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Unit-I

Right Issue, Bonus Issue, Sweat Equity Shares

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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 financiers 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.

- 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-

- General Reserves
- Capital Reserves
- Securities or Share Premium Account
- Capital Redemption Reserve Account
- Balance in Profit and Loss Account
- 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.

- For provision made for issue of bonus shares

Share Premium A/c	Dr
To Bonus to Equity Shareholders A/c	
- 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.

$$4000 / 5 = 800 \times 100 = 80,000$$

Journal

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

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.

$$600 / 3 = 200 \times 1000 = 2,00,000$$

Journal

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

Illustration 3. Following is the extract from the draft Balance Sheet of Aishwarya Ltd. as on 31st 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	-----
Profit & Loss A/c	1,00,000
	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.

$$25\% \text{ of } 5,00,000 = 1,25,000$$

Provision – from Profit & Loss A/c	50,000	
from Reserve Fund	<u>75,000</u>	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 (Being provision made for issue of bonus shares)			1,25,000

31/3/2023	Bonus to Equity Shareholders A/c Dr		1,25,000	
	To Equity Share Capital A/c (Being 1 bonus share is issued for every 5 shares)			1,25,000

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 (Being provision made for issue of bonus shares)			1,20,000
31/3/2023	Bonus to Equity Shareholders A/c Dr		1,20,000	
	To Equity Share Capital A/c (Being 1 bonus share is issued for every 5 shares)			1,20,000

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	1,80,000			
		4,00,000		By Gen. Reserve A/c	20,000			
					4,00,000			

Check your progress - 1

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

- shares are the shares issued by a company free of charge to its existing shareholders on a pro-rata basis.
 - Bonus
 - Right
 - Sweat
 - Preference
- at the time of issue, will be entitled to receive bonus shares.
 - All the members of Board of Directors,
 - All the existing shareholders,
 - All the Preference Shareholders
 - All the investors

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 its 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' stock 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

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

OR

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

Valuation of ex-right Value

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

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.

$$\text{ex-right Value} = \text{Cum-market price} - \text{Right Value}$$

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

$$\begin{aligned}
 \text{b) Value of Right Share} &= \frac{\text{Market Price} - \text{Subscription Price}}{\text{No. of old shares required to purchase one new share} + 1} = R = \frac{M - S}{N + 1} \\
 &= \frac{1800 - 1200}{4 + 1} = 120 \text{ ₹}
 \end{aligned}$$

OR

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

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

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

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

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

OR

$$\text{ex-right Value} = \text{Cum-market price} - \text{Right Value} = 1800 - 120 = 1680$$

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 of ₹ 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

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

$$= \frac{160 - 130}{5 + 1} = 5 \text{ ₹}$$

OR

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

$$= \frac{1}{6} \times (160 - 130) = 5 \text{ ₹}$$

Calculation of ex-right value

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

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

OR

$$\text{ex-right Value} = \text{Cum-market price} - \text{Right Value} = 160 - 5 = 155$$

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

$$\begin{aligned} \text{Value of Right Share} &= \frac{\text{Market Price} - \text{Subscription Price}}{\text{No. of old shares required to purchase one new share} + 1} = R = \frac{M - S}{N + 1} \\ &= \frac{2500 - 1250}{3 + 1} = 312.50 \text{ ₹} \end{aligned}$$

Calculation of ex-right value

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

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

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.

4. As per Section -----of the Companies Act 2013, where at any time a company proposes to increase its 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) 1 to 15 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 = $\frac{\text{(Cum-market price x no.of old shares entitling purchase one share) + subscription price for a new share}}{\text{no.of old shares entitling purchase one share} + 1}$

- 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.

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 into 12,000 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.

1.9 Reference for Further Study

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Unit-II

Issue of Debentures

Meaning and classification of Debentures, Accounting for issue of Debentures, Different Terms of Issue of Debentures. Redemption of Debentures, Accounting under Sinking Fund Method

Index :

- 2.0 Objectives
- 2.1 Introduction
- 2.2 Issue of Debentures
 - 2.2.1 Meaning and Definitions
 - 2.2.2 Features of Debentures
 - 2.2.3 Types of Debentures
 - 2.2.4 Difference between Debentures and Shares
 - 2.2.5 Accounting Entries
- 2.3 Redemption of Debentures
 - 2.3.1 Meaning and Nature
 - 2.3.2 Methods of Redemption of Debentures
 - 2.3.3 Sinking Fund Method
 - 2.3.3.1 Meaning and Nature
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 - 2.3.3.3 Calculation of interest
- 2.4 Check Your Progress
- 2.5 Illustrations
 - 2.5.1 Issue of Debentures
 - 2.5.2 Redemption of Debentures

- 2.6 Summary
- 2.7 Terms to remember
- 2.8 Answers to check your progress
- 2.9 Exercise
- 2.10 Reference for further study

2.0 Objectives

After studying this unit, you will be able to –

- Understand the meaning, nature and types of Issue of Debentures.
- Pass accounting entries regarding issue of debentures.
- Understand the meaning, nature and methods of Redemption of Debentures
- Know accounting of 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 and 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 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 accounting entries in the books of the company regarding issue and redemption of debentures.

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'	Shareholder 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 the company and deductible in determining taxable profit	Dividend is an appropriation of profit. It 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	Shareholders 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

Important points regarding issue of debentures

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).

2.2.5 Accounting / Journal Entries for Issue of Debentures

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.

1. Debentures issued at par repayable at par

Journal Entry	Amount
Bank A/c 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 Loss on Issue of Debentures A/c To Debentures A/c To Premium on Redemption of Debent. 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 Discount on Issue of Debentures A/c 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 Discount on Issue of Debentures A/c Loss on Issue of Debentures A/c To Debentures A/c To Premium on Redemption of Debent. A/c (Being debentures issued at discount repayable at premium)	No. of debentures x amount received No. of debentures x discount amount No. of debentures x premium amount 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 To Debentures A/c To Premium on Issue of Debentures A/c (Being debentures issued at par repayable at premium)	Dr 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 Loss on Issue of Debentures A/c 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)	Dr Dr No. of debentures x amount received No. of debent. x redemption premium amount No. of debentures x face value No. of debentures x issue premium amount No. of debent. 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 To Debentures Application A/c (Being debenture applications received)	Dr No. of debentures applied x application money

b) If debentures are issued at discount

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

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

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

2. On receipt of allotment money

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

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

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

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

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 Redemption of Debentures

2.3.1 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.

2.3.2 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.

2.3.3 Sinking Fund or Debenture Redemption Fund Method

2.3.3.1 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.

2.3.3.2 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 Debent. A/c Dr	Total balance of debentures account

To Debenture holders A/c (Being balance of debentures account transferred to debenture holders 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.

2.3.3.3 Calculation of interest

At the end of	Interest calculation	Total investment
1	2	3
First year	Nil	1 st year's provision
Second year	Amount as shown in column 3 in the first year's row x Rate = Interest	1 st and 2 nd years provision + interest as calculated in previous column OR Amount as shown in column 3 in the first 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	1 st , 2 nd and 3 rd 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	1 st , 2 nd , 3 rd and 4 th 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	1 st , 2 nd , 3 rd , 4 th and 5 th 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

2.4 Check Your Progress

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

- 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.

2.5 Illustrations

2.5.1 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.

Illustration 1. Rohit Bat Producing Co. issued the following debentures during the year 2024-25.

1. On 1/7/2024, 2000 12% debentures of `200 each issued at 10% discount repayable at par at the end of 12th year
2. On 30/9/2024, 4000 9% debentures of `500 each issued at 5% discount repayable at 12% Premium at the end of 15th year
3. On 1/1/2025, 500 10% debentures of `1000 each issued at par repayable at par after 5 years.
4. On 31/3/2025, 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 ₹
1/7/2024	Bank A/c Dr Discount on Issue of 12% Debentures A/c Dr To 12% Debentures A/c (Being debentures issued at 10% discount repayable at par)		3,60,000 40,000	4,00,000
30/9/2024	Bank A/c Dr Discount on Issue of 9% Debentures A/c Dr Loss on Issue of 9% Debentures A/c Dr To 9% Debentures A/c To Premium on Redem. of 9% Debent. A/c (Being 9% debentures issued at 5% discount repayable at 12% premium)		19,00,000 1,00,000 2,40,000	20,00,000 2,40,000
1/1/2025	Bank A/c Dr To 10% Debentures A/c (Being debentures issued at par repayable at par)		5,00,000	5,00,000
31/3/2025	Bank A/c Dr Loss on Issue of 9% Debentures A/c Dr To 9% Debentures A/c To Premium on Redem. of 9% Debent. A/c (Being debentures issued at par repayable at 10% premium)		5,00,000 50,000	5,00,000 50,000

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

Illustration 2. Rahul Stumps Producing Co. issued following debentures during the financial year 2024-25. On issued at repayable at.

Date	Debentures	Issued at	Repayable at
30/4/2024	10000 11% debentures of ₹100 each	2% discount 5% discount	Par at the end of 4 th year
30/9/2024	2000 9% debentures of ₹100 each	7% premium	10% Premium at the end of 5 th year
31/12/2024	7000 7% debentures of ₹100 each	15% premium	Par at the end of 8 th year
31/3/2025	5000 15% debentures of ₹200 each		15% Premium at the end of 15 th 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 ₹
30/4/2024	Bank A/c Dr Discount on Issue of 11% Debentures A/c Dr To 11% Debentures A/c (Being 11% debentures issued at 2% discount repayable at par)		980000 20000	1000000
30/9/2024	Bank A/c Dr Discount on Issue of 9% Debentures A/c Dr Loss on Issue of 9% Debentures A/c Dr To 9% Debentures A/c To Premium on Redem. of 9% Debent. A/c (Being 9% debentures issued at 5% discount repayable at 10% premium)		1,90,000 10,000 20,000	2,00,000 20,000
31/12/2024	Bank A/c Dr To 7% Debentures A/c To Premium on Issue of 7% Debent. A/c (Being 7% debentures issued at 7% premium repayable at par)		7,49,000	7,00,000 49,000

31/3/2025	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 Prem. on Redem. of 15% Deben. 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

Illustration 3. Ashwin Ball Producing Co. issued following debentures during the financial year 2024-25.

Date	Debentures	Issued at	Repayable at
30/6/2024	1000 8% debentures of ₹100 each	Par	9% Premium at the end of 7 th year
31/10/2024	5000 6% debentures of ₹100 each	7% discount	10% Premium at the end of 10 th year
31/1/2025	8000 12% debentures of ₹100 each	14% premium	15% Premium at the end of 12 th 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 ₹
30/6/2024	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)			

31/10/2024	Bank A/c	Dr	4,65,000	
	Discount on Issue of 6% Debentures A/c	Dr	35,000	
	Loss on Issue of 6% Debentures A/c	Dr	50,000	
	To 6% Debentures A/c			5,00,000
	To Premium on Redem. of 6% Debent. A/c			50,000
	(Being 6% debentures issued at 7% discount repayable at 10% premium)			

31/1/2025	Bank A/c	Dr	9,12,000	
	Loss on Issue of 12% Debentures A/c	Dr	1,20,000	
	To 12% Debentures A/c			8,00,000
	To Premium on Issue of 12% Deben. A/c			1,12,000
	To Prem. on Redem. of 12% Deben. 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.

Illustration 4. Mahendra Pitch Preparing Co. issued following debentures during the financial year 2024-25.

1. On 31/5/2024, issued 1000 7% debentures of ₹1000 each at 4% discount repayable at par.
2. On 31/7/2024, issued 2000 8% debentures of ₹1000 each at par repayable at par.
3. On 30/9/2024, issued 30000 6% debentures of ₹100 each at 5% premium repayable at par
4. On 30/11/2024, issued 1000 7% debentures of ₹2500 each at par repayable at 4% premium.
5. On 31/1/2025, 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 ₹
31/5/2024	Bank A/c Dr Discount on Issue of 7% Debentures A/c Dr To 7% Debentures A/c (Being 7% debentures issued at 4% discount repayable at par)		9,60,000 40,000	10,00,000
31/7/2024	Bank A/c Dr To 8% Debentures A/c (Being 8% debentures issued at par repayable at par)		20,00,000	20,00,000
30/9/2024	Bank A/c Dr To 6% Debentures A/c To Premium on Issue of 6% Debent. A/c (Being 6% debentures issued at 5% premium repayable at par)		31,50,000	30,00,000 1,50,000
30/11/2024	Bank A/c Dr Loss on Issue of 7% Debentures A/c Dr To 7% Debentures A/c To Premium on Redemof 7% Debent. A/c (Being 7% debentures issued at par repayable at 4% premium)		25,00,000 1,00,000	25,00,000 1,00,000
31/1/2025	Bank A/c Dr Loss on Issue of 5% Debentures A/c Dr To 5% Debentures A/c To Premium on issue of 5% Debent. A/c To Premium on Redem. of 5% Debent. A/c (Being 5% debentures issued at par repayable at 5% premium)		42,00,000 2,00,000	40,00,000 2,00,000 2,00,000

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

Illustration 5. Ravi Cricket Pad Producing Co. issued following debentures during the financial year 2024-25.

1. On 31/7/2024 issued 11000 12% debentures of ₹100 each at 3% discount repayable at 4% premium.
2. On 31/10/2024 issued 12000 13% debentures of ₹100 each at par repayable at par.
3. On 31/12/2024 issued 13000 14% debentures of ₹100 each at par repayable at 12% premium
4. On 28/2/2025 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 ₹
31/7/2024	Bank A/c	Dr	10,67,000	
	Discount on Issue of 12% Debentures A/c	Dr	33,000	
	Loss on Issue of 12% Debentures A/c	Dr	44,000	
	To 12% Debentures A/c			11,00,000
	To Prem. on Redem. of 12% Deben. A/c			44,000
(Being 12% debentures issued at 3% discount repayable at 4% premium)				
31/10/2024	Bank A/c	Dr	12,00,000	
	To 13% Debentures A/c			12,00,000
(Being 13% debentures issued at par repayable at par)				
31/12/2024	Bank A/c	Dr	13,00,000	
	Loss on Issue of 14% Debentures A/c	Dr	1,56,000	
	To 14% Debentures A/c			13,00,000
	To Prem. on Redem. of 14% Deben. A/c			1,56,000

	(Being 14% debentures issued at par repayable at 12% premium)			
	-----		14,70,000	
28/2/2025	Bank A/c Dr		1,54,000	14,00,000
	Loss on Issue of 15% Debentures A/c Dr			70,000
	To 15% Debentures A/c			1,54,000
	To Premium on issue of 15% Debent. A/c			
	To Prem. on Redem. of 15% Deben. A/c			
	(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

Illustration 6. Panchganga Irrigation Co. issued 2000 10% debentures of ₹ 1000 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 to 10% 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 To 10% Debentures Allotment A/c (Being 10% Debentures allotment money received)	Dr	6,00,000	6,00,000
5	10% Debentures First Call A/c To 10% Debentures A/c (Being 10% Debentures first call money due)	Dr	4,00,000	4,00,000
6	Bank A/c To 10% Debentures First Call A/c (Being 10% Debentures first call money received)	Dr	4,00,000	4,00,000

2) Debentures issued at par repayable at premium

Illustration 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 To 9% Debentures Application A/c (Being applications received for 9% debentures)	Dr	8,00,000	8,00,000
2	9% Debentures Application A/c To 9% Debentures A/c (Being application money transferred to 9% debentures account)	Dr	8,00,000	8,00,000
3	9% Debentures Allotment A/c Loss on issue of 9% Debentures A/c To 9% Debentures A/c To Prem. on Redem. of 9% Debentures A/c (Being 9% Debentures allotment money due and premium on redemption adjusted)	Dr Dr	4,00,000 1,20,000	4,00,000 1,20,000

4	Bank A/c To 9% Debentures Allotment A/c (Being 9% Debentures allotment money received)	Dr	4,00,000	4,00,000
5	9% Debentures First Call A/c To 9% Debentures A/c (Being 9% Debentures first call money due)	Dr	8,00,000	8,00,000
6	Bank A/c To 9% Debentures First Call A/c (Being 9% Debentures first call money received)	Dr	8,00,000	8,00,000

3) Debentures issued at discount repayable at par

Illustration 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 To 14% Debentures Application A/c (Being applications received for 14% debentures repayable at par)	Dr	24,00,000	24,00,000
2	14% Debentures Application A/c To 14% Debentures A/c (Being application money transferred to 14% debentures account)	Dr	24,00,000	24,00,000
3	14% Debentures Allotment A/c Discount on Issue of 14% Debentures A/c To 14% Debentures A/c	Dr Dr	18,00,000 6,00,000	24,00,000

	(Being 14% Debentures allotment money due and discount on issue adjusted)			
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 To 14% Debentures A/c (Being 14% Debentures first call money due)		12,00,000	12,00,000
6	Bank A/c Dr To 14% Debentures First Call A/c (Being 14% Debentures first call money received)		12,00,000	12,00,000

4) Debentures issued at discount repayable at premium

Illustration 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 To 7% Debentures Application A/c (Being applications received for 7% debentures repayable at par)		12,00,000	12,00,000
2	7% Debentures Application A/c Dr To 7% Debentures A/c (Being application money transferred to 7% debentures account)		12,00,000	12,00,000

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

5) Debentures issued at premium repayable at premium

Illustration 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	15,00,000	
	To 12% Debentures Application A/c			15,00,000
	(Being applications received for 12% debentures repayable at premium)			

2	12% Debentures Application A/c	Dr	15,00,000	
	To 12% Debentures A/c			15,00,000
	(Being application money transferred to 14% debentures account)			

3	12% Debentures Allotment A/c	Dr	12,00,000	
	Loss on Issue of 12% Debt. 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 Redemption of Debentures

Illustration 1. 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.

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

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2022	Bank A/c Dr Discount on Issue of 8% Debentures A/c Dr Loss on Issue of 8% Debentures A/c Dr To 8% Debentures A/c To Premium on Redem. of 8% Debent. A/c (Being 8% debentures issued at 2% discount repayable at 3% premium)		49,00,000 1,00,000 1,50,000	50,00,000 1,50,000
31/3/2023	Profit & Loss Appropriation A/c Dr To Sinking Fund A/c (Being proportionate amount transferred to sinking fund)		10,00,000	10,00,000
31/3/2023	9% Government Securities A/c Dr To Bank A/c (Being amount provided invested in Govt. Securities)		10,00,000	10,00,000

Illustration 2. 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.

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 provision 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	Bank A/c Dr To Interest on 12% Government Securities A/c (Being interest on government securities received)		60,000	60,000
31/3/2023	Interest on 12% Government Securities 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
31/3/2023	12% Government Securities A/c Dr To Bank A/c (Being amount provided and interest received invested in Govt. Securities)		5,60,000	5,60,000

3) Calculation of Interest on Sinking Fund Investment

Illustration 3. Sindhu Co. Ltd. issued on 1/4/2013, 15,00,000 8% Debentures at par and repayable at the end of 10th year at a premium of 5%. It was decided 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	
2014-15	$10 / 100 \times 1,50,000 = 15,000$	1,50,000
2015-16	$10 / 100 \times 3,15,000 = 31,500$	$1,50,000 + 1,50,000 + 15,000 = 3,15,000$
2016-17	$10 / 100 \times 4,96,500 = 49,650$	$3,15,000 + 1,50,000 + 31,500 = 4,96,500$
2017-18	$10 / 100 \times 6,96,150 = 69,615$	$4,96,500 + 1,50,000 + 49,650 = 6,96,150$
2018-19	$10 / 100 \times 9,15,765 = 91,576$	$6,96,150 + 1,50,000 + 69,615 = 9,15,765$
2019-20	$10 / 100 \times 11,57,341 = 1,15,734$	$9,15,765 + 1,50,000 + 91,576 = 11,57,341$
2020-21	$10 / 100 \times 14,23,075 = 1,42,308$	$11,57,341 + 1,50,000 + 1,15,734 = 14,23,075$
2021-22	$10 / 100 \times 17,15,383 = 1,71,538$	$14,23,075 + 1,50,000 + 1,42,308 = 17,15,383$
2022-23	$10 / 100 \times 20,36,921 = 2,03,692$	$17,15,383 + 1,50,000 + 1,71,538 = 20,36,921$

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

Illustration 4. On 1/4/2021 Painganga Construction Ltd. issued 6000 10% Debentures of ₹ 100 each at par repayable at the end of the 6th 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 government bonds is receivable annually on 31st 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

$$= 6000 \times 100 / 6 = 1,00,000$$

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 To 11% Debentures A/c (Being 11% Debentures issued at par repayable at par)	Dr	6,00,000	6,00,000
31/3/2022	Profit & Loss A/c To Sinking Fund A/c (Being proportionate amount provided for sinking fund)	Dr	1,00,000	1,00,000
31/3/2022	11% Government Bonds A/c To Bank A/c (Being amount provided for sinking fund invested in Govt. Securities)	Dr	1,00,000	1,00,000
31/3/2023	Bank A/c To Interest on 11% Government Bonds A/c (Being interest on Sinking Fund Investment received)	Dr	11,000	11,000
31/3/2023	Profit & Loss A/c To Sinking Fund A/c (Being proportionate amount provided for sinking fund)	Dr	1,00,000	1,00,000

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

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

Illustration 5. 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 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

$$= 3000 \times 1000 / 6 = 5,00,000$$

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 ₹
31/3/2023	Bank A/c Dr To Interest on 11% Government Bonds A/c (Being interest on government securities received) -----		1,16,050	1,16,050
31/3/2023	Interest on 11% Government Bonds 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	11% Government Bonds A/c Dr To Bank A/c (Being amount provided and interest received invested in Govt. Securities)		6,16,050	6,16,050

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

Illustration 6. 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.

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	Bank A/c Dr To Interest on 12% Govt. of India Loan A/c (Being interest on government loans received)		2,28,702	2,28,702
31/3/2023	Interest on 12% Govt of India Loan A/c Dr To Sinking Fund A/c (Being interest on sinking fund investment transferred to sinking fund account)		2,28,702	2,28,702
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 12% Govt of India Loan A/c (Being Sinking Fund Investments realised)		19,10,000	19,10,000

31/3/2023	12% Govt of India Loan A/c To Sinking Fund A/c (Being profit on realisation of sinking fund investment transferred to sinking fund account)	Dr	4146	4146
31/3/2023	11% Debentures A/c To 11% Debenture holders A/c (Being balance of Debentures transferred to Debenture holders account)	Dr	18,00,000	18,00,000
31/3/2023	11% Debenture holders' A/c To Bank A/c (Being payment made to debenture holders)	Dr	18,00,000	18,00,000
31/3/2023	Sinking Fund A/c To General Reserve A/c (Being balance of sinking fund account transferred to general reserve account)	Dr	24,38,702	24,38,702

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

Illustration 7. 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

Debenture Redemption 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

Debenture Redemption 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

Illustration 8. 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	
2019-20	8% on 1,00,000 = 8,000	1,00,000
2020-21	8% on 2,08,000 = 16,640	1,00,000 + 1,00,000 + 8,000 = 2,08,000
2021-22	8% on 3,24,640 = 25,971	2,08,000 + 1,00,000 + 16,640 = 3,24,640
2022-23	8% on 4,50,611 = 36,049	3,24,640 + 1,00,000 + 25,971 = 4,50,611

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

Illustration 9. 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
		14,98,013			15,00,000
1/4/2022	To Balance b/d	1987	31/3/2023	By Bank A/c	
31/3/2023	To D. R. F. A/c	15,00,000			15,00,000

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

Illustration 10. 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 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 = $(2500 \times 500) / 5 = 2,50,000$

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 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

Illustration 11. 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 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 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 = $(2000 \times 200) / 5 = 80,000$

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

Illustration 12. 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 = $(4000 \times 250) / 5 = 2,00,000$

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 P & L 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 P & L 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 P & L 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 P & L Appro	2,00,000
			31/3/2023	By D. R. F. Invest. A/c	5,374
		12,02,316			12,02,316

2.10 Summary

A company needs money for the purposes of growth, expansion, extension, development etc. A company may turn to the debt financing. 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. 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. Debentures can be classified from different points of view as, Security; Convertibility; Permanence; Negotiability; and Priority.

As debentures is a loan, it should be repaid after the specified period. The redemption of debentures can be carried out by different ways. However, sinking fund method is used mostly.

2.11 Terms to remember

- 1) *Debentures* - 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”.
- 2) *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.
- 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 (either at par or premium or discount) 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. As per the terms of issue, these debentures are redeemed.
- 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*: These debentures are not repayable during the life time of the company.
- 8) *Registered Debentures*: Register of Debenture holders is maintained in which the details of debenture holders such as name, address etc. are recorded.
- 9) *Bearer Debentures*: These debentures are transferable by delivery.
- 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.

2.12 Answers to check your progress

- 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.

2.13 Exercise

Write Short Notes

1. Definition of Debenture and its features.
2. Types of debentures.
3. Difference between Debentures and Shares.
4. Journal entries for issue of debentures when debentures are issued at single payment
5. Journal entries for issue of debentures when value of debentures is collected in instalments.
6. Redemption of Debentures – meaning, nature and methods
7. Sinking Fund Method – meaning and accounting entries

Practical Questions

Problem 1. Mohite Milk Producing Co. Ltd. issued the following debentures during the year 2024-25.

On 30/9/2024, 1500 10% debentures of ₹100 each issued at par repayable at par after 5 years.

On 31/3/2025, 2000 9% debentures of ₹200 each issued at par repayable at 7% premium after 7 years.

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 2024-25.

Date	Debentures	Issued at	Repayable at
1/7/2024	2500 11% debentures of ₹100 each	10% discount	Par at the end of 10 th year
1/1/2025	5000 9% debentures of ₹200 each	5% discount	10% Premium at the end of 5 th 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 2024-25.

Date	Debentures	Issued at	Repayable at
31/12/2024	6000 6% debentures of ₹100 each	6% premium	Par at the end of 10 th year
31/3/2025	7000 12% debentures of ₹200 each	12% premium	10% Premium at the end of 10 th 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. Bindu Co. Ltd. issued on 1/4/2019, ₹12,00,000 9% Debentures at par and the repayable at the end of 10 year at a premium of 7%. It was decided 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 7. Ranga Colours Ltd. issued 10% Debentures of ₹25,00,000 on 1/4/2020 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 8. Munnabhai Finance Co. Ltd. issued 9% Debentures of ₹30,00,000 on 1/4/2019 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. 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 2019-20 and 2020-21 only.

Problem 9. Krishnamai Construction Ltd. issued 15000 10% Debentures of ₹100 each at par repayable at the end of the 6th year at par on 1/4/2019. 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 first 3 years.

Problem 10. On 1 April 2019, Bramha Construction Co. issued 9,000 11% Debentures of Rs 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 2024.

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 2024-25

Problem 11. Swati Stationery Co. issued on 1/4/2020, 1600 8% Debentures of ₹1000 each

repayable at the end of 5th 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 12. Jammu Tourist Co. has issued on 1/4/2015 7% Debentures of ₹10,00,000 at par repayable at a premium of 5% after 10 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 st

bonds at the end of every year. The interest on debentures is payable annually on 31 March every year. 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 13. Trupti Hotels Ltd. has issued on 1/4/2021 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 31 March every year. On 31st March 2025, 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.

2.14 Reference for Further Study

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Unit-III

Accounting for Interest on Debentures and Amortisation of Discount and Loss on Issue of Debentures

- 3.0 Objectives
- 3.1 Introduction
- 3.2 Interest on Debentures
- 3.3 Discount on Issue of Debentures
- 3.4 Loss on Issue of Debentures
- 3.5 Accounting / Journal Entries
- 3.6 Check Your Progress
- 3.7 Illustrations
- 3.8 Summary
- 3.9 Terms to remember
- 3.10 Answers to check your progress
- 3.11 Exercise
- 3.12 Reference for further study

3.0 Objectives

After studying this unit, you will be able to –

1. Understand meaning and other required information of Interest on Debentures
2. know what is Discount on Issue of Debentures
3. learn what is meant by Loss on Issue of Debentures
4. pass Accounting of Interest on Debentures and amortisation of Discount and Loss on Issue of Debentures

3.1 Introduction

In the previous unit you studied issue and redemption of debentures. You know that debentures can be issued at discount and they may be redeemed at premium. Debentures is a loan. So, interest is to be paid on debentures. Discount on issue and premium on redemption is a loss of the company. Such loss is to be written off during the period of debentures. Thus, after issue of debentures till the redemption of debentures, interest is to be paid and discount and loss are to be written off. In this unit, we will study how to pass accounting records and how to prepare ledger accounts in respect of interest on debentures and writing of discount and loss on issue of debentures.

3.2 Interest on Debentures

Debenture interest can be defined as the money the owner of the debenture is supposed to earn after they invest money in the debenture of the company. It is paid at a rate that is fixed on the face value. Interest is a charge on the company that issues a debenture and the interest must be paid irrespective of the status of revenue or profit. Interest is as an award where all the holders of the debentures receive for investing in the company's debentures. The company pays the interest at a fixed percentage on face value at a regular period which is set at the time of issue of debentures. Debenture interest is paid at regular intervals at a fixed percentage of the face value. Interest on debentures is an expense and creates a charge against the profits of the organization and is thus, debited to the Profit & Loss Account.

Generally, debentures are issued with a fixed rate of interest. A debenture holder receives interest according to the rate specified in the debenture certificate. The rate of interest on a particular debenture is specified before the name of such debenture as -- % debentures (e.g. 8% debentures, 10% debentures, etc.), and is always provided at the face value of the said debentures.

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.

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)

Note – 1. A direct entry can be passed for each payment of interest on debentures as -
 Debentures Interest A/c Dr

To Bank A/c

(Being debenture interest paid)

2. If the interest is paid quarterly or half yearly, the above one or two entries are repeated for every payment i.e. four time for quarterly payment and twice for half yearly payment.

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

Note – The total amount of interest paid during the year is transferred to the Profit & Loss A/c.

5. To write off the balance of Discount and Loss on issue of Debentures A/c

Entry	Amount
Profit & Loss A/c. Dr To Discount on Issue of Debentures To Loss on Issue of Debentures	The total of following two amounts Proportionate amount of Discount on Issue of Debentures to be written off Proportionate amount of Loss on Issue of Debentures to be written off

3.6 Check Your Progress

Multiple Choice questions

1. ----- is payable regardless of the level of profit or loss.
 - a) Interest on debentures
 - b) Dividend on equity share capital
 - c) Interest on preference share capital
 - d) Dividend on Debentures
2. Interest on debentures is ----- of the company.
 - a) expense
 - b) income
 - c) asset
 - d) appropriation of profit
3. ----- can be defined as the money the owners of the debenture is supposed to earn after they invest money in the debenture of the company.
 - a) Discount on Debentures
 - b) Premium on Debentures
 - c) Interest on Debentures
 - d) Discount on issue of Debentures
4. ----- is paid at a rate that is fixed on the face value.
 - a) Discount on Debentures
 - b) Premium on Debentures
 - c) Discount on issue of Debentures
 - d) Interest on Debentures
5. Interest on Debentures is always calculated on ----- value.
 - a) face
 - b) market
 - c) redeemable
 - d) present
6. Rate of interest on debentures is fixed -----
 - a) at the time of redemption of debentures
 - b) at the time of issue of debentures
 - c) when interest falls due
 - d) at the time of payment of interest

7. At the end of the year, after making payment, interest on debentures is transferred to -----.
- a) Debentures A/c
 - b) Debenture holders' A/c
 - c) Profit & Loss A/c
 - d) Debenture Redemption A/c
8. As per -----, a company is required to deduct tax at source at the prevailing rate of tax before payment of interest on debentures, if it exceeds certain limit.
- a) Income Tax Act 1956
 - b) Income Tax Act 2013
 - c) Income Tax Act 1916
 - d) Income Tax Act 1961
9. When debentures are issued for a sum less than the face value of the debenture, the debenture is said to have been issued at a -----.
- a) discount
 - b) par
 - c) premium
 - d) face value
10. The discount amount is the difference between the -----.
- a) face value and market value
 - b) face value and the issue price
 - c) face value and redeemable value
 - d) market value and issue price
11. ----- does not prohibit to issue debentures at discount, as well as, it does not define maximum limit of discount on issue of debentures.
- a) The Companies Act 2031
 - b) The Companies Act 2023
 - c) The Companies Act 2013
 - d) The Companies Act 2011

12. When debentures are redeemed at the price higher than the face value, it is called as -----.
- a) Issue of debentures at discount
 - b) issue of debentures at premium
 - c) redemption of debentures at discount
 - d) redemption of debentures at premium
13. Premium on redemption of debentures is -----
- a) loss on issue of debentures
 - b) profit on issue of debentures
 - c) profit on redemption of debentures
 - d) discount on redemption of debentures
14. Premium on Redemption of Debentures is also -----.
- a) a liability payable in annual instalments
 - b) a liability payable at the time of maturity
 - c) a contingent liability
 - d) a non-refundable liability
15. Discount and Loss on Issue of Debentures are ----- and are shown to the Assets side of the Balance Sheet under the heading 'Miscellaneous Expenditures and Losses'.
- a) capital profits
 - b) revenue losses
 - c) capital losses
 - d) revenue profits
16. Proportionate amount from Discount and Loss on Issue of Debentures is ----- every year till it is fully amortised.
- a) credited to Profit & Loss A/c
 - b) added to the debentures in the Balance Sheet
 - c) added to the Miscellaneous Expenditures and Losses in the Balance Sheet
 - d) debited to Profit & Loss A/c

3.7 Illustrations

1) When Interest on Debentures is paid annually

Illustration 1. On 1st April 2022 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 interest on debentures.

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 ₹
1/4/2022	Bank A/c Dr To 12% Debentures A/c (Being debentures issued repayable at par)		20,00,000	20,00,000
31/3/2023	Debenture Interest A/c Dr To 12% Debenture holders' A/c (Being interest on 12% debentures is due)		2,40,000	2,40,000
31/3/2023	12% Debenture holders' A/c Dr To Bank A/c (Being interest on 12% debentures paid)		2,40,000	2,40,000
31/3/2023	Profit & Loss A/c Dr To Debenture Interest A/c (Being balance of debenture interest account transferred to profit & loss account)		2,40,000	2,40,000
31/3/2024	Debenture Interest A/c Dr To 12% Debenture holders' A/c (Being interest on 12% debentures is due)		2,40,000	2,40,000
31/3/2024	12% Debenture holders' A/c Dr To Bank A/c		2,40,000	2,40,000

	(Being interest on 12% debentures paid)			
31/3/2024	Profit & Loss A/c Dr To Debenture Interest A/c (Being balance of debenture interest account transferred to profit & loss account)		2,40,000	2,40,000
31/3/2025	Debenture Interest A/c Dr To 12% Debenture holders' A/c (Being interest on 12% debentures is due)		2,40,000	2,40,000
31/3/2025	12% Debenture holders' A/c Dr To Bank A/c (Being interest on 12% debentures paid)		2,40,000	2,40,000
31/3/2025	Profit & Loss A/c Dr To Debenture Interest A/c (Being balance of debenture interest account transferred to profit & loss account)		2,40,000	2,40,000

2) When Interest on Debentures is paid half yearly

Illustration 2. Narmada Dam Ltd. issued 12,000 12% Debentures of ₹ 100 each, repayable at par at the end of 5 years on 1st April 2023. 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 = $12,00,000/100 \times 12 \times \frac{1}{2} = 72,000$

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2023	Bank A/c Dr To 12% Debentures A/c (Being debentures issued repayable at par)		12,00,000	12,00,000

30/9/2023	Debenture Interest A/c To 12% Debenture holders' A/c (Being interest on 12% debentures is due for first half of the year)	Dr	72,000	72,000
30/9/2023	12% Debenture holders' A/c To Bank A/c (Being interest on 12% debentures paid for first half of the year)	Dr	72,000	72,000
31/3/2024	Debenture Interest A/c To 12% Debenture holders A/c (Being interest on 12% debentures is due for second half of the year)	Dr	72,000	72,000
31/3/2024	12% Debenture holders' A/c To Bank A/c (Being interest on 12% debentures paid for second half of the year)	Dr	72,000	72,000
31/3/2024	Profit & Loss A/c To Debenture Interest A/c (Being balance of debenture interest account transferred to profit & loss account)	Dr	1,44,000	1,44,000
30/9/2024	Debenture Interest A/c To 12% Debenture holders' A/c (Being interest on 12% debentures is due for first half of the year)	Dr	72,000	72,000
30/9/2024	12% Debenture holders' A/c To Bank A/c (Being interest on 12% debentures paid for first half of the year)	Dr	72,000	72,000
31/3/2025	Debenture Interest A/c To 12% Debenture holders' A/c (Being interest on 12% debentures is due for second half of the year)	Dr	72,000	72,000
31/3/2025	12% Debenture holders' A/c To Bank A/c (Being interest on 12% debentures paid for second half of the year)	Dr	72,000	72,000

31/3/2025	Profit & Loss A/c To Debenture Interest A/c (Being balance of debenture interest account transferred to profit & loss account)	Dr	1,44,000	1,44,000
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C) Interest on Debentures and Amortisation of Discount

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

Illustration 3. On 1st April 2023 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 ₹
1/4/2023	Bank A/c Discount on Issue of 15% Debent. A/c To 15% Debentures A/c (Being debentures issued at discount repayable at par)	Dr Dr	49,50,000 5,50,000	55,00,000
31/3/2024	Debenture Interest A/c To 15% Debenture holders' A/c (Being interest on 15% debentures is due)	Dr	8,25,000	8,25,000
31/3/2024	15% Debenture holders' A/c To Bank A/c (Being interest on 15% debentures paid)	Dr	8,25,000	8,25,000
31/3/2024	Profit & Loss A/c	Dr	9,35,000	

	To Debenture Interest A/c			8,25,000
	To Discount on Issue of Debentures A/c (Being interest on debentures and proportionate amount of discount on issue of debentures written off)			1,10,000
31/3/2025	----- Debenture Interest A/c Dr To 15% Debenture holders' A/c (Being interest on 15% debentures is due)		8,25,000	8,25,000
31/3/2025	----- 15% Debenture holders' A/c Dr To Bank A/c (Being interest on 15% debentures paid)		8,25,000	8,25,000
31/3/2025	----- Profit & Loss A/c Dr To Debenture Interest A/c To Discount on Issue of Debentures A/c (Being interest on debentures and proportionate amount of discount on issue of debentures written off)		9,35,000	8,25,000 1,10,000

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

Illustration 4. On 1st April 2023 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 ₹
1/4/2023	Bank A/c Dr Loss on Issue of 12% Debentures A/c Dr To 12% Debentures A/c To Prem. on Redem. of 12% Debentures A/c (Being debentures issued at par repayable at 12% premium)		12,00,000 1,44,000	12,00,000 1,44,000
31/3/2024	Debenture Interest A/c Dr To 12% Debenture holders' A/c (Being interest on 12% debentures is due)		1,44,000	1,44,000
31/3/2024	12% Debenture holders' A/c Dr To Bank A/c (Being interest on 12% debentures paid)		1,44,000	1,44,000
31/3/2024	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
31/3/2025	Debenture Interest A/c Dr To 12% Debenture holders' A/c (Being interest on 12% debentures is due)		1,44,000	1,44,000
31/3/2025	12% Debenture holders' A/c Dr To Bank A/c (Being interest on 12% debentures paid)		1,44,000	1,44,000
31/3/2025	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.

Illustration 5. On 1st April 2024 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 –

$$10\% \text{ on } (15000 \times 100) = 1,50,000 / 10 = 15,000$$

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

$$7\% \text{ on } (15000 \times 100) = 1,05,000 / 10 = 10,500$$

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
1/4/2024	Bank A/c Dr Discount on Issue of 11% Debentures A/c Dr Loss on Issue of 11% Debentures A/c Dr To 11% Debentures A/c To Prem. on Redem. of 11% Debentures A/c (Being debentures issued at 10% discount repayable at 7% premium)		13,50,000 1,50,000 1,05,000	15,00,000 1,05,000
31/3/2025	Debenture Interest A/c Dr To 11% Debenture holders' A/c (Being interest on 11% debentures is due)		1,65,000	1,65,000
31/3/2025	11% Debenture holders' A/c Dr To Bank A/c (Being interest on 11% debentures paid)		1,65,000	1,65,000
31/3/2025	Profit & Loss A/c Dr To Debenture Interest A/c To Discount on Issue of 11% Debentures A/c		1,90,500	1,65,000 15,000

	To Loss on Issue of 11% Debentures A/c (Being interest on debentures and proportionate amount of discount and loss on issue of debentures written off)			10,500
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Illustration 6. 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 the years 2023-24 and 2024-25.

Solution – In the books of Warana Industries Ltd.

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

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

$$6\% \text{ on } (5,000 \times 1,000) = 3,00,000 / 10 = 30,000$$

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

$$8\% \text{ on } (5,000 \times 1,000) = 4,00,000 / 10 = 40,000$$

Journal

Date	Particulars	L/F	Dr ₹	Cr ₹
31/3/2024	Debenture Interest A/c To Bank A/c (Being interest on 13% debentures paid)	Dr	6,50,000	6,50,000
31/3/2024	Profit & Loss A/c To Debenture Interest A/c To Discount on Issue of 13% Debentures A/c To Loss on Issue of 13% Debentures A/c (Being interest on debentures and proportionate amount of discount and loss on issue of debentures written off)	Dr	7,20,000	6,50,000 30,000 40,000
31/3/2025	Debenture Interest A/c To Bank A/c (Being interest on 13% debentures paid)	Dr	6,50,000	6,50,000

31/3/2025	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
	(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

Illustration 7. Vedganga Waterproof Furniture Co. issued on 1/4/2017 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	₹
1/4/2017	To 8% Debent. A/c	1,28,000	31/3/2018	By Profit & Loss A/c	16,000
			31/3/2018	By Balance c/d	1,12,000
		1,28,000			1,28,000
1/4/2018	To Balance b/d	1,12,000	31/3/2019	By Profit & Loss A/c	16,000
			31/3/2019	By Balance c/d	96,000
		1,12,000			1,12,000
1/4/2019	To Balance b/d	96,000	31/3/2020	By Profit & Loss A/c	16,000
			31/3/2020	By Balance c/d	80,000
		96,000			96,000
1/4/2020	To Balance b/d	80,000	31/3/2021	By Profit & Loss A/c	16,000
			31/3/2021	By Balance c/d	64,000
		80,000			80,000

1/4/2021	To Balance b/d	64,000	31/3/2022 31/3/2022	By Profit & Loss A/c By Balance c/d	16,000
		64,000			48,000
1/4/2022	To Balance b/d	48,000	31/3/2023 31/3/2023	By Profit & Loss A/c By Balance c/d	16,000
		48,000			32,000
1/4/2023	To Balance b/d	32,000	31/3/2024 31/3/2024	By Profit & Loss A/c By Balance c/d	16,000
		32,000			16,000
1/4/2024	To Balance b/d	16,000	31/3/2025	By Profit & Loss A/c	16,000
		16,000			16,000

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

Illustration 8. Mulamutha Waterproof Furniture Co. issued on 1/4/2017 9% Debentures of ₹ 24,00,000 at par repayable at the end of 8th 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 –

$$12\% \text{ on } 24,00,000 = 2,88,000 / 8 = 36,000$$

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

Date	Particulars	₹	Date	Particulars	₹
1/4/2017	To Premi. on Redmp. of 9% Debnt. A/c	2,88,000	31/3/2018 31/3/2018	By Profit & Loss A/c By Balance c/d	36,000
		2,88,000			2,52,000
1/4/2018	To Balance b/d	2,52,000	31/3/2019 31/3/2019	By Profit & Loss A/c By Balance c/d	36,000
		2,52,000			2,16,000
					2,52,000

1/4/2019	To Balance b/d	2,16,000	31/3/2020 31/3/2020	By Profit & Loss A/c By Balance c/d	36,000
					1,80,000
		2,16,000			2,16,000
1/4/2020	To Balance b/d	1,80,000	31/3/2021 31/3/2021	By Profit & Loss A/c By Balance c/d	36,000
					1,44,000
		1,80,000			180,000
1/4/2021	To Balance b/d	1,44,000	31/3/2022 31/3/2022	By Profit & Loss A/c By Balance c/d	36,000
					1,08,000
		1,44,000			1,44,000
1/4/2022	To Balance b/d	1,08,000	31/3/2023 31/3/2023	By Profit & Loss A/c By Balance c/d	36,000
					72,000
		1,08,000			1,08,000
1/4/2023	To Balance b/d	72,000	31/3/2024 31/3/2024	By Profit & Loss A/c By Balance c/d	36,000
					36,000
		72,000			72,000
1/4/2024	To Balance b/d	36,000	31/3/2025	By Profit & Loss A/c	36,000
					36,000
		36,000			36,000

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

Illustration 9. Satlaj Waterproof Furniture Co. issued on 1/4/2020 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

Calculation of Discount on Issue of 8% Debentures - 5% on 15,00,000 = 75,000

Calculation of amount to be written off every year = 75,000 / 5 = 15,000

Calculation of Loss on Issue of 8% Debentures - 7% on 15,00,000 = 1,05,000

Calculation of amount to be written off every year = 1,05,000 / 5 = 21,000

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

Date	Particulars	₹	Date	Particulars	₹
1/4/2020	To 8% Debent. A/c	75,000	31/3/2021 31/3/2021	By Profit & Loss A/c By Balance c/d	15,000 60,000
		75,000			75,000
1/4/2021	To Balance b/d	60,000	31/3/2022 31/3/2022	By Profit & Loss A/c By Balance c/d	15,000 45,000
		60,000			60,000
1/4/2022	To Balance b/d	45,000	31/3/2023 31/3/2023	By Profit & Loss A/c By Balance c/d	15,000 30,000
		45,000			45,000
1/4/2023	To Balance b/d	30,000	31/3/2024 31/3/2024	By Profit & Loss A/c By Balance c/d	15,000 15,000
		30,000			30,000
1/4/2024	To Balance b/d	15,000	31/3/2025	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	₹
1/4/2020	To Prem. On Red. of 8% Debent. A/c	1,05,000	31/3/2021 31/3/2021	By Profit & Loss A/c By Balance c/d	21,000 84,000
		1,05,000			1,05,000
1/4/2021	To Balance b/d	84,000	31/3/2022 31/3/2022	By Profit & Loss A/c By Balance c/d	21,000 63,000
		84,000			84,000
1/4/2022	To Balance b/d	63,000	31/3/2023 31/3/2023	By Profit & Loss A/c By Balance c/d	21,000 42,000
		63,000			63,000

1/4/2023	To Balance b/d	42,000	31/3/2024 31/3/2024	By Profit & Loss A/c By Balance c/d	21,000
		42,000			21,000
1/4/2024	To Balance b/d	21,000	31/3/2025	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

Illustration 10. Patalganga Fishing Co. issued on 1/4/2021, 2,500 11% Debentures of 1,000 each at a premium of 8% repayable at a premium of 9% at the end of 4th 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.			Cr.		
Interest on 11% Debentures A/c					
Date	Particulars	₹	Date	Particulars	₹
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
31/3/2024	To Bank	2,75,000	31/3/2024	By Profit & Loss A/c	2,75,000
		2,75,000			2,75,000
31/3/2025	To Bank	2,75,000	31/3/2025	By Profit & Loss A/c	2,75,000
		2,75,000			2,75,000

Dr			Cr		
11% Debentures A/c					
Date	Particulars	₹	Date	Particulars	₹
31/3/2022	To Balance c/d	25,00,000	1/4/2021	By Bank	25,00,000
		25,00,000			25,00,000
31/3/2023	To Balance c/d	25,00,000	1/4/2022	By Balance b/d	25,00,000
		25,00,000			25,00,000
31/3/2024	To Balance c/d	25,00,000	1/4/2023	By Balance b/d	25,00,000
		25,00,000			25,00,000
31/3/2025	To Bank	25,00,000	1/4/2024	By Balance b/d	25,00,000
		25,00,000			25,00,000

Dr			Cr		
Loss on Issue of 11% Debentures A/c					
Date	Particulars	₹	Date	Particulars	₹
1/4/2021	To Prem. On Red. of 8% Debentures A/c	2,25,000	31/3/2022	By Profit & Loss A/c	56,250
		2,25,000	31/3/2022	By Balance c/d	1,68,750
		2,25,000			2,25,000
1/4/2022	To Balance b/d	1,68,750	31/3/2023	By Profit & Loss A/c	56,250
		1,68,750	31/3/2023	By Balance c/d	1,12,500
		1,68,750			1,68,750
1/4/2023	To Balance b/d	1,12,500	31/3/2024	By Profit & Loss A/c	56,250
		1,12,500	31/3/2024	By Balance c/d	56,250
		1,12,500			1,12,500
1/4/2024	To Balance b/d	56,250	31/3/2025	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

Illustration 11. Kumbhi Fishing Co. issued on 1/4/2021, 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 Kumbhi 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			Cr		
Interest on 12% Debentures A/c					
Date	Particulars	₹	Date	Particulars	₹
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
31/3/2024	To Bank	60,000	31/3/2024	By Profit & Loss A/c	60,000
		60,000			60,000
31/3/2025	To Bank	60,000	31/3/2025	By Profit & Loss A/c	60,000
		60,000			60,000

Dr			Cr		
12% Debentures A/c					
Date	Particulars	₹	Date	Particulars	₹
31/3/2022	To Balance c/d	5,00,000	1/4/2021	By Bank	4,55,000
		5,00,000		By Discount	45,000
31/3/2023	To Balance c/d	5,00,000	1/4/2022	By Balance b/d	5,00,000
		5,00,000		5,00,000	

31/3/2024	To Balance c/d	5,00,000	1/4/2023	By Balance b/d	5,00,000
		5,00,000			5,00,000
31/3/2025	To Bank	5,00,000	1/4/2024	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	₹
1/4/2021	To 12% Debent. A/c	45,000	31/3/2022	By Profit & Loss A/c	11,250
			31/3/2022	By Balance c/d	33,750
		45,000			45,000
1/4/2022	To Balance b/d	33,750	31/3/2023	By Profit & Loss A/c	11,250
			31/3/2023	By Balance c/d	22,500
		33,750			33,750
1/4/2023	To Balance b/d	22,500	31/3/2024	By Profit & Loss A/c	11,250
			31/3/2024	By Balance c/d	11,250
		22,500			22,500
1/4/2024	To Balance b/d	11,250	31/3/2025	By Profit & Loss A/c	11,250
		11,250			11,250

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

Illustration 12. Kasari Fishing Co. issued on 1/4/2022, 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 Kasari 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	₹
31/3/2023	To Bank	84,000	31/3/2023	By Profit & Loss A/c	84,000
		84,000			84,000
31/3/2024	To Bank	84,000	31/3/2024	By Profit & Loss A/c	84,000
		84,000			84,000
31/3/2025	To Bank	84,000	31/3/2025	By Profit & Loss A/c	84,000
		84,000			84,000

Dr 7% Debentures A/c Cr

Date	Particulars	₹	Date	Particulars	₹
31/3/2023	To Balance c/d	12,00,000	1/4/2022	By Bank	11,04,000
		12,00,000		By Discount	96,000
31/3/2024	To Balance c/d	12,00,000	1/4/2023	By Balance b/d	12,00,000
		12,00,000		12,00,000	
31/3/2025	To Bank	12,00,000	1/4/2024	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	₹
1/4/2022	To 7% Debent. A/c	96,000	31/3/2023	By Profit & Loss A/c	32,000
		96,000		By Balance c/d	64,000
1/4/2023	To Balance b/d	64,000	31/3/2024	By Profit & Loss A/c	32,000
		64,000		By Balance c/d	32,000

1/4/2024	To Balance b/d	32,000	31/3/2025	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	₹
1/4/2022	To Prem. On Red. of 7% Debent. A/c	72,000	31/3/2023	By P & L A/c	24,000
			31/3/2023	By Balance c/d	48,000
		72,000			72,000
1/4/2023	To Balance b/d	48,000	31/3/2024	By P & L A/c	24,000
			31/3/2024	By Balance c/d	24,000
		48,000			48,000
1/4/2024	To Balance b/d	24,000	31/3/2025	By P & L A/c	24,000
		24,000			24,000

3.8 Summary

Debenture interest is paid at a rate that is fixed on the face value. It must be paid irrespective of the status of revenue or profit. Debenture interest is paid at regular intervals at a fixed percentage of the face value. Interest on debentures is an expense and creates a charge against the profits of the organization and is thus, debited to the Profit & Loss Account. 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.

When debentures are issued for a sum less than the face value of the debenture, the debenture is said to have been issued at a discount. The discount amount is the difference between the face value and the issue price. The Companies Act 2013 does not define a maximum limit for the discount on debentures. The Act requires that the discount amount be recorded on the assets side of the balance sheet under the heading "Miscellaneous Expenditure" until it is written off.

When debentures are redeemed at the price higher than the face value, it is called as Redemption of Debentures at Premium. It is a loss to the company. Such loss is considered at the time of the issue of the shares and is written off during the period of the debentures. Premium on Redemption of Debentures is a liability.

Discount and Loss on Issue of Debentures are capital losses and are shown to the Assets side of the Balance Sheet under the heading 'Miscellaneous Expenditures and Losses'. Proportionate amount from these is written off every year till it is fully amortised.

3.9 Terms to remember

1. Interest on Debentures - Debenture interest can be defined as the money the owner of the debenture is supposed to earn after they invest money in the debenture of the company. Interest on debentures represents the cost of borrowing for a company and is a fixed financial obligation that must be met regardless of whether the business turns a profit or incurs a loss.
2. Discount on Issue of Debentures - When debentures are issued for a sum less than the face value of the debenture, the debenture is said to have been issued at a discount. The discount amount is the difference between the face value and the issue price.
3. Loss on Issue of Debentures - When debentures are redeemed at the price higher than the face value, it is called as Redemption of Debentures at Premium.

3.10 Answers to check your progress

1. a) Interest on debentures
2. a) expense
3. c) Interest on Debentures
4. d) Interest on Debentures
5. a) face
6. b) at the time of issue of debentures
7. c) Profit & Loss A/c
8. d) Income Tax Act 1961
9. a) discount
10. b) face value and the issue price
11. c) The Companies Act 2013
12. d) redemption of debentures at premium
13. a) loss on issue of debentures
14. b) a liability payable at the time of maturity of debentures
15. c) capital losses
16. d) debited to Profit & Loss A/c

3.11 Exercise

A) Write Short Notes

1. Interest on Debentures with example and journal entries.
2. Discount on Issue of Debentures with example and journal entries.
3. Loss on Issue of Debentures with example and journal entries.

B) Practical Questions

Problem 1. 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 2. 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 3. 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 prepare Discount on Issue of Debentures A/c and Loss on Issue of Debentures A/c for all the years.

Problem 4. 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.

Please, pass journal entries for interest on debentures and loss on issue of debentures in the books of the company for all the years.

Problem 5. 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 6. 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 7. 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 8. 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, Interest on 12% Debenture A/c and Loss on issue of 12% Debentures A/c

3.12 Reference for further study

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- Jain S. P. Narang K. L., Agrawal Simmi and Sehgal Monik, (2018) Advanced Accountancy (Corporate Accounting) Vol. II, Kalyani Publishers New Delhi
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- Hanif M and Mukharjee A (2018) Modern Accountancy Vol. II, McGraw Hill Education India (Private) Ltd., Noida
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- Chakravorty Hrishikesh, Advanced Accountancy, Oxford University Press

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Unit-IV

Profit and Loss Prior Incorporation (In Vertical Form)

Meaning, Basis of Apportionment, Computation of Profits/ Loss Prior to and after Incorporation

4.0 Objectives

4.1 Introduction

4.2 Presentation of Subject Matter

4.2.1 Definitions

4.2.2 Computation of Profits and Loss Prior to and After Incorporation

4.2.3. Steps for ascertaining profit and loss prior to and after incorporation

4.2.4 Accounting Treatment of Profit and Loss Prior to and After Incorporation

4.2.5 Illustration on Profits and Loss Prior to Incorporation

4.3 Summary

4.4 Terms to be Remember

4.5 Answers to Check your Progress

4.6 Exercise

4.7 Reference to further study

4.0 Objectives

After studying this unit the student will be able to:

- Understand the concept of Profit and Loss Prior to and After Incorporation
- Understand the basis of apportionment of expenditures and incomes appearing in Profit & Loss A/c
- Understand steps for ascertaining profit or loss prior to and after incorporation

- Understand the Statement of Profit and Loss as per Provisions of Company Act 2013
- Solve practical problems based on ascertainment of profit and loss prior to and after incorporation

4.1 Introduction

In the previous units of Corporate Accounting we have studied Issue of Debentures, Accounting for Interest on debenture and Amortization of Discount and Loss on Issue of Debentures. In this unit we are going to study another one different unit of Corporate Accounting titled Profit and Loss Prior to Incorporation (In Vertical Form)

A private company can start 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.

4.2 Presentation of Subject Matter

4.2.1 Definition:

1. Profit and Loss Prior to 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 purchase to the date of incorporation is known as Pre-incorporation Profit or Loss. Profit or loss pertaining to the period before incorporation is treated as capital profit or loss. If there is profit before incorporation, it is treated as a capital profit and the same cannot be distributed by way of dividend but, it is transferred to Capital Reserve or may be adjusted against Goodwill. If there is loss before incorporation, 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.

2. Profit and Loss after Incorporation:

The profit earned or loss suffered from the date of incorporation to the date of first year ending is known as Profit and Loss after Incorporation. The profit or loss pertaining to the period after incorporation is treated as revenue profit or loss. If there is profit it is treated as revenue profit and is available for dividend. If there is a loss in the after-incorporation period, it is a revenue loss. It is carried forward to the next year

Example: Sun Ltd. was incorporated on 1st August 2024 by taking over a running business of Moon Ltd., from 1st April 2024 and it closed its accounts on 31st March 2025, any profit or loss made from 1st April 2024 to 1st August 2024 is known as “**Profit and Loss Prior to Incorporation**” and any profit or loss made from 1st August 2024 to 31st March 2025 is known as “**Profit and Loss After Incorporation**”.

4.2.2 Computation of Profits and 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 and loss prior to incorporation and after incorporation can be ascertained by the following two ways –

- a) Separate Statement of Profit and Loss is 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 Statement of Profit and Loss 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.

4.2.3. Steps for ascertaining profit and 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 (Count the months/ period from the date of purchase to the date of incorporation)
- (ii) The period from the date of incorporation to the closing of the first accounting year is called as post-incorporation period. (Count the months/period from the date of incorporation to the end of the first accounting year)

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 or 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.

Step XI: Prepare Notes related to Statement of Profit and Loss considering above apportion of various expenditure and Income into prior to incorporation period and after incorporation period.

Step XII: Prepare Statement of Profit and Loss as per Company Act, 2013 in Vertical Form by transferring balance of related Notes and finally ascertain the profit and loss prior to and after incorporation by deducting total expenditures from total revenue of the company.

Check Your Progress

A) Choose correct alternative given below the sentence to fill the gaps and rewrite the sentence.

- 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.
 - Pre-incorporation
 - After Incorporation
 - Post Incorporation
 - Post Registration
- 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) After Incorporation	b) Pre-incorporation
c) Prior Incorporation	d) Post Registration

15. The Companies Act 2013 prescribed ----- Form for preparation of Final Accounts of a company.

- a) Horizontal
- b) Vertical
- c) Traditional
- d) Crosscut

4.2.4 Accounting Treatment of Profit and Loss Prior to and After Incorporation:

The provision in the Companies Act 2013 regarding preparation of Final Account states that the statement of Profit and Loss is to be prepared in **Vertical Form**. So, all the problems are solved in Vertical Form. Students are advised understand the vertical form of Statement of Profit and Loss and its related notes and use Vertical Form only for solution of problem even though the account given in the problem is in horizontal form.

Companies have to prepare the Statement of Profit and Loss as per Schedule III of Companies Act, 2013 in vertical form. Following is the format of Statement of Profit and Loss mentioned in [Schedule III](#)

Statement of Profit & Loss

Name of the Company.....

Statement of Profit and Loss for the period ended.....

Particulars	Note No.	Figures for the current reporting period	Figures for the previous reporting period
1	2	3	4
I) Revenue From operations		Xxx	Xxx
II) Other Income		Xxx	Xxx
III) Total Income (I+II)		<u>Xxx</u>	<u>Xxx</u>
IV) EXPENSES			
a) Cost of materials consumed		Xxx	Xxx
b) Purchases of Stock-in-Trade		Xxx	xxx
c) Changes in inventories of finished goods, Stock-in -Trade and work-in-progress		Xxx	xxx
d) Employee benefits expense		Xxx	xxx

e) Finance costs		Xxx	xxx
f) Depreciation and Amortisation expenses		Xxx	xxx
g) Other expenses		Xxx	xxx
Total Expenses		<u>Xxx</u>	<u>xxx</u>
V)Profit/ (loss) before tax (III-IV)		<u>Xxx</u>	<u>xxx</u>
VI)Tax Expense:		Xxx	xxx
VII) Profit (Loss) for the period (V-VI)		<u>Xxx</u>	<u>xxx</u>

- 1. Revenue from operation:** It consists of a) Sale of product b) Sale of services etc, here Gross profit is considered as revenue from operation. If there is Trading is given in the problem, students can take gross profit directly as revenue from operation.
- 2. Employee Benefit Expenses:** It includes salaries and wages, contribution to provident fund, staff welfare expenses, expenses on Employee Stock Option Scheme etc.
- 3. Finance Cost:** It consist interest expenses paid or payable like debenture interest, Interest on borrowings like interest on loan etc.
- 4. Depreciation and Amortisation Expenses:** It consist of Depreciation on fixed assets and amortisation expenses like goodwill written off, patents written off, preliminary expenses etc.
- 5. Other Expenses:** It includes all other expenses which are not recorded in above notes i.e. office and administrative expenses, bad debts, reserve for doubtful debts, interest to vendor (interest payable on purchase price), printing and stationery, directors fees, audit fees, advertisement, commission, insurance etc.

4.2.5 Illustrations

Illustration 1. Haripriya Ltd. incorporated on 1st August 2024 to take over the running business of Prasad from 1st April 2024. The Profit & Loss Account for the year ended 31st March 2025 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 2025 was ₹10,00,000 divided into ₹3,00,000 for the period up to 1st August 2024 and ₹ 7,00,000 for the remaining period.

Prepare a statement showing profit prior to and after incorporation of Haripriya Ltd. and its related notes.

Solution –

Working Notes:

1. Time Ratio – Prior period – 1/4/2024 to 1/8/2024 – 4 months

Post period – 1/8/2024 to 31/3/2025 – 8 months

Time Ratio = 4:8 = 1:2

2. Sales Ratio – 3,00,000 : 7,00,000 = 3:7

Statement of Profit & Loss for the year ending on 31st March 2025

Particulars	Note No.	Total (₹)	Pre- incorporation (₹)	Post- incorporation (₹)
I. Revenue from Operation	1	3,10,000	93,000	2,17,000
I. Expenses-				
a) Employee Benefit Expenses	2	94,800	31,600	63,200
b) Depreciation and Amortization Expenses	3	13,000	-----	13000

c) Other Expenses	4	1,84,200	53,500	1,30,700
Total Expenses		2,92,000	85,100	2,06,900
Profit for the period (I-II)		18,000	7,900	10,100

Note No 1: Revenue from Operation

Particulars	Basis of Apportionment	Total ₹	Pre-Incorporation ₹	Post-Incorporation ₹
Gross Profit	Sales Ratio (3:7)	3,10,000	93,000	2,17,000

Note No 2: Employee Benefit Expenses

Particulars	Basis of Apportionment	Total ₹	Pre-Incorporation ₹	Post-Incorporation ₹
Salaries	Time Ratio (1:2)	94,800	31,600	63,200

Note No. 3: Depreciation and Amortization Expenses

Particulars	Basis of Apportionment	Total ₹	Pre-Incorporation ₹	Post-Incorporation ₹
Preliminary Expenses	Only to post incorporation	13,000	-	13,000

Note 4: Other Expenses

Particulars	Basis of Apportionment	Total ₹	Pre-Incorporation ₹	Post-Incorporation ₹
Rent & Taxes	Time Ratio (1:2)	24,000	8,000	16,000
Insurance	Time Ratio (1:2)	6,000	2,000	4,000
Commission	Sales ratio (3:7)	1,20,000	36,000	84,000
Advertisement	Sales ratio (3:7)	21,000	6,300	14,700
Bad Debts	Sales ratio (3:7)	4,000	1,200	2,800
Directors' fee	Post Incorporation	9,200	-----	9,200
Total		1,84,200	53,500	1,30,700

Illustration 2: Ajinkya Industries Limited was incorporated on 1st August 2024. It had acquired a running business of Amar & Co. with effect from 1st April, 2024. During the year 2024-23, 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, 2024 to 31st July, 2024 i.e. 4 months will be $4 \times 1 = 4$

Sales for the after period, from 1st August, 2024 to 30th Sept., 2024 i.e. 2 months $2 \times 1 = 2$ and

From 30th Sept., 2024 to 31st March, 2025 i.e. 6 months $6 \times 2 = 12$. Thus, $2 + 12 = 14$

Sales ratio is 4 : 14 or 2:7.

2. Time Ratio

Prior period - 1st April, 2024 to 31st July, 2024 : 4 months

After period - 1st August, 2024 to 31st March, 2025 : 8 months

= 4: 8 or 1:2.

3. Ratio for interest to vendors

Prior period - 1st April, 2024 to 31st July, 2024 : 4 months

After period - 1st August, 2024 to 31st August, 2024 : 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 3: Sky Ltd., which was incorporated on 1st September 2024, took over the business of Star, a proprietary concern, from 1st April 2024, for ₹ 10,00,000 on the condition that all profits earned from 1/4/2024 shall belong to the company. Following data is extracted from the Profit and Loss Account for the year ended 31st March 2025:

- 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 at 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 – 1/4/2024 to 1/9/2024 –5 months

Post incorporation period – 1/9/2024 to 31/3/2025 – 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 – 1/4/2024 to 1/9/2024 – $144000/6 \times 5 = 120000$

d) Gross Profit for Post incorporation period –

1/9/2024 to 30/9/2024 – $144000/6 \times 1 = 24000$

1/10/2024 to 31/3/2025 – 80000

$24000 + 80000 = \mathbf{104000}$

3. Calculation of Sales Ratio

1/4/2024 to 1/9/2024 – $1200000/6 \times 5 = 1000000$

1/9/2024 to 30/9/2024 – $1200000/6 \times 1 = 200000$

1/10/2024 to 31/3/2025 – $1000000 = 1200000$ $1000000 : 1200000 = 5 : 6$

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 4: The Narayani Ltd. took over on behalf of the company a running business of M^{rs} Padmavati with effect from 1st April, 2024. The company get incorporated on 1st July, 2024. The annual accounts were made up to 31st March, 2025 which revealed that the sales for the whole year totalled ₹ 160 lakh, out of which sales till 1st July, 2024 were for ₹ 40 lakh. Gross profit ratio was 25%. The expenses from 1st April 2024 to 31st March, 2025 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 Statement of Profit and Loss for the year ending 31st March 2025, showing Profit for the pre-incorporation and post-incorporation periods

Solution - Working Notes:

1) **Time Ratio** - 1st April, 2024 to 1st July, 2024 : 1st July, 2024 to 31st March, 2025

= 3 months: 9 months = 1:3

2) **Sales Ratio**

Particulars	(₹ in lakh)
Sales for the whole year	160
Sales up to 1st July, 2024	40
Sales for the period from 1 st July, 2024 to 31 st March, 2025	120

Thus, Sale Ratio= 40:120 = 1:3

Statement of Profit and Loss for the year ending on 31st March 2025

Particulars	Note No	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
I. Revenue from Operation	1	40,00,000	10,00,000	30,00,000
II. Expenses				
a. Employee benefit Expenses	2	6,90,000	1,72,500	5,17,500
b. Finance Cost	3	1,10,000	---	1,10,000
c. Depreciation and Amortization Expenses	4	1,20,000	30,000	90,000
d. Other Expenses	5	15,60,000	3,27,500	12,32,500
Total Expenses (II)		24,80,000	5,30,000	19,50,000
Net profit for the period (I-II)		15,20,000	4,70,000	10,50,000

Note No 1. Revenue from Operation

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Gross Profit (25% of 1,60,00,000)	Sales	40,00,000	10,00,000	30,00,000

Note No 2. Employee Benefit Expenses

Particulars	Basis of Apportion	Total	Pre-incorporation	Post incorporation
Salary	Time	6,90,000	1,72,500	5,17,500

Note No 3. Finance Cost

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Debenture Interest	Post	1,10,000	-	1,10,000

Note No 4. Depreciation and Amortisation Expenses

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Depreciation	Time	1,20,000	30,000	90,000

Note No 5. Other Expenses

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Rent, rates and Insurance	Time	2,40,000	60,000	1,80,000
Sundry office expenses	Time	6,60,000	1,65,000	4,95,000
Travellers' commission	Sales	1,60,000	40,000	1,20,000
Discount allowed	Sales	1,20,000	30,000	90,000
Bad debts	Sales	40,000	10,000	30,000
Tax Audit Fees	Sales	90,000	22,500	67,500
Directors' fee	Post	2,50,000	-	2,50,000
Total		15,60,000	3,27,500	12,32,500

Illustration 5: Mr. Soham 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 2024 but the company was incorporated on 1st July 2024. The following balances were extracted from the books as on 31st March 2025:

Trial Balance as on 31/3/2025

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:

- Monthly sales in April 2024, February and March 2025 are double of the average monthly sales of the year.
- The Preliminary Expenses are to be written-off.
- Depreciation shall be provided at 25% p.a. on Fixed Assets.

You are required to prepare Statement of Profit and Loss and related notes for the year ended on 31st March 2025 apportioning the profit and loss of the periods before and after incorporation.

Solution –

Working Notes:

- Time Ratio – Pre incorporation period – 1/4/2024 to 1/7/2024 – 3 months
Post incorporation period – 1/7/2024 to 31/3/2025 – 9 months
Sales Ratio 3:9 = 1:3
- 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.
- Depreciation – 25% on 100000 = 25000
- Ignored the items which appears to the balance sheet such as Fixed Assets, Capital, Current Liabilities and current assets.

Statement of Profit & Loss for the year ending on 31st March 2025

Particulars	Note no .	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
I. Revenue from operation	1	86,700	23,120	63,580
II. Expenses				
a. Employee benefit expenses	2	21,000	5,250	15,750
b. Depreciation and Amortisation Expenses	3	30,200	6,250	23,950
c. Other expenditures	4	57,500	10,000	47,500
Total Expenses (II)		1,08,700	21,500	87,200
Net profit or loss for the period (I-II)		-22,000	1,620	- 23,620

Note No1. Revenue from operation

Particulars	Basis of	Total ₹	Pre Incorporation ₹	Post Incorporation
Gross Profit	Sales (4:11)	86,700	23,120	63,580
	Total	86,700	23,120	63,580

Note No 2. Employee benefit Expenses

Particulars	Basis of Apportion	Total	Pre Incorporation	Post Incorporation
Salaries	Time (1:3)	21,000	5,250	15,750
	Total	21,000	5,250	15,750

Note No. 3 Depreciation and Amortization of Expenses

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Depreciation	Time (1:3)	25,000	6,250	18,750
Preliminary Expenditures	Post	5200	-----	5,200
	Total	30,200	6,250	23,950

Note No 4. Other Expenses

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Sales Commission	Sales(4:11)	7,500	2,000	5,500
Administrative Expenses	Time (1:3)		5,000	15,000
Rent and Taxes	Time (1:3)	20,000	3,000	9,000
Director's fees	Post	12,000	-----	18,000
		18,000		
	Total	57,500	10,000	47,500

Illustration 6: Tanishka Co. Ltd. was registered on 1st July 2024 to take over a business of a firm with effect from 1st April 2024. The company received certificate of commencement of business on 1st Oct. 2024. The accounts of the company prepared for the year ending 31st March 2025 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 30 th Sept. 2024)	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.)

Working Notes:

1. Time Ratio – Prior period – 1/4/2024 to 1/7/2024 – 3 months
 Post period – 1/7/2024 to 31/3/2025 – 9 months
 Time Ratio = 3:9 = 1:3
2. Sales Ratio – Prior period - 1/4/2024 to 1/7/2024 – 30000
 Post period – 1/7/2024 to 31/3/2025 – 800000 – 300000 = 500000
 Ratio – 300000 : 500000 = 3:5
3. Ratio for interest to vendors - Prior period – 1/4/2024 to 1/7/2024 – 3 months
 Post period – 1/7/2024 to 30/9/2024 – 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.

Statement of Profit & Loss for the year ending on 31st March 2025

Particulars	Note No.	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
I. Revenue From Operation	1	240000	90000	150000
II. Expenses				
a. Employee benefit expenses	2	18,000	4,500	13,500
b. Finance Cost	3	6,000	---	6,000
c. Depreciation and Amortization Expenses	4	36,000	9,000	27,000
d. Other Expenses	5	34,700	10,400	24,300
Total Expenses		94700	23900	70800
Net profit for the period (I-II)		145300	66100	79200

Note No. 1 Revenue from operation

Particulars	Basis of Apportion	Basis of apportion ₹	Pre-incorporation ₹	Post Incorporation ₹
Gross Profit	Sales (3:5)	2,40,000	90,000	1,50,000

Note No. 2 Employee benefit Expenses

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post Incorporation ₹
Salary	Time (1:3)	18000	4,500	13,500

Note No. 3 Finance Cost

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post Incorporation ₹
Interest on Debenture	Post	6000	---	6000

Note No. 4 Depreciation and Amortization of Expenses

Particulars	Basis of Apportion	Total	Pre-incorporation	Post Incorporation
Depreciation	Time (1:3)	36,000	9,000	27,000

Note No. 5 Other Expenses

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post Incorporation ₹
Discount allowed to debtors	Sales (3:5)	4,800	1,800	3,000
	Time (1:3)	2,400	600	1,800
Office Expenditures	Sales (3:5)	20,000	7,500	12,500
Advertising	As per given	2,500	500	2,000
Bad Debts	Post	5000	----	5,000
Interest to vendor				
	Total	34,700	10,400	24,300

Illustration 7: Bharati Ltd. was formed on 1/7/2024 to take over business of partnership as from 1/4/2024. The following is Profit & Loss A/c of the company for the year ending on 31/3/2025

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 31/8/2024)	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 ₹4,500 related to the debtors taken over from partnership. The sales for the period up to 1/7/2024 were $\frac{2}{3}$ rd of the sales for remaining period.

Compute the profit and 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:

- Time Ratio** – Prior period – 1/4/2024 to 1/7/2024 – 3 months
 Post period – 1/7/2024 to 31/3/2025 – 9 months Time Ratio = 3:9 = 1:3
- Sales Ratio** – if the sales for the post incorporation period are 3, then for pre incorporation period – $3 \times \frac{2}{3} = 2$. Thus, the ratio = 2:3
- Ratio for interest to vendors** - Prior period – 1/4/2024 to 1/7/2024 – 3 months
 Post period – 1/7/2024 to 31/8/2025 – 2 months
 Ratio = 3:2
- Bad debts** related to debtors taken over from partnership firm are charged to prior period and remaining to the after period.

Note No 1. Revenue from operation

Particulars	Basis of apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Gross Profit	Sales (2:3)	1,80,000	72,000	1,08,000

Note No. 2 Employee Benefit Expenses

Particulars	Basis of apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Salary	Time	1,8000	4,500	13,500

Note No. 3 Depreciation and Amortization Expenses

Particulars	Basis of apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Depreciation	Time	36,000	9,000	27,000
Preliminary Expenditures	Post period	9,000	-----	9,000
Total		45,000	9000	36000

Note No. 4 Other Expenses

Particulars	Basis of apportion	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
Printing & Stationery	Time	6,000		4,500
Bad Debts	Given	18,000	1,500	13,500
Interest to Vendors	3:2	7,500	4,500	3,000
Provision for Bad Debts	post	24,000	4,500	24,000
Advertising	Sales	15,000	6,000	9,000
Total		70,500	16500	54000

Statement of Profit & Loss for the year ending on 31st March 2025

Particulars	Note No.	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
I. Revenue from Operations	1	1,80,000	72,000	1,08,000
II. Expenditures				
a) Employee Benefit Expenditures	2	18,000	4,500	13,500
b) Depreciation and amortisation Expenditures	3	45,000	9,000	36,000
c) Other Expenditures	4	70,500	16,500	54,000
Total Expenditure		1,33,500	30,000	1,03,500
Profit for the period (I-II)		46,500	42,000	4,500

Illustration 8: Akhilesh Ltd. took over a running business with effect from 1/4/2024. The company was incorporated on 1/8/2024. The following summarised Profit and Loss Account for the year ended 31/3/2025 and additional information is given below. Additional information:

- Total sales for the year, which amounted to ₹ 19,20,000 out of which ₹ 4,80,000 are related to the prior incorporation period.
- Rent of office building was paid at ₹ 2,000 per month up to the end of September, 2024 and thereafter it was increased by ₹ 400 per month.
- Purchase consideration was discharged by the company on 30th September, 2024 by issuing equity shares of ₹ 100 each.

Profit and Loss A/c for the year ended 31/3/2025

Particulars	₹	Particulars	₹
To Rent of office building	26,400	By Gross profit	3,20,000
To Expenses of fixed nature	1,21,200		
To Tax Audit fee	6,000		
To Expenses of variable nature	60,400		
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

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 1/4/2024 to 1/8/ 2024 i.e. 4 months

Post incorporation period is 1/8/ 2024 to 31/3/2025 i.e. 8 months

Time ratio is 4:8 = 1:2.

2. Sales Ratio

Pre incorporation period	4,80,000
Post incorporation period	<u>14,40,000</u>
Total	19,20,000

Sales ratio is 4,80,000 : 14,40,000 = 1 : 3

3. Rent

Particulars		₹
Rent for pre-incorporation period (₹ 2,000 x 4)		8,000
Rent for post incorporation period August & September, 2024 (₹ 2,000 x 2)	4,000	
October,2024 to March,2025 (₹ 2,400 x 6)	14,400	18,400

4. Interest on Purchase Consideration

Pre incorporation period is 1/4/2024 to 1/8/ 2024 i.e. 4 months

Post incorporation period is 1/8/ 2024 to 30/9/2025 i.e. 2 months Time ratio is 4 : 2 = 2:1.

Note No 1. Revenue from Operation

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Gross Profit	Sales	3,20,000	80,000	2,40,000

Note No 2. Finance Cost

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Debenture Interest	Post Incorporation	3,000	---	3,000

Note No 3. Other Expenses

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Rent of office building	As per working note 3	26,400	8,000	18,400
Expenses of fixed nature	Time	1,21,200	40,400	80,800
Expenses of variable nature	Sales	60,400	15,100	45,300
Tax audit Fees	2:1	6,000		4,500
Interest to vendor	Post incorporation	4,200	1,500	1,400
Director's Fees		11,200	2,800	11,200
Total		2,29,400	67,800	1,61,600

Statement of Profit and Loss for the year ended 31/3/2025

Particulars	Note No	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
I. Revenue from Operation	1	3,20,000	80,000	2,40,000
II. Expenses				
a. Finance Cost	2	3,000	---	3,000
b. Other Expenses	3	2,29,400	67,800	1,61,600
Total Expenses (II)		2,32,400	67,800	1,64,600
Net profit for the period (I-II)		87,600	12,200	75,400

Illustration 9: Sudeep Ltd. was incorporated on 1/6/2024 to take over the business of Manjeet & Co. from 1/4/2024. The summarised Profit and Loss Account as given by Sujeet Ltd. for the year ending 31/3/2025 is as under:

Profit and Loss Account for the year ending 31/3/2025

Particulars	₹	Particulars	₹
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 Statement of Profit & Loss for the year ended on 31/3/2025, 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 $1\frac{1}{2}$ 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 1/8/2024.
3. The audit fees are paid for the audit under Companies Act

Solution –

Working Notes:

1. Sales Ratio

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 = 16000

Original salary 72000

Original Salary per month 72000 / 12 = 6000

Prior period – 1/4/2024 to 1/6/2024 – 2 months x 6000 = 12000

After period - 1/6/2024 to 31/3/2025 – 10 months = 88000 – 12000 = 76000

3. Time Ratio

Prior period – 1/4/2024 to 1/6/2024 – 2 months

After period - 1/6/2024 to 31/3/2025 – 10 months

Time ratio – 2:10 = 1:5

Statement of Profit & Loss for the year ended 31/3/2025

Particulars	Note No	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
I. Revenue from Operation	1	10,66,000	1,33,250	9,32,750
II. Expenses				
a. Employee benefit Expenses	2	3,31,000	52,500	2,78,500
b. Depreciation and Amortization Expenses	3	54,000	-----	54,000

c. Finance Cost	4	25,000	-----	25,000
d. Other Expenses	5	2,88,800	34,975	253825
Total Expenses (II)		6,98,800	87,475	6,11,325
Net profit for the period (I-II)		3,67,200	45,775	3,21,425

Note no 1. Revenue from Operation

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Gross Profit	Sales (1:7)	10,66,000	1,33,250	9,32,750

Note no 2. Employee Benefit Expenses

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Salary	Time	2,43,000	40,500	2,02,500
Manager's Salary	As per working note	88,000	12,000	76,000
Total		3,31,000	52,500	2,78,500

Note No 3. Finance Cost

Particulars	Basis of apportion	Total	Pre incorporation	Post incorporation
Interest on debentures	Post	25,000	-----	25,000

Note No 4. Depreciation and Amortisation Expenses

Particulars	Basis of apportion	Total ₹	Pre incorporation ₹	Post incorporation ₹
Underwriting Commission	Post	26,000	-----	26,000
Preliminary expenses	Post	28,000	-----	28,000
Total		54,000	-----	54,000

Note No 6. Other Expenses

Particulars	Basis of apportion	Total ₹	Pre incorporation ₹	Post incorporation ₹
Rent and taxes	Time	90,000	15,000	75,000
Carriage outward	Sales	14,000	1,750	12,250
Printing and Stationery	Time	18,000	3,000	15,000
Sales commission	Sales	30,800	3,850	26,950
Bad debts	Sales	91,000	11,375	79,625
Audit fees	Post	45,000	-----	45,000
Total		2,88,800	34,975	253825

Illustration 10: Brahma and Vishnu, working in partnership registered a joint stock company under the name of Safar Travellers Ltd. on August 31, 2024 to take over their existing business. It was agreed that they would take over the assets of the partnership from April 1st, 2024 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, 2024. 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, 2025

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	1 st 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 To	1,00,000	By Gross profit b/d	6,00,000
Debenture Interest	52,500		
To Depreciation	10,000		
To Interest on purchase Consideration	90,000		
To Selling commission To Directors' Fee	90,000		
	6,000		
To Preliminary expenses	9,000		
To Provision for taxes	60,000		
To Dividend paid on equity shares at 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 and losses for the 'post' and 'pre-incorporation' periods.

Solution – In the books of Safar Travellers Ltd.

Working Notes:

Time Ratio

Pre incorporation period = 1st April 2024 to 31st August 2024 = 5 months

Post incorporation period = 1st Sept. 22 to 31st March 2025 = 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 2024 to 31st August 2024 = 5 months

Post incorporation period = 1st September to 30th September 2024 = 1 month- Ratio = 5:1

Note: Dividend on Equity Shares is not considered as it is an appropriation of profit.

Note No 1. Revenue from Operation

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Gross Profit	Sales(1:2)	4,00,000	2,00,000	4,00,000

Note No 2. Employee Benefit Expenses

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Salaries and wages	Time (5:7)	1,00,000	41,667	58,333

Note No 3. Finance Cost

Particulars	Basis of Apportion	Total ₹	Pre-incorporation Rs	Post incorporation ₹
Debenture Interest	Post	52,500	-----	52,500

Note No 4. Depreciation and Amortisation expenses

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Depreciation	Time (5:7)	10,000	4167	5,833
Preliminary Expenses	Post	9,000	-----	9000
Total		19,000	4,167	14,833

Note No 5. Other Expenses

Particulars	Basis of Apportion	Total ₹	Pre-incorporation ₹	Post incorporation ₹
Selling Commission	1:2	90,000	30,000	60,000
Interest on Purchase Price	5:1	90,000	75,000	15,000
	Post	6,000	-----	6,000

Directors Fees	Post	60,000	-----	60,000
Provision for Taxes				
Total		2,46,000	1,05,000	1,41,000

Statement of Profit & Loss for the year ending 31st March 2025

Particulars	Note No	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
I. Revenue from Operation	1	6,00,000	2,00,000	4,00,000
II. Expenses				
a. Employee benefit Expenses	2	1,00,000	41,667	58,333
b. Finance Cost	3	52,500	-----	52,500
c. Depreciation and Amortization Expenses	4	19,000	4,167	14,833
d. Other Expenses	5	2,46,000	1,05,000	1,41,000
Total Expenses (II)		4,17,500	1,50,834	2,66,666
Net profit for the period (I-II)		1,82,500	49,166	1,33,334

Illustration 11: Kiran Ltd. was formed on 1 July, 2024 to take over Business of partnership as from 1 April, 2024. The following is Profit and Loss Account of the company for the year ending 31 March, 2025.

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 31-8-2024)	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 1-7-2024 were $\frac{2}{3}$ of the sales for the remaining period. The salary was evenly paid throughout the year.

Prepare a statement of Profit and Loss made by the company prior to and after incorporation.

Solution

Working Notes:

- Time Ratio – Prior period – 1/4/2024 to 1/7/2024 – 3 months
Post period – 1/7/2024 to 31/3/2025 – 9 months Time Ratio = 3:9 = 1:3
- Sales Ratio – if the sales for the post incorporation period are 3, then for pre incorporation period – $3 \times \frac{2}{3} = 2$. Thus the ratio = 2:3
- Ratio for interest to vendors - Prior period – 1/4/2024 to 1/7/2024 – 3 months
Post period – 1/7/2024 to 31/8/2024 – 2 months Ratio = 3:2
- Bad debts related to debtors taken over from partnership are charged to prior period and remaining to the after period.

Statement of Profit & Loss for the year ending on 31st March 2025

Particulars	Note No	Total Amount ₹	Pre-incorpo. ₹	Post-incorpo ₹
I. Revenue form operation	1	9,00,000	3,60,000	5,40,000
II. Expenses				
a. Employee Benefit Expenses	2	90,000	22,500	67,500
b. Depreciation and Amortisation expenses	3	2,25,000	45,000	1,80,000
c. Other Expenditures	4	3,52,500	82,500	2,70,000
Total Expenses (II)		6,67,500	1,50,000	5,17,500
Net profit for the period (I-II)		2,32,500	2,10,000	22,500

Note No 1 Revenue from Operation

Particulars	Basis of Apportion	Total ₹	Pre Incorporatio ₹	Post Incorporation ₹
Gross Profit	Sales	9,00,000	3,60,000	5,40,000

Note No. 2 Employee Benefit Expenses

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Salary	Time	90,000	22,500	67,500

Note No. 3 Depreciation and Amortization of Expenses

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Depreciation	Time (1:3)	1,80,000	45,000	1,35,000
Preliminary Expenditures	Post	45,000	-----	45,000
Total		2,25,000	45,000	1,80,000

Note No. 4 Other Expenses

Particulars	Basis of Apportion	Total ₹	Pre Incorporation ₹	Post Incorporation ₹
Printing and stationery	Time (1:3)	30,000	7,500	22,500
Bad debts	As per given	90,000	22,500	67,500
Interest to Vendor	3:2	37,500	22,500	15,000
Provision for bad debts	Post	1,20,000	-----	1,20,000
Advertising	Sales (2:3)	75,000	30,000	45,000
Total		3,52,500	82,500	2,70,000

Illustration 12: Janavi Ltd. was registered on 1st July 2024 to take over business of M/s Meena and Teena as from 1st April 2024. The company received its certificate for commencement of business on 1st August 2024. The accounts of the company prepared for the year ending 31st March 2025 showed the following.

1. Total turnover for the year amounting to ₹ 240000 of which ₹ 40000 relating to the period from 1st April 2024 to 1st August 2024.
2. Trading Account showed gross profit of ₹ 96000
3. Following expenses were debited to Profit & Loss 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 31 st Dec. 2024)	4000

Find out profit made by the company 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.

Working notes:-

1. **Time Ratio** – Prior period – 1/4/2024 to 1/7/2024 – 3 months

Post period – 1/7/2024 to 31/3/2025 – 9 months Time Ratio = 3:9 = 1:3

2. **Sales Ratio** – assuming sales are taken place evenly from 1/4/2024 to 1/8/2024

Prior period - 1/4/2024 to 1/7/2024 – $40000 / 4 \times 3 = 30000$

Post period – 1/7/2024 to 1/8/2024 - $40000 / 4 \times 1 = 10000$

1/8/2024 to 31/3/2025 – $240000 - 40000 = 200000$

Total post period – 10000 + 200000 = 210000 Ratio – 30000 : 210000 = 1:7

3. Ratio for interest to vendors - Prior period – 1/4/2024 to 1/7/2024 – 3 months

Post period – 1/7/2024 to 31/12/2024 – 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.

Statement of Profit & Loss A/c for the year Ending on 31st March 2025

Particulars	Note No.	Total (₹)	Pre-Incorporation (₹)	Post-Incorporation (₹)
I. Revenue from Operations	1	96,000	12,000	84,000
II. Expenditures	2	21,000	5,250	15,750
a) Employee Benefit Expenditures				
b) Depreciation and Amortization Expenditures	3	3,600	900	2,700
c) Other Expenditures	4	32,500	3,858	28,642
Total Expenditure		57,100	10,008	47,092
Profit for the Period (I-II)		38,900	1,992	36,908

Note No 1: Revenue from Operation

Particulars	Basis of Apportionment	Total ₹	Pre- incorporation ₹	Post- incorporation ₹
Gross Profit	Sales Ratio (1:7)	96,000	12,000	84,000

Note No 2: Employee Benefit Expenses

Particulars	Basis of Apportionment	Total ₹	Pre- incorporation ₹	Post- incorporation ₹
Salaries	Time Ratio (1:3)	21,000	5,250	15,750

Note No 3: Depreciation and Amortization Expenses

Particulars	Basis of Apportionment	Total ₹	Pre- Incorporation ₹	Post- Incorporation ₹
Depreciation	Time Ratio (1:3)	3,600	900	2,700

Note No 4: Other Expenses

Particulars	Basis of Apportionment	Total ₹	Pre- Incorporation ₹	Post- Incorporation ₹
Advertising	Sales ratio (1:7)	12,600	1,575	11,025
Commission on sales	Sales ratio (3:7)	3,600	450	3,150
Bad debts	As per given	1,500	500	1,000
Interest to vendor	1:2	4,000	1,333	2,667
Directors fees	Post Incorporation	10,800	-----	10,800
Total		32500	3858	28,642

4.3 Summary:

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. 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. 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. Companies have to prepare the Statement of Profit & Loss as per Schedule III of Companies Act, 2013 in vertical form. As the profit earned prior to incorporation is capital profit and not available for dividend, it is necessary to separate it from total profits for the first year so for this purpose a statement of Profit and Loss is prepared considering the apportionment of expenses and incomes pertaining to pre incorporation and post incorporation period.

4.4 Terms to Remember

1. **Profit or Loss Prior to 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 purchase to the date of incorporation is known as Pre-incorporation Profit or Loss.
2. **Profit or Loss after 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. **Sales Ratio:** Ratio of amount of sales pertaining to the pre-incorporation period to that of post-incorporation period.
4. **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.
5. **Gross profit and variable expenses and expenses connected with sales** are allocated between the two periods on the basis of sales ratio.
6. **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.
7. 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.
8. The provision in the Companies Act 2013 regarding preparation of Final Account states that the statement of Profit and Loss is to be prepared in Vertical Form along with related Notes.
9. Revenue from operation consists of a) Sale of product b) Sale of services etc, here Gross profit is considered as revenue from operation.
10. The Statement of Profit and Loss classifies the total expenses into employee benefit expenses, finance cost, depreciation and amortisation expenses and other expenses.

4.5 Answers to check your Progress

- | | |
|--|---------------------------|
| 1-a) Pre-incorporation | 2- a) 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 |

4.6 Exercise

A) Answer the following questions.

1. Explain Profit Prior to and After Incorporation with example.
2. Which Steps are used to calculate profit prior to and after incorporation
3. Write the expenses which are divided in Time Ratio and Sales Ratio.
4. Which expenses are only charged to pre incorporation and post incorporation?

B) Solve the following problems.

Problem 1: 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 2024 but the company was not incorporated till 1st July 2024. No entries relating to transfer of the business was entered in the books, which were carried on without a break till 31st March 2025. The following balances were extracted from the books as on 31st March 2025:

Trial Balance as on 31/3/2025

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:

- Stock on 31st March 2025 amounted to ₹ 44,000.
- The Gross Profit Ratio is constant and monthly sales in April 2024, February and March 2025 are double of the average monthly sales of the year.
- The Preliminary Expenses are to be written-off.
- Depreciation shall be provided at 25% p.a. on Fixed Assets.

You are required to -

- Compute Gross Profit
- Compute Sales Ratio
- Find the items which are not to be considered while preparing Profit & Loss A/c.

Problem 2: : Star Ltd., which was incorporated on 1st September 2024, took over the business of Surendra, a proprietary concern, from 1st April 2024, for ₹ 10,00,000 on the condition that all profits earned from 1/4/2024 shall belong to the company.

Following data is extracted from the Profit and Loss Account for the year ended 31st March 2025:

- 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 at 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

Problem no. 3: Anil Ltd. was formed on 1 July, 2024 to take over Business of partnership as from 1 April, 2024. The following is Profit and Loss Account of the company for the year ending 31 March, 2025.

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 31-8-2024)	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 1-7-2024 were 2/3 of the sales for the remaining period. The salary was evenly paid throughout the year.

Prepare a statement of Profit or Loss made by the company prior to and after incorporation.

Problem 4: Aniket Ltd. incorporated on 1st July 2024 to take over the running business of Pramod from 1st April 2024. The Profit & Loss Account for the year ended 31st March 2025 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 2025 was ₹3300000, out of this ₹660000 are related to the period up to 1st July 2024.

Prepare a statement showing profit prior to and after incorporation of Aniket Ltd.

Problem no 5: Rana Ltd. was formed on 1/8/2024 to take over business of partnership as from 1/4/2024. The following is Profit & Loss A/c of the company for the year ending on 31/3/2025

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	97,650		
	3,78,000		3,78,000

Out of Bad Debts ₹ 9,450 related to the debtors taken over from partnership. The sales for the period up to 1/8/2024 were 1/3rd of the sales for remaining period.

Compute the profit and loss made by the company prior to and after incorporation.

4.7 Reference to further study

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