

2.2.4 Net Asset Method / Intrinsic Value Method/ Assets Backing Method

Student can use the following steps for calculating Intrinsic Value of each Equity Share.

Step I: To calculate value of Goodwill as per Average Profit Method.

$$\text{Amount of Goodwill} = \frac{\text{(Total Profit} - \text{Loss)}}{\text{Number of Years}} \text{ x Number of Year Purchases}$$

Step II: To calculate Net Assets

Particular	**Amount**
Market Value of Assets	
Goodwill	xxx
Land and Building	xxx
Plant and Machinery	xxx
Furniture and Fixture	xxx
Copy right	xxx
Trade mark	xxx
Leasehold Property	xxx
Fixtures	xxx
Investment	xxx
Current Assets	xxx
Loans and Advances	xxx
Bills receivables	xxx
Stock	xxx
Cash and bank balance	xxx
Sundry debtors	xxx
Total Assets (A)	

Less: Outside Liabilities Preference share capital Secured loan Unsecured loan Debenture Sundry creditors Bank overdraft Outstanding expenses Bills payable Current Liabilities	 xxx xxx xxx xxx xxx xxx xxx xxx
Total Liabilities (B)	xxx
Net Assets (A-B)	xxx

Step III: To calculate Intrinsic Value of each Equity Shares.

$$\text{Intrinsic Value of each Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

When amount of goodwill find out as per super profit method following steps should be considered for intrinsic value of each equity shares-

Step I: To Calculate Goodwill by Super Profit Method

1) To calculate Average Profit

$$\text{Average Profit} = \frac{\text{Total Profit} - \text{Loss}}{\text{Number of Years}}$$

2) To calculate Average Future Maintainable Profit

Particular	**Amount**
Average Profit Less: Non Recurring Income (Interest on Investment)	xxx xxx
 Less: Preference Shares Dividend	xxx xxx
Average Future Maintainable Profit	xxx

3) To calculate Cpaital Employed

Particular	**Amount**	**Amount**
Market Value of Tangible Assets		
Land and Building	xxx	
Plant and Machinery	xxx	
Investment	xxx	
Stock	xxx	
Cash and bank balance	xxx	
Sundry debtors	xxx	xxx
Less: Outside Liabilities	xxx	
Preference share capital	xxx	
Debenture	xxx	
Sundry creditors	xxx	
Bank overdraft	xxx	
Provision for tax	xxx	xxx
		xxx
Less: ½ of current year profit		xxx
Capital Employed		**xxx**

4) To Calculate Normal Profit

$$\text{Normal Profit} = \frac{\text{NRR}}{100} \text{ x Capital Employed}$$

5) To Calculate of Super Profit

Super Profit = Average Maintainable Profit – Normal Profit

6) To Calculate of Goodwill

Goodwill = Super Profit × Number of years purchase

Step II: To Calculate Net Assets

Particular	Amount
<u>Market Value of Assets</u>	
Goodwill	xxx
Land and Building	xxx
Plant and Machinery	xxx
Furniture and Fixture	xxx
Copy right	xxx
Trade mark	xxx
Leasehold Property	xxx
Fixtures	xxx
Investment	xxx
Current Assets	xxx
Loans and Advances	xxx
Bills receivables	xxx
Stock	xxx
Cash and bank balance	xxx
Sundry debtors	xxx
Total Assets (A)	
<u>Less: Outside Liabilities</u>	
Preference share capital	xxx
Secured loan	xxx
Unsecured loan	xxx
Debenture	xxx
Sundry creditors	xxx
Bank overdraft	xxx
Outstanding expenses	xxx
Bills payable	xxx
Current Liabilities	
Total Liabilities (B)	xxx
Net Assets (A-B)	xxx

Step III: Calculation of Intrinsic Value of each Equity shares

$$\text{Intrinsic Value of per Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

Illustration 1:

Determine the intrinsic value of each equity share from the following information.

10,000 Equity shares of Rs. 10 each	Rs. 1,00,000
7,000, 6% Preference shares of Rs. 10 each	Rs. 70,000
Assets at market value	Rs. 5,54,000
Total Liabilities	Rs. 2,04,000

(S. U. Oct. 2005)

Solution:

1) Calculation of Net Assets

Particular	Amount
Market value of Assets Less: Total Liabilities	5,54,000 2,04,000
Net Assets	3,50,000

2) **Calculation of Intrinsic Value of each Equity Shares**

$$\text{Intrinsic Value of per Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs. } 3{,}50{,}000}{10{,}000 \text{ Shares}}$$

= Rs. 35

$$\boxed{\text{Intrinsic Value of per Equity Shares} = \text{Rs. } 35}$$

Illustration 2:

From the following Balance Sheet of Santosh Ltd; and additional information given below ascertain the Intrinsic Value of each Equity Share.

Liabilities	Amount	Assets	Amount
Share Capital		Fixed Assets	
Equity Share of Rs.10 each	3,00,000	Goodwill	1,20,000
12% Preference Share of	1,00,000	Leasehold Property	3,50,000
Rs.10 each		Fixtures	60,000
Reserve and Surplus		Investment	50,000
General Reserve	80,000	Current Assets and	
Profit and Loss A/C	70,000	Advances	
Unsecured loan	1,00,000	Current Assets	75,000
Current Liabilities	30,000	Loans and Advances	15,000
		Miscellaneous exp.	10,000
	6,80,000		6,80,000

Additional Information:-

1) Leasehold Property and Fixtures are valued at Rs.4,00,000 and Rs. 50,000 respectively.

2) Goodwill should be valued at three years purchases of average profit at last five years. The profit for the last five years are Rs.70,000, Rs.90,000, Rs.75,000, Rs.85,000 and Rs.80,000 **(S. U. April 2017/2004)**

Solution:

In the Books of Santosh Ltd

1) Calculation of Goodwill

$$\text{Goodwill} = \frac{(\text{Total Profit} - \text{Loss})}{\text{Number of Years}} \text{ x Number of Year Purchases}$$

$$= \frac{(70{,}000 + 90{,}000 + 75{,}000 + 85{,}000 + 80{,}000}{5} \text{ x } 3$$

Goodwill = Rs.2,40,000

2) Calculation of Net Assets

Particular		Amount
<u>Market Value of Assets</u>		
Goodwill	2,40,000	
Leasehold Property	4,00,000	
Fixtures	50,000	
Investment	50,000	
Current Assets	75,000	
Loans and Advances	15,000	8,30,000
Less: <u>Market Value</u> Unsecured loan	1,00,000	
Current Liabilities	30,000	
		1,30,000
Net Assets		**7,00,000**

3) Calculation of Intrinsic Value of Per Equity Share

$$\text{Intrinsic Value of per Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs.}7,00,000}{30,000 \text{ Shares}}$$

$$= \text{Rs. } 23.33$$

Intrinsic Value of per Equity Shares = Rs.23.33

Illustration 3

From the following Balance Sheet of Swara Ltd; you are asked to ascertain the value of each Equity Share of the company.

Balance Sheet

as on 31/03/2019

Liabilities	Amount	Assets	Amount
2,000 Equity Shares of Rs.100 each	2,00,000	Goodwill	5,000
100 6% Preference shares of Rs. 100 each	10,000	Land and Building	1,00,000
General Reserve	9,000	Plant and machinery	1,20,000
7% Debentures	60,000	Investment	30,000
Sundry Creditors	5,000	Stock	5,000
Provision for Tax	3,000	Sundry Debtors	4,000
Bills Payable	2,000	Bank balance	24,000
		Preliminary expenses	1,000
	2,89,000		2,89,000

Additional Information:

1) The assets were revalued as:

   Goodwill Rs. 10,000

   Land and Building Rs.1,50,000

   Plant and machinery Rs.96,000

   Market value of Investment Rs.25,000

   Debtors after providing for bad debts at 10%

2) Interest on debentures is outstanding for 6 months

3) Actual tax liability as calculated by the tax consultant is Rs.2,500

4) Other assets and liabilities have no change in their values.

Solution:

In the Books of Swara Ltd

1) Calculation of Net Assets

Particular		Amount
<u>Market Value of Assets</u>		
Goodwill	10,000	
Land and Building	1,50,000	
Plant and machinery	96,000	
Investment	25,000	
Stock	5,000	
Sundry Debtors	3,600	
Bank balance	24,000	3,13,600
<u>Less: Market Value of Liabilities</u>		
6% Preference share capital	10,000	
7% Debentures	60,000	
Outstanding Interest on debenture	2,100	
Sundry Creditors	5,000	
Tax Liability	2,500	
Bills Payable	2,000	81,600
Net Assets		2,32,000

2) Calculation of Intrinsic Value of Per Equity share

$$\text{Intrinsic Value of per Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs.2,32,00}}{\text{2,000 Shares}}$$

= Rs. 116

Intrinsic Value of per Equity Shares = Rs.116

Illustration 4:

The following is the summarized Balance Sheet of Tejas Ltd; as on 31^{st} March 2019.

Balance Sheet
As on 31^{st} March 2019

Liabilities	Amount	Assets	Amount
3000 Equity shares of Rs.100 each	3,00,000	Goodwill	15,000
		Land and Building	3,15,000
3000 Redeemable Preference shares of Rs. 100 each	3,00,000	Plant and machinery	1,65,000
		Investment in Government Bonds	15,000
General Reserve	45,000	Stock	1,35,000
Dividend Equalization fund	15,000	Sundry Debtors	60,000
Profit and Loss A/C	3,00,000	Bank	3,60,000
Employees Compensation fund	15,000	Preliminary expenses	15,000
Employee saving A/C	30,000		
Sundry Creditors	75,000		
	10,80,000		10,80,000

On 1^{st}April 2019 all the Preference shares were redeemed at a premium of Rs.10 per share out of profit otherwise available from dividend.

You are asked to ascertain the intrinsic value of each equity share by assets backing method, on the basis of the balance sheet immediately after the redemption of preference shares.

Take into account the following information:

1) Goodwill to be taken at Rs.1,50,000
2) 10% of the sundry debtors are bad.
3) A claim for compensation to an employee has been admitted on 1^{st} April 2018 the amount involved being Rs.3,000.
4) All other assets are to be taken at book value as shown in the above balance sheet. **(S.U. Nov. 2008)**

Solution:

Notes- Amount of preference share capital=

Amount of Redeemable preference capital + Rs.10 per share premium

= Rs.3,00,000 + Rs.30,000

= Rs.3,30,000

In the books of Tejas Ltd.

1) Calculation of Net Assets

Particular		**Amount**
Market Value of Assets		
Goodwill	1,50,000	
Land and Building	3,15,000	
Plant and machinery	1,65,000	
Investment in Government Bonds	15,000	
Stock	1,35,000	
Sundry Debtors (60,000-10%R.D.D.)	54,000	
Bank (3,60,000-Preference Capital)	30,000	8,64,000
Less: Market Value of Liabilities		
Employees Compensation fund	3,000	
Employee saving A/C	30,000	
Sundry Creditors	75,000	1,08,000
Net Assets		**7,56,000**

2) Calculation of Intrinsic Value of each Equity shares

$$\text{Intrinsic Value of per Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs.7,56,000}}{\text{3,000 Shares}}$$

= Rs. 252

Intrinsic Value of per Equity Shares = Rs. 252

Illustration 5:

Following is the Balance sheet of Vedika Ltd; as on 31st March 2019

Balance sheet
As on 31st March 2019

Liabilities	**Amount**	**Assets**	**Amount**
20,000 shares of Rs.10 each	2,00,000	Land and Building	75,000
General Reserve	50,000	(Market value Rs.1,50,000)	
Creditors	50,000	Plant and Machinery	80,000
Workmen's Saving A/c	50,000	(Market value Rs.1,00,000)	
Profit and Loss A/c	25,000	Trade Marks(Market value Rs.8,000)	10,000
		Stock	1,00,000
		Debtors	54,000
		Investment	20,000
		Cash at Bank	20,000
		Preliminary expenses	16,000
	3,75,000		3,75,000

Find out the Intrinsic value after taking into account.

Interest payable to Creditors Rs.1,000

Bad debts amounted Rs.2,000

Investments are worth Rs.16,000

Solutions:

In the Books of Vedika Ltd

1) Calculation of Net Assets

Particular		**Amount**
Market Value of Assets		
Land and Building	1,50,000	
Plant and Machinery	1,00,000	
Trade Mark	8,000	
Stock	1,00,000	
Debtors (54,000-2,000)	52,000	
Investment	16,000	
Cash at Bank	20,000	4,46,000
Less: Market value of Liabilities		
Creditors (50,000+1,000)	51,000	1,01,000
Workmen's Saving A/C	50,000	
Net Assets		3,45,000

2) Calculation of Intrinsic Value of each Equity shares

$$\text{Intrinsic Value of per Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs.3,45,000}}{\text{20,000 Shares}}$$

= Rs. 17.25

Intrinsic Value of per Equity Shares = Rs.17.25

Illustration 6:

The Balance Sheet of Speed Ltd; as follows

Balance Sheet
As on 31-03-2019

Liabilities	Amount	Assets	Amount
1000, 6% Preference share capital of Rs.100 each fully paid up	2,00,000	Goodwill	20,000
		Land and Building	2,00,000
		Plant and Machinery	1,00,000
2,000 Equity share of Rs.100 each fully paid up	4,00,000	Stock	3,00,000
		Debtors	2,00,000
Reserve	80,000	Investment: 10% Govt. Bonds face value Rs.1,00,000	1,20,000
Profit and Loss A/c	90,000		
Sundry Creditors	1,00,000		
Bills Payable	1,00,000	Bank	40,000
Outstanding expenses	30,000	Preliminary expenses	20,000
	10,00,000		10,00,000

Additional Information:

1) Revaluation of assets was made as under:

   Land and Building Rs. 2,40,000 and Plant and Machinery Rs.90,000

2) Income Tax Liability not provided for in account was Rs. 60,000.

3) Fair return on capital employed for the purpose of valuation of goodwill is 10%

4) The basis of valuation of goodwill is 3 years purchase of super profit.

5) The average profit for the last four years amounted to Rs.80,000.

   Find out the value of each equity shares according to the assets backing method.

Solution:

In the Books of Speed Ltd

1) Calculation of Goodwill by Super Profit Method

a) Calculation of Average Maintainable Trading Profit

Particular	**Amount**
Average Profit after tax	80,000
Less: Return on Non Trading Investment@ 10% on Rs.1,00,000	10,000
	70,000
Less: Preference Dividend @ 6% on Rs.2,00,000	12,000
Average Maintainable Trading Profit	58,000

b) Calculation of Average Trading Capital Employed

Particular		**Amount**
Market Value of Assets		
Land and Building	2,40,000	
Plant and Machinery	90,000	
Stock	3,00,000	
Debtors	2,00,000	
Bank	40,000	8,70,000
Less: External Liabilities		
Sundry Creditors	1,00,000	
Bills Payable	1,00,000	
Outstanding expenses	30,000	
Unrecorded Tax	60,000	2,90,000
		5,80,000
Less: 8% Preference Capital		2,00,000
		3,80,000
Less: ½ Average Maintainable Trading Profit (58,000×½)		29,000
Average Trading Capital Employed		3,51,000

c) Calculation of Normal Profit

Normal Profit = $\frac{\text{NRR}}{100}$ × Capital Employed

$= \frac{10}{100} \times 3{,}51{,}000$

Normal Profit = 35,100

d) Calculation of Super Profit

Super Profit = Average Maintainable Profit – Normal Profit

= 58,000 – 35,100

Super Profit = 22,900

e) Calculation of Goodwill

Goodwill = Super Profit × Number of years purchase

= 22,900 × 3

Goodwill = 68,700

2) Calculation of Net Assets

Particular		**Amount**
<u>Market Value of Assets</u>		
Goodwill	68,700	
Land and Building	2,40,000	
Plant and Machinery	90,000	
Stock	3,00,000	
Debtors	2,00,000	
Investment	1,20,000	
Bank	40,000	10,58,700

Less: Outside Liabilities 6% Pref. capital Sundry Creditors Bills Payable Outstanding expenses Unrecorded Tax	 2,00,000 1,00,000 1,00,000 30,000 60,000	 4,90,000
Net Assets		5,68,700

3) Calculation of Intrinsic Value of each Equity shares

$$\text{Intrinsic Value of per Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs.5,68,700}}{\text{2,000 Shares}}$$

= Rs. 284.35

Intrinsic Value of per Equity Shares = Rs. 284.35

2.2.5. YIELD VALUE / MARKET VALUE METHOD

I) Yield or Market Value Method on the basis of Expected Dividend (Earning) Rate

Student can use the following steps for calculating market value of each equity share on the basis of expected rate of dividend (earning).

Step I- Calculation Profit Available for Equity Shareholder

Particular	Amount
Average Profit Less- Provision for Tax	XX XX
Less- Transfer to reserve	XX XX

Less- Preference dividend	XX XX
Profit Available for Equity Shareholder	XX

Step II- Calculate Expected Rate of Dividend (Earning)

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \times 100$$

Step III- Calculate Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid up value per Eq. sh.}$$

Illustration 7:

From the following information calculate the market value per share on dividend declared basis.

1) 4,000, 9% preference shares of Rs.1000 each – Rs.4,00,000
2) 1,00,000 Equity shares of Rs.10 each Rs.8 paid up – Rs.8,00,000
3) Expected profit per year before tax - Rs.4,36,000
4) Rate of tax 50%
5) Normal rate of return 15%
6) Transfer to general reserve every year 20% of profit

Solution:

Valuation of each equity share by market value method on dividend basis

1) Calculation of Adjusted Average Profit

Particular	Amount
Average Profit Less- Provision for 50% Tax	4,36,000 2,18,000
Less- Transfer to general reserve	2,18,000 43,600

Less- Preference share dividend	1,74,400 36,000
Adjusted Average Profit	1,38,400

2) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \times 100$$

$$= \frac{\text{Rs.1,38,400}}{\text{Rs.8,00,000}} \times 100$$

= 17.3%

3) Calculate Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid up value per Eq. sh.}$$

$$= \frac{17.3}{15} \times 8$$

= Rs.9.23

Market Value of each Equity Share on dividend basis = Rs.9.23

Illustration 8:

Following information pertains to XYZ Co. Ltd:

1)	8% 25,000 preference shares of Rs.10 each	Rs.2,50,000
2)	62,500 Equity shares of Rs.100 each	Rs.62,50,000
3)	Average Annual profits	Rs.12,50,000
4)	Income tax	50%
5)	Transfer to general reserve	25%
6)	Normal return	10%

Mr. Balwant the holder of 200 equity shares in the company assign you the work of valuing his shareholding. **(S. U. Nov. 2016)**

Solution:

In the books of XYZ Co. Ltd;

1) Calculation of Adjusted Average Profit

Particular	**Amount**
Average Profit	12,50,000
Less- Provision for 50% Tax	6,25,000
	6,25,000
Less- Transfer to general reserve	1,56,250
	4,68,750
Less- Preference share dividend	50,000
Adjusted Average Profit	4,18,750

2) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \times 100$$

$$= \frac{\text{Rs.}4{,}18{,}750}{\text{Rs.}62{,}50{,}000} \times 100$$

$$= 6.7\%$$

3) Calculate Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid up value per Eq. sh.}$$

$$= \frac{6.7}{10} \times 100$$

$$= \text{Rs.}67$$

4) Calculation of Balwant's holding

Value of Balwant's holding = 200 shares x Rs.67

= Rs.13,400

Value of Balwant's holding under market value method on dividend basis = Rs.13,400

Illustration 9:

Ding Dong Ltd; had issued 10,000 equity shares of Rs.100 each Rs.90 paid up and 1,500 10% preference shares of Rs.100 each fully paid. The company has a practice of transferring 20% of profit to general reserve every year. The annual average profit of the company is Rs.6,00,000 before tax and the rate of tax is 50%. Normal rate of return on equity share is 15%.

Find out market value of each equity share.

Solution:

In the books of Ding Dong Ltd.

1) Calculation of Profit Available for Equity Shareholder

Particular	Amount
Average Profit	6,00,000
Less- Provision for 50% Tax	3,00,000
	3,00,000
Less- Transfer to general reserve	60,000
	2,40,000
Less- Preference share dividend	15,000
Profit Available for Equity Shareholder	2,25,000

2) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \times 100$$

$$= \frac{\text{Rs.}2{,}25{,}000}{\text{Rs.}9{,}00{,}000} \times 100$$

$$= 25\%$$

3) Calculate Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid up value per Eq. sh.}$$

$$= \frac{25}{15} \times 90$$

$$= \text{Rs.}150$$

Market value of each Equity Share on dividend basis = Rs. 150

Illustration 10:

On 31st March 2019 the Balance sheet of a Smart Ltd; co. disclosed the following position

Balance Sheet
As on 31st March 2019

Liabilities	Amount	Assets	Amount
Share capital(Rs.10 share)	4,00,000	Fixed Assets	5,00,000
Reserve	90,000	Current Asses	2,00,000
Profit and Loss A/C	20,000	Goodwill	40,000
5% Debenture	1,00,000		
Current Liabilities	1,30,000		
	7,40,000		7,40,000

On 31st March 2019 the fixed assets were valued at Rs.3,50,000 and the goodwill Rs.50,000.

Net profits for three years were:

Year	Rs.
2017	51,600
2018	52,000
2019	51,650

of which 20% was placed to reserves. The fair return on investment in the industry may be considered at 10%.

Calculate the value of a shares by yield method. **(S. U. March 2007)**

Solution:

1) Calculation of Average profit

$$\text{Average profit} = \frac{\text{Total profit} - \text{Loss}}{\text{Number of years}}$$

$$= \frac{51{,}600 + 52{,}000 + 51{,}650}{3}$$

$$= \frac{1{,}55{,}250}{3}$$

$$= 51{,}750$$

2) **Calculation of Profit Available for Equity Shareholder**

Particular	Amount
Average Profit Less- Provision for Tax	51,750 --------
Less- Transfer to general reserve	51,750 10,350
Less- Preference share dividend	41,400 -------
Profit Available for Equity Shareholder	41,400

3) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \times 100$$

$$= \frac{\text{Rs.}41{,}400}{\text{Rs.}4{,}00{,}000} \times 100$$

$$= 10.35\%$$

4) **Calculate Market Value of each Equity Share**

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid up value per Eq. sh.}$$

$$= \frac{10.35}{10} \times 10$$

$$= \text{Rs.}10.35$$

Market value of each Equity Share on dividend basis = Rs.10.35

Illustration 11:

The following is the summarized Balance sheet of confident Ltd; as on 31st March 2019

Balance sheet

Liabilities	Amount	Asset	Amount
<u>Share capital</u>		Fixed Assets	8,00,000
3,000 Equity shares of Rs.100 each	3,00,000	Stock	2,00,000
		Debtors	2,00,000
7,000 8% preference shares of Rs.100 each	7,00,000	Bank	50,000
Profit and Loss A/C	1,00,000		
creditors	1,50,000		
	12,50,000		12,50,000

The net profit of the company for the five years before providing for taxation were:

Year	Rs.
2015	1,80,000
2016	2,00,000
2017	1,80,000
2018	1,50,000
2019	1,00,000

Another company engaged in the same type of business pay a dividend of 10% and its shares are quoted on the stock exchange at Rs.110. Assuming taxation at 50% and appropriated of 10% of balance to reserve.

Ascertained the value of each equity share under market value method.

Solution:

In the books of Confident Ltd.

1) Calculation of Average profit

$$\text{Average profit} = \frac{\text{Total profit} - \text{Loss}}{\text{Number of years}}$$

$$= \frac{1{,}80{,}000+2{,}00{,}000+1{,}80{,}000+1{,}50{,}000+1{,}00{,}000}{5}$$

$$= \frac{8{,}10{,}000}{5}$$

$$= \text{Rs.}1{,}62{,}000$$

2) Calculation of Profit Available for Equity Shareholder

Particular	**Amount**
Average Profit	1,62,000
Less- Provision for Tax 50%	81,000
	81,000
Less- Transfer to general reserve 10%	8,100
	72,900
Less- Preference share dividend 8%	56,000
Profit Available for Equity Shareholder	16,900

3) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \text{ x } 100$$

$$= \frac{\text{Rs.16,900}}{\text{Rs.3,00,000}} \text{ x } 100$$

$$= 5.63\%$$

4) Calculate Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \text{ x Paid up value per Eq. sh.}$$

$$= \frac{5.63}{10} \text{ x } 100$$

$$= \text{Rs. } 56.33$$

Market value of each Equity Share on dividend basis = Rs.10.35

Illustration 12:

A company has following capital structure-

1) 20,000 'X' Equity shares of Rs.100 each fully paid
2) 12,000 'Y' Equity shares of Rs.100 each Rs.70 paid up

3) 8,000 'Z' Equity shares of Rs.100 each Rs.60 paid up

The average net profits of the company after tax were Rs. 2,98,800 and the companies of the same class yield a dividend of 15%.

Ascertain the yield value of each class of equity shares.

Solution:

1) Calculation of Total Paid up Equity Capital

Particular	Amount
20,000 'X' Equity shares of Rs.100 each fully paid	20,00,000
12,000 'Y' Equity shares of Rs.100 each Rs.70 paid up	8,40,000
8,000 'Z' Equity shares of Rs.100 each Rs.60 paid up	4,80,000
Total Paid up Equity Capital	33,20,000

2) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \times 100$$

$$= \frac{\text{Rs.}2{,}98{,}800}{\text{Rs.}33{,}20{,}000} \times 100$$

$$= 9\%$$

3) Calculate Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid up value per Eq. sh.}$$

X Equity share = $\frac{9}{15} \times 100$ = **Rs. 60 per share**

Y Equity share = $\frac{9}{15} \times 70$ = **Rs. 42 per share**

Z Equity share = $\frac{9}{15} \times 60$ = **Rs. 36 per share**

II) Yield or Market Value Method on the basis of Capitalization Value

Student can use the following steps for calculating market value of each equity share on the basis of Capitalization Value.

Step I- Calculate Profit Available for Equity shareholder

Particular	**Amount**
Average Profit	XX
Less- Provision for Tax	XX
	XX
Less- Transfer to reserve	XX
	XX
Less- Preference dividend	XX
profit available for Equity Shareholder	XX

Step II- Calculate Capitalization of Profit

$$\text{Capitalization of Profit} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Normal Rate of Return}} \times 100$$

Step III- Calculate Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Capitalization of Profit}}{\text{Number of Equity Shares}}$$

Illustration 13:

From the following information extracted from the books of Sonia Ltd. Calculate the value per equity share by yield method on basis of capitalization.

2,000 9% preference shares of Rs.100 each	Rs.2,00,000
50,000 Equity shares of Rs.10 each Rs.8 per share	Rs. 4,00,000
Expected profits per year before tax	Rs.2,18,000
Rate of Tax	50%
Transfer to General Reserve every Year	20% of profit
Normal Rate of Return	15%

Solution:

In the books of Sonia Ltd.

1) Calculation Profit Available for Equity shareholder

Particular	**Amount**
Average Profit Less- Provision for Tax 50%	2,18,000 1,09,000
Less- Transfer to reserve	1,09,000 21,800
Less- Preference dividend	87,200 18,000
profit available for Equity Shareholder	69,200

2) Calculation Capitalization of Profit

$$\text{Capitalization of Profit} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{69{,}200}{15} \times 100$$

$$= 4{,}61{,}333$$

3) Calculation Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Capitalization of Profit}}{\text{Number of Equity Shares}}$$

$$= \frac{4{,}61{,}333}{50{,}000 \text{ shares}}$$

$$= \text{Rs.}9.23$$

Market value of each Equity Share on capitalisation basis = Rs.10.35

Illustration 14:

Santosh Ltd; has 50,000 equity shares of Rs.10 each Rs.8 paid. The company transfers 10% of profit to general reserve every year. The expected profit before tax is Rs.10,00,000 and the rate of tax is 65%. Normal rate of dividend is 16%. Santosh Ltd. has 7% preference share capital is Rs.4,00,000 dividend into shares of Rs.10 each.

Find out the value of share by yield method on capitalization basis.

Solution:

In the books of Santosh Ltd.

1) Calculation Profit Available for Equity shareholder

Particular	Amount
Average Profit Less- Provision for Tax 65%	10,00,000 6,50,000
Less- Transfer to reserve 10%	3,50,000 35,000
Less- Preference dividend	3,15,000 28,000
profit available for Equity Shareholder	2,87,000

2) Calculation Capitalization of Profit

$$\text{Capitalization of Profit} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{2,87,000}{16} \times 100$$

$$= 17,93,750$$

3) Calculation of Yield Value of each Equity Share

$$\text{Yield Value of each Equity Share} = \frac{\text{Capitalization of Profit}}{\text{Number of Equity Shares}}$$

$$= \frac{17,93,750}{50,000 \text{ shares}}$$

$$= \text{Rs.}35.87$$

Market value of each Equity Share on capitalisation basis = Rs. 35.87

Illustration 15:

Music Co. Ltd. is providing you the following information for the financial year 2018-19

1) 3,250 Equity shares of Rs.1,000 each
2) 250 9% preference shares of Rs.1,000 each.
3) 100 11% debentures of Rs.2,000 each.
4) Bank loan Rs.5,00,000 taken for business expansion. Interest is payable@ 12% annually.
5) Net sale Rs.21,17,500
6) Operating expenses Rs.17,71,500
7) Rate of tax is 50%
8) Transfer to reserve as per policy of the company Rs.12,000 per year.
9) Normal rate of return in the industry is 15%.

Calculate Value of each equity share by market value capitalization method.

Solution:

In the books of Music Co. Ltd.

1) Calculation Profit Available for Equity shareholder

Particular	Amount	Amount
Net sale		21,17,500
Less: operating expenses	17,71,500	
Interest on debenture	22,000	
Interest on bank loan	60,000	18,53,500
		2,64,000
Less- Provision for Tax 50%		1,32,000
		1,32,000
Less- Transfer to reserve		12,000
		1,20,000
Less- Preference dividend		22,500
Profit available for Equity Shareholder		97,500

2) Calculation Capitalization of Profit

$$\text{Capitalization of Profit} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Normal Rate of Return}} \text{ x } 100$$

$$= \frac{97,500}{15} \text{ x } 100$$

$$= 6,50,000$$

3) Calculation Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Capitalization of Profit}}{\text{Number of Equity Shares}}$$

$$= \frac{6,50,000}{3,250 \text{ shares}}$$

$$= \text{Rs.}200$$

Market value of each Equity Share on capitalisation basis = Rs. 200

III) Yield or Market Value Method on the basis of Normal Rate and Number of Shares

Students can use the following steps for calculating market value of each equity share on the basis of normal rate and number of shares.

Step I- Calculate Profit Available for Equity shareholder

Particular	Amount
Average Profit	XX
Less- Provision for Tax	XX
	XX
Less- Transfer to reserve	XX
	XX
Less- Preference dividend	XX
Profit available for Equity Shareholder	XX

Step II- Calculate Normal Rate and Number of Shares

$$\text{Market Value of each Equity Share} = \frac{\text{Average Profit/Profit Available for Equity Sareholder}}{\text{Normal Rate x Number of Equity Shares}} \text{x}100$$

Illustration 16:

The following is the Balance Sheet of Shanti Co. Ltd. as on 31.03.2019

Balance Sheet

Liabilities	Amount	Assets	Amount
10,000 Equity shares of Rs.10 each	1,00,000	Building	2,00,000
		Plant	1,00,000
12% Preference shares of Rs.10 each	1,00,000	Investment	50,000
		Stock	60,000
General Reserve	60,000	Debtors	40,000
Profit and Loss A/C	40,000	cash	10,000
15% Debenture	1,00,000	Discount on issue of debentures	20,000
Creditors	80,000		
	4,80,000		4,80,000

Average profit of the company is Rs.1,20,000 and 12½ of profit is transferred to general reserve, rate of taxation being 50%. Normal fair return on capital employed is 10%.

Ascertain the value of each equity share under market value method on the basis of Normal rate and Number of shares.

Solution:

In the books of Shanti Ltd.

1) Calculation Profit Available for Equity shareholder

Particular	Amount
Average Profit	1,20,000
Less- Provision for Tax 50%	60,000
	60,000
Less- Transfer to reserve 12.5%	7,500
	52,500
Less- Preference dividend	12,000
Profit available for Equity Shareholder	40,500

2) Calculation Market Value of each Equity Share

$$\text{Market Value of each Equity Share} = \frac{\text{Average Profit/Profit Available for Equity Sareholder}}{\text{Normal Rate x Number of Equity Shares}} \text{x100}$$

$$= \frac{40{,}500}{10 \text{ x } 10{,}000 \text{ shares}} \text{ x } 100$$

$$= \frac{40{,}500}{1{,}00{,}000} \text{ x } 100$$

$$= 40.5$$

Market value of each Equity Share on the basis of Normal Rate and Number of Shares = Rs. 40.5

2.2.6. Fair Value Method

This is another method of valuation of equity shares. It is combination of intrinsic value method and yield value method. It is also called as dual value method.

Under this method equity share is valued at average of intrinsic value and yield value method

$$\text{Fair value of each equity share} = \frac{\text{Intrinsic value + Yield value}}{2}$$

Illustration 17:

Following is the balance sheet of Aditya Ltd; as on 31st March 2019

Balance Sheet
As on 31st March 2019

Liabilities	Amount	Assets	Amount
Issued capital		Fixed Assets	6,00,000
48,000 shares of Rs.10	4,80,000	Current Assets	2,40,000
each		Goodwill	48,000
General Reserve	1,08,000		
Profit and Loss A/C	24,000		
5% Debenture	1,20,000		
Current Liabilities	1,56,000		
	8,88,000		8,88,000

On 31st March 2019 the fixed assets were independently valued at Rs. 6,60,000, current assets at Rs.2,64,000 and goodwill at Rs.60,000

The net profits for the last three years were Rs.65,000, Rs.70,000 and Rs.67,500 of which 20% was placed to reserve, this proportion being considered reasonable in the industry. The fair investment return may be taken at 10%.

Compute fair value of each share. **(S. U. Nov. 2017)**

Solution:

In the books of Aditya Ltd

A) Calculation of Intrinsic Value of Equity share

1) Calculation of net assets

Particular	Amount	Amount
Market value of Assets		
Goodwill	60,000	
Fixed assets	6,60,000	
Current assets	2,64,000	9,84,000
Less: Outside Liabilities		
5% Debenture	1,20,000	
Current liabilities	1,56,000	2,76,000
Net Assets		7,08,000

2) Calculation of Intrinsic value of each equity share

$$\text{Intrinsic Value of each Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{7{,}08{,}000}{48{,}000 \text{ shares}}$$

$$= \text{Rs.}14.75$$

B) Calculation of market value of each equity shares

1) Calculation of Average Profit

$$\text{Average profit} = \frac{\text{Total profit} - \text{Loss}}{\text{Number of years}}$$

$$= \frac{65{,}000+70{,}000+67{,}500}{3 \text{ years}}$$

= Rs. 67,500

2) Calculation Profit Available for Equity shareholder

Particular	Amount
Average Profit	67,500
Less- Provision for Tax 50%	-------
	67,500
Less- Transfer to reserve 12.5%	13,500
	54,000
Less- Preference dividend	-------
Profit Available for Equity Shareholder	54,000

3) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Paid up Equity Share Capital}} \times 100$$

$$= \frac{54{,}000}{4{,}80{,}000} \times 100$$

= 11.25%

4) Calculation of Market Value of each Equity share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}} \times \text{Paid up value per Eq. sh.}$$

$$= \frac{11.25}{10} \times 10$$

= Rs.11.25

C) Calculation of Fair Value of each Equity share

$$\text{Fair value of each equity share} = \frac{\text{Intrinsic value} + \text{Yield value}}{2}$$

$$= \frac{14.75 + 11.25}{2}$$

= Rs.13

Fair value of each equity share = Rs.13

Illustration 18 :

The following is the Balance sheet of Sujit Co. Ltd. as on 31stMarch 2019

Balance sheet
As on 31stMarch 2019

Liabilities	Amount	Assets	Amount
Share capital		Land and Building	15,40,000
15,000 shares of Rs.100 each	15,00,000	Plant and Machinery	17,60,000
		Vehicles	4,50,000
4,000 8% preference share	4,00,000	Debtors	6,80,000
General Reserve	7,00,000	Stock	4,70,000
Profit and Loss A/c	5,00,000		
10% Debenture	10, 00,000		
Sundry creditors	8,00,000		
	49,00,000		49,00,000

The land and building and plant and machinery are to be depreciated by 10% and vehicles by 20% the stock was revalued at Rs.4,45,000 and debtors subject to provision for bad debts of Rs.80,000.

The profits for the last five years were as-

2014-15	4,30,000	2015-16	4,70,000
2016-17	5,00,000	2017-18	6,00,000
2018-19	6,45,000		

The taxation provision is to be made at 50% and a profit earning capacity of similar companies' show 10%.

Find out Fair Value of the equity share.

Solution:

In the books of Sujit Co. Ltd.

A) Calculation of Intrinsic Value of Equity share

1) Calculation of net assets

Particular	Amount	Amount
<u>Market value of Assets</u>		
Land and Building	13,86,000	
Plant and Machinery	15,84,000	
Vehicles	3,60,000	
Debtors	6,00,000	
Stock	4,45,000	43,75,000
<u>Less: Outside Liabilities</u>		
8% preference capital	4,00,000	
10% Debenture	10,00,000	
Sundry creditors	8,00,000	22,00,000
Net Assets		21,75,000

2) Calculation of Intrinsic value of each equity share

$$\text{Intrinsic Value of each Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{21{,}75{,}000}{15{,}000 \text{ shares}}$$

$$= \text{Rs.}145$$

B) Calculation of market value of each equity shares

1) Calculation of Average Profit

$$\text{Average profit} = \frac{\text{Total profit} - \text{Loss}}{\text{Number of years}}$$

$$= \frac{4{,}30{,}000+4{,}70{,}000+5{,}00{,}000+6{,}00{,}000+6{,}45{,}000}{5 \text{ years}}$$

$$= \text{Rs.}5{,}29{,}000$$

2) Calculation Profit Available for Equity shareholder

Particular	Amount
Average Profit	5,29,000
Less- Provision for Tax 50%	2,64,500
	2,64,500
Less- Transfer to reserve 12.5%	26,450
	2,38,050
Less- Preference dividend	32,000
Profit available for Equity Shareholder	2,06,050

3) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \times 100$$

$$= \frac{2,06,050}{15,00,000} \times 100$$

$$= 13.74\%$$

4) Calculation of Market Value of each Equity share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid up value per Eq. sh.}$$

$$= \frac{13.74}{10} \times 100$$

$$= \text{Rs.}137$$

C) Calculation of Fair Value of each Equity share

$$\text{Fair value of each equity share} = \frac{\text{Intrinsic value} + \text{Yield value}}{2}$$

$$= \frac{145 + 137}{2}$$

$$= \text{Rs.}141$$

Fair value of each equity share = Rs.141

Illustration 19:

The balance sheet of Mohan- Megha Ltd, as on 31st March 2018 was as follows:

Balance sheet
As on 31st March 2018

Liabilities	Amount	Assets	Amount
Share capital Equity shares of Rs.100 each fully paid 15% preference share of Rs.100 each fully paid Profit and Loss A/C On 1-4-2017 1,20,000 For 2017-2018 1,08,000 Depreciate fund on fixed assets Current Liabilities	 12,00,000 8,00,000 12,00,000 40,000 1,00,000	Fixed assets 5% Investment Stock in trade (Market Price) Debtors 10,00,000 Less: R.D.D 40,000 Bank Preliminary expenses	2,00,000 8,00,000 8,00,000 9,60,000 4,00,000 1,80,000
	33,40,000		33,40,000

Other information:

1) Fixed assets are worth Rs.4,00,000.
2) Profit for the past three years have shown an increase of Rs.40,000 annually.
3) Public companies doing similar business show a profit earning of capacity of 10% on the market value of their shares.
4) The company prospects for 2018-19 are equally good.
5) Assume taxation at 50%.

Find the fair value of shares of the company assuming goodwill at 3 years purchases of super profit.

Solution:

In the books of Mohan Megha Co. Ltd

A) Calculation of Intrinsic value of each equity share

1) Calculation of goodwill by super profit

a) Calculation of Average Profit

$$\text{Average profit} = \frac{\text{Total profit} - \text{Loss}}{\text{Number of years}}$$

$$= \frac{10{,}80{,}000+10{,}40{,}000+1\ \ ,00{,}000}{3 \text{ years}}$$

= Rs.5,29,000

b) Calculation of Average Maintainable Trading Profit

Particular	Amount
Average Profit	10,40,000
Less: Interest on Investment (8,00,000 x 5%)	40,000
	10,00,000
Less- Provision for Tax 50%	5,00,000
	5,00,000
Less- Preference share dividend (8,00,000 x 15%)	1,20,000
Average Maintainable Trading Profit	41,400

c) Calculation of Capital Employed

Particular	Amount	Amount
<u>Market Value Of Tangible Asset</u>		
Fixed assets	4,00,000	
Stock	8,00,000	
Debtors	9,60,000	
Bank	4,00,000	25,60,000

<u>Less: Outside Liabilities</u> Preference capital Current liabilities Provision for tax	 8,00,000 10,00,000 5,40,000	 14,40,000
 Less: ½ current year profit(4,00,000 ÷ 2) Current year profit Less: Interest on investment	 10,80,000 40,000	11,20,000 2,00,000
 Less: 50% Tax	10,40,000 5,20,000	
 Less: Preference Dividend	5,20,000 1,20,000	 4,00,000
	4,00,000	
Capital Employed		9,20,000

d) Calculation of Normal Profit

Normal Profit = $\frac{NRR}{100}$ × Capital Employed

= $\frac{10}{100}$ × 9,20,000

Normal Profit = 92,000

e) Calculation of Super Profit

Super Profit = Average Maintainable Profit – Normal Profit

= 3,80,000 – 92,000

Super Profit = 2,88,000

f) Calculation of Goodwill

Goodwill = Super Profit × Number of years purchase

= 2,88,000 × 3 years

Goodwill = 8,64,000

2) Calculation of Net Assets

Particular		Amount
Market value of Tangible Assets		
Goodwill	8,64,000	
Fixed assets	4,00,000	
5% Investment	8,00,000	
Stock	8,00,000	
Debtors	9,60,000	
Bank	4,00,000	42,24,000
Less: Outside Liabilities		
Preference share capital	8,00,000	
Current liabilities	1,00,000	
Provision for tax	5,40,000	14,40,000
Net Assets		27,84,000

3) Calculation of Intrinsic value of each Equity shares

$$\text{Intrinsic Value of per Equity Shares} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs.27,84,000}}{\text{12,000 Shares}}$$

$$= \text{Rs. } 232$$

B) Calculation of Market Value of Equity Share

1) Calculation Profit Available for Equity shareholder

Particular	**Amount**
Average Profit	10,40,000
Less- Provision for Tax 50%	5,20,000
	5,20,000
Less- Transfer to reserve	--------
	5,20,000
Less- Preference dividend	1,20,000
profit available for Equity Shareholder	4,00,000

2) Calculation of Expected Rate of Dividend

$$\text{Expected Rate of Dividend} = \frac{\text{Profit Available for Equity Shareholder}}{\text{Total paid up Equity Capital}} \text{ x } 100$$

$$= \frac{4{,}00{,}000}{12{,}00{,}000} \text{ x } 100$$

= 33.33%

3) Calculation of Market Value of each Equity share

$$\text{Market Value of each Equity Share} = \frac{\text{Expected Rate of Return}}{\text{Normal Rate of Return}} \text{ x Paid up value for Eq. sh.}$$

$$= \frac{33.33}{10} \text{ x } 100$$

= Rs.333

C) Calculation of Fair Value of each Equity share

$$\text{Fair value of each equity share} = \frac{\text{Intrinsic value} + \text{Yield value}}{2}$$

$$= \frac{232 + 333}{2}$$

$$= \frac{565}{2}$$

= Rs.282.5

Fair value of each equity share = Rs.282.5

Check your progress

1) Choose the correct alternative

1. The unit of corporate ownership is a ....

   a) Debenture b) Share c) Bond d) Net Assets

2. An amount noted an each share of company it is called …….......... of the share.

   a) Face value b) Market value c) Intrinsic value d) Fair value

3. ……..... of share means the value which is determined by the market.

a) Intrinsic value b) Market value c) Fair value d) Normal value

4. ……...... is the main factor which affect greatly on the valuation of shares.

a) Dividend yield b) market yield

c) Fair value d) expected rate of earning

5. The valuation is made on the basis of the assets of the company it is called as ……..method.

a) Net Assets b) Market value c) Fair value d) Normal value

6. Intrinsic value of par equity share = $\frac{\text{Net Assets}}{\text{..........}}$

a) Number of pref. shares b) Number of equity shares

c) Number of debenture d) Total capital

7. …… method the valuation depends upon the company's earning capacity.

a) Intrinsic value b) Yield value c) Fair value d) Normal value

8. Yield value of each equity share = $\frac{\text{......................}}{\text{Normal rate of return}}$ × paid up value of each Equity Share

a) Expected rate of earning b) Issues share capital

c) Market value of shares d) Net assets

9. ……… method suggest to average the intrinsic value and market value to give weightage profitability and solvency.

a) Market value b) Fair value c) Intrinsic value d) Paid up value

10. Fair value of each equity share = $\frac{\text{..........}}{2}$

a) Intrinsic value of share + Market value of share

b) Paid up value of share + Yield value of share

c) Market value of share + Face value of shares

d) Dividend yield + Net Assets

2) State True or False.

1. An mount noted an each share of company it is called market value.

2. Market value of shares increase or decrease based on company's performance, rate of dividend, demand and supply of the shares.
3. Net assets is the difference between assets and liabilities.
4. Intrinsic value method is also called as market value method.
5. Net assets = share capital + reserve and surplus – fictitious assets
6. Fair value method of valuation of shares is suitable for small investors as the price they are prepared to pay depends upon the yield
7. To ascertain expected rate of dividend the average profit available for equity shareholder is calculated.
8. Market value of shares gives weightage to profitability.
9. Intrinsic value gives consideration to the net asset backing.
10. Fair value ignore the profitability or solvency of the business while valuing shares.

2.3 Summary

Valuation of shares of company becomes essential on some occasions but the market value of shares is not available, as in case of a private limited company or a proprietorship company (as the shares of private or proprietary companies are not quoted in share market). In some cases the market price does not reflect the true value of shares. Under such circumstances the accountant has to ascertain the value of shares by employing a suitable method. An amount is noted on each share of a company, it is called face value of the shares or par value. On the basis of financial performance and the demand & supply forces of the market the market price of some of the shares is determined at stock exchanges or share market.

2.4 Terms to Remember

a) Net Asset Method or Intrinsic Value Method Or Asset Backing Method

In this method, the net assets of the company are determined and then the figure is divided by the number of shares. The Net Assets include value of Goodwill and non trading assets but excludes fictitious assets and accumulated losses in the Balance sheet. If there are preference shares, the preference capital will be deducted and only the remainder will be available for equity shareholders.

b) Yield or market value method

Under this method, the valuation depends upon the comparison of the company's earning capacity and the normal rate of profit or dividend that is prevailing in the market. Here, the profit means, profit available for equity dividend. It may be termed as average profit or maintainable profit or expected profit.

c) Fair Value Method :

Fair value of share is simply the average of intrinsic value and market value of shares. Total of Intrinsic value of share and yield value of share is found out and this total is divided by two in order to find out fair value, Intrinsic value gives consideration to net assets backing but ignores profitability of concern.

2.5 Answer to check your progress

1) Choose the correct alternative

   1) b , 2) a , 3) b , 4) a , 5) a , 6) b , 7) b , 8) a , 9) b , 10) a

2) State 'True' or 'false'

   1) F , 2)T , 3)T, 4) F, 5) T, 6) F, 7) T, 8) T, 9) T, 10) F

2.6 Exercise

1. What is the need of valuation of shares?
2. Which factors affect the valuation of shares?
3. Explain the term 'Intrinsic Value of Shares'.
4. Which points are to be considered for determination of net asset?
5. Explain in brief methods of valuation of shares.
6. Write the process of calculation of value of equity share under yield value method on the basis of earning or dividend rate.
7. Write the process of calculation of value of equity share under yield value method on the basis of capitalization of profit.
8. Explain fair value of shares.

Net Asset Method

9. From the following information find out the value of each equity share by net asset method.

Balance sheet of 'x' co. Ltd.

As on 31st March 2019

Liabilities	Amount	Asset	Amount
Share capital		Goodwill	3,80,000
20,000 Equity shares of	4,00,000	Investments	6,00,000
Rs.10 each fully paid		Current assets	1,00,000
General reserve	5,00,000	Loans and advances	60,000
Profit and Loss A/c	60,000	Miscellaneous expenditure	20,000
Unsecured liabilities	1,60,000		
Other liabilities	40,000		
	11,60,000		11,60,000

For the purpose of valuation of shares goodwill shall be taken at two years purchases of the average profit of the last five years.

The profit for the last five years are: Rs.1,20,000 Rs.1,40,000 Rs.80,000 Rs.1,00,000 and Rs.1,00,000.

[Hint : Value of equity shares = Rs. 19.40]

10. The following is the summarized Balance sheet of Jay Ltd; as on 31st March 2019

Balance sheet

As on 31st March 2019

Liabilities	Amount	Asset	Amount
1,000 Equity shares of	1,00,000	Goodwill	5,000
Rs.100 each		Building	1,60,000
1,000 Redeemable	1,00,000	Investments	5,000
preference share of Rs.100		Stock	45,000
each		Sundry debtors	20,000
General reserve	15,000	Cash at bank	1,20,000
Profit and Loss A/C	1,05,000	Preliminary expenses	5,000
Sundry creditors	25,000		
Employees saving	10,000		
Woker's compensation fund	5,000		
	3,60,000		3,60,000

On 1st April 2019 all preference shares were redeemed at 10% premium out of divisible profits. Ascertain intrinsic value of each equity shares on the basis of balance sheet immediately after redemption of preference shares.

Adjustment:-

1) Goodwill to be taken at Rs.50,000.
2) 10% of sundry debtors are bad.
3) A claim of compensation to a worker has been admitted on 1st April 2019 for Rs.1,000.
4) All other assets are to be taken at book values.

[Hint: Intrinsic value of each equity share = Rs.252]

11. The balance sheet of Sahara co. Ltd. as on 31st March 2019.

Balance Sheet
As on 31st March 2019

Liabilities	Amount	Assets	Amount
10,000 shares of Rs.100 each	10,00,000	Land and Building	4,40,000
		Plant and Machinery	1,90,000
Profit and Loss A/C	2,00,000	Stock	7,00,000
Creditors	1,80,000	Debtors	3,00,000
Provision for tax	1,00,000		
Proposed dividend	1,50,000		
	16,30,000		16,30,000

The net profit of the company after providing for taxation were-

2014-15 Rs. 1,70,000; 2015-16 Rs.1,92,000; 2016-17 Rs.1,80,000; 2017-18 Rs.2,00,000 and 2018-19 Rs.1,90,000

On 31st March 2019 land and building were revalued at Rs.5,00,000 and plant and machinery of Rs.3,00,000. In view of the nature of business, it is considered 10% is a reasonable return on investment.

Prepare a valuation of the companies each share valuing goodwill at five year purchase of the annual profit.

[Hint : Intrinsic value of each equity share = Rs.166.45]

12. Balance sheet of Sujit Co. ltd. as on 31/03/2019

Balance Sheet

As on 31/03/2019

Liabilities	Amount	Asset	Amount
19,000 Equity shares of Rs.100 each	19,00,000	Goodwill	47,500
		Land and Building	9,50,000
950 6% preference share of Rs.100 each	95,000	Plant and Machinery	11,40,000
		Investments	2,85,000
General reserve	85,500	Stock	47,500
7% Debentures	5,70,000	Sundry debtors	38,000
Sundry creditors	47,500	Bank balance	2,28,000
Provision for tax	28,500	Preliminary expenses	9,500
Bills payable	19,000		
	27,45,500		27,45,500

1) The assets were revalued as:

   Goodwill Rs.95,000 land and building Rs.14,25,000 plant and machinery Rs.9,12,000 market value of investment Rs.2,37,500 debtors after providing for bad debts at 10%.

2) Interest on debentures is outstanding for 6 months.

3) Actual tax liabilities as calculated by the tax consultant is Rs.23,750.

4) Other assets and liabilities have no change in their values.

   You are asked to ascertain the value of each equity share of the company.

[Hint : Intrinsic value of each equity share = Rs. 116]

13. Arati Ltd. presented the following Balance sheet as on 31st march 2019.

Balance Sheet

As on 31st March 2019

Liabilities	Amount	Assets	Amount
900 shares of Rs.100 each	90,000	Land and Building	54,000
Profit and Loss A/c	81,000	Plant and Machinery	1,08,000
Capital Reserve	27,000	Investment in shares	45,000
General Reserve	32,400	Stock	27,000

8% Debenture Sundry creditors	39,600 45,000	Sundry Debtors Bank balance	43,200 37,800
	3,15,000		3,15,000

Additional Information:

1) Land and building and plant and machinery were revalued at 150% and 120% respectively.
2) The value of the shares purchased by company is fallen down by 20% in the market.
3) Stock is valued at Rs.36,000 and debtors subject to a deduction @ 5% for bad debts.
4) Manager's remuneration Rs.1,440 is payable.

Ascertain the Intrinsic value of each share.

[Hint : Intrinsic value of each equity share = Rs. 306]

Yield or Market Value of Shares

14. Following information pertains to 'z' Ltd.

	Rs.
8% 1,000 preference shares of Rs.10 each	1,00,000
25,000 equity share of Rs.100 each	25,00,000
Average annual profits	5,00,000
Income tax	50%
Transfer to reserve	25%
Normal return	10%

Mr. Black the holder of 100 equity shares in the above company assigns you the work of valuating his shareholding. Apply the yield method. **:(S. U. Nov. 2000)**

[Hint : Market value of Equity share= Rs.46.8, Value of Mr. Black holding= Rs. 4680]

15. P. Sharad Ltd. has 50,000 equity shares of Rs.10 each Rs.8 paid. The company transfers 10% of profits to general reserve every year. The expected profit before tax is Rs.10,00,000 and the rate of tax is 65%. Normal rate of dividend is 16%. The 7% preference share capital is Rs.4,00,000 divided into shares of Rs.10 each.

Find out the value of each equity share by yield method.

[**Hint**.: Market value of each Equity share Rs. 35.875]

16. A company has as its capital

1) 1,00,000 'A' Equity share of Rs.1 each fully paid.

2) 1,00,000 'B' Equity share of Rs.1 each 75 paise paid up.

3) 1,00,000 'C' Equity share of Rs.1 each 50 paise paid up.

The normal average net profit less tax of the company is estimated to be Rs.36,000 and estimated rate of capitalization is 8%.

Calculate the value of each class of share.

[Hint : Market Value of

'A' Equity share= Rs. 2 per share

'B' Equity share= Rs. 1.50 per share

'C' Equity share= Rs. 1 per share]

17. The following is the summarized balance sheet of Speed Ltd; as on 31st March 2019.

Balance Sheet
As on 31st March 2019

Liabilities	Amount	Assets	Amount
Share capital		Fixed assets	4,00,000
1,500 Equity shares of Rs.100 each	1,50,000	Stock	1,00,000
		Debtors	1,00,000
3,500 8% preference share of Rs.100 each	3,50,000	Bank	25,000
Profit and Loss A/c	50,000		
Creditors	75,000		
	6,25,000		6,25,000

The net profit of the company for the five years before providing for taxation were:

2015	Rs. 90,000
2016	Rs. 1,00,000
2017	Rs. 90,000
2018	Rs. 75,000
2019	Rs. 50,000

Another company engaged in the same type of business pay a dividend of 10% and its shares are quoted on the stock exchange at Rs.55. Assuming taxation at 50% and appropriated of 10% of balance to reserve.

Ascertain the value of each equity shares.

[Hint : Market Value of each Equity share = Rs. 56.33]

18. From the following information of Sangam co. Ltd;. Compute the value of its equity share on the basis of –

a) Expected Earning (Dividend)

b) Capitalization

c) Normal rate and number of shares.

Balance Sheet
As on 31st March 2019

Liabilities	Amount	Assets	Amount
650 Equity shares of Rs.100 each	65,000	Fixed assets	91,000
		Current assets	59,800
Reserve and surplus	23,400	Discount on issue of debenture	5,200
10% Debenture	39,000		
Current liabilities	28,600		
	1,56,000		1,56,000

Other information –

1) Average profit before tax is Rs.36,660.

2) Rate of tax is 50%.

3) Every year the company transfers Rs.2,600 to reserve fund.

4) The rate of normal earnings is 12.5%.

[Hint : Market value of each Equity share = Rs. 193.6]

Fair Value Method

19. Following is the balance sheet of XYZ Ltd. as on 31st march 2019.

Balance Sheet
As on 31st march 2019

Liabilities	Amount	Assets	Amount
Issued capital		Fixed assets	2,80,000
20,000 Shares of Rs.10 each	2,00,000	Current assets	77,500
		Discount on issue of debenture	12,500
General Reserve	60,000		
Profit and Loss A/c	10,000		
5% Debenture	55,000		
Current liabilities	45,000		
	3,70,000		3,70,000

On 31st March 2019 the fixed assets was independently valued at Rs.3,00,000 and goodwill Rs.22,500.

The average net profit of the company for last three year was Rs.25,000 out of which 12% was transferred to reserve, this proportion being considered reasonable in industry in which the company is engaged and where a normal rate of return may be taken at 10%.

Calculate the fair value of share. **(S. U. April 2015)**

[Hint : Intrinsic value of each equity share = Rs.15

Market value of each equity share = Rs. 11

Fair value of each equity share = Rs. 13]

20. Following is the balance sheet of Janta Ltd, as on 31.03.2019.

Balance Sheet

As on 31.03.2019

Liabilities	Amount	Assets	Amount
Issued capital		Debtors	2,25,000
1,00,000 Shares of Rs.10 each	10,00,000	Stock (market value Rs.7,50,000)	7,25,000
General Reserve	2,50,000	Plant	5,30,000
Profit and Loss A/c	1,65,000	Premises	5,60,000
Bank overdraft	1,50,000		
Creditors	2,25,000		
Provision for tax	1,00,000		
Depreciation fund on plant	50,000		
Workman saving A/c	1,00,000		
	20,40,000		20,40,000

1) Following are the re-valued amounts of assets goodwill Rs.7,75,000 plant Rs.5,50,000 premises Rs.6,00,000.

2) Net profit of the company after taxation but before deduction amount of dividend.

   31.03.2017 Rs.3,50,000

   31.03.2018 Rs.4,25,000

   31.03.2019 Rs.5,00,000

3) Transfer of general reserve during the year Rs.5,000.

4) Normal profit in the same type of the business is 10%.

   Calculate Fair Value of each Equity share.

[Hint : Intrinsic value of each equity share = Rs.23.25

Market value of each equity share = Rs. 42

Fair value of each equity share = Rs. 32.625]

2.7 Reference for further study

1. Gupta, R.L.; Radhaswamy, M.; Finanacial Accounting Volume- II, S.Chand and Co., New Delhi
2. Jain, S.P.; Narang, K.L.,Advanced Accountancy, Kalyani Publishers, New Delhi.
3. Dr. Maheshwari S.N. and Dr. Maheshwari S.K., ‘Studies in Advanced Accountancy, Sultan Chand and Sons, New Delhi.

❑❑❑

Unit-3

Preparation of Final Accounts of Companies

Index :

3.0 Objectives-

After studying this unit you will be able to:

1. understand the provisions of and format in which the final accounts of a company are prepared;
2. explain the concepts used in final accounts of a company;
3. find relationship between different concepts used in final accounts of a company.

3.1 Introduction-

We have studied the rules, regulations and practice of issue, forfeiture, re-issue of forfeited shares and redemption of Preference Shares of a company. We have also studied the issue and redemption of debentures of the company. Now it is to study how these items appear in the final accounts. For this purpose, we are to study how to prepare final accounts of a company. These final accounts are prepared at the end of each financial year. The principles and procedure of preparation of final accounts of a company are same as to that of other organisations. However, they are to be prepared in a format as given in the Companies Act, 2013.

These financial statements are prepared on the accrual basis of accounting. The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for that foreseeable future.

It is to note that the provisions of The Companies Act, 2013 regarding preparation of financial statements are not applicable to insurance, banking and electricity companies as these companies are governed by the special acts.

The objective of financial statements is to provide information about the financial position, performance and cash flows of an entity to the interested parties. They are present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their different needs.

3.2 Presentation of Subject matter

All companies are to prepare their financial statements each year in the form prescribed in Schedule III of section 129 of The Companies Act, 2013. They are Balance Sheet (Part –I) and Profit and Loss Account (Part-II). The profit and loss account shows either profit or loss which is the operating result; whereas, the balance sheet shows financial position of the company. These statements shall give a true and fair view of the state of affairs of the company. For this purpose the company must comply with the accounting standards notified under section 133. It is mandatory to the company to present its financial statements before the shareholders at the time of annual general meeting of the company.

3.2.1 Schedule of Balance Sheet

Schedule-III

PART I — BALANCE SHEET

(Section 129 of Companies Act, 2013)

Name of the Company……………………

Balance Sheet as at ………………………

Particulars	Note No.	Current Year ₹	Previous Year ₹
1	2	3	4
I. EQUITY AND LIABILITIES			
(1) **Shareholders' funds**			
(a) Share Capital	XX	XXX	XXX
(b) Reserves and Surplus	XX	XXX	XXX
(c) Money received against share warrants	XX	XXX	XXX
(2) **Share Application money pending allotment**	XX	XXX	XXX
(3) **Non-current Liabilities**			
(a) Long-term borrowings	XX	XXX	XXX
(b) Deferred tax liabilities (Net)	XX	XXX	XXX
(c) Other Long term liabilities	XX	XXX	XXX
(d) Long-term provisions	XX	XXX	XXX
(4) Current Liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
TOTAL		XXXX	XXXX

II ASSETS	XX	XXX	XXX
Non-current Assets	XX	XXX	XXX
(1) (a) Fixed assets	XX	XXX	XXX
(i) Tangible assets	XX	XXX	XXX
(ii) Intangible assets	XX	XXX	XXX
(iii) Capital work-in-progress	XX	XXX	XXX
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long-term loans and advances			
(e)Other Non-Current Assets	XX	XXX	XXX
	XX	XXX	XXX
(2) **Current assets**	XX	XXX	XXX
(a) Current investments	XX	XXX	XXX
(b) Inventories	XX	XXX	XXX
(c) Trade receivables	XX	XXX	XXX
(d) Cash and cash equivalents			
(e) Short-term loans and advances			
(f) Other current assets			
TOTAL		XXXX	XXXX

See accompanying notes to the financial statements

Accompanying Notes to the Financial Statements-

In order to fulfill the need of different stakeholders, these statements must be readily understandable to them. For this purpose, notes on items involved in these statements are to be accompanied to these statements. Therefore, notes of each item of assets and liabilities, income and expenditure are to be given separately as per requirement as explained hereafter:

1. **Shareholders' funds** is also known as shareholders' equity, shareholders' fund proprietors' fund, proprietors' equity, owners' fund or owners' equity. It refers to the sum of Share capital and reserves and surplus

A. **Share capital** –Share Capital should be classified as:

Authorised Capital- Authorised capital in all types of shares- Number and **Issued, Subscribed and Paidup** - amount of shares Issued, Subscribed and fully paid and, Subscribed but not fully paid-

Number of shares with par value per share

Shares issued for other than cash,

Calls unpaid

Forfeited Shares (Amount originally paid up)

Money received against share warrants

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–(specifying the nature and purpose of each reserve and its amount);

(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.;

Debit balance of statement of profit and loss shall be shown as a negative figure under the head —'Surplus'. Similarly, the balance of —Reserves and Surplus, after adjusting negative balance of surplus, if any, shall be shown under the head —Reserves and Surplus, even if the resulting figure is in the negative.

2. 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 and nature of security

(iii) Where loans have been guaranteed by directors or others,

(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,

(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.

3. **Other Long-term Liabilities** -Other Long-term Liabilities shall be classified as:

(a) Trade payables;

(b) Others.

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

(a) Provision for employee benefits;

(b) Others (specify nature).

5. **Current Liability** - The liability which satisfies any of the following criteria is called current liability.

(a) it is to be settled within the period of one accounting period;

(b) it is held for the purpose of trade;

6. 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 and nature of security

(iii) Where loans have been guaranteed by directors or others,

(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.

7. 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 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).

8. **Short-term provisions** -The amounts shall be classified as:

   (a) Provision for employee benefits.

   (b) Others (specify nature).

9. **Non-Current Assets-** Fixed assets are termed as non-current assets. All assets which, are not current assets, shall be classified as fixed or non-current. These assets are held for more than one accounting year. In other words, benefit from such assets can be enjoyed for more than one accounting year. Generally, the cost of acquisition of such assets is comparatively more than that of current assets.

10. **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 shown separately

11. **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, patents, trademarks and other intellectual property rights;

(g) Recipes, formulae, models, designs and prototypes;

(h) Licences and franchise;

(i) Others (specify nature).

12. Non-current investments

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

(a) Investment in 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).

(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.

13. 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

14. 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) Secured, considered good;

   (B) Unsecured, considered good;

   (C) Doubtful

15. Current Asset - The asset which satisfies any of the following criteria is called current asset.

(a) it is to be realised or consumed within the same accounting year.

(b) it is held for the purpose of trade;

(c) it is to be sold within the same accounting year

(d) it is cash or cash equivalent.

16. Current Investments

(i) Current investments shall be classified as:

   (a) Investments in Equity Instruments;

   (b) Investments in Preference Shares;

   (c) Investments in Government or trust securities;

   (d) Investments in debentures or bonds;

(e) Investments in Mutual Funds;

(f) Investments in partnership firms;

(g) Other investments (specify nature).

(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.

17. 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.

18. 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.

19. 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).

20. 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.

21. Other current assets (specify nature)

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

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

(i) Contingent liabilities shall be classified as:

(a) Claims against the company not acknowledged as debt;

(b) Guarantees;

(c) Other money for which the company is contingently liable.

(ii) Commitments shall be classified as:

(a) Estimated amount of contracts remaining to be executed on capital account and not provided for;

(b) Uncalled liability on shares and other investments partly paid;

(c) Other commitments (specify nature).

23. **Net Worth** means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

Check your Progress - 1

1. Balance Sheet of a company prepared in …….
2. Section …….. of The Companies Act, 2013 is applicable for preparation of the Balance Sheet of a company
3. The objective of Balance Sheet is to provide information about …….. of a company.
4. The objective of Profit and Loss Account is to provide information about …….. of a company.
5. Shareholders' Fund refers to the sum of **………**and reserves and surplus.
6. Shareholders' Fund refers to the sum of share capital and……and …….. .
7. Goodwill and Trade Marks are ………. asset.
8. Computer Software is ………. asset.
9. Office Furniture is ………. asset.
10. Claims against the company not acknowledged as debt is …………….liability.

3.2.2 Schedule of Profit and Loss Statement

In case of a company, trading and profit and loss account are not prepared separately; only a statement of profit and loss is prepared which shows operating result - profit or loss. The income and loss from other activities are shown separately in the profit and loss statement. Net result of statement of profit and loss (i.e. profit or loss for the period) is taken to balance sheet under sub-head 'Surplus' under the head 'Reserves and Surplus'.

Schedule-III

PART II – STATEMENT OF PROFIT AND LOSS

(Section 129 of Companies Act, 2013)

Name of the Company…………………….

Profit and loss statement for the year ended ………………………

Particulars	Note No.	Current Year ₹	Previous Year ₹
1	2	3	4
I . Revenue from Operations	XX	XXX	XXX
II. Other Income	XX	XXX	XXX
III. Total Revenue (I + II)			
IV. Expenses:			
Cost of materials consumed (in case of	XX	XXX	XXX
Manufacturing concern)	XX	XXX	XXX
Purchases of Stock-in-Trade	XX	XXX	XXX
Changes in inventories of finished goods	XX	XXX	XXX
work-in-progress and Stock-in-Trade	XX	XXX	XXX
Employee benefits expense	XX	XXX	XXX
Finance costs	XX	XXX	XXX
Depreciation and amortisation expense	XX	XXX	XXX
Other expenses		XXX	XXX
Total expenses			
V. Profit before tax (III- IV)		XXX	XXX
VI. Tax expense (Tax on Profit) :		XXX	XXX
VII. Profit (Loss) for the period (V - VI)		XXX	XXX

See accompanying notes to the financial statements

The Companies Act requires that the profit and loss account must exhibit true and fair view of the profit earned or loss suffered by the company during the accounting year. Therefore, it is necessary to –

i) disclose in full all material facts under most convenient heads

ii) show separately the prior period items and extraordinary claims

iii) show separately the change in accounting policy and its impact on profit /loss.

From this point of view following items are need to show in detail as notes, while preparing the profit and loss statement.

1. **Revenue from operations** consists of —

(a) Sale of products;

(b) Sale of services;

(c) Other operating revenues;

Less: Excise duty.

This is to be disclosed separately in the notes

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

(a) Interest; and

(b) Other financial services.

Revenue under each of the above heads shall be disclosed separately by way of notes.

2. **Other Income -**Other income shall consist of:

(a) Interest Income (in case of a company other than a finance company);

(b) Dividend Income;

(c) Net gain/loss on sale of investments;

(d) Other non-operating income (net)

3. **Employee Benefit Expense -**This consists of:

(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

4. **Finance Costs -**Finance costs shall be classified as:

(a) Interest expense (paid/payable);

(b) Interest on borrowings;

(c) Applicable net gain/loss on foreign currency transactions.

5. **Surplus Account-** In this surplus A/c all appropriations of profits are shown as under.

Balance of surplus (from last year) at the beginning of the year			xxxx
Add: Profit for the year			xxxx
	Total		xxxx
Less:	Adjustments relating to previous year- shortfall of		
	Provision for tax etc.	xxx	
	Transfer to General Reserve	xxx	
	Proposed Dividend	xxx	
	Interim Dividend	xxx	xxxx
Balance of Surplus taken to Balance Sheet			xxxx

6. **Divisible Profits**- The term divisible profit as per section123 of the Companies Act, 2013 refers to the profit available for declaration of dividend to the shareholders. Following points should be kept in mind in order to arrive at divisible profit.

   1. The profit must be arrived at from regular business operations.
   2. It must be excess of income over expenditure. That means it must be revenue profit.
   3. The profit arrived from revaluation of assets and liabilities is capital profit and it is not divisible profit.
   4. The profit must be arrived at after depreciation on fixed assets.
   5. The company may transfer its profit for the year to the reserves at appropriate percentage.
   6. Free reserves can be used as divisible profit.

7. **Dividend-** As we have seen earlier, declaration and payment of dividend is governed by Sec. 123 of the Companies Act, 2013. Dividend is the amount of

profit distributed among shareholders. It is the return on investment in shares of a company. The Board of Directors of the company declare dividend and it is passed by the shareholders in the annual general meeting. The amount of dividend can be reduced but cannot exceed the amount declared by the Board of Directors. The dividend is paid to shareholders on the paid up amount of shares held by them.

The dividend can be paid out of current profits, out of past reserves and/or out of money provided by the Government. Utmost care is taken that the dividend declared and paid must not result in payment out of capital.

The amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

Types of Dividend- Dividend can be of two types Viz. interim and final dividend.

Interim Dividend- The dividend declared in between two annual general meetings is called interim dividend. The Board of Directors after considering future prospects of the profit of the company can declare and pay interim dividend. The rate of interim dividend depends upon estimated by and opinions of the board of directors. It is appropriation of profit. It is deducted from surplus. Interim dividend does not create a debt against the company and it can be revoked or reduced.

Final Dividend- A dividend declared at the annual general meeting of the shareholders is called final dividend. It is recommended by the Board of Directors and passed by the shareholders at their annual general meeting. Final dividend depends upon information shown by the final statements of accounts. It is provided for in the final accounts of the company. It is paid only after passed at annual general meeting. Once the final dividend is declared it creates debt against the company.

Dividend on Preference shares- Preference Shareholders enjoy preferential right over the equity shareholders in respect of payment of dividend. They are paid dividend at fixed rate as prefixed to their name. Eg. 8% Preference Shares. This implies that the rate of preference divided is 8%. Preference dividend is paid only if there is adequate amount of profit in that year. If there is inadequate amount of profit to pay dividend the non-cumulative preference shareholders cannot claim dividend in subsequent years whenever there is sufficient profit in future. The holders of the cumulative preference shares can claim the unpaid dividend in any subsequent year/s when there are sufficient profits. Arrears of dividend on cumulative preference shares are shown as a contingent liability.

The amount of dividend is deducted from surplus as shown earlier. It is shown in the balance sheet under the head 'Current Liabilities', sub-head 'Short Term Provisions'.

8. **Income Tax on Dividends-** The Company has to deduct income tax at prescribed rate on dividend and pay it to the Government. This is in addition to the tax paid by the company on its profit. Gross amount of dividend is deducted from surplus and the tax on it at prescribed rate is to be paid to the Government and the net amount of dividend is to be paid to the shareholders. The company must send a return to the income tax authority showing the amount deducted as tax from dividend. Also the company has to give certificate of income tax deducted to each shareholder. A Company can give tax-free dividend to its shareholders. However, in such case the company is to pay tax on dividend and gross dividend and tax paid is to deduct from surplus.

9. **Provision for Tax-** A Company is to pay tax on its profit. This tax is charged on the profit for the accounting year. However, the profit is assessed and actual tax liability is determined in the following year. Till then, it is necessary, on the part of the company, to make provision for tax on the basis of accounted profit. Therefore, the taxable profit and the accounted profit may differ from each other. The amount of provision for tax is charged to profit and loss statement by way of deduction from 'Profit Before Tax' and it is shown in balance sheet under the head 'Current Liabilities', sub-head 'Short Term Provisions'.

10. **Managerial Remuneration**

As per section 197 of the companies Act, 2013 total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed **eleven per cent** of the net profits of that company for that financial year before deduction of such remuneration (section 198). The company in general meeting may, with the approval of the Central Government, authorise the payment of remuneration exceeding eleven per cent of the net profits of the company

As per the section 198 and other related sections, remuneration shall include:

(a) any expenditure incurred by the company on rent-free accommodation and on amenities therein for any of the managerial personnel;

(b) any expenditure incurred by the company in providing any amenities or benefits free of cost or at concessional rate to them;

(c) any expenditure incurred by the company in respect of any obligations of the managerial personnel;

(d) any expenditure incurred by the company on insurance on life, provide any pension, annuity of gratuity for any of the managerial personnel or his/her spouse or child.

However, this will not include any fees to the director for attending meeting of the board or a committee.

In case of negative or inadequate profits, the company may pay remuneration to the managerial personnel by way of salary, dearness allowance, perquisites and any other allowances as per Part II of Schedule-V as given below.

Where the effective capital is	**Limit of yearly remuneration payable shall not exceed (Rupees)**
(i) Negative or less than 5 crores	30 lakhs
(ii) 5 crores and above but less than 100 crores	42 lakhs
(iii) 100 crores and above but less than 250 crores	60 lakhs
(iv) 250 crores and above	60 lakhs *plus* 0.01% of the effective capital in excess of Rs. 250 crores:

Provided that the above limits shall be doubled if the shareholders pass special resolution.

Check your Progress -2

(A) Fill in the blanks with appropriate word.

1. Profit and Loss statement of the company is prepared as per……….
2. Section …….. of The Companies Act, 2013 is applicable for preparation of the Statement of Profit and Loss of a company
3. The objective of the statement of Profit and Loss is to provide information about …….. of a company.
4. Preference Shareholders enjoy preferential right over ….. in respect of payment of………. and repayment of share capital.
5. The term Employee Benefits Expenses refers to payments to …………including……….. .

(B) State whether the following statements are true or false.

1. Tax on dividend is tax in addition to the tax paid by the company on its profit.
2. Managerial Remuneration in any financial year shall not exceed eleven per cent of the net profits of the company for that financial year before deduction of such remuneration.
3. The rate of preference dividend is not fixed.
4. A dividend declared at the annual general meeting is called interim dividend.
5. Other income consists of income earned by way of sources other than income from operations.

(C) Chose the correct alternative.

1. Once the final dividend is declared, it becomes ……… the company.

   a. liability to b. debt to c. payable by d. all

2. Dividend is declared when there is sufficient ………… .

   a. sale b. credit period c. profit d. non of these

3. Revenue from operation refers to ………. .

a. income from main business	b. interest on deposits
c. profit on sale of asset	d. rent received

4. All appropriations are shown in the ……….account.

a. Revenue A/c	b. Surplus A/c
c. Capital A/c	d. all of these

5. Operating profit does not include ………. income.

a. rent received	b. dividend received
c. profit on sale of investment	d. all of these

3.2.3 Illustrations on Company Final Accounts :

Illustration-1 : Following particulars from the books of The Legend Company Ltd. are available for the year ended on 31-3-2019:

Particulars	Dr. ₹	Cr. ₹
Purchases	5,00,500	
Selling expenses	75,000	
Stock on 1-4-2018	1,49,300	
Salaries and wages	66,500	
Interest on Bank Overdraft	9,300	
Interest on Debentures up to 30-9-2018	3,750	
Dividends		4,250
Surplus A/c (1-4-2018)		30,500
Sales (Net)		7,53,700
Audit fees	15,000	

a) Closing stock was valued at Rs. 1,45,500.

b) Rs. 6,000 worth of goods distributed as free sample.

c) Salaries and wages include Directors' remuneration Rs. 10,000.

d) Interest on debentures for the half year ending on 31-3-2019 was due Rs. 3,750.

e) Provide for depreciation on premises and furniture Rs. 3,800

e) Provide for taxation @ 50% of profit.

You are required to prepare –

1) The Statement of Profit and Loss for the year ended 31-3-2019 alongwith accompanying notes.

Solution-

Legend Company Ltd.,

Statement of Profit and Loss

for the year ended 31st March

Ref No.	Particulars	Note No.	2019 ₹	2018 ₹
	1) Revenue from Operations	1	7,53,700	
	2) Other Income		4,250	
	3) Total Revenue (1+2)		7,57,950	
	4) Expenses			
	Cost of Goods Sold	2	4,98,500	
	Employee Benefits Expense	3	56,500	
	Finance Costs	4	16,800	
	Depreciation	5	3,800	
	Other Expenses	6	1,06,000	
	Total Expenses		6,81,600	-
	5) Profit before tax (3-4)		76,350	
	6) Provision for Tax 50% of profit		38,175	
	7) Profit and Loss for the Period (5-6)		38,175	

Accompanying notes to the Statement of Profit and Loss -

1) Revenue from Operations:

Particulars	31-3-2019 ₹	31-3-2018 ₹
Sales (Net)	7,53,700	-

2) Cost of Goods Sold:

Opening Stock		1,49,500	
Add: Purchases	5,00,500		
Less: Goods Distributed as Free Samples	6,000	4,94,500	

	6,43,000 1,45,500	-
Less: Closing Stock	4,98,500	-

3) Employee Benefit Expenses:

Salary and Wages (66,500-10,000)	56,500	-

4) Finance Cost:

Interest paid on Overdraft		9,300	
Interest on Debentures	3,750		
Outstanding of Interest	3,750	7,500	
Total		16,800	-

5) Depreciation:

Furniture and Fixtures	3,800	-

6) Other Expenses:

Selling Expenses	75,000	
Audit Fee	15,000	
Advertisement - Goods Distributed as Free Sample	6,000	
Directors Remuneration	10,000	
Total	1,06,000	-

7) Surplus:

Surplus (1-4-2018)	30,500	
Profit for the year	38,175	
To be taken to Reserve and Surplus	68,175	-

Illustration-2 : The authorised capital of Roxy Company Limited is Rs. 5,00,000 consisting of equity shares of Rs. 10 each. Following was the extract of Trial Balance of the company as on 31-3-2019:

Particulars	Dr. ₹	Cr. ₹
Investment at cost	1,00,000	
Cash on hand	53,000	
Bills Receivable	55,800	
Sundry Debtors and Creditors	55,100	90,500
Freehold property at cost	5,10,500	
Depreciation Reserve		15,000
Equity Share Capital fully paid up		4,00,000
5% Debentures		1,50,000
Bank Overdraft		1,50,000
Total		

Stock on 31/03/2019 was valued at Rs. 1,45,500.
Outstanding Interest on Debentures is provided for Rs. 3,750

Provision for tax was made @ 50% of net profit at Rs. 38,175

Depreciation was provided Rs. 3,800

Surplus after making all above adjustments was resulted at Rs. 68,675

You are required to prepare –

1) Balance Sheet as on 31-3-2019 along with required notes. (10)

Solution-

Roxy Company Ltd.
Balance Sheet
As on 31-3-2019

Ref. No.	Particulars	Note No.	31-3-2019 ₹	31-3-2018 ₹
I	**EQUITY AND LIABILITIES** 1) Shareholders' Funds Share Capital	A	4,00,000	

	Reserve and Surplus	B	68,675	
	2) Non-Current Liabilities			
	Long-term Borrowings	C	1,50,000	
			1,50,000	-
	3) Current Liabilities			
	Trade Payables (Creditors)		90,500	
	Other Current Liabilities	D	1,53,750	
	Short-term Provisions	E	38,175	
	Total Equity and Liabilities (1+2+3)		9,01,100	-
II	**ASSETS**			
	Non Current Assets			
	1) Fixed Assets			
	Tangible Assets	F	4,91,700	
	Non Current Investments	G	1,00,000	
			5,91,700	-
	2) Current Assets			
	Inventories	H	1,45,500	
	Trade Receivables	I	1,10,900	
	Cash and Cash Equivalents	J	53,000	
	Other Current Assets	K	-	
			3,09,400	
	Total of All Assets (1+2)		9,01,100	

Accompanying Notes to the Balance Sheet-

A) Share Capital:

Particulars	31-3-2019 ₹	31-3-2018 ₹
a) Authorised Capital 50,000 Equity Shares of Rs. 10 each	5,00,000	
b) Issued, Subscribed and Paid-up Capital 40000 Equity Shares of Rs. 10 each fully paid	4,00,000	
Total		-

B) Reserve and Surplus:

Surplus	68,675	-

C) Long-term Borrowings:

5% Debentures	1,50,000	-

D) Other Current Liabilities:

Bank Overdraft	1,50,000	
Interest Outstanding on Debentures	3,750	
Total	1,53,750	-

E) Short-term Provisions:

Provisions for Tax	38,175	-

F) Tangible Assets:

Freehold Property at Cost	5,10,500	
Less: Depreciation Provision (15000 +3800)	18,800	
Total	4,91,700	-

G) Non-Current Assets:

Investment at cost	1,00,000	

H) Inventories:

Closing Stock	1,45,500	

I) Trade Receivables:

Sundry Debtors	55,100	

Bills Receivable	55,800	
Total	1,10,900	-

J) Cash and Cash Equivalents:

Cash on hand	53,000	-

Illustration-3 : The Paid-up Capital of the IBN Distributors Ltd. is – Rs. 3,00,000 3% Preference Shares Capital and Rs. 2,25,000 Equity Shares Capital. Following balances are extracted from the books of the company for the year ended on March 31, 2019:

Particulars	₹	Particulars	₹
Salaries	1,05,000	Purchases	4,77,100
Surplus Account (Cr.)	58,500	Freight and carriage inward	3,750
Distribution expenses	1,02,000	Debenture Interest (for half year)	5,250
Rent and rates	48,000		
General expenses	12,000	Stock on 1st April, 2018	1,40,500
Sales	9,18,000	Preference Dividend Paid	9,000
		Shares forfeited account	2,000

a) The value of stock on March 31, 2019 was Rs. 2,15,000.

b) Depreciation on freehold properties is to be provided at 2.5% on its cost Rs. 3,40,000 and on furniture at 6% on Rs. 84,000.

You are required to prepare the Statement of Profit and Loss of the company for the year ended on 31st March, 2019.

Solution-

IBN Distributors Ltd.,

Statement of Profit and Loss

for the year ended 31st March, 2019

Ref No.	Particulars	Note No.	31-3-2019 ₹	31-3-2018 ₹
	1) Revenue from Operations	1	9,18,000	
	2) Other Income		NIL	
	3) Total Revenue (1+2)		9,18,000	-

	4) Expenses			
	Cost of Goods Sold	2	4,06,350	
	Employee Benefits Expense	3	1,05,000	
	Finance Costs	4	10,500	
	Depreciation and Administrative Expenses	5	13,540	
	Other Expenses	6	1,62,000	
	Total Expenses		6,97,390	-
	5) Profit before tax (3-4)		2,20,610	-

Accompanying notes to the Statement of Profit and Loss -

1) Revenue from Operations:

Particulars	31-3-2019 ₹	31-3-2018 ₹
Sales	9,18,000	-

2) Cost of Goods Sold:

Opening Stock	1,40,500		
Add: Purchases	4,77,100		
Freight and Carriage Inwards	3,750	6,21,350	
Less: Closing Stock		2,15,000	
		4,06,350	-

3) Employee Benefit Expenses:

Salaries	1,05,000	-

4) Finance Cost:

Debentures Interest	5,250	
Add: Outstanding for ½ year	5,250	
Total	10,500	-

5) Depreciation:

Depreciation on Premises (@ 2.50% an Rs. 3,40,000)	8,500	
Depreciation on Furniture (@ 6% an Rs. 84,000)	5,040	
Total	13,540	-

6) Other Expenses:

Distribution Expenses	1,02,000	
Rent and Rates	48,000	
General Expenses	12,000	
Total	1,62,000	-

Illustration-4 : The authorised capital of IBN Distributors Ltd. is Rs. 7,50,000 consisting of 3,000 6% cumulative preference shares of Rs. 100 each and 45,000 equity shares of Rs. 10 each. Following balances are extracted from the books of the company for the year ended on March 31, 2019:

Particulars	₹	Particulars	₹
Paid-up Capital:		Furniture at cost	84,000
3,000 6% Preference Shares	3,00,000	Bills receivable	16,000
		Investments in Shares	60,000
30,000 Equity Shares (Rs. 7.5 paid)	2,25,000	Bills Payables	22,250
		Balance at bank	90,000
Goodwill	1,50,000	Cash in hand	1,42,650
5% Debentures	2,10,000	Shares forfeited account	2,000
Trade debtors	1,67,500	Surplus Account (Cr.)	58,500
Trade creditors	1,25,000	Preference Dividend Paid	9,000
Freehold properties at cost	3,40,000		
General Reserve	82,000		
Provision for taxation	10,000		

a) The value of stock on March 31, 2019 was Rs. 2,15,000.

b) Depreciation on freehold properties is to be provided at 2.5% and on furniture at 6%.

c) Debenture interest is payable for half year.

d) The directors proposed 10% dividend on equity shares. Corporate dividend tax need not to provide.

e) Surplus after incorporating all above adjustments but before tax was Rs. 2,20,610.

You are required to prepare only the Statement of Balance Sheet of the company as on 31st March, 2019.

Solution-

The IBN Distributors Ltd.

Balance Sheet as on 31-3-2019

Ref. No.	Particulars	Note No.	31-3-2019 Rs.	31-3-2018 Rs.
I	EQUITY AND LIABILITIES			
	1) Shareholders' Funds			
	Share Capital	A	5,27,000	
	Reserve and Surplus	B	3,29,610	
			8,56,610	-
	2) Non-Current Liabilities			
	Long-term Borrowings	C	2,10,000	-
	3) Current Liabilities			
	Trade Payables (Creditors)			
	Other Current Liabilities	D	1,52,500	
	Short-term Provisions	E	32,500	
			1,85,000	-
	Total Equity and Liabilities (1+2+3)		12,51,610	-
II	ASSETS			
	1) Non Current Assets			
	a) Fixed Assets			
	Tangible Assets	F	4,10,460	
	Intangible Assets	G	1,50,000	
	b)Non Current Assets	H	60,000	
			6,20,460	-

	2) Current Assets			
	Inventories	I	2,15,000	
	Trade Receivables	J	1,83,500	
	Cash and Cash Equivalents	K	2,32,650	
	Other Current Assets	L	NIL	
			6,41,150	-
	Total of All Assets (1+2)		12,51,610	-

Accompanying notes to the Balance Sheet -

A) Share Capital:

Particulars	31-3-2019 Rs.	31-3-2018 Rs.
a)Authorised Capital		
3,000 3% Preference Shares of Rs. 100 each	3,00,000	
4,500 Equity Shares of Rs. 10 each	4,50,000	
b)Issued, Subscribed and Paid-up Capital		
3,000 3% Preference Shares of Rs. 100 each fully paid	3,00,000	
30,000 Equity Shares of Rs. 10 each, Rs. 7.50 per share called and paid	2,25,000	
	5,25,000	
Share Forfeited Account	2,000	
Total	5,27,000	-

B) Reserves and Surplus:

General Reserve		82,000	
Surplus as on 1-4-2018	58,500		
Add: Profit for the year	2,20,610		
	2,79,110		
Less: Proposed Dividend	22,500		
Preference Dividend Paid	9,000		-
Total		2,47,610	
		3,29,610	-

C) Long-term Borrowings:

5% Debentures	2,10,000	-

D) Other Current Liabilities:

Trade Creditors	1,25,000	
Interest Outstanding on Debentures for the ½ year		
(5% p.a. on Rs. 2,10,000 = 10,500 x ½ year)		
Bills Receivable	5,250	
Total	22,250	
	1,52,500	-

E) Short-term Provisions:

Provisions for Taxation	10,000	
Proposed Dividend	22,500	
Total	32,500	-

F) Tangible Assets:

Freehold Property at Cost	3,40,000		
Less: Depreciation @ 2.50% p.a.	8,500	3,31,500	
Furniture at cost	84,000		
Less: Depreciation @ 6% p.a.	5,040	78,960	
Total		4,10,460	-

G) Intangible Assets:

Goodwill	1,50,000	-

H) Non Current Investments:

Investment in Shares	60,000	-

I) Inventories:

Closing Stock	2,15,000	-

J) Trade Receivables:

Trade Debtors	1,67,500	
Bills Receivables	16,000	
Total	1,83,500	-

K) Cash and Cash Equivalents:

Balance at Bank	90,000	
Cash in hand	1,42,650	
Total	2,32,650	-

Illustration-5 : Following balances have been extracted from the books of Jain Co. Ltd. as on 31-3-2019.

Particulars	Rs.	Particulars	Rs.
Cost of goods sold	3,10,000	Income from Investment	12,000
Salaries	12,000	Provision for bad debts	2,000
Contribution to EPF	3,000	Sales	4,50,000
wages	5,000	Surplus Account 1-4-2018	3,500
Miscellaneous Expenses	8,000		
Interest paid	3,000		
Bad Debts	1,000		
Repairs and maintenance	1,500		

Following particulars may be taken into account:

a) Provision for doubtful debts is to be made at 5% on Rs. 1,50,000 of debtors.

b) Provision for taxation is to be made at 50%.

c) The Managing Director is entitled to a remuneration of Rs. 5,500.

d) Depreciation @ 2% on cost of building and at 10% on the cost of furniture is to be charged. The cost of Building is Rs. 1,75,000 and that of Furniture is Rs. 25,000.

1) Prepare Statement of Profit and Loss for the year ended 31st March, 2019.

Solution-

Jain Company Ltd.,

Statement of Profit and Loss

for the year ended 31st March, 2019

Ref No.	Particulars	Note No.	31-3-2019 Rs.	31-3-2018 Rs.
	I) Revenue from Operations	1	4,50,000	
	II) Other Income – From Investment		12,000	
	III) Total Revenue (I+II)		4,62,000	-
	IV) Expenses			
	Cost of Goods Sold	2	3,10,000	
	Employee Benefits Expense	3	20,000	
	Finance Costs	4	3,000	
	Depreciation and Administrative Expenses	5	6,000	
	Other Expenses	6	21,500	
	Total Expenses		3,60,500	-
	V) Profit before tax (III-IV)		1,01,500	
	VI) Provision for tax @ 50% of profit		50,750	
	VII) Profit after tax for the year (V-VI)		50,750	

Accompanying notes to the Statement of Profit and Loss -

1) Revenue from Operations:

Particulars	31-3-2019 Rs.	31-3-2018 Rs.
Sales	4,50,000	-

2) Cost of Goods Sold:

	3,10,000	-

3) Employee Benefit Expenses:

Salaries	12,000	
Contribution to EPF	3,000	
Wages	5,000	
Total	20,000	-

4) Finance Costs:

Interest Paid	3,000	-

5) Depreciation:

Depreciation on Building (@ 2% on Rs. 1,75,000)	3,500	
Depreciation on Furniture (@ 10% on Rs. 25,000)	2,500	
Total	6,000	-

6) Other Expenses:

Miscellaneous Expenses		8,000	
Bad Debts	1,000		
Add: Provision for doubtful debts	7,500		
	8,500		
Less: Existing (Old) Provision for			-
Bad Debts	2,000	6,500	
Repairs and Maintenance		1,500	
Managing Directors' Remuneration		5,500	
Total		21,500	-

Illustration-6 : Following balances have been extracted from the books of Adinath Fort Co. Limited as on 31-3-2019.

Particulars	Rs.	Particulars	Rs.
Freehold Land	1,70,000	Creditors	30,000
Goodwill	30,000	Depreciation Reserve on 1-4-2018	
Buildings (Cost)	1,75,000		
Furniture (Cost)	25,000	Building	15,000
Debtors	1,50,000	Furniture	6,000
Stock (on 31-3-2019)	60,000	Suspense	6,000
Cash at Bank	5,000	Equity Share Capital	3,66,500
Cash in hand	9,000	9% Preference Shares of	
Advance payment of income-tax	6,000	Rs.100 each	1,00,000
		Securities Premium	10,000
Investment in Shares	1,80,000	Bank Overdraft	52,500
		Term Loan	1,00,000
		Surplus Account 1-4-2018	3,500

Following particulars may be taken into account:

a) Provision for doubtful debts is to be made at 5% of debtors.

b) Equity Share Capital comprised of Rs. 10 shares, fully paid

c) Provision for taxation is to be made at 50%.

d) Market value of investment was Rs. 1,90,000 on 31st March, 2019.

e) The Managing Director is entitled to a remuneration of Rs. 5,500.

f) Depreciation is to be charged on cost of building @ 2% and furniture at 10% p.a.

g) Surplus after considering all above adjustments was Rs. 50,750 .

Prepare Balance Sheet of the company as on 31st March, 2019 as per Schedule- III, Part- I of The Companies Act, 2013.

Solution-

Adinath Fort Co. Limited

Balance Sheet as on 31-3-2019

Ref. No.	Particulars	Note No.	31-3-2019 Rs.	31-3-2018 Rs.
I	**EQUITY AND LIABILITIES**			
	1) Shareholders' Funds			
	Share Capital	A	4,66,500	
	Reserve and Surplus	B	64,250	
			5,30,750	-
	2)Non-Current Liabilities			
	Long-term Borrowings	C	1,00,000	-
	3)Current Liabilities			
	Trade Payables (Creditors)		30,000	
	Other Current Liabilities	D	58,000	
	Short-term Provisions	E	50,750	
			1,38,750	-
	Suspense		6,000	
	Total Equity and Liabilities (1+2+3)		7,75,500	-
II	**ASSETS**			
	1) Non Current Assets			
	a) Fixed Assets			
	Tangible Assets	F	3,43,000	
	Intangible Assets	G	30,000	
	Non Current Investments	H	1,80,000	
			5,53,000	-
	2) Current Assets			
	Inventories	I	60,000	
	Trade Receivables	J	1,42,500	
	Cash and Cash Equivalents	K	14,000	
	Other Current Assets	L	6,000	
			2,22,500	-
	Total of All Assets (1+2)		7,75,500	-

Notes-

A) Share Capital:

Particulars	31-3-2019 Rs.	31-3-2018 Rs.
a) Authorised Capital		
9% Preference Shares of Rs. 100 each	?	?
Equity Shares of Rs. 10 each	?	?
b) Issued, Subscribed and Paid-up Capital		
1,000 9% Preference Shares of Rs. 100 each fully paid	1,00,000	
36,650 Equity Shares of Rs. 10 each fully paid	3,66,500	
Total	4,66,500	-

B) Reserve and Surplus:

Securities Premium		82,000	
Surplus A/c balance (1-4-2018)	3,500		
Current Year Profit (Surplus)	50,750	54,250	
Total		64,250	-

C) Long-term Borrowings:

Term Loan	1,00,000	-

D) Other Current Liabilities:

Bank Overdraft	52,500	
Managing Directors' Remuneration	5,500	
Total	58,000	-

E) Short-term Provisions:

Provisions for Taxation	50,750	

F) Tangible Assets:

Freehold Property at Cost Building at cost 1,75,000 Less: Depreciation until date (15,000 + 3,500) 18,500 Furniture at cost 25,000 Less: Depreciation until date	16,500	- -
(6,000 + 2,500) 8,500 Total	3,43,000	-

G) Intangible Assets:

Goodwill	30,000	-

H) Non Current Investments:

Investment in Shares (Market Value Rs. 1,90,000)	1,80,000	-

I) Inventories:

Stock on 31-3-2019	60,000	-

J) Trade Receivables:

Debtors	1,50,000	
Less: Provision for doubtful debts @ 5%	7,500	
Total	1,42,500	-

K) Cash and Cash Equivalents:

Cash at Bank	5,000	
Cash in hand	9,000	
Total	14,000	-

I) Short term Loans and Advances:

Advance Payment of Income Tax	6,000	-

Illustration-7 : Amit Enterprises Ltd. was incorporated with an Authorised Capital of Rs. 50 lakhs. It has issued, subscribed and paid up Capital of Rs. 40 lakhs in 4,00,000 Equity Shares of Rs, 10 each.

TRIAL BALANCE

As on 31st March, 2019 (Rs. 000)

Particulars	Dr. Rs.	Cr. Rs.
Sales		140,00
Cost of Sales	69,00	
Administrative Costs	20,00	
Distribution Costs	15,00	
Dividend- Interim	12,00	
Fixed Assets at Cost	90,00	
Depreciation on Fixed Assets		15,00
Stock on 31st March, 2019	4,00	
Trade Debtors	4,40	
Cash at Bank	1,60	
Trade Creditors		5,00
Equity Share Capital in Shares of Rs. 10 each		40,00
Surplus		16,00
Total	216,00	216,00

Additional Information:

a) Directors have proposed a Final Dividend at 20%.

b) Income tax rate may be assumed at 50%.

You are asked to prepare-

1) Statement of Profit and Loss for the year ended 31st March, 2019; and

2) Balance Sheet as on 31st March, 2019.

Your answer should include necessary notes on both the statements.

Solution-

Amit Enterprise Ltd.,

Statement of Profit and Loss

for the year ended 31st March, 2019

Ref No.	Particulars	Note No.	31-3-2019 Rs. (Rs.000)	31-3-2018 Rs. (Rs. 000)
	1) Revenue from Operations	1	14,000	
	2) Other Income		-	
	3) Total Revenue (1)+(2)		14,000	-
	4) Expenses			
	Cost of Goods Sold	2	6,900	
	Employee Benefits Expense	3	2,000	
	Finance Costs	4	-	
	Depreciation	5	-	
	Other Expenses	6	1,500	
	Total Expenses		10,400	-
	5) Profit before tax (3)-(4)		3,600	
	6) Provision for tax @ 50%		1,800	
	7) Profit After tax for the year		1,800	

Notes-

1) Revenue from Operations: (Rs. 000)

Particulars	31-3-2019 Rs.	31-3-2018 Rs.
Sales	14,000	-

2) Cost of Goods Sold: (Rs. 000)

	6900	-

3) Employee Benefit Expenses: (Rs. 000)

Administrative costs	2,000	-

4) Finance Cost: Nil

5) Depreciation: Nil

6) Other Expenses: (Rs. 000)

Distribution costs	1,500	-

Amit Enterprise Ltd.

Balance Sheet as on 31-3-2019 (Rs. 000)

Ref. No.	Particulars	Note No.	31-3-2019 Rs. 000	31-3-2018 Rs. 000
I	EQUITY AND LIABILITIES			
	1) Shareholders' Funds			
	Share Capital	A	4,000	
	Reserve and Surplus	B	1,400	
			5,400	-
	2)Non-Current Liabilities			
	Long-term Borrowings	C	-	-
				-
	3)Current Liabilities			
	Trade Payables (Creditors)		500	
	Other Current Liabilities	D	-	
	Short-term Provisions	E	2,600	
			3,100	-
	Total Equity and Liabilities (1+2+3)		8,500	-

II	ASSETS 1) Non Current Assets a) Fixed Assets			
	Tangible Assets	F	7,500	
	Intangible Assets	G	-	
	Non Current Investments	H	-	
			-	-
	2) Current Assets		-	
	Inventories	I	400	
	Trade Receivables	J	440	
	Cash and Cash Equivalents	K	160	
	Other Current Assets	L	-	
	Short term Loans and Advances	M		
	Total of All Assets (1+2)		8,500	-

Notes-

A) Share Capital: (Rs. 000)

Particulars	31-3-2019 Rs.	31-3-2018 Rs.
a) Authorised Capital …… Equity Shares of Rs.10 each	?	
b) Issued, Subscribed and Paid up Capital 400.000 Equity Shares of Rs.10 each fully paid	4,000	

B) Reserve and Surplus: (Rs. 000)

Surplus A/c balance (1-4-2018)		1,600		
Profit for the year		1,800		
		3,400		
Less: Interim Dividend	1,200			
Proposed Final Dividend	800	2,000	1,400	

C) Long-term Borrowings: NIL

D) Other Current Liabilities: NIL

E) Short-term Provisions: (Rs. 000)

Final Dividend	800	
Provisions for Tax	1800	
Total	2600	-

F) Tangible Assets: (Rs. 000)

Fixed Assets	9,000		
Less :Depreciation	1,500	7,500	

G) Intangible Assets: NIL

H) Non Current Investments: NIL

I) Inventories: (Rs. 000)

Stock on 31-3-2019	400	-

J) Trade Receivables: (Rs. 000)

Debtors	440	-

K) Cash and Cash Equivalents: (Rs. 000)

Bank Balance	160	-

Illustration-8 : Authorised Capital of Assam Co. Ltd. is Rs. 10 lakhs divided into 10,000 equity shares of Rs. 100 each. Profit before tax for the year was Rs. 60,500 after incorporation of following adjustments.

i) Depreciation on written down value of land and building at 5% and plant and machinery at 10%.

ii) Provision for taxation is to be made at 50% of net profit.

iii) Directors proposed dividend @ 5% after transfer of Rs. 10,000 to General Reserve.

a) You are to prepare Balance Sheet of the company as on 31-3-2019 as per Schedule III of the Companies Act, 2013.

b) Prepare the Statement of Profit and Loss for the year ending 31-3-2019.

TRIAL BALANCE

As on 31^{st} March, 2019

Particulars	Debit Rs.	Credit Rs.
Equity Share Capital (Rs. 75 paid)		7,50,000
Securities Premium Reserve		1,00,000
Land and Buildings	5,00,000	
Plant and Machinery	8,00,000	
Depreciation Provision		
Land and Building		1,00,000
Plant and Machinery		1,20,000
General Reserve		1,40,000
6% Debentures		50,000
Investments (Shares in Limited Companies) Market Value Rs. 85,000	1,00,000	
Stock as on 31-3-2019	70,000	
Balance at Bank	23,000	
Cash in Hand	18,600	
Profit and Loss A/c (Bal. on 1-4-2018)		25,000
Sundry Creditors		77,800
Income Tax deducted at source (TDS)	1,200	
Cost of Goods Sold	2,00,000	
Employee Benefits Expenses	47,000	
Rent and Taxes	3,400	
Debenture Interest	1,500	
Audit Fees	3,000	
Directors' Fees	6,000	

Sundry Expenses	12,700	
Dividend (Gross)		11,200
Gross Sales		4,12,400
	17,86,400	17,86,400

Solution- (a)

Asam Company Ltd.,

Balance Sheet

As on 31st March,

Ref. No.	Particulars	Note No.	2019 Rs.	2018 Rs.
	I.EQUITY AND LIABILITIES			
	1) Shareholder's Funds			
	Share Capital	A	7,50,000	
	Reserves and Surplus	B	2,57,750	
	2) Non Current Liabilities			
	Long-term Borrowings	C	50,000	-
	3) Current Liabilities			
	Trade Payables (Sundry Creditors)		77,800	
	Other Current Liabilities	D	1,500	
	Short Term Provisios	E	67,750	
	Total		12,04,800	-
	II.ASSETS			
	1) Non Current Assets			
	a) Fixed Assets			
	1) Tangible Assets	E	9,92,000	
	2) Intangible Assets	F	--	-
	b) Non Current Investments	G	1,00,000	
	2) Current Assets			
	Inventories	H	70,000	
	Trade Receivables		--	
	Cash and Cash Equivalents	J	41,600	
	Other Current Assets	K	1,200	
	Total		12,04,800	

Notes -

A) Share Capital:

Particulars	31st March,2019 ₹	31st March, 2018 ₹
a) Authorised Capital 10,000 Equity Shares of Rs. 100 each	10,00,000	-
b)Issued, Subscribed and Paid up Capital 10,000 Equity Shares of Rs. 100 each, Rs. 75 paid	7,50,000	
Total	7,50,000	-

B) Reserve and Surplus:

Securities Premium Reserve			1,00,000	
General Reserve		1,40,000		
Add: Addition during the year		10,000	1,50,000	
Profit and Loss Account				
Balance on 1-4-2018		25,000		
Add: Profit for the year		30,250		
		55,250		
Less: Transfer to General Reserve	10,000		7,750	
Dividend	37,500	47,500	2,57,750	-
Total				

C) Long-term Borrowings:

6% Debentures	50,000	
Total	50,000	

D) Other Current Liabilities:

Interest Outstanding on Debentures	1,500	
Total		1,500

E) Short-term Provisions:

Provisions for Taxation	30,250	
Proposed Dividend	37,500	
Total	67,750	

F) Tangible Assets:

Land and Buildings 5,00,000		
Less: Depreciation Provision		
(1,00,000+20,000) 1,20,000	3,80,000	
Plant and Machinery 8,00,000		
Less: Depreciation Provision		
(1,20,000+68,000) 1,88,000	6,12,000	
Total	9,92,000	-

G) Non-Current Assets:

Investment (Shares in Limited Companies)		
(Market value of shares is Rs. 85,000)	1,00,000	
Total	1,00,000	

H) Inventories:

Stock	70,000	
Total	70,000	

I) Cash and Cash Equivalents:

Cash in hand	18,600	
Balance at bank	23,000	
Total	41,600	

J) Other Current Assets:

Income Tax Deducted at Source (TDS)	1,200	
Total	1,200	

Solution (b)

Asam Company Ltd.

Statement of Profit and Loss

For the year ended 31st March,

Ref No.	Particulars	Note No.	2019 ₹	2018 ₹
	1) Revenue from Operations	1	4,12,400	
	2) Other Income		11,200	
	3) Total Revenue (1)+(2)		4,23,600	-
	4) Expenses			
	Cost of Goods Sold	2	2,00,000	
	Employee Benefits Expense	3	47,000	
	Finance Costs	4	3,000	
	Depreciation	5	88,000	
	Other Expenses	6	25,100	
	Total Expenses		3,63,100	-
	5) Profit before tax (3)-(4)		60,500	
	6) Provision for tax @ 50%		30,250	
	7) Profit After tax for the year		30,250	

Notes Accompanied to Statement of Profit and Loss

Note : 1. Revenue from Operations

Sales Rs. 4,12,400

2. Cost of Goods Sold Rs. 2,00,000

3. Employee Benefits Expenses Rs. 47,000

4. Finance Cost

Debenture Interest	1,500
Add: Outstanding	1,500
	3,000

5. Depreciation

Plant & Machinery	68,000
Land & Building	20,000
	88,000

6. Other Expenses

Rent & Taxes	3,400
Audit Fee	3,000
Director's Fees	6,000
Sundary Expenses	12,700
	25,100

Illustration-9 : Basavaraj Printers Ltd. had an authorised capital of Rs. 1,00,00,000 divided into 10,00,000 equity shares of Rs. 10 each. The Trial Balance of the company as on 31st March, 2019 was as follows:

TRIAL BALANCE

as on 31-3-2019

Debit	Rs.	Credit	Rs.
Premises	22,50,000	Equity Shares Capital	42,50,000
Plant and Machinery	17,45,860	Profit and Loss A/c (1-4-2018)	1,01,200
Sundry Debtors	6,08,900		
Furniture	2,67,500	Revenue from operations	15,58,190
Bad Debts	14,250	Reserve for Bad Debts	45,000
Rent, Rates and Taxes	1,41,940	General Reserve	3,25,000
Advertising	97,540	Sundry Creditors	2,55,150
Cash in hand	47,230	Transfer Fees	550
Cash at Bank	2,80,200	Accrued Wages	64,150
Cost of Goods Sold	5,23,200	Staff Benevolent Fund	89,500
Directors' Fees	18,000		
Contribution to Provident Fund	39,980		
Salaries	1,59,140		
Motor Lorries	4,00,000		
Interim Dividend	95,000		
Total	66,88,740	Total	66,88,740

1) Depreciation on Plant and Machinery at 10% and Furniture at 5%.

2) Create Reserve for Bad Debts at 10% on Sundry Debtors.

3) Make provision for Taxation to the extent of Rs. 1,00,000.

4) Interest accrued Rs. 20,000 on Bank Deposits.

5) Rent and Taxes paid in advance amounted to Rs. 16,970.

   1) Prepare the statement of Balance Sheet as on 31st March, 2019 as per Schedule III of the Companies Act, 2013.

   2) Prepare Statement of Profit and Loss for the year ending 31st March, 2019

Solution- 1)

Basavaraj Printers Ltd.

Balance Sheet as on 31st March,

Ref. No.	Particulars	Note No.	2019 Rs.	2018 Rs.
	I.EQUITY AND LIABILITIES			
	(1) Shareholder's Funds			
	Share Capital	A	42,50,000	
	Reserves & Surplus	B	6,29,009	
			48,79,009	
	(2) Non Current Liabilities			
	Long Term Borrowings	C	89,500	
	(3) Current Liabilities			
	Trade Payables (Sundry Creditors)		2,55,150	
	Other Current Liabilities	D	---	
	Short-term Provisions	E	1,64,150	
	Total of Equity and Liabilities (1)+(2)+(3)		4,19,300	
			53,87,809	

	II.ASSETS 1)Non Current Assets a) Fixed Assets Tangible Assets b) Non Current Investments	 F G	 44,75,399 - 44,75,399	
	2) Current Assets Trade Receivables Cash and Cash Equivalents Other Current Assets Short term Loans and Advances	H I J K	 5,48,010 3,57,430 20,000 16,970 9,12,410	
	Total Assets [(1) + (2)]		53,87,809	

Accompanying Notes to the Balance Sheet-

A. Share Capital:

Particulars	31-3-2019	31-3-2018
a)Authorised Capital 10,00,000 Equity Shares of Rs. 10 each	1,00,00,000	-
b)Issued, Subscribed and Paid-up Capital 4,25,000 Equity Shares of Rs. 10 each Fully paid	42,50,000	
Total	42,50,000	-

B. Reserves and Surplus:

General Reserve		3,25,000	
Profit and Loss Account (1-4-2018)	1,01,200		
Add: Profit during the year	2,97,809		
	3,99,009		
Less: Interim Dividend	95,000	3,04,009	
Total		6,29,009	-

C.Long-term Borrowings

Staff Benevolent Fund	89,500	
Total	89,500	

D. Other Current Liabilities:

	NIL	

E. Short-term Provisions:

Accrued Wages	64,150	
Provisions for Taxation	1,00,000	
Total	1,64,150	

F. Tangible Assets:

Plant and Machinery	17,45,860		
Less: Depreciation Provision	1,74,586	15,71,274	
Furniture	2, 67,500		
Less: Depreciation Provision	13,375	2,54,125	
Premises		22,50,000	
Motor Lorries		4,00,000	
Total		44,75,399	-

G. Non-current Investments

	NIL	

H. Trade Receivables:

Sundry Debtors	6,08,900		
Less: Reserve for Bad Debts (New)	60,890	5,48,010	
		5,48,010	

I. Cash and Cash Equivalents:

Cash in hand	47,320	
Balance at bank	2,80,200	
Total	3,27,430	

J. Other Current Assets:

Interest Accrued on Deposits	20,000	
Total	20,000	

K. Short term Loans and Advances

Rent and Rates Paid in Advance	16,970	
Total	16,970	

Solution- 2)

Basavaraj Printers Ltd.

Statement of Profit and Loss

For the year ended 31st March,

Ref. No.	Particulars	Note No.	2019 Rs.	2018 Rs.
	A.CONTINUING OPERATIONS (Gross)			
	1) Revenue from Operations (Net)	1	15,58,190	-
	2) Other Income	2	20,550	-
	3) Total Revenue (1+2)		15,78,740	-
	4) Expenses			
	Cost of Goods Sold	3	5,23,200	-
	Employee Benefits Expense	4	1,99,120	-
	Depreciation & Amortisation Expenses	5	1,87,961	-
	Other Expenses	6	2,70,650	
	Total Expenses		11,80,931	-
	5) Profit / (Loss) before exceptional and extraordinary items of tax (3-4)		3,97,809	-
	6) Provision for Tax		1,00,000	-
	7) Profit & Loss the Period (5-6)		2,97,809	-

Notes forming part of Statement of Profit and Loss A/c

1) Revenue from Operations

Particulars	31-3- 2019 Rs.	31-3-2018 Rs.
Gross Profits	15,58,190	-
Total	15,58,190	-

2) Other Income

Transfer Fees	550	-
Interest Accrued on Bank Deposits	20,000	-
Total	20,550	

3) Cost of Goods Sold

Cost of Goods Sold	5,23,200	-
	5,23,200	

4) Employee Benefit Expenses

Salaries	1,59,140	-
Contribution to Provident Fund	39,980	
	1,99,120	

5) Depreciation on

Land and Building	1,74,586	-
Plant and Machinery	13,375	-
Total	1,87,961	-

6) Other Expenses

Bad Debts	14,250		
Add: Reserve for Bad Debts (New)	60,890		
Less: Reserve for Bad Debts (Old)	(45,000)	30,140	
Rent, Rates and Taxes	1,41,940		
Less: Prepaid	16,970	1,24,970	

Director's Fees	18,000	-
Advertising	97,540	
Total	2,70,650	

Illustration-10 : The balances as per ledger of The Zomato Trading Co. Ltd. as at 31st March, 2019 were as follows:

Particulars	Rs.	Particulars	Rs.
Purchases	38,000	Opening Stock	15,000
Freight	2,620	Wages	16,960
Directors Fees	1,148	General Expenses	3,380
Bad Debts	422	Salaries	2,900
Plant and Machinery	72,000	Debenture Interest upto 30-9-2018	1,800
Fixtures	1,440		
		Sales	83,000
		Provision for Bad Debts	700

Prepare Statement of Profit and Loss for the year ending 31-3-2019 as per Schedule III Part II of the Companies Act 2013 after taking into account following adjustments.

1) The Stock at 31-3-2019 was valued at Rs. 30,200.
2) Depreciate Plant and Machinery by 10% and Fixtures 5%.
3) Make provision for bad debts at Rs. 600
4) Make Provision for Income Tax to the extent of Rs. 5,000.
5) Interest on 4% Government Securities is due for the year which were purchased on 1st May, 2018 for Rs. 12,000.

Solution-

The Zomato Trading Co. Ltd.

Statement of Profit and Loss

For the year ended 31st March,

Ref. No.	Particulars	Note No.	2019 Rs.	2018 Rs.
	A.CONTINUING OPERATIONS (Gross)			

	I Revenue from Operations (Net)	1	83,000	-
	II Other Income	2	400	-
	III Total Revenue (I+II)		83,400	-
	IV Expenses			
	Cost of Goods Sold	3	42,380	-
	Employee Benefits Expense	4	2,900	-
	Finance Cost	5	3,600	-
	Depreciation & Amortisation Expenses	6	7,272	-
	Other Expenses	7	4,850	
	Total Expenses		61,002	-
	V Profit before tax (III-IV)		22,328	
	VI Provision for Tax		5,000	-
	VII Profit for the year (V-VI)		17,398	-

Notes forming part of Statement of Profit and Loss

1) Revenue from Operations

Particulars	31-3- 2019 Rs.	31-3-2018 Rs.
Sales	83,000	-

2) Other Income

Interest on Govt. Securities 12,000 X 4% = 480 X 10/12	400	-

3) Cost of Goods Sold

Opening Stock	15,000	
Add: Purchases	38,000	
Freight	2,620	
Wages	16,960	
	72,580	-
Less: Closing Stock	30,200	
Total	42,380	-

4) Employee Benefit Expenses

Salaries	2,900	-

5) Finance Cost

Debenture Interest 1,800 + 1,800	6,000	-

6) Depreciation

Plant & Machinery	7,200		
Fixture	72		
Total		7,272	-

6) Other Expenses

Bad Debts	422		
Add: New Reserve for Bad Debts	600		
	1,022		
Less: Old Reserve for Bad Debts	700	322	
Directors' Fee		1,148	
General Expenses		3,380	
Total		4,850	-

Illustration-11 : The Zomato Trading Co. Ltd had an Authorised Capital of Rs. 1,20,000 dividend into equity shares of Rs. 100 each. The balances as per ledger of the company as at 31st March, 2019 were as follows:

Particulars	Rs.	Particulars	Rs.
Calls in Arrears	1,500	Fixtures	1,440
Premises	60,000	Sundry Debtors	13,400
Plant and Machinery	72,000	Goodwill	5,000
Interim Dividend Paid	1,500	Cash in hand	4,150
6% Debentures	60,000	Cash at Bank	17,980
Profit and Loss A/c (1-4-2018)	2,900	Debenture Interest upto 30-9-2018	1,800
Sundry Creditors	10,000		

General Reserves	5,000	Bills Payable	7,600
4% Government Securities (1-5- 2018)	12,000	Share Capital (Fully Called 1020 Shares of Rs. 100 each)	1,02,000

Prepare Balance Sheet as on 31-3-2019 as per Schedule III Part I of the Companies Act 2013. Profit for the year after taking into account following adjustments was Rs.17,398.

1) The Stock at 31-3-2019 was valued at Rs. 30,200.
2) Depreciate Plant and Machinery by 10% and Fixtures 5%.
3) Make Provision for Income Tax to the extent of Rs. 5,000.
4) Make provision for bad debts at Rs. 600
5) Provide Final Dividend at 5%.
6) Interest on Govt. Securities is due for the year.

Solution-

The Zomato Trading Co. Ltd.

Balance Sheet as on 31st March,

Ref. No.	Particulars	Note No.	2019 Rs.	2018 Rs.
I.	**EQUITY AND LIABILITIES**			
	(1) **Shareholders' Funds**			
	Share Capital	A	1,00,500	
	Reserves & Surplus	B	18,773	
			1,19,273	
	(2) **Non Current Liabilities**			
	Long Term Borrowings	C	60,000	
	(3) **Current Liabilities**			
	Trade Payables (Sundry Creditors)		17,600	
	Other Current Liabilities	D	-	
	Short-term Provisions	E	11,825	
			29,425	-
	Total of Equity and Liabilities (1)+(2)+(3)		2,08,698	-

II.	**ASSETS**			
	1) **Non Current Assets**			
	a) Fixed Assets			
	Tangible Assets	F	1,26,168	
	Intangible Assets	G	5,000	
	Non Current Investment	H	12,000	
			1,43,168	-
	2) Current Assets			
	Inventories			
	Trade Receivables	I	30,200	
	Cash and Cash Equivalents	J	12,800	
	Other Current Assets	K	22,130	
	Short term Loans and Advances	L	400	
		M	-	
	Total Assets		65,530	-
			2,08,698	-

Accompanying Notes to the Balance Sheet-

A. Share Capital:

Particulars	31-3-2019 Rs.	31-3-2018 Rs.
a) Authorised Capital		
1,200 Equity Shares of Rs. 100 each	1,20,000	-
b) Issued, Subscribed and Paid-up Capital		
1,020 Equity Shares of Rs. 100 each Fully called	1,02,000	
Less: Calls in Arrears	1,500	
Total	1,00,500	-

B. Reserves and Surplus:

General Reserve	5,000	
Profit and Loss Account balance on1-4-2018 2,900		

Add: Profit during the year	17,398		
	20,298		
Less: Final Dividend @ 5% on Rs. 1,00,500	5,025		
Interim Dividend	1,500	13,773	
Total		18,773	-

C. Long-term Borrowings

6% Debentures	60,000	-

D. Other Current Liabilities: NIL

E. Short-term Provisions:

Final Dividend	5,025	
Debenture Interest	1,800	
Provision for Tax	5,000	
	11,825	-

F. Tangible Assets:

Premises		60,000	
Plant and Machinery	72,000		
Less: Depreciation	7,200	64,800	
Furniture	1,440		
Less: Depreciation Provision	72	1,368	
Total		1,26,168	-

G. Intangible Assets:

Goodwill	5,000	-

H. Non Current Investments:

4% Government Securities	12,000	-

I. Inventories:

Closing Stock	30,200	-

J. Trade Receivables:

Sundry Debtors	13,400	
Less: Reserve for Bad Debts	600	
Total	12,800	

K. Cash and Cash Equivalents:

Cash in hand	4,150	
Cash at Bank	17,980	
Total	22,130	

L. Other Current Assets:

Interest due on Govt. Securities	400	-

M. Short term Loans and Advances: NIL

Illustration-12 : Shrimant Company Ltd. was registered with capital of Rs. 4,00,000 divided in 4,000 Equity Shares. The Trial Balance of the company as on 31-3-2019 was as under:

TRIAL BALANCE

As on 31-3-2019

Particulars	Debit Rs.	Credit Rs.
Issued share capital		2,00,000
Motor Car	74,000	
Sundry Debtors	19,200	
Salaries	30,000	
Bank Interest	800	
Rent received		7,000
Travelling Expenses	8,000	
Machinery	1,60,000	
Sales		2,10,000
Building	1,00,000	
Discount allowed	3,000	
Sundry Creditors		33,600
Wages	16,000	

Bank Overdraft		24,400
Stock on 1-1-2002	14,000	
Profit and Loss Appropriation A/c		45,000
Purchases	60,000	
Carriage	4,000	
Cash in hand and at bank	2,000	
Printing and stationery	4,000	
Repairs and Renewals	3,000	
Directors' Remuneration	5,000	
Audit Fees	1,000	
Calls in arrears	6,000	
Interim Dividends	10,000	
Total	**5,20,000**	**5,20,000**

Prepare the statement of Profit and Loss for the year ended 31-3-2019 alongwith detailed notes as per Schedule III Part II after considering the following.

1) Stock on 31-03-2019 is Rs. 12000.
2) Create a R.D.D. at 10% on Debtors.
3) Depreciate Machinery by Rs. 4,000, Building by Rs. 14,000 and Motor Car by Rs. 1240.
4) Outstanding Wages Rs. 2000.
5) Directors' declared a final dividend at 20% on paid up capital.

Solution-

Shrimant Company Ltd.

Statement of Profit and Loss

For the year ended 31st March,

Ref. No.	Particulars	Note No.	2019 Rs.	2018 Rs.
	A.CONTINUING OPERATIONS (Gross)			
	I Revenue from Operations (Net)	1	2,10,000	-
	II Other Income	2	7,000	-
	III Total Revenue (I+II)		2,17,000	-
	IV Expenses			

	Cost of Goods Sold	3	66,000	-
	Employee Benefits Expense	4	48,000	-
	Finance Cost	5	800	-
	Depreciation	6	19,240	-
	Other Expenses	7	25,920	
	Total Expenses		1,59,960	-
	V Profit before tax (III-IV)		57,040	
	VI Provision for Tax		-	-
	VII Profit for the year (V-VI)		57,040	-

Notes forming part of Statement of Profit and Loss

1) Revenue from Operations

Particulars	31-3- 2019 Rs.	31-3-2018 Rs.
Sales	2,10,000	-

2) Other Income

Rent Received	7,000	-

3) Cost of Goods Sold

Opening Stock	14,000	
Add: Purchases	60,000	
Carriage	4,000	
	78,000	
Less- Closing Stock	12,000	
Total	66,000	

4) Employee Benefit Expenses

Salaries		30,000	-
Wages	16,000		
Add: Outstanding	2,000	18,000	
Total		48,000	

5) Finance Cost

Bank Interest	800	-

6) Depreciation

Machinery	4,000	
Building	14,000	
Motor Car	1,240	
Total	19,240	-

6) Other Expenses

Travelling Expenses	8,000	
Discount	3,000	
Printing and Stationery	4,000	
Repair and Renewals	3,000	
Directors' Remuneration	5,000	
Audit Fees	1,000	
RDD	1,920	
Total	2,25,920	-

3.3 Summary-

Every company is to prepare its final accounts in a format prescribed in Schedule III, Part-I and II of The Companies Act, 2013. Part I is of Balance sheet and Part-II is of Statement of Profit and Loss. The balance sheet exhibits financial position of a company as on a particular date, whereas the statement of profit and loss exhibits operating result of the company for a specific period. The assets and liabilities and income and expenditures are recorded in groups. These statements are prepared in vertical form instead of 'T' form. Necessary notes on the items of assets and liabilities appearing in the balance sheet and that of income and expenditures are to be accompanied to both the statements.

3.4 Terms to Remember-

1. **Schedule III Part- I :** It is the form of Balance Sheet to be prepared as per this schedule prescribed in The Companies Act, 2013.

2. **Schedule III Part- II :** It is the form of Balance Sheet to be prepared as per this schedule prescribed in The Companies Act, 2013.

3. **Shareholders' fund :** It is the amount of funds invested by the shareholders of the company. It includes share capital and accumulated (undistributed) profits viz. reserves and surplus.

4. **Non-current Liabilities :** The long term liabilities of a company are termed as no-current liabilities. It include long-term loans, debentures, bonds and deferred liabilities.

5. **Current Liabilities :** The liabilities which are held for the trading purpose and are to be repaid within the period of one accounting period are called current liabilities.

6. **Non-current Assets :** Fixed Assets are termed as non-current assets. These assets are used for more than one accounting year. It involves comparatively large amount.

7. **Current Assets :** This include the assets which are held for the purpose of trade and to be realised or consumed within the same accounting year.

8. **Revenue from Operations :** Income earned by way of regular operations of the business is called revenue from operations. It is the main source of income of the company.

9. **Other Income :** Income earned by the company by way of other than main source of income is called other income. It is recorded separately.

3.5 Answers to Check your Progress

Check your progress-1 :

1. Schedule III Part-I, 2. 129, 3. financial position, 4. performance, 5. share capital, 6. reserves and surplus, 7. intangible/fixed, 8. intangible/fixed, 9. tangible/ fixed, 10. contingent.

Check your progress-2 :

(A) 1. Schedule III Part-II, 2. 129, 3. Operating result, 4. equity shareholders, dividend, 5. employee, salary, wages, etc.

(B) 1. True, 2. True, 3. False, 4. False, 5. True

(C) 1. d, 2. c , 3. a, 4. b, 5. d

3.6 Exercise

1. What is Equity?
2. What is mean by current assets?
3. What is mean by current liabilities?
4. What is mean by contingent liabilities?
5. What is mean by paid-up capital?
6. What is mean by share capital?
7. What forms reserves and surplus?
8. What are the long-term borrowings?
9. What are the short-term borrowings?
10. What are the intangible assets?
11. What is mean by tangible assets?
12. What is mean by non-current investments?
13. What is mean by current assets?
14. What is mean by short-term loans and advances?
15. What is mean by operating revenue?
16. What is mean by finance costs?
17. Explain the employee benefit expenses.
18. Prepare the summarized form of statement of Profit and Loss.
19. Give a specimen of statement of profit and loss.
20. Give a specimen of balance sheet of a company.

1. Following particulars from the books of The Super Company Ltd. are available for the year ended on 31-3-2019:

Particulars	Dr. Rs.	Cr. Rs.
Purchases	6,00,000	
Selling expenses	55,000	
Stock on 1-4-2018	1,60,000	
Salaries and wages	55,500	
Interest on Bank Overdraft	9,300	
Interest on Debentures up to 30-9-2018	6,000	
Dividends		12,000
Surplus A/c (1-4-2018)		64,500
Sales (Net)		10,50,000
Audit fees	11,000	

a) Closing stock was valued at Rs. 1,55,500.

b) Rs. 4,000 worth of goods distributed as free sample.

c) Salaries and wages include Directors' remuneration Rs. 12,000.

d) Interest on debentures for the half year ending on 31-3-2019 was due Rs. 6,000.

e) Provide for depreciation on premises Rs. 44,795

f) Provide for taxation @ 50% of profit.

You are required to prepare –

1) The Statement of Profit and Loss for the year ended 31-3-2019 along with accompanying notes.

2. The authorised capital of Roxy Company Limited is Rs. 5,00,000 consisting of equity shares of Rs. 10 each. Following was the extract of Trial Balance of the company as on 31-3-2019:

Particulars	Dr. Rs.	Cr. Rs.

Investment at cost	2,00,000	
Cash on hand	58,000	
Bills Receivable	5,800	
Sundry Debtors and Creditors	75,000	90,000
Freehold property at cost	8,95,900	
Depreciation Reserve		1,15,000
Equity Share Capital fully paid up		4,50,000
6 % Debentures		2,00,000
Bank Overdraft		1,50,000
Total		

a) Closing stock was valued at Rs. 1,55,500.

b) Interest on debentures for the half year ending on 31-3-2019 was due Rs. 6,000.

c) Provide for depreciation on premises and furniture Rs. 44,795

d) Provision for tax was made @ 50% of net profit.

e) Profit after making all above adjustments was resulted at Rs. Rs. 1,17,202

You are required to prepare –

1) Balance Sheet as on 31-3-2019 along with required notes.

3. The Paid-up Capital of the FLIPCART Ltd. is Rs. 2,00,000 in 3% Preference Shares of Rs. 100 each and Rs. 5,00,000 in Equity Shares of Rs. 100 each. Following balances are extracted from the books of the company for the year ended on March 31, 2019:

Particulars	Rs.	Particulars	Rs.
Salaries	1,00,000	Purchases	4,90,000
Contribution to PF	10,000	Freight and carriage inward	4,000
Surplus Account (Cr.)	50,500	Debenture Interest (for half year)	5,000
Selling and Distribution expenses	98,000	Stock on 1^{st} April, 2018	1,50,000
Rent and rates	78,000	Preference Dividend Paid	10,000
General expenses	52,000	Shares forfeited account	2,000
Sales	9,20,000		

a) The value of stock on March 31, 2019 was Rs. 2,00,000.

b) Depreciation on freehold properties is to be provided at 2.5% on its cost Rs. 3,00,000 and on furniture at 5% on Rs. 85,000.

You are required to prepare the Statement of Profit and Loss of the company for the year ended on 31st March, 2019.

24. The authorised capital of Reliance Distributors Ltd. is Rs. 7,50,000 consisting of 3,000 6% cumulative preference shares of Rs. 100 each and 45,000 equity shares of Rs. 10 each. Following balances are extracted from the books of the company for the year ended on March 31, 2019:

Particulars	Rs.	Particulars	Rs.
Paid-up Capital:		Furniture at cost	85,000
3,000 6% Preference Shares	3,00,000	Bills receivable	20,000
30,000 Equity Shares	3,00,000	Investments in Shares	50,000
Goodwill	1,00,000	Bills Payables	20,000
5% Debentures	2,00,000	Balance at bank	2,50,000
Trade debtors	1,67,500	Cash in hand	60,500
Trade creditors	1,27,000	Shares forfeited account	2,000
Freehold properties at cost	3,00,000	Surplus Account (Cr.)	50,500
General Reserve	70,000	Preference Dividend Paid	18,000
Provision for taxation	12,000		

a) The value of stock on March 31, 2019 was Rs. 2,00,000.

b) Depreciation on freehold properties is to be provided at 2% and on furniture at 5%.

c) Debenture interest is payable for half year.

d) The directors proposed 10% dividend on equity shares.

e) Surplus after incorporating all above adjustments but before tax was Rs. 1,66,250.

You are required to prepare only the Statement of Balance Sheet of the company as on 31st March, 2019.

5. Following balances have been extracted from the books of Finolex Company Ltd. as on 31-3-2019.

Particulars	Rs.	Particulars	Rs.
Cost of goods sold	4,10,000	Income from Investment	22,000
Salaries	1,12,000	Provision for bad debts	6,000
Contribution to EPF	13,000	Sales	7,50,000
wages	25,000	Surplus Account 1-4-2018	33,500
Miscellaneous Expenses	18,000		
Interest paid	13,000		
Bad Debts	10,000		
Repairs and maintenance	21,500		

Following particulars may be taken into account:

a) Provision for doubtful debts is to be made at 5% on Rs. 50,000 of debtors.

b) Provision for taxation is to be made at 50%.

c) The Managing Director is entitled to a remuneration of Rs. 10,500.

d) Depreciation @ 2% on cost of building and at 10% on the cost of furniture is to be charged. The cost of Building is Rs. 3,50,000 and that of Furniture is Rs. 50,000.

Prepare Statement of Profit and Loss for the year ended 31st March, 2019.

6. Following balances have been extracted from the books of Surbhi Co. Limited as on 31-3-2019.

Particulars	Rs.	Particulars	Rs.
Freehold Land	4,00,000	Creditors	50,000
Goodwill	40,000	Depreciation Reserve on	
Buildings (Cost)	3,50,000	1-4-2018	
Furniture (Cost)	50,000	Building	25,000
Debtors	50,000	Furniture	5,000
Stock (on 31-3-2019)	30,000	Equity Share Capital	4,00,000
Cash at Bank	25,000	7% Preference Shares for	1,00,000
Cash in hand	39,000	Rs.100 each	
Advance payment of	6,000	Securities Premium	10,000

income-tax		Bank Overdraft	70,500
Investment in Shares	1,00,000	Term Loan	2,00,000
		Surplus Account 1-4-2018	40,500

Following particulars may be taken into account:

a) Provision for doubtful debts is to be made at 5% of debtors.

b) Equity Share Capital comprised of Rs. 10 shares, fully paid

c) Provision for taxation is to be made at 50%.

d) Market value of investment was Rs. 90,000 on 31st March, 2019.

e) The Managing Director is entitled to a remuneration of Rs. 10,500.

f) Depreciation is to be charged on cost of building @ 2% and furniture at 10% p.a.

g) Surplus after considering all above adjustments but before tax was Rs. 1,64,000

Prepare Balance Sheet of the company as on 31st March, 2019 in as per Schedule- III, Part- I of The Companies Act, 2013.

7. From the under mentioned items extracted from the Trial Balance of RAFELL Co. Ltd., prepare-

a) The Balance Sheet as on 31st March, 2019.

Debit	Rs.	Credit	Rs.
Buildings (1/2 Factory)	1,80,000	Equity Share Capital	2,00,000
Sundry Debtors	25,000	(Shares of Rs. 100 each)	
Goodwill	50,000	5% Debentures	50,000
Plant and Machinery	70,000	Creditors	22,000
Loose Tools	16,000	Bank overdraft	50,000
Cash and Bank balance	27,000		
Trademark	40,400		

Additional Information:

1. The Authorised Capital of the company is Rs. 2,00,000.

2. Stock on 31st March, 2019 of Raw Materials was Rs. 16,000 and Finished Goods Rs. 32,000

3. Finished goods worth Rs. 2,000 are issued as samples.
4. Depreciate Factory Building and Plant and Machinery by 10%.
5. Debenture Interest was paid for half year only.
6. Make Provision for taxation at 50% of profit.
7. Profit for the year before tax is Rs. 87,900.
8. The directors have proposed 5% equity dividend.

8. From the under mentioned extracted balances from Trial Balance of RAFELL Co. Ltd., prepare-

b) Statement of Profit and Loss for the year ended 31st March, 2019 and

TRIAL BALANCE
as on 31-3-2019

Debit	Rs.	Credit	Rs.
Opening Stock of		Sales	3,80,000
Raw Materials	15,000	Commission	10,000
Finished Goods	25,000	Transfer Fees	1,000
Goods and Service Tax (GST)	8,000		
Purchase of Raw Materials	1,50,000		
Wages	20,000		
Freight	3,500		
Fuel and Power	5,500		
Octroi	2,100		
Advertisement	13,500		
General Expenses	25,800		
Bad debts	7,000		
Debenture Interest (Half Year)	2,500		
Salaries	23,700		
Factory Insurance	3,000		

Additional Information:

1. Stock on 31st March, 2019 of Raw Materials was Rs. 6,500 and Finished Goods Rs. 12,500
3. Finished goods worth Rs. 2,000 are issued as free sample.
4. Depreciate Factory Building and Plant and Machinery by 10%. The cost of Building is Rs. 80,000 and that of Plant and Machinery is Rs. 70,000.
5. Make Provision for taxation at 50% of profit.

9. The Modi and Company Ltd. had authorised Capital of Rs. 6,00,000 divided into equity shares of Rs. 100 each. The Trial Balance of the company as at 31st March, 2019 was as follows:

TRIAL BALANCE
As on 31-3-2019

Particulars	Rs.	Particulars	Rs.
Plant and Machinery	4,90,000	6% Debentures	3,00,000
Interim Dividend Paid	18,000	Sundry Creditors	40,000
Purchase	2,16,000	General Reserve	45,000
Investment in Government Securities	50,000	Share Capital (Fully paid)	3,60,000
		Bills Payable	33,000
Stock (1-4-2018)	50,000	Sales	4,15,200
Sundry Debtors	60,000		
Cash in hand	58,200		
Cash at Bank	1,77,000		
General Expenses	11,000		
Salaries	45,000		
Debentures Interest	18,000		
Total	11,93,200	Total	11,93,200

Prepare –

a) Statement of Profit and Loss for the year ending 31st March, 2019 and

b) The Balance Sheet as on 31st March, 2019 as per Schedule III of the Companies Act after taking into account the following adjustments.

1. The Stock on 31-3-2019 was Rs. 1,41,000.

2. Depreciate Plant and Machinery by 10%.

3. Maintain Bad Debts provision at 5% of the Sundry Debtors.

4. Make a Provision for Income tax to the extent of 50%.

5. Provide a final dividend at 5%.

10. Abhijit Company Ltd. was registered with Nominal Capital of Rs. 1,20,000 divided into Equity Shares of Rs. 100 each. The following are the balances extracted from its books on 31st March, 2019.

TRIAL BALANCE
As on 31-3-2019

Particulars	Rs.
Plant and Machinery	1,44,000
Calls in Advance	8,000
Interim Dividend Paid on 31-9-2017	11,000
Goodwill	8,500
Debtors	3,500
Purchases	19,000
Sundry Expenses	1,200
Salary	1,800
Directors' Fees	700
Bad Debts	250
Debentures Interest Paid	2,400
Subscribed and Called up-Capital	80,000
6% Debentures	40,000
Profit and Loss A/c (Cr. Balance)	2,000
Bills Payable	3,500
Sales	65,000
Creditors	4,200
Cash-in-hand	10,350

Prepare Statement of Profit and Loss for the year ended 31st March, 2018 and Balance Sheet as on that date after considering as following.

1. Stock on 31st March, 2018 was valued at cost Rs. 25,000 (Market value Rs. 27,600).
2. Depreciate Plant and Machinery at 10%.

11. Modee Shah and Co. Ltd. was registered with capital Rs. 3,00,000 divided into 30,000 equity shares of Rs. 10 each. The Trial Balance of the company as on 31st March, 2019 was as under.

TRIAL BALANCE

As on 31-3-2019

Particulars	Rs.	Particulars	Rs.
Plant and Machinery	6,00,000	Share Capital	3,00,000
Stock (1-4-2018)	50,000	Unsecured Loans	60,000
Cash in hand	88,000	Sales	6,50,000
Salaries	50,000	Profit and Loss A/c	75,000
Furniture	80,000	(1-4-2018)	
Debtors	40,000	10% Debentures	1,50,000
Purchases	2,22,000	Sundry Creditors	24,000
Investments	1,00,000	Share transfer fee	5,000
Printing and Stationary	10,000		
Debenture Interest	9,000		
Advertisement	15,000		

Additional Information:

1) Stock on 31st March, 2019 was valued at Rs. 50,000.
2) Transfer Rs. 34,000 to General Reserve.
3) Make provision for taxation to the extent of 50%.
4) Depreciate Plant and Machinery by 10% and Furniture by 5%.

Prepare:

a) Statement of Profit and Loss for the year ending on 31st March, 2019
b) Balance Sheet as on 31st March, 2019.

12. Following is the Trial Balance of Dev and Anand Ltd. on 31st March, 2019.

TRIAL BALANCE

As on 31-3-2019

Particulars	Rs.	Particulars	Rs.
Investments	1,20,000	Equity Share Capital	2,50,000
Stock (1-4-2018)	12,000	General Reserve	8,000
Plant and Machinery	2,00,000	P and L account (1-4-2018)	25,000
Rent and rates	9,900	Commission	5,000
Purchases	1,29,500	Sundry Creditors	20,000
Sundry Debtors	1,000	Sales	2,29,000
Cash	55,000	Interest on Investment	2,000
Salaries	11,600		
Total	5,39,000	Total	5,39,000

Other Information:

1. Authorised capital of the company is in 40,000 equity shares of Rs. 10 each.
2. Provisions for taxation is required @ 50%.
3. Depreciate Plant and Machinery by 15%.
4. Stock on 31-3-2019 was Rs. 65,000.

Prepare:

a) Profit and Loss A/c for the year ending on 31-3-2019.

b) Balance Sheet as on 31-3-2019.

13. Menon and Menon Co. Ltd. has an authorised capital of Rs. 6,00,000 divided into 6,000 shares of Rs. 100 each. From the following balances extracted from the ledger. Prepare Profit and Loss Statement and Balance Sheet in the prescribed form for the year ending 31-3-1991.

TRIAL BALANCE

As on 31-3-1991

Particulars	Rs.	Particulars	Rs.
Loose Tools	22,000	Sundry Creditors	65,200
Furniture and Fixtures	26,000	Reserve Fund	34,000

Machinery	5,00,000	Returns	10,000
Preliminary Expenses	18,800	Sales	6,54,000
Calls in Arrears	3,000	Share Capital	4,00,000
Cash in hand	5,000	Bank Overdraft (Secured by Furniture and Fixtures)	39,800
Trademark	33,200		
Goodwill	36,000	12% Debenture Mortgaged	1,60,000
Sundry Debtors	41,600	Profit and Loss Appropriation A/c	14,800
Purchases	5,00,000		
Returns	14,000		
Legal Charges	1,000		
Carriage Inward	8,400		
Salaries	24,000		
Stock (1-4-1990)	98,800		
Income Tax Advance	3,000		
Repairs and Maintenance	1,200		
Debenture Interest upto 30-9-1990	9,600		
Wages	32,200		
Total	13,77,800	Total	13,77,800

You are required to consider the following information:

1) Stock on 31-3-2019 valued at Rs. 204800.

2) Directors' are entitled at remuneration at Rs. 6000.

5) Depreciate Machinery at 15%, Furniture at 10% and write off Trademark by 15%.

Also, prepare detailed Note on-

1) Share Capital

2) Tangible Assets

3) Intangible Assets

4) Cost of Goods Sold

5) Other Expenses

14. From the following balances given of Warana Company Ltd. as on 31st March, 2019. Prepare notes on –

1) Revenue from Operations
2) Cost of Goods Sold
3) Employee Benefit Expenses
4) Depreciation
5) Share Capital
6) Long-term Liabilities
7) Tangible Assets
8) Current Assets
9) Short-term Provisions
10) Short-term loans and Advances

TRIAL BALANCE
As on 31-3-2019

Particulars	Rs.	Particulars	Rs.
Stock (1-4-2018)	3,00,000	Cash-in-hand	3,000
Fixtures	28,800	Cash at Bank	1,59,600
Sundry Debtors	3,48,000	Wages	3,39,200
Goodwill	1,00,000	General Expenses	67,600
Debenture Interest	36,000	Salaries	58,000
Bills Payable	1,52,000	Share Capital fully called	18,40,000
Sales	16,60,000	18400 shares of Rs. 100	
Provision for Bad Debts	14,000	@ calls in arrears	30,000
Premises	12,00,000	Plant and Machinery	14,40,000
Interim Dividend Paid	30,000	Preliminary Expenses	20,000
Purchases	7,40,000	Freight	52,400
Bad Debts	8,440	Directors Fees	22,960
6% Debentures	12,00,000	Profit and Loss A/c	58,000
Sundry Creditors	2,00,000	(Credit)	
8% Govt. Securities taken on 31-3-2018	2,40,000	General Reserve	1,00,000

15. Shweta Company Ltd. was registered with a Nominal Capital of Rs. 6,00,000 in equity shares of Rs. 10 each. The following is the list of balances taken from its books on 31-3-2019.

TRIAL BALANCE
As on 31-3-2019

Particulars	Rs.		Rs.
Premises	3,30,000	Called-up capital	4,00,000
Machinery	3,00,000	6% Debentures	3,00,000
Interim dividend paid	37,500	Profit and Loss A/c (Cr. balance)	14,000
Furniture	12,000		
Goodwill	20,200	Bills payable	38,500
Sundry debtors	87,000	Sales	4,20,000
Opening Stock	75,000	Sundry creditors	38,000
Cash at bank	48,150	General reserve	32,000
Share brokers commission	5,000	Bad-debts reserve (1-4-2018)	3,500
Wages	84,000		
Purchases	1,85,865		
Freight	13,115		
Sundry expenses	16,000		
Salaries	15,335		
Director's fees	5,000		
Bad debts	2,835		
Debenture interest paid	9,000		
	12,46,000		12,46,000

Prepare

a) Balance Sheet as on 31st March, 2019 when profit before tax is Rs.83,800

b) Statement of Profit and Loss for the year ended 31st March, 2019 along with notes thereto.

Following adjustments are to be incorporated while preparing final accounts.

1) Depreciate Machinery by 10%, Premises by 5% and Furniture by 10% p.a.

2) Write off 50% of Share Broker's Commission.

3) Provide for bad-debts and doubtful-debts at 5% on Sundry Debtors.

4) Stock on 31st March, 2019 was valued at cost Rs. 1,30,000.

5) Transfer Rs. 2000 to General Reserve.

16. Rajesh Trading Company Ltd. asks you to prepare -

a) Balance Sheet as on 31-3-2019 in prescribed form. Profit before tax is Rs. 5,300.

b) Statement of Profit and Loss for the year ending on 31-3-2019

The Trial Balance of the Company as at 31-3-2019 was as follows:

TRIAL BALANCE
As on 31-12-1990

Particulars	Debit Rs.	Credit Rs.
Equity Share Capital		1,50,000
Share Premium		20,000
General Reserve		28,000
6% Debentures		10,000
Land and Building	80,000	
Plant and Machinery	136,000	
Investment	20,000	
Stock (31-3-2019)	14,000	
Balance at Bank	4,600	
Cash in Hand	160	
Profit and Loss Account (1-4-2018)		5,000
Sundry Creditors		12,000
Income-tax Deducted at Source	240	
Establishment Expenses	10,400	
Rent and Taxes	480	
Debenture Interest	300	
Audit Fees	600	
Director's Fees	1,200	
Sundry Expenses	1,740	

Dividend (Gross) Revenue from Operations		2,240 42,480
Total	**2,69,720**	**2,69,720**

Instructions:

1) Authorised Capital of the Company is 20,000 Equity Shares of Rs. 10 each.

2) Depreciation is to be provided 5% on Land and Building and 15% on Plant and Machinery.

3) Provision for Taxation is to be made at 50% of net profit.

4) Transfer Rs. 200 to General Reserve.

17. The following Trial Balance has been extracted from the Books of Khan Trading Company Ltd. as on 31st March, 2019:

TRIAL BALANCE
As on 31st March, 2019

Debit	Rs.	Credit	Rs.
Building	3,50,000	Sundry Creditors	25,500
Machinery	3,37,000	Reserve Fund	35,000
Loose Tools	15,000	Bank overdraft	18,000
Furniture	10,000	Returns	7,000
Preliminary expenses	7,500	Sales	4,37,000
Calls in Arrears	1,200	Share Capital	5,00,000
Cash in hand	4,350	15% Debentures	90,000
Motor Vehicles	25,000	Profit and Loss	7,500
Goodwill	20,000		
Sundry Debtors	15,500		
Purchases	2,25,000		
Legal Charges	5,000		
Carriage Inward	1,200		
Wages	4,500		
Salary	15,000		
Stock on 1st April, 2018	18,000		
Income Tax Advance	55,000		

Repairs Debenture Interest upto 30th September, 2018	4,000 6,750		
Total	**11,20,000**		**11,20,000**

You are also given following information:

1) Stock on 31st March, 2019 was valued at Rs. 85000.
2) Depreciation is to be charged at 15% on Building and Machinery, 10% on Furniture, 20% on Motor Vehicles and 40% on Loose Tools.
3) Provide 15% for Dividend on Equity Shares.
4) Wages include Rs. 10,000 spent for adding rooms to the Building.
5) Authorised Capital of the Company is Rs. 1000000 divided into Equity Shares of Rs.100 each.

Prepare –

a) Notes on 1) Cost of Sale, 2) Depreciation, 3) Employee Benefits Expenses, 4) Finance Costs, 5) Share Capital, 6) Reserves and Surplus, 7) Tangible Assets, 8) Long Term Liabilities.
b) Balance Sheet as on 31st March, 2019.
c) Statement of Profit and Loss for the year ending 31st March, 2019.

18. The Ganesh Industrial Company Ltd., had the Authorised Capital of Rs. 20,00,000 divided into 20,000 Equity Shares of Rs. 100 each. The Trial Balance of the Company as on 31st March, 2019 was as follows:

TRIAL BALANCE
As on 31st March, 2019

Particulars	Debit Rs.	Particulars	Credit Rs.
Purchases	5,00,000	Sales	8,50,000
Debtors	4,00,000	Sundry Creditors	4,00,000
Freehold Property	12,00,000	Reserve for Bad Debts	20,000
Plant and Machinery	4,24,000	Profit and Loss A/c	1,60,000

Audit Fees	26,000	Bills Payable	30,000
Bank Charges	16,000	10% Debentures	5,00,000
Cash at Bank	28,000	Equity Share Capital	10,00,000
Advertisement	41,000	General Reserve	50,000
Bills Receivable	1,25,000		
Rent and Taxes	32,000		
Debenture Interest	25,000		
Bad Debts	6,000		
Salaries	72,000		
Stock (1-4-2018)	1,00,000		
Cash-in-hand	15,000		
Total	30,10,000	Total	30,10,000

Prepare-

A) Balance Sheet in the prescribed form as on 31st March, 2019.

B) Statement of Profit and Loss for the year ending 31st March, 2019

C) 1) Cost of Sale, 2) Depreciation, 3) Employee Benefits Expenses, 4) Finance Costs, 5) Share Capital, 6) Reserves and Surplus, 7) Tangible Assets, 8) Long Term Liabilities.

Following adjustments are to be incorporated while preparing final statements.

1) Depreciate Plant and Machinery and Fixtures and Fittings at 10%.

2) Create Reserve for Bad Debts at 5% on Sundry Debtors.

3) Stock on 31st March, 2019 was valued at Rs. 2,55,000.

4) Provide Equity Dividend of Rs. 10 per Share.

5) Make Provision for Taxation to the extent of Rs. 25,000.

6) Provide Interest on Debentures for 6 months.

19. The following are the balances extracted from the books of Maharashtra Traders on 31st March, 2019. Share Capital of the Company is Rs. 5,00,000 in Equity shares of Rs. 100 each fully paid.

TRIAL BALANCE

As on 31-3-2019

Particulars	Debit Rs.	Particulars	Credit RS.
Debtors	2,50,000	Purchases	3,50,000
Wages	38,700	Stock (1-4-2018)	42,000
Salaries	35,000	Audit Fees	9,200
Sales	7,00,910	Sundry Creditors	3,190
Preliminary Expenses	60,000	Profit and Loss A/c (Cr.)	79,000
Advertisement	3,000	Bills Receivable	7,000
8% Government Securities	30,000	Cash in hand	18,000
Insurance	10,000	Rent and Taxes	12,000
Bad Debts Reserve	4,000	Debenture Interest	3,000

Prepare Statement of Profit and Loss alongwith the Notes on it for the year ended 31st March, 2019 after considering the following:

1) Stock on 31st March, 2019 was valued at Rs. 125000.
2) Depreciation on Plant and Machinery is estimated at Rs.4,500, Premises Rs. 3,400 and Furniture Rs. 2,300
3) Provide for bad debts at 5% on Debtors.
4) Make Provision for Taxation to the extent of Rs. 20,000.
5) Transfer Rs. 15,000 to General Reserve.
6) Provide Final Dividend at 15%.
7) Interest on Government Securities was outstanding for the year.
8) Write off preliminary expenses @ 20%.

3.7 Reference for further study

1. The Companies Act, 2013.
2. Jain, S. P. and Narang, K. L. (2017): Advanced Accountancy- Corporate Accounting Vol- II, (21st revised edition) Ludhiana: Kalyani Publishers.
3. Datey, V. S. (2015): Company Law Ready Reckoner (3rd Edn.), New Delhi: Taxmann Publications (P.) Ltd.
4. Sehgal, Ashok and Sehgal, Deepak (2001): Advanced Accounting Vol. 2, New Delhi: Taxmann Publications (P.) Ltd.
5. Shukla, M. C., Grewal, T. S. and Gupta, S. C. (2016): Advanced Accounts, 19th Edn. New Delhi: D. Chand and Company Pvt. Ltd.

❑❑❑

Unit-4

Store Accounting with Practical using Tally

Index :

4.0 Objectives -

After Studying this Unit you will be able to:

1. Understand the meaning, need and importance of Materials Management and Inventory Control,
2. Explain how to computerise the process of Inventory Control using Tally ERP9, and
3. Find relation between the value of Stock of Materials and the Financial Statements and the Finance Management.

4.1 Introduction -

In the previous semesters, we learnt how to computerize the Financial Accounting using the ready-made accounting software Tally ERP 9. While computerising the financial accounting transactions, you have accounted for the closing stock of materials. Normally, this final accounts adjustment is done as per the amount of value of stock of materials as given in the exercise. Again, the stock of materials is treated as a non-liquid current assets in Finance Management. So the value of closing stock of goods is not considered while verifying the liquidity of an organisation. At this stage, we do not know how this amount is calculated, nor do we have any question in our mind about how this amount is arrived at. This is because the valuation of stock of materials is outside the scope of Financial Accounting and it is a part of Cost Accounting, which you haven't learnt it yet. Now, in this unit, we will study the basics of this part of the Cost Accounting.

To be a successful accountant, you must have sufficient working knowledge of other branches of accounting viz. Cost Accounting and Management Accounting.

4.2 Presentation of Subject Matter

4.2.1 Basic Concepts of Stores Accounting –

4.2.1.1 Nature of Inventories

The term "inventory" means stock of goods on hand. The term goods indicates those commodities that are purchased for reselling. Therefore, the term "goods" in a trading organisation indicates the goods purchased for reselling. In case of an industry, it means the commodities that are purchased as raw material from which finished goods will be produced and also includes the finished goods on hand and work in process which is partially processed. So the manufacturing organisations generally have three kinds of inventories viz. raw materials, work-in-process and finished goods. The inventory of goods is normally measured in quantity and in the value of materials in the godown at a particular time. The value of Work-in-process consists of materials cost, labour cost and factory expenses spent on the product in the assembly department wherein the goods are likely to be in various stages of completion. Finished goods inventory comprises of finished goods in the warehouse at inventory date, which are ready for sale. Again in case of industries, there can be stock of consumables too.

4.2.1.2 Functions of Inventories

The primary function of inventories is to serve as a cushion i) to facilitate smooth production and marketing operations; and ii) to absorb planning errors and unforeseen fluctuations in supply and demand.

4.2.1.3 Importance of Material Management and Inventory Control

The fast developing Indian economy has placed before the materials manager, a tremendous challenge and responsibility. The task is really difficult when we recognise that India's absolute material consumption has been estimated to be more than 8 billion tonnes in the year 2019. This material includes biomass, non-metal minerals, fossil fuels and metals. (Source: IGEP, 2013; p. 21).

In many organisations, the materials form the largest single expenditure item. An analysis of the financial statements of a large number of private and public sector organisations indicates that materials account for nearly 60 per cent of the total expenditure. The information on the average materials expenditure for different manufacturing industries is given in Exhibit 1.1.

Average expenditure of materials in different manufacturing industries.

Average expenditure of materials %	Industry groups
Above 65	Cotton yarn, earthmoving, sugar, wool, vehicles, fabrication
60-65	Cotton textiles, bread
55-60	Engineering, non-ferrous
50-55	Shipbuilding, chemicals, tyre, machine tools, cement, electricity
45-50	Pharmaceuticals
40-45	Steel, newspaper, fertilizer, aircraft

Exhibit 1.1

Thus, the importance of materials management lies in the fact that any significant contribution made by the materials manager in reducing materials cost will go a long way in improving the profitability and the rate of return on investment. Such increase in profitability, no doubt, can be effected by increasing sales. But with the increased competition, recurring occurrence of depression and government restrictions; increase in sales cannot be easily achieved. But some increase in profitability can be achieved by concentrating on the material costs which is typically a major cost for most organisations. In fact, today every organisation is forced to cut down the costs and here the materials manager can play an important role. Consider, for example,

Financial results of Tata Motors Ltd *(Amount in crores)*

Financial Year	***2018-19***	***2017-18***
Net sales	68,764.88	58,234.33
Closing Stock of Materials	4,662.00	5,670.13
Operating Profit before tax	2,602.00	19.74
Inventory to Sales %	6.78	9.74
Inventory Turnover ratio	14.75	10.27
Sales Increase	10,530.55	---
Sales Increase%	18.08	---
Operating Profit ratio	3.78	0.03

Exhibit 1.2, the financial results of Tata Motors Ltd.

In the year 2018-19, Tata Motors Ltd earned an operating profit of Rs. 2,602 Crores against Rs. 19.74 in previous year. It had net sales of Rs. 68,764.88 as against Rs. 58,234.33 and closing stock of materials Rs. 4,662 as against Rs. 5,670.13 in previous year. Among other factors, the Inventory turnover ratio was also much improved from 10.27 in previous year to 14.75 in the current year. Its inventory was 9.74% of its sales last year and it was reduced up to 6.78% in the current year achieving a great reduction in its inventory by 2.96%, i. e. actually reducing its investment in materials to the extent of Rs. 2035.44 crores. This must have brought major contribution resulting into increasing the profitability.

As you know, the term "Inventory" means stock of materials on hand. These materials are the things, supplies or equipments that are used in manufacturing or other activities. The stock of materials, which is a non-liquid asset, forms an important part of the current assets in any organisation. The return on investment (ROI) depends to a great deal on the manner of utilization of materials. Again, normally every organisation borrows loans for its working capital requirements. If the amounts invested in materials are reduced, the interest on loans taken also decreases. So, it can be easily understood that the improving the return on investment much depends on the efficient management of materials which constitute the bulk of the current assets. Therefore, in this context, the control of materials assumes great importance.

4.2.1.4 Definition and Scope of materials management

We can define **materials management** as "the function responsible for the coordination of planning, sourcing, purchasing, moving, storing and controlling materials in an optimum manner so as to provide a pre-decided service to the customer at a minimum cost."

4.2.1.5 Functions of Materials Management

From the definition it is clear that the scope of materials management is vast. We can broadly identify the following functions:

i) **Materials Planning and Control**: After the sales forecast is finalized, the production plan is made. And, the materials budgets are then prepared to assure smooth execution of the production plans. Here, various functions like estimating the individual requirements of parts, preparing materials budget, forecasting the levels of inventories, scheduling the expected receipts of raw materials and monitoring the performance in relation to production and sales are involved.

ii) **Purchasing**: This includes selection of the suppliers of materials, finalisation of terms of purchase, placement of purchase orders, follow-up, maintenance of smooth relations with suppliers, approval of payments to suppliers, evaluating and rating suppliers.

iii) **Stores and Inventory Control**: This involves physical control of materials, preservation of stores, minimisation of obsolescence and damage through timely disposal and efficient handling, maintenance of stores records, proper location and stocking. The Stores manager is also responsible for the physical verification of stocks and reconciling them with book figures. The inventory control covers aspects such as setting inventory levels, ABC analysis, fixing economical ordering quantities, setting safety stock levels, lead time analysis and reporting.

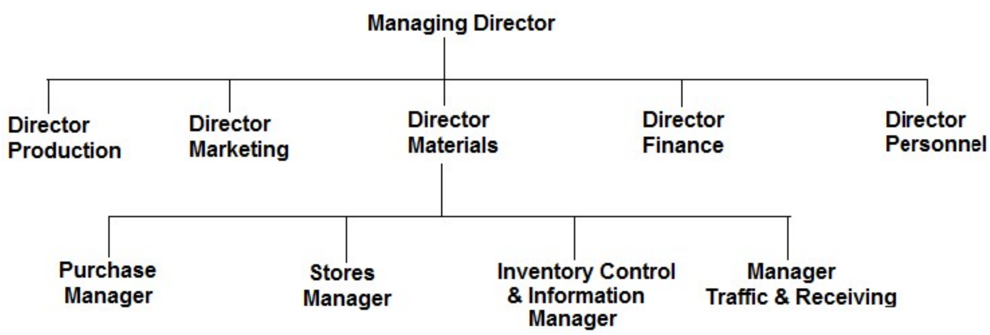

Exhibit 1.3 : Total Organisational Plan

The exhibit 1.3 shows the positions of various officers concerned with the materials management in an organisation. While the Director-Materials is responsible for the overall materials management, the Stores Manager is responsible for the physical custody of all the goods lying in the stores(s) and its proper recording. He is to report to both the Director Materials as well as to the Inventory Control & Information Manager. In a small organisation, there may be one or two officers working in relation to the stores department, being further assisted by many other store clerks. The above chart also shows that the stores manager is also related to the purchase manager, the marketing manager, the production manager and the finance manager.

4.2.1.6 Concept of Inventory Control

The Chartered Institute of Management Accountants, London (CIMA) defines *Inventory Control as "the function of ensuring that sufficient goods are stored in stock to meet all requirements without carrying unnecessarily large stocks."*

The term 'inventory control' is rather loosely used to cover two functions, which are quite different and are related to each other only in that they both require maintenance of adequate records of inventories as well as of receipt and issues corresponding to these two functions. The term 'inventory control' is, therefore, interpreted as 'accounting control' and 'operating control'. *The Stores accounting is, therefore, an essential task for the exercise of the inventory control.*

a) **Accounting Control** of inventories is concerned with:

   (i) the safeguarding of the organisation's property in the form of raw materials, work-in-process and semi-finished as well as finished products, and,

   (ii) the proper recording of the receipt and consumption of materials as well as the flow of goods through the plant into finished stock and eventually to customers.

b) **Operating Control** of inventories is concerned with maintaining inventories at the optimum level keeping in view the operational requirements and financial resources of the business.

The accounting control of inventories is generally recognized as an important part of storekeeper's property control function, and the operating control of inventories is a primary responsibility of the Storekeeper restricted only to the record keeping and data-reporting to management to make the material management possible. But in view of the fact that these two aspects are closely connected, a controller has to assume at least a part of the responsibility for operating control of inventories. So a storekeeper has both to the keep the stores records properly and also to keep the inventories at the optimum level, considering both the demands from the production or marketing departments as well as the restrictions from the finance department as to how much stock can be stored at a time.

4.2.1.7 Importance of Inventory Control

Investment in inventory represents in many cases, as one of the largest current asset item of business enterprises, particularly those engaged in manufacturing, wholesale trade and retail trade.

Moreover, the cost of materials used in production often surpasses the total cost of labour and factory overheads. Therefore, the ability to keep the materials cost at a minimum in each unit of finished product is a significant factor in profitable operations of a business. So, the task of inventory control through proper planning, purchasing, handling and accounting becomes very important.

It is a fact that the control of inventories has been one of the most neglected problems of management. It is often said that more firms fail on account of poor and insufficient inventory management than any other reason. Therefore, for most of the manufacturing and trading organisations, the formulation and execution of sound inventory management policies must be a managerial responsibility of the highest order.

In the exhibit 1.2 above, you must have observed that Tata Motors Ltd could raise its profitability from 19.74 crores in 2017-18 to an unbelievable amount of Rs. 2,602 crores and among the other reasons, it's inventory turnover ratio was also much improved from 10.27 in previous year to 14.75 in the current year. Its inventory was as high as 9.74% of its sales last year and it was reduced up to 6.78% in the current year, achieving a great reduction in its inventory by 2.96%, i. e. actually reducing its investment in materials to the extent of Rs. 2,035.44 crores. This great reduction in inventories, thus reduced the expenses towards interest on loan used for its working capital used for inventories as well as reduced its overall working capital requirements. This must have brought major contribution resulting into increasing the profitability.

The managerial objective must be the avoidance of 'over-investment' and 'under-investment' in inventories. So, there must be some 'right amount of inventory investment' for maximizing profits. However, it is most difficult to detect over-investment and under-investment in actual conditions. This, therefore, is the difficult problem involved in 'inventory management'.

4.2.1.8 Objectives of Inventory Control System:

To have a proper control over the inventories, an appropriate stores accounting system is to be employed, wherein all the receipts, issues, and movements of goods within and out of the organisation are to be recorded. The objective of inventory control is to make a balance between sufficient stock and over-stock. The stock maintained should be sufficient so that uninterrupted production flow can be maintained. Insufficient stock not only pauses the production but also causes loss of revenue on the lost sales and goodwill. The inventory control system used must try to keep the investment blocked into inventory at a minimum level while keeping the production or sales process uninterrupted. It should be such that right quality of material is supplied at right time to the various departments. It must try to avoid wastages, or obsolescence of stock. The management may employ various methods of inventory control to have a balance between sufficient stock and over-stock.

There are two levels of **operating control of inventory**—**unit control** and **value control**. Purchasing and production departments' executives are primarily interested in unit control with the consequence that they think of the requisitions and orders in terms of units instead of money values. It is, of course, true that the number of units multiplied by the price per unit can yield the money value, but their control emphasis is only on units i.e. the quantities to be purchased and to be stored. On the other hand, those responsible for financial planning are mainly concerned with financial control of inventories, because their overriding concern is that the resources invested in inventory must be efficiently and effectively utilized.

Thus, basically, the operating control of inventories must meet two opposing needs—i) the maintenance of an inventory of adequate size and diversity for efficient operations, and ii) the maintenance of an inventory which is not financially detrimental.

The fundamental objective of a good system of operating control of inventories is to be able to place an order at the right time from the right source to acquire the right quantity at right price and of right quality. This fundamental objective may be amplified into the following objectives which have to be kept in view while developing and maintaining a system of inventory control:

1. **Service to customers**— sufficient stock of finished product must be maintained to match reasonable expectations of customers for prompt execution of their orders.
2. **Effective use of Capital**—Capital available to business must be put to effective use for the financing of the cycle of purchase, manufacture, sale and collection.
3. **Reduction of risk of loss**—As far as possible, the possibility of the risk of loss through obsolescence or shrinkage in market value between the time of purchase or manufacture, on one hand, and the time of sale, on the other, has to be minimized.
4. **Economy in Purchasing** —An every attempt has to be made to effect economy in purchasing through quantity buying and taking advantage of favourable raw-material markets.
5. **Avoidance of out-of-stock danger**—Steps have to be taken to rule out the slightest possibility of business running short of the stock of finished good so that the implementation of the customer's orders may not be starved.

While these objectives are applicable to a manufacturing business, they are equally applicable to trading businesses with slight amendment.

4.2.1.9 Functions and Duties of Store-keeper

A storekeeper is appointed to look after the function of controlling the inventory. He should, in consultation with the production and purchase departments, fix the stocking levels such as minimum level, maximum level and reordering level for each of the item in stock. He should also fix the method of valuation for each stock item on the basis of their manner of issues. He should try to keep the investment of funds in the inventory at the minimum possible level.

A **Store** is the place where all inventory items are stored systematically. Normally the store is located in the factory premises or a godown near the place of a trading business. A **Store-keeper** is a person appointed to receive, issue and store the various items of stock and to keep record of stock and movement of all items of inventory. The store-keeper must know the kinds of inventories required and its usage. He is in charge of inventory control. He has to perform several functions and duties. These can be briefly set out as follows:

i) **General control over store:** Store keeper should keep control over all activities in stores department. He should check the quantities as mentioned in Goods Received Note and with the purchased materials forwarded by the receiving department and to arrange for their storage in appropriate places.

ii) **Safe custody of materials:** Store keeper should ensure that all the materials are stored in safe condition and environment required to preserve the quality of the materials.

iii) **Maintaining records:** He should maintain proper record of quantity received, issued, balance in hand and transferred to/from other stores.

iv) **Initiate purchase requisition:** He should initiate purchase requisitions for the replacement of stock of all regular store items whenever the stock level of any item of the store approaches the re-order level fixed.

v) **Maintaining adequate level of stock:** Store keeper should maintain adequate level of stock at all time. He should take all necessary actions so that production could not be interrupted due to lack of materials. He should also take immediate action for stoppage of further purchasing when the stock level approaches the maximum stocking level. He should reserve a particular material for a specific job when so required.

vi) **Issue of materials:** Store keeper should issue materials only against the Material requisition slip approved by the appropriate authority. He should also refer to the Bill of materials while issuing materials to requisitioning department.

vii) **Stock verification and reconciliation:** Store keeper should verify the book balances of stock items with their actual physical stock at frequent intervals, by way of internal control and check the any irregular or abnormal issues, pilferage, etc.

Check Your Progress - 1

Que. 1 – State whether the below given statements are true or false.

a) The term 'Inventory' includes stock of goods, plant and machinery and furniture.

b) The primary function of inventories is to ensure smooth production and marketing operations, by maintaining sufficient stock of goods.

c) Normally, the stock of goods forms a smaller part of the current assets of an organisation.

d) The inventory control system must try to keep the investment in inventory at a maximum level.

e) The duty of a storekeeper is to maintain the stores records only.

Que. 2 – Fill in the blanks.

a) …… is the place where all inventory items are kept systematically.

b) A ……… is appointed to receive, issue and store the various items of stock and to keep records of stock and movement of all items of inventory.

c) There are two levels of inventory control—unit control and …… control.

d) The objective of Inventory Control is to make a balance between sufficient stock and ………..

e) The managerial objective must be the avoidance of '……………..' and 'under-investment' in inventories

4.2.2 Key Terms

After understanding the concepts, need and importance of both the material management and inventory control, we need to learn about the different terms used in inventory control system. You can be fluent in using a computerised inventory control system if you are properly familiar with these terms.

4.2.2.1 Stock Group of Items –

Stock Groups in Inventory are similar to Groups in Financial Accounting Masters. They are helpful in the classification of Stock Items. You can group Stock Items under different Stock Groups to reflect their classification based on some common features such as brand name, product type, quality, etc.

4.2.2.2 Stock Category of item –

Stock Category offers a parallel classification of stock items. The advantage of categorizing items is that, you can classify the stock items (based on functionality) together–across different stock groups, which enables you to obtain reports on alternatives or substitutes for a stock item. For example, where different types of audio systems are in stores, they can be classified as groups belonging to their manufacturers i.e. Philips, National Panasonic, Sony, etc. as well as they can be further classified using different categories based on the type of the audio system i.e. Home theatre, Cassette Player & Recorder, DVD Player, iPod, etc. So, you can obtain reports of stocks of goods based on both categories as well as the groups of stock items.

4.2.2.3 Stock items –

Stock Item refers to goods that you manufacture or trade. It is the primary inventory entity and is the lowest level of information on your inventory. As you know, a stock item may represent a raw material, a work-in-process, finished goods, a consumable material or a spare part of the plant and machinery. It also includes the returnable containers.

4.2.2.4 Item Name –

Each stock item must bear a proper name, an alias and/or a part code number, if it forms a part of a machine. Some computerised systems need a Stock Item Code to be assigned for proper identification. But Tally ERP 9 does not need any separate item code as it is a codeless accounting system.

4.2.2.5 Unit of Measurement –

Stock Items are mainly purchased and sold on the basis of quantity. The quantity in turn is measured by units. In such cases, it is necessary to create the Unit of Measure. The Units of Measure can either be simple or compound.

4.2.2.6 Purchase –

Though the term 'Purchase' is similar to that used in financial accounting where it is meant as the purchases of goods only and not any assets; but in context of inventory control, it also includes purchases of consumables, returnable containers and sundry spare parts required frequently. Whatever goods is purchased, is all covered by this term. Of course, when both the financial accounting and inventory control are integrated, the journal entry passed in financial books must indicate the specific ledger accounts relating to purchases of the items covered by this term e.g. Raw Material Purchases, Finished Goods Purchases, Consumables Purchased and Spare Parts Purchased, etc. A purchase invoice is received from the vendor which gives all the information required to compute the purchase rates of each type of item purchased. So, you must have understood that the Stores Accounting is only concerned with the physical quantity of item and is not concerned with the ledger account which is used for the Financial Accounting of such purchases.

4.2.2.7 Purchase Returns –

Purchase return means the return of the full or a part of goods purchased by the businessman to its suppliers. Such returns include all those items of goods described in above paragraph. The purchase returns are to be valued at invoice price and not the stores ledger price. The stores ledger price will include its invoice price plus freight, receiving and handling charges, etc. But the difference between the invoice price and stores ledger price is to be accounted as an overhead and therefore, to be debited to Inventory Adjustment account.

4.2.2.8 Purchase Rate per Unit -

When a purchase takes place, its invoice gives us the rates charged by the vendor but it does not include the cost of Carriage Inward, Transit Insurance if any, loading-unloading charges and the receiving and handling charges, etc. The stores ledger is price shall include all these items of costs and finally the cost of acquisition of the goods so purchased is to be calculated. This cost divided by the quantity purchased gives us the purchase rate per unit.

4.2.2.9 Sales and Issues of Materials -

On receiving Material Requisition Notes from various production, sales or any other departments, the storekeeper issues the goods to the respective department. He prepares a delivery challan or a Material Issue Note for recording these issues. He also puts the valuation rate for the issued material or goods.

4.2.2.10 Sales Return –

Sales return means the return of the full or a part of the goods sold by the customer to a businessman. It is followed by a debit not sent by the customer. Or, we can prepare a credit note to record this transaction. In fact, a debit note received from a customer has same accounting effect as that of the credit note prepared by us.

4.2.2.11 Opening Stock Quantity –

Opening Stock is the quantity of materials that a company has available for sale or use at the beginning of an accounting period. The closing Stock of the previous accounting period becomes the opening Stock of the current accounting period.

4.2.2.12 Opening Valuation Rate –

Like the opening stock quantity, the current valuation rate of the closing stock of goods in the previous year is only treated as the opening valuation rate of goods.

4.2.2.13 Current Stock Quantity –

The stock of goods or materials on hand available now for issues or sales is known as the current stock quantity. It is the quantity of goods available for issues after the last movement of that stock item took place.

4.2.2.14 Current Valuation Rate -

In a stores ledger, the process of the stock valuation is done at each stage of an issue or a receipt of goods or material. After every stock movement, the stock is valued by the inventory control system. Since we are also studying the computerisation of inventory control, we have to understand that it is an on-line process of computing the stock valuation rate on every issue or receipt of materials. On happening of any stock movement, the latest stock valuation rate is immediately computed. This rate is known as the Current Valuation Rate and using this rate, the current stock is valued. This rate is used also for valuing the issues of materials.

Check Your Progress – 2

Que. 1 – State whether the below given statements are true or false.

a) Stock Group offers a parallel classification of stock items.

b) Sales return means the full or a part of the goods sold to the customer is returned by him to the seller.

c) Stock Item is the lowest level of information on your inventory.

d) The units of Measure can either be simple or compound units.

e) Sales return means the return of the full or a part of goods purchased by the businessman to its suppliers.

Que. 2 – Fill in the blanks.

a) The quantity is measured by……….

b) Purchase return means the return of the full or a part of the goods sold by the ……. to a businessman.

c) The stock of goods or materials on hand, available now for issues or sales, is known as the…………….

d) You can group …………under different Stock Groups.

e) A ……………invoice is received from the vendor of the goods.

4.2.3 Process of Store Accounting

You now, know that the term "inventory" or "goods" include the goods purchased for reselling, consumable materials like stationary, materials aiding the manufacturing process e.g. the coolants used in machine shops, raw materials, work-in-process, and the finished goods. Now, you also know the importance of maintaining a proper stores accounting system for exercising good control over the inventory used in both trading and industrial organisations. The process of maintaining a stores accounting system involves the following steps –

a) Identifying Inventory Transactions & Events

First identify the transactions involving any movement of goods. Theses are normally – purchases of goods, sales of goods, purchase returns and sales returns and any abnormal losses of goods in a trading organisation. In an industry, these include the purchase and purchase returns of raw materials and consumables, issues of materials to various departments, issues to and receipts from sub-contractors of work-in-process, transfer of excess materials taken by one department to the other, returned excess material from a department, abnormal loss of goods and materials due to whatever reason and the sale of finished goods by delivering it to the customers.

b) Journalising and Recording the Inventory Transactions & Events

To journalise a transaction means writing it in a proper subsidiary book. In case of the above mentioned transactions, the subsidiary books include – 1. Purchase book or register, 2. Stores ledger, 3. Sales book or register, 4. Debit notes register, 5. Credit notes register, and lastly 6. Journal. If you are using an integrated computer accounting system, then every journal entry, once entered into computer, it will have its necessary effects in all the concerned subsidiary books of account. But if you are using a stand alone inventory control system, then only stores ledger is to be used for recording a transaction. *Remember that, in today's environment of GST, you have to use an integrated accounting system to enable the preparation of GST returns. When the financial accounting and stores accounting is combined and both the systems use some common transactions data, it can be said to be an integrated accounting system.*

c) Stores Ledger Posting

The ledger posting refers to the general ledger in financial accounting as well as in the stores ledger in inventory control. A stores ledger contains all the information about an item viz. name, alias name, group and category to which it belongs, its ABC category, units of measure, minimum and maximum stocking levels, reordering level, etc. Apart from this, additional information of inventory transactions is included in columnar format of all the purchases i.e. receipts of goods or materials, all issues and sales, the purchase rates per lot of purchases, dates, etc. The figures to be calculated are the current quantity of that item, its current valuation rate, etc. In the stores ledger, the effects are given to each concerned stock items ledger, using the receipts or issues column. Here, the point to note is that the double entry system is not used while entering the receipts or issues of goods in the stores ledger.

d) Reports

You have already learn the reports taken in the financial accounting using double entry system. The reports are taken as per one's individual requirements but normally they include – 1. *Bin-wise* List of Stock Items, 2. Stock Statement, 3. Slow Moving Items Report, 4. Fast Moving Items Report, 5. Material Return Report, 6. Stock Item Summary, 8. Stock Summary, 9. Stock Group Summary, 10. Exception Reports- Negative Stock, Negative Ledgers Summary.

Check Your Progress – 3

Que. 1 – State whether the below given statements are true or false.

a) To journalise a transaction means writing it in a proper subsidiary book.

b) Debit Notes register is not included in the subsidiary books.

c) Negative stock report is available in Exception Reports in Tally.

d) Purchase book and Sales book register are the examples of subsidiary books.

e) The term "inventory" or "goods" include the goods purchased for reselling.

Que. 2 – Fill in the blanks.

a) While doing stores accounting, you should first identify the ………………… involving any movement of goods.

b) The ………………refers to the general ledger in financial accounting as well as the stores ledger in inventory control.

c) The double entry system of bookkeeping is not used while entering the receipts or issues of goods in the ……….. Ledger.

d) In today's environment of GST, you have to use an ……… accounting system to enable the preparation of GST returns.

e) In the stores ledger, the effects are given to each concerned …… items ledger, using the receipts or issues column.

4.2.4 Creating Inventory Masters in Tally.ERP 9

After Studying, this section you will be able to: (a) Understand the nature of master data and its various components while computerising the stores accounting, (b) Understand how to create the master data components and each of them works for aiding the process of computerisation of stores accounting, and (c) Understand to use, alter and delete the master data components.

4.2.4.1 Company Creation

1. Creating a company
2. Setting the Company's Accounting Features
3. Setting the Company's Inventory Features

The students have learnt about the company creation and related portion in the semester III while learning the computerised financial accounting using Tally ERP9; and hence it is not discussed in this book. But, before you start working on the stores accounting, you have to set the inventory and statutory parameters of the company.

4.2.4.2 Stock Groups-

Stock Groups in Inventory are similar to Groups in Accounting Masters. They are helpful in the classification of Stock Items. You can group Stock Items under different Stock Groups to reflect their classification based on some common features such as brand name, product type, quality, etc. Grouping enables you to locate Stock Items easily and report their details in statements.

The **Inventory Info** menu, lists the inventory masters like Stock Group, Stock Items, Units of Measure of the company, using which you can create, alter and display the inventory master details.

Go to **Gateway of Tally > Inventory Info.**

Figure 1 - Inventory Info. Menu

1. Creating Single Stock Group

Tally. ERP 9 allows you to create Stock Groups using single or multiple options.

Go to **Gateway of Tally > Inventory Info. > Stock Groups > Create**

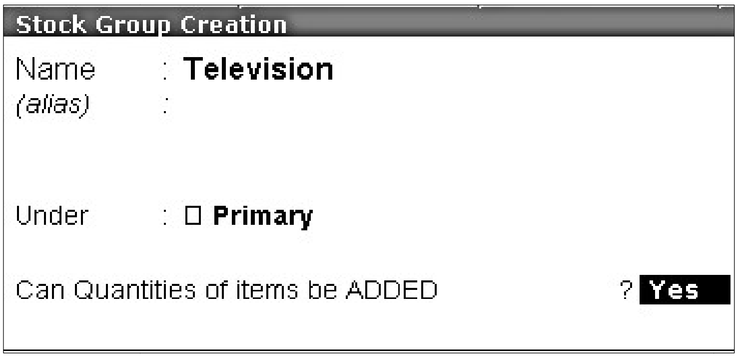

Figure 2 Stock Group Creation – Television

2. Creating Multiple Stock Groups

To create Multiple Stock Groups - Go to Gateway of Tally > Inventory Info. > Stock Groups > Create (under Multiple Stock Groups)

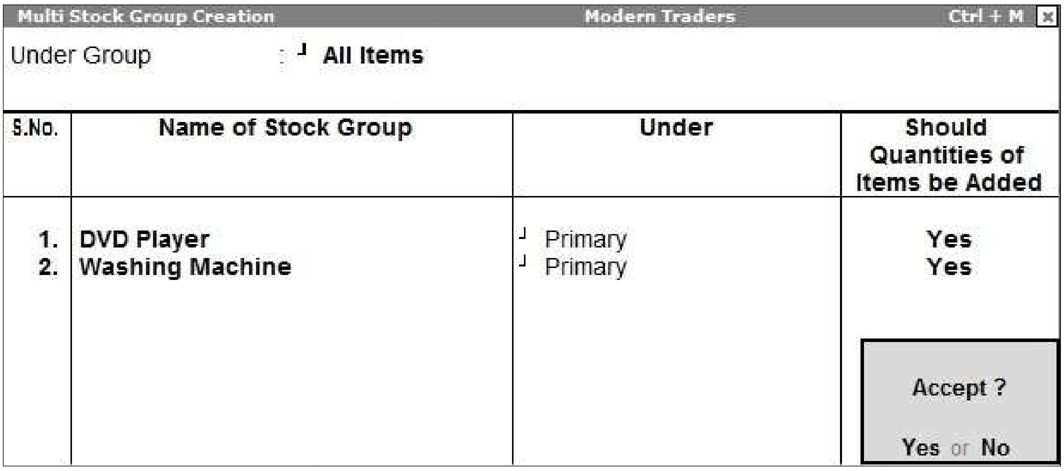

Figure 3 Multiple Stock Group Creation

3. Displaying a Stock Group

You can display the existing Stock Group in Single mode and multiple mode, since it is only display Tally.ERP 9 does not allow you to alter any information in display mode. To Display Single Stock Group **-** Go to Gateway of Tally > Inventory Info. > Stock Groups > Display. Select the Stock Group whose particulars you want to display from the List of Groups. The Stock Group Display screen will be displayed as shown.

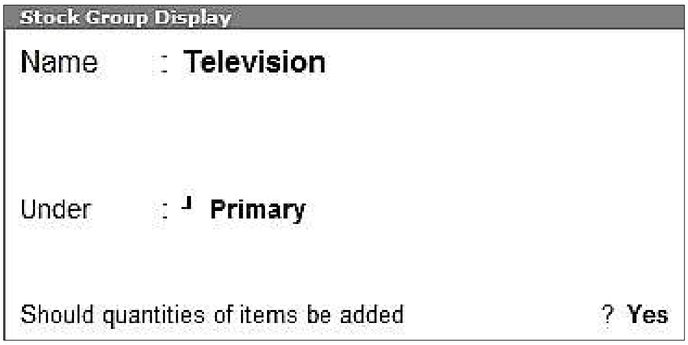

Figure 4 - Display Stock Group Creation

4. Altering a Stock Group

You can alter the existing Stock Group in Single mode and multiple mode.

To Alter Single Stock Group - Go to Gateway of Tally > Inventory Info. > Stock Groups > Alter

Select the Stock Group whose particulars you want to alter from the List of Groups. The Stock Group alter screen is displayed as shown

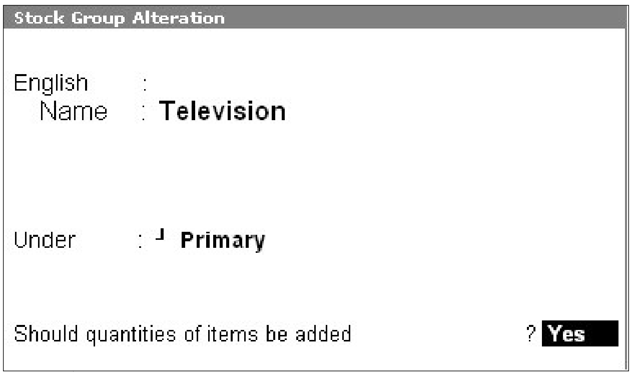

Figure 5 - Alter Stock Group Creation

4.2.4.3 Units of Measure-

Stock Items are purchased or sold on the basis of quantity. The quantity is measured by Units. Hence, it is necessary to create Units of Measure. You can have simple units such as numbers, meters, kilograms, and pieces.

1. Creating Simple Units

Go to **Gateway of Tally > Inventory Info. > Units of Measure > Create**

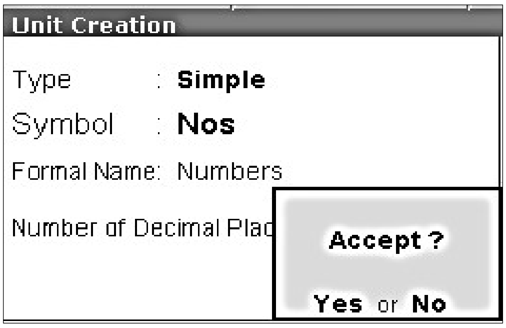

Figure 6 - Units of Measure Creation

2. Displaying Units of Units

You can display the existing Units of Measure, since it is only display Tally.ERP 9 does not allow you to alter any information in display mode.

To display Units of Measure -

1. Go to Gateway of Tally > Inventory Info. > Units of Measure > Display.
2. Select the Unit of Measure you would like to view from the Units list. You can select a compound unit or a simple unit from the list. The Unit Display screen is as shown below:

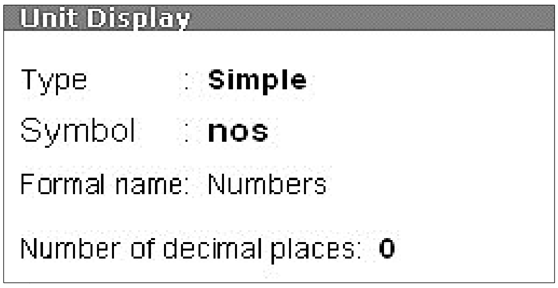

Figure 7 Display Units of Measure

3. Altering Units of Measure

You can alter the units of measurement created in Tally.ERP 9.

To alter Units of measurement, following steps are taken.

1. Go to Gateway of Tally > Inventory Info. > Units of Measure > Alter.
2. Select the Name of Unit you want to alter from the Units list. The Unit Alteration screen appears as shown below:

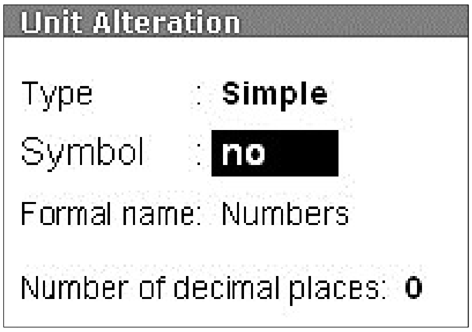

Figure 8 - Alter Units of Measure

3. Make the necessary changes
4. Press Alt + D Key – for delete units.
5. Press Ctrl+A to accept.

4.2.4.4 Stock Items

Stock Item refers to the item of goods that you purchase, manufacture or trade. It is the primary inventory entity and is the lowest level of information on your inventory. You have to create a Stock Item in Tally.ERP 9 for each inventory item that you want to account for.

1. Creating Single Stock Items

Go to Gateway of Tally > Inventory Info. > Stock Items (Single Stock Item) > Create

1. Enter the Name of the Stock Item.

2. Enter the Alias name of Stock item (if required).

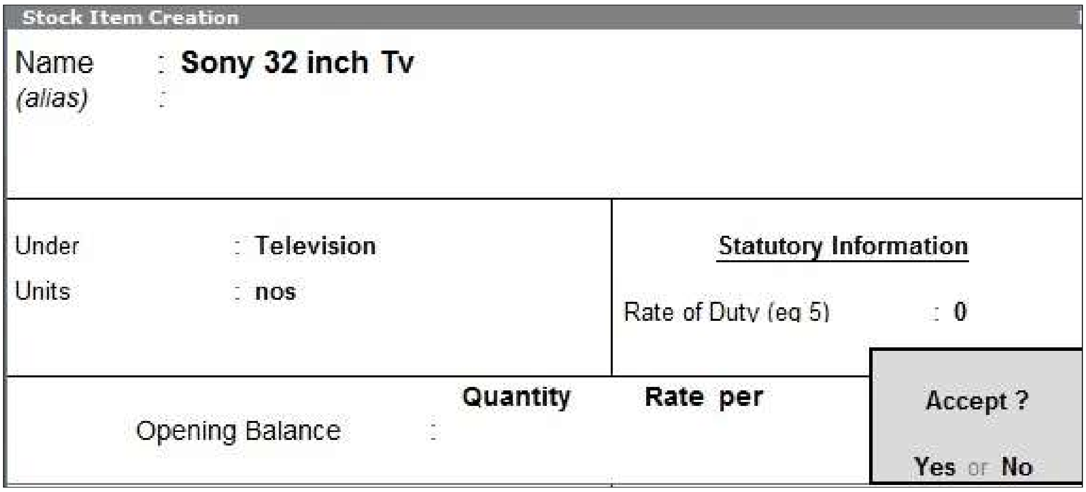

Figure 9 Stock Item Creation – Sony 32 inch

Press Y or Enter to accept the screen.

2. Creating Multiple Stock Items

Go to Gateway of Tally > Inventory Info. > Stock Items (Multiple Stock Item) > Create

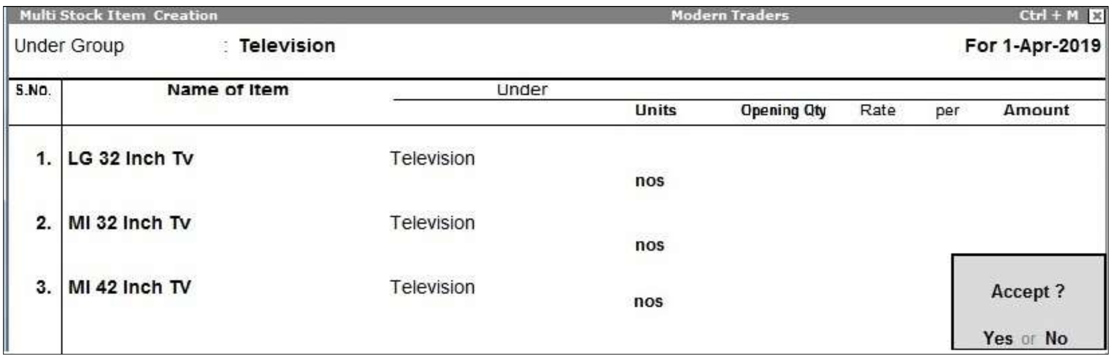

Figure 10 - Multiple Stock Item Creation

3. Displaying Stock Items

You can display the existing Single Stock Item master and Multiple Stock Item masters, since it is only display you are not allowed to alter any information in display mode.

To Display a Single Stock Item - Go to Gateway of Tally > Inventory Info > Stock Items > Display (under Single Stock Item).

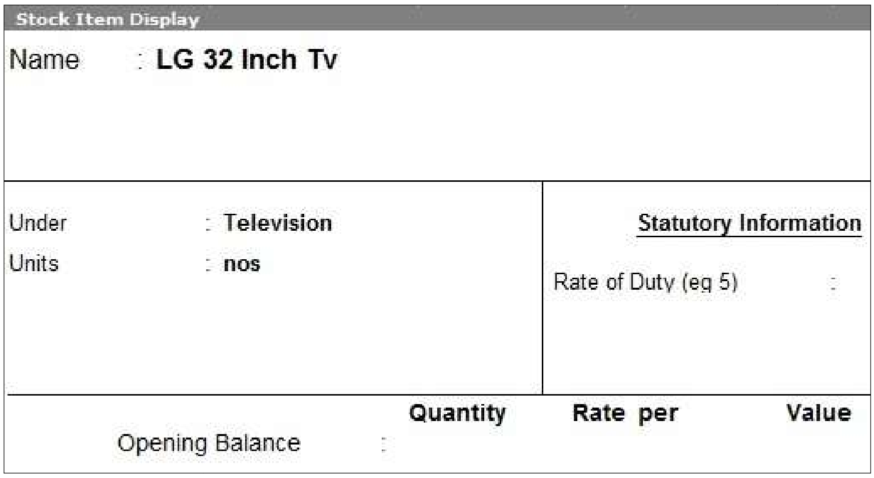

Figure 11 - Display Stock Items

4. Altering a Stock Item

This option allows you to view and change the details for the existing Single Stock Item master and Multiple Stock Item masters. If a transaction is entered for a stock item, it is not possible to alter the units or delete the stock item.

To Alter a Single Stock Item

1. Go to Gateway of Tally > Inventory Info. > Stock Items > Alter **(Single** Stock Item**).**

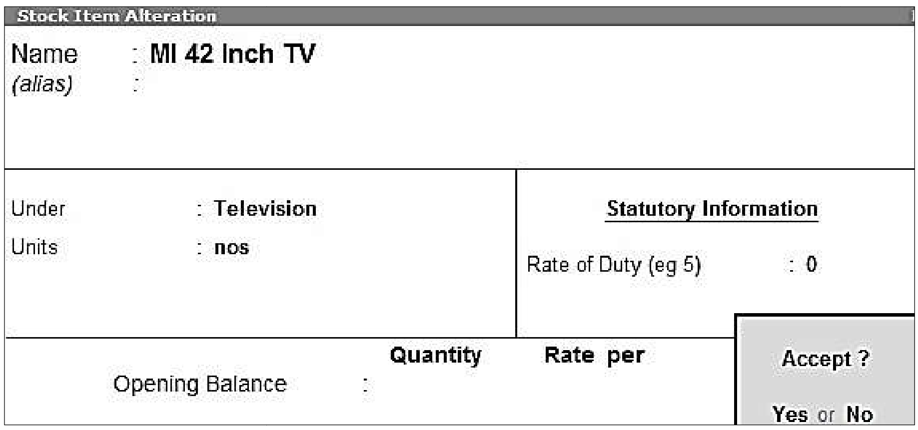

Figure 12 Alter Stock Item

Check Your Progress – 4

Que. 1 – State whether the below given statements are true or false.

a) Stock Groups in Inventory are similar to Groups in Accounting Masters.

b) Stock Items are purchased or sold on the basis of quantity.

c) Stock Group is the primary inventory entity on your inventory.

d) Tally allow you to alter units of measurement information in display mode.

e) Stock Grouping enables you to locate Stock Items easily and report their details in statements.

Que. 2 – Fill in the blanks.

a) You can display the existing Units of Measure, since it is only display Tally.ERP 9 does not allow you to alter any information in ………… mode.

b) Stock Groups are helpful in the classification of …………

c) Stock Items are purchased or sold on the basis of …………….

d) To Create Stock Group in Tally.ERP 9 you can go to …………….. Menu.

e) Stock Item…….option allows you to view and change the details for the existing Single Stock Item master.

4.2.5 Stock Valuation Methods

The Study of this section will be enable you to (a) Understand the need and importance of valuation of material issues; and of the inventory at the end of financial year, (b) Understand the various methods of their valuation. You can learn to use computerisation process for valuation of material issues and the inventory at the end of financial year using Tally ERP9, and (c) Find the relation between the valuation of Stock of Materials and all the three branches of accounting.

As explained in the beginning, the investment in inventory is often much large in proportion to the other current assets in financial statement. Therefore, the proper valuation or costing of inventory becomes a considerably important task of every organisation. An incorrect valuation of the inventory will result in a wrong statement of the costs of goods sold, gross margin on sales and net income as well as of proprietor’s equity i.e. capital during the period in which the stock valuation error occurs. Moreover, as the closing stock value at the end of one accounting period is the opening stock value at the beginning of the next year, it brings about a misstatement of cost of the opening stock, the goods sold, gross margin on sales and net income of the next year.

4.2.5.1 Need for Valuation of Inventories –

So, after understanding the importance of the valuation of inventories, we can summaries the need for proper valuation of inventories as under.

a) The stock of unsold goods at the end of a financial year is not reflected through the general transactions entered in financial books of account, but their purchase cost is debited in the Trading, Profit & Loss account. Here, the matching principle comes into picture as this is a case of non-matching. Therefore, the value of closing stock has to be brought into books of account. This is done by debiting the closing stock and crediting the trading account.

b) Secondly, for the cost accounting purposes, valuation of every material issue must be calculated correctly. Therefore, we apply an appropriate valuation method to calculate cost of each material issue.

c) Thirdly, for finance management purposes, the inventories being treated as non-liquid current assets; the investment in inventories must always be supervised and controlled to keep it at the minimum.

This is why, you must understand the importance of this function and since we are also studying its computerisation, we should know how to use various stock valuation methods using Tally ERP 9.

While computerising the inventories, you create an inventory master data by creating the desired groups and categories of stock items so that a proper classification of stock items can be done. Then, we start creating stock items masters. While inputting the details, you have to select a method of valuation of that item of material based on its manner of issues. To do this, you must have a reasonable working knowledge of the commonly used methods of valuation of material issues.

4.2.5.2 Stock Valuation Methods

Some of the commonly used methods of costing materials issues are –

1. Average Price methods –

    i) Weighted Average Price method,

2. Cost Price Methods -

   i) Specific Price method,

   ii) First-in First-out (FIFO) method,

   iii) Last-in Last -out (LIFO) method,

3. Notional Price methods -

   i) Standard Cost method.

Among these methods, Weighted Average Price method, Specific Price method and First-in First-out (FIFO) method are recommended by the Institute of Chartered Accountant of India through the Accounting Standard AS-2.

a) First-In First-Out (FIFO) Method

Under this method, the assumption is that materials are issued from the oldest supply in stock and that units issued are priced at the oldest cost price listed on stock ledger, the materials on hand at all times being the most recent purchases. When requisition for a certain type of material as presented to a storekeeper, he uses the cost price of the first lot of material received, which is still on hand. If the quantity desired is greater than the units remaining in the first lot, he uses the cost price of the second lot, then of the third and fourth until enough material is obtained to complete the requisition. This method is considered suitable in times of falling prices because the material cost charged to production will be high while the replacement cost will be low. The application of FIFO method is illustrated below.

3. Stock Valuation as per FIFO Method

Date	Particulars	Opening Stock		Receipts			Issues		Current	Current Valuation	
		Qty	Valuation Rate	Qty	Purchase Rate	Amount	Qty	Issued @ Rate	Stock Qty	Lot Rates used	Amount
1	Opening Bal. b/d	1,000	20	--	--	--	--	--	1000	20	20,000
3	Purchases			5,000	25	125,000			6000	20,25	145,000
4	Purchases			50	70	3,500			6050	20,25,70	148,500
6	Sales						2,100	22.62	3950	20,25,70	101,000
15	Purchases			5,600	30	168,000			9550	(20)25,70,30	269,000
20	Sales						8,000	27.47	1550	(20,25),70,30	46,500
25	Purchases			10	15	150			1560	(20,25,70),30,15	46,650

Figure 18 Stock Valuation as per FIFO Method

Here, when the 2100 quantity of material is issued, it will include the opening lot 1000 units @ Rs. 20 + from first purchase lot 1100 units @ Rs. 25, resulting into an issue rate of Rs. 22.62. While in second issue of 8,000 quantity, it will be valued at – (3900 x 25 + 50 x 70 + 4050 x 30) = Rs. 27.47 per issued unit. So, the closing stock will contain 1550 units valued @ Rs. 30 and 10 units @ Rs. 15, resulting into closing stock valuation of Rs. 46,650.

b) Last-In-First-Out (LIFO) Method

This is based on the assumption that the items of the last batch (lot) purchased are the first to be issued. Thus, cost of the latest materials purchased will be the costs assigned to the first materials issued, until they are exhausted, then the price of the preceding lot is used and so on. Materials are issued at costs approximating current market prices but inventories tend to be valued at the oldest lots on hand giving a price which is out-of-date with current invoice prices.

The main purpose of the LIFO method is to apply current costs to current sales. The use of this method during the period of rising prices does not reflect undue high profit which is a case with FIFO and Weighted Average method. In LIFO method, the issues will be charged at rising prices of latest lots purchased while the closing stocks will be valued at the old purchase rates which are lower. This method is illustrated below.

4. Stock Valuation as per LIFO Method

Date	Particulars	Opening Stock		Receipts			Issues		Current	Current Valuation	
		Qty	Valuation Rate	Qty	Purchase Rate	Amount	Qty	Issued @ Rate	Stock Qty	Lot Rates used	Amount
1	Opening Bal. b/d	1,000	20	--	--	--	--	--	1000	20	20,000
3	Purchases			5,000	25	125,000			6000	20,25	145,000
4	Purchases			50	70	3,500			6050	20,25,70	148,500
6	Sales						2,100	26.07	3950	20,25,70	93,750
15	Purchases			5,600	30	168,000			9550	20,25,(70),30	261,750
20	Sales						8,000	28.50	1550	20,25,(70),30	33,750
25	Purchases			10	15	150			1560	20,25,(70,30),15	33,900

Figure 19 Stock Valuation as per LIFO Method

Here, you can observe that the first issue of 2100 units is charged @ Rs. 26.07 whereas it was charged @ Rs. 22.62 only in the FIFO method. Again, here the closing inventories are valued at Rs. 33,900 as against Rs. 46,650 in FIFO method; therefore, the income statement does not show so undue high profits.

c) Weighted Average Price Method

Under this method, the materials issued during the month are generally valued at the weighted average unit cost (total cost of units divided by number of units) as at the end of the previous month. Since the weighted-average unit costs at the end of the previous month are available during the current period for costing requisitions, this method can be used with either a perpetual or periodic inventory system.

Stock Valuation as per Weighted Average Method

((Cur V. Rate x Cur. Qty) + (Pur Rate x Pur Qty)) / (Cur Qty + Pur Qty) = Revised Current Valuation Rate

Date	Particulars	Opening Stock		Receipts			Issues		Current Stock	Current Valuation	
		Qty	Valuation Rate	Purchase Qty	Purchase Rate	Amount	Qty	Issued @ Rate	Qty	Rate	Amount
1	Opening Bal. b/d	1,000	20	--	--	--	--	--	1,000	20.00	20,000
3	Purchases			5,000	25	125,000			6,000	24.17	145,000
4	Purchases			50	70	3,500			6,050	24.55	148,500
6	Sales						2,100	24.55	3,950	24.55	96,955
15	Purchases			5,600	30	168,000			9,550	27.74	264,955
20	Sales						8,000	27.74	1,550	27.74	43,003
25	Purchases			10	15	150			1,560	27.66	43,153

Figure 20- Stock valuation as per Weighted Average Price Method

This method is useful in case when quantity purchased under each lot is different and prices fluctuates frequently, e. g. a petrol pump where goods are purchased and sold at frequently different prices, can better use this method to value its issues and the closing stocks. The issue prices in this method need not be calculated for each issue unless a new lot of materials is received.

Here, when the first lot of 5,000 units is purchased, the revised current valuation rate is calculated as (20 x 1000 + 25 x 5000) / (1000 + 5000) which comes to Rs. 24.17 per unit. The rate is not to be calculated when materials are issued. Just the current rate is applied.

d) Standard Cost Method

FIFO, LIFO and Average Cost methods of valuing materials issued are often cumbersome to work within the subsidiary records for materials under a perpetual inventory system. Moreover, these methods involve a certain amount of arithmetic calculations; it may become awkward to work with. For this, as well as other reasons, standard cost method may be used in accounting for individual items in materials inventory.

This method charges material units into the factory at a predetermined, budgeted or estimated price reflecting a normal or an expected future price. Receipts and issues of materials are recorded in quantities only on materials card thereby greatly simplifying the record-keeping. Standard prices are fixed for each material and the requisitions are priced at the standard price. In case of highly fluctuating prices of materials, it is difficult to fix their standard cost on long-term basis.

Check Your Progress – 5

Que. 1 – State whether the below given statements are true or false.

a) The commonly used cost price methods include weighted average price method.

b) A proper valuation of inventories is needed for financial and cost accounting systems to produce correct accounting results.

c) Investment in inventory is often large in proportion to other current assets in financial statement.

d) Last-in-First-Out method is recommended by the Accounting Standard AS-2.

e) Strictly speaking, the price of such returned materials should be valued at the stores ledger price.

Que. 2 – Fill in the blanks.

a) The commonly used notional price methods include …….. Price method.

b) Under the weighted average price method, the materials issued are generally valued at the weighted average unit cost (total cost of units divided by ………………)

c) ………….. method is useful, specifically when the materials are purchased for a specific job or a work order.

d) …….. method is based on the assumption that the items of the last batch (lot) purchased are the first to be issued.

e) The ………… accounting concept creates need for the valuation of closing stock of goods.

4.2.6 Source Documents

After Studying this section you will be able to (a) Understand the meaning of different source documents prepared for recording the transactions and will understand the type of transaction by reading a source document, (b) Explain how to prepare a source document, how to pass a journal entry and how to record it using a computer, (c) Find relationship between accounting of a transaction in financial accounting books and in the stores accounting books.

In the previous section, we have learnt about the various terms used in inventory control system. These include some movements of inventory, which are recorded in either financial accounting or stores accounting, or the both. For any accounting transaction to be recorded, a document is a must. The accounting concept or accounting assumption of Objective Evidence Concept strictly tells us that a transaction cannot be recorded if it does not have any proper evidence in writing. Therefore, it is very much clear that each financial transaction in any business will be supported by proper documentary evidence. Such documentary evidence, which gives the first-hand information about that transaction, is known as the 'Source Document" in a computerised information system or is known as a 'Voucher' in financial accounting.

4.2.6.1 Concept of a Source Document or Voucher -

In the previous semester, you learnt the process of computerisation of financial accounting. There you understood the nature of various financial transactions that normally take place in a trading or manufacturing organisation. Mainly, they include sale of goods, purchases of goods and/or raw materials. Whenever the quality of any goods sold or purchased is found to be sub-standard, they are returned to the vendor. All these issues and receipts of goods/materials are authorized by proper documents, which are prepared at the time the transaction takes place. These documents provide us the first-hand information about these transactions. These documents being the original source of these transactions, they are called the 'Source Documents' or 'Vouchers' in computerised accounting. The examples of such source document include a debit voucher, a receipt of cash or by cheque, a sale or purchase invoice, a debit or credit note either sent or received or any journal voucher, etc. And recording such transactions is referred to as doing "Voucher entry" by many accounting softwares like Tally.

4.2.6.2 Types of Inventory Transactions and their Source Documents

The chart given below states the various inventory transactions and the source documents prepared for them. The chart also indicates the transactions, which are common in both financial accounting and in the stores accounting. The stores accounting is a part and parcel of its parent system of cost accounting. So, some of these transactions are also recorded in the books for cost accounting.

Inventory Transactions and Source Documents

Transactions & Source Document prepared			Used for recording in	
			Financial Accounting	Stores Accounting
A.	**Receipts of goods, materials and consumables.**			
1	Purchases of goods, materials and consumables.			
		Purchase Invoice with Delivery Challan	Yes	Yes
2	Sales returns of goods			
		Credit Note	Yes	Yes
3	Receipt of goods/materials by Stores			
		Goods Received Note	No	Yes
4	Goods or materials returned by production departments			
		Material Returned Note or Shop Credit Note	No	Yes
5	Goods or materials returned by the sub-contracters			
		Stores Debit Note	No	Yes
B.	**Issues of goods, materials and consumables.**			
6	Sales of goods			
		Sales Invoice with Delivery Challan	Yes	Yes
7	Purchase returns of goods, materials or consumables			
		Debit Note	Yes	Yes
8	Issues of goods/materials by Stores to internal departments			
		Material Requisition Note	No	Yes
9	Goods or materials issued to the sub-contracters			
		Stores Cedit Note	No	Yes
C.	**Stores Accounting Books & Other documents**			
		Store Ledger	No	Yes
		Purchase Requisition	No	Yes
		Material Transfer Note	No	No

Fig 13. The source documents used for different types of inventory transactions.

While working as a data entry operator, you must be familiar with all the source documents because you will be entering data from source documents only. By reading a source document, you should be able to understand the type of transaction, its date, accounts involved (a transaction may involve 2 or more accounts and stock items), the stock items names, their purchase rates and the transaction amount. You should reasonably understand which account to debit and which to credit, and how to calculate the purchase rates for each stock item purchased or issued. So you MUST obtain reasonable knowledge about all the source documents commonly created in a business transaction. Now let us learn about few of the above source documents.

4.2.6.3 Purchase Invoice

When goods are purchased from a supplier, a (Purchase) Invoice is prepared. In it the information about name of the customer i.e. name of your company, date of sale, serial no. of sales invoice, description, quantity and the selling rate of the goods sold, HSN code number of each stock item, etc. are mentioned. It also includes the date when its delivery is given, whether the purchase is in cash or on credit, if on credit, then the credit days allowed, taxes collected and other expenses like transportation charged, etc. It finally contains the total purchase amount in number as well as in words. When the purchase is in cash, a Cash Memo is prepared and for a credit purchases a Credit Memo or Invoice is prepared.

In fact, your purchase means the supplier's sales. Therefore, whether it is a purchase or a sales transaction, simply an 'Invoice' is prepared, which the purchaser refers to it as a 'purchase invoice', and the seller refers to as the 'sales invoice'. In fact, the heading printed contains the only word 'Invoice'.

4.2.6.4 Goods Received Note

After incoming materials have been examined and approved, they are passed on to the store together with the Goods Received Note. It is also called as Material Inward Note. Generally, it is prepared in quadruplicate and the copies are distributed to purchase department, stores department and accounting department. It contains the information of all the stock items received with their quantities, the delivery challan number and date, name of the vendor, sales invoice, if any, date and time of receiving the goods and the delivery challan number and its date. The storekeeper verifies the quantities actually received and that mentioned in the goods received note and then records the receipts into stores ledger. The goods may be received earlier to or after the receipt of purchase invoice. If both the documents are received together, then there arises no problem about data entry for the purchase rates of the goods so received. But if the goods is received prior to the purchase invoice, then the storekeeper can record only the quantities received but the purchase rates can be recorded after the purchase invoice is received.

4.2.6.5 Sales Invoice

When goods are sold to a customer, a (Sales) Invoice is prepared in which the information includes name of the customer, date of sale, serial no. of sales invoice, description, quantities and selling rates of the goods sold. It also includes the date when its delivery is given whether the sales is in cash or on credit, if on credit then the credit days allowed, HSN code number of each stock item, taxes collected and other expenses like transportation charged, etc. It finally contains the total sales amount in number as well as in words. When the sale is in cash, a Cash Memo is prepared and for a credit sale, a Credit Sales Memo or Sales Invoice is prepared.

4.2.6.6 Delivery Challan

When goods are sold to a customer, along with the (Sales) Invoice, a delivery challan is also prepared in which the information about name of the customer, date of dispatch of goods from factory or godown, serial no. description and quantities of the goods delivered, date when its delivery is given, etc. are mentioned. A delivery challan goes along with the goods to be delivered. The goods may be delivered earlier to or after the issue of sales invoice.

As shown in the above chart, there are many other source documents which are not considered here. The above four source documents are the most used ones in a trading concern. A manufacturing organisation will require the other source documents.

Check Your Progress – 6

Que. 1 – State whether the below given statements are true or false.

a) The documentary evidence prepared on making a transaction does not give the first-hand Information.

b) The stores accounting is a part and parcel of its parent system of cost accounting.

c) Sales Return of goods transaction recorded as debit note entry in Tally.

d) Goods Received Note is also called as Material Inward Note.

e) When goods are purchased from a supplier, a (Sales) Invoice is prepared.

Que. 2 – Fill in the blanks.

a) To understand any financial/inventory transaction correctly, the only remedy is to read the ………………..twice carefully.

b) Goods Received Note is prepared in quadruplicate and the copies are distributed to ……….. department,..………… department and accounting department. .

c) When goods are sold to a customer, a …………….Invoice is prepared.

d) Purchase Return of goods transaction recorded as ………………. entry in Tally.

e) When goods are received against a ……….. order, it is recorded using Tally as Goods Received Note.

4.2.7 Voucher Entry in TalIy ERP 9

4.2.7.1 Voucher Types

In above sections, you have learnt about the various transactions that take place in a business organisation. You have also learnt about the source documents used to record these transactions. Then, these source documents, viz. sales invoice, purchase invoice, debit notes, etc. are given to the data entry operator to input the data. Tally ERP 9 refers to these transactions as 'Vouchers'. You are to select the 'Voucher Entry' menu option to input the transaction data. The following are the most commonly used voucher types.

4.2.7.2 Purchase Voucher (F9)

When a company buys goods on credit or cash, Purchase voucher is used to record all the Purchase transactions of the company.

- Go to Gateway of Tally > Accounting Vouchers.
- Click on F9: Purchase on the Button Bar or press F9.

For example, a company purchases 2 nos. of Sony 32 Inch TVs @ Rs. 25,000 each from Anand Enterprises, on a credit of 10 days.

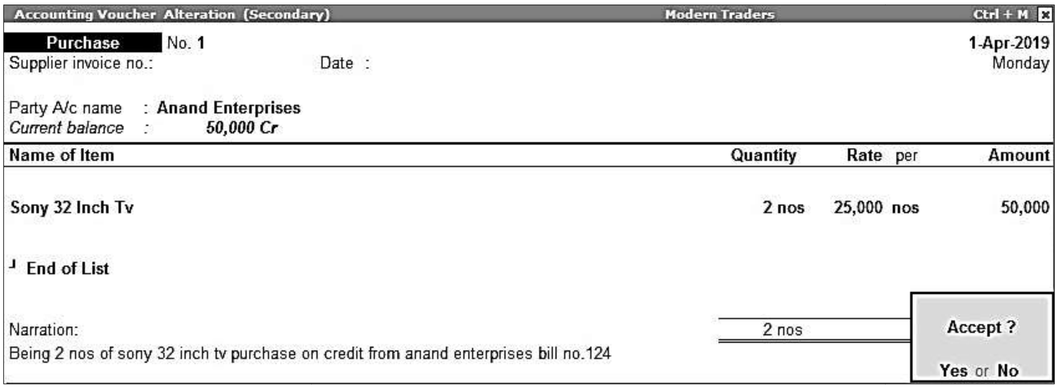

Figure 14 Purchase Voucher Entry in Tally. ERP 9 with invoice mode.

4.2.7.3 Sales Voucher (F8)

Sales Voucher is used to record the sales of goods transactions of the company. You can pass an entry using the Voucher mode, or the Invoice mode where the calculations can be automated and the transactions can be fed into the system easily. When a company sells goods on credit or cash, Sales voucher is used to record all the Sales transactions of the company.

- Go to Gateway of Tally > Accounting Vouchers
- Click on F8: Sales on the Button Bar or press F8.

For example, Company Sold 2 nos. of Sony 32 Inch TV @ Rs. 28,000 to Rajesh Electronics on credit.

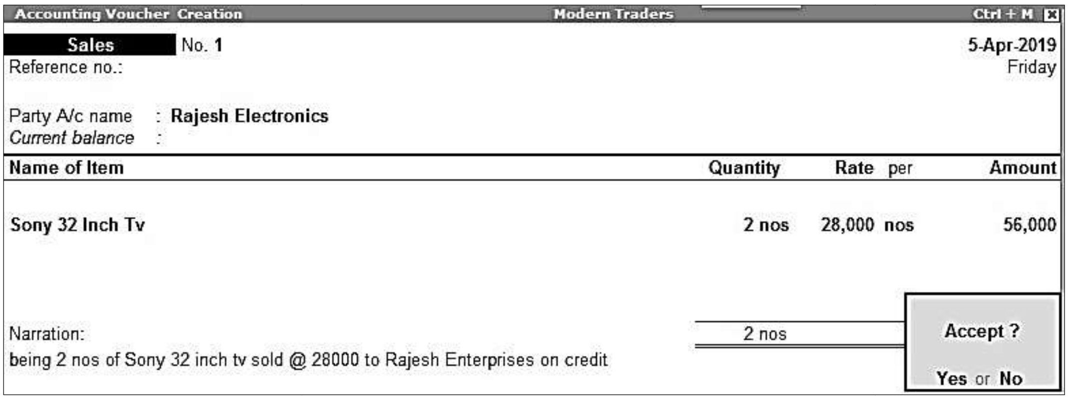

Figure 15 Sales Voucher Entry in Tally. ERP 9 with invoice mode.

4.2.7.4 Credit Note Voucher (Ctrl + F8)

A Credit Note is a document issued to a party stating that you are crediting their Account in your Books of Accounts for the stated reason or vise versa. It is commonly used in case of Sales Returns, escalation/de-escalation in price, etc.

A Credit Note can be entered in voucher or Invoice mode. You need to enable the feature in F11: Accounting or Inventory features.

- To use it in Voucher mode you need to enable the feature in F11: Accounting Features - Use debit and credit notes.
- To make the entry in Invoice mode enable the option F11: Accounting Features - Record credit notes in invoice mode.

  To go to Credit Note Entry Screen -

  1. Go to Gateway of Tally > Accounting Vouchers.
  2. Click on Ctrl+F8: Credit Note on the Button Bar or press Ctrl+F8.

You can toggle between voucher and Invoice mode by clicking Ctrl+V. Pass an entry for goods sold returned from Rajesh Electronics as under:

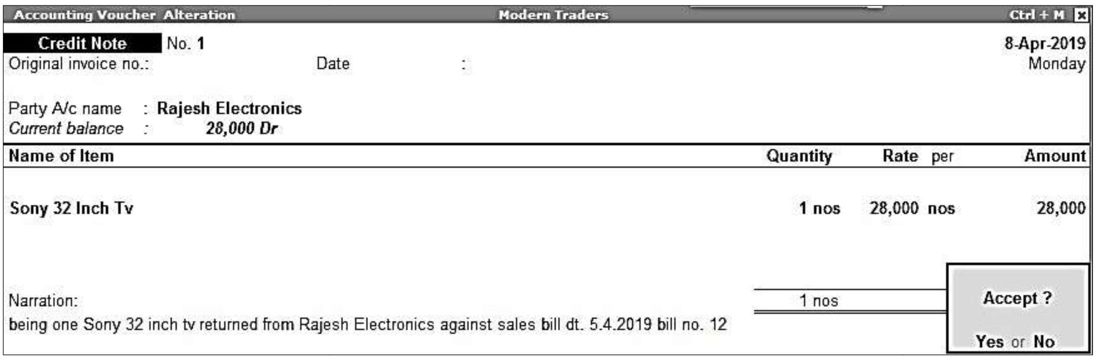

Figure 16 - Credit Note Voucher entry in Tally. ERP 9 with invoice mode

4.2.7.5 Debit Note Voucher (Ctrl + F9)

Debit Note is a document issued to a party stating that you are debiting their Account in your Books of Accounts for the stated reason or vise versa. It is, commonly used in case of Purchase Returns, Escalation/De-escalation in price, any other expenses incurred by you on behalf of the party etc.

To go to Debit Note Entry Screen,

- Go to Gateway of Tally > Accounting Vouchers.
- Click on Ctrl+F9: Debit Note on the Button Bar or press Ctrl+F9.
- Pass an entry for goods returned to Anand Enterprises as under:

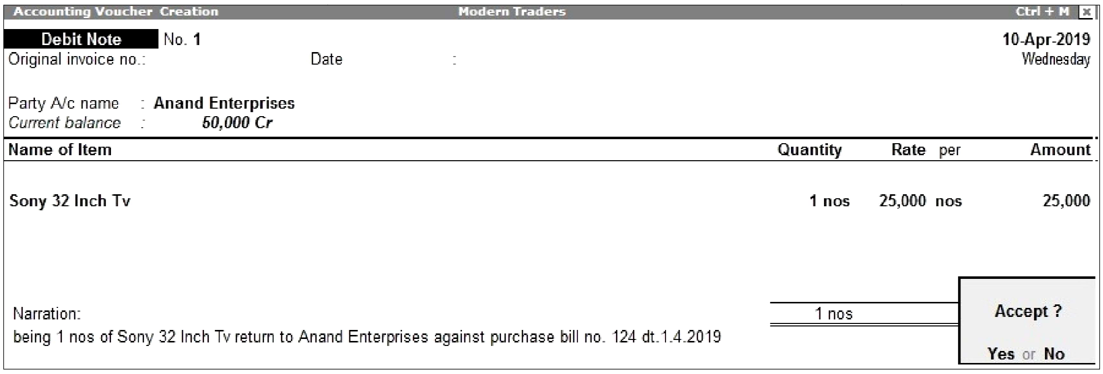

Figure 17 Debit Note Voucher Entry in Tally. ERP 9 with invoice mode

Check Your Progress – 7

Que. 1 – Fill in the blanks.

a) …………. Voucher is used for company buys goods on credit or cash.

b) Sales Voucher is used to record the ………. transactions of the company.

c) Credit Note voucher is commonly used in case of ……………….

d) ……………… voucher is commonly used in case of purchase return.

e) To choose Credit Note Voucher press__________ function key

4.2.8 Tally Reports & Books of Accounting

After studying this section, you will be able to (a) Understand the need and importance of various reports prepared in the Stores Accounting, (b) Explain computerisation process for display and printing of various reports using Tally ERP9, and (c) Find relation between the input vouchers data, designing a query using buttons provided by Tally and the reports so generated.

After the input data entry is done properly, its time to display a variety of reports required by management information system department (MIS). This requires reasonable working knowledge of the material management. In fact, if you possess this knowledge, then only you can decide on the issue of designing the master data structure using Tally.

4.2.8.1 Books of Stores Accounting -

Material Receipts/Purchases Register - A Purchase Register displays the information on the periodic purchases of a business concern. Purchase register helps in analyzing the details of movement of purchased goods to various godowns, on the basis of which the stock movement at each godown is determined. You can also view the columnar register for purchase. To view Purchases Register -

Go to *Gateway of Tally > Display > Account Books > Purchase Register*

Purchase Register   Modern Traders   Ctrl + M

Particulars	*Purchase* **Modern Traders** 1-Apr-2019 to 31-Mar-2020		
	Transactions		**Closing Balance**
	Debit	Credit	
April	*3,96,000*		3,96,000 Dr
May			3,96,000 Dr
June			
July			
August			
September			
October			
November			
December			
January			
February			
March			
Grand Total	***3,96,000***		**3,96,000 Dr**

Figure 23 Purchase Register Report

b) Material Issues/ Sales Register - Sales Register displays the monthly summary of sales transactions and closing balances. The list of transactions pertaining to each month can be viewed by selecting that month. You can change the display according to the information required. To view Sales Register –

Go to *Gateway of Tally > Display > Account Books > Sales Register*

Sales Register Modern Traders Ctrl + M

Particular	Sales **Modern Traders** 1-Apr-2019 to 31-Mar-2020		
	Transactions		**Closing Balance**
	Debit	Credit	
April		*2,06,500*	2,06,500 Cr
May		*1,12,000*	3,18,500 Cr
June			
July			
August			
September			
October			
November			
December			
January			
February			
March			
Grand Tot		***3,18,500***	**3,18,500 Cr**

Figure 24 Sales Register Report

c) Store Ledger-

In manual stores accounting, a book called Stores Ledger is maintained, in which a separate account for each stock item is opened. The information which has been described in para 4.232.3 is all mentioned. Thus, the book containing all the information about each of the stock item is collectively refered to as the 'Stores Ledger'. But in computerised accounting, displaying or printing a ledger is same as printing each of the ledgers. So when we ask Tally t display a report on stores ledger, it will prompt you to select a stock item from the list displayed in the right side of the screen. On selecting a desired stock item, its stock ledger will be displayed or printed.

4.2.8.2 Tally Reports of Stores Accounting -

a) Bin-wise list of Stock Items

A 'bin' is a place where an item of stock is stored. If the nature of a stock item is not big, it may be stored in a cupboard using different compartments, e.g. in any medical store, the medicines are stored using such bins, which are numbered with particular sequence. That helps easy searching any desired medicine quickly. In an industry, the number of stock items may range between few hundreds to thousands. In such a situation, while stock counting this report is very useful. It gives you information of stock items in the sequence in which you can find them easily. But this report is not available in Tally ERP9.

b) Stock Statement

A Stock Summary is a statement of the stock-in-hand on any given particular date. It is one of the primary inventory statements that is generated in Tally.ERP 9 which updates the stock record in real time as and when transactions are entered. Stock Summary provides information of stock groups and the stock items classified under those groups; and shows the quantity details, rate and closing value of the stock items under them.

To View Stock Summary, *Go to Gateway of Tally > Stock Summary*

Stock Summary	Modern Traders		Ctrl + M
Particulars	Modern Traders 1-Apr-2019 to 30-Apr-2019 Closing Balance		
	Quantity	Rate	Value
Music System	**8 nos**	*9,500*	**76,000**
Philips DVD player	*3 nos*	4,500	*13,500*
Sony 5.1 Music System	*5 nos*	12,500	*62,500*
Television	**13 nos**	*20,769*	**2,70,000**
LG 32 Inch Tv	*5 nos*	21,000	*1,05,000*
MI 32 Inch Tv	*5 nos*	18,000	*90,000*
Sony 32 Inch Tv	*3 nos*	25,000	*75,000*
Grand Total	**21 nos**		**3,46,000**

Figure 22 Stock Summary Report

c) Slow Moving Items Report

Movement analysis shows the analysis of only those inventory transactions which are integrated with the accounts, i.e. inventories which are also recorded in the financial books of accounts. Inventory vouchers which affect the stock only in quantitative terms are not considered.

d) Fast Moving Items Report

Movement analysis report is used for comparative studies. They give an insight into the flow characteristics of the stock in an organization. It also helps in finding out the slow moving items which cause blockages in the flow of the working capital of the organization. To display both the above reports, go to *-Gateway of Tally > Display > Inventory Books > Movement Analysis > Stock Item Analysis.*

Item Movement Analysis   **Modern Traders**   **Ctrl + M**

Particulars	*Sony 32 Inch Tv* **Modern Traders** 1-Apr-2019 to 31-Mar-2020			
	Movement Values			
	Quantity	*Basic Rate*	*Effective Rate*	Value
Movement Inward:				
Suppliers:				
Anand Enterprises	4 nos	*25,000*	*25,000*	1,00,000
	4 nos		**25,000**	1,00,000
Movement Outward:				
Buyers:				
Cash	4 nos		28,000	1,12,000
Rajesh Electronics	1 nos		28,000	28,000
	5 nos		**28,000**	1,40,000

Figure 26 Stock Item Movement Analysis Report

e) Material Return Report

A Debit Note is issued to the supplier of goods or materials for the purchased goods returned back to him. Normally, in case of a trader the term material returned means Purchase Returns and along with the goods so returned, a debit note is sent to the supplier stating the reasons of rejections made and amount debited to his account. Debit Note register displays all the debit notes recorded for each month. The Debit Note Register appears as shown: Go *to Gateway of Tally > Display > Account Books > Journal Register > Debit Note Register.*

Debit Note Register	Modern Traders	Ctrl + M
Particulars	*Debit Note* **Modern Traders** 1-Apr-2019 to 31-Mar-2020 **Transactions** Total Vouchers	(cancelled)
April	1	
May		
June		
July		
August		
September		
October		
November		
December		
January		
February		
March		
Grand Total	1	

Figure 25 Debit Note Register Report

f) Stock Item Summary

You can view stock items in based on the configuration you need for effective analysis of your stocks. To view stock items Summary Go to Gateway of Tally > Display > Inventory Books > Stock Item > Select Sony 32 Inch TV

Stock Item Monthly Summary | Modern Traders | Ctrl + M

Particulars	Sony 32 Inch Tv Modern Traders 1-Apr-2019 to 31-Mar-2020					
	Inwards		Outwards		Closing Balance	
	Quantity	Value	Quantity	Value	Quantity	Value
Opening Balance						
April	4 nos	1,00,000	1 nos	28,000	3 nos	75,000
May						75,000
June						75,000
July						75,000
August						75,000
September						75,000
October						75,000
November						75,000
December						75,000
January						75,000
February						75,000
March						75,000
Grand Total	**4 nos**	**1,00,000**	**1 nos**	**28,000**	**3 nos**	**75,000**

Figure 31 Stock Item Summary Report

g) Stock Summary

You can view Stock Summary in condensed or detailed mode, as per your requirements. You can change the period to view the inward, outward and closing balance of stock items for the selected period.

Go to Gateway of Tally > Stock Summary.

By default, Stock Group balances are displayed.

Stock Summary | Modern Traders | Ctrl + M

Particulars	Modern Traders 1-Apr-2019 to 30-Apr-2019		
	Closing Balance		
	Quantity	*Rate*	Value
Music System	8 nos	*9,500*	76,000
Philips DVD player	*3 nos*	4,500	*13,500*
Sony 5.1 Music System	*5 nos*	12,500	*62,500*
Television	**13 nos**	*20,769*	**2,70,000**
LG 32 Inch Tv	*5 nos*	21,000	*1,05,000*
MI 32 Inch Tv	*5 nos*	18,000	*90,000*
Sony 32 Inch Tv	*3 nos*	25,000	*75,000*
Grand Total	**21 nos**		**3,46,000**

Figure 30 Stock Summary Report

h) Stock Group Summary

Stock Group Summary provides information on stock groups and shows the quantity details, rate and closing value of the stock items under them. To view Stock Group Summary

Go to Gateway of Tally > Display > Inventory Books > Stock Group > Select Stock Group Television

Stock Summary	Modern Traders		Ctrl + M
	Television Modern Traders 1-Apr-2019 to 31-Mar-2020		
Particulars	Closing Balance		
	Quantity	*Rate*	Value
LG 32 Inch Tv	5 nos	*21,000*	1,05,000
MI 32 Inch Tv	5 nos	*18,000*	90,000
Sony 32 Inch Tv	3 nos	*25,000*	75,000
Grand Total	**13 nos**		**2,70,000**

Figure 32 Stock Group Summary Report

i) Exception Reports

It is possible to get the following exceptional reports for managerial purposes.

1. Items for which, consumption is more than the norms.
2. Items for which there is a supply shortage and anticipated price increase.
3. Items, those are out of stock.
4. Items with stock level above maximum norms.
5. Obsolete items.

j) Negative Stock

This Negative Stock report displays a list of all stock items that have a negative quantity (closing value) balance at the end of a specified period.

Go to Gateway of Tally > Display > Exception Reports > Negative Stock.

List of Negative Stock Items | Modern Traders | Ctrl + M

Particulars	Modern Traders 1-Apr-2019 to 10-May-2019 Closing Balance Quantity	 Rate	 Value
Sony 32 Inch Tv	(-)1 nos	*25,000*	(-)25,000
Grand Total	**(-)1 nos**		**(-)25,000**

Figure 33 Negative Stock Summary Report

4.2.8.3 Financial Statements

a) Balance Sheet

A balance sheet is a financial statement that reports a company's financial position. This report shows the balance between the assets and liabilities of a firm. The balance sheet follows the fundamental accounting equation: Assets = Liabilities + Owner's Equity.

To view the Balance Sheet

Go to Gateway of Tally > Display > Balance Sheet.

Balance Sheet | Modern Traders | Ctrl + M

Liabilities	Modern Traders as at 31-May-2019		Assets	Modern Traders as at 31-May-2019	
Capital Account		**4,89,500**	**Fixed Assets**		**2,17,500**
Anand Capital	*5,00,000*		*Buildings*	*1,50,000*	
Drawings	*(-)10,500*		*Computer*	*25,000*	
Loans (Liability)			*Electrical Fittings*	*12,500*	
Current Liabilities		**3,71,000**	*Furniture & Fixtures*	*30,000*	
Sundry Creditors	*3,71,000*		**Current Assets**		**6,54,450**
Profit & Loss A/c		**11,450**	*Closing Stock*	*2,46,000*	
Opening Balance			Loans & Advances (Asset)	*3,000*	
Current Period	*11,450*		Sundry Debtors	*28,000*	
			Cash-in-Hand	*3,55,450*	
			Bank Accounts	*22,000*	
Total		**8,71,950**	**Total**		**8,71,950**

Figure 27 Balance Sheet Report

b) Profit & Loss A/c

Profit and Loss Account or Income Statement is a periodic statement, which shows the net result of business operations for a specified period. All the expenses incurred and incomes earned during the reporting period are recorded in the Profit and Loss account or Income and Expenditure account.

To view the Profit & Loss Account

Go to Gateway of Tally > Display > Profit & Loss A/c.

Profit & Loss A/c — Modern Traders — Ctrl + M

Particulars		Modern Traders 1-Apr-2019 to 31-May-2019	Particulars		Modern Traders 1-Apr-2019 to 31-May-2019
Opening Stock			**Sales Accounts**		**2,90,500**
Music System			*Sales*	*2,90,500*	
Television			**Closing Stock**		**1,08,000**
Purchase Accounts		**3,71,000**	Music System	*76,000*	
Purchase	*3,71,000*		Television	*32,000*	
Expenses (Direct)		**5,000**			
Carriage Inward Expense	*3,500*				
Wages	*1,500*				
Gross Profit c/o		*22,500*			
		3,98,500			3,98,500
Expenses (Indirect)		**3,550**	*Gross Profit b/f*		*22,500*
Office Maintenance Charges	*2,300*				
Repairs & Maintenance Charges	*1,250*				
Nett Profit		*18,950*			
Total		22,500	**Total**		22,500

Figure 28 Profit & Loss Account Report

c) Trial Balance

A trial balance is a summary of all ledger balances, and helps in checking whether the transactions are correct and balanced. If journal entries are error-free and posted correctly to the general ledger, the total of all debit balances should be equal the total of all credit balances.

To view the Trial Balance

Go to Gateway of Tally > Display > Trial Balance. The Trial Balance appears as shown below:

Trial Balance	Modern Traders	Ctrl + M
Particulars	**Modern Traders** 1-Apr-2019 to 31-May-2019	
	Closing Balance	
	Debit	Credit
Capital Account	**10,500**	**5,00,000**
Anand Capital		*5,00,000*
Drawings	*10,500*	
Current Liabilities		**3,71,000**
Sundry Creditors		3,71,000
Fixed Assets	**2,17,500**	
Buildings	*1,50,000*	
Computer	*25,000*	
Electrical Fittings	*12,500*	
Furniture & Fixtures	*30,000*	
Current Assets	**5,53,950**	
Opening Stock		
Loans & Advances (Asset)	3,000	
Sundry Debtors	1,78,500	
Cash-in-Hand	3,50,450	
Bank Accounts	22,000	
Sales Accounts		**2,90,500**
Sales		*2,90,500*
Purchase Accounts	**3,71,000**	
Purchase	*3,71,000*	
Expenses (Direct)	**5,000**	
Carriage Inward Expense	*3,500*	
Wages	*1,500*	
Expenses (Indirect)	**3,550**	
Office Maintenance Charges	*2,300*	
Repairs & Maintenance Charges	*1,250*	
Grand Total	**11,61,500**	**11,61,500**

Figure 29 Trial Balance Report

4.2.8.4 Financial Accounting Books & Registers

a) Cash Book- It is used for recording all receipt and payments of cash, including cash purchases and cash sales of goods. Go to Gateway of Tally > Display > Account Books > Cash/Bank Book(s) > Alt + P: Print

b) Bank Book - All transactions that involve a Bank including deposits, credits, and withdrawals and so on, are displayed in the Bank Book Reports. Go to Gateway of Tally > Display > Account Books > Cash/Bank Book(s) > Alt + P: Print

c) Purchase Register – A Purchase Register displays the information on the periodic purchases of a business concern. Go to Gateway of Tally > Display > Account Books > Purchase Register > Alt + P: Print

d) Sales Register - Sales Register displays the monthly summary of sales transactions and closing balances. Go to Gateway of Tally > Display > Account Books > Sales Register > Alt + P: Print

e) Journal Register- Journal register report displays all the journal vouchers that have been passed. Go to Gateway of Tally > Display > Account Books > Journal Register > Alt + P: Print

f) Debit Note Register - Debit Note report displays all the debit note vouchers that have been passed. Go to Gateway of Tally > Display > Account Books > Journal Register > Debit Note Register > Alt + P: Print

g) Credit Note Register – Credit Note register report displays all the credit note vouchers that have been passed. Go to Gateway of Tally > Display > Account Books > Journal Register > Credit Note Register > Alt + P: Print

h) Day Book - The Day Book lists all transactions made in a particular day and by default displays the last voucher entry date of a regular voucher. It could also be set up to list all the transactions made over a certain period. Go to Gateway of Tally > Display > Day Book > Alt + P: Print

i) Statistics - The Statistics report displays the Masters created and the number of vouchers types entered. You can drill down to the transaction level from this report.

To view the Statistics report Go to Gateway of Tally > Display > Statement of Accounts > Statistics

Check Your Progress – 8

Que. 1 – State whether the below given statements are true or false.

a) A Purchase Register displays the information on the periodic purchases of a business.

b) In Tally ERP 9 you cannot view the columnar register for purchase.

c) Sales Register displays the monthly summary of sales transactions and closing balances

d) Journal register report displays all the Payment vouchers.

e) A Balance sheet is a financial statement that reports a company's financial position.

Que. 2 – Fill in the blanks.

a) A …………. is a statement of the stock-in-hand on any given particular date.

b) ………………….. Report is used for comparative studies.

c) A Debit Note is issued to the supplier for the ………. goods returned back to him.

d) Negative Stock report displays a list of all …………….that have a negative quantity

e) ……………………. provides information on stock groups and shows the quantity details, rate and closing value of the stock items under them.

4.3 Summary

1. The term "inventory" means stock of goods on hand. The term "goods" in a trading organisation indicates the goods purchased for reselling. Manufacturing organisations generally have three kinds of inventories viz. raw materials, work-in-process and finished goods.

2. In many organisations, the materials form the largest single expenditure item. The stock of materials, which is a non-liquid asset, forms an important part of the current assets in any organisation. The return on investment (ROI) depends to a great deal on the manner of utilization of materials.

3. We can define materials management as the function responsible for the coordination of planning, sourcing, purchasing, moving, storing and controlling materials in an optimum manner so as to provide a pre-decided service to the customer at a minimum cost. When all of the these functions are centrally controlled while fixing each department's responsibility and their authorities, it is referred to as the Integrated Materials Management. Today, computers are used beneficially for an efficient and effective integrated materials management.

4. The Chartered Institute of Management Accountants, London (CIMA) defines Inventory Control as "*the function of ensuring that sufficient goods are stored in stock to meet all requirements without carrying unnecessarily large stocks.*" The term 'inventory control' covers two functions, which are quite different and are related to each other only in that they both require maintenance of adequate records of inventories as well as of receipt and issues corresponding to these two functions. This maintenance of records is called 'Stores Accounting'. The 'Inventory control' is, therefore, interpreted as 'accounting control' and 'operating control'.

5. The managerial objective must be the avoidance of 'over-investment' and 'under-investment' in inventories. So, there must be some 'right amount of inventory investment' for maximizing profits. There are two levels of inventory control—unit control and value control. Purchasing and production departments' executives are primarily interested in unit control while those responsible for financial planning are mainly concerned with financial control of inventories. Thus, basically, the operating control of inventories must meet two opposing needs—the maintenance of an inventory of adequate size and diversity for efficient operations as well as maintenance of an inventory which is not financially detrimental.

6. A storekeeper is appointed to look after the function of controlling the inventory. He should, in consultation with the production and purchase departments, fix the stocking levels such as minimum level, maximum level and reordering level for each of the item in stock. He should also fix the method of valuation for each stock item on the basis of their manner of issues. He should try to keep the investment of funds in the inventory at the minimum possible level.

The process of stores accounting is similar to the financial accounting with the difference that instead of money, the quantities of goods received and issued are recorded. Some transactions are common in both these accounting systems e.g.

purchases of goods, raw materials, etc; sales of goods, sales rejections and purchase rejections. The main book is called the stores ledger. A separate ledger account is opened for each of the stores item.

The master data includes stock groups, stock categories, units of measure, stock items and godowns, etc. The master data is not normally altered. After the company creation, this is the first step to be performed.

1. For the cost accounting purposes, valuation of every material issue must be calculated correctly. So, we apply an appropriate valuation method to calculate cost of each material issue.
2. FIFO - The first goods purchased are also the first goods sold or issued.
3. LIFO - The last item of inventory purchased is the first one sold or issued.
4. Weighted Average - The weighted average method is an inventory costing method that assigns average costs to each piece of inventory when it is sold during the year.
5. Standard Cost - Standard prices are fixed for each material and the requisitions are priced at the standard price. In case of highly fluctuating prices of materials, it is difficult to fix their standard cost on long-term basis.

The most common movements of stock of goods or material include - sale of goods, purchases of goods, purchase returns i.e. goods returned to vendor and sales returns i.e. goods returned by customers. All these issues and receipts of goods/materials are authorized by proper documents, which are prepared at the time the transaction take place. The documents so prepared provide us the first-hand information about these transactions. These documents being the original source of these transactions, they are called the ‘Source Documents’ or ‘Vouchers’ in computerised accounting. The various types of Source documents that are commonly used to recording in Financial & Stores accounting is Purchase Invoice, Goods Received Note, Sales Invoice and Delivery Challan, etc

As aforesaid, voucher entry is the process of feeding transaction data to computer. This data relates to the sales, purchases, rejections of goods and materials. The usefulness of computerized reports solely depends on the correctness of the vouchers entered.

A report contains information of specific nature, e.g. a stock item, stock statement, movements of stocks, etc. The books of stores accounting mainly include the stores ledger, and a few more depending on needs. A stores ledger gives the complete information of each item of stock along with their master data.

4.4 Terms to Remember

1. **Inventory** – It means stock of goods or materials on hand.
2. **Inventory Turnover Ratio** – This ratio shows how many times the inventory has turned over in a given period. It is calculated by dividing sales by the average inventory on hand. It indicates the degree of efficiency of the materials management.
3. **Non-liquid Asset** – The asset which cannot be easily converted into cash can be referred to as a non-liquid asset e.g. stock of goods cannot be converted into either cash or sundry debtors unless it is sold. Among the current assets, stock of goods/materials is a non-liquid asset while Cash, Bank balance and Sundry Debtors are treated as liquid assets.
4. **Return on Investment** – This financial ratio indicates the percentage of net profit to the capital invested.
5. **EDP** – It is a short form of the term – Electronic Data Processing. Here, data is processed using computers.
6. **Over-investment** or **Over Stock**– Here it means maintaining inventory more than the maximum level of stock.
7. **Under-investment** or **Under Stock** - Here it means maintaining inventory less than the minimum level of stock.
8. **Stock Group** - Stock Group are helpful in the classification of Stock Items. You can group Stock Items under different Stock Groups to reflect their classification based on some common features.
9. **Stock Item** refers to goods that you manufacture or trade. It is the primary inventory entity.
10. **Units of Measure** - Stock Items are purchased or sold on the basis of quantity. The quantity is measured by Units. Hence, it is necessary to create Units of Measure.

11. **Perpetual** – It means continuous or uninterrupted. This term is used to differentiate a stock valuation method into two sub-types. The first is periodic revising the valuation rate and the second is a perpetual process. So a weighted average method may be either monthly or perpetually applied.
12. **Purchase Voucher -** When a company buys goods on credit or cash, Purchase voucher is used to record all the Purchase of goods & services transactions of the company
13. **Sales Voucher -** Sales Voucher is used to record the Cash & Credit Sales of goods or services transactions of the company
14. **Credit Note – Credit** Note is a document issued to a party stating that you are crediting their Account in your Books of Accounts for the stated reason. It is commonly used in case of Sales Returns.
15. **Debit Note -** Debit Note is a document issued to a party stating that you are debiting their Account in your Books of Accounts for the stated reason. It is commonly used in case of Purchase Returns.
16. **Stock Statement** - Stock Summary provides information on stock groups and shows the quantity details, rate and closing value of the stock items under them
17. **Purchases Register** - A Purchase Register displays the information on the periodic purchases of a business concern
18. **Sales Register** - Sales Register displays the monthly summary of sales transactions and closing balances
19. **Movement analysis** - Movement analysis helps in finding out the slow moving items which cause blockages in the flow of the working capital of the organization.
20. **Stores Ledger** - A stores ledger gives the complete information of each item of stock along with their master data.
21. **Balance sheet** - A balance sheet is a financial statement that reports a company's financial position. This report shows the balance between the assets and liabilities of a firm.
22. **Profit and Loss Account** - Profit and Loss Account or Income Statement is a periodic statement, which shows the net result of business operations for a specified period.

23. **Trial balance** - A trial balance is a summary of all ledger balances, and helps in checking whether the transactions are correct and balanced

4.5 Answers to Check Your Progress

Check Your Progress – 1

Que. 1 – a) False, b) True, c) False, d) False, e) False

Que. 2 – a) Store, b) Storekeeper, c) value, d) over-stock, e) over-investment

Check Your Progress – 2

Que. 1 – a) False, b) True, c) True, d) True e) False

Que.2 – a) Units, b) Supplier, c) current stock quantity d) Stock Items e) Purchase

Check Your Progress – 3

Que. 1 – a) True, b) False, c) True d) True e) True

Que.2 – a) Transactions, b) Ledger Posting, c) Stores, d) Integrated e) Stock.

Check Your Progress – 4

Que. 1 – a) True, b) True, c) False, d) False e) True.

Que.2 – a) Display b) Stock Items, c) Quantity, d) Inventory Info e) Altering

Check Your Progress-5

Que. 1 a) False, b) True, c) True, d) False, e) True.

Que. 2 a) Standard Price method, b) number of units, c) Specific Price method, d) LIFO, e) Matching.

Check Your Progress - 6

Que. 1 – a) False, b) True, c) False, d) True, e) False.

Que. 2 – a) Source Document, b) Purchase, Stores, c) Sales, d) Debit Note, e) Purchase

Check Your Progress-7

Que. 1 – a) Purchase b) Sales c) Sales Return d) Debit Note e) Ctrl + F8

Check Your Progress – 8

Que. 1 – a) True b) False c) True d) False e) True.

Que. 2 – a) Stock summary b) Movement analysis c) Purchase
d) Stock Items e) Stock Group Summary

4.6 Exercise

1. What is the importance of materials management?
2. What is an integrated Materials Management? What are its benefits?
3. What are the functions and duties of Store-Keeper?
4. Write short notes on – a) Inventories, b) Storekeeper,
5. Explain the form and the contents of a stores ledger.
6. What is Stock Group? Write steps to create Single Stock Group in Tally.
7. Write steps to create multiple stock items in tally with example.
8. Write short notes on –

   a) Stock Items b) Units of Measurement
9. Explain the need for inventory valuation.
10. What are the commonly used methods of valuation of inventories?
11. Write short notes on –
    a) Valuation of materials returned to vendor,
    b) Purchase rate,
    c) Material Issue rate
12. Explain the Types of Inventory Transactions?
13. What are the source documents used for financial and Store accounting.
14. Write short notes on –

    a) Sales Invoice, b) Delivery Challan, c) Goods Received Note
15. Explain Purchase & Sales Voucher Types used in Tally.
16. Explain difference between Credit Note & Debit Note Voucher Types in Tally.
17. Write short notes on –

    a) Purchase Voucher b) Credit Note c) Debit Note
18. Explain the store accounting reports in Tally.
19. Write short notes on –

a) Stock Statement b) Material Receipts/Purchases Register

c) Movement Analysis Report

20. Write short notes on –

a) Balance Sheet b) Profit & loss Account c) Trial Balance

4.7 Reference for further study

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