

As Per New Syllabus: 2020-21 (CBCS-Semester Scheme)

CORPORATE ACCOUNTING

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KALYANI

As per new Syllabus: 2020-21 (CBCS – Semester Scheme)

CORPORATE ACCOUNTING

*(For 5 Year B.Com., LL.B. 2nd Semester of Karnataka State Law University
and useful for others affiliated courses of other universities)*

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Foreword

In today's competitive world of business, finance and accounting have assumed critical significance. Accounting information is imperative to perform the functions of management efficiently and effectively especially in planning, control and decision making. This is only possible, the accounts are maintained accurately and up-to-date.

The main purpose of this book is to present the subject matter in such a way that a student who has no prior knowledge of the corporate accounting can understand the subject without any difficulty. This study material has been presented in a logical way and the preliminary overview of corporate accounting principles to final discussion of various mechanisms of accounting.

The study material has primarily been prepared in a simple language and in a fluent style with a view to explain the basic principles of corporate accounting to the students. The subject matter is accompanied by adequate number of illustrations and special care has been taken to explain on the underwriting and issue of shares. An attempt has been made in all chapters to provide requisite theoretical framework for the understanding of practical problems in corporate accounting. A good number of questions and practical problems are given at the end of each study lesson as Self-Test Questions for the practice of students to test their understanding on the corporate accounting.

Rev. Fr. Dr. Augustine George

Principal

Kristu Jayanti College (Autonomous)

Preface

The fear of the Lord is the beginning of wisdom. This book has been written to provide readers with a balanced discussion of different concepts of corporate accounting. Corporate accounting is one such a wide and a vast subject yet a dynamic and interesting subject for the young generation. One has to find job for his livelihood either self-employed or work for others, has to know about the rules and regulations of the Accounting, keeping this in mind, it makes necessary for everybody to know the regulations of business. This text book Corporate accounting makes the requirement of everybody to know the Accounting of the modern world. The text book is not only for 2nd Semester 5 years B.Com., LL.B. students but also can be used as reference book for other students who belong to other various universities of B.Com., and is framed according to the prescribed syllabus of Karnataka State Law University. This text book is simple in language, catering to the needs of both urban and rural students, it's lucid and easily understandable.

We express our sincere gratitude to our Principal **Rev. Fr. Dr. Augustine George**, Kristu Jayanti College (Autonomous) for his constant support, prayers and blessing for us, **Dr. Aloysius Edward J**, Dean Department of Commerce and Management of Kristu Jayanti College.

We are very much thankful to **M/s. Kalyani Publishers, Ludhiana**. Our special thanks goes to **Mr. Mohammed Smeer**, Branch Manager and **Mr. Mohammed Zakir** of **M/s Kalyani Publishers Bangalore** branch, who helped us to bring out this text book within a short span of time. Constructive and valuable suggestions are most welcome for the better improvement of the text book at our e-mail lourdunathan@kristujayanti.com.

Our acknowledgements are also due to **Rev. Fr. Lijo P Thomas**, Head Department of Computer science and Financial Administrator **Rev. Fr. Emmanuel** Director, Kristu Jayanti College of Law without whose support and sacrifice, this work wouldn't have been completed by the deadline Finally, our acknowledgement is due to the Almighty who has blessed us with the knowledge, routed for writing this book. We do not claim any originality in the subject matter of this book, yet this book claims originality in the exposition and presentation of the subject matter.

We hope readers continue to find this book interesting, informative and enjoyable to read and I welcome constructive feedback.

Dr. Aloysius Edward J
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Syllabus

Karnataka State Law University

COURSE II : CORPORATE ACCOUNTING

Objectives : The objective of this subject is to enable the students to have a comprehensive awareness about the provisions of the Company's Act and Corporate Accounts.

NIT I : UNDERSRITING OF SHARES

Meaning – Underwriting Commission – Underwriter – Functions – Advantages of underwriting, Types of Underwriting – Marked and Unmarked Applications Problems.

NIT II : ISSUE OF SHARES

Meaning of Share, Types of Shares – Preference Shares and Equity Shares – Debentures – Issue of Shares at Par, at Premium, at Discount, Pro-rata Allotment – Journal Entries and Bank account – Preparation of Balance Sheet in the Vertical Form.

NIT III : PROFIT PRIOR TO INCORPORATION

Meaning – Calculation of Sales Ratio – Time Ratio – Weighted Ratio – Treatment of Capital and Revenue Expenditure – Ascertainment of Pre-Incorporation and Post-Incorporation Profits by Preparing Profit and Loss Account and Balance Sheet in the Vertical Form.

NIT IV : VALUATION OF GOODWILL AND SHARES

Meaning – Circumstances of Valuation of Goodwill – Factors influencing the Value of Goodwill – Methods of valuation of Goodwill : Average Profit Method, Super Profit Method, Capitalization of Average Profit Method, Capitalization of Super Profit Method and Annuity method – Problems.

Meaning of Valuation of Shares – Need for Valuation – Factors Affecting Valuation – Methods of Valuation : Intrinsic Value Method, Yield Method, Earning Capacity Method, Fair Value of Shares.

NIT V : COMPANY FINAL ACCOUNTS

Statutory Provisions regarding Preparation of Company Final Accounts – Treatment of Special Items – Tax Deducted at Source – Advance Payment of Tax – Provision for Tax – Depreciation – Interest on Debentures – Dividends – Rules regarding payment of Dividends – Transfer to Reserves – Preparation of Profit and Loss Account and Balance Sheet in Vertical Form (As per 2011 revised format)

Contents

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UNDERWRITING OF SHARES

Learning Outcomes

After studying this chapter, you will be able to :

- Understand the provisions of the Companies Act, 2013, regarding underwriting of shares
- Determine the liability of underwriters where shares are fully underwritten or partially underwritten
- Determine Account for firm underwriting of shares

Contents

- ☐ Introduction
- ☐ SEBI (Underwriters) (Amendment) Regulations, 2006
- ☐ Meaning of Underwriting of shares
- ☐ Top 5 underwriting /Investment companies in India
- ☐ The Importance of Underwriting
- ☐ Types of Underwriting
- ☐ Syndicate Underwriting
- ☐ Underwriting Commission as per Companies Act, 2013
- ☐ Payment of Commission
- ☐ Important terms in underwriting
- ☐ Marked Application
- ☐ Unmarked Application
- ☐ Determining the Liability of Underwriter/Underwriters
- ☐ Complete Underwriting
- ☐ Proforma Statement showing Net Liability of Underwriter
- ☐ PROFORMA JOURNAL ENTRIES in the books of Company
- ☐ Illustration and solutions

Abstract : Introduction, definition Section 2(1)(f) of the SEBI (Underwriters) (Amendment) Regulations, 2006, meaning, types, importance, Illustration, and exercise.

Introduction : In the present contemporary era it is inevitable to depend on others to survive and to achieve the said goal in the growing global market concerning manufacturing, sales, marketing even to raise the required capital to start and run the companies. To be very specific to subscribe the capital the company need to depend on Underwriters because as per the Companies Act, any

company going for public issue, the company must subscribe 90% of the total issue. In such a circumstance it has to depend on underwriters for subscription. Underwriters play a very crucial role by guaranteeing the company to subscribe the required capital (Provide ready fund to start business).

SEBI (Underwriters) (Amendment) Regulations, 2006.

According to Section 2(1)(f) of the SEBI (Underwriters) (Amendment) Regulations, 2006, Underwriter means individual engaged in the underwriting business. Underwriting is a standard procedure used in financial, insurance, and investment banking and in various industries. Regulation 2(fa) of the SEBI (Underwriters) Regulations, the term underwriting has been described as 'an agreement with or without conditions to subscribe to the securities of a corporation if the existing shareholders of such corporation or the public do not subscribe to the securities offered to them'. The underwriter's status in the entire public offering process is that of an intermediary between the Company and the potential investors.

Meaning of Underwriting of shares :

'Underwriting' refers to the functions of an under-writer. An under-writer may be an individual, a firm or a joint stock company, performing the under-writing function. Under-writing is a contract between the issuing company and the individual or firm called underwriters who agree to subscribe (purchase) whole or a portion of such issues in the absence of public subscription.

In other words, Underwriters are those individuals or firm guarantee's issuing company the required capital by purchasing the shares whole or partly as may not be purchased by the public. Such agreements are called 'Under-writing agreement'.

Top 5 underwriting /Investment companies in India

NAME OF THE COMPANY
• Axis Capital Ltd.
• Birla Capital & Financial Services Ltd.
• Central Bank Of India
• Deutsche Equities India Pvt. Ltd.
• ICICI Securities Ltd.

The Importance of Underwriting

Guarantee's required funds : It is an act under which the underwriters guarantee the company the purchase of shares issued by the company irrespective of public purchases. The underwriters provide a ready fund to the company.

Capital market Advisor to the Company : In addition, reducing the burden of issuing companies' risk regarding subscription of capital the underwriters support the companies in giving advice on the capital market conditions, investors' expectations etc., and time to time these underwriters' advice the company in decision making with regard to dividend.

Allocation of shares : The underwriters play a very important role in allocating (dividing) shares once agreed to subscribe the same to actual investors. Through agents and others, the underwriters allocate the issue over all investors scattered across different parts of the country.

Goodwill of the Issuing Company : The Underwriting of shares issued by well-established or reputed firm improves opinion on Issuing Company. The underwriters allocate the issue over all investors scattered across different parts of the country. Investors in other nations are depend wholly by the Underwriting firm's reputation than by the issuing company's reputation. Underwriters or Underwriting firm, therefore, increases the goodwill of the issuing company.

Guide to the Investors : Underwriters or underwriting firm guides the investors, in their investment portfolio decisions by giving real facts about the capital market condition, knowledge about the issuing companies stocks and shares at good faith. The underwriting firm also allow investors to invest more on capital gain.

Types of Underwriting

Complete Underwriting : It is an agreement, wherein the underwriter/underwriters will give guarantee to the issuing company to subscribe the whole issue of shares irrespective of public subscription.

Example : - Deena & Co. issues 1,00,000 shares of ₹ 100 each at par. The whole issue has been under written by X Co. for a commission of 2%.

Characteristics of Complete Underwriting.

- Shares are issued to public.
- The Whole issue is agreed to be purchased by the underwriters.
- Full issue or portion may be purchased by the public.
- Full issue is purchased by the public, the underwriters will have a advantage of getting commission without purchasing single shares.

Partial Underwriting : It is an agreement, wherein the underwriter/underwriters will give guarantee to the issuing company to subscribe only a part or portion in the whole issue of shares irrespective of public subscription.

Characteristics of Partial underwriting.

- Shares are issued to public.
- Only a part or portion issue is agreed to be purchased by the underwriters.
- Full issue may be purchased by the public.
- Full issue is purchased by the public, the underwriters will have an advantage of getting commission without purchasing single shares.

Example : -Aswitha an Underwriter enter into an underwritng agreement with Sushmitha for 80% of the issue of 50,000 Equity shares of ₹ 10 each.

In the above case Ashwitha 's underwritting liability is only 80% of 50,000 Equity shares of ₹ 10 each (i.e.) $50,000 \times 80/100 = 40,000$ Equity shares of ₹ 10 each only.

Firm Underwriting : It is an agreement, wherein the underwriter/underwriters will give guarantee to the issuing company to subscribe a definite or certain number of shares in addition to whole or only part or portion in the whole issue of shares irrespective of public subscription.

Example : -The following underwriting takes place A-5000 shares B-3000 shares and C-2000 shares. In addition, there is a firm underwriting A- 1000 shares B- 500 and C -1500 Shares.

A Characteristics of Firm underwriting.

- Shares are issued to public.
- A definite or certain number of shares must be purchased by the underwriters, in addition whole or only a part or portion issue is agreed to be purchased by the underwriters.
- Full issue may be purchased by the public.
- Full issue is purchased by the public, the underwriters will have an advantage of getting commission without purchasing single shares.

Syndicate Underwriting : It is an agreement, wherein the few underwriting firms together will give guarantee to the issuing company to subscribe whole issue of shares irrespective of public subscription.

A Characteristics of Syndicate underwriting.

- Shares are issued to public in Large numbers.
- It is not possible to individual underwriter or one single underwriting firm to subscribe huge number of shares.
- A few Underwriting companies join together and agree with issuing companies to buy such large number of shares.
- The Allocation of shares and the ratio with underwriting firms is decided in advance among the firms.
- Full issue may be purchased by the public.
- Full issue is purchased by the public, the underwriters will have an advantage of getting commission without purchasing single shares.

Joint Underwriting : It is an agreement, wherein the issuing company itself enter in to contract with more than one underwriter to reduce the burden of single underwriter, when issue is too large and difficult for one single underwriter to subscribe whole issue of the shares.

A Characteristics of Joint underwriting.

- Shares are issued to public in Large numbers.
- It is not possible to individual underwriter or one single underwriting firm to subscribe such huge number of shares.
- The issuing companies itself appoints few underwriters to reduce the risk.
- The Allocation of shares and the ratio with underwriting firms is decided in advance.
- Full issue may be purchased by the public.
- Full issue is purchased by the public, the underwriters will have an advantage of getting commission without purchasing single shares.

Best Efforts Underwriting : It is an agreement, wherein the underwriter/underwriters will not give guarantee to the issuing company to subscribe the whole issue of shares irrespective of public subscription but puts best efforts that the issuing companies must arrange every possible attempt to ensure that shares are sold at the highest price. Under this type of underwriting the underwriter will have less responsibility because the underwriters will not bear any unintended consequence of over-subscription or action if the entire shares remain unsold.

A Characteristics of Best Efforts Underwriting.

- Shares are issued to public in large numbers.
- The underwriter/underwriting firm will not assure subscription of shares in the event of unsubscribed shares.
- Underwriter will have less responsibility. Because the underwriter will not bear any unintended consequences of event or action if the entire shares remain unsold.

Sub-Underwriting: It is an agreement, wherein the underwriter/underwriters will give guarantee to the issuing company to subscribe the whole issue of shares irrespective of public subscription. At times it is impossible him to take huge pressure due to individual financial and firms' ability, the underwriter then enters into a contract with sub underwriter to protect himself. The sub underwriter is only responsible to underwriter, and he has no relation to issuing company.

Underwriting Commission as per Companies Act, 2013.**Payment of Commission**

A company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions, namely :-

- (a) the payment of such commission shall be authorized in the company's articles of association;
- (b) the commission may be paid out of proceeds of the issue or the profit of the company or both;
- (c) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent of the price at which the debentures are issued, or as specified in the company's articles, whichever is less;
- (d) the prospectus of the company shall disclose -
 - (i) the name of the underwriters;
 - (ii) the rate and amount of the commission payable to the underwriter; and
 - (iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.
- (e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;
- (f) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Important terms in underwriting

Marked Application- Those applications (forms) which bears the names and stamps/seal and signature of underwriters in order to differentiate application of one underwriter from that of others since more than one underwriter agree with issuing companies for subscription such applications are marked application.

1.6**Underwriting of Shares**

Unmarked Application– Those applications (forms) which will not bear any names and stamps/seal and signature of the underwriters. The application forms which are received by the issuing company without any name of the underwriter are called unmarked applications.

Determining the Liability of Underwriter/Underwriters.**Complete Underwriting.**

(a) When the whole issue of shares is agreed to be underwritten by ONE underwriter, then his net liability will be calculated as follows.

Proforma Statement showing Net Liability of Underwriter

Particulars	Amount
Gross Liability of Underwriter	XXXX
Less : Shares subscribed by public	XXXX
NET LIABILITY OF UNDERWRITER	XXXX

Proforma Journal Entries in the Books of Company

Date	Particulars	L/F	Debit	Credit
1.	(Entry for shares subscribed by the public) Bank A/c -----Dr To Share Capital A/c (Being money received from the public for shares subscribed)		xxx	xxx
2.	(Entry for unsubscribed shares taken over by the underwriter) Underwriters account -----Dr To Share Capital Account (Being the unsubscribed shares are taken over by the underwriter as per agreement)		xxx	xxx
3.	(Entry for underwriting commission due) Underwriting commission account -----Dr To underwriters Account (Being underwriting commission due to underwriters)		xxx	xxx
4.	(Entry for final amount receivable from the underwriter) Bank Account -----Dr To Underwriters Account		xxx	xxx

ILLUSTRATION 1.

B company Ltd, Issues 10,000 shares of ₹100 each at par. The whole issue has been underwritten by Suresh & Co, for a commission of 5%. The company received application for 7,000 shares. All the application was accepted. Give Journal entries to record the above transactions in the books of B company Ltd.

SOLUTION**Statement showing Net Liability of Underwriter**

Particulars	₹
Gross Liability of Underwriter	10,000
Less : Shares subscribed by public	7,000
NET LIABILITY OF UNDERWRITER	3,000

JOURNAL ENTRIES IN THE BOOKS OF B COMPANY LTD,

Date	Particulars	L/F	Dr.	Cr.
1.	(Entry for shares subscribed by the public) Bank A/C -----Dr To Share Capital A/C (Being money received from the public for 7,000 shares ₹100 each)		₹ 7,00,000	₹ 7,00,000
2.	(Entry for unsubscribed shares taken over by the underwriter) Suresh & Co Underwriters account -----Dr To Share Capital Account (Being the unsubscribed 3,000 shares of ₹100 each are taken over by the underwriter as per agreement)		3,00,000	3,00,000
3.	(Entry for underwriting commission due) Underwriting commission account -----Dr To Suresh & Co underwriters Account (Being underwriting commission due to underwriters on 10,000 shares of 100 each at 5%) $10,000 \times 100 = 10,00,000 \times 5/100$		50,000	50,000
4.	(Entry for final amount receivable from the underwriter) Bank Account -----Dr To Suresh & Co Underwriters Account (Being final amount settled by underwriter, 3,00,000-50,000)		2,50,000	2,50,000

(a) When the whole issue of shares is agreed to be underwritten by more number of underwriters, then his net liability will be calculated as follows.

Statement showing Net Liability of each Underwriters

Particulars	UW-1	UW-2	UW-3
Gross liability of each underwriter	xx	xx	xx
Less : - Marked Application	xx	xx	xx
BALANCE	xx	xx	xx
Less : -Unmarked application (Unmarked application = total application received from public - marked application)	xx	xx	xx
Net Liability of each underwriters	xx	xx	xx

ILLUSTRATION 2.

Zakir and company issued 1, 00,000 shares of ₹ 100 each. These shares were underwritten as follows : Alvin- 70,000 Brown- 30,000. The public applied for 80,000 shares which included marked applications as follows : Alvin- 50,000 and Brown 20,000. Determine the liability of Alvin and Brown.

SOLUTION

Statement Showing Net Liability of Underwriters

Particulars	ALVIN	BROWN
GROSS LIABILITY OF UNDERWRITERS	70,000	30,000
Less : - Unmarked applications $(80,000 - 70,000) 10,000 \times 7 : 3/10$	7,000	3,000
Balance	63,000	27,000
Less : - marked Applications	50,000	20,000
Net Liability of Underwriters	13,000	7,000

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Underwriting of Shares

Calculation of Unmarked applications

Particulars		
Total number of shares applied by public		80,000
Less : Marked application		70,000
Unmarked applications		10,000

ILLUSTRATION 3.

Sea limited issued 50,000 equity shares, the whole of the issue was underwritten as follows : Tall- 40% Thin- 30% Short- 30%. Application for 40,000 shares were received in all out of which applications for 10,000 shares had the stamp of Tall, Those for 5,000 shares that of Thin and 10,000 shares that of Short. The remaining application did not have any stamp. Show the liability of the underwriters.

SOLUTION

Particulars	Tall	Thin	Short
GROSS LIABILITY OF UNDERWRITERS (50,000 × 4 : 3 : 3/10)	20,000	15,000	15,000
Less : -Unmarked applications (15,000 × 4 : 3 : 3/10)	6,000	4,500	4,500
Balance	14,000	10,500	10,500
Less : - marked Applications	10,000	5,000	10,000
Net Liability of Underwriters	4,000	5,500	500

Calculation of Unmarked applications

Particulars		
Total number of shares Public applied (Subscription)		40,000
Less : - marked application (10,000+5,000+10,000)		25,000
Unmarked applications		15,000

ILLUSTRATION 4.

Sagar India Limited issued 1,50,000 equity shares. The whole of the issue was underwritten as follows Kiran 50% Arun 25% Charan 25%. Applications for 1,20,000 shares were received in all out of which application for 30,000 shares had the stamp of Kiran those were 15,000 shares that have Arun, 30,000 shares of Charan. The remaining application for 45,000 did not have any stamp. Determine the liability of each underwriter.

SOLUTION

Particulars	Kiran	Arun	Charan
GROSS LIABILITY OF UNDERWRITERS (1,50,000 × 50 : 25 : 25/100)	75,000	37,500	37,500
Less : -Unmarked applications (45,000 × 4 : 3 : 3/10)	18,000	13,500	13,500
Balance	57,000	24,000	24,000
Less : - marked Applications	30,000	15,000	30,000
Less :-surplus of Charan's oversubscription divided among Kiran and Arun (6,000 × 4 : 3/7)	27,000	9,000	-6,000
	3,429	2,571	+6,000
Net Liability of each underwriters	23,571	6,429	-

Calculation of Unmarked applications

Particulars	
Total number of shares Public applied (Subscription)	1,20,000
Less : - marked application (30,000+15,000+30,000)	75,000
Unmarked applications	45,000

Treatment of over subscription/Surplus from particular underwriter : -

(b) When the whole issue of shares is agreed to be underwritten by more number of underwriters, then there is possibility that oversubscription of shares from underwriters in such a situation the net liability will be calculated as follows.

ILLUSTRATION 5.

Singh & company issued prospectus inviting applications for 1,75,000 equity shares of rupees 10 each. The whole issue was fully underwritten by P, Q, R and S as follows P- 70,000 Q-52,500, R-35,000 S 17,500 Applications were received 1,57,500 shares of which marked application was as follows P- 77,000 Q- 38,500 R- 31,500 S- 3,500. Calculate the liability of the underwriters. (adopted from Bangalore university examination modified)

SOLUTION

Particulars	P	Q	R	S	Total
GROSS LIABILITY OF UNDERWRITERS	70,000	52,500	35,000	17,500	1,75,000
Less : - marked applications	77,000	38,500	31,500	3,500	1,51,000
Balance	-7,000	14,000	3,500	14,000	24,000
Less : -Surplus of P's over subscription of shares divided between Q, R and S ($7,000 \times 3 : 2 : 1/6$)	+7,000	3,500	2,333	1,167	24,000
	-	10,500	1,167	12,833	
Less : -Unmarked application ($7,000 \times 3 : 2 : 1/6$)		3,500	2,333	1,667	7,000
Less : -Surplus of R, oversubscription between Q and S ($1,166 \times 3 : 1/4$)		7,000	-1,166	11,166	17,000
		875	+1,166	291	
Net Liability of Underwriters	-	6,125	-	10,875	17,000

Calculation of Gross liability Ratio.

Shares agreed to be subscribed by underwriters as,

P-70,000 : Q-52,500 : R-35,000 : S-17,500 = 4 : 3 : 2 : 1

Calculation of Unmarked applications

Particulars	
Total shares subscribed by the public	1,57,500
Less :-Marked Application (77,000+38,500+31,500+3,500)	1,50,500
Unmarked applications	7,000

ILLUSTRATION 6.

MN limited issued equity shares ₹ 2,00,000 at ₹ 10 per share. The whole issue was fully underwritten by the following underwriters A -70,000 B-60,000 C -40,000 D-20,000 E-6000 F-4000. The application forms marked by the underwriters were A-20,000 B-45,000 C -40,000 D-15,000 E-17,000 and F nil. Applications for 40,000 shares were received on forms not marked. You are required to find out the liability of underwriters.

SOLUTION

Particulars	A	B	C	D	E	F	Total
GROSS LIABILITY OF UNDERWRITERS	70,000	60,000	40,000	20,000	6,000	4,000	
Less Marked Application Balance	20,000	45,000	40,000	15,000	17,000	-	
Less : -Surplus of Underwriter 'E' between A,B,D and F	50,000	15,000	-	5,000	-11,000	4,000	
	5,000	4,285	-	1,429	+11,000	286	
(11,000×35 :30 :10 :2/77	45,000	10,715	--	3,571		3,714	
Less : - Unmarked applications (40,000×35 :30 :10 :2/77	18,181	15,584		5,192	-	1,038	
Less : -Surplus of Underwriter 'B' and D between A, and F	26,819	-4,869	--	-1,621	-	2,676	
(6,490×35 :2/37	6,139	+4,869		+1,621		351	
Net Liability of Underwriters	20,680	-	-	-		2,325	23,005

Calculation of Gross Liability Ratio of Underwriters

A-70,000 : B-60,000 : C-40,000 : D-20,000 : E-6,000 : F-4,000

Therefore= 70 : 60 : 40 : 20 : 6 : 4 = 35 : 30 : 20 : 10 : 3 : 2

ILLUSTRATION 7.

DD limited incorporated on first January 2019 issued a prospectus inviting applications for 50,000 equity shares of rupees 100 each, the whole issue was underwritten by ABC and D as follows A-20,000 B-15,000 C-10,000 D-5,000. Applications were received for 45,000 shares of which marked applications were as follows A 22,000 B 11,000 C 9,000 and D 1,000. You are required to find out liability of underwriters and commission received by cash.

SOLUTION

Particulars	A	B	C	D	Total
Gross Liability of underwriters	20,000	15,000	10,000	5,000	50,000
Less : -marked Application	22,000	11,000	9,000	1,000	43,000
Balance	-2,000	4,000	1,000	4,000	7,000
Less : -Surplus/oversubscription of Underwriter 'A' divided between, B, C and D(2,000×3 :2 :1/6	-	3,000	333	3,667	
Less :-unmarked application		1,000	667	333	,000
45,000-22,000+11,000+9,000+1,000)= 2,000X3 :2 :1/6		2,000	-334	3,334	5,000
Less :surplus of underwriter 'C' adjusted with B and D (334×3 :1/4)		250	+334	84	
Net liability of underwriters	-	1,750	-	3,250	5,000

Calculation of underwriting commission

Commission is always calculated on the gross liability of each underwriter irrespective of public subscription. Therefore, commission due.

As per company Act, 2013 the commission payable on shares=5%

Commission due to Underwriter 'A'-----	$20,000 \times 100 = ₹20,00,000 \times 5/100 = 1,00,000$
Commission due to Underwriter 'B'-----	$15,000 \times 100 = ₹15,00,000 \times 5/100 = 75,000$
Commission due to Underwriter 'C'-----	$10,000 \times 100 = ₹10,00,000 \times 5/100 = 50,000$
Commission due to Underwriter 'D'-----	$5,000 \times 100 = ₹5,00,000 \times 5/100 = 25,000$

ILLUSTRATION 8.

AJF Company issued 36,000 equity shares of rupees 100 each. The issue was fully underwritten by S, T and V equally. Applications were received for 32,000 shares out of which marked applications were as follows S-12,000, T-8,000 and V-6,000. Determine the liability of S, T and V and pass journal entries assuming 5% rate of commission.

SOLUTION

Particulars	S	T	V	TOTAL
Gross Liability of underwriters	12,000	12,000	12,000	36,000
Less : -Unmarked Application (6,000×1 : 1 : 1/2)	2,000	2,000	2,000	6,000
	10,000	10,000	10,000	30,000
Balance	12,000	8,000	6,000	26,000
Less :-marked application	-2,000	2,000	4,000	
Less : -Surplus/oversubscription of Underwriter 'S' divided between, T and V (2,000×1 : 1/2)	+2,000	1,000	1,000	4,000
	--	1,000	3,000	
NET LIABILITY OF UNDERWRITERS	-	1,000	3,000	4,000

Calculation of Unmarked applications

Particulars		
Total shares subscribed by the public		32,000
Less : -Marked Application (12,000+8,000+6,000)		26,000
Unmarked applications		6,000

Calculation of underwriting commission

Commission is always calculated on the gross liability of each underwriter irrespective of public subscription. Therefore, commission due.

As per company Act, 2013 the commission payable on shares=5%

Commission due to Underwriter 'S'----- $12,000 \times 100 = ₹12,00,000 \times 5/100 = 60,000$

Commission due to Underwriter 'T'----- $12,000 \times 100 = ₹12,00,000 \times 5/100 = 60,000$

Commission due to Underwriter 'V'----- $12,000 \times 100 = ₹12,00,000 \times 5/100 = 60,000$

ILLUSTRATION 9.

When only a Part of shares is underwritten by a number of underwriters,

BEE Limited issues 20,000 equity shares of ₹ 100 each. The issue was underwritten as follows.

M-30%, N-30% P-20%. The company received application for 16,000 shares only. Determine the liability of each underwriters.

Underwriting of Shares					
Particulars	M	N	P	Company	TOTAL
Gross Liability of each Underwriter (20,000x30:30:20:20/100)	6,000	6,000	4,000	4,000	20,000
Less :- Share application received	4,800	4,800	3,200	3,200	16,800
Net Liability of each underwriters	1,200	1,200	800	800	4,000

Calculation of Unmarked applications

Particulars		
Total shares subscribed by the public		16,800
Less :- Marked Application ((12,000+8,000+6,000)		26,800
Unmarked applications		6,000

ILLUSTRATION 10.

Problem on Partial Underwriting, when marked application are not given

A company issued 1,00,000 shares of ₹10 each. These shares were underwritten as follows : X-30,000 shares and Y-50,000 shares. The public applied to 70,000 shares. Determine the liability of X and Y.
(Bangalore University II B.Com Examination 1991)

SOLUTION

Particulars	X	Y	Company	TOTAL
Gross Liability of each Underwriter	30,000	50,000	20,000	1,00,000
Less :- Unmarked application			14,000	14,000
Less :- Marked application	30,000	50,000	6,000	86,000
Net Liability of each underwriters	21,000	35,000		56,000
	9,000	15,000	6,000	30,000

Calculation of Marked and Unmarked applications

Particulars	X	Y	Company	TOTAL
Total application applied by public	21,000	35,000	14,000	70,000
Marked application of each underwriters (70,000x3:5:2/10 (treat marked application of company share as unmarked application)				
Marked application of each underwriter	21,000	35,000	14,000	70,000

Note : In the absence of marked application the total application received from the public should be apportioned (divided) among the underwriter in their gross liability ratio and share of company is treated as unmarked application.

ILLUSTRATION 11.

Popular Ltd., issued 40000 shares of rupees 10 each for public subscription, the issue were underwritten by P Q and R as follows P 25% of issue Q 30% of the issue R 25% of the issue. The marked applications for P, Q and R 5000 shares, 6000 shares and 4000 shares respectively. The company received applications for 30000 shares. Ascertain the net liability of each of the underwriters.

(Bangalore University Oct, 1991)

SOLUTION

Statement showing Net Liability of Each Underwriter

Particulars	P	Q	R	Company	TOTAL
Gross Liability of each Underwriter (40,000X25:30:25:20/100)	10,000	12,000	10,000	8,000	40,000
Less:- Unmarked application	-	-	-	6,000	6,000
Balance	10,000	12,000	10,000	2,000	34,000
Less:-Marked application	8,000	6,000	8,000	-	22,000
Net Liability of each underwriters	2,000	6,000	2,000	2,000	12,000

Calculation of Marked and Unmarked applications

Particulars	TOTAL
Total application applied by public	28,000
Less:-Marked application of each underwriters (8,000+6,000+8,000)	22,000
(treat marked application of company share as unmarked application) Therefore unmarked application	6,000

Note:- Under partial underwriting the Issuing Company will play a role of Underwriter, under such a circumstances the whole unmarked application will go in favour of issuing company only. It should not be deducted from any underwriters Gross liability.

Firm Underwriting

It is an agreement, wherein the underwriter/underwriters will give guarantee to the issuing company to subscribe a definite or certain number of shares in addition to whole or only part or portion in the whole issue of shares irrespective of public subscription

PROFORMA FOR FIRM UNDERWRITING, BUT EXCLUDING TOTAL APPLICATION.

(i) When the whole issue of shares underwritten are treated as Marked Application.

SOLUTION

Particulars	S	T	V	TOTAL
Gross Liability of underwriters	xx	xx	xx	xx
Less :-Unmarked application=(total application received-marked application)	xx	xx	xx	xx
Less :-Marked application	xx	xx	xx	xx
Balance	xx	xx	xx	xx
Less :-Firm Underwriting	xx	xx	xx	xx
Less :-Surplus/over subscription/excess application IF ANY	xx	xx	xx	xx
Net Liability of underwriters	xx	xx	xx	xx
Add :- firm Underwriting	xx	xx	xx	xx
Total liability of underwriters	xx	xx	xx	xx

Problems on Firm Underwriting**ILLUSTRATION 12.**

The following underwriting takes place A 5000 shares B 3000 shares and C 2000 shares. In addition, there is a firm underwriting A 1000 shares B 500 and C 1500 Shares.

1.14

The company issued 10,000 shares. Total subscription including firm underwriting was 8500 shares and the forms included the following marked forms A 2000, B 1000 and C 1000. Show the allocation of the liability of the underwriters.

SOLUTION

When Firm Underwriting treated as Marked application

Particulars	S	T	V	TOTAL
Gross Liability of underwriters	5,000	3,000	2,000	10,000
Less Un marked application=(total application received- marked application)	2,250	1,350	900	4,500
4,500x5 : 3 : 2/10	2,750	1,650	1,100	5,500
Less : -Marked application	2,000	1,000	1,000	4,000
Balance	750	650	100	1,500
Add : - Firm Underwriting	1,000	500	1,500	3,000
Less : -Surplus/over subscription/excess application IF ANY	1,750	1,150	1,600	4,500
Net Liability of underwriters	1,750	1,150	1,600	4,500
Total liability of underwriters	1,750	1,150	1,600	4,500

Particulars		
Total shares subscribed by the public		8,500
Less :-Marked Application (2,000+1,000+1,000)		4,000
Unmarked applications		4,500

ILLUSTRATION 13.

N Ltd. issues 2,50,000 shares of ₹ 10 each which was underwritten as follows :

A-75,000 shares (Firm Underwriting 8,000 shares)

B 62,500 shares (Firm Underwriting 12,000 shares)

C 62,500 shares (Firm Underwriting Nil)

D 50,000 shares (Firm Underwriting 30,000 shares)

The total application excluding firm underwriting but including marked applications were for 180000 shares. The marked applications were as under :

A 40,000 B 36,000 C 24,000 and D 48,000 shares, Calculate the Net liability of each underwriting treating :

(a) Firm Underwriting as marked application

(Bangalore University Examination 2006)

SOLUTION :

(a) Firm Underwriting as marked application

Calculation of total subscription

Particulars		
Total application received from public		1,80,000
Add :- firm underwriting (8,000+12,000+30,000)		50,000
Total subscription		2,30,000

Underwriting of Shares

1.15

Particulars	A	B	C	D	TOTAL
Gross Liability of each Underwriter	75,000	62,500	62,500	50,000	2,50,000
Less : -Unmarked application = Total application received-Marked application including firm underwriting $32,000 \times 6 : 5 : 5 : 4/20$					
Balance	9,600	8,000	8,000	6,400	32,000
Less : Marked Applications	65,400	54,500	54,500	43,600	2,18,000
Balance	48,000	48,000	24,000	78,000	1,98,000
Less: Surplus/over subscription/excess application of D transferred to A, B and C	17,400	6,500	30,500	-34,400	20,000
$(-34,400 \times 6 : 5 : 5/16)$	12,900	10,750	10,750	+34,400	-
Balance	4,500	-4,250	19,750	-	20,000
Surplus of B transferred to A and C in 6 : 5					
$4,250 \times 6 : 5/11$	-2,318	+4,250	1,932	-	-
Net Liability	2,182	-	17,818	-	20,000
Add : Firm underwriting	8,000	12,000	-	30,000	50,000
	10,182	12,000	17,818	30,000	70,000

Calculation of unmarked application when firm underwriting is treated as marked application

Particulars		
Total application received from public including firm underwriting (1,80,000+8,000+12,000+30,000)		2,30,000
Less : Marked application including firm underwriting since it is given in the question to treat firm underwriting as marked application.		
A-(40,000+8,000)	48,000	
B-(36,000+12,000)	48,000	
C-(24,000+NIL)	24,000	
D-(48,000+30,000)	78,000	1,98,000
Total subscription		32,000

ILLUSTRATION 14.

Anand Ltd. issued 200000 shares of ₹ 10 each. The entire issue was underwritten as follows :
Ananth = 100000 shares (firm underwriting 20000 shares)

Bhaskar = 60000 shares (firm underwriting 10000 shares)

Chander = 40000 shares (firm underwriting 10000 shares)

Shares applied for were 180000 (including firm underwriting). The following being the marked forms : Ananth = 70000 shares, Bhaskar = 28000 shares, Chander = 32000 shares. Calculate the total liability of each underwriter. (Karnataka State Law University B.Com LLB December 2019)

SOLUTION

When Firm Underwriting treated as Marked application

Particulars	Anand	Bhaskar	Chander	TOTAL
Gross Liability of underwriters	1,00,000	60,000	40,000	2,00,000
Less : Unmarked application= (total application received- marked application) (50,000×5 :3 :2/10)	25,000	15,000	10,000	50,000
	75,000	45,000	30,000	1,50,000
Less : -Marked application	70,000	28,000	32,000	1,30,000
Balance	5,000	17,000	-2,000	20,000
Less : -Surplus/oversubscription/excess application	1,250	750	+2,000	-
Chander's shares between Anand and Bhaskar (2,000×5 :3/8)	3,750	16,250	-	20,000
+Firm Underwriting	20,000	10,000	10,000	40,000
Net Liability of underwriters	23,750	26,250	10,000	60,000
Total liability of underwriters	23,750	26,250	10,000	60,000

Calculation of unmarked application when firm underwriting is treated as marked application

Particulars		
Total application received from public including firm underwriting		1,80,000
Less : Marked application including firm underwriting since it is given in the question to treat firm underwriting as marked application.		
Anand	70,000	
Bhaskar	28,000	
Chandar	32,000	1,30,000
Total unmarked application		50,000

ILLUSTRATION 15.

Naveen Ltd. issued 100000 equity shares of ₹ 100 each. A, B, C and D underwrite the entire issue in the proportion of 40%, 30%, 20% and 10% respectively in consideration of commission in cash at 4%. They also apply for firm shares as under : A – 3000 shares, B – 2000 shares, C – 2000 shares and D – 3000 shares. Besides, firm applications from the underwriters, the public apply for 60000 shares, of which the marked applications are as under : A – 10000 shares, B – 6000 shares, C – 8000 shares and D – 16000 shares. Show the number of shares to be taken up by each of the underwriters, treating firm underwriting as unmarked applications.

(Karnataka state Law University B.Com. LLB December 2019)

SOLUTION

When firm underwriting is treated as unmarked application.

Statement showing Net Liability of each underwriters.

Particulars	A	B	C	D	TOTAL
Gross Liability of each Underwriter (1,00,000×4 :3 :2 :1/10)	40,000	30,000	20,000	10,000	1,00,000
Less : -Unmarked application = Total application received+ firm underwriting- Marked application (30,000×4 :3 :2 :1/10)	12,000	9,000	6,000	3,000	30,000

Underwriting of Shares**1.17**

Balance	28,000	21,000	14,000	7,000	70,000
Less :-Marked application	10,000	6,000	8,000	16,000	40,000
Less :-surplus of shares of D between A,B and C(9,000×4 :3 :2/9)	18,000	15,000	6,000	-9,000	30,000
	4,000	3,000	2,000	+9,000	-
	14,000	12,000	4,000	-	30,000
Add :-Firm Underwriting	3,000	2,000	2,000	3,000	10,000
Net liability of each underwriters	17,000	14,000	6,000	3,000	40,000

Calculation of total applications

Particulars		
Total application received from public		60,000
Add :- firm underwriting (3,000+2,000+2,000+3,000)		10,000
Total subscription		70,000

Calculation of total unmarked applications

Particulars		
Total application received from public including firm underwriting (Since firm underwriting treated as unmarked application)		70,000
Less :-Marked applications (10,000+6,000+8,000+16,000)		40,000
Total unmarked application		30,000

Calculation of underwriting commission.

Commission in cash at 4%.

40,000 shares at ₹100 each – $(40,000 \times 100 = 40,00,000 \times 4 / 100 = 1,60,000)$

30,000 Shares at ₹100 each = $(30,000 \times 100 = 30,00,000 \times 4 / 100 = 1,20,000)$

20,000 shares at ₹100 each = $(20,000 \times 100 = 20,00,000 \times 4 / 100 = 80,000)$

10,000 shares at ₹100 each = $(10,000 \times 100 = 10,00,000 \times 4 / 100 = 40,000)$.

Note :- "Besides, firm applications" means excluding firm underwriting.

ILLUSTRATION 16.

Sunshine Ltd. came up with an issue of 20,00,000 equity shares of ₹ 10 each at par. 5,00,000 shares were issued to the promoters and the balance offered to the public was underwritten by Mr. S, Mr. M and Mr. R equally, with firm underwriting of 50,000 shares each. Subscriptions totalled 12,97,000 shares (excluding firm underwriting) but including the marked form which were : Mr. S – 4,25,000 shares, Mr. M – 4,50,000 shares and Mr. R – 3,50,000 shares. The underwriters had applied for number of shares covered by firm underwriting. The amounts payable on applications and allotment were ₹ 2.50 and ₹ 2 respectively. The agreed commission was 2.5%. The unmarked application are to be credited equally to all the underwriter. Calculate : (i) Liability of underwriters (ii) Underwriters commission.

(Karnataka State Law University B.Com. LLB June 2019)

SOLUTION :

When firm underwriting is treated as marked application

Statement showing Net Liability of Each underwriter

Particulars	Mr. S	Mr. M	Mr. R	Total
Gross Liability of underwriters	5,00,000	5,00,000	5,00,000	15,00,000
Less: Unmarked application= (total application received- marked application)	24,000	24,000	24,000	72,000
(72,000×1 : 1 : 1/3)	4,76,000	4,76,000	4,76,000	14,28,000
Less :-Firm Underwriting	50,000	50,000	50,000	1,50,000
Balance	4,26,000	4,26,000	4,26,000	12,78,000
Less : Marked application	4,25,000	4,50,000	3,50,000	12,25,000
	1,000	-24,000	76,000	53,000
Less : Surplus/ over subscription/ excess application	12,000	+24,000	12,000	-
Mr. M's shares between S and R (24,000×1 : 1/2)	-11,000	-	64,000	53,000
Less : Surplus/ over subscription/ excess application	+11,000	-	11,000	-
Mr. S's shares to R	-	-	53,000	53,000
+Firm Underwriting	50,000	50,000	50,000	1,50,000
Net Liability of underwriters	50,000	50,000	1,03,000	2,03,000
Total liability of underwriters	50,000	50,000	1,03,000	2,03,000

Calculation of unmarked application when firm underwriting is treated as marked application

Particulars	
Total application received from public excluding firm underwriting	12,97,000
Less : Marked application including firm underwriting	
Mr. S (4,25,000)	
Mr. M (4,50,000)	
Mr. R (3,50,000)	12,25,000
Total unmarked application	72,000

Calculation of underwriting commission.

Commission in cash at 2.5%.

Mr. S 5,00,000 shares at ₹10 each-(5,00,000×10=50,00,000×2.5/100=1,25,000

Mr. M 5,00,000 shares at ₹10 each-(5,00,000×10=50,00,000×2.5/100=1,25,000

Mr. R 5,00,000 shares at ₹10 each-(5,00,000×10=50,00,000×2.5/100=1,25,000

ILLUSTRATION 17.

Goodwill Ltd. offered to the public 18,00,000 shares at par. These offers were underwritten by 3 underwriters. Cheethu, Neethu and Reethu equally with firm underwriting 60,000 shares each. Subscriptions totalled 15,80,000 shares including the marked forms which were : Chethu - 5,00,000 shares Neethu - 5,40,000 shares Reethu - 4,40,000 shares The underwriters had applied for the number of shares covered by firm undertaking. The underwriters have agreed for the commission at 2.5%. You are required to : (i) find the Liability of underwriters (ii) Find the commission of underwriters.

(Karnataka state Law University B.Com. LLB June 2019)

SOLUTION :

When firm underwriting is treated as marked application

Statement showing Net Liability of Each underwriter

Particulars	Cheethu	Neethu	Reethu	Total
Gross Liability of underwriters	6,00,000	6,00,000	6,00,000	18,00,000
Less : Unmarked application= (total application received- marked application (1,00,000×1 : 1 : 1/3)	33,333	33,333	33,334	1,00,000
Less :-Firm Underwriting	5,66,667	5,66,667	5,66,666	17,00,000
Balance	60,000	60,000	60,000	1,80,000
Less : -Marked application	5,06,667	5,06,667	5,06,666	15,20,000
	5,00,000	5,40,000	4,40,000	14,80,000
Less : -Surplus/over subscription/excess application Neethu's shares between Cheethu and Reethu (33,333×1 : 1 : 2)	6,667	-33,333	66,666	40,000
Less : -Surplus/over subscription/excess application Cheethu's shares to Reethu	16,667	+33,333	16,666	-
+Firm Underwriting	-10,000	-	50,000	40,000
	+10,000	-	10,000	-
	-	-	40,000	40,000
Net Liability of underwriters	60,000	60,000	60,000	1,80,000
Total liability of underwriters	60,000	60,000	1,00,000	2,20,000

Calculation of unmarked application when firm underwriting is treated as marked application

Particulars		
Total application received from public		15,80,000
Less : Marked application including		
Cheethu	5,00,000	
Neethu	5,40,000	
Reethu	4,40,000	14,80,000
Unmarked application		1,00,000

Calculation of underwriting commission.

commission in cash at 2.5%.

Mr. Cheethu-6,00,000 shares at ₹10 each- $(6,00,000 \times 10 = 60,00,000 \times 2.5 / 100 = 1,50,000)$

Mr. Neethu-6,00,000 shares at ₹100 each- $(6,00,000 \times 100 = 60,00,000 \times 2.5 / 100 = 1,50,000)$

Mr. Reethu-6,00,000 shares at ₹100 each- $(6,00,000 \times 100 = 60,00,000 \times 2.5 / 100 = 1,50,000)$

ILLUSTRATION 18.

ABC Limited issued 20000 equity shares which were underwritten as follows X 12000 shares Y 5000 shares and Z 3000 shares. The underwriters made applications for firm underwriting as follows X 1600 shares Y 600 shares and Z 2000 shares. The total subscriptions excluding firm underwriting but including marked applications were for 10000 shares. The marked applications were as follows : X 2000 shares Y 4000 shares and Z 1000 shares. You are required to show the allocation of liability of the underwriters

SOLUTION :

When firm underwriting is treated as marked application

Statement showing Net Liability of Each underwriter

Particulars	X	Y	Z	TOTAL
Gross Liability of underwriters	12000	5000	3000	20,000
Less Unmarked application= (total application received- marked application) (7000 × 12 : 5 : 3/20)	4,200	1,750	1,050	7,000
	7,800	3,250	1,950	13,000
Less :-Firm Underwriting	1,600	600	2,000	4,200
Balance	6,200	2,650	-50	8,800
Less :-Surplus/over subscription/excess application Z's shares between X and Y (50 × 12 : 5/17)	35	15	+50	-
Less :-Marked application	6,165	2,635	-	8,800
Balance	2,000	4,000	1,000	7,000
Less :-Surplus/over subscription/excess application Y and Z shares between X (1,365+1,000)	4,165	-1,365	-1,000	1,800
+Firm Underwriting	2,365	+1,365	+1,000	-
Net Liability of underwriters	1,800	-	-	1,800
Total liability of underwriters	1,600	600	2,000	4,200
	3,400	600	2,000	6,000
	3,400	600	2,000	6,000

Calculation of unmarked application when firm underwriting is treated as marked application

Particulars		
Total application received from public excluding firm underwriting		10,000
Less : Marked application including		
X-2,000		
Y-4,000		7,000
Z-1,000		3,000
Total unmarked application		

ILLUSTRATION 19.

ABC Ltd, incorporated 01-01-2017 issued a prospectus inviting application for 5,00,000 Equity shares of ₹10 each. The whole issue was underwritten by W, X, Y and Z are as follows.

W-2,00,000, X-1,50,000 Y-1,00,000 and Z-50,000 shares. Application was received for 4,50,000 shares of which marked application were as follows W-2,20,000, X-1,10,000 Y-90,000 and Z-10,000.

You are required to find out the liability of underwriters.

(Karnataka State Law University B.Com. L.L.B. June 2019)

SOLUTION

Particulars	W	X	Y	Z	Total
Gross Liability of underwriters	2,00,000	1,50,000	1,00,000	50,000	5,00,000
Less :-Marked Application	2,20,000	1,10,000	90,000	10,000	4,30,000
Balance	-20,000	40,000	10,000	40,000	70,000
Less :-Surplus/over subscription of Underwriter "W" divided between, X, Y and Z(20,000×3 : 2 : 1/6)	+20,000	10,000	6,667	3,333	-
	Nil	30,000	3,333	36.667	70,000

Underwriting of Shares**1.21**

Less :-Unmarked application $4,50,000 - 2,20,000 + 110,000 + 90,000 + 10,000 =$	8,000	6,000	4,000	2,000	20,000
$20,000 \times \frac{4}{3} : \frac{2}{2} : \frac{1}{10}$	-8,000	24,000	-667	34,667	50,000
Less : Surplus of underwriter 'W and Y adjusted with X and Z ($8,667 \times \frac{3}{1} : \frac{4}{4}$)	+8,000	6,500	+667	2,167	
Net liability of underwriters	NIL	17,500	NIL	32,500	50,000

ILLUSTRATION 20.

Sooraj Ltd. issued 200000 equity shares of ₹ 100 each. A, B, C and D underwrite the entire issue in the proportion of 40%, 30%, 20% and 10% respectively in consideration of commission in cash at 4%. They also apply for firm shares as under : A – 6000 shares, B – 4000 shares, C – 4000 shares and D – 6000 shares. Besides, firm applications from the underwriters, the public apply for 1,20,000 shares, of which the marked applications are as under : A – 20000 shares, B – 12000 shares, C – 16000 shares and D – 32000 shares. Show the number of shares to be taken up by each of the underwriters, treating firm underwriting as unmarked applications.

(Bangalore University III Semester B.Com. Examination Nov/Dec., 2014)

SOLUTION

When firm underwriting is treated as unmarked application.

Statement showing Net Liability of each underwriters.

Particulars	A	B	C	D	TOTAL
Gross Liability of each Underwriter ($2,00,000 \times \frac{4}{3} : \frac{2}{2} : \frac{1}{10}$)	80,000	60,000	40,000	20,000	2,00,000
Less :-Unmarked application=Total application received+ firm underwriting-Marked application ($60,000 \times \frac{4}{3} : \frac{2}{2} : \frac{1}{10}$)	24,000	18,000	12,000	6,000	60,000
Balance	56,000	42,000	28,000	14,000	1,40,000
Less :-Marked application	20,000	12,000	16,000	32,000	80,000
Less :-surplus of shares of D between A,B and C($18,000 \times \frac{4}{3} : \frac{2}{2} : \frac{9}{9}$)	36,000	30,000	12,000	-18,000	60,000
	8,000	6,000	4,000	+18,000	-
	28,000	24,000	8,000	-	60,000
Add :-Firm Underwriting	6,000	4,000	4,000	6,000	20,000
Net liability of each underwriters	34,000	28,000	12,000	6,000	80,000

Calculation of total subscription

Particulars		
Total application received from public		1,20,000
Add : - firm underwriting($6,000 + 4,000 + 4,000 + 6,000$)		20,000
Total subscription		1,40,000

Calculation of total unmarked applications

Particulars		
Total application received from public including firm underwriting(Since firm underwriting treated as unmarked application)		1,40,000
Less :-Marked applications ($20,000 + 12,000 + 16,000 + 32,000$)		80,000
Total unmarked application		60,000

Calculation of underwriting commission.

Commission in cash at 4%.

A- 80,000 shares at ₹100 each = $(80,000 \times 100 = 80,00,000 \times 4 / 100 = 3,20,000)$

B- 60,000 Shares at ₹100 each = $(60,000 \times 100 = 60,00,000 \times 4 / 100 = 2,40,000)$

C- 20,000 shares at ₹100 each = $(40,000 \times 100 = 40,00,000 \times 4 / 100 = 1,60,000)$

D- 20,000 shares at ₹100 each = $(20,000 \times 100 = 20,00,000 \times 4 / 100 = 80,000)$.

Note : "Besides, firm applications" means excluding firm underwriting.

ILLUSTRATION 21.

The following underwriting takes place A 20000 shares B 12000 shares and C 8000 shares. In addition, there is a firm underwriting A 4000 shares B 2000 and C 6,000 Shares.

The company issued 40,000 shares. Total subscription including firm underwriting was 34,000 shares and the forms included the following marked forms A 8000, B 4000 and C 4000. Show the allocation of the liability of the underwriters.

SOLUTION.

When Firm Underwriting treated as Marked application.

Particulars	S	T	V	TOTAL
Gross Liability of underwriters	20,000	12,000	8,000	40,000
Less Un marked application=(total application received-marked application)	9,000	5,400	3,600	18,000
$18,000 \times 5 : 3 : 2$	11,000	6,600	4,400	22,000
Less : -Marked application	8,000	4,000	4,000	16,000
Balance	3,000	2,600	400	6,000
Add : - Firm Underwriting	4,000	2,000	6,000	12,000
Less : -Surplus/over subscription/excess application IF ANY	7,000	4,600	6,400	18,000
Net Liability of underwriters	7,000	4,600	6,400	18,000
Total liability of underwriters	7,000	4,600	6,400	18,000

Particulars		
Total shares subscribed by the public		34,000
Less : -Marked Application ((8,000+4,000+4,000)		16,000
Unmarked applications		18,000

Exercise

SHORT ANSWER TYPE

1. Define Underwriting of shares.
2. Write the meaning of underwriting
3. What is underwriting of agreement?
4. Who is an underwriter?
5. State the different types of underwriting.
6. What is meaning of underwriting commission?

7. What is the maximum percentage of commission payable to underwriters on shares and debentures as per companies act.
8. State the meaning of marked application
9. State the meaning of unmarked application.
10. Distinguish between complete underwriting and partial underwriting.
11. What do you mean by firm underwriting?
12. Write a short note the following.
 - (i) Pure underwriting
 - (ii) Firm underwriting
 - (iii) Underwriting commission

LONG ANSWER TYPE

1. What is the meaning of underwriting of Shares? Explain various types of underwriting. State the proforma of determining net liability of underwriters.
2. State the advantages and disadvantages of underwriting of shares.
3. A company issued prospectus inviting applications for 7,00,000 equity shares of rupees 10 each. The whole issue was fully underwritten by A, B, C and D as follows A -2,80,000 B-2,10,000. C-1,40,000 D-70,000 Applications were received 6,30,000 shares of which marked application was as follows A-3,08,000 B-1,54,000 C-1,26,000 D-14,000. Calculate the liability of the underwriters.
4. ABC Limited issued equity shares ₹ 100000 at ₹ 10 per share. The whole issue was fully underwritten by the following underwriters A 35,000 B 30,000 C 20,000 D 10,000 E 3000 F 2000. The application forms marked by the underwriters were A 10,000 B 22,500 C 20,000 D 7500 E 85,000 and F nil. Applications for 20,000 shares were received on forms not marked. You are required to find out the liability of underwriters
5. A company issued 100000 shares. These shares are underwritten as follows :
X 60000 Y 25000 Z 15000. In addition, there is firm underwriting- X 8000 Y 3000 Z 10000. The total subscription including the firm underwriting was 71000 shares and the forms included the following marked forms- X 10000 Y 20000 Z 5000. Determine the net liability of underwriters.
6. M Ltd. has authorized capital of ₹ 5000000 divided into 100000 equity shares of ₹ 50 each. The company issued for subscription 50000 shares at a premium of ₹ 10 each. The entire issue was underwritten as follows
A-30000 shares (Firm Underwriting 5000 shares)
B-15000 shares (Firm Underwriting 2000 shares)
C-5000 shares (Firm Underwriting 500 shares)
Out of the total issue, 45000 shares including firm underwriting were subscribed
The following were the marked forms :
A-16000 : B-10000 : C-4000
Calculate the liability of each underwriter.

7. X Ltd. issued 400000 shares of ₹ 10 each. The entire issue was underwritten as follows :

A 200000 (Firm Underwriting 40000 shares)

B 120000 (Firm Underwriting 20000 shares)

C 80000 (Firm Underwriting 20000 shares)

Shares applied for were 360000 the following being the marked forms including firm underwriting A 140000 B 56000 C 64000.

Calculate the liability of each underwriting

(Bangalore University B.Com. 2002. Examination)

8. Embassy Ltd. issued 10000 shares of ₹ 100 each at a premium of ₹ 20 per shares. The entire issue was underwritten by A B and C as follows :

5000 shares (Firm Underwriting 1000 shares)

B 3000 shares (Firm Underwriting 500 shares)

C 2000 shares (Firm Underwriting 500 shares)

Public have applied for 9000 shares. The following are the marked forms including firm underwriting

A 3500 shares B 1400 shares and C 1600 shares

Determine the liability of each underwriter.

(Bangalore University B.Com. 1997, Examination)

9. ABC Company issued 20,000 shares which were underwritten by X, Y and Z as follows :

X 10000 shares Y 6000 shares Z 4000 shares. In addition there was firm underwriting by : X 1000 shares Y 500 shares and Z 1500 shares.

The company received applications for 15200 shares including firm underwriting and the number of marked forms were as below X 3000 shares Y 4500 shares Z 1700 shares. Show the allocation of liability of the underwriters assuming that the underwriting agreement did not provide any relief for firm application.

(CA Inter, June 1988 Examination)

10. (Entire issue is underwritten with firm underwriting when total subscription is excluding firm underwriting by including mark application)

Bangalore house building Association issued 100000 equity shares of ₹ 100 each; P, Q, R and S underwrite the entire issue in the proportion of 40% 30% 20% and 10% respectively in consideration of commission in cash at 4%. They also apply for firm shares as follows : P 3000 shares Q 2000 shares R 2000 shares and S 3000 shares. Besides the firm applications from the underwriters the public apply for 60000 shares of which marked applications are as follows : P 10000 shares Q 6,000 shares R 8000 shares and S 16000 shares. Show the number of shares to be taken up by each of the underwriters and also the commission receivable in cash.

(Bangalore University B.Com. 1994. Examination)



ISSUE OF SHARES

Learning Outcomes

After studying this chapter, you will be able to:

- Familiar meaning of Shares and Types of shares and Debentures.
- Learn the accounting treatment if shares issued under different circumstances like at par, at discount and at premium.
- Deal with forfeiture of shares issued with different conditions.

Contents

- ☐ Meaning of share capital
- ☐ Share capital of the company
- ☐ Types of shares
- ☐ Ordinary equity shares
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- ☐ Types of Preference shares.
- ☐ Issue of Shares for Cash
- ☐ Issue Price of the shares
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- ☐ Proforma journal entries for issue of shares for cash
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- ☐ Meaning of Under Subscription/Illustration
- ☐ Meaning of Oversubscription/Illustration
- ☐ Meaning of issue of shares at Premium/Illustration

Abstract : The Draw backs in sole trading concern and partnership firm i.e., limited capital and unlimited liability which will not allow them to expand their business to meet the growing demand, Industrial revaluation and less earning lead to new type of business organization which helps them to overcome these draw backs is Joint stock companies.

Meaning of Companies

Company follows the provisions mentioned in the Companies Act 2013, which says that a – “Company” means a company incorporated under this Act or any previous company law; In other words, A company is a legal entity which is formed by different individuals to generate profits through their commercial activities.

Meaning of Share Capital

In total paid up capital of the company a portion or a unit is called share capital. In other words, total capital of the company is divided into a number of small indivisible units is called share.

Share capital of the company is divided into following categories;

1. **Authorized Capital** : This is the estimated maximum amount of capital stated in the capital clause of Memorandum of Association. It is also known as "**Nominal Capital**" or "**Registered Capital**". The company is authorized (Allowed) to subscribe finance by the issue of shares only up to this amount throughout life time of their business.
2. **Issued Capital** : A company usually will not issue full authorized share capital to the public for subscription. It issues only a **portion or part of registered capital to general public** for subscription such a portion is called **Issued capital**.
3. **Subscribed Capital** : It is that part or portion of the issued capital which is subscribed by the general public. Sometimes, the public may not purchase all the shares that are offered to the public, for subscription. In such case, the subscribed capital shall be less than the issued capital.
4. **Called up Capital** : It is that part of the subscribed capital, which has been called up on shares. For example, if the company issues 20,000 shares of ₹ 10 each ₹ 5 has been called up, then the called capital shall be (20000 5) ₹ 1,00,000.
5. **Paid-up Capital** : It is that part of the subscribed capital which has been actually paid up by the shareholders. For example, if the company issues 20,000 shares of ₹ 10 each ₹ 5 has been called up, then the paid-up capital shall be (20000 5) ₹ 1,00,000.
6. **Reserve Capital** : It is that part of the capital which the company has decided not to be called up except in the event of winding up of the company. Sometimes, a company may feel that the capital already paid up is sufficient for the proper conduct and smooth running of the company. In such case, it may decide not to call up a certain portion of its subscribed capital except in the event of winding up. The company law also sanctions the creation of a reserve capital otherwise known as "**Reserve Liability**".

TYPES OF SHARES

As per the Companies Act 2013, under section 43, shares are classified into two types :

- Ordinary equity shares
- Preference shares

Meaning of Ordinary Shares

Ordinary or equity shares are those shares which are not preference shares. It means that these shares holders do not have any priority over in matters of repayment and dividend.

Characteristics of Equity Shares:

- (i) Equity shareholders enjoy the voting rights.
- (ii) Equity shareholders will have right to take part in the annual general body meeting of the company.

- (iii) Equity shareholders entitled to a company's surplus profits.
- (iv) The Equity shares can be issued by the company either (i) cash or (ii) for consideration other than cash.

Meaning of Preference Shares

Preference shares are those shares which will have priority or (preference) over other equity shares are called Preference shares.

Characteristics of Preference shares

- Preference shareholders carry special right in regards to dividend receipt.
- These Preference shareholders will have priority in repayment of their capital when the organisation is winding up.
- These Preference shareholders will enjoy the benefit of fixed rate of dividend irrespective of the company's financial performance.
- Preference share holders will not have right to take part in the day-today administration of companies.
- Preference share holders will not have any voting rights.

Types of Preference Shares

- **Redeemable Preference share:** -These are those shares which can be redeemed or repaid to the shareholders at a particular period of time sometimes even earlier at companies' discretion. The repayment on these shares is called redemption and it is governed by section 80 of the companies act of 1956.
- **Irredeemable preference shares:** -These are those shares which cannot be redeemed or repaid to the shareholders at a particular period of time sometimes even later at companies' discretion are called Irredeemable Preference shares. According to Companies Act 1956 section 80(5A), no company limited by shares shall issue irredeemable preference shares or preference shares redeemable after the expiry of 20 years from the date of issue.
- **Convertible Preference shares:** -These are those shares which can be converted into equity shares at their option according to the terms and conditions of the issue of these shares.
- **Non-convertible preference shares:** -When holders of the preference shares have not been conferred the right to get his holding converted into equity share, it is called non-convertible preference shares. Preference shares are non-convertible unless otherwise stated.
- **Participating preference shares:** -Holders of participating preference shares have the right to partake in a company's profits once a company allots dividends to ordinary shareholders. Therefore, when a company's net income is substantially high, such shareholders stand to receive a part of such profits.
- **Non-participating preference shares:** -A share on which only a fixed rate of dividend is paid every year, without any accompanying additional rights in profits and in the surplus on a winding-up, is called Non-participating Preference shares.

- **Cumulative preference shares:** - A cumulative preference share is one that carries the right to a fixed amount of dividend or dividend at a fixed rate, such dividend is payable even out of future profit current years profits are insufficient for the purpose. This means the dividend on these shares accumulate unless it is paid in full and, therefore, the shares are called Cumulative Preference shares.
- **Non-cumulative preference shares:** - A cumulative preference share is one that carries the right to a fixed amount of dividend or dividend at a fixed rate, In case no dividend is declared in a year due to any reasons, the right to receive such dividend for that year expires, It implies that holder of such share is not entitled to arrears of dividend in future.

ISSUE OF SHARES FOR CASH

To issue shares, private companies depends upon "Private Placement" of shares. Public companies issue a Prospectus and invite general public to subscribe for shares. To maintain books of accounts and to learn accounting treatment it is advisable to concentrate on public companies which issues shares and Debentures for general public for subscription.

A public company issues a prospectus inviting general public to subscribe for its shares. On the basis of prospectus, applications are deposited in a scheduled bank by the interested parties along with the amount payable at the time of application, in cash.

The company can issue shares in two ways.

- Fixed Price Issue
- Book Building Issue

Fixed Price Issue:- Under this method the price of the shares is pre determined. The investors can buy the shares at the price fixed by the issuing company. Example :- If the share is issued at ₹ 210, the investor has to quote the same price at and he cannot change the price.

Book Building Issue:- Under this method, the price is discovered through the public bid. There will be a price band, lower or upper price band. The final price is finalised depends on the number of the application received based on the price band.

Example:- The price band is ₹ 505-510. If the maximum number of application quoted is ₹ 510, the company determines the price as ₹ 510. Almost all the IPO's (Initial Public Offer) are book building issues in India.

First instalment paid along with application is called "application Money". Application money cannot be less than 5% of the face value of shares. After the closing date of the issue (last date for filling applications), company decides about allotment of shares in consultation with SEBI and stock exchange concerned. According to the Companies Act, 2013, a company cannot proceed to allot shares unless minimum subscription is received by the company.

Minimum Subscription: - A company should subscribe minimum subscription within 30 days from the date of issue of prospectus. In case minimum subscription is not received the whole issue is considered as failed. The Amount of minimum subscription to be disclosed in prospectus by the Board of Directors taking into account the following.

- Preliminary expenses of the company

Issue of Shares

2.5

- (ii) Commission payable on the issue of shares.
- (iii) Cost of fixed assets purchased or to be purchased
- (iv) Working capital requirements of the company, and
- (v) Any other expenditure for the day-to-day operation of the business.

As per SEBI guidelines a company must receive minimum of 90% of total issued capital before making any allotment of shares or debentures to the public. If the company fail to subscribe 90% of the issue it should refund the application money to applicant within 15 days as per section 39(3).

Allotment of shares:- If the company allotting the shares to general public it has file a return of allotment with registrar in case of default. Company has to pay ₹ 1,000 for each during which such delay continues, or ₹ 1,00,000. Whichever is less.

Issue Price of the Shares

The issue price of shares is generally received by the company in instalments and these instalments are known as under:

First Instalment	Share Application Money
Second Instalment	Share Allotment Money
Third Instalment	Share First Call Money
Fourth Instalment	Second call Money
Last Instalment	Final call Money

Basic Terminologies on Issue of Shares

- Issue of shares at Par
- Issue of shares at premium
- Issue of shares at Discount
- Calls in arrears
- Calls in advance
- Oversubscription
- Under subscription
- Forfeiture
- Reissue of shares
- Pro- rata issue of shares

PROFORMA JOURNAL ENTRIES FOR ISSUE OF SHARES FOR CASH

Date	Particulars	L/F No	Debit	Credit
01	(Entry for share application money received) Bank Account ————— Dr. To share Application account (Being share application money received)		xxx	xxx

02	(Entry for share application money transferred to share capital account) Share Application Account ————— Dr. To share capital account (Being share application money transferred to share capital account)	XXXX	XXXX
03	(Entry for share allotment money due) Share allotment account ————— Dr. To Share Capital account (Being share Allotment money due)	XXXX	XXXX
04	(Entry for Allotment money received) Bank Account ————— Dr. To Share Allotment account (Being share allotment money duly received)	XXXX	XXXX
05	(Entry for Share first call money due) Share first call account ————— Dr. To share Capital account (Being Share first call money due)	XXXX	XXXX
06	(Entry for share first call money received) Bank account ————— Dr. To Share first call account (Being Share first call money received)	XXXX	XXXX
07	(Entry share second and Final call money due) Share second and final call a/c ————— Dr. To share capital account (Being share second and final call money due)	XXXX	XXXX
08	(Entry for second and final call money received) Bank Account ————— Dr. To Share Capital a/c (Being share second and final call money received)	XXXX	XXXX

SUBSCRIPTION OF SHARES

A public company is authorised to issue prospectus inviting general public to subscribe shares. It is not necessary that company receives application for the numbers of shares to be issued by it. There are three possibilities :

FULL SUBSCRIPTION: means the number of shares issued to the public for subscription, if all the shares are purchased by the public and shares issued and subscribed by the public is the same numbers then it is called full subscription.

ILLUSTRATION 1.

X Limited issued 10,000 equity shares of ₹ 10 each payable on Application ₹ 3 On allotment ₹ 1 on First ₹ 2 and on Final Call ₹ 2. Application are received for full 10,000 shares. All the applicant are allotted the shares and money duly received by the company. Pass journal entries in the books of the company.

SOLUTION:**2.7****JOURNAL ENTRIES FOR ISSUE OF SHARES FOR CASH**

Journal Entries in the books of X Company Limited

Date	Particulars	L/F No	Debit	Credit
01	(Entry for share application money received) Bank Account Dr. To share Application account (Being share application money received on 10,000 shares of ₹ 3 each)		30,000	30,000
02	(Entry for share application money transferred to share capital account) Share Application Account Dr. To share capital account (Being share application money transferred to share capital account on 10,000 shares of ₹ 3 each)		30,000	30,000
03	(Entry for share allotment money due) Share allotment account Dr To Share Capital account (Being share Allotment money due on 10,000 shares of ₹ 3 each)		30,000	30,000
04	(Entry for Allotment money received) Bank Account Dr. To Share Allotment account (Being share allotment money duly received on 10,000 shares of ₹ 3 each)		30,000	30,000
05	(Entry for Share first call money due) Share first call account Dr. To share Capital account (Being Share first call money due 10,000 shares of ₹ 2 each)		20,000	20,000
06	(Entry for share first call money received) Bank account Dr. To Share first call account (Being Share first call money received on 10,000 shares of ₹ 2 each)		20,000	20,000
07	(Entry for share second and Final call money due) Share final call a/c Dr. To share capital account (Being share second and final call money due 10,000 shares of ₹ 2 each)		20,000	20,000
08	(Entry for final call money received) Bank Account Dr. To Share Capital a/c (Being share final call money received on 10,000 shares ₹ 2 each)		20,000	20,000

Meaning of Under Subscription:

The applications for shares received are less than the number of shares issued. For instance, a Company issued 1,000 shares to the public and the Company received applications for 900 shares from the public. This situation is called Under-subscription.

ILLUSTRATION 2.

On 1st April 2019, Gee Ltd., issued 50,000 shares of ₹ 10 each Payable as follows.

On Application ₹ 3 On allotment ₹ 3 on First ₹ 21st October 2019 and on Final Call ₹ 2.1st March 2019.

By 22nd June 2019, only for 46,000 shares application were received. Allotment was made on 7th July 2019. All money on allotment were received on 14th July, those on 1st call were received on 20th August, and second and final call on 18th December 2019. Journalize the transaction when accounts were closed on 31st March 2020.

SOLUTION:**Journal entries in the books of Gee Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
June 22	(Entry for share application money received) Bank Account ————— Dr. To share Application account (Being share application money received on 46,000 shares of ₹ 3 each)		1,38,000	1,38,000
June 22	(Entry for share application money transferred to share capital account) Share Application Account ————— Dr. To share capital account (Being share application money transferred to share capital account on 46,000 shares of ₹ 3 each)		1,38,000	1,38,000
July 7	(Entry for share allotment money due) Share allotment account ————— Dr. To Share Capital account (Being share Allotment money due on 46,000 shares of ₹ 3 each)		1,38,000	1,38,000
July 14	(Entry for Allotment money received) Bank Account ————— Dr. To Share Allotment account (Being share allotment money duly received on 46,000 shares of ₹ 3 each)		1,38,000	1,38,000
July 14	(Entry for Share first call money due) Share first call account ————— Dr. To share Capital account (Being Share first call money due on 46,000 shares of ₹ 2 each)		92,000	92,000

Aug 20	(Entry for share first call money received) Bank account ----- To Share first call account (Being Share first call money received on 46,000 shares of ₹ 2 each)	Dr.	92,000	92,000
Aug 20	(Entry for share second and Final call money due) Share second and final call a/c----- To share capital account (Being share second and final call money due 46,000 shares of ₹ 2 each)	Dr.	92,000	92,000
18 th Dec	(Entry for final call money received) Bank Account ----- To Share Capital a/c (Being share final call money received on 10,000 shares ₹ 2 each)	Dr.	92,000	92,000

Meaning of Oversubscription: The company receives applications for a large number of shares than that of actual shares issued to the general public for subscription is called oversubscription. For instance, a Company issued 1,000 shares to the public and the Company received applications for 1,500 shares from the public. This situation is called over-subscription. However, allotment can be made only to the number of shares that are issued. The Company cannot allot more shares than the issued even if there is demand for the shares.

ILLUSTRATION 3.

A company limited issued 10,000 equity shares of ₹ 10 each and the money was payable as under:

On application ₹ 2

On allotment ₹ 3

On first and final call ₹ 5 per share.

Public subscribed for 11,000 shares. 1,000 shares application money were returned. All the shares were allotted and the money duly received. Pass necessary journal entries in the books of the company.

SOLUTION:**Journal entries in the books of Gee Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	(Entry for share application money received) Bank Account ----- To share Application account (Being share application money received on 11,000 shares of ₹ 2 each)	Dr.	22,000	22,000
2.	(Entry for excess application money returned) Share Application account ----- To Bank account (Being excess of share application money on 1,000 shares ₹ 2 each returned)	Dr.	2,000	2,000

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3.	(Entry for share application money transferred to share capital account) Share Application Account ----- Dr. To share capital account (Being share application money transferred to share capital account on 10,000 shares of ₹ 2 each)	20,000	20,000
4.	(Entry for share allotment money due) Share allotment account ----- Dr. To Share Capital account (Being share Allotment money due on 10,000 shares of ₹ 3 each)	30,000	30,000
5.	(Entry for Allotment money received) Bank Account ----- Dr. To Share Allotment account (Being share allotment money duly received on 10,000 shares of ₹ 3 each)	30,000	30,000
6.	(Entry for Share first and final call money due) Share first and final call account ----- Dr. To share Capital account (Being Share first call money due on 10,000 shares of ₹ 5 each)	50,000	50,000
7.	(Entry for share first call money received) Bank account ----- Dr. To Share first and final call account (Being Share first call money received on 10,000 shares of ₹ 5 each)	50,000	50,000

Meaning of issue of shares at Premium:- The shares of many Listed and reputed companies which pays high rates of dividend on their existing share capital fetch a higher price than their face value in the market. When shares are issued at a price higher than the face value, they are said to be issued at a premium. In India all the companies issue the shares at premium. Share premium is capital profit for the company.

ILLUSTRATION 4.

(Issue of Shares at Premium)

Mithul Company Limited offers 20000 shares of ₹ 10 each to the public for subscription at a premium of ₹ 2 per share. Money is payable as follows:

₹ 3 on application

₹ 5 on allotment (Including premium of ₹ 2)

₹ 4 on first and final call

The shares are fully subscribed and paid. Pass necessary journal entries, prepare bank account, share premium account.

SOLUTION:**Journal entries in the books of Gee Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	(Entry for share application money received) Bank Account ----- Dr. To share Application account (Being share application money received on 20,000 shares of ₹ 3 each)		60,000	60,000
2.	(Entry for share application money transferred to share capital account) Share Application Account ----- Dr. To share capital account (Being share application money transferred to share capital account on 20,000 shares of ₹ 3 each)		60,000	60,000
3.	(Entry for share allotment money due including Premium) Share allotment account ----- Dr. To Share Premium account To Share Capital account (Being share Allotment money due including ₹ 2 on premium due on 20,000 shares of ₹ 5 each)		1,00,000	40,000 60,000
4.	(Entry for Allotment money received) Bank Account----- Dr. To Share Allotment account (Being share allotment money including premium duly received on 20,000 shares of ₹ 5 each)		1,00,000	1,00,000
5.	(Entry for Share first and final call money due) Share first and final call account ----- Dr. To share Capital account (Being Share first and final call money due on 20,000 shares of ₹ 4 each)		80,000	80,000
6.	(Entry for share first call money received) Bank account ----- Dr. To Share first and final call account (Being Share first and final call money received on 20,000 shares of ₹ 4 each)		80,000	80,000

DR

BANK ACCOUNT

CR

Particulars	Amount ₹	Particulars	Amount ₹
To share Application account	60,000	By balance c/d	2,40,000
To Share Premium account	40,000		
To Share Capital account	60,000		
To Share first and final call account	80,000		
	2,40,000		2,40,000

Share Premium Account			
DR	Particulars	Amount ₹	CR
Particulars	Amount ₹	Particulars	Amount ₹
To Share allotment account	40,000	By balance c/d	40,000
	40,000		

Meaning of issue of shares at Discount:

When Shares are issued at a price lower than their face value, they are said to have been issued at a discount. For example, if a share value of ₹ 10 is issued at ₹ 9 per share then ₹ 1 (i.e. ₹ 10—9) is the amount of discount. It is a loss to the company.

ILLUSTRATION 5.

A company offers 50,000 shares of rupees 10 each at a discount of 10% to the public for subscription. Money was payable as follows:

- ₹ 4 on application,
- ₹ 3 on allotment
- balance ₹ 2 first and final call.

All applicants paid application and allotment money. You are required to pass necessary journal entries and necessary ledger accounts.

SOLUTION:

Journal entries in the books of Gee Limited

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	(Entry for share application money received) Bank Account ————— Dr. To share Application account (Being share application money received on 50,000 shares of ₹ 4 each)		2,00,000	2,00,000
2.	(Entry for share application money transferred to share capital account) Share Application Account ————— Dr. To share capital account (Being share application money transferred to share capital account on 50,000 shares of ₹ 4 each)		2,00,000	2,00,000
3.	(Entry for share allotment money due discount adjusted) Share allotment account ————— Dr. Discount on Share account ————— Dr. To Share Capital account (Being share Allotment money due ₹ 3 with discount adjusted on 50,000 shares of ₹ 4 each)		1,50,000 50,000	2,00,000
4.	(Entry for Allotment money received) Bank Account ————— Dr. To Share Allotment account (Being share allotment money including premium duly received on 20,000 shares of ₹ 5 each)		1,50,000	1,50,000

5.	(Entry for Share first and final call money due) Share first and final call account ----- Dr. To share Capital account (Being Share first and final call money due on 50,000 shares of ₹ 2 each)	1,00,000	1,00,000
6.	(Entry for share first call money received) Bank account ----- Dr. To Share first and final call account (Being Share first and final call money received on 50,000 shares of ₹ 2 each)	1,00,000	1,00,000
	Grand total	9,50,000	9,50,000

Meaning of Calls in arrears:- When a company makes calls upon shares allotted, there is a liability of shareholders holding the shares to pay the call money within the date fixed for such payment.

If any shareholder fails in paying the call money within the said date, the amount which is not paid, called Calls-in-Arrear.

ILLUSTRATION 6.

Y Limited Company issued 1,00,000 equity shares of ₹ 10 each at ₹ 12 per share payable as:

₹ 2 On application

₹ 4 on allotment

₹ 5 on first call (including premium)

₹ 1 on final call

Money duly received except on 1,000 shares of final call. Pass journal entries.

SOLUTION:

Journal entries in the books of Gee Limited

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	(Entry for share application money received) Bank Account ----- Dr. To share Application account (Being share application money received on 1,00,000 shares of ₹ 2 each)		2,00,000	2,00,000
2.	(Entry for share application money transferred to share capital account) Share Application Account ----- Dr. To share capital account (Being share application money transferred to share capital account on 1,00,000 shares of ₹ 2 each)		2,00,000	2,00,000
3.	(Entry for share allotment money due) Share allotment account ----- Dr. To Share Capital account (Being share Allotment money due on 1,00,000 shares of ₹ 4 each)		4,00,000	4,00,000

4.	(Entry for Allotment money received) Bank Account----- To Share Allotment account (Being share allotment money duly received on 1,00,000 shares of ₹ 4 each)	Dr.	4,00,000	4,00,000
5.	(Entry for Share first call money due including premium) Share first call account ----- To Share Premium account To Share Capital account (Being Share first call money due on 1,00,000 shares of ₹ 5 each)	Dr.	3,00,000 2,00,000	5,00,000
6.	(Entry for share first call money received including premium) Bank account ----- To Share first call account (Being Share first call money received on 1,00,000 shares of ₹ 5 each)	Dr.	5,00,000	5,00,000
7.	(Entry for Share final call money due) Share final call account ----- To Share Capital account (Being share final call money due on 1,00,000 shares ₹ 1 each)	Dr.	1,00,000	1,00,000
8.	(Entry for share final call money received) Bank account ----- Call-in arrears account----- To Share Final call account (Being share final call money duly received on (1,00,000-1,000) 99,000 shares of ₹ 1 each)	Dr. Dr.	99,000 1,000	1,00,000
	Grand Total		24,00,000	24,00,000

Meaning of Calls in Advance :- Excess Money received by the company which has been called up is known as **calls in advance**. If authorized by its Articles.

A Company may accept call in **advance** from its shareholders. When a company receives such an amount, it needs to credit it to the **calls-in-advance** account.

ILLUSTRATION 7.

Tea Limited issued 25,000 shares of rupees 90 each. The amount was payable as follows

₹ 20 on application,

₹ 40 on allotment,

₹ 30 on the first and final call.

A shareholder holding 1,000 shares paid all the call money along with allotment money. All the shares were subscribed and the amount were duly received.

Pass journal entries in the book of the company.

SOLUTION:**Journal entries in the books of Gee Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	(Entry for share application money received) Bank Account ----- Dr. To share Application account (Being share application money received on 25,000 shares of ₹ 20 each)		5,00,000	5,00,000
2.	(Entry for share application money transferred to share capital account) Share Application Account ----- Dr. To share capital account (Being share application money transferred to share capital account on 25,000 shares of ₹ 20 each)		5,00,000	5,00,000
3.	(Entry for share allotment money due) Share allotment account ----- Dr. To Share Capital account (Being share Allotment money due on 25,000 shares of ₹ 40 each)		10,00,000	10,00,000
4.	(Entry for Allotment money received) Bank Account----- Dr. To Calls in advance account To Share Allotment account (Being share allotment money duly received on 25,000 shares of ₹ 40 each, on 1,000 30 each)		10,30,000	30,000 10,00,000
5.	(Entry for Share first and final call money due) Share first and final call account----- Dr. To share Capital account (Being Share first and final call money due on 25,000 shares of ₹ 30 each)		7,50,000	7,50,000
6.	(Entry for share first and final call money received) Bank account ----- Dr. Calls in advance account----- Dr. To Share first and final call account (Being Share first and final call money received on 24,000 shares of ₹ 30 each, on 1,000 shares calls in advance adjusted)		7,20,000 30,000	7,50,000
	Grand total		45,30,000	45,30,000

INTEREST ON CALLS-IN-ARREARS-AND CALLS-IN-ADVANCE

Interest on calls in arrears is recoverable or (chargeable) interest on calls in advance is payable. Directors, however have the right to waive the payment of interest on calls in arrears. Calls received in advance are not entitled to any dividend. According to provision in this regard is In case if the company is following table A (1956) – Interest would be 5% and if the company is following table F (2013) – interest would be 10%.

Calculation of Interest on Calls in Arrears

Interest on arrears = No. of shares in arrears $\times$ call money $\times$ No. of months $\times$ percentage interest.

Calculation of Interest on Calls in Advance

Interest on advance = No. of shares in arrears $\times$ call money $\times$ No. of months $\times$ percentage interest.

ILLUSTRATION 8.

(Issue of shares at discount with calls-in-arrears)

Mysore Sugar Co. Ltd. Issued 40,000 equity shares of ₹ 100 each at a discount of ₹ 5 per share. amount was to be paid as follows:

On application ₹ 20

On allotment ₹ 35

On first and final call ₹ 40

All shares were subscribed and money duly received except on first and final call on 2,000 shares.

Pass necessary journal entries in the books of the company.

Journal entries in the books of Mysore Sugar Co. Ltd.

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	(Entry for share application money received) Bank Account ----- Dr. To share Application account (Being share application money received on 40,000 shares of ₹ 20 each)		8,00,000	8,00,000
2.	(Entry for share application money transferred to share capital account) Share Application Account ----- Dr. To share capital account (Being share application money transferred to share capital account on 40,000 shares of ₹ 20 each)		8,00,000	8,00,000
3.	(Entry for share allotment money due) Share allotment account ----- Dr. Discount on issue of shares a/c ----- Dr. To Share Capital account (Being share Allotment money due on 40,000 shares of ₹ 35 each, discount on issue of shares adjusted)		14,00,000 2,00,000	16,00,000
4.	(Entry for Allotment money received) Bank Account ----- Dr. To Share Allotment account (Being share allotment money duly received on 40,000 shares of ₹ 35 each,)		14,00,000	14,00,000

5.	(Entry for Share first and final call money due) Share first and final call account----- Dr.	16,00,000	
	To share Capital account (Being Share first and final call money due on 40,000 shares of ₹ 40 each)		16,00,000
6.	(Entry for share first and final call money received) Bank account ----- Dr.	15,20,000	
	Calls in arrears account----- Dr.	80,000	
	To Share first and final call account (Being Share first and final call money received on (40,000-2,000) 38,000 shares of ₹ 40 each, on 2,000 shares calls in arrears adjusted) (2000 40)		16,00,000
	Grand total	78,00,000	78,00,000

Meaning of Forfeiture of Shares: The term 'forfeit' actually means taking away of property on breach of a condition. It is very common that one or more shareholders fail to pay their allotment and/or calls on the due dates. Failure to pay call money results in forfeiture of shares. Forfeiture of shares is the action taken by a company to cancel the shares.

The directors are usually empowered by the article of the Association to forfeit those shares by serving proper notice to the defaulting shareholders. When shares are forfeited, the title of such shareholder is extinguished but the amount paid to date is not refunded to him. The shareholder then has no further claim on the company.

Points to be remembered while passing Journal entries for forfeiture of shares.

- Amount called-up (i.e., amount credited to share capital account) in respect of forfeited shares.
- Amount already received in respect of those shares.
- Amount due but has not been received in respect of those shares.
- Accounting entries for forfeiture of shares will vary according to shares issued at par or at a discount or at a premium.

ILLUSTRATION 9.

(Forfeiture of shares which were issued at Par)

Bee Ltd, forfeited 3,000 shares of ₹ 100 each fully called up held by Mr. Been for non-payment of final call at ₹ 40 each. However, he paid ₹ 20 on application and ₹ 40 on allotment. these shares were originally issued at par. Pass journal entries in the books of the company for the forfeiture.

SOLUTION :

Journal entries in the books of the company for the forfeiture

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Share Capital account (3,000 100) ----- Dr. To Forfeited shares account (3,000 20+40) To Share Final Call account (3,000 40) (Being 3,000 shares of ₹ 100 each forfeited due to non-payment of ₹ 40 each on final call)		3,00,000	1,80,000 1,20,000

Points to be remembered while passing journal entries for forfeiture of shares.

- Always Share capital account should be debited with number of shares which is forfeited with its full value of shares as shown in the above illustration ($3,000 \times 100$)
- Always forfeited shares account should be credited to the extent of money received on forfeited shares ($3,000 \times 20 + 40$) the company received ₹ 20 on Application and ₹ 40 on allotment.
(Forfeited shares account credited because the company gets income by cancelling shares and amount received will not be refunded to shareholders) as per nominal account rule.
- Always credit first/final call on which ever the money is due.

ILLUSTRATION 10.

Z Ltd, forfeited 2,000 equity shares of ₹ 10 each, ₹ 8 called-up for non-payment of first call money at ₹ 2 each. Application money ₹ 2 per share and Allotment money ₹ 4 per share have been already received by the company. Pass journal entries for the forfeiture (assume that all money due is transferred to Calls-in-Arrears account)

SOLUTION :

Journal entries in the books of the company for the forfeiture

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Share Capital account (2000 8) ----- Dr. To forfeited shares account (2,000 2+4) To Calls-in-arrears account (2,000 2) (Being 2,000 shares of ₹ 10 each ₹ 8 called-up were forfeited due to non-payment of ₹ 2 each on final call on 2,000 shares)		16,000	12,000 4,000

ILLUSTRATION 11.

(Forfeiture of shares which were issued at Premium)

Fun Ltd, forfeited 1,000 equity shares of ₹ 100 each fully called-up which were issued at a premium of 20%. Amount payable on shares were on Application ₹ 20 on allotment ₹ 50 (including premium) on first and final call ₹ 50. Only application money was paid by the shareholder in respect of these shares. Pass journal entries for forfeiture.

SOLUTION:

Journal entries in the books of the company for the forfeiture

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Share Capital account (1000 100)----- Dr. Share Premium Account (1,000 20)----- Dr. To forfeited shares account (1,000 20) To Share Allotment account (1,000 50) To first and final call account (1,000 50) (Being 1,000 shares of ₹ 100 each fully called-up were forfeited due to non-payment of ₹ 50 on allotment and on final call on ₹ 50 per share)		1,00,000 20,000	20,000 50,000 50,000

ILLUSTRATION 12.

(Forfeiture of shares which were issued at Discount)

IPO Ltd, forfeited 2,000 Equity shares of ₹ 10 each fully called-up for non-payment of final call at ₹ 2 per share. These shares were originally issued at a discount at ₹ 1 per share. The company Received ₹ 2 on application; ₹ 3 on Allotment (Discount adjusted) and ₹ 2 on first call. Pass journal in the books of the company.

SOLUTION

Journal entries in the books of the company for the forfeiture

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Equity Share Capital account (2000 10) ----- Dr. To Discount on issue of Share Account (2,000 1) To forfeited shares account (2,000 7) To final call account (2,000 2) (Being 2,000 shares of ₹ 10 each fully called-up were forfeited due to non-payment of ₹ 2 on final call)		20,000	2,000 14,000 4,000

Forfeiting Fully Paid Shares; A fully paid shares are forfeited, when a right to share have been violated (Condition), then the company can forfeit those shares by informing the concerned shareholders. Once the fully paid shares are forfeited the concerned shareholder will lose all rights from the shares and the shareholder will not be entitled to any amount if the forfeited shares are sold. For instance, A company issues shares to an existing employee in the organization on the condition that he will stay in the company for minimum of 6 years, but if the employees leave the organization within 3 years after the allotment of shares then the company can forfeit these shares. However, it should be noted that if the employees leave due injury or disability or terminated or retirement and death shares will not be forfeited.

Re-issue of forfeited shares. A forfeited share (cancelled shares) available to company for sale and it is with the company. Re-issue of shares is not an allotment of shares it is sale of share.

The process to re-issue is as follows:

According to the Articles of Association, Articles 29 to 32, the Board of Directors have the power to Re-issue the shares, and this power cannot be delegated by the Board of Directors to any committee.

The Board of Directors may take up the Reissue of shares at the same Board Meeting as a forfeiture or at a subsequent Board Meeting. The Board may pass an Ordinary Resolution at the meeting for such forfeited shares to be re-issued to other persons. The shares may be issued at a discount which does not exceed the amount already paid on such shares such that the total of the sum paid by the original owner and re-issue price is not less than the par value. Since this is a reissue of shares and not an allotment, there is no requirement to file an application for Reissue with Registrar of Companies (Sri Gopal Jalan V Calcutta Stock Exchange Ltd (1963) 33 COM. Case 862: AIR 1964 SC 250).

ILLUSTRATION 13.

(Re-issue of forfeited shares)

Board of directors of Deena Ltd, forfeited 400 Preference shares of ₹ 100 each of Mr. short, on

which ₹ 75 per share has been called-up not able to pay his dues on Allotment and first call each ₹ 25 per share. The board of Director re-issued 400 shares at ₹ 65 per share paid-up as ₹ 75 per share.

SOLUTION:

Journal entries in the books of the company for the forfeiture

Date	Particulars	L/F No	Debit ₹	Credit ₹
01	(Entry for Forfeiture/Cancellation of shares) Preference share capital account 400 75 ————— Dr. To Share Allotment account (400 25) To Share first call account (400 25) To Forfeited shares account (400 25) (Being 400 preference shares of ₹ 100 each ₹ 75 called up forfeited due to non-payment of allotment and first call money)		30,000	10,000 10,000 10,000
02	(Entry for Re-issue of forfeited shares) Bank account (400 65) ————— Dr. Forfeited share account (400 10) ————— Dr. To Preference share capital account (Being forfeited 400 preference shares of ₹ 100 each ₹ 75 called-up re-issued at ₹ 65 per share and the money were duly received.)		26,000 4,000	30,000
03	(Entry for balance on forfeited shares amount transferred to capital reserve account) Forfeited shares account ————— Dr. To Capital reserve account (Being balance on forfeited shares ie (10,000-4,000))		6,000	6,000

ILLUSTRATION 14.

(Issue of Shares at Par—Journal and Cash Book)

A Limited Company issued 25,000 Ordinary Shares of ₹ 25 each payable ₹ 5 on application, ₹ 10 on allotment and ₹ 5 each on First call and the Balance on final calls, 20,000 shares were fully-subscribed and moneys duly received. You are required to give journal entries, Cash Book and Balance Sheet of the company.

SOLUTION:

Journal entries in the books of A Limited Co.

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Bank Account ————— Dr. To share Application account (Being share application money received on 20,000 shares of ₹ 5 each)		1,00,000	1,00,000
2.	Share Application Account ————— Dr. To share capital account (Being share application money transferred to share capital account on 20,000 shares of ₹ 5 each)		1,00,000	1,00,000

3.	Share allotment account ----- To Share Capital account (Being share Allotment money due on 20,000 shares of ₹ 10 each)	Dr.	2,00,000	2,00,000
4.	Bank Account----- To Share Allotment account (Being share allotment money duly received on 20,000 shares of ₹ 10 each)	Dr.	2,00,000	2,00,000
5.	Share first call account ----- To share Capital account (Being Share first call money due on 20,000 shares of ₹ 5 each)	Dr.	1,00,000	1,00,000
6.	Bank account ----- To Share first call account (Being Share first call money received on 20,000 shares of ₹ 5 each)	Dr.	1,00,000	1,00,000
7.	Share final account ----- To share capital account (Being share final call money due on 20,000 shares of ₹ 5 each)	Dr.	1,00,000	1,00,000
8.	Bank account ----- To Share final call account (Being share final call money duly received on 20,000 shares of ₹ 5 each)	Dr.	1,00,000	1,00,000
	Grand Total		10,00,000	10,00,000

DR.

BANK ACCOUNT

CR.

Particulars	Amount ₹	Particulars	Amount ₹
To Share Application account	1,00,000	By balance c/d	2,40,000
To Share Allotment account	2,00,000		
To Share first call account	1,00,000		
To share final call account	1,00,000		
	5,00,000		5,00,000

ILLUSTRATION 15.

Ram Co. Ltd. issued 1, 00,000 shares of ₹ 20 each on which the amount payable is as follows:

₹ 5 on Application,

₹ 4 on allotment,

₹ 3 on First Call,

₹ 5 on Second Call

₹ 3 on Third and Final Call

From the following particulars, journalise the transactions for third call, forfeiture and re-issue of shares:

Name	Shares held	Amount paid on
Stalin	400	Up to Allotment
Reenu	800	Up to First Call
Meenu	1,200	Up to Second call

The Company made the third call in August. Call money was received in full, except from above persons. The Directors then forfeited these shares and reissued 2,400 shares, as fully paid, ₹ 22 per share.

SOLUTION:

Journal entries in the books of the company for the forfeiture

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Share Third and final call ----- Dr. To Share Capital Account (Being share first and final call account due on 1,00,000 shares of ₹ 3 each)		3,00,000	3,00,000
2.	Bank account ----- Dr. To Share third and final call account (Being Share third and final call money duly received on (1,00,000-2,400)97,600x3 each)		2,92,800	2,92,800
3.	(Entry for Forfeiture/Cancellation of shares) Share capital account (2,400 20) ----- Dr. To Share first call account (400 3) To Share Second call account (400+800) 1,200 5 To Share third and final call account (400+800+1,200) 2,400 3 To Forfeited shares account (Being 2,400 shares of ₹ 20 each fully called up forfeited due to non-payment of allotment and first call, second call and third and final call money)		48,000	1,200 6,000 7,200 33,600
4.	Bank account (2,400 22) ----- Dr. To share Premium account (2,400 2) To Share capital account To Preference share capital account (2,400 20) (Being forfeited 2,400 shares of ₹ 20 each ₹ 22 called-up re-issued at ₹ 22 per share and the money were duly received.)		52,800	4,800 48,000
5.	(entry for balance on forfeited shares amount transferred to capital reserve account) Forfeited shares account ----- Dr. To capital reserve account (Being balance on forfeited shares ie (10,000-4,000))		33,600	33,600

Calculation of Capital Reserve

Name	Number of shares held	Amount paid	Amount paid on	
Stalin	400	(Application + Allotment) $(5+4) = 9$	(400 9)	3,600
Reenu	800	Application + Allotment + first call $(5+4+3)$	(800 12)	9,600
Meenu	1,200	Application + allotment + first call + second call $(5+4+3+5) = 17$	(1,200 17)	20,400
		Capital Reserve		33,600

ILLUSTRATION 16.

(Forfeiture and Re-issue of forfeited shares)

AB Co. Ltd. forfeited 1000 shares of ₹ 20 each fully called up, held by Mr. George for non-payment of allotment money of ₹ 6 per share and first and final call of ₹ 8 per share. He paid application money @ ₹ 6 per share. These shares were reissued @ ₹ 18 per share as fully paid. Pass forfeiture and reissue journal entries.

SOLUTION

Journal entries in the books of the company for the forfeiture

Date	Particulars	L/F No	Debit ₹	Credit ₹
01	Share capital account (1,000 20) ----- Dr. To Share Allotment account (1,000 6) To Share first and final call account (1,000x8) To Forfeited shares account (1,000x6) (Being 1,000 shares of ₹ 20 each fully called up forfeited due to non-payment of allotment and first and final call money)		20,000	6,000 8,000 6,000
02	(Entry for Re-issue of forfeited shares) Bank account (1,000 18) ----- Dr. Forfeited share account (1,000 2) ----- Dr. To Share capital account (Being forfeited 1,000 shares of ₹ 20 each re-issued at ₹ 18 per share and the money were duly received.)		18,000 2,000	20,000
03	(Entry for balance on forfeited shares amount transferred to capital reserve account) Forfeited shares account ----- Dr. To capital reserve account (Being balance on forfeited shares ie (6,000-2,000))		4,000	4,000

ILLUSTRATION 17.

(Over-subscription, rejection, forfeiture and Re-issue of forfeiture shares)

The UB Company Limited issued for public subscription 20,000 shares of ₹ 10 each at a premium of ₹ 2 payable as follows:

On application ₹ 2 per share

On allotment ₹ 5 per share (including premium)

On first Call ₹ 2 per share

On second and final call ₹ 3 per share.

Application was received for 30,000 shares 20,000 shares were allotted and excess application money received is returned. The company received all the due except the final call on 1,000 shares from Rehim. These shares were forfeited and later re-issued as fully paid at ₹ 8 per share. Pass Journal entries and also show how share capital appears in the Balance sheet.

SOLUTION:**Journal entries in the books of Gee Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Bank Account ----- Dr. To Share Application account (Being share application money received on 30,000 shares of ₹ 2 each)		60,000	60,000
2.	Share application account----- Dr. To Bank account (Being excess of share application on 10,000 shares of ₹ 2 each returned)		20,000	20,000
3.	Share Application Account ----- Dr. To Share capital account (Being share application money transferred to share capital account on 20,000 shares of ₹ 2 each)		40,000	40,000
4.	Share allotment account ----- Dr. To Share Premium account To Share Capital account (Being share Allotment money due including ₹ 2 on premium due on 20,000 shares of ₹ 5 each)		1,00,000	40,000 60,000
5.	(Entry for Allotment money received) Bank Account----- Dr. To Share Allotment account (Being share allotment money including premium duly received on 20,000 shares of ₹ 5 each)		1,00,000	1,00,000
6.	Share first call account ----- Dr. To Share Capital account (Being Share first call money due on 20,000 shares of ₹ 2 each)		40,000	40,000
7.	Bank account ----- Dr. To Share first call account (Being Share first and final call money received on 20,000 shares of ₹ 2 each)		40,000	40,000
8.	Share second and final call account----- Dr. To Share Capital account (Being share second and final call money due on 20,000 shares of ₹ 3 each)		60,000	60,000
9.	Bank Account ----- Dr. To Share second and final call account (Being share second and final call money duly received on (20,000-1000) = 19,000 x 3 each)		57,000	57,000

10.	Share capital account ----- Dr. To Share second and final call account To Forfeiture shares account (Being 1,000 shares of ₹ 10 each forfeited due to non-payment of ₹ 3 each on second and final call)	10,000 3,000 7,000
11.	Bank account ----- Dr. Forfeiture shares account ----- Dr. To Share capital account (Being 1,000 forfeited shares of ₹ 10 re-issued ₹ 8 per share fully paid and money duly received)	8,000 2,000 10,000
12.	Forfeited shares account ----- Dr. To Capital reserve account (Being Balance on forfeited shares i.e., (7,000-2,000) Transferred to capital reserve account)	5,000 5,000

Calculation of capital Reserve

Name	Number of shares held	Amount paid	Amount paid on
Rahim	1,000	Application + allotment + First call 2+3+2	7,000

Total Amount received on 1,000 (2+3+2) ----- 7,000

Less-Loss on issue of shares adjusted (1,000 2) ----- 2,000

Balance Sheet ----- 5,000

Equity and Liability	Amount
Authorized share capital	
Issued and called up share capital	
20,000 shares of ₹ 10 Each fully called up and paid up	2,00,000
Reserves and surplus	
Share premium	40,000
Total	2,40,000
Assets and Properties	
Current assets	
Cash	2,40,000
Total	2,40,000

ILLUSTRATION 18.

(Issue of Equity shares and Preference shares)

A company was registered with an Authorized Capital of ₹ 5,00,000 divided into 3,750 Equity Shares of ₹ 100 each and ₹ 1,250; 5% Preference Shares of ₹ 100 each. 500 Equity and 250 Preference Shares were offered to public on the following terms- Equity Shares payable ₹ 10 on application, ₹ 40 on allotment and the balance in two calls of ₹ 25 each. Preference Shares are payable ₹ 25 on application, ₹ 25 on allotment and ₹ 50 on first and final call. All the shares were applied for and allotted. Amount due was duly received. Prepare Cash Book and pass necessary Journal entries to record the above issue of shares and show how the Share Capital Account will appear in the Balance Sheet.

SOLUTION:**Journal entries in the books of A Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
			5,000	
1.	Bank Account ----- To Equity share Application account (Being Equity share application money received on 500 shares of ₹ 10 each)	Dr.		5,000
2.	Equity Share Application Account ----- To Equity share capital account (Being share application money transferred to share capital account on 500 shares of ₹ 10 each)	Dr.	5,000	
3.	Bank Account ----- To 5% Preference share Application account (Being 5% preference share application money received on 250 shares of ₹ 25 each)	Dr.	6,250	
4.	5% Preference Share Application Account ----- To 5% Preference share capital account (Being share application money transferred to share capital account on 250 shares of ₹ 25 each)	Dr.	6,250	
5.	Equity Share allotment account ----- To Equity Share Capital account (Being Equity share Allotment money due on 500 shares of ₹ 40 each)	Dr.	20,000	
6.	Bank Account ----- To Equity Share Allotment account (Being share allotment money duly received on 500 shares of ₹ 40 each)	Dr.	20,000	
7.	5% Preference Share allotment account ----- To 5% preference Share Capital account (Being 5% Preference share Allotment money due on 250 shares of ₹ 25 each)	Dr.	6,250	
8.	Bank Account ----- To 5% Preference Share Allotment account (Being share allotment money duly received on 250 shares of ₹ 25 each)	Dr.	6,250	
9.	Equity Share first call account ----- To Equity share Capital account (Being Share first call money due on 500 shares of ₹ 25 each)	Dr.	12,500	
10.	Bank account ----- To Equity Share first call account (Being Equity Share first call money received on 500 shares of ₹ 25 each)	Dr.	12,500	
11.	5% Preference Share first and final account ----- To 5% Preference share capital account (Being share final call money due on 250 shares of ₹ 50 each)	Dr.	12,500	

Issue of Shares

2.27

12.	Bank account ----- To 5% Preference share first & final call account (Being share first and final call money duly received on 250 shares of ₹ 50 each)	Dr.	12,500	12,500
13.	Equity Share final call account ----- To Equity share Capital account (Being Share first call money due on 500 shares of ₹ 25 each)	Dr.	12,500	12,500
14.	Bank account ----- To Equity Share final call account (Being Equity Share first call money received on 500 shares of ₹ 25 each)	Dr.	12,500	12,500
	Grand total		1,50,000	1,50,000

Balance Sheet

Equity and Liability	Amount ₹
Authorized share capital	
3,750 Equity shares of ₹ 100 each	3,75,000
1,250, 5% Preference shares of ₹ 100 each	1,25,000
Issued and called up share capital	
500 Equity shares of ₹ 100 each called up fully	
250, 5% Preference shares of ₹ 100 each	
Paid up capital	
500 Equity shares of ₹ 100 each called up fully and paid up	50,000
250, 5% Preference shares of ₹ 100 each fully paid up	25,000
	75,000
Assets and Properties	
Current assets	
Cash	75,000
	75,000

ILLUSTRATION 19.

(Over-subscription and Pro-rata basis allotment)

East west Ltd., was registered with a capital of ₹ 5, 00,000 divided into 20,000 Equity shares of ₹ 25 each. The company offered to public for subscription 10,000 shares payable ₹ 5 per share on application, ₹ 5 per share on allotment and the balance in two calls of ₹ 7.50 each. The company received application for 11,600 shares. Applications for 1,000 Shares were rejected and application money was refunded the applicants. A person who applied for 1,000 shares was allotted only 400 shares and excess of application money was carried forward towards the payment of allotment and calls. Give Journal entries to record the above issue of shares.

SOLUTION:

Journal entries in the books of A Limited

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Bank Account ----- To Equity share Application account (Being Equity share application money received on 11,600 shares of ₹ 5 each)	Dr.	58,000	58,000

SOLUTION

Profit Prior and Post Incorporation

Statement showing profit earned prior to and after incorporation

Particulars	Total Amount ₹	Basis of Allocation	Pre-incorporation ₹	Post-Incorporation ₹
Gross Profit			1,50,000	
Less: -Cost of Goods Sold			1,00,000	4,75,000
Gross Profit	44,200		50,000	2,80,000
Less Expenses and Losses	21,875			1,90,000
Administrative expenses	5,000		11,050	
Selling commission	9,325			39,200
Goodwill written off	31,250	Post	5,250	
Interest to vendors (loan repaid on February 2012)		Post	6,993	16,400
Distribution expenses (60% variable)			4,500	5,000
60% variable $(31,250 \times 60/100) = 18,750$		1:3		2,300
40% Fixed $(31,250 \times 40/100) = 12,500$	8,250	1:3		14,200
Preliminary expenses	8,000		3,125	9,300
Debenture interest	11,100	Post	-	8,200
Depreciation	2,500		2,000	6,000
Directors fee			2,775	8,300
			-	2,500
			33,693	1,07,800
Net Profit			16,308	82,217

Calculation of Time Ratio

Pre-incorporation= 1-4-2017 to 1-8-2017= (April, May, June and August) =4 months

Post Incorporation period=1-8-2017 to 31-03-2018 (August, September, October, November, December, January, February and March) =8 months

Calculation of Sales Ratio=

Total sales for the year ----- 10,00,000

Less:-Pre incorporation sales----- 3,00,000

Post incorporation sales - 7,00,000

Therefore Sales Ratio=3,00,000:7,00,000 Or 3:7

ILLUSTRATION 9.

Pavan Ltd incorporated on 1-07-2019, with a capital of ₹ 5,00,000 in equity shares of ₹ 10 each took over the running business of Pavithra as from 1-04-2019. The purchase price of ₹ 2,00,000 was settled on 1-10-2019, together with interest at 10% p.a by fully paid shares of ₹ 1,75,000 and the balance by cheque.

Company's Trial Balance as on 31 March 2020 was as follows :

Cash and bank balance (cash ₹ 1,800)	48,600	
Share capital		2,25,000

Profit Prior and Post Incorporation

3.17

Land and building	80,000	
Fixtures	7,500	
Cycles	10,000	
Salaries	12,000	
Purchases	4,85,000	
Sales		4,50,000
Debtors and Creditors	45,000	30,000
Rent from tenant		6,000
Rent rates and taxes	3,000	
Building upkeep	1,500	
Director's fee	720	
Sundry charges	120	
Interest to vendor	1,000	
	71,100	71,100

Prepare the final accounts for the year ending 31 March 2020, considering the following additional details;

- Stock at the end ₹1,40,000
- Bad debts ₹ 2,000 (including ₹ 500 on debtors taken over from vendor) to be written off.
- Sales above include sales up to July 1st 2019 , ₹ 75,000
- Provide for doubtful debts ₹ 2,500
- Depreciate building 5% and cycle 20%

SOLUTION

Statement showing profit earned prior to and after incorporation

Particulars	Total Amount ₹	Basis of Allocation	Pre- incorporation ₹	Post- Incorporation ₹
Gross Profit		1:5	17,500	87,500
Rent from tenant	6,000	1:3	1,500	4,500
			19,000	92,000
Less Expenses and Losses				
Salaries		1:3	3,000	9,000
Rent, rates		1:3	750	2,250
Building upkeep		1:3	380	1,120
Director's fees		Post		720
Sundry Charges		1:3	300	900
Interest to vendors		1:1	5,000	5,000
Bad debts		1:3	500	500
Provision for doubtful debts		1:3	500	1,500
Depreciation on				
Building--- -4,000		1:3	1,500	4,500
Cycle----- 2,000				
Net Profit transferred to Capital reserve			7,570	58,030
Profit and Loss A/c			19,000	92,000
Net Profit				

Calculation of Time Ratio

Pre-incorporation = 1-4-2019 to 1-7-2017 = (April, May, June and) = 3 months

Post Incorporation period = 1-7-2017 to 31-03-2018 (July, August, September, October, November, December, January, February and March) = 9 months

Therefore time Ratio = 3:9 or 1:3

Calculation of Sales Ratio =

Total sales for the year ----- 4,50,000

Less:- Pre incorporation sales ----- 75,000

Post incorporation sales - 3,75,000

Therefore Sales Ratio = 75,000:3,75,000 Or 1:5

Balance Sheet		Note	Amount (₹)	Amount (₹)
Share Holder's Funds				2,25,000
Share Capital				7,50,000
Reserves and Surplus				59,500
Capital Reserve				
Profit and Loss Account				
Non-Current Liabilities				30,000
Current Liabilities				3,20,000
Sundry creditors				
Assets			80,000	76,000
Land and Buildings			4,000	
Less:-Depreciation				7,500
Fixtures			10,000	
Cycles			2,000	80,000
Less:-Depreciation				
Investments				1,40,000
Stock			43,000	
Debtors (45,000-2,000)			2,500	
Less:-Provision for bad debts				4,680
Bank (48,600-1,800)				1,800
Cash				3,20,600

ILLUSTRATION 10.

Beem Limited was incorporated on 1st July, 2019 to acquire from Sultan as and from 1st January, the individual business carried on by him. The purchase price of the fixed assets and goodwill was agreed to be the sum equal to 80% of the profits made each year on ascertainment of the sum due.

The following Trial Balance as on 31st Dec., 2019 is presented to you to enable you to prepare a Balance Sheet as at that date.

Profit Prior and Post Incorporation

3.19

	Dr.	Cr.
	₹	₹
Share Capital – 6,000 equity shares of ₹ 100 each, ₹ 80 paid up		4,80,000
Trade receivables	3,28,000	
Inventory on 31 st Dec., 2019	2,68,000	
Cash at Bank and on hand	96,000	
Directors' fee	12,000	
Preliminary expenses	96,000	
Trade Payables		1,28,000
Net Profit for the year after providing for all expenses under agreement entered into with Bijli		1,92,000
	8,00,000	8,00,000

SOLUTION :

Balance Sheet of M/s Mittul Ltd. as on 31st Dec., 2019

	Particulars	Notes	₹
1.	Equity and Liabilities		
	Shareholders' funds		
	(a) Share Capital Reserves and		
	(b) Surplus Current	1	4,80,000
2.	Liabilities	2	84,000
(a)	Trade Payables		
(b)	Other Current Liabilities		1,28,000
	Assets		
	Non-current assets		
	Fixed assets		
2.	Current Assets		
(a)	Inventories	3	1,53,600
(b)	Trade receivables		2,68,000
(c)	Cash and Cash equivalents		3,28,000
	Total		<u>8,45,600</u>

Notes to accounts

	₹
1. Share Capital	
Equity share capital	
Issued & Subscribed Capital	
6,000 Equity Shares of ₹ 100 each, ₹ 80 paid up	4,80,000
2. Reserves and Surplus	
Capital Reserve (Pre incorporation profit)	
Profit and loss Account	96,000
Net Profit and for the Year	96,000
Less: Directors' fee	12,000
Preliminary Expenses'	<u>96,000</u>
	<u>(1,08,000)</u>
Total	<u>84,000</u>
3. Fixed Assets	
Goodwill and Fixed Assets (WN)	1,53,600

Working Note

Amount Payable to Bijli :

Profit for the year

1,92,000

80% due as cost of goodwill, assets, etc.

1,53,600

ILLUSTRATION 11.

Mithul and Rijul, working in partnership registered a joint stock company under the name of Millon Tours on May 31, 2019 to take over their existing business. It was agreed that they would take over the assets of the partnership for a sum of ₹ 6,00,000 as from January 1st, 2019 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 June 30, 2019. To discharge the purchase consideration, the company issued 20,000 equity shares of ₹ 10 each at a premium of ₹ 1 each and allotted 7% Debentures of the face value of ₹ 1,50,000 to the vendors at par.

The summarized Profit and Loss Account of the "Millon Tours" for the year ended 31st December, 2019 was as follows :

	₹		₹
To Purchase, including Inventory	2,80,000	By Sales :	
To Freight and Carriage	10,000	1 st January to 31 st May, 2014	1,20,000
To Gross Profit c/d	1,20,000	1 st June to 31 st Dec., 2014	2,40,000
		By Inventory in hand	50,000
	<u>4,10,000</u>	By Gross Profit b/d	4,10,000
To Salaries and Wages	20,000		1,20,000
To Debenture Interest	10,500		
To Depreciation	2,000		
To Interest on purchase			
Consideration (up to 30-6-2014)	18,000		
To Selling Commission	18,000		
To Directors' Fee	1,200		
To Preliminary Expenses	1,800		
To Provision for Taxes	12,000		
To Dividend on equity shares @ 5%	10,000		
To Balance c/d	<u>26,500</u>		
	<u>60,000</u>		<u>60,000</u>

Prepare statement apportioning the expenses and calculate profits/losses for the 'post' and 'pre-incorporation' periods and also show how these figures would appear in the Balance Sheet of the company.

SOLUTION

Millon Tours

Statement showing Calculation of Profit/Losses for Pre and Post Incorporation Periods

	Ratio	Pre-Incorporation	Post-Incorporation
Gross Profit allocated on the basis of sale	1:2	40,000	80,000
Less: Administrative Expenses allocated on time basis:			
(i) Salaries and Wages		20,000	
(ii) Depreciation		2,000	
		22,000	
Selling Commission on the basis of sales	5:7	9,166	12,834
Interest on Purchase Consideration (Time basis)	1:2	6,000	12,000
Expenses applicable wholly to the Post-incorporation period:	5:1	15,000	3,000
Debenture Interest		10,500	
Director's Fee			
Preliminary expenses Balance		1,200	11,700
c/d to Balance Sheet			1,800
		9,834	28,534

ILLUSTRATION 12.

Successful Ltd. was incorporated on 1.5.2019 to take over the business of Unsuccessful & Co. from 1.1.2019. The summarized Profit and Loss Account as given by Successful Ltd. for the year ending 31.12.2019 is as under :

Summarized Profit and Loss Account

	₹		₹
To Rent and Taxes	2,25,000	By Gross Profit	26,60,000
To Salaries including manager's salary of ₹ 85,000	8,27,500	By Interest on Investors	90,000
To Carriage Outwards	35,000		
To Printing and Stationery	45,000		
To Interest on Debentures	62,500		
To Sales Commission	77,000		
To Bad Debts (related to sales)	2,27,500		
To Undertaking Commission	65,000		
To Preliminary Expenses	70,000		
To Audit Fees	1,12,500		
To Loss on Sale of Investments	28,000		
To Net Profit	9,75,000		
	27,50,000		27,50,000

Prepare a statement showing allocation of expenses and calculations of pre-incorporation and post-incorporation profits after considering the following information:

- G.P. ratio was constant throughout the year.
- Sales for January and October were $1\frac{1}{2}$ times the average monthly sales while sales for December were twice the average monthly sales.

- (iii) Bad debts are shown after adjusting a recovery of ₹ 17,500 of Bad debt for a sale made in July, 2011.
- (iv) Manager's salary was increased by ₹ 5,000 p.m. from 1.5.2014.
- (v) All investments were sold in April, 2014.
- (vi) The entire audit for relates to company.

SOLUTION

Pre-incorporation period is for four months, from 1st January, 2019 to 30th April, 2019. 8 months period (from 1st May, 2019 to 31st December, 2019) is post-incorporation period.

Statement showing Calculation of Profit/Losses for Pre and Post Incorporation Periods

	Pre-Inc ₹	Post-Inc ₹
Gross Profit	8,55,000	18,05,000
Interest on Investments	90,000	-
Bad debts Recovery	17,500	-
	9,62,500	18,05,000
Less : Rent and Taxes	75,000	1,50,000
Salaries		
Manager's salary	57,500	1,55,000
Other salaries	2,05,000	4,10,000
Printing and Stationery	15,000	30,000
Audit fees	-	1,12,500
Carriage outwards	1,12,500	23,750
Sales commission	24,750	52,250
Bad Debts (91,000 + 7,000)	78,750	1,66,250
Interest on Debentures		62,500
Underwriting Commission		65,000
Preliminary Expenses		70,000
Loss on sale of investments	28,000	-
Net Profit	4,67,250	5,07,750

* Pre-incorporation is a capital profit and will be transferred to Capital Reserve.

Working Notes :

- (i) Calculation of ratio of Sales.

Let average monthly sales be x.

Thus sales from January to April are $4\frac{1}{2}x$ and sales from May to December are $9\frac{1}{2}x$. Sales are in the ratio of $9/2x : 19/2x$ or 9 : 19.

- (ii) Gross profit, carriage outwards, sales commission and bad debts written off have been allocated in pre and post incorporation periods in the ratio of Sales i.e. 9 : 19.
- (iii) Rent, salaries, printing and stationery, audit fees are allocated on time basis.

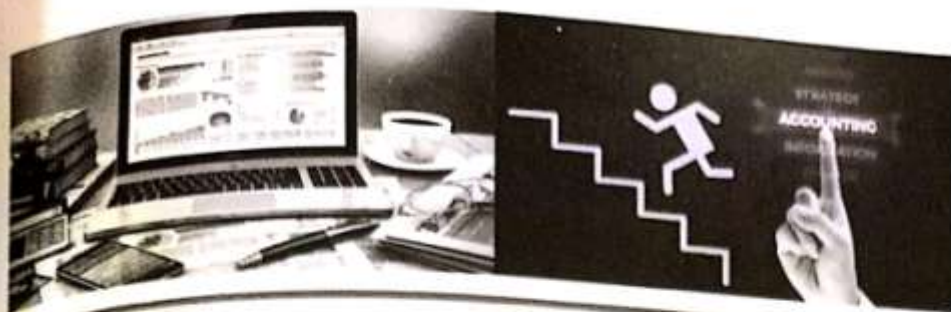
- (iv) Interest on debentures, underwriting commission and preliminary expenses are allocated in post incorporation period.
- (v) Interest on investments, loss on sale of investments and bad debt recovery are allocated in pre-incorporation period.

Exercise

- What do you mean by Profit Prior to Incorporation?
- What is Time ratio?
- What is sales Ratio?
- Which ratio are normally used to apportion pre and post -incorporation profit?
- When do you use weighted ratio?
- What do you mean by revised time Ratio?
- How do you apportion the interest to vendors on purchase consideration, if the settlement is made before closure of books of accounts?
- Name any 2 expenses debited to only to Post incorporation period.
- Calculate sales ratio from the following: Sajan company was incorporated on 1-8-2019 and acquired a business with effect from 1-4-2019. Total sales from 1-4-2019 to 31-03-2020 was ₹ 24,00,000. Sales for April and May = $1\frac{1}{2}$ times the average monthly sales. Sales from June to October = $\frac{1}{2}$ of average monthly sales. Sales for November and December = $\frac{1}{4}$ of average monthly sales and sales from January to March = Double the average monthly sales.
- Singh Consultant Company Limited was incorporated on August 1, 2019. It had acquired a running business of Thakur & Co. with effect from April 1, 2019. During the year 2019-20, the total sales were ₹ 18,00,000. 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 August 31, 20 X1 ₹ 5,000. You are required to ascertain pre-incorporation and post-incorporation profit for the year ended 31st March, 2012.
- Garib Ltd was incorporated on 1-7-2019 to take over the business of Aameer enterprise as a going concern with effect from 1-4-2019. Their profit and loss account for the year ended 31-3-2020 is as follows:

To Opening stock	24,000	By Sales (₹ 20,000)	60,000
To Purchases	35,000	By Closing Stock	14,000
To Administration expenses	3,600		
To Director's fee	600		
To Selling expenses	7,200		
To Audit fee	200		
To Preliminary expenses	300		
To Net profit	7,000		
	74,000		74,000

Prepare a statement showing profit earned prior to and after incorporation.



UNIT

4

VALUATION OF GOODWILL AND SHARES

Learning Outcomes

After studying this chapter, you will be able to:

- Understand the concept and significance of valuation
- Familiarize with the bases of valuation
- To provide conceptual insights into the valuation of Shares.

Contents

- Meaning of goodwill
- Characteristics of goodwill
- Need for the valuation of goodwill
- A Sole-Proprietorship Organisation
- A Partnership Firm:
- A Company or Firm
- Methods of valuation of goodwill
- Average profits method/Illustration
- Super profit method/Illustration
- Annuity method of super profit/Illustration
- Capitalization method/Illustration
- Valuation of shares
- Meaning
- Objectives of Valuation of shares
- Methods of valuation of shares
- Asset Backing Method: - Method /Net Asset Method
- Yield Method
- Earning Capacity
- Illustrations.

Abstract : Valuation of goodwill and valuation of shares is one of most important elements in an corporate world, because both plays very important role in Branding the organization in terms reputation and shows their strong capacity position in finance, in terms of declaring dividend and future earnings. Therefore it is most significant topic to learn this chapters.

Meaning of goodwill- In simple word the future earning capacity of a business is basically known as goodwill. The term "Goodwill" is a present value of firms' anticipated future excess earnings.

Characteristics of goodwill

- Goodwill is an Intangible Assets.
- It may arise from such contribution of a business as good reception.
- Location of the Business Organisation
- The Skill and ability of its employees and Management
- Nature of the product.

NEED FOR THE VALUATION OF GOODWILL:

A Sole-Proprietorship Organisation

- At the time of purchase and sale of Business to another person's.
- At the time admitting a new person to the organization to raise required capital.
- At the times of converting or expanding collaboration of business.

A Partnership Firm:

- At the time of admitting a new person to the organization to raise required capital.
- At time of retirement / death of partner.
- At the times of converting or expanding Partnership firm of business.
- At time of Amalgamation
- At the times of converting or expanding collaboration of business of different partnership firm.

A Company or Firm:

- If the goodwill has already been written-off in the past but the value of the same is to records further in the books of accounts.
- An existing company taking with or amalgamated with another existing company.
- The Stock Exchange Quotation of the value of shares of the company is not available to compute gift tax, wealth tax, etc., and.
- The shares are valued based on intrinsic values, market value, or fair value methods.

METHODS OF VALUATION OF GOODWILL

1. Average Profits Method;
2. Super Profits Method;
3. Capitalization Method;
4. Annuity Method;

1. AVERAGE PROFITS METHOD

The Goodwill will be valued in this method based on taking average profit of past few years and at agreed number of years purchase.

A newly started business does not earn profit for few years of its establishment. If a person wants to buy a business, which is running successfully from some years, is required to pay for Goodwill along with purchase price as agreed. Thus goodwill is to be calculated by multiplying the past average profits by the number of years during which the expected profits will accrue. Goodwill is paid for obtaining future advantage.

$$\text{Goodwill} = \text{Average Profits} \times \text{Number of years' purchase}$$

Weighted Average Profit Method is modified version of Average Profits Method. In this method weighted average has to be found instead of simple average. For this each year's profit is multiplied by the respective number of weights to determine the value of the product and it is totalled. This product is divided by the total weights assigned to different years' profit.

$$\text{Weighted Average Profit} = \frac{\text{Total of Products of profits}}{\text{Total of Weights}}$$

$$\text{Goodwill} = \text{Weighted Average Profit} \times \text{Agreed Number of Years' Purchase.}$$

ILLUSTRATION 1.

Mr. Zameer has been running a organisation decided to sell his business organization on 1st March 2019. From the following particulars compute the value of goodwill based on 3 years purchase of average profits of last 4 years. The profits during last 4 years were as follows.

2015-16 -	1, 00,000
2016-17-	1, 20,000
2017-18-	1, 50,000
2018-19-	1, 80,000

At the time buying the business the buyer was employed as manager of similar business on a salary of ₹ 3,000 of per month. The Profit of 2018-19 included an income from investment of ₹ 10,000. The profit 2015-16 was reduced by ₹ 30,000 being loss on speculation. Similarly, in 2017-18 profit were reduced by ₹ 50,000 due to loss from betting.

SOLUTION

Particulars	2015-16 ₹	2016-17 ₹	2017-18 ₹	2018-19 ₹
Balance of Profit as per profit and loss account	1, 00,000	1, 20,000	1, 50,000	1, 80,000
Less:- Revenue expenses and Loss which are debited to Profit and Loss A/c				
Less-Remuneration to Manager (Proprietor) (3,000×12)	36,000	36,000	36,000	36,000
	64,000	84,000	1,14,000	1,44,000
Less-Capital or non-recurring income which are credited to Profit and loss A/c	-	-	-	10,000
	64,000	84,000	1,14,000	1,34,000
Add-Capital Loss which debited to profit and loss account	30,000			
Less from speculation	94,000	84,000	1,14,000	1,34,000
Loss due to betting	-	-	50,000	-
Adjusted annual Profit	94,000	84,000	1,64,000	1,34,000

4.4**Valuation of Goodwill and Super Profits**

Step-2 : Calculation of Adjusted Average Annual Profit

Adjusted Average Annual Profit = $94,000 + 84,000 + 1,64,000 + 1,34,000 = 4,76,000 / 4 = ₹ 1,19,000$

Step-3 : Calculation of Goodwill

Goodwill = Average Profit $\times$ number of years of Purchase

Goodwill based on 3 years purchase of average profits of last 4 years. $1,19,000 \times 3 = ₹ 3,57,000$

ILLUSTRATION 2.

The Profit disclosed by Chitra Ltd, for the past 5 years were as follows.

2014-15- ₹ 40,000 (including abnormal profit ₹ 5,000)

2015-16- ₹ 50,000 (after charging abnormal loss ₹ 10,000)

2016-17- ₹ 45,000 (excluding ₹ 5,000 insurance premium)

2017-18- ₹ 60,000

2018-19- ₹ 80,000 (including profit on sale of building ₹ 20,000)

You are required to calculate the value of goodwill at 2 years purchase of average profits last 5 years.

(BU, B.Com. Examination 2020)

SOLUTION**Step-1**

Particulars	2014-15 ₹	2015-16 ₹	2016-17 ₹	2017-18 ₹	2018-19 ₹
Balance of Profit as per profit and loss account	40,000	50,000	45,000	60,000	80,000
Less:- Revenue expenses and Loss which are not debited to Profit and Loss A/c	-	-	5,000	-	-
Less:- Insurance Premium	40,000	50,000	40,000	60,000	80,000
Less:- Capital or non-recurring income which are credited to Profit and loss a/c	5,000	-	-	-	-
	35,000	50,000	40,000	60,000	80,000
Add:- Capital Loss which debited to profit and loss account	-	10,000	-	-	-
Abnormal Loss	35,000	60,000	40,000	60,000	80,000
Less:- Capital Gains	-	-	-	-	20,000
Profit on sale of buildings	35,000	60,000	40,000	60,000	60,000
Adjusted annual Profit	35,000	60,000	40,000	60,000	60,000

Step-2 : Calculation of Adjusted average annual Profit.

Adjusted average annual profit = $35,000 + 60,000 + 40,000 + 60,000 + 60,000 = 2,55,000 / 5 = ₹ 51,000$

Step-3 : Calculation of goodwill

Goodwill = 2 years purchase of average profits last 5 years = $51,000 \times 2 = ₹ 1,02,000$.

ILLUSTRATION 3.

The following particulars are available in respect of the business carried on by Mr. Prabhu

(a) Profits earned:

(i) 2016-17- ₹ 1,00,000

(ii) 2017-2018- ₹ 96,000

(iii) 2018-2019- ₹ 1,04,000

- (b) Profits of 2017-18 is reduced by ₹10,000 due to stock destroyed by fire and profit of 2016-17 included non-recurring income of ₹6,000
- (c) Profits of 2017-2018 include ₹4,000 income on investment
- (d) The stock is not insured and it is thought necessary to insure the stock in future. The insurance premium is estimated at ₹1,000 p.a.
- (e) Fair remuneration to the Proprietor (Not taken in the calculation of profits) is ₹10,000 p.a.
- You are required to compute the value of goodwill on the basis of 2 years purchase of average profits of the last 3 years.

Particulars	2016-17 ₹	2017-18 ₹	2018-19 ₹
Balance of Profit as per profit and loss account	1,00,000	96,000	1,04,000
Less:- Revenue expenses and Loss which are debited to Profit and Loss A/c			
Less-Insurance Premium	1,000	1,000	1,000
Fair remuneration to the Proprietor	99,000	95,000	1,03,000
	10,000	10,000	10,000
Less:- Capital or non-recurring income which are credited to Profit and loss a/c	89,000	85,000	93,000
Income from Investment	-	4,000	-
Non-recurring Income	89,000	81,000	93,000
	6,000	-	-
Add:- Capital Loss which debited to profit and loss account	83,000	81,000	93,000
Loss of stock due fire	-	-	-
Loss due to betting	-	10,000	-
Adjusted annual Profit	83,000	91,000	93,000

ILLUSTRATION 4.

Ram purchased business from Shyam from 1-4-2017. Profit earned by Shyam from the preceding Years were 2015- ₹ 10,00,000; 2016- ₹ 12,00,000; 2017- ₹ 10,80,000

It was found that the profits for the year 2015 included a non-recurring income of ₹ 40,000 and profits for the year 2017 was reduced by ₹ 60,000 due to an abnormal loss on account of a small fire in the shop. The properties of the business were not insured in the past. But it was thought prudent to insure the property in future at a premium of ₹ 10,000 p.a. Ram at the time of purchase of business was employee as manager of an identical business concern at a monthly salary of ₹ 20,000. He intends to replace the manager of business who is drawing a salary of ₹ 15,000 p.m.

The goodwill is estimated at 2 years of purchase of average profits. Calculate Goodwill.

SOLUTION**Step-I**

Particulars	2015 ₹	2016 ₹	2017 ₹
Balance of Profit as per profit and loss account	10,00,000	12,00,000	10,80,000
Less:- Revenue expenses and Loss which are not debited to Profit and Loss A/c	10,000	10,000	10,000
Less- Insurance Premium	9,90,000	11,90,000	10,70,000

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Valuation of Goodwill and Shares

Less:- Manager's salary (20,000×12)	2,40,000	2,40,000	2,40,000
	7,50,000	9,50,000	8,30,000
Less:- Capital or non-recurring income which are credited to Profit and loss A/c	40,000	-	-
Non-recurring income	7,10,000	9,50,000	8,30,000
	-	-	60,000
Add:- Capital Loss which debited to profit and loss account	7,10,000	9,50,000	8,90,000
Abnormal Loss fire in the shop Adjusted Annual Profit			

Step-2 : Calculation of Adjusted average annual Profit

$$= 7,10,000 + 9,50,000 + 8,90,000 = 25,50,000 / 3 = ₹ 8,50,000$$

Step-3 : Calculation on of goodwill

$$\text{Goodwill} = 3 \text{ years average Profit} \times 2 \text{ years purchase}$$

$$= 8,50,000 \times 2 = ₹ 17,00,000$$

ILLUSTRATION 5.

The profit disclosed by Sudha Ltd, for the past 5 years were as follows:

2006- ₹ 20,000 (Including abnormal profit ₹ 2,500)

2007- ₹ 25,000 (after charging abnormal loss ₹ 500)

2008- ₹ 22,500 (excluding ₹ 2,500 insurance premium)

2009- ₹ 30,000

2010- ₹ 40,000 (including profit on sale of building ₹ 10,000)

Calculate goodwill at 2 years purchase of average profits. (BU, B.Com. October/November 2011)

SOLUTION

Step-I

Particulars	2006 ₹	2007 ₹	2008 ₹	2009 ₹	2010 ₹
Balance of Profit as per profit and loss account	20,000	25,000	22,500	30,000	40,000
Less:- Revenue expenses and Loss which are not debited to Profit and Loss A/c					
Less-Insurance Premium	-	-	2,500	-	-
Less:- Capital or non-recurring income which are credited to Profit and loss A/c	20,000	25,000	37,500	30,000	40,000
	2,500	-	-	-	-
Add:- Capital Loss which debited to profit and loss account	17,500	25,000	37,500	30,000	40,000
Abnormal Loss	-	500			
Less:- Capital Gains	17,500	24,500	37,500	30,000	40,000
Profit on sale of buildings	-	-	-	-	10,000
Adjusted annual Profit	17,500	24,500	37,500	30,000	30,000

Step-2 : Calculation of Adjusted average annual Profit.

$$\text{Adjusted average annual profit} = 17,500 + 24,500 + 37,500 + 30,000 + 30,000 = 1,39,500 / 5 = ₹ 27,900$$

Step-3 : Calculation of goodwill

Goodwill = 2 years purchase of average profits last 5 years. = $27,900 \times 2 = ₹ 55,800$

ILLUSTRATION 6.

Josh Ltd proposed to purchase the business carried on by Mr. Shah. Goodwill for this purpose is agreed to be valued at 3 years purchase of the weighted average profits of the past 4 years, the appropriate

Weights to be used are:

Year	Profit (₹)	weights
2016	1,01,000	1
2017	1,24,000	2
2018	1,00,000	3
2019	1,50,000	4

On a scrutiny of the accounts the following matters are revealed:

- On 1st January, 2018 a major repair was made in respect of the plant incurring ₹ 30,000. Which amount was charged to revenue? The said sum is agreed to be capitalized for goodwill. Calculation subject to adjustment of depreciation of 10% p.a on reducing balance method.
- The closing stock for the year 2017 was overvalued by ₹ 12,000
- To cover management cost an annual charge of ₹ 24,000 should be made for the purpose of Goodwill valuation. Compute the value of goodwill.

SOLUTION**Step-I**

Particulars	2016 ₹	2017 ₹	2018 ₹	2019 ₹
Balance of Profit as per profit and loss account	1,01,000	1,24,000	1,00,000	1,50,000
Less:- Revenue expenses and Loss which are debited to Profit and Loss A/c	—	—	3,000	—
Less- Depreciation ($30,000 \times 10/100$)	1,01,000	1,24,000	97,000	1,50,000
Less- Depreciation ($30,000-3,000$) $27,000 \times 10/100$	—	—	—	2,700
	1,01,000	1,24,000	97,000	1,47,300
Less- Management annual charges	24,000	24,000	24,000	24,000
Less- Overvaluation of stock (closing)	77,000	1,00,000	73,000	1,23,300
	—	12,000	—	—
Add- Over valuation of stock (opening)	77,000	88,000	73,000	1,23,300
	—	—	12,000	—
Add:- Capital Loss which debited to profit and loss account	77,000	88,000	85,000	1,23,300
Loss from repairs on plant	—	—	30,000	—
Adjusted annual Profit	77,000	88,000	1,15,000	1,23,300

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Step-2: Calculation of Weighted Average Profits

Year	Adjusted annual profit ₹	Weight	Total
2016	77,000	1	77,000
2017	88,000	2	1,76,000
2018	1,15,000	3	1,45,000
2019	1,23,300	4	4,93,200
		10	10,91,200

Weighted average Profit = total weighted / total weight
 $= 10,91,200 / 10 = ₹ 1,09,120$

Step 3: Calculation of value of goodwill

Goodwill = weighted average profits = Number of years purchase
 $= 1,09,120 \times 3 = ₹ 3,27,360$

ILLUSTRATION 7.

ABC Ltd purchase the business of XYZ Ltd. Calculate goodwill on the basis of 3 years purchase weighted average for 4 years. The appropriate weights are:

Year Profit (₹) Weights

Year	Profit	Weight
2016	40,500	1
2017	46,500	2.5
2018	60,000	3.8
2019	75,000	4.2

2001	40,500	1
2002	46,500	2.5
2003	60,000	3.8
2004	75,000	4.2

- The company purchased new furniture on 30th June 2018 which was entered in purchase day Book. The value of furniture was ₹ 10,000. For the purpose of goodwill, the error has to be rectified and depreciation should be provided at 10% under written down value method.
- The opening stock of year 2018 was undervalued by ₹ 2,500
- Anticipated additional expenses in administration is ₹ 5,000

SOLUTION

Step-I

Particulars	2016 ₹	2017 ₹	2018 ₹	2019 ₹
Balance of Profit as per profit and loss account	40,500	46,500	60,000	75,000
Less:- Revenue expenses and Loss which are debited to Profit and Loss A/c				
Less-depreciation $(10,000 \times 10/100)$	-	-	1,000	-
Less-Depreciation $(10,000-1,000) 9,000 \times 10/100$	40,500	46,500	59,000	75,000
Less-Administration expenses	-	-	-	900
	40,500	46,500	59,000	74,100

Valuation of Goodwill

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Add:-undervaluation of stock(opening)	5,000	5,000	5,000	5,000
Less:- Over valuation of stock(opening)	35,500	41,500	54,000	79,100
	-	-	2,500	-
Add:-Capital Loss which debited to profit and loss account	35,500	41,500	56,500	79,100
	-	-	-	2,500
Loss :-Purchase of furniture	35,500	41,500	56,500	76,600
Adjusted annual Profit	-	-	30,000	-
	35,500	41,500	86,500	76,600

Step-2 : Calculation of Weighted Average Profits

Year	Adjusted annual profit ₹	Weight	Total ₹
2016	35,500	1	35,500
2017	41,500	2.5	1,03,750
2018	86,500	3.8	3,28,700
2019	76,600	4.2	3,21,720
		11.5	7,89,670

Weighted average Profit = total weighted / total weight
 $= 7,89,670 / 11.5 = ₹ 68,667$

Step3 : Calculation of value of goodwill

Goodwill = Weighted average profits = Number of years purchase
 $= 68,667 \times 3 = ₹ 2,06,000$

2. SUPER PROFIT METHOD

Super profit is the excess of estimated future maintainable profits over normal profits.

In starting or initial stages or years of business it is not possible to earn any profits. Any organization, which is buying an existing business, has to pay an amount equal to profits the firm is likely to earn in the next "few years". What the firm paid for is the capacity of a business to earn profits in future i.e. for Goodwill earned by the concern in previous years, on the basis of which it can earn profits in future also.

Under Super Profit Method, we consider not the normal profits a concern is earning year to year under normal business conditions, it is the excess profits from the average or normal profit a firm is earning. We compare our business or entity with the other entities in the market in the same line of business. The Super Profit is the profit earned by a concern in excess of profit earned by its competitor in the same market under same business conditions.

Following steps are required in calculation of Super Profits;

- Normal Rate of Return in similar business;
- The Fair Value of Capital Employed;
- The Average of Profits earned in previous years.

Steps to be followed while calculating goodwill under super profit method.

Step-I : Calculation of capital Employed

4.10

Step-II : Calculation of Average capital Employed

Step-III : Average Profit to be calculated.

Step-IV : Normal Profit on Capital Employed on the Basis of Normal Rate of Return is calculated.

Step-V : Super Profit = Normal Profit if Deducted from Average Profit

Step VI : Goodwill = Super Profit $\times$ Number of years' purchase

ILLUSTRATION 8.

From the following particulars, compute the value of Goodwill on the basis of 3 years purchase of super profit taking average of last 4 years.

Fixed assets- ₹ 16,00,000, Current assets- ₹ 1,60,000, Current liabilities- ₹ 3,20,000, Normal rate of return-15%, Managerial remuneration if employed else where- ₹ 20,000 P.a Profits for the last 4 years were ₹ 2,40,000, ₹ 2,80,000, ₹ 2,60,000 and ₹ 3,00,000 respectively.

SOLUTION

Step-1. Calculation of Capital employed

Capital employed=Tangible Assets- Tangible Liabilities	Amount ₹	Amount ₹
Fixed assets	16,00,000	
Current assets	1,60,000	17,60,000
Total market value of tangible assets		17,60,000
Less:-Tangible Liabilities		3,20,000
Current liabilities		
Capital employed		14,40,000

Step-2. Calculation of Average capital employed

Average Capital employed= Total capital employed-1/2 of the current year's profit.

	₹
Capital employed=	14,40,000
Current year's profit=	3,00,000
½ of the current year's profit-----	-3,00,000
Less:-Managerial remuneration-----	20,000
½ of the current year's profit -----2,80,000 $\times$ 1/2=	1,40,000
Average capital employed=14,40,000 - 1,40,000=	13,00,000.

Step-3. Calculation of Average profit

Average Profit = 2,40,000 + 2,80,000+2,60,000+3,00,000/4	
= 10,80,000/4=-----	2,70,000
Less : Managerial Remuneration-----	20,000
	= <u>2,50,000</u>

Step-4. Calculation of Normal Profit

Normal Profit (return) = Average capital employed percentage of normal rate of return
 $= 13,00,000 \times 15/100 = ₹ 1,95,000$

Valuation of Goodwill and Shares

4.11

Step -5. Calculation of Super profit

$$\begin{aligned}\text{Super profit} &= \text{Adjusted average profit-normal rate of return.} \\ &= 2,50,000 - 1,95,000 = ₹ 55,000\end{aligned}$$

Step-6. calculation of goodwill

$$\begin{aligned}\text{4 years adjusted average super profit} \times 3 \text{ years purchase} \\ &= 55,000 \times 3 = ₹ 1,65,000.\end{aligned}$$

ILLUSTRATION 9.

Mr. Manoj invested a sum of ₹6,00,000 in a business which is a very profitable one. The annual profit earned from this business is ₹ 1,20,000 which included a sum of ₹ 20,000 received as compensation for acquisition of part of his business premises. The money could have been invested in deposits for a period of 5 years at 10% interest and himself could earn ₹ 14,400 p.a in alternative employment. Considering 2% as fair compensation for the risk involved in the business. Calculate the value of goodwill of his business on capitalization of super profits at a normal rate of return of 12%.

Step-1. Calculation of Capital employed

In the given question Capital employed is at ₹6,00,000. Therefore it not necessary to calculate capital employed.

Step-2. Calculation of Average capital employed

Average Capital employed = Total capital employed - 1/2 of the current year's profit.

Since in the given in the question ₹6,00,000 as capital employed. It is not required.)

Step-3. Calculation of Average profit

Particulars	₹	Amount ₹
Annual Profit		1,20,000
Less-Compensation for acquisition not a part of business income	20,000	
Remuneration if employed elsewhere	14,400	34,400
Adjusted average annual Profit		85,600

Step-4. Calculation of Normal Profit

$$\begin{aligned}\text{Normal Profit (return)} &= \text{Average capital employed percentage of normal rate of return} \\ &= 6,00,000 \times 12/100 = ₹ 72,000\end{aligned}$$

Step -5. Calculation of Super profit

$$\begin{aligned}\text{Super profit} &= \text{Adjusted average profit-normal rate of return.} \\ &= 85,600 - 72,000 = ₹ 13,600\end{aligned}$$

Step-6. Calculation of goodwill

$$\begin{aligned}\text{Capitalization of super profits} &= \text{Super profit/Normal rate of return} \times 100 \\ &= 13,600/12 \times 100 = ₹ 1,13,334.\end{aligned}$$

ILLUSTRATION 10.

The net profit of a business, after providing for taxation, for the past 5 years are; ₹ 40,000,

4.12

₹ 42,500, ₹ 46,000, ₹ 52,500, and ₹ 59,000. The capital employed in the business is ₹ 4,00,000. The normal rate of return expected in this type of business is 10%. It is expected that the company will be able to maintain its super profit for the next 5 years. Calculate the value of goodwill on the basis of:

- (1) 5 year's purchase of super profit method
- (2) Annuity method, taking the present value of annuity of Re.1 for 5 years at 10% as 3.78 and
- (3) Capitalization of super profit method.

SOLUTION

- (1) Calculation of goodwill under super profit method

$$\begin{aligned}\text{Goodwill} &= \text{super profit} \times 5 \text{ years purchase} \\ &= 8,000 \times 5 = ₹ 40,000\end{aligned}$$

- (2) Calculation of goodwill Annuity method

Super profit $\times$ annuity value

$$8,000 \times 3.78 = ₹ 30,240$$

$$\begin{aligned}\text{Calculation} &= \text{Super profit} / \text{normal rate of return} \times 100 \\ &= 8,000 / 10 \times 100 = 80,000\end{aligned}$$

- (3) Goodwill under Capitalization of super profit method.

Step-1. Calculation of Average profit

$$\text{Average Profit} = 40,000 + 42,500 + 46,000 + 52,500 + 59,000 / 5 = 2,40,000 / 5 = ₹ 48,000.$$

Step-2. Calculation of Normal Profit

$$\begin{aligned}\text{Normal Profit} &= \text{Capital employed} \times \text{percentage of normal return.} \\ &= 4,00,000 \times 10 / 100 = ₹ 40,000\end{aligned}$$

Step-3. Calculation of Super profit

$$\begin{aligned}\text{Super profit} &= \text{Average profit} - \text{Normal profit} \\ &= 48,000 - 40,000 = ₹ 8,000\end{aligned}$$

ILLUSTRATION 11.

The net profit of a company after providing for taxation, for the past 5 years are: ₹ 40,000, ₹ 42,000, ₹ 45,000, ₹ 47,000 and ₹ 46,000 respectively. The capital employed in the business is ₹ 4,00,000 on which a reasonable rate of return of 10% is expected. It is expected that the company will be able to maintain its super profits for the next 5 years. Calculate the value of goodwill of the business on the basis of;

- (a) Annuity of super profits, taking the present value of annuity of one rupee for 5 years at 10% interest is ₹3.78
- (b) Capitalization of super profit method.
- (c) 5 years purchase of super profit method.

(BU III Semester B.Com. Examination Nov/Dec 2010)

SOLUTION

Step-1. Calculation of Average profit

$$\text{Average Profit} = 40,000 + 42,000 + 45,000 + 47,000 + 46,000 / 5 = 2,20,000 / 5 = ₹ 44,000.$$

Step-2. Calculation of Normal Profit

$$\begin{aligned}\text{Normal Profit} &= \text{Capital employed} \times \text{percentage of normal return.} \\ &= 4,00,000 \times 10/100 = ₹ 40,000\end{aligned}$$

Step-3. Calculation of Super profit

$$\begin{aligned}\text{Super profit} &= \text{Average profit} - \text{Normal profit} \\ &= 44,000 - 40,000 = ₹ 4,000\end{aligned}$$

Calculation of goodwill under super profit method

$$\begin{aligned}\text{Goodwill} &= \text{Super profit} \times 5 \text{ years purchase} \\ &= 4,000 \times 5 = ₹ 20,000\end{aligned}$$

Calculation of goodwill Annuity method

$$\begin{aligned}\text{Super profit} \times \text{annuity value} \\ &= 4,000 \times 3.78 = 15,120\end{aligned}$$

Calculation of goodwill under Capitalization of super profit method.

$$\begin{aligned}\text{Capitalization} &= \text{Super profit} / \text{normal rate of return} \times 100 \\ &= 4,000 / 10 \times 100 = 40,000\end{aligned}$$

ILLUSTRATION 12.

The following information is given:

- (a) Capital employed ₹ 3,00,000
- (b) Normal rate of return 10%
- (c) Present value of annuity ₹ 1 for 5 years at 10% = 3.78
- (d) Net profits for 5 years : 2015—₹ 28,800, 2016—₹ 30,800, 2017—₹ 34,800, 2018—₹ 33,800 and 2019 – ₹ 35,800.

The profits included non-recurring profits on an average basis of ₹ 2,000 out of which it was declined that even non-recurring profits had a tendency of appearing at the rate of ₹ 1,200 p.a.

You are required to calculate goodwill:

- (a) As per annuity method
- (b) As per 5 years purchase of super profit method
- (c) As per capitalization of super profit method.

SOLUTION

Step-1. Calculation of Average profit

$$\text{Average Profit} = 28,800 + 30,800 + 34,800 + 33,800 + 35,800 / 5 = 164,000 / 5 = ₹ 32,800$$

Step-2. Calculation of Normal Profit

$$\begin{aligned}\text{Normal Profit} &= \text{Capital employed} \times \text{percentage of normal return.} \\ &= 3,00,000 \times 10/100 = ₹ 30,000\end{aligned}$$

Step-3. Calculation of Super profit

Super profit = Average profit-Normal profit

$$= 32,800 - 30,000 = 3,200$$

Calculation of goodwill Annuity method

Super profit $\times$ annuity value

$$= 3,200 \times 3.78 = ₹ 12,096$$

Calculation of goodwill under super profit method

Goodwill = super profit $\times$ 5 years purchase

$$= 3,200 \times 5 = ₹ 16,000$$

Calculation of goodwill under Capitalization of super profit method.

Capitalization = Super profit/normal rate of return $\times 100$

$$= 3,200 / 10 \times 100 = 32,000$$

3. ANNUITY METHOD OF SUPER PROFIT

Goodwill is determined by using following equation; Goodwill is the present value of future Super Profits to be earned by the firm.

Goodwill = Super Profit $\times$ Present Value Factor

Formula : Goodwill is calculated as follows;

Step-I. Future Super Profits has to be calculated.

(i) Capital Employed. = (Tangible assets-Tangible Liabilities)

(ii) Calculation of Average capital employed = (Capital employed-1/2 of current year's profit)

Step-II. Calculation of Average annual Profit (Usually 4 to 5 previous profit will be taken)

Step-III. Normal Rate of Return has to be on capital employed

Normal Rate of Return = Average capital employed $\times$ percentage of Normal rate of return

Calculation of Average capital employed

Step- Calculation Super profit

Super profit = Average annual profit - Normal rate of return.

Step-IV. Present Value Factor has to be calculated by using Annuity Table.

Step-V. Present Value Factor has to be multiplied by Super Profit

Step-VI. Average Sum Total of Product of the Present Value Factor and Super Profits of the Goodwill.

4. CAPITALIZATION METHOD;

(1) Capitalization of Average Profits;

In this method the value of Goodwill is determined by deducting the Actual Capital Employed in the business from the Capitalized Value of Average Profits on the basis of Normal Rate of Return.

Step-I. Average Profits are ascertained on the basis of Past Few Years' Performance.

Valuation of Goodwill and Shares

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Step-II. The Average Profits calculated in Step-I, are to be Capitalized on the basis of Normal Rate of Return as follows;

Average Profits

Total Value of Business = Normal Rate of return

Step-III. Actual Capital Employed (Net Assets) is calculated by deducting Outside Liabilities from the Total Assets (Excluding Goodwill) as

Capital Employed = Total Assets (Excluding Goodwill) - Outside Liabilities

Step-IV. Goodwill = Actual Capital Employed - Average Value of Business [Step III-Step]

(2) Capitalization of Super Profits.

Step-I. Capital Employed in the business is calculated as follows

Capital Employed = Total Assets - Outside Liabilities.

Step-II. required profit on Capital Employed is calculated as follows

Required Profit = Capital Employed × required rate of return

Step-III. Average Profits for last few years is to be calculated

Step-IV. Super Profit = Required Profits - Average Profits [Step II-Step-III]

Step-V. Goodwill = Super Profits × Required Rate of Return.

ILLUSTRATION 13.

The Balance Sheet of Aryan Ltd, as on 31-03-2014 is as under

Equity and Liabilities	Amount ₹
1,500 Preference shares of ₹100 each	1,50,000
2,500 Equity shares of ₹100 each	2,50,000
Reserves and Surplus	
General Reserve	20,000
Profit and Loss A/c	40,000
Current Liability	
Creditors	40,000
	5,00,000
Assets and Properties	
Fixed assets	2,50,000
Stock	87,500
Debtors	1,12,500
Bank	50,000
	5,00,000

The profit of the company (before providing for tax 40%) and the rate of dividend declared in respect of the past 5 years are as under.

Year	2008-09	2009-10	2010-11	2011-12	2012-13
Profits (₹)	67,500	77,500	85,000	82,500	90,000
Rate of dividend	8%	10%	12%	15%	15%

You are required to find out the value of goodwill of the company on the basis of :

- 3 years purchase of super profits
- Capitalization of super profits method
- As per annuity of super profits taking present value of annuity of Re.1 for 5 years at 10% as

(BU III Semester B.Com Examination Nov/Dec.2014)

SOLUTION

Step-1. Calculation of Capital employed

Capital employed=Tangible Assets- Tangible Liabilities	Amount ₹	Amount ₹
Fixed assets	2,50,000	
Stock	87,500	
Debtors	1,12,500	
Bank	50,000	
Total Market value of tangible assets		5,00,000
Less:-Tangible liabilities		40,000
Creditors		
Capital employed		4,60,000

Step-2. Calculation of Average capital employed

Average Capital employed= Total capital employed-1/2 of the current year's profit.

Capital employed = ₹ 4,60,000

Current year's profit = ₹ 90,000

½ of the current year's profit = 90,000x1/2 = ₹ 45,000

Average capital employed = 4,60,000-45,000 = ₹ 4,15,000

Step-3. Calculation of Average profit

Average Profit= 67,500+77,500+85,000+82,500+90,000/5=4,02,500/5= ₹ 80,500

Step-4. Calculation of Normal Profit

Calculation of average Normal rate of return.

Year	2008-09	2009-10	2010-11	2011-12	2012-13
Rate of dividend	8%	10%	12%	15%	15%

Therefore = 8 + 10 + 12 + 15 + 15 = 60/5 = 12

Average Normal rate of Return=12%.

Normal Profit (return) = Average capital employed percentage of normal rate of return
= 4,15,000x12/100 = ₹ 49,800

Step -5. Calculation of Super profit

Super profit = Adjusted average profit-normal rate of return.
= 80,500-49800 = ₹ 30,700

Step-6. Calculation of goodwill under super profit method

Super profit x 3 years purchase
= 30,700x3 = ₹ 92,100

(b) Capitalization of super profit method.

Capitalization = Super profit/Normal rate of returnx100
= 30,700/12x100= ₹ 2,55,833.

ILLUSTRATION 14.

The following is the Balance sheet of X Ltd, as on 31st March, 2019

Equity and Liabilities		Amount ₹
Equity shares capital of ₹10 each		5,00,000
General reserve		2,00,000
Profit and Loss a/c		1,00,000
Sundry creditors		60,000
Bills payable		20,000
Provision for tax		20,000
		9,00,000
Buildings		1,65,000
Machinery		85,000
Furniture		50,000
Motor vans		1,00,000
Investments(market value 1,20,000)		1,00,000
Stock		1,50,000
Debtors		80,000
Bank		1,70,000
		9,00,000

Year	2016-17	2017-18	2018-19
Profits (before tax, rate of tax 40%)	2,10,000	2,20,000	2,50,000

Income from investments may be taken at 6%. Normal rate of return on average capital employed is 15%. Building is valued at ₹1,80,000 and machinery at ₹90,000. Taking weighted average of profits after tax as basis, calculate the value of goodwill based on

- years purchase of super profits
- Capitalization of super profits method
- As per annuity of super profits taking present value of annuity of Re.1 for 5 years at 10% as ₹3.78

(BU III Semester B.Com. Examination Nov/Dec. 2005)

SOLUTION**Step-1. Calculation of Capital employed**

Capital employed=Tangible Assets – Tangible Liabilities	Amount ₹	Amount ₹
Buildings	1,80,000	
Machinery	90,000	
Furniture	50,000	
Motor vans	1,00,000	
Stock	1,50,000	
Debtors	80,000	
Bank	1,70,000	8,20,000
Less:-Tangible Liabilities		
Sundry creditors	60,000	
Bills payable	20,000	
Provision for tax	20,000	1,00,000
Capital employed		7,20,000

Step-2. Calculation of Average capital employed

Average Capital employed = Total capital employed - 1/2 of the current year's profit.

Capital employed = ₹ 7,20,000

Current year's profit = ₹ 2,50,000

½ of the current year's profit = $2,50,000 \times 1/2$ = ₹ 1,25,000

Average capital employed = $7,20,000 - 1,25,000$ = ₹ 5,95,000

Step-3. Calculation of Weighted Average Profits

Year	Adjusted annual profit ₹	Weight	Total ₹
2016-17	2,10,000	1	2,10,000
2017-18	2,20,000	2	4,40,000
2018-19	2,50,000	3	5,00,000
		6	11,50,000

Calculation of Weight Average profit

Weight Average profit = Total sum of weight/Weight
 $= 11,50,000 / 6 = ₹ 1,91,667$

Step-4. Calculation of Normal Profit

Average Normal rate of Return = 15%.

Normal Profit (return) = Average capital employed × percentage of normal rate of return
 $= 5,95,000 \times 15/100 = ₹ 89,250$

Step -5 calculation of Super profit

Super profit = Adjusted weighted average profit - normal rate of return.
 $= 1,91,667 - 89,250 = ₹ 1,02,417$

Step-6 calculation of goodwill under super profit method

Super profit × 5 years purchase
 $= 1,02,417 \times 5 = ₹ 5,12,085$

(b) Capitalization of super profit method.

Capitalization = super profit / Normal rate of return × 100
 $= 1,02,417 / 15 \times 100 = ₹ 6,82,780$

(c) As per annuity of super profits taking present value of annuity of ₹ 1 for 5 years at 10% as ₹ 3.78

Goodwill = Super profit × Annuity value
 $= 1,02,417 \times 3.78 = ₹ 3,87,136.26$

ILLUSTRATION 15.

The Balance Sheet of Aryan Ltd, as on 31-03-2017 is as under

Equity and Liabilities	Amount
6,000 15% Preference shares of ₹100 each	6,00,000
10,000 Equity shares of ₹100 each	10,00,000
Reserves and Surplus	
General Reserve	80,000
Profit and Loss A/c	1,60,000
Current Liability	
Creditors	1,60,000
	20,00,000
Assets and Properties	
Fixed assets	10,00,000
Stock	3,50,000
Debtors	4,50,000
Cash and Bank	2,00,000
	20,00,000

The profit of the company (before providing for tax 40%) and the rate of dividend declared in respect of the past 5 years are as under.

Year	2011-12	2012-13	2013-14	2014-15	2015-16
Profits (₹)	2,70,000	3,10,000	3,40,000	3,30,000	3,60,000
Rate of dividend	8%	10%	12%	15%	15%

You are required to find out the value of goodwill at 5 years purchase of the super profit of the company.
(KSLU III Semester 5 year B.Com. L.L.B.Examination December 2018)

SOLUTION

Step-1. Calculation of Capital employed

Capital employed=Tangible Assets – Tangible Liabilities	Amount ₹	Amount ₹
Fixed assets	10,00,000	
Stock	3,50,000	
Debtors	4,50,000	
Cash at Bank	2,00,000	
Total Market value of tangible assets		20,00,000
Less:-Tangible liabilities		
Creditors		1,60,000
Capital employed		18,40,000

Step-2. Calculation of Average capital employed

Average Capital employed= Total capital employed-1/2 of the current year's profit.

Capital employed = ₹ 18,40,000

Current year's profit = ₹ 3,60,000

½ of the current year's profit = 3,60,000 × 1/2 = ₹ 1,80,000

Average capital employed=18,40,000-1,80,000 = ₹ 16,60,000

Step-3. Calculation of Average profit

Average Profit= 2,70,000 + 3,10,000 + 3,40,000 + 3,30,000 + 3,60,000/5 = 12,80,000/5 = ₹ 2,56,000

Step-4. Calculation of Normal Profit

Calculation of average Normal rate of return.

Year	2011-12	2012-13	2013-14	2014-15	2015-16
Rate of dividend	8%	10%	12%	15%	15%

Therefore $= 8+10+12+15+15=60/5=12$

Average Normal rate of Return=12%.

Normal Profit (return) = Average capital employed $\times$ percentage of normal rate of return
 $= 16,60,000 \times 12/100 = 1,99,200$

Step -5. calculation of Super profit

Super profit = Adjusted average profit-normal rate of return.

 $= 2,56,000 - 1,99,200 = 56,800$ **Step-6. calculation of goodwill under super profit method**Super profit $\times$ 5 years purchase $= 56,800 \times 5 = 2,84,000$ **ILLUSTRATION 16.**

The Balance Sheet of Aryan Ltd, as on 31-03-2017 is as under

Equity and Liabilities	Amount ₹
Equity shares of ₹10 each	10,00,000
General Reserve	4,00,000
Profit and Loss A/c	2,00,000
Current Liability	2,00,000
	18,00,000
Assets and Properties	
Fixed assets	8,00,000
Investments (6% Govt. Loans)	2,00,000
Current Assets	8,00,000
	18,00,000

Net profit after taxation:

2015-16 ₹ 2,60,000

2016-17 ₹ 2,50,000

2017-18 ₹ 3,00,000

The Goodwill may be taken as 4 years purchase of average super profits. Normal return on capital employed is 15%. The current Assets are to be taken as ₹ 8,40,000. Ascertain value of Goodwill under

- 4 years purchase of super profits method.
- Capitalization of super profits method.

SOLUTION

Step-1. Calculation of Capital employed

Capital employed = Tangible Assets - Tangible Liabilities		Amount ₹	Amount ₹
Fixed assets		8,00,000	
Current Assets		8,40,000	
Total Market value of tangible assets			16,40,000
Less: Tangible liabilities			2,00,000
Current Liabilities			14,40,000
Capital employed			

Step-2. Calculation of Average capital employed

Average Capital employed = Total capital employed - 1/2 of the current year's profit.

Capital employed = ₹ 14,40,000

Current year's profit = ₹ 3,00,000

1/2 of the current year's profit = $3,00,000 \times 1/2$ = ₹ 1,50,000

Average capital employed = $14,40,000 - 1,50,000$ = ₹ 12,90,000

Step-3. Calculation of Average profit

Average Profit = $2,60,000 + 2,50,000 + 3,00,000 = 8,10,000 / 3$ = ₹ 2,70,000

Step-4. Calculation of Normal Profit

Calculation of average Normal rate of return.

Average Normal rate of Return = 15%.

Normal Profit (return) = Average capital employed $\times$ percentage of normal rate of return

= $12,90,000 \times 15/100$ = ₹ 1,93,500

Step-5. Calculation of Super profit

Super profit = Adjusted average profit - normal rate of return.

= $2,70,000 - 1,93,500$ = ₹ 76,500

Step-6. Calculation of goodwill under super profit method

Super profit $\times$ 4 years purchase

= $76,500 \times 5$ = ₹ 3,82,500

VALUATION OF SHARES

Meaning

Valuation of shares is the process of knowing (determining) the intrinsic value of company's shares. It is common to know the real/present market of value of shares of any company while interested in investing in company. This will be possible if we can calculate the intrinsic value of the share. The process of calculating this intrinsic value is known as share valuation.

Intrinsic value refers to the value which is theoretical in nature. The share price of the listed companies which are traded publicly can be known easily. But in case of private companies where shares are not publicly traded, valuation of shares is very important.

Objectives of Valuation of shares.

The valuation of shares is usually required in the following situations –

- At the time of sale of companies to another organization.
- At the time pledging the company's shares as security to financial institution avail long term loans.
- At the time of amalgamation, Absorption, Acquisitions and reconstruction.
- At the time convert of Preference shares to Equity shares.

METHODS OF VALUATION OF SHARES

- (1) Net assets method / Asset Backing Method,
- (2) Yield-Basis Method,
- (3) Fair Value Method,
- (4) Return on Capital Employed Method,
- (5) Price-Earnings Ratio Method.

1. Asset Backing Method: -Method / Net Asset Method:

This is also known as Balance Sheet Method or Intrinsic Method or Break-up Value Method or Valuation of Equity basis or Asset Backing Method. Here the emphasis is on the safety of investment as the investors always need safety for their investments. Under this method, net assets of the company are divided by the number of shares to arrive at the net asset value of each share.

The following points may be borne in mind

- (1) The value of goodwill will be ascertained.
- (2) Fixed assets of the company, disclosed or undisclosed in Balance Sheet, are taken at their realizable values.
- (3) Floating assets are to be taken at market value.
- (4) Remember to exclude fictitious assets, such as Preliminary Expenses, Accumulated
- (5) Provision for depreciation, bad debts provision etc. must be considered.
- (6) Find out the external liabilities of the company payable to outsiders including contingent liabilities, losses etc.

2. Yield Method:

Under the Net Asset Method, the weightage is given on the safety of the investment. One, who invests money on shares, always needs safety. Even if the return is low, safety is always looked upon. At the same time under the yield method, the emphasis goes to the yield that an investor expects from his investment. The yield, here we mean, is the possible return that an investor gets out of his holdings—dividend, bonus shares, right issue. If the return is more, the price of the share is also more. Under this method the valuation of shares is obtained by comparing the expected rate of return with normal rate of return.

3. Earning Capacity:

When someone is interested to have majority of shares of a company in order to have controlling interest in it, he makes use of earning capacity method for the purpose of valuation of shares. He is interested to know the disposable profits of the company. The profit is found out by deducting reserves and taxes from the net profit of the company.

ILLUSTRATION 17.

The following is the Balance sheet of X Ltd, as on 31st march 2019

Equity and Liabilities		Amount ₹
Equity shares capital of ₹10 each		16,00,000
Reserve Fund		3,00,000
10% debentures		4,00,000
creditors		4,00,000
Provision for tax		3,00,000
		30,00,000
Goodwill		2,00,000
Other fixed assets		24,00,000
Current assets		4,00,000
		30,00,000

On the above date, an independent valuation of goodwill and other fixed assets was made at ₹3,00,000, ₹30,00,000 respectively. Current assets include debtors of ₹2,00,000 of which 15% is bad. The net profit of the company for the past 3 years were ₹2,40,000, ₹2,80,000 and 3,05,000 of which 20% was placed to reserve. The normal rate of return is 10%. Calculate the value of a share by net assets and yield method. (KSLU II Semester 5 year B.Com. L.L.B. Examination December 2019)

SOLUTION**Step-1. Calculation of Intrinsic value**

Intrinsic value = Total value of assets - Liabilities		Amount ₹	Amount ₹
Goodwill			3,00,000
Other fixed assets			30,00,000
Current assets	4,00,000		
Less :- 15% bad debts on (2,00,000 × 15/100)	30,000		3,70,000
Total Market value of assets			36,70,000
Less:- Liabilities:-	4,00,000		
10% debentures	4,00,000		
Creditors	3,00,000		11,00,000
Provision for tax			
Intrinsic value assets			25,70,000

Step-2. Calculation of Amount available to Equity share holders

Particulars	Amount ₹	Amount ₹
Intrinsic value assets		25,70,000
Less- Preference share capital		-
Amount available to Equity share holders		25,70,000

Step-3. Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares = Amount available to equity share holders/Number of equity shares

$$= 25,70,000 / 1,60,000 = ₹ 16.06 \text{ per equity share.}$$
Calculation of value of shares under Yield method.**Step-1. Calculation of Average Profit**

Average Profit = $2,40,000 + 2,80,000 + 3,05,000 / 3 = 8,25,000 / 3 = ₹ 2,75,000$

Less :- Transfers to Reserve $(2,75,000 \times 20/100) = 55,000$

Therefore Adjusted average profit available to shareholders = ₹ 55,000

Step-2 .Calculation of capitalization of profits

Capitalization of profit = profit available to shareholders for dividend/Normal rate of return

$$= 55,000 / 10 \times 100 = ₹ 5,50,000$$
Step-3. Valuation of shares = Capitalization of Profit/Number of shares

$$= 5,50,000 / 1,60,000 = 3.43$$
ILLUSTRATION 18.

On March 31, 2015 the Balance Sheet of a Limited Company reveals the following position

Equity and Liabilities	Amount ₹
Issue capital of ₹10 per share	4,00,000
Reserve Fund	90,000
Profit and Loss account	20,000
5% debentures	1,00,000
Current Liabilities	1,30,000
	7,40,000
Fixed assets	5,00,000
Current Assets	2,00,000
Goodwill	40,000
	7,40,000

On March 31, 2015 the fixed assets were indecently valued at ₹3,50,000 and the goodwill at ₹50,000. The Net Profit for the Three years was 2012-13-₹51,600, 2013-14 ₹52,000, 2014-15- ₹51,650 of which 20% was placed under reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%. Compute the value of the company's shares by

(a) Net Assets method

(b) Yield method (KSLU III semester 5 year B.Com. L.L.B. Examination December 2018)

SOLUTION**Step-1. Calculation of Intrinsic value**

Intrinsic value = Total value of assets - Liabilities	Amount ₹	Amount ₹
Fixed assets		3,50,000
Goodwill		50,000
Current assets		2,00,000
Total Market value of assets		6,00,000

Valuation of Goodwill and Shares

4.25

Less:- Liabilities:-
5% debentures
Current Liabilities
Intrinsic value assets

1,00,000	
1,30,000	2,30,000
	3,70,000

Step-2. Calculation of Amount available to Equity share holders

Particulars	Amount ₹	Amount ₹
Intrinsic value assets		3,70,000
Less- Preference share capital		-
Amount available to Equity share holders		3,70,000

Step-3. Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares = Amount available to equity share holders / Number of equity shares

$$= 3,70,000 / 40,000 = ₹ 9.25 \text{ per equity share.}$$

Calculation of value of shares under Yield method.

Step-1 Calculation of Average Profit

$$\text{Average Profit} = 51,600 + 52,000 + 41,320 = 1,44,920 / 3 = ₹ 48,306.66$$

Less :- Transfers to Reserve 2014-15 - ₹51,650 of which 20% was placed under reserve (51,650 × 20/100) = 10,330 (51,650 - 10,330) = ₹ 41,320

Therefore Adjusted average profit available to shareholders = ₹ 48,306.66

Step-2 Calculation of capitalization of profits

Capitalization of profit = profit available to shareholders for dividend / Normal rate of return

$$= 48,306.66 / 10 \times 100 = 4,83,000 \text{ (Appr)}$$

Step-3. Valuation of shares = Capitalization of Profit / Number of shares

$$= 4,83,000 / 40,000 = 12.07$$

ILLUSTRATION 19.

On 31-03-2010 the Balance Sheet of Sanam Ltd was as follows

Share Capital	
5,000 shares of ₹100	5,00,000
Profit and Loss A/c	1,03,000
Bank Overdraft	20,000
Creditors	77,000
Provision for Tax	45,000
Proposed Dividend	75,000
	8,20,000
Land and Buildings	2,20,000
Plant and Machinery	95,000
Stock	3,50,000
Sundry Debtors	1,55,000
	8,20,000

4.26

Valuation of Goodwill and Shares

The net profits of the company after deducting all working charges and providing for depreciation and taxation were as under.

Financial year	Profit (₹)
2005-06	85,000
2006-07	96,000
2007-08	90,000
2008-09	1,00,000
2009-10	95,000

On 31-03-2010, Land and Building was revalued at ₹2,50,000, Plant and Machinery at ₹1,50,000 and goodwill at ₹1,50,000. The normal rate of return is 10%.

You are required to ascertain the value of Equity Shares under:

(i) Intrinsic Value method

(ii) Yield method

(iii) Fair value method

(BU, III Semester B.Com, Examination, November/December 2010)

SOLUTION**Step-1. Calculation of Intrinsic value**

Intrinsic value = Total value of assets - Liabilities	Amount ₹	Amount ₹
Land and Buildings		2,50,000
Plant and Machinery		1,50,000
Stock		3,50,000
Sundry Debtors		1,55,000
Goodwill		1,50,000
Total Market value of assets		10,55,000
Less:- Liabilities:-		
Bank Overdraft	20,000	
Creditors	77,000	
Provision for Tax	45,000	
Proposed Dividend	75,000	2,17,000
Intrinsic value assets		8,38,000

Step-2. Calculation of Amount available to Equity share holders

Particulars	Amount	Amount
Intrinsic value assets		8,38,000
Less- Preference share capital		-
Amount available to Equity share holders		8,38,000

Step-3. Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares = Amount available to equity share holders / Number of equity shares

$$= 8,38,000 / 5,000 = ₹ 167.6 \text{ per equity share.}$$

Valuation of Goodwill and Shares

4.27

Calculation of value of shares under Yield method.

Step-1. Calculation of Average Profit

$$\text{Average Profit} = 85,000 + 96,000 + 90,000 + 1,00,000 + 95,000 = 4,66,000 / 5 = 93,200$$

Therefore Adjusted average profit available to shareholders = 93,200

Step-2. Calculation of capitalization of profits

$$\text{Capitalization of profit} = \text{Profit available to shareholders for dividend} / \text{Normal rate of return} \\ = 93,200 / 10 \times 100 = ₹ 9,32,000$$

$$\text{Step-3. Valuation of shares} = \text{Capitalization of Profit} / \text{Number of shares} \\ = 9,32,000 / 5,000 = ₹ 186.4$$

ILLUSTRATION 20.

1. Following is the balance sheet of ABC company as on 31 March 2016:

Liabilities	
3,000 shares of ₹100 each	₹ 3,00,000
General reserve	50,000
Profit & loss account	25,000
Creditors	40,000
Provision for taxation	20,000
Provident fund	10,000
	4,45,000
Assets	
Land & Building	₹ 1,50,000
Machinery	1,00,000
Investment at cost (market value ₹ 40,000)	45,000
Debtors	1,00,000
Stock	40,000
Cash	10,000
	4,45,000

- Goodwill is taken at ₹50,000
- Depreciate machinery at 10% and increase Land & Building to ₹1,80,000
- Provide 8% towards bad debts.
- 20% is the normal rate of dividend declared by similar type of business on their paid up capital, however the company could declare only 18% dividend for the current year. Calculate the intrinsic value of shares of the company.

SOLUTION

Step-1. Calculation of Intrinsic value

Intrinsic value = Total value of assets–Liabilities	Amount ₹	Amount ₹
Land & Building		1,80,000
Machinery	1,00,000	
Less:- Depreciation at 10% (1,00,000×10/100)	10,000	90,000

Investment at cost	1,00,000	40,000
Goodwill	8,000	50,000
Debtors		90,000
Less:-Bad debts (1,00,000x8/100)		40,000
Stock		10,000
Cash		5,00,000
Total Market value of assets		
Less:-Liabilities:-	40,000	
Creditors	20,000	
Provision for Tax	10,000	70,000
Proposed Dividend		
Intrinsic value assets		4,32,000

Step-2 Calculation of Amount available to Equity share holders

Particulars	Amount	Amount
Intrinsic value assets		4,32,000
Less- Preference share capital		-
Amount available to Equity share holders		4,32,000

Step-3. Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares

= Amount available to equity share holders/Number of equity shares

= 4,32,000/3,000 = ₹ 144

ILLUSTRATION 21.

Following is the balance sheet of Santhosh Ltd as on 31 March 2013:

Liabilities	₹
4,000,6% preference shares of ₹10 each	40,000
16,000 Equity shares of ₹10 each	1,60,000
Reserve fund	1,00,000
Profit & Loss A/c	32,000
Workmen's savings A/c	30,000
Sundry Creditors	98,000
Total	4,60,000
Assets	₹
Buildings	1,10,000
Machinery	1,30,000
Patents	20,000
Stock	56,000
Sundry Debtors	80,000
Cash	52,000
Preliminary expenses	12,000
	4,60,000

(a) It was discovered that machinery was under depreciated by ₹10,000

(b) Value of Buildings is ₹ 2,60,000 and Goodwill is ₹40,000

Valuation of Goodwill and Shares

4.29

(c) ₹12,000 worth of debts are bad

(d) The preference shares have priority for capital repayment. Find out the intrinsic value of both types of shares.

SOLUTION

Step-1. Calculation of Intrinsic value

Intrinsic value = Total value of assets - Liabilities

	Amount ₹	Amount ₹
Buildings		2,60,000
Machinery	1,30,000	
Less: Depreciation (under depreciated)	10,000	1,20,000
Goodwill		40,000
Patents		20,000
Stock		56,000
Sundry Debtors	80,000	
Less: Bad Debts	12,000	68,000
Cash		52,000
Total Market value of assets		6,16,000
Less: Liabilities:-		
Workmen's savings A/C	30,000	
Sundry Creditors	98,000	1,28,000
Intrinsic value assets		4,88,000

Step-2 Calculation of Amount available to Equity share holders

Particulars	Amount ₹	Amount ₹
Intrinsic value assets		4,88,000
Less: 4,000, 6% Preference share capital 10 each		40,000
Amount available to Equity share holders		4,48,000

Step-3. Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares

= Amount available to equity share holders / Number of equity shares

= 4,48,000 / 16,000 = ₹28

Step-4. Calculation of Intrinsic value of Preference shares

Intrinsic value of Preference shares

= Amount available to Preference share holders / Number of equity shares

= 40,000 / 4,000 = ₹10

ILLUSTRATION 22.

Following is the balance sheet of AB Ltd. as on 31st March 2019:

Liabilities	
5,000 Equity shares of ₹100 each fully paid	₹ 10,00,000
Profit & Loss A/c	2,06,000
Bank Overdraft	40,000
Creditors	1,54,000
Provision for taxation	90,000
Proposed dividend	1,50,000
	16,40,000
Assets	
Land & Building	₹ 4,40,00
Plant & Machinery	1,90,000
Stock	7,00,000
Sundry Debtors	3,10,000
	16,40,000

The net profit of the company after deducting all working charges and providing for depreciation and taxation were as under:

Year	2015	2016	2017	2018	2019
profit	1,70,000	1,92,000	1,80,000	2,00,000	1,90,000

On 31-03-2019 Land and Buildings were valued at ₹ 5,00,000 and Plant & Machinery at ₹ 3,00,000. In view of the nature of the business it is considered that, 10% is a reasonable return on the tangible capital. For the purpose of valuation of shares, Goodwill is calculated at 5 years purchase of the super profits based on the average profits of the last 5 years. Calculate the Intrinsic value.

SOLUTION

Step-1. Calculation of Capital employed

Capital employed=Tangible Assets – Tangible Liabilities	Amount	Amount ₹
Land & Building		5,00,000
Plant & Machinery		3,00,000
Stock		7,00,000
Sundry Debtors		3,10,000
Total Market value of tangible assets		18,10,000
Less:-Tangible liabilities		
Bank overdraft		40,000
Creditors		1,54,000
Provision for taxation		90,000
Proposed dividend		1,50,000
Capital employed		13,76,000

Step-2 Calculation of Average capital employed

Average Capital employed= Total capital employed – 1/2 of the current year's profit.

Capital employed = ₹ 13,76,000

Valuation of Goodwill and Shares

4.31

Current year's profit

= ₹ 1,90,000

½ of the current year's profit = $1,90,000 \times 1/2$

= ₹ 95,000

Average capital employed = $13,76,000 - 95,000$

= ₹ 12,81,000

Step-3 Calculation of Average profit

Average Profit = $1,70,000 + 1,92,000 + 1,80,000 + 2,00,000 + 1,90,000$
 $= 9,32,000 / 5 = ₹ 1,86,400$

Step-4 Calculation of Normal Profit

Calculation of average Normal rate of return.

Average Normal rate of Return = 10%.

Normal Profit (return) = Average capital employed $\times$ percentage of normal rate of return
 $= 12,81,000 \times 10 / 100 = ₹ 1,28,100$

Step-5 calculation of Super profit

Super profit = Adjusted average profit - normal rate of return.

$= 1,86,400 - 1,28,100 = ₹ 58,300$

Step-6 calculation of goodwill under super profit method

Super profit $\times$ 4 years purchase = $58,300 \times 5 = ₹ 2,91,500$

Step-1. Calculation of Intrinsic value

Intrinsic value = Total value of assets - Liabilities	Amount ₹	Amount ₹
Goodwill		2,91,500
Land & Building		5,00,000
Plant & Machinery		3,00,000
Stock		7,00,000
Sundry Debtors		3,10,000
Total Market value of assets		21,01,500
Less:- Liabilities:-		
Bank overdraft	40,000	
Creditors	1,54,000	
Provision for taxation	90,000	
Proposed dividend	1,50,000	4,34,000
Intrinsic value assets		16,67,500

Step-2 Calculation of Amount available to Equity share holders

Particulars	Amount ₹	Amount ₹
Intrinsic value assets		16,67,500
Amount available to Equity share holders		16,67,500

Step-3 Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares

= Amount available to equity share holders/Number of equity shares

= 16,67,500/5,000 = ₹333.50.

ILLUSTRATION 23.

Following is the balance sheet of K Ltd as on 31st March 2002:

Liabilities		₹
15,000 Equity shares of ₹ 20 each fully paid		3,00,000
12,500 Equity shares of ₹ 20 each, ₹ 8 paid		1,00,000
7,500 Equity shares of ₹ 10 each, fully paid		75,000
5,000 Equity shares of ₹ 10 each, ₹ 5 paid		25,000
Reserves & surplus:		
General Reserve		2,25,000
Profit & Loss account		25,000
Current Liabilities:		
Creditors		1,00,000
Total		8,50,000
Assets		₹
Goodwill		12,500
Building		3,00,000
Machinery		1,87,500
Investments		25,000
Stock		1,50,000
Debtors		75,000
Bills receivables		25,000
Bank		65,000
Discount on issue of shares		10,000
Total		8,50,000

The Goodwill is valued at ₹7,500; Building at ₹6,00,000, Machinery at ₹1,50,000. Investments ₹17,500, Stock at ₹1,25,000, Debtors at ₹70,000. There was a contingent liability of ₹10,000. Determine the value of different shares.

SOLUTION**Step-1. Calculation of Intrinsic value**

Intrinsic value = Total value of assets - Liabilities	Amount ₹	Amount ₹
Goodwill		7,500
Building		6,00,000
Machinery		1,50,000
Investments		17,500
Stock		1,25,000
Debtors		70,000
Bills receivables		25,000
Bank		65,000
		10,60,000

Valuation of Assets

Total Market value of assets
Less: Liabilities-
Bank overdraft
Creditors
Contingent liability
Intrinsic value assets

4.33

Step-2 Calculation of Amount available to Equity share holders

Particulars		
-------------	--	--

Particulars	Amount ₹	Amount ₹
Intrinsic value assets		
Amount available to Equity share holders		9,50,000
		9,50,000

Step-3. Calculation of Total paid up capital

Particulars		
-------------	--	--

Particulars	Amount ₹	Amount ₹
15,000 Equity shares of ₹ 20 each fully paid		3,00,000
12,500 Equity shares of ₹ 20 each, ₹ 8 paid		1,00,000
7,500 Equity shares of ₹ 10 each, fully paid		75,000
5,000 Equity shares of ₹ 10 each, ₹ 5 paid		25,000
		5,00,000

Therefore unit value of capital = $9,50,000 / 5,00,000 = 1.9$

Step-3 Calculation of Intrinsic value of equity shares

15,000 Equity shares of ₹20 each fully paid = $20 \times 1.90 = 38$
12,500 Equity shares of ₹20 each, ₹8 paid = $8 \times 1.9 = 15.20$
7,500 Equity shares of ₹10 each, fully paid = $10 \times 1.9 = 19.00$
5,000 Equity shares of ₹10 each, ₹5 paid = $5 \times 1.90 = 9.50$

ILLUSTRATION 24.

Following is the balance sheet of Weak Ltd as on 31st March 2002:

Liabilities		₹
10,000, 6% Preference shares of ₹10 each, fully paid		1,00,000
30,000 Ordinary shares of ₹ 10 each, fully paid		3,00,000
Debenture redemption fund		30,000
7% Debentures		50,000
Depreciation fund		30,000
Sundry creditors		1,00,000
Total		6,10,000
Assets		₹
Sundry Assets		5,10,000
Discount on debenture		10,000
Preliminary expenses		30,000
Profit & Loss A/c		60,000
Total		6,10,000

The sundry assets are worth ₹5,25,000. One Year's interest owes on debentures and the dividend on Preference shares are in arrears for 2 years. You are required to value the shares on the Net Asset method If:

- Preference shares have priority both as to the payment of capital and arrears of dividend, in the event of liquidation.
- Preference shares have no priority as to capital or arrears of dividend.
- Preference shares have no priority as to payment of capital only.
- Preference shares have no priority as to the payment of arrears of dividend only.

SOLUTION

(a) Preference shares have priority both as to the payment of capital and arrears of dividend, in the event of liquidation.

Step-1. Calculation of Intrinsic value

Intrinsic value = Total value of assets-Liabilities	Amount ₹	Amount ₹
Sundry Assets		5,25,000
Total Market value of assets		5,25,000
Less:-Liabilities:-		
7% Debentures	50,000	
Depreciation fund	30,000	
Sundry creditors	1,00,000	1,80,000
Intrinsic value assets		3,45,000

Step-2 Calculation of Amount available to Equity share holders

Particulars	Amount ₹	Amount ₹
Intrinsic value assets		3,45,000
Less:-10,000,6% Preference share capital	1,00,000	
Less- arrears of Dividend 10,000, 6% Preference share capital 10 each (1,00,000x6/100x2 years)	12,000	1,12,000
Amount available to Equity share holders		2,33,000

Step-3. Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares

$$= \text{Amount available to equity share holders} / \text{Number of equity shares}$$

$$= 2,33,000 / 30,000 = ₹7.76$$

(b) Preference shares have no priority as to capital or arrears of dividend

Calculation of Amount available to Equity share holders

Particulars	Amount	Amount
Intrinsic value assets		3,45,000
Preference shares have no priority as to capital or arrears of dividend		Nil
Amount available to Equity share holders		3,25,000

3 Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares

$$= \text{Amount available to equity share holders} / \text{Number of equity shares}$$

$$= 3,25,000 / 30,000 = ₹10.83$$

(c) Preference shares have no priority as to payment of capital only.

Calculation of Amount available to Equity share holders

Particulars		Amount
Intrinsic value assets		
Less- arrears of Dividend 10,000, 6% Preference share capital 10 each		3,45,000
(1,00,000 × 6 / 100 × 2 years)	12,000	12,000
Amount available to Equity share holders		3,33,000

Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares

$$= \text{Amount available to equity share holders} / \text{Number of equity shares}$$

$$= 3,33,000 / 30,000 = ₹11.10$$

(d) Preference shares have no priority as to the payment of arrears of dividend only.

Calculation of Amount available to Equity share holders

Particulars		Amount
Intrinsic value assets		
Less- 10,000, 6% Preference share capital 10 each	1,00,000	3,45,000
Amount available to Equity share holders		1,00,000
		2,45,000

Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares

$$= \text{Amount available to equity share holders} / \text{Number of equity shares}$$

$$= 2,45,000 / 30,000 = ₹8.166$$

ILLUSTRATION 25.

From the following information, Calculate the value of an Equity share under Yield method:

- The paid up share capital of a company consists of 1,000, 15% Preference shares of ₹ 100 each and 20,000 Equity shares of ₹10 each
- The average annual profit of the company, after providing for depreciation and taxation amounted to ₹75,000. It is considered necessary to transfer ₹ 10,000 to general reserve before declaring dividend.
- The normal return expected by investors on Equity shares from this type of business carried on by the company is 10%.

SOLUTION.

Calculation of value of shares under Yield method.

Step-1 Calculation of Average Profit

Average Profit after providing for depreciation and taxation amounted tot = 75,000

Less:- to transfer to general reserve

10,000

Adjusted average profit

65,000

Therefore Adjusted average profit available to shareholders = 65,000

Step-2 Calculation of capitalization of profits

Capitalization of profit

$$= \text{Profit available to shareholders for dividend / Normal rate of return}$$

$$= 65,000 / 10 \times 100 = 6,50,000$$

Step-3 Valuation of shares = Capitalization of Profit / Number of shares

$$= 6,50,000 / 20,000 = 32.50$$

ILLUSTRATION 26.

Compute the value of shares by :

(a) Net Asset Method

(b) Yield method

Following is the Balance sheet of MN limited Company as on 31-03-2019

Liabilities	
40,000 Shares of ₹10 each	4,00,000
Reserve fund	50,000
Profit & Loss Account	25,000
5% Debenture	50,000
Creditors	1,50,000
Provision for tax	50,000
Total	7,25,000
Goodwill	25,000
Fixed Assets	5,00,000
Current assets	2,00,000
Total	7,25,000

On 31.03.2019 fixed assets were valued at ₹ 6,00,000 and Goodwill at ₹ 37,500. The Net profits in the last 3 years were ₹37,500; ₹39,000; and ₹ 43,500 of which 20% was placed to reserve. The rate of return is 10%.

SOLUTION**Step-1. Calculation of Intrinsic value**

Intrinsic value = Total value of assets - Liabilities	Amount	Amount
Fixed Assets		6,00,000
Goodwill		37,500
Current assets		2,00,000
Total Market value of assets		8,37,500
Less:-Liabilities:-		
5% Debenture	50,000	
Creditors	1,50,000	
Provision for tax	50,000	2,50,000
Intrinsic value assets		5,87,500

(a) Net Asset Method**Calculation of Intrinsic value of equity shares**

Intrinsic value of equity shares

$$= \text{Amount available to equity share holders / Number of equity shares}$$

$$= 5,87,500 / 40,000 = ₹14.67$$

(b) Yield method

Calculation of value of shares under Yield method.

Step-1 Calculation of Average Profit

$$\text{Average Profit} = 37,500 + 39,000 + 43,500 = 1,20,000/3$$

Less:- transfer to reserve $(40,000 \times 20/100)$

40,000

Adjusted average profit

8,000

Therefore Adjusted average profit available to shareholders = 32,000

32,000

Step-2. Calculation of capitalization of profits

$$\begin{aligned} \text{Capitalization of profit} &= \text{Profit available to shareholders for dividend/Normal rate of return} \\ &= 32,000/10 \times 100 = 3,20,000 \end{aligned}$$

$$\begin{aligned} \text{Step-3 Valuation of shares} &= \text{Capitalization of Profit/Number of shares} \\ &= 3,20,000/40,000 = 8 \end{aligned}$$

ILLUSTRATION 27.

The following figure were extracted from the books of Zee Ltd:

Share Capital	
9% preference shares of ₹ 100 each	
1,000 Equity shares of ₹ 100 each, ₹ 50 called up	₹ 6,00,000
1,000 Equity shares of ₹ 100 each, ₹ 25 called up	1,00,000
1,000 Equity shares of ₹ 100 each, fully called up	50,000
Reserves & Surplus	2,00,000
General reserve	
Profit & Loss account	4,00,000
	1,00,000

On a fair valuation of all the assets of the company, it is found that they have an appreciation of ₹ 1,50,000. The articles of association provided that, in case of liquidation, the preference shareholders will have a further claim to the extent of 10% of the surplus assets. Ascertain the value of Preference and equity shares & intrinsic value of partly paid shares.

SOLUTION

(Liability Based Approach)
Calculation of Total value of Assets

Total assets = Share capital + Reserves and surplus		₹	₹
Share Capital			
9% preference shares of ₹ 100 each		6,00,000	
2,000 Equity shares of ₹ 100 each, ₹ 50 called up		1,00,000	
2,000 Equity shares of ₹ 100 each, ₹ 25 called up		50,000	9,50,000
2,000 Equity shares of ₹ 100 each, fully called up		<u>2,00,000</u>	
Add:- Reserves & Surplus			
General reserve		4,00,000	<u>5,00,000</u>
Profit & Loss account		<u>1,00,000</u>	14,50,000
Add:- Appreciation in value of assets			<u>1,50,000</u>
Add:- Calls in advance			16,00,000
2,000 Equity shares of ₹ 100 each, ₹ (Balance 50 called up and fully paid up (1,000x50)		1,00,000	
2,000 Equity shares of ₹ 100 each, (Balance ₹ 75 called up and paid up (1,000x75)		<u>1,50,000</u>	2,50,000

Total amount available to Share holders

Less:- 9% preference shares of ₹ 100 each

Less:- Equity share Capital (2,000 Equity shares of ₹ 100 each, fully paid
2,000 Equity shares of ₹ 100 each, fully paid (2,00,000 + 2,00,000 + 2,00,000 +

Surplus available after paying share capitals

Less:- preference shareholders will have a further claim to the extent of 10% of
the surplus assets Ascertain (6,50,000 × 10/100)

Surplus available to equity shareholders

18,50,000
6,00,000
12,50,000
6,00,000
6,50,000
65,000
5,85,000

Calculation of Intrinsic value of equity shares

Intrinsic value of equity shares

= Amount available to equity share holders / Number of equity shares

(Surplus available to equity shareholders + paid up share capital) (5,85,000 + 6,00,000)

= 11,85,000 / 3,000 = 395

Calculation of intrinsic value of partly paid equity shares

= Intrinsic value of fully paid per equity shares - uncalled money on equity shares capital.

(a) Intrinsic value of 2,000 Equity shares of ₹ 100 each, fully called up and paid up = ₹ 395.

(b) Intrinsic value 2,000 Equity shares of ₹ 100 each, ₹ 50 called up (395 - 50) = ₹ 345

(c) Intrinsic value 2,000 Equity shares of ₹ 100 each, ₹ 25 called up (395 - 75) = ₹ 325

Note: Always it is advisable to assume / call up partly paid shares to fully paid shares for easy calculation of intrinsic value of Equity Shares.

ILLUSTRATION 28.

Following information relates to AXN Ltd:

80,000, 10% Preference Shares of ₹ 10 each	8,00,000
1,00,000 Equity shares of ₹ 10 each	10,00,000
Average profit before tax	6,45,160
Rate of tax	38%
Transfer to be made to reserve	20%
Normal rate of return	15%

Ascertain the value of Equity shares under Yield method.

SOLUTION

Step-I

Calculation of value of shares under Yield method

Average profit before tax	6,45,160
Less:- Tax @ 38% (6,45,160 × 38/100)	2,45,160
	4,00,000
Less:- Transfer to reserve at 20% (4,00,000 × 20/100)	80,000
Less:- 80,000, 10% Preference Shares Dividend	3,20,000
8,00,000 × 10/100	80,000
Adjusted Average profit available to equity shares	2,40,000

Step-2 Calculation of capitalization of profits

Capitalization of profit = Profit available to shareholders for dividend / Normal rate of return
= 2,40,000 / 15 × 100 = 16,00,000

Step-3 Valuation of shares = Capitalization of Profit / Number of shares = 16,00,000 / 1,00,000 = 16

Exercise

4.39

1. On 1st April 2019, a firm had assets of ₹ 6,00,000 including Cash of ₹10,000. The Partner's Capital A/c showed a balance of ₹ 4,00,000 & the Reserve Constituted the rest. If the normal rate of return of is 10% and the goodwill of the firm is valued at ₹4,00,000 at four years purchase of Super Profit. Find the average Profit of the firm. (Hint:- Average Profit = Super Profit + Normal Profit)

2. Calculate value of goodwill of the firm-

- At 3 years purchase of Average Profit
- At 3 year's purchase of Super Profit
- On the basis of Capitalization of Super Profit
- On the basis of Capitalization of Average Profit

(i) Average capital Employed is ₹2,40,000

(ii) Net Profit/(Loss) of the firm for the last 3 year sending are:

31st March 2019	80,000
31st March 2018	72,000
31st March 2017	64,000

(iii) Normal Rate of return in similar business is 10 %

(iv) Remuneration of ₹ 40,000 to partners is to be taken as charge against profit.

(v) Assets of the firm (excluding goodwill) fictitious assets and Non-trade investments) is ₹ 2,80,000 where as Partner's Capital is ₹ 2,40,000 & outside liabilities ₹ 40,000

3. Shweta purchased a business on 1st April 2019. It was agreed to value goodwill at three years purchase of average normal profits of last 4 years. The Profits are as follows:

Year Ended	Profits
31st March 2016	₹90,000
31st March 2017	₹1,60,000
31st March 2018	₹1,80,000
31st March 2019	₹2,20,000

- During the year ended 31/March/2016, an asset was sold at a profit of ₹ 10,000
- During the year ended 31/March/2017, firm had incurred a abnormal loss of ₹ 20,000
- Repairs to car amounting to ₹ 50,000 was wrongly debited to vehicles on 1st May 2017. Depreciation charged on vehicles @ 10 % on straight line Method
- Firm had abnormal gain of ₹10,000 during the year ended 31 March 2019.

During the year ended 31 March 2019, a machine got destroyed in accident & ₹ 30,000 was written off as loss in Profit & Loss Account

4. Average Profit of the firm is ₹ 1,50,000. Total tangible assets in the firm are ₹ 12,00,000 & outside liabilities are ₹ 7,00,000. In the same type of business, the normal rate of return

is 20%. Calculate the value of goodwill of the firm by Capitalization of Super Profit method if the goodwill is valued at 2 years. Purchase of Super Profit.

Balance Sheet of M/s Lax Stores as at 31/3/2019 was as follows

Liabilities	
40,000 Shares of ₹10 each	
Reserve fund	1,00,000
Profit & Loss Account	20,000
5% Debenture	10,000
Creditors	20,000
Provision for tax	60,000
Total	2,90,000
Goodwill	2,90,000
Fixed Assets	10,000
Current assets	2,00,000
Total	80,000
	2,90,000

On 31.03.2019 fixed assets were valued at ₹2,40,000 and Goodwill at ₹ 15,000. The Net profits for the last 3 years were ₹15,000; ₹15,600; and ₹ 17,400 of which 20% was placed to reserve. The rate of return is 10%.

5. The net profit of a business, after providing for taxation, for the past 5 years are; ₹ 4,00,000, ₹ 4,25,000, ₹ 4,60,000, ₹ 5,25,000, and 5,90,000. The capital employed in the business is ₹40,00,000. The normal rate of return expected in this type of business is 10%. It is expected that the company will be able to maintain its super profit for the next 5 years. Calculate the value of goodwill on the basis of:
- 5 year's purchase of super profit method
 - Annuity method, taking the present value of annuity of ₹ 1 for 5 years at 10% as 3.79 and
 - Capitalization of super profit method.

Following is the balance sheet of Weak Ltd as on 31 March 2020:

Liabilities	
10,000, 6% Preference shares of ₹10 each, fully paid	2,50,000
30,000 Ordinary shares of ₹ 10 each, fully paid	7,50,000
Debenture redemption fund	75,000
7% Debentures	1,25,000
Depreciation fund	75,000
Sundry creditors	2,50,000
Total	15,25,000
Assets	
Sundry Assets	12,75,000
Discount on debenture	25,000
Preliminary expenses	75,000
Profit & Loss A/c	1,50,000
	15,25,000

The sundry assets are worth ₹13,12,500s. One Year's interest owes on debentures and the

dividend on Preference shares are in arrears for 2 years. You are required to value the shares on the Net Asset method If:

- (a) Preference shares have priority both as to the payment of capital and arrears of dividend, in the event of liquidation.
 - (b) Preference shares have no priority as to capital or arrears of dividend.
 - (c) Preference shares have no priority as to payment of capital only.
 - (d) Preference shares have no priority as to the payment of arrears of dividend only.
6. Following information relates to AXN Ltd:

80,000, 10% Preference Shares of ₹10 each	8,00,000
1,00,000 Equity shares of ₹10 each	10,00,000
Average profit before tax	6,45,160
Rate of tax	38%
Transfer to be made to reserve	20%
Normal rate of return	15%

Ascertain the value of Equity shares under Yield method.

◆ ◆ ◆

The header graphic for Unit 5 features a collage of images: a laptop displaying a website, a coffee cup, a hand pointing upwards, and a stylized figure climbing a staircase. The text 'UNIT 5' is prominently displayed in the top right corner. Below the graphic, the title 'COMPANY FINAL ACCOUNTS' is written in a large, bold, serif font.

UNIT 5

COMPANY FINAL ACCOUNTS

Learning Outcomes

After studying this chapter, you will be able to:

- To Determine gross profit and net Profit of business during the year
- To Present the Annual Report with fair financial position of the business on a given date.
- To provide information about the resources available with business (i.e. production capacity, labour hours, cash reserves, inventory, WIP percentage, delivery mechanism, etc.) and its usage parameters. It also gives information about changes in the resources between two periods.¹

Contents

- Schedule III for financial statements as per Ind AS Background
- Overview of the revised Schedule III – Division II
- Applicability
- Balance sheet
- Statement of profit and loss
- General Instructions for Preparation of Balance Sheet
- General Instructions for Preparation of Statement of Profit and Loss
- Profit & Loss A/c of a Company as per Revised Schedule III of the Companies Act 2013
- Illustrations
- Exercises

Abstract : Indian Accounting Standards, Statement of Profit & Loss A/c, Balance Sheet, Companies Act, 2013, Liabilities & Assets.

Schedule III for financial statements as per Ind AS Background

The Schedule III to the Companies Act, 2013 (2013 Act) provides general instructions for preparation of the balance sheet and the statement of profit and loss of a company.

The Ministry of Corporate Affairs (MCA) issued a road map for implementation of the Indian Accounting Standards (Ind AS) converged with the International Financial Reporting Standards (IFRS):

Source : www.educba.com/objectives-of-financial-statements/

5.2

- On 16th February 2015 by companies other than insurance companies, banking companies and Non-Banking Financial Companies (NBFCs) (corporate road map) in a phased manner commencing from accounting periods beginning on or after 1st April 2015
- On 30th March 2016 by banking companies, insurance companies and NBFCs in a phased manner commencing from accounting periods beginning on or after 1st April 2016

Overview of the revised Schedule III – Division II

Division II of the Schedule III provides instructions for preparation of financial statements and additional disclosure requirements for companies required to comply with Ind AS. The following is an overview of the Division II of the Schedule III:

Applicability

- It is applicable to every company to which Ind AS apply in preparation of its financial statements.
- The provisions of Schedule III also apply when a company is required to prepare consolidated financial statements, in addition to the disclosure requirements specified under Ind AS.

Balance Sheet

- Schedule III provides a format of the balance sheet and sets out the minimum requirements of disclosure on the face of the balance sheet
- Items presented in the balance sheet are to be classified as current and non-current.
- Schedule III does not permit companies to avail of the option of presenting assets and liabilities in the order of liquidity, as provided by Ind AS 1, *Presentation of Financial Statements*.

Statement of Profit and Loss

- Schedule III provides a format of the statement of profit and loss and sets out the minimum requirements of disclosure on the face of the statement of profit and loss.

The statement of profit and loss is to be presented in accordance with the nature of expenses and would include profit or loss for the period and other comprehensive income for the period

General Instructions for Preparation of Balance Sheet

- An asset shall be classified as current when it satisfies any of the following criteria:—
 - It is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;¹
 - It is held primarily for the purpose of being traded;
 - It is expected to be realized within twelve months after the reporting date; or
 - It is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non-current.

2. An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of twelve months.
3. A liability shall be classified as current when it satisfies any of the following criteria:—
 - (a) It is expected to be settled in the company's normal operating cycle;
 - (b) It is held primarily for the purpose of being traded;
 - (c) It is due to be settled within twelve months after the reporting date; or
 - (d) The company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counter party, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities shall be classified as non-current.

4. A receivable shall be classified as a "trade receivable" if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
5. A payable shall be classified as a "trade payable" if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.
6. A company shall disclose the following in the notes to accounts.

A. Share Capital

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

- (a) The number and amount of shares authorized;
- (b) The number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
- (c) Par value per share;
- (d) A reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;
- (e) The rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;
- (f) Shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
- (g) Shares in the company held by each share holder holding more than 5 per cent shares specifying the number of shares held;
- (h) Shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;
- (i) For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
 - (i) Aggregate number and class of shares allotted as fully paid-up pursuant to contract(s) without payment being received in cash.

- (ii) Aggregate number and class of shares allotted as fully paid-up by way of transfer of shares.
- (iii) Aggregate number and class of shares bought back.
- (j) Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date;
- (k) Calls unpaid (showing aggregate value of calls unpaid by directors and officers);
- (l) Forfeited shares (amount originally paid-up).

B. Reserves and Surplus

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

C. Long-term Borrowings

- (i) Long-term borrowings shall be classified as:
 - (a) Bonds/debentures;¹
 - (b) Term loans:
 - (A) From banks.
 - (B) From other parties.

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

D. Other Long-term Liabilities

Other Long-term Liabilities shall be classified as:

- (a) Trade payables;
- (b) Others.

E. Long-term Provisions

The amounts shall be classified as:

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

F. Short-term Borrowings

(i) Short-term borrowings shall be classified as:

- (a) Loans repayable on demand;
 - (A) From banks.
 - (B) From other parties.
- (b) Loans and advances from related parties;
- (c) Deposits;
- (d) Other loans and advances (specify nature).

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

G. Other Current Liabilities¹

The amounts shall be classified as:

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

H. Short-term Provisions

The amounts shall be classified as:

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

1. Tangible Assets

(i) Classification shall be given as:

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

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

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

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

1. Intangible Assets

(i) Classification shall be given as:

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

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

- (iii) Where sums have been written-off on a reduction of capital or revaluation of assets, every balance sheet subsequent to the date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.¹

K. Non-current Investments

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

L. Long-term Loans and Advances

- (i) Long-term loans and advances shall be classified as:
- Capital Advances;
 - Security Deposits;
 - Loans and advances to related parties (giving details thereof);
 - Other loans and advances (specify nature).

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

M. Other non-current Assets

Other non-current assets shall be classified as:

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

N. Current Investments

- (i) Current investments shall be classified as:
 - (a) Investments in Equity Instruments;
 - (b) Investment in Preference Shares;
 - (c) Investments in Government or trust securities;
 - (d) Investments in debentures or bonds;
 - (e) Investments in Mutual Funds;
 - (f) Investments in partnership firms;
 - (g) Other investments (specify nature). Under each classification, details shall be given of names of the bodies corporate [indicating separately whether such bodies are:
 - (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities] in whom investments have been made and the nature and extent of the

investment so made in each such body corporate (showing separately investments which are partly paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the share of each partner) shall be given.

- (ii) The following shall also be disclosed:
 - (a) The basis of valuation of individual investments;
 - (b) Aggregate amount of quoted investments and market value thereof;
 - (c) Aggregate amount of unquoted investments;
 - (d) Aggregate provision made for diminution in value of investments.¹

O. Inventories

- (i) Inventories shall be classified as:
 - (a) Raw materials;
 - (b) Work-in-progress;
 - (c) Finished goods;
 - (d) Stock-in-trade (in respect of goods acquired for trading);
 - (e) Stores and spares;
 - (f) Loose tools;
 - (g) Others (specify nature).
- (ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.
- (iii) Mode of valuation shall be stated.²

P. Trade Receivables

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

Cash and Cash Equivalents

Cash and cash equivalents shall be classified as:

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

Short-term Loans and Advances

Short-term loans and advances shall be classified as:

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

Other Current Assets (Specify Nature)

This is an all-inclusive heading, which incorporates current assets that do not fit into any other categories.

Contingent Liabilities and Commitments (To the extent not provided for)

- (i) Contingent liabilities shall be classified as:
 - (a) Claims against the company not acknowledged as debt;
 - (b) Guarantees;
 - (c) Other money for which the company is contingently liable.

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(ii) Commitments shall be classified as:

- (a) Estimated amount of contracts remaining to be executed on capital account and not provided for;
- (b) Uncalled liability on shares and other investments partly paid;
- (c) Other commitments (specify nature).

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

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

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

General Instructions for Preparation of Statement of Profit and Loss

1. The provisions of this Part shall apply to the income and expenditure account referred to in sub-clause (ii) of clause (40) of section 2 in like manner as they apply to a statement of profit and loss.
2. (A) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes, revenue from—
 - (a) Sale of products;
 - (b) Sale of services;
 - (c) Other operating revenues; Less:
 - (d) Excise duty.¹(B) In respect of a finance company, revenue from operations shall include revenue from—
 - (a) Interest; and
 - (b) Other financial services. Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.
3. Finance Costs
Finance costs shall be classified as:
 - (a) Interest expense;
 - (b) Other borrowing costs;
 - (c) Applicable net gain/loss on foreign currency transactions and translation.

4. Other income

Other income shall be classified as:

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

5. Additional Information

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

- (i) (a) Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses].
- (b) Depreciation and amortisation expense;
- (c) Any item of income or expenditure which exceeds one per cent of the revenue from operations or ₹ 1,00,000, whichever is higher;
- (d) Interest Income;
- (e) Interest expense;
- (f) Dividend income;
- (g) Net gain/loss on sale of investments;
- (h) Adjustments to the carrying amount of investments;
- (i) Net gain or loss on foreign currency transaction and translation (other than considered as finance cost);
- (j) Payments to the auditor as (a) auditor; (b) for taxation matters; (c) for company law matters; (d) for management services; (e) for other services; and (f) for reimbursement of expenses;
- (k) In case of Companies covered under section 135, amount of expenditure incurred on corporate social responsibility activities;
- (l) Details of items of exceptional and extraordinary nature;
- (m) Prior period items;
- (ii) (a) In the case of manufacturing companies—
 - 1. Raw materials under broad heads.
 - 2. Goods purchased under broad heads.
- (b) In the case of trading companies, purchases in respect of goods traded in by the company under broad heads.
- (c) In the case of companies rendering or supplying services, gross income derived from services rendered or supplied under broad heads.

- (d) In the case of a company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if purchases, sales and consumption of raw material and the gross income from services rendered is shown under broad heads.
- (e) In the case of other companies, gross income derived under broad heads.
- (iii) In the case of all concerns having works in progress, works-in-progress under broad heads.
- (iv) (a) The aggregate, if material, of any amounts set aside or proposed to be set aside, by reserve, but not including provisions made to meet any specific liability, by contingency or commitment known to exist at the date as to which the balance sheet is made up.
- (b) The aggregate, if material, of any amounts withdrawn from such reserves.
- (v) (a) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.
- (b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.
- (vi) Expenditure incurred on each of the following items, separately for each item:—
 - (a) Consumption of stores and spare parts;
 - (b) Power and fuel;
 - (c) Rent;
 - (d) Repairs to buildings;
 - (e) Repairs to machinery;
 - (f) Insurance;
 - (g) Rates and taxes, excluding, taxes on income;
 - (h) Miscellaneous expenses,
- (vii) (a) Dividends from subsidiary companies.
- (b) Provisions for losses of subsidiary companies.
- (viii) The profit and loss account shall also contain by way of a note the following information, namely:—
 - (a) Value of imports calculated on C.I.F basis by the company during the financial year in respect of—
 - 1. Raw materials;
 - 2. Components and spare parts;¹
 - 3. Capital goods;
 - (b) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;
 - (c) Total value if all imported raw materials, spare parts and components consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;

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

Note: Broad heads shall be decided taking into account the concept of materiality and presentation of true and fair view of financial statements.

ILLUSTRATION 1.

From the following extract of Ledger Balances taken from XYZ Ltd, for the year ending 31-03-2019 prepare a statement of Profit and Loss account.

Particulars	Amount ₹
Revenue from Operations	1,96,000
Other Incomes	4,000
Advertising	10,500
Salaries	54,000
Depreciation	5,600
Insurance	2,000
Interest on debentures	2,000
Preliminary expenses written off	2,000
Bad debts	1,000
Discount	1,000
Printing and stationery	2,000
Cost of materials consumed	50,000

SOLUTION:

Name of the Company...XYZ LTD.

Profit and loss statement for the year ended 31-03-2019

I. Revenue from operations	1,96,000
II. Other income	4,000
III. Total Revenue (I + II)	2,00,000
IV. Expenses:	50,000
Cost of materials consumed	—
Purchases of Stock-in-Trade	—
Changes in inventories of finished goods, work-in-progress and Stock-in-Trade	—
Employee benefits expense	54,000
Finance costs	2,000
Depreciation and amortization expense	5,600
Other expenses	18,500
Total expenses	81,100
V. Profit before exceptional and extraordinary items and tax (III-IV)	

Other expenses

Particulars	Amount ₹
Advertising	10,500
Insurance	2,000
Preliminary expenses written off	2,000
Bad debts	1,000
Discount	1,000
Printing and stationery	2,000
	18,500

Problems on Profit & Loss A/c of a Company as per Revised Schedule III of the Companies Act 2013**FORMAT OF P & L Account**P & L Account of Company Limited for the year ended 31st March.....

Particulars	Note No	Amount
(I) Revenue from Operations		0000
(II) Other Income		0000
(III) Total revenue (I + II)		0000
(IV) Expenses:		
(a) Material Consumed		0000
(b) Purchases		0000
(c) Changes in Inventories (Finished goods, work-in-progress & stock-in-trade)		0000
(d) Employees benefit expenses		0000
(e) Finance Cost		0000
(f) Depreciation and Amortization Exp		0000
(g) Other Expenses		0000
Total Expenses		0000
(V) Profit & Loss before Tax (III-IV)		0000
(VI) Provision for Tax		0000
(VII) Profit Loss after Tax (V-VI)		0000

EXPLANATION

- I. Revenue from operations (Cash sales+Credit sales Less Sales returns Less Excise Duty) II Other Income (All incomes other than sales)
- II. Total Revenue (I+II)
- III. Expenses
 - (a) Cost of materials consumed (it given specifically; No need to calculate if not given)
 - (b) Purchases of stock-in-trade (purchases)

Company Final Accounts

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- (c) Changes in inventories of finished goods, work-in-progress & stock-in-trade. (Opening stock less closing stock)
- (d) Employees Benefits Expenses (salaries, wages, canteen expenses, all their employee welfare expenses, PF contribution of the employer)
- (e) Finance cost (Interest on borrowings)
- (f) Depreciation & Amortisation expenses (Dep. On fixed tangible assets & amortisation of intangible asset)
- (g) Other expenses (All other revenue expenses & losses + loss by theft/fire etc.)

ILLUSTRATION 2.

You are given the following information from the books of Siraj Co. Ltd., as on 31st March 2018.

Sindhu Co. Ltd

Trial Balance as on 31st March, 2018

Particulars	Amount ₹	Particulars	Amount ₹
Depreciation on premises	4,000	Sales	6,20,000
Materials Consumed	4,00,000	Equity Share Capital	4,00,000
Opening Stock	20,000	Outstanding wages	3,000
Salaries	57,000		
Bad debts	1,900		
Bonus to employees	10,000		
Interest on Loan	8,000		
Depreciation on machinery	9,000		
Conveyance	2,000		
Loss on sale of machinery	10,000		
Insurance	8,100		
Sales Returns	20,000		
Provision for Tax	30,000		
Machinery	3,00,000		
P. F. Contribution	43,000		
Premises	80,000		
Computer	20,000		
	10,23,000		10,23,000

Additional information:

Closing stock was valued at ₹ 60,000.

SOLUTION:

Sindhu Co. Ltd

Statement of Profit and Loss as on 31st March, 2018

	Note No	Amount ₹
(I) Revenue from Operations		
(II) Other Income		
(III) Total revenue (I + II)	1	6,00,000

(IV) Expenses:	
(a) Material Consumed	
(b) Purchases	
(c) Changes in Inventories	
(d) Employees benefit expenses	
(e) Finance Cost	
(f) Depreciation and Amortization Exp	
(g) Other Expenses	
Total Expenses	
(V) Profit & Loss before Tax (III-IV)	
(VI) Provision for Tax	
(VII) Profit Loss after Tax (V-VI)	

2
3
4
56,00,000
4,00,000
Nil
(40,000)
1,10,000
8,000
13,000
22,000
5,13,000
87,000
(30,000)
57,000**Notes:**

1. Revenue from Operations	
Sales	6,20,000
Less Sales Returns	<u>20,000</u>
	6,00,000
2. Changes in Inventories	
Opening Stock	20,000
Less Closing Stock	<u>(60,000)</u>
	(40,000)
3. Employees benefit expenses	
Salaries	57,000
PF Contribution	43,000
Bonus to employees	<u>10,000</u>
	1,10,000
4. Depreciation & Amortisation	
Depreciation on premises	4,000
Depreciation on machinery	<u>9,000</u>
	13,000
5. Other Expenses	
Bad debts	1,900
Conveyance	2,000
Loss on sale of machinery	10,000
Insurance	<u>8,100</u>
	22,000

ILLUSTRATION 3.

From the following Trial balance of Gladys Co. Ltd., as on 31st March 2019 Prepare a statement of P & L Account as per schedule III of the companies Act.

Gladys Co. Ltd.
Trial Balance as on 31st March, 2015

Particulars	Amount ₹	Particulars	Amount ₹
Interest on Debentures	16,200	Share Transfer Fees	7,500
Travelling Expenses	10,200	12% Debentures	1,35,000
Delivery van expenses	2,550	Commission received	

Company Final Accounts

	3,250	Sales	5.19
Bad Debts	3,500	Share Capital	3,700
Discount	1,57,900		3,22,750
Purchases	36,000		2,50,000
Opening Stock	4,200		
Freight outward	2,500		
Free samples	19450		
Depreciation	5,700		
Showroom expenses	79,300		
Bank balance	46,500		
Wages	2,00,000		
Land & Building	72,500		
Office Equipment	3,000		
Insurance	61,300		
Furniture			
Total	7,18,950	Total	7,18,950

Additional Information:

Closing stock was valued at ₹ 42,750

SOLUTION :

Glady Co. Ltd. Statement of Profit and Loss as on 31st March, 2019

Particulars	Note No	Amount ₹
(I) Revenue from Operations	1	3,22,750
(II) Other Income		<u>11,200</u>
(III) Total revenue (I + II)		<u>3,33,950</u>
(IV) Expenses:		
(a) Material Consumed	2	Nil
(b) Purchases		1,57,900
(c) Changes in Inventories		(6,650)
(d) Employees benefit expenses		46,500
(e) Finance Cost	3	16,200
(f) Depreciation and Amortization Exp		19450
(g) Other Expenses		29,800
Total Expenses		2,63,200
(V) Profit & Loss before Tax (III-IV)		70,750
(VI) Provision for Tax		<u>Nil</u>
(VII) Profit Loss after Tax (V-VI)		<u>70,750</u>

Notes :

1. Other Income	
Share Transfer Fees	7,500
Commission Received	<u>3,700</u>
	11,200

2. Changes in Inventories	
Opening Stock	36,000
Less Closing Stock	<u>(42,750)</u>
	(6,750)
3. Other Expenses	
Travelling Expenses	5,100
Delivery van Expenses	2,550
Bad Debts	3,250
Discount	3,500
Freight Outward	4,200
Free samples	2,500
Showroom expenses	10,700
Insurance	<u>3,000</u>
	59,800

ILLUSTRATION 4.

From the following extracts of ledger balances taken from Excise Co. Ltd., for the year ending 31st March 2017.

Prepare a statement of P & L A/c as per revised schedule III

Particulars	₹
Excise Duty	24,000
Provision for tax	30,000
Depreciation on Machinery	9,900
Sundry expenses	21,000
Rent	12,000
Salaries	22,500
Materials consumed	2,70,000
Machinery	75,000
Directors remuneration	60,000
Factory expenses	7,500
Sales	13,65,000
Returns inward	15,000
Purchases	7,05,000
Closing Stock	6,75,000
Opening Stock	2,46,000
Wages	90,000
Bank loan	1,20,000
Interest on Bank loan	12,000
Interest on Investment	15,000
Rent received	9,000
Motive power	36,000
Transport Charges	3,000

SOLUTION:

Exercise Co. Ltd.
Statement of Profit and Loss as on 31st March, 2017

Particulars	Note No	Amount
(I) Revenue from Operations	1	13,26,000
(II) Other Income	2	24,000
(III) Total revenue (I + II)		13,50,000
(IV) Expenses:		
(a) Material Consumed		2,70,000
(b) Purchases		7,05,000
(c) Changes in Inventories	3	21,000
(d) Employees benefit expenses	4	1,12,500
(e) Finance Cost		12,000
(f) Depreciation and Amortization Exp		9,900
(g) Other Expenses	5	1,39,500
Total Expenses		12,69,900
(V) Profit & Loss before Tax (III-IV)		80,100
(VI) Provision for Tax		(30,000)
(VII) Profit Loss after Tax (V-VI)		50,100

Notes :

1. Revenue from Operations	13,65,000
Sales	15,000
Less Sales Returns	<u>24,000</u>
Less Excise Duty	13,26,000
2. Other Income	15,000
Interest on investment	<u>9,000</u>
Rent received	24,000
3. Changes in Inventories	2,46,000
Opening Stock	<u>(2,25,000)</u>
Less Closing Stock	21,000
4. Employees benefit expenses	22,500
Salaries	<u>90,000</u>
Wages	1,12,500

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Other Expenses	21,000
Sundry Expenses	12,000
Rent	30,000
Directors remuneration	7,500
Factory expenses	36,000
Motive power	
Transport	3,000
Charges	1,39,500

ILLUSTRATION 5.

From the following extracts of ledger balances taken from Sultan a company Ltd. For the year ending 31st March 2019.
Prepare a statement of P & L A/C as per revised schedule III

Particulars	₹
Opening stock of finished goods	1,90,500
Cost of material consumed	2,92,000
Salaries to office staff	68,000
Closing stock of finished goods	2,03,000
Interest on debentures paid	16,250
General expenses	8,250
Discount earned	4,900
Cash sales	2,66,000
Credit sales	3,87,500
Income tax refund	11,500
Provision fortaxation	30,000
Good will written off	18,000
Sales returns	17,000
Provision for bad debts	8,200
Delivery Expenses	7,200
Printing & stationery	22,600
Factory expenses	82,000
Bonus to employees	32,000
Depreciation on Plant & machinery	50,000

SOLUTION:

Sultana Company Limited Statement of Profit and Loss as on 31st March, 2015

Particulars	Note No	Amount ₹
(I) Revenue from Operations	1	6,36,500
(II) Other Income	2	16,400
(III) Total revenue (I + II)		6,52,900

counts

Company Final Accounts

(IV) Expenses:		
(a) Material Consumed		2,92,000
(b) Purchases		0
(c) Changes in Inventories		(12,500)
(d) Employees benefit expenses	3	1,00,000
(e) Finance Cost	4	16,250
(f) Depreciation and Amortization Exp	5	68,000
(g) Other Expenses	6	1,28,250
Total Expenses		5,92,000
(V) Profit & Loss before Tax (III-IV)		60,900
(VI) Provision for Tax		(30,000)
(VII) Profit Loss after Tax (V-VI)		30,900

Notes :

1. Revenue from Operations	
Cash sales	2,66,000
Credit sales	3,87,500
Less: Sales returns	<u>(17,000)</u>
	6,36,000
2. Other Income	
Discount earned	4,900
Income tax refund	<u>11,500</u>
	16,400
3. Changes in Inventories	
Opening Stock	1,90,500
Less Closing Stock	<u>(2,03,000)</u>
	(12,500)
4. Employees benefit expenses	
Salaries to office staff	68,000
Bonus to employees	<u>32,000</u>
	1,00,000
5. Depreciation & Amortisation	
Good will written off	18,000
Dep. on Plant & Machinery	<u>50,000</u>
	68,000
6. Other Expenses	
General Expenses	8,250
Provision for Bad debts	8,200
Freight on purchases	7,200
Printing & Stationery	22,600
Factory expenses	<u>82,000</u>
	1,28,250

ILLUSTRATION 6

- From the following particulars, prepare income statement for the year ending 31st March, 2015
- P & L A/c balance for last year ₹ 62,500
 - N/P for the year before tax ₹ 5,40,000 (Provide for tax at 40%)
 - Transfer to general reserve ₹ 52,500, Dividend equalization fund ₹ 40,000 and development reserve ₹ 37,500
 - Dividend at 7.5% on Preference shares ₹ 3,00,000
 - Dividend at 12.5% on 5,000 Equity shares of ₹ 10, ₹ 7.50 called-up (Calls in arrears ₹ 13,000)
 - Corporate dividend tax of 20.36%

(KSLU III Semester 5 Years B.Com, LL.B., Examination December 2010)

SOLUTION

Statement of Profit and Loss as on 31st March, 2015

Particulars	Amount ₹
Net Profit as per Profit and Loss A/c	
Less: Adjustments	5,40,000
Provide for tax at 40% (5,40,000 × 40/100)	2,16,000
Profit after Tax	
Transfer to general reserve	52,500
Dividend equalization fund	40,000
Development reserve	37,500
Dividend at 7.5% on Preference shares (3,00,000 × 7.5/100)	
Dividend at 12.5% on 5,000 Equity shares of ₹ 10, ₹ 7.50 (5,000 × 7.5) 37,500	22,500
Less: Call in arrears (37,500 - 13,000)	24,500
Net Profit	1,37,000
	1,87,000

ILLUSTRATION 7.

Following ledger balances are taken from Virupaksh Ltd., for the year ending 31/3/2015. Prepare & L Account in vertical form with major heads.

Particulars	₹
Stock of finished goods as on 01-04-2014	2,90,000
Stock of work-in-progress as on 01-04-2014	3,93,000
Stock of finished goods as on 31-03-2015	1,84,000
Stock of work-in-progress as on 31-03-2015	2,60,000
Material consumed	3,15,000
Wages	74,000
Coal & Coke	87,500
Live stock	1,00,600
Patents written off	25,200
Directors fees	57,000

Trial Balance

Sales	10,95,000
Depreciation on plant	38,000
Bad debts	16,570
Provision for taxation	18,000
Royalty received	18,300
Bank loan	4,00,000
Administrative expenses	37,400
Interest on loan	60,000

Virupaksh Co.Ltd

Statement of Profit and Loss as on 31st March, 2015

Particulars	Note No	Amount
Revenue from Operations		10,95,000
Other Income		18,300
Total revenue (I + II)		11,13,300
Expenses:		
(a) Material Consumed		3,15,000
(b) Purchases		0
(c) Changes in Inventories	1	2,39,000
(d) Employees benefit expenses		74,000
(e) Finance Cost		60,000
(f) Depreciation and Amortization Exp	2	63,200
(g) Other Expenses	3	1,98,470
Total Expenses		9,49,670
(V) Profit & Loss before Tax (III-IV)		1,63,630
(VI) Provision for Tax		(18,000)
(VII) Profit Loss after Tax (V-VI)		1,45,630

Notes :

1. Changes in Inventories Opening Stock

Work-in-progress	3,93,000	
Finished Goods	<u>2,90,000</u>	
	6,83,000	
LESS : Closing Stock		
Work-in-progress	2,60,000	
Finished Goods	<u>1,84,000</u>	
	4,44,000	2,39,000

2. Depreciation & Amortization

Depreciation on plant	38,000
Patents written off	<u>25,200</u>
	63,200

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3. Other Expenses
 Coal & Coke
 Bad debts
 Administrative expenses
 Directors fees

87,500
 16,570
 37,400
 52,000
 1,98,470

Company Final Accounts

Exercise

PROBLEM 1.

You are given the following extracts of ledger balances taken from Abhinav Co.Ltd., for the year ending 31 March, 2015.

Prepare P & L A/c as per schedule III of the companies Act.

Particulars	₹
Salary	40,000
Selling expenses	18,750
Interest on loan (Debit)	17,500
Closing stock	7,75,000
Purchases	2,42,500
Wages	51,000
Manufacturing expenses	18,000
Sales	5,25,500
Sales returns	7,500
Opening stock	2,75,000
Audit fees	20,000
Interest on debentures	12,000
Depreciation on Plant & machinery	27,000
Depreciation on furniture	13,000
Provision for tax	12,500
Interest on investment	16,750
Machinery	2,00,000
Furniture	1,00,000
Discount on issue of shares written off	2,000
Directors fees	20,000

PROBLEM 2.

You are given the following extracts of ledger balances taken from Ashirvad Co. Ltd., for the year ending 31st March, 2015.

Prepare P & L A/c as per revised schedule III of the companies Act.

Particulars	₹
Closing stock	50,000
Sales	4,25,000
Purchases	3,00,000
Bonus to workers	27,500
Discount received	3,150
Opening stock	91,500
Discount allowed	4,200
Insurance	3,040
Consumables	2,600
Trade marks	8,000
Repairs	6,950
Printing & Stationery	2,400
Interest on debenture	8,500
Depreciation machinery	7,200
Machinery	80,000
Rent from sub-let	36,000
Loss by fire	4,700
Wages	65,000

PROBLEM 3.

Following ledger balances are taken from the books of Navbharat Trading Co. for the year ending 31/3/2013.

Prepare P & L A/c as per revised Schedule III

Particulars	₹
Profit on sale of furniture	58,780
Cash purchases	2,58,120
Credit purchases	1,02,560
Sales	5,36,000
Returns outward	15,050
Royalty paid	36,000
Salesman's commission	24,000
Bad debts	2,540
Depreciation on furniture	9,800
Opening stock of finished	1,03,000
Opening stock of work-in-process	2,58,000
Rentals	26,000
Closing stock of work-in-process	32,500

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Company Final Accounts

Closing stock of finished goods	1,89,500
Interest on Bank overdraft	14,580
Freight Outward	5,790
Share transfer fees	11,200
Provision for tax	53,000

PROBLEM 4.

The following is the Trial Balances of Sangeetha Company Ltd, as on 31-03-2016. The company has 20,000 shares of ₹ 100 each as Registered Capital.

Particulars	Debit (₹)	Credit (₹)
Shares (3000 shares of ₹ 100 each)	-	3,00,000
Call in Arrears	16,000	
Reserve fund		2,50,000
Buildings	1,80,000	
Fixed Deposits		1,00,000
Wages	30,000	
Machinery	89,000	
Furniture	80,000	
Purchases and Sales	2,10,000	
Salaries	60,000	5,25,000
Debtors and Creditors	2,20,000	
B/R and B/P	61,000	1,50,000
Directors fees	20,000	90,000
Returns	15,000	
Freight	10,000	20,000
Manufacturing expenses	5,000	
Opening Stock	65,000	
Interim dividend (Excluding CTD)	25,000	
Audit fees	15,000	
P/L A/c		27,000
Tools	38,000	
Preliminary Expenses	60,000	
Debentures		1,00,000
Investments	2,50,000	
Goodwill	52,000	
Insurance and Taxes	20,000	
Printing and stationery	15,000	
Cash and Bank Balance	12,000	
	15,62,000	15,62,000

Adjustments :

- (a) Directors proposed a total dividend of 25%

Company Final Account

- (b) Write off 25% of Preliminary expenses and 10% of goodwill
 - (c) Depreciate buildings by 2% and furniture by 5%
 - (d) Transfer ₹ 60,000 to Reserve fund
 - (e) Insurance prepaid ₹ 1,500
 - (f) Closing stock ₹ 80,000
- Prepare income statement and Balance Sheet.

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(KSLU III Semester 5 years B.Com., L.L.B. Examination December 2018)

PROBLEM 5.

From the following balances of Krishna Co., Ltd, on 31-03-2018. Prepare a statement of Profit and

Particulars	Amount (₹)
Interest on debentures	32,400
Travelling expenses	15,000
Delivery van expenses	5,000
Bad Debts	6,000
Discounts	7,000
Purchases	3,15,000
Opening stock	75,000
Freight charges	8,000
Depreciation	25,000
Insurance	5,000
Commission received	7,500
Sales	6,50,000
Shares transfer fees	5,000

(KSLU III Semester 5 years B.Com., L.L.B. Examination December 2019)

PROBLEMS SOLVED AS PER THE REVISED SCHEDULE VI

ILLUSTRATION 1.

Given is the Trial Balance of Singha Limited as on 31st March, 2019. You are required to prepare Profit and Loss Account and Balance Sheet on 31st March, 2019.

	Dr.	Cr.
Authorized Share Capital divided into 16,000		
6% preference shares of ₹ 100 each and		56,00,000
40,000 equity shares of ₹ 100 each		
Subscribed Capital		10,00,000
10,000, 6% preference shares of ₹ 100 each		16,00,000
Equity Share Capital		10,000
Capital Reserve		

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Company Final Accounts

Purchases –	Coco, Tea, Coffee	1,17,600	
–	Bakery products	72,400	
Wages and Salary		30,600	
Rent, Rates and Taxes		17,800	
Laundry		1,500	
Sales –	Coco, Tea and Coffee		1,64,000
–	Bakery products		89,000
Coal and Firewood		6,580	
Carriage		1,620	
Sundry Expenses		11,680	
Advertising		16,720	
Repair		17,000	
Rent of Rooms			96,000
Receipt from Billiards			11,400
Miscellaneous Receipts			11,200
Discount Received			13,200
Transfer Fee			2,800
Freehold Land and Building		17,00,000	
Furniture and Fittings		1,72,600	
Stock on hand, 1 st April, 2011			
Coco, Tea, Coffee		25,600	
Bakery products		10,520	
Cash in Hand		4,400	
Cash with Bank		1,72,000	
Preliminary and Formation Expenses		16,000	
2000, 8% debentures of ₹ 100 each			4,00,000
Profit and Loss Account			83,000
Sundry Creditors			84,000
Sundry Debtors		1,72,600	
Investment		1,72,600	
Goodwill at Cost		10,00,000	
General Reserve			4,00,000
		39,50,000	39,50,000

Additional Information:

- Wages and Salaries outstanding ₹ 8,560
- Stock as on 31st March, 2012
 - Coco, Tea, Coffee ₹ 45,000
 - Bakery Products ₹ 32,800
- Provide 5% depreciation on Furniture and Fittings and 2% on Land and Building.

Company Final Accounts

The equity capital on 1st April, 2018 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares of ₹ 60 paid. The directors made a call of ₹ 40 per share on 1st October, 2018. A shareholder would not pay the call on 100 shares and his shares were then forfeited and reissued at ₹ 90 per share as fully paid. The director proposes a dividend of 8% on equity shares, transferring any amount that may be required from general reserve. Ignore taxation.

5.31

SOLUTION

Profit and Loss Account of Singha and Limited for the year ended on 31st March, 2019

Particulars	Notes	Amount (₹)
I. Revenue from Operations	10	3,59,400
II. Other Receipts	11	13,600
III. Total Revenue (I + II)		3,73,000
IV. Expenses		
Purchase of Stock in Trade	12	1,90,000
Change in Inventories of Finished Goods	13	(41,680)
Employee Benefit Expenses	14	39,160
Other Operating Expenses	15	47,680
Selling and Administrative Expenses	16	16,720
Finance Costs	17	32,000
Depreciation and Amortization Expenses	18	42,630
Total Expenses		3,26,510
V. Profit (Loss) for the period (III-IV)		46,490
Balance from Previous Years		83,000
Transfer from General Reserve		58,000
Less: Proposed Dividend		
- Preference Share Capital @ 6%		60,000
- Equity Share Capital @ 8%		1,28,000
Profit (Loss) carried to Balance Sheet		0

Balance Sheet of Singha Limited as on 31st March, 2019

Particulars	Notes	Amount (₹)
I. Equity and Liabilities		
1. Shareholders' Fund		
(a) Share Capital	1	26,00,000
(b) Reserve and Surplus	2	3,51,490
2. Non-current liabilities		
(a) Long term liabilities	3	4,00,000
3. Current liabilities		
(a) Trade Payables	4	92,560
(b) Short Term Provisions	5	2,20,000
TOTAL		36,64,050

II. Assets**1. Non-Current Assets**

- (a) Fixed assets
 - (i) Tangible Fixed Assets
 - (ii) Intangible Assets (Goodwill)
- (b) Non-Current Investments

2. Current Assets

- (a) Inventories
- (b) Trade Receivables
- (c) Cash and Cash Equivalents
- (d) Other Current Assets

TOTAL

6

7

8

9

18,29,300
10,00,000
5,44,000

77,000
38,500
1,57,340
16,000
36,64,000

Notes to the Financial Statements**2. Share Capital***Equity Share Capital*

- Authorised Equity Share Capital : 40,000 Equity Shares of ₹ 100 each
- Issued and Subscribed 16,000 Equity Shares of ₹ 100 each

Preference Share Capital

- Authorised Preference Share Capital
- 16,000, 6% Preference Shares of ₹ 100 each
- Issued and Subscribed
- 10,000, 6% Preference Shares of ₹ 100 each

40,00,000

16,00,000

16,00,000

10,00,000

26,00,000

3. Reserve and Surplus

- Capital Reserve
- General Reserve

4,00,000

10,000

Less : Amount used to pay dividend on Equity and Preference Share Capital

58,510

3,41,490

3,51,490

4. Long Term Borrowings

- 2000, 8% Debentures of ₹ 100 each

4,00,000

5. Trade Payables

- Sundry Creditors
- Wages and Salaries Outstanding

84,000

8,560

6. Short Term Provision

- Interest on Debentures
- Proposed Preference Dividend
- Proposed Equity Dividend

92,560

32,000

60,000

1,28,000

2,20,000

7. Tangible Assets		
- Freehold Land and Building	17,00,000	
Less: Depreciation @ 2%	<u>34,000</u>	
- Furniture and Fitting	86,300	16,66,000
Less: Depreciation @ 5%	<u>4,315</u>	
		<u>1,63,970</u>
		<u>18,29,970</u>
8. Inventories		
- Coco, Tea, Coffee		45,000
- Bakery Products		<u>32,800</u>
		<u>77,800</u>
9. Cash and Cash Equivalents		
- Cash at Bank	1,52,760	
- Cash in Hand	<u>4,400</u>	
	<u>1,57,160</u>	
10. Other Current Assets		
- Preliminary and Formation Expenses	16,000	
11. Revenue from Operations		
<i>Sale of products</i>		
- Coco, Tea and Coffee	2,05,000	
- Bakery Products	<u>88,000</u>	2,52,000
<i>Sale of services</i>		
- Rent of Rooms	96,000	
- Receipt from Billiards	<u>10,400</u>	<u>1,07,400</u>
		<u>3,59,400</u>
12. Other Receipts		
- Miscellaneous Receipts		5,600
- Discount Received		6,600
- Transfer Fee		<u>1,400</u>
		<u>13,600</u>
13. Purchases of Stock in Trade		
- Coco, Tea and Coffee		1,17,600
- Bakery Products		72,400
		1,90,000
14. Change in Inventories of Finished Goods		
- Coco, Tea Coffee	25,600	
Opening Stock	<u>45,000</u>	(19,4000)
Less: Closing Stock		
- Bakery Products		
Opening Stock	10,520	
Less : Closing Stock	<u>32,800</u>	<u>(22,280)</u>
		<u>(41,680)</u>

15. Employee Benefit Expenses

Wages and Salaries

Add: Outstanding Wages and Salaries

16. Other Operating Expenses

- Rent Rates and Taxes
- Coal and Firewood
- Laundry
- Carriage
- Repair
- Sundry Expenses

17. Selling and Distribution Expenses

- Advertising

18. Finance Cost

- Interest on Debentures

19. Depreciation and Amortization Expenses

- Land and Building
- Furniture and Fittings

30,000

8,500

22,500

17,800

6,500

1,500

1,620

8,500

11,680

47,680

16,720

32,000

34,000

8,630

22,630

PROBLEM 2.

You are required to prepare financial statements from the following trial balance of Ronan & Company Ltd. for the year ended 31st March, 2019.

Ronan Company Ltd.
Trial Balance as at 31st March, 2019

Particulars	₹	Particulars	₹
Stock	1,70,000	Equity Shares Capital (Shares of ₹ 10 each)	6,25,000
Furniture & Fixtures	1,25,000	11% Debentures	1,25,000
Discount	10,000	Bank Loans	1,61,250
Loan to Directors	20,000	Bills Payable	31,250
Advertisement	5,000	Creditors	39,000
Bad Debts	8,750	Sales	10,67,000
Commission	30,000	Rent Received	11,500
Purchases	5,79,750	Transfer Fees	2,500
Plant and Machinery	2,15,000	Profit & Loss Appropriation Account	34,750
Rentals	6,250	Provision for Depreciation on Plant & Machinery	36,500
Current Account	11,250		
Cash	2,000		
Interest on Bank Loan	29,000		

Company Final Accounts

5.35

	2,500	
Preliminary Expenses	2,25,000	
Wages	21,000	
Consumables	3,86,500	
Freehold land	61,250	
Tools and Equipments	66,250	
Goodwill	71,750	
Debtor	38,250	
Bills Receivables	5,250	
Dealer Aids	7,500	
Transit Insurance	18,000	
Trade Expenses	13,500	
Distribution Freight	5,000	
Debitures Interest	21,33,750	21,33,750

Additional Information:

- Closing stock as on 31st March, 2019, ₹ 2,05,750
- Depreciation on furniture & fixtures @ 5%. Freehold land @ 2% and Tools and Equipment's @ 5% to be provided.

SOLUTION

Profit and Loss Account of Mehul Company Ltd. for the year ended on 31st March, 2012

Particulars	Notes	Amount (₹)
I. Revenue from Operations		10,67,000
II. Other Receipts	8	14,000
III. Total Revenue (I + II)		10,81,000
IV. Expenses		
Purchase of Stock in Trade	9	5,79,750
Change in Inventories of Finished Goods	10	(35,750)
Employee Benefit Expenses	11	2,25,000
Other Operating Expenses	12	1,20,250
Selling and Administrative Expenses	13	5,000
Finance Costs	14	34,000
Depreciation and Amortization Expenses	15	17,042
Total Expenses		9,45,293
V. Profit (Loss) for the Period (III-IV)		1,35,707
Balance from Previous Years		34,750
Profit (Loss) carried to Balance Sheet		1,70,458

5.36

**Balance Sheet of Ronan Company
Ltd. as on 31st March, 2012**

Company Final Accounts

Particulars	Notes	Amount (₹)
I. Equity and Liabilities		
1. <i>Shareholders' Fund</i>	1	
(e) Share Capital	2	6,25,000
(f) Reserve and Surplus		1,70,458
2. <i>Non-current liabilities</i>	3	
(g) Long term liabilities		2,28,000
3. <i>Current liabilities</i>	4	
(h) Trade Payables		70,250
TOTAL		11,51,958
II. Assets		
1. <i>Non-Current Assets</i>		
(a) Fixed assets		
(i) Tangible Fixed Assets	5	7,34,207
(ii) Intangible Assets (Goodwill)		
2. <i>Current Assets</i>		
(a) Inventories		2,05,750
(b) Trade Receivables		71,750
(c) Cash and Cash Equivalents	6	13,250
(d) Short Term Loan and Advances	7	58,250
(e) Other Current Assets		2,500
TOTAL		11,51,958

Notes to the Financial Statements

1. Share Capital

Equity Share Capital

Authorised Share Capital

25,000 Equity Shares of ₹ 10 each

6,25,000

Issued and Subscribed

25,000 Equity Shares of ₹ 10 each

6,25,00026,00,000

2. Reserve and Surplus

– Balance as per last Balance Sheet

34,750

Add: Balance in Current Year Profit

1,35,7071,61,250

3. Long Term Borrowings

11% Debentures of ₹ 100 each

1,25,000

Bank Loan

1,61,2502,86,250

4. Trade Payables

Sundry Creditors
Bills Payables

39,000

31,250

70,250

5. Tangible Assets

Freehold Land and Building
Furniture and Fixtures
Plant and Machinery
Tools and Equipments
Total

Book Value	Depreciation	Net Value
3,86,500	7,730	3,78,770
1,25,000	6,250	1,18,750
2,15,000	36,500	1,78,500
61,250	3,063	<u>58,187</u>
<u>7,87,500</u>	<u>36,500</u>	<u>7,34,207</u>

6. Cash and Cash Equivalents

Cash at Bank
Cash in Hand

11,250

2,000

13,250

7. Short Term Loans and Advances

Loan to Directors
Bills Receivables

20,000

38,25058,250

8. Other Income

Rent Received
Transfer Fee

11,500

2,500

14,000

9. Purchase of Stock in Trade

Purchases

5,79,750

10. Change in Inventories of Finished Goods

Closing Stock
Less: Opening Stock

2,05,750

1,70,00035,750

11. Employee Benefit Expenses

Wages

2,25,000

12. Other Operating Expenses

Consumables
Bad Debts
Discount
Rentals
Commissions
Dealer's Aid
Transit Insurance
Trade Expenses
Distribution Freight

21,000

8,750

10,000

6,250

30,000

5,250

7,500

18,000

13,5001,20,250

5.38

13. Selling and Administrative Expenses

Advertisements

14. Finance Costs

Interest on Bank Charges

Debenture Interest

15. Depreciation and Amortization Expenses

Freehold Land and Building

Furniture and Fixtures

Tools and Equipments

5,000

29,000

5,000

34,000

7,730

6,250

3,062

17,042

Exercise

1. The following Trial Balance has been extracted from the books of Agro India Ltd. on 31.03.2015.

Trial Balance as on 31st March 2015

Debit	₹	Credit	₹
Plant & Machinery	9,00,000	Sinking Fund	1,00,000
Stock of raw material	1,75,000	Sundry Creditors	1,00,000
Live stock	4,30,000	Equity Share capital	15,00,000
Loan to director	1,35,000	15% Debentures	25,000
IFCI Bonds	2,00,000	Outstanding salary	10,000
Profit & Loss A/c	10,000	Proposed dividend	2,00,000
Patents	3,74,000	Revaluation Reserve	1,65,000
Discount on issue of shares	25,000	Mortgage Loan	2,54,000
Interest Accrued	1,05,000		
	23,54,000		23,54,000

Prepare the Balance sheet of the company as per schedule III of the Companies Act 2013.

2. Prepare Balance sheet of Samarth Ltd. In a prescribed proforma as on 31-03- 2015 from the following trial balance.

Trial balance as on 31st March 2015

Debit	₹	Credit	₹
Lease hold premises	13,00,000	Debenture redemption reserve	3,75,000
Plant & Equipment	9,45,000	Provision for warranties	1,35,000
Book debts	3,44,000	Short Term loan from Ambica Ltd.	2,65,000
Bank balance	1,45,000	Profit & loss A/c	2,69,000
Advance Income tax	85,000	12% Debentures	4,55,000
Licenses & Franchise	2,25,000	Commission payable	44,000
redeemable pref. shares in		32000 equity shares of ₹ 100	

Scania Ltd.	6,30,000	Each, ₹ 50 called up	16,00,000
Cheques on hand	95,000	Provision for tax	46,000
Rent paid in advance	36,000	Interest accrued	54,000
		Mortgage loan from IDBI	5,62,000
	38,05,000		38,05,000

3. From the following Ledger balances of Mahan LTD., prepare a Balance Sheet of the company as on 31st March 2014 as per Schedule III of the Companies Act 2013.

Particulars	₹	Particulars	₹
Furniture & fixtures	2,00,000	Free hold property	32,00,000
Public Issue of 7% bonds	15,00,000	8% Government bonds	8,00,000
Provident Fund	4,60,000	Provision for taxation	1,40,000
General Reserve	5,40,000	Cash in hand	5,00,000
10% Preference share capital	15,00,000	Acceptances received	7,20,000
Equity share capital	26,00,000	Discount on issue of shares	1,30,000
Outstanding printing & stationery	86,000	Bank overdraft	4,50,000
Payment due to suppliers	9,00,000	Loan to Managing director	3,72,000
Trade Investment	3,24,000	Goodwill	5,40,000
Interest accrued on investment	48,000	Cash at bank	10,42,000

4. From the following Ledger balances of PUSHPAK CO. LTD., prepare a Balance Sheet of the company as on 31st March 2020 as per Schedule III of the Companies Act, 2013:

Particulars	₹	Particulars	₹
Plant & machinery	30,000	Premises	50,000
6% Debenture	40,000	Fixed Deposits with Banks	25,000
Provision for workmen, compensation	6,500	Provision for taxation	9,000
General Reserves	4,000	Loan from Bank of India	25,000
Cash in hand	1,7,00	Discount on issue of Debentures	5,500
Equity Share capital	60,000	(unwritten off)	
Sundry creditors	5,800	Bills Receivable	12,000
Advance salary to staff	3,500	Bank overdraft	7,500
Shares of Reliance Co. Ltd.	9,900	Security deposits	6,200
Commission receivable	5,000	Goodwill	9,000

5. From the following ledger balances of Anand Co. Ltd., prepare a Balance Sheet of the company as on 31st March 2020 as per Schedule III of the Companies Act, 2013:

Particulars	₹	Particulars	₹
Equity Share Capital	26,00,000	Advances to employees	1,50,000
Reserves Fund	30,000	Discount on issue of debentures	12,500
6% Debentures	4,00,000	(unwritten off)	
Land & Buildings	15,54,970	Tools and equipment	3,75,000
Goodwill	10,00,000	Provident Fund	3,00,000
Bank Overdraft	2,45,100	Debtors	1,38,520

5.40

Company Final Accounts

Proposed Dividend	82,000	Cash at Bank	1,57,160
Prepaid insurance	25,000	Stores & Spares	1,77,800
Mutual Fund	1,68,000	Profit & Loss A/c [Cr.]	21,400
Interest payable	32,400	Bills Receivable	44,600
		Sundry Creditors	92,500

6. The following balances have been extracted from the books of Rakesh Ltd, as on 31st March, 2018.

Particulars	Amount (₹)
Share capital (Equity shares of ₹ 10 each fully paid)	10,00,000
Securities premium	1,00,000
12% debentures	4,00,000
Bills payable	2,00,000
Proposed dividend	50,000
Profit and Loss A/c (Dr.)	30,000
Investments	4,00,000
Work-in-progress	1,00,000
Patents	40,000
Unclaimed dividend	10,000
Bills receivable	20,000
Public deposits	50,000
Plant and equipment's	6,00,000
Furniture and fixtures	1,00,000
Office equipment's	2,00,000
Stock-in-trade	2,60,000
Stores and spares	40,000
Expenses on issue of debentures	20,000

Prepare a Balance sheet of the Company as per schedule III part I of companies act, 2013%

(KSLU III Semester 5 years B.Com., L.L.B. Examination December 2019)

Exercise

SHORT ANSWER TYPE

1. What are current Assets?
2. What are noncurrent assets?
3. What do you mean by cost of sales?
4. Write note on calculation of cost of goods sold.
5. Under which heading and sub-heading will the following items appear in the Balance sheet of a company as per schedule III, Part-I of the Companies Act 2013?
 - (a) Preliminary expenses
 - (b) Loose Tools
 - (c) Forfeiture of shares
 - (d) Bank Overdraft

- (e) Provision for taxation
- (f) Goodwill.
- ★ From the following particulars calculate reserves and surplus.
 - (i) Net Profit before tax ₹ 67,000
 - (ii) Provision for taxation 33.5%
 - (iii) Transfer Reserve funds 20% after tax
 - (iv) Share Capital (a) 1,200 15% Preference shares ₹ 100 each (b) 1,200 equity shares of ₹ 100 each ₹ 75 per share paid up.
 - (v) Proposed dividend to equity share holders 20%
 - (vi) Profit and loss account balance ₹ 8,000.

♦ ♦ ♦



PROBLEMS ON BALANCE SHEET OF A COMPANY AS PER REVISED SCHEDULE III OF THE COMPANIES ACT 2013

FORMAT OF BALANCE SHEET
Balance Sheet of Company Limited as on 31st March.....

Particulars	Note No.	₹
EQUITY AND LIABILITIES		
1. Shareholders' Funds:		
(a) Share Capital		
(b) Reserves and surplus		
(c) Money received against share warrants		(Not to be evaluated)
2. Share Application Money pending allotment:		(Not to be evaluated)
3. Non - Current Liabilities:		
(a) Long-term borrowings		
(b) Deferred Tax Liabilities (Net)		(Not to be evaluated)
(c) Other Long Term Liabilities		(Not to be evaluated)
(d) Long-term provisions		(Not to be evaluated)
4. Current Liabilities:		
(a) Short-term borrowings		
(b) Trade payables		
(c) Other current liabilities		
(d) Short-term provisions		
TOTAL [1 +2+3+4]		

2

II. ASSETS

1. Non-Current Assets:

- (a) Fixed Assets
 - (i) Tangible Assets
 - (ii) Intangible Assets
- (b) Non-Current Investments
- (c) Long Term Loans & Advances
- (d) Other Non-Current Assets

2. Current Assets:

- (a) Current investments
- (b) Inventories
- (c) Trade receivables
- (d) Cash and cash equivalents
- (e) Short-term loans and advances
- (f) Other current assets

TOTAL [1 + 2]

EXPLANATION

I. ITEMS APPEARING UNDER THE HEAD EQUITY AND LIABILITIES IN THE BALANCE SHEET

(1) Shareholders' Funds

(a) Share Capital:

Note: Equity Share Capital and Preference Share Capital are to be shown separately.

(b) Reserves and Surplus: The following items are shown under this head:

- (i) Capital Reserves
- (ii) Capital Redemption Reserve
- (iii) Securities Premium
- (iv) Debenture Redemption Reserve
- (v) Revaluation Reserve (Accounting Treatment—Not to be evaluated)
- (vi) Share options Outstanding Account (Accounting Treatment—Not to be evaluated);
- (vii) Other reserves (restricted to General Reserve only);
- (viii) Surplus i.e. balance in the Statement of Profit & Loss [Add Cr. Bal or Less Dr. balance] The balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in negative.

(c) Money received against share warrants: (Accounting Treatment—Not to be evaluated)

(2) Share application money pending allotment (Accounting Treatment—Not to be evaluated)

(3) Non-current liabilities

- (a) Long Term borrowing : (Debentures/Bonds, Bank Loans, Long Term Loans, Mortgage Loans, Public Deposits etc.)

- (b) **Deferred Tax Liabilities:** (Net) (Accounting Treatment-Not to be Evaluated).
- (c) **Other Long Term Liabilities:** (Accounting Treatment-Not to be evaluated). Inter company Owings from associates, subsidiaries or other companies, long term trade payable.
- (d) **Long Term provisions:** (Provision for Employee Benevolent/Welfare Fund, Provident Fund, Gratuity Fund, Provision for Warranties, Provision for Pension Fund)
- (4) **Current Liabilities**
 - (a) **Short-term Borrowings:** Loans repayable on demand from banks and other parties, Bank Overdrafts, Cash credits.
 - (b) **Trade Payables:** Sundry Creditors, Bills Payable, Outstanding Expenses
 - (c) **Other Current Liabilities:** Unpaid dividends, Interest accrued and due or not due on borrowings, Income received in advance, Calls in advance, o/s Interest on calls in advance.
 - (d) **Short-term Provisions:** (Provision for tax and Propose dividend)

II. ITEMS APPEARING UNDER THE HEAD ASSETS IN THE BALANCE SHEET.

1. Non-Current Assets

(a) Fixed Assets:

- (i) **Tangible Assets:** (Land, Building, Plant and Equipment, Furniture & Fixture, Vehicles, Office Equipment, Live Stock, Railway sidings etc.)

(ii) Intangible Assets:

- (a) Goodwill
- (b) Brand /Trademarks
- (c) Computer Software & Mining rights
- (d) Mast head and Publishing titles.¹
- (e) Copyrights and patents and other intellectual property rights, services and operating rights.
- (f) Recipes, formulae, models, designs and prototypes
- (g) Licenses and franchise

(iii) Capital working Progress: (Accounting Treatment-Not to be evaluated)

- (iv) **Intangible Assets under Development:** Like patents, intellectual property rights, etc. which are being developed by the company (Accounting Treatment-Not to be evaluated).

- (b) **Non-Current Investments:** Investments/Trade Investments and Non-trade investment (If it is a long term)

- (c) **Deferred Tax Assets (Net):** (Accounting Treatment-Not to be evaluated).

Problems on Balance Sheet of a Company as per Revised Schedule III...

4

(d) Long-term Loans and Advances: Only Capital Advances and Security Deposits.

(e) Other non-current assets:

- (i) Preliminary Expenses
- (ii) Discount on issue of shares/ debentures Underwriting Commission
- (iii) Deferred revenue expenses/Discount on issue of shares/debenture/Share expenses

2. Current Assets

(a) Current Investments: (Investments in Equity Instruments (Shares), Preference shares, Government Securities, Debentures and Mutual Funds etc.) (For short duration, i.e., meant for resale)

(b) Inventories: Inventories include the following:

- (i) Raw Material
- (ii) Work-in-progress
- (iii) Finished Goods
- (iv) Stock-in-trade (in respect of goods acquired for trading)
- (v) Stores and Spares
- (vi) Loose Tools

(c) Trade Receivables: Debtors and Bills receivables.

(d) Cash and cash equivalents: As discussed in the salient features of Schedule-VI in General Instructions:-

- (i) Balance with banks
- (ii) Cheques, drafts on hand.
- (iii) Cash in hand
- (iv) Deposit with Banks.
- (v) Short-term Loans and Advances: (short term loans/advances given to employees)
- (vi) Other Current Assets: (Restricted to prepaid expenses, Accrued Incomes, Interest accrued on Investments, Advance Tax)

3. Contingent Liabilities and Capital Commitments (Not to be evaluated)

(a) **Contingent Liabilities** – Those liabilities which may or may not arise because they are dependent on a happening in future. It is not recorded in the books of accounts but is disclosed in the Notes to Accounts for the information of the users (Claims against the company not acknowledged as debts, Guarantees, Other money for which the company is contingently liable).

(b) **Capital Commitments**– A future liability for capital expenditure in respect of which contacts have been made. (Uncalled liability on shares and other investments partly paid etc.)¹

Illustration 1.

From the following is the trial balance of Stalin Pvt Ltd., prepare the Balance Sheet of the company as on 31st March 2019 as per Schedule III of the Companies Act.

Trial Balance as on 31st March 2019

Debit	₹	Credit	₹
Advances to employees	1,50,000	Equity Share Capital	26,00,000
Cash at Bank	1,57,160	Capital Reserve	30,000
Furniture & Fixture	3,75,000	Loan from SBI	4,00,000
Premises	2,054,970	Provision for Employees Welfare Fund	3,00,000
Patents	5,00,000	Proposed Dividend	82,000
Discount on issue of shares (unwritten off)	12,500	Short term loan from bank	2,45,100
Trade Receivables	1,83,120	Unpaid dividend	32,400
Advance Tax	25,000	Profit & Loss A/c	21,490
8% Govt. Bonds	1,68,000	Bills Payable	42,550
Stock in trade	1,77,800	Sundry Creditors	50,010
	38,03,550		38,03,550

Balance Sheet of Stalin Pvt Limited as on 31st March 2014

Particulars	Note No.	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' funds:		
(a) Share capital		26,00,000
(b) Reserves and surplus	1	51,490
2. Share application money pending allotment:		Nil
3. Non-current liabilities:		
(a) Long-term borrowings		4,00,000
(b) Long-term provisions		3,00,000
4. Current liabilities:		
(a) Short-term borrowings		2,45,100
(b) Trade payables	2	92,560
(c) Other current liabilities		32,400
(d) Short-term provisions		82,000
TOTAL		38,03,550
II. ASSETS		
1. Non-current assets:		
(a) Fixed assets		
(i) Tangible assets	3	24,29,970
(ii) Intangible assets		5,00,000
(b) Other non-current assets		12,500

2. Current assets:

- (a) Current investments
- (b) Inventories
- (c) Trade receivables
- (d) Cash and cash equivalents
- (e) Short-term loans and advances
- (f) Other current assets

TOTAL

4

1,68,000
1,77,800
1,83,120
1,57,160
1,50,000
25,000
38,03,990

SOLUTION :**Notes to the Financial Statement:**

1. Reserve and Surplus

Capital Reserve	30,000
Profit & Loss A/c (Cr. Bal.)	21,490
Total	51,490

2. Trade Payables

Sundry creditors	50,010
Bills payable	42,550
Total	92,560

3. Tangible Fixed Assets

Premises	20,54,970
Furniture & Fixture	3,75,000
Total	24,29,970

ILLUSTRATION 2.

From the following Ledger balances of Bharat Ltd., prepare the Balance Sheet of the company as on 31st March 2018 as per Schedule III of the Companies Act.

Particulars	₹	Particulars	₹
Plant & machinery	18,00,000	Immovable property	30,00,000
8% Debenture	24,00,000	Public deposit	15,00,000
Employee's provident Fund	3,90,000	Provision for taxation	5,40,000
Securities premium	2,40,000	Drafts on hand	5,00,000
Cash at bank	1,02,000	Bills Receivable	7,20,000
24000 fully paid Equity shares of ₹ 100 each ₹ 50 called up	36,00,000	Brokerage on issue of shares	3,30,000
Sundry Creditors	3,48,000	Bank overdraft	4,50,000
Loan to Manager	2,10,000	Security Deposit	3,72,000
Deposits with ICICI Bank (5 years)	5,94,000	Trade marks	5,40,000
Prepaid insurance	3,00,000		

SOLUTION:

Balance Sheet of Bharat Ltd. as on 31st March 2018

Particulars	Note No.	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' funds:		
(a) Share capital	1	24,00,000
(b) Reserves and surplus		2,40,000
2. Share application money pending allotment:		Nil
3. Non-current liabilities:		
(a) Long-term borrowings	2	39,00,000
(b) Long-term provisions		3,90,000
4. Current liabilities:		
(a) Short-term borrowings		4,50,000
(b) Trade payables		3,48,000
(c) Short-term provisions		5,40,000
TOTAL		94,56,000
II. ASSETS		
1. Non-current assets:		
(a) Fixed assets		
(i) Tangible assets	3	48,00,000
(ii) Intangible assets		5,40,000
(b) Non-current investment		5,94,000
(c) Long-term loans & advances		3,72,000
(d) Other non-current assets		3,30,000
2. Current assets:		
(a) Trade receivables	4	7,20,000
(b) Cash and cash equivalents		16,02,000
(c) Short-term loans and advances		2,10,000
(d) Other current assets		3,00,000
TOTAL		94,56,000

Notes to the Financial Statement:

1. Share Capital

Authorized Capital (24000 Equity shares of ₹ 100 each)	72,00,000
Issued & Subscribed capital (24,000 Equity shares of ₹ 100 each)	72,00,000
Called up & Paid up capital (24000 Equity shares of 80 each)	36,00,000
TOTAL	36,00,000

2. Long Term borrowings

8% Debentures	24,00,000
Public deposits	15,00,000
TOTAL	39,00,000

3. Tangible Assets

Plant & Machinery	18,00,000
Immovable property	30,00,000
TOTAL	48,00,000

4. Cash & Cash equivalent

Cash in hand	1,02,000
Drafts on hand	15,00,000
TOTAL	16,02,000

ILLUSTRATION 3.

From the following ledger balances of Diamond Company Limited as on 31st March 2017. You are required to prepare the Balance Sheet as on 31st March 2017 as per Revised schedule III of the Indian Companies Act 2013.

Particulars	₹	Particulars	₹
Office Equipment	1,92,240	Reserve General	1,66,000
9% Debentures in APCO Ltd,	98,000	Creditors for Goods	67,400
Loose Tools	65,200	Creditors for expenses	14,400
Plant & machinery	7,20,000	Cash Credit	30,000
Computer Software	33,300	Mortgage loan	1,24,000
Debtors for goods	76,000	8% Preference share capital	2,20,000
Advertisement (un written off)	12,000	Equity Share Capital	6,00,000
Stores & Spares	40,080	Staff Welfare Fund	34,000
Interest accrued on investment	20,400	Provision for Taxation	10,620
Cash at Bank	9,200		

SOLUTION:**Balance Sheet of Diamond Company Limited as on 31st March 2017**

Particulars	Note No.	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' funds:		
(a) Share capital : (i) Equity Share Capital	1	6,00,000
(ii) Preference Share Capital		2,20,000
(b) Reserves and surplus		1,66,000
		Nil
2. Share application money pending allotment:		
3. Non-current liabilities:	2	
(a) Long-term borrowings		1,24,000
(b) Long-term provisions		34,000

Problems on Balance Sheet of a Company as per Revised Schedule III...

9

I. Current liabilities:

- (a) Short-term borrowings
- (b) Trade payables
- (c) Short-term provisions

TOTAL

30,000
81,800
10,620
12,66,420

II. ASSETS

1. Non-current assets:

- (a) Fixed assets
 - (i) Tangible assets
 - (ii) Intangible assets
- (b) Other non-current assets

3

912,240
33,300
12,000

2. Current assets:

- (a) Current investments
- (b) Inventories
- (c) Trade receivables
- (d) Cash and cash equivalents
- (e) Other current assets

4

98,000
1,05,280
76,000
9,200
20,400

TOTAL

12,66,420

Notes to the Financial Statement:

1. Trade payables

Creditors for Goods	67,400
Creditors for expenses	14,400
Total	81,800

2. Tangible Fixed Assets

Office Equipment	1,92,240
Plant and machinery	7,20,000
Total	9,12,240

3. Inventories

Loose tools	65,200
Stores & Spares	40,080
Total	1,05,280

ILLUSTRATION 4.

Prepare Balance sheet of Day Light company Ltd., in the prescribed proforma as on 31st March 2019 from the following Trial balance

Trial Balance as on 31st March 2019

Particulars	₹	Particulars	₹
Leasehold property	6,40,000	Share Capital	8,26,000
Bank balance	42,000		

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Problems on Balance Sheet of a Company as per Revised Schedule III...

Plant & Machinery	3,60,000	Staff Provident fund	
Goodwill	1,20,000	Capita redemption reserve	32,000
Investment in a subsidiary Co.	4,60,000	General reserve	88,000
P & L A/c	28,000	Deposits from public	76,000
Stock of finished goods	48,000	Accounts payable	3,60,000
Accounts receivable	96,000	Short Term loan from SBI	84,000
Preliminary Expenses	15,600	Unclaimed dividend	71,200
Underwriting commission	18,000		2,400
	18,27,600		18,27,600

SOLUTION:Balance Sheet of Day Light company Ltd as on 31st March 2019

Particulars	Note No.	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' funds:		
(a) Share capital	1	8,26,000
(b) Reserves and surplus		1,36,000
2. Share application money pending allotment:		
3. Non-current liabilities:		
(a) Long-term borrowings		3,60,000
(b) Long-term provisions	2	3,20,000
4. Current liabilities:		
(a) Short-term borrowings		71,200
(b) Trade payables		84,000
(c) Other current liabilities		2,400
TOTAL		17,99,600
II. ASSETS		
1. Non-current assets:		
(a) Fixed assets	3	10,00,000
(i) Tangible assets		1,20,000
(ii) Intangible assets		4,60,000
(b) Non-current Investment		33,600
(c) Other Non-current assets	4	
2. Current assets:		
(a) Inventories		48,000
(b) Trade receivables		96,000
(c) Cash and cash equivalents		42,000
TOTAL		17,99,600

Problems on Balance Sheet of a Company as per Revised Schedule III...

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Notes to the Financial Statement:

1. Reserve and Surplus

Capital Redemption Reserve	88,000
General Reserves	76,000
Debit balance of P&L	(28,000)
Total	1,36,000

2. Tangible Fixed Assets

Leasehold property	6,40,000
Plant & machinery	3,60,000
Total	10,00,000

3. Other non-current assets

Underwriting Commission	18,000
Preliminary expenses	15,600
Total	33,600

ILLUSTRATION 5.

From the following ledger balances of Jack Company Ltd., prepare the Balance Sheet of the company as on 31st March 2019 as per Schedule VI of the Companies Act.

Particulars	₹	Particulars	₹
Equity Share Capital	5,20,000	Advances to employees	30,000
General Reserves	6,000	Discount on issue of debentures	2,500
12% Debenture	80,000	(unwritten off)	
Land & Buildings	3,10,994	Tools and equipment	75,000
Goodwill	2,00,000	Gratuity Fund	60,000
Bank Overdraft	49,020	Debtors	27,704
Proposed Dividend	16,400	Cash at Bank	31,432
Prepaid insurance	5,000	Stores & Spares	35,560
Mutual Fund	33,600	Profit & Loss A/c (credit)	4,298
Interest payable	6,480	Bills Receivable	8,920
		Sundry Creditors	18,512

SOLUTION:

Balance Sheet of Jack Company Ltd as on 31st March 2019

Particulars	Note No.	Amount (₹)
I. EQUITY AND LIABILITIES		
1. Shareholders' funds:		
(a) Share capital		5,20,000
(b) Reserves and surplus	1	10,298
2. Share application money pending allotment:		Nil
3. Non-current liabilities:		
(a) Long-term borrowings	2	80,000
(b) Long-term provisions		60,000

Problems on Balance Sheet of a Company as per Revised Schedule III...

4. Current liabilities:		
(a) Short-term borrowings		49,020
(b) Trade payables		18,512
(c) Other current liabilities		6,480
(d) Short-term provisions		16,400
TOTAL		7,60,710
II. ASSETS		
1. Non-current assets:		
(a) Fixed assets	3	
(i) Tangible assets		
(ii) Intangible assets		
(b) Other non-current assets		3,85,994
2. Current assets:		
(a) Current investments	4	2,00,000
(b) Inventories		2,500
(c) Trade receivables		33,600
(d) Cash and cash equivalents		35,560
(e) Short-term loans and advances		36,624
(f) Other current assets		31,432
TOTAL		30,000
		5,000
		7,60,710

Notes to the Financial Statement:**1. Reserve and Surplus**

General Reserve	6,000
Profit & Loss A/c (Cr. Bal.)	4,298
Total	10,298

2. Tangible Fixed Assets

Land & Buildings	3,10,994
Tools & Equipment	75,000
Total	3,85,994

3. Trade Receivables

Sundry Debtors	27,704
Bills Receivable	8,920
Total	36,624

PREVIOUS YEAR QUESTION PAPER

Question Paper, December 2018

III Semester 5 Year B.Com. L.L.B. Examinational Corporate Accounting

Duration : 3 Hours
Instructions :

Max. Marks : 100

1. Answer Q. No. 9 and any five of the remaining questions.
 2. Q. No. 9 carries 20 marks and the remaining questions carry 16 marks each.
 3. Answer should be written either in English or Kannada completely.
1. Define Goodwill. Explain different methods of Valuation of Goodwill. **Marks : 16**
 2. Sam Ltd. invited applications from public for 1,00,000 equity shares of ₹ 10 each at a premium of ₹ 5 per share. The entire issue was underwritten by the underwriters A, B, C and D to the extent of 30%, 30%, 20% and 20% respectively with the provision of firm underwriting of 3000, 2000, 1000 and 1000 shares respectively. The underwriters were entitled to the maximum commission permitted by Law. The company received applications for 70,000 shares from public out of which applications for 19,000, 10,000, 21,000 and 8,000 shares were marked in favour of A, B, C and D respectively.
Calculate the liability of each of the underwriters. Also ascertain the underwriting commission payable to the different underwriters. **Marks : 16**
 3. POR Trading Company Limited issued 1000 equity shares of 10 each at a premium of 2 per share. The amount was payable as follows : **Marks : 16**
₹ 2 application
₹ 5 on allotment including premium
₹ 3 on first call and
₹ 2 on final call.
All the shares were subscribed and the money duly received except the final call on 1000 shares. The directors forfeited these shares and re-issued them as fully paid at 8 per share. Pass the Journal entries.
 4. Reedhanya formed a Pvt. Ltd. Co., under the name of Reedhanya Pvt. Ltd. to take over his existing business as on April 1, 2016, but the company could not be incorporated till July 1, 2016. No entries relating to transfer of the business were entered in the books, which were carried on without a break till March 31st, 2017. The following Trial Balance was extracted from the books as on March 31, 2017 : **Marks : 16**

Trial Balance

Particulars	Dr. (₹)	Cr. (₹)
Inventory April 1, 2016	4,300	
Sales		27,800

Purchases	18,900	
Carriage outwards	330	
Travellers commission	750	
Office salaries and expenses	2,100	
Rent and rates	1,200	
Reedhanya's Capital A/c April 1, 2016		
Director's fees	1,800	23,000
Fixed Assets- Tangible	13,400	
Current liabilities		
Current Assets (other than stock)	11,200	3,700
Preliminary expenses	520	
Total	54,500	54,500

You are also given the following informations :

- Inventory on March 31, 2017 ₹ 4,400.
- The purchase consideration was agreed at 30,000 to be satisfied by the issue of 3000 equity shares of ₹ 10 each.
- The gross profit margin is constant and the monthly sales in April 2016, February 2017 and March 2017 are double the monthly sales for the remaining months of the year.
- The Preliminary expenses are to be written-off.
- You are to assume that carriage outwards and travellers commission vary in direct proportion to sales.

You are required to calculate Gross Profit and prepare a statement of Profit and Loss for the year ended March 31, 2017 apportioning the periods before and after incorporation and a Balance Sheet as on that date. Ignore depreciation.

5. Balance Sheet of Atharva Ltd. as on 31-03-2017 is as under :

Liabilities	₹	Assets	Marks : 16
Share Capital :		Fixed Assets	₹
10,000 Equity share of ₹ 100 each	10,00,000	Stock	10,00,000
6000, 15% Preference		Debtors	3,50,000
Share of 100 each	6,00,000	Cash and Bank	4,50,000
General Reserve	80,000		80,000
Profit and Loss A/c	1,60,000		
Sundry Creditors	1,60,000		
	20,00,000		2,00,000

ie Profit of the Company (before providing for taxation at 38.5%) and the rate of dividend declared in respect of the past 5 financial years are as under :

Financial Year	Profit ₹	Rate of Dividend
2011-2012	2,70,000	8%
2012-2013	3,10,000	10%
2013-2014	3,40,000	12%
2014-2015	3,30,000	15%
2015-2016	3,60,000	15%

You are required to find out the value of goodwill at 5 years purchase of the super profits of the company.
 6. On March 31, 2015 the Balance Sheet of a Limited Company reveals the following position.

Liabilities	₹	Assets	₹
Issued Capital :	4,00,000	Fixed Assets	
@ 10/Share Reserves	90,000	Current Assets	5,00,000
P/L A/c	20,000	Goodwill	2,00,000
5% Debentures	1,00,000		40,000
Current Liabilities	1,30,000		
	<u>7,40,000</u>		<u>7,40,000</u>

On March 31, 2015 the fixed assets were independently valued at 3,50,000 and the goodwill at ₹ 50,000. The Net Profits for the three years were :

2012 - 13 - ₹ 51,600

2013 - 14 - ₹ 52,000

2014 - 15 - ₹ 51,650 of which 20% was placed under reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%. Compute the value of the company's shares by

- Net Asset Method
- Yield Value Method and
- Earning Capacity Method

7. The following is the 'Trial Balance of Sangeetha Company as on 31-3-2016. The company has 20,000 shares of ₹ 100 each as Registered Capital.

Particulars	Dr. (₹)	Cr. (₹)
Shares (3000 shares of ₹100 each)		3,00,000
Calls in Arrears	16,000	
Reserve Fund		2,50,000
Buildings	1,80,000	
Fixed Deposits		1,00,000
Wages	30,000	
Machinery	89,000	
Furniture	80,000	
Purchases and Sales	2,10,000	5,25,000
Salaries	60,000	
Debtors and Creditors	2,20,000	1,50,000
BR and BP	61,000	90,000
Directors Fees	20,000	
Returns	15,000	
Freight	10,000	

Manufacturing Expenses	5,000
Opening Stock	65,000
Interim Dividend (Excluding Corporate Dividend tax)	25,000
Audit Fees	15,000
P/L A/c	
Tools	38,000
Preliminary Expenses	60,000
Debentures	
Interest on Debentures	14,000
Investments	2,50,000
Goodwill	52,000
Insurance and Taxes	20,000
Printing and Stationery	15,000
Cash and Bank Balances	12,000
	15,62,000

27,000

1,00,000

15,62,000

Adjustments:

- Directors proposed a total dividend of 25%.
- Write off 25% of preliminary expenses and 10% of goodwill.
- Depreciate buildings by 2% and furniture by 5%.
- Transfer ₹ 60,000 to Reserve Fund.
- Insurance prepaid ₹ 1,500
- Closing Stock ₹ 80,000

Prepare Income Statement and Balance Sheet.

8. Write a short notes on any two of the following :

Marks : 2 8=16

- Preference shares
- Underwriting and its types
- Methods of valuation of shares.

9. Solve any two of the following problem :

Marks : 2 10=20

- From the following particulars, prepare Income Statement for the year ending 31st March 2015.
 - P & L A/c balance for Last Year ₹ 62,500.
 - N/P for the year before tax ₹ 5,40,000 (provide for tax at 40%)
 - Transfer to general reserve ₹ 52,500, Dividend equalization fund ₹ 40,000 and development reserve ₹ 37,500.
 - Dividend on 7.5% on Preference shares ₹ 3,00,000.
 - Dividend on 12.5% on 5,000 Equity shares of ₹ 10, ₹ 7.50 called up (calls in arrears ₹ 13,000)
 - Corporate dividend tax of 20.36%.

- (b) ABC Ltd. incorporated 01-01-2017 issued a prospectus inviting applications for 5,00,000 Equity shares of ₹ 10 each. The whole issue was underwritten by W, X, Y and Z as follows :
- W-2,00,000, X-1,50,000, Y-1,00,000 and Z-50,000 shares. Applications were received for 4,50,000 shares of which marked application were as follows W-2,20,000, X-1,10,000, Y-90,000 and Z-10,000. You are required to find out the liability of underwriters.
- (c) The Goodwill Company Ltd. issued 20,000 Preference shares of ₹ 100 each. The amount was payable as follows :
- ₹ 10 on application
 - ₹ 50 on allotment
 - ₹ 40 on first and final call

All the shares were subscribed and the amount was duly received. Pass the Necessary Journal entries.

♦ ♦ ♦

MODEL QUESTION PAPER

III Semester 5 Year B.Com. L.L.B. Examination Corporate Accounting

Duration : 3 Hours

Max. Marks : 100

Instructions :

1. Answer Q. No. 9 and any five of the remaining questions.
2. Q. No. 9 carries 20 marks and the remaining questions carry 16 marks each.
3. Answer should be written either in English or Kannada completely.

1. What do you mean by underwriting of shares ? Explain various types of underwriting. How the liability of underwriters is determined ?

Marks : 16

2. Popular Ltd., issued 40,000 shares of rupees 10 each for public subscription, the issue were underwritten by P, Q and R as follows P 25% of issue Q 30% of issue R 40% of the issue. The marked applications for P, Q and R 5,000 shares, 6,000 shares and 4,000 shares respectively. The company received applications for 30,000 shares. Ascertain the net liability of each of the underwriters.

Marks : 16

3. The UB Company Limited issued for public subscription 20,000 share of ₹ 10 each at a premium of ₹ 2 payable as follows :

Marks : 16

On application ₹ 2 per share

On allotment ₹ 5 per share (including premium)

On first call ₹ 2 per share

On second and final call ₹ 3 per share.

Application was received for 30,000 shares 20,000 shares were allotted and excess application money received is returned. The company received all the due except the final call on 1,000 shares from Rehim. These shares were forfeited and later re-issued as fully paid at ₹ 8 per share. Pass journal entries and also show how share capital appears in the Balance Sheet.

4. Stalin & Ruth Wedding Company Limited was incorporated on August 1, 2019. It had acquired a running business of Raj Kamal & Co. with effect from April 1, 2019. During the year 2019-20, 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 August 31, 2019 ₹ 5,000. You are required to ascertain pre-incorporation and post-incorporation profit for the year ended 31st March, 2020.

Marks : 16

5. The following particulars are available in respect of the business carried on by Mr. Prabhu.

(a) Profits earned :

(i) 2016-17- ₹ 1,00,00

- (ii) 2017-2018- ₹ 96,000
 (iii) 2018-2019- ₹ 1,04,000
- (b) Profits of 2017-18 is reduced by ₹ 10,000 due to stock destroyed by fire and profit of 2016-17 included non-recurring income of ₹ 6,000.
- (c) Profits of 2017-18 include ₹ 4,000 income on investment.
- (d) The stock is not insured and it is thought necessary to insure the stock in future. The insurance premium is estimated at ₹ 1,000 p.a.
- (e) Fair remuneration to the Proprietor (Not taken in the calculation of profits) is ₹ 10,000 p.a. You are required to compute the value of goodwill on the basis of 2 years purchase of average profits of the last 3 years.
6. ABC Ltd purchase the business of XYZ Ltd. Calculate goodwill on the basis of 3 years of purchase weighted average for 4 years. The appropriate weights are :

Years	Profit (₹)	Weights
2016	40,500	1
2017	46,500	2.5
2018	60,000	3.8
2019	75,000	4.2

- (a) The company purchased new furniture on 30th June 2018 which was entered in purchase day Book. The value of furniture was ₹ 10,000. For the purpose of goodwill, the error has to be Rectified and depreciation should be provided at 10% under written down value method.
- (b) The opening stock of year 2018 was undervalued by ₹ 2,500.
- (c) Anticipated additional expenses in administration is ₹ 5,000.
7. From the following extract of Ledger Balances taken from XYZ Ltd., for the year ending 31-03-2019 prepare a statement of Profit and Loss Account.

Particulars	Amount (₹)
Revenue from Operations	1,96,000
Other Incomes	4,000
Advertising	10,500
Salaries	54,000
Depreciation	5,600
Insurance	2,000
Interest on debentures	2,000
Preliminary expenses written off	2,000
Bad debts	1,000
Discount	1,000
Printing and Stationery	2,000
Cost of materials consumed	50,000

You are required to prepare financial statements from the following trial balance of Ronan & Company Ltd. for the year ended 31st March, 2019

**Ronan Company Ltd.
Trial Balance as at 31st March, 2019**

Particulars	₹	Particulars	₹
Stock	1,70,000	Equity Shares Capital (Shares of ₹ 10 each)	6,25,000
Furniture & Fixtures	1,25,000	11% Debentures	1,25,000
Discount	10,000	Bank Loans	1,61,250
Loan to Directors	20,000	Bills Payable	31,250
Advertisement	5,000	Creditors	39,000
Bad Debts	8,750	Sales	10,67,000
Commission	30,000	Rent Received	11,500
Purchases	5,79,750	Transfer Fees	2,500
Plant and Machinery	2,15,000	Profit & Loss Appropriation Account	34,750
Rentals	6,250	Provision for Depreciation on Plant & Machinery	36,500
Current Account	11,250		
Cash	2,000		
Interest on Bank Loan	29,000		
Preliminary Expenses	2,500		
Wages	2,25,000		
Consumables	21,000		
Freehold Land	3,86,500		
Tools and Equipments	61,250		
Goodwill	66,250		
Debtors	71,750		
Bills Receivables	38,250		
Dealer Aids	5,250		
Transit Insurance	7,500		
Trade Expenses	18,000		
Distribution Freight	13,500		
Debentures Interest	5,000		
	<u>21,33,750</u>		<u>21,33,750</u>

Additional Information :

- Closing stock as on 31st March, 2019, ₹ 2,05,750.
 - Depreciation on furniture & fixtures @5%, Freehold land @2% Equipment's @5% to be provided and Tools and Equipment's @5% to be provided.
- 2 10=20
9. Solve any two following questions :
- (a) Reliable Limited issued equity shares ₹ 2,00,000 at ₹ 10 per share. The whole issue was fully underwritten by the following underwriters Rakesh-70,000 Lokesh-60,000

Santhosh-40,000, Dinesh-20,000, Mahesh-6,000, Avinash-4,000. The application forms marked by the underwriters were Rakesh-20,000, Lokesh-45,000, Santhosh-40,000, Dinesh-15,000, Mahesh-17,000 and Avinash-nill, Applications for 40,000 shares were received on forms not marked. You are required to find out the liability of underwriters.

- (b) A company limited issued 10,000 equity shares of ₹ 10 each and the money was payable as under :

On application ₹ 2

On allotment ₹ 3

On first and final call ₹ 5 per share.

Public subscribed for 11,000 shares. 1,000 shares application money were returned. All the shares were allotted and the money duly received. Pass necessary journal entries in the books of the company.

- (c) Calculate sales ratio from the following : X company was incorporated on 1-8-2017 and acquired a business with effect from 1-4-2017. Total sales from 1-4-2017 to 31-03-2018 was ₹ 6,00,000. Sales for April and May = $1\frac{1}{2}$ times the average monthly sales. Sales from June to October = $\frac{1}{2}$ of average monthly sales. Sales for November and December = $\frac{1}{4}$ of average monthly sales and sales from January to March = Double the average monthly sales.

For 5 Year B.Com, LL.B. 2nd Sem. of Karnataka State Law University
and useful for other affiliated courses of other Universities

Author's Profile

Dr. Aloysius Edward J. is a Dean, Faculty of Commerce and Management and a Professor of finance in School of Management, KristuJyanti College, Autonomous, Bengaluru. Further, Prof. Aloysius coordinates quality assurance activities of the college as Director of Internal Quality Assurance Cell (IQAC) of the college.

He presented the paper on 'Systematization of Internal Quality Assurance System - KristuJyanti College, Bangalore: A Case Study' in International Conference on 'Quality Assurance - Foundation for Future' in Madrid, Spain organized by INQAAHE in April 2011 besides more than 30 papers published and presented in various National & International Journals and Conferences. Prof. Aloysius served as resource person/chief guest in various national and international conferences and workshops across the country including Refresher Courses organized by the Department of Commerce, Bangalore University. Dr. Aloysius is an External Examiner of University of West of Scotland, Scotland for the MBA International Business & Finance and he was a member of BoS and BoE in Bangalore University for M.Com programme and is a member of BoS, School of Commerce, Finance and Accountancy in Christ University, Bengaluru. Prof. Aloysius assists higher educational institutions in setting up of the internal quality assurance systems and processes.



Dr. Aloysius Edward was honoured with the ACBS Teaching Excellence Award 2018 from Region 10 of ACBS at Kansas City, USA on June 08 2018 during International Conference by the Accreditation Council for Business Schools and Programs (ACBS), USA. The award was for the Region 10 which comprises of 16 countries in South and Southeast Asia including India. He was also recipient of Dr APJ Abdul Kalam Life Time Achievement National Award for achieving outstanding excellence in the field of Teaching, Research and Publications on Feb. 24, 2018 from International Institute for Social and Economic Reforms. Dr. Aloysius also received Principal Excellence Award 2020 from Higher Education Forum - Gujarat Chapter. Prof. Aloysius has more than 25 years of teaching experience and he is an advisor for personal investment and tax planning.

Prof. Xavier. P M.Com, PGDCA, MBA (Ph.D) is the HOD, Faculty of Commerce and Management, Jindal College for Women, Bengaluru. Further, Prof. Xavier coordinates quality assurance activities of the college as NAAC co-ordinator of the college. He has presented and published papers in many national and International conferences. Prof. Xavier is also given guest lectures in various colleges in Bengaluru. He was also a resource person in Chandana TV on the subject marketing. Prof. Xavier has also authored Business Regulations and Global Talent Management for Bangalore University and its affiliated colleges. Prof. Xavier has also guided many number of students for their project in M.com when he was the Co-ordinator of M.Com in Jindal College for Women. He is also awarded twice as the best faculty from Jindal Management. Prof. Xavier has more than 20 years of experience in teaching. Apart from teaching his hobby is to take short documentary movies and for the same has been appreciated from Government Flying Training School Jakkur, Bengaluru.



Prof. Lourdanathan F., is a, Faculty of Commerce and Management, teaching Finance and Accounts in Department of Commerce and Management, KristuJyanti College, Autonomous, Bengaluru. Further, Prof. Lourdanathan has total 18 years of teaching experience and expertise in Accounts and Finance. He has published research articles in both national and international journal and a chapters in a books at The Native Tribe Publication which is available at more than 12 countries. He had Authored a books on Business Regulation and Global Talent Management for the Bangalore University and its affiliated colleges. Prof. Lourdanathan was awarded as the best advocate by the president of CIMA UK for his outstanding contribution for CIMA course. He was also resource person for various online webinars and seminars, and Deputy custodian for Bangalore University, MBA Programme during 2005 and 2006 University examination and he was a member of BoS and BoE in Bangalore University for B.com programme and is a member of BoS, and BoE, Department of Commerce, KristuJyanti College, Autonomous, Bangalore.



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2.	Equity Share Application Account ----- Dr. To Equity share capital account (10,000 5) To Calls in advance account (600 5) To Bank account (1,000 5) (Being share application money transferred to share capital account on 500 shares of ₹ 10 each)	58,000	50,000 3,000 5,000
3.	Equity Share allotment account ----- Dr. To Equity Share Capital account (Being Equity share Allotment money duly received on 10,000 shares of ₹ 5 each)	50,000	50,000
4.	Bank Account ----- Dr. Calls in advance account (400 5) ----- Dr. To Equity Share Allotment account (Being share allotment money duly received on (10,000-400) 9,600 5 and the balance on 400 adjusted through excess application money received shares)	48,000 2,000	50,000
5.	Equity Share first call account ----- Dr. To Equity share Capital account (Being Share first call money due on 10,000 shares of ₹ 7.5 each)	75,000	75,000
6.	Bank account ----- Dr. Calls-in advance account ----- Dr. To Equity Share first call account (Being Equity Share first call money received on (10,000-400) 9,600 7.5 per shares each and calls in advance adjusted to extent of ₹ 1,000, 400 7.5 (3,000-1,000))	74,000 1,000	75,000
7.	Equity Share final call account ----- Dr. To Equity share Capital account (Being Share final call money due on 10,000 shares of ₹ 7.5 each)	75,000	75,000
8.	Bank account ----- Dr. To Equity Share final call account (Being Equity Share first call money received on 10,000 shares of ₹ 7.5 each)	75,000	7,500
	Grand total	5,16,000	5,16,000

Calculation of Rejection Money

Company Issued 10,000 Shares of ₹ 25 each

i.e. Total Share Application Issued	10,000
Less: Public subscribed for	11,600
∴ Excess Application received	1,600
Less: As per instruction given in Question 1,000 Share Application rejected and money returned (i.e.)	1,000 600

Money returned = 1,000 × 5 each : ₹ 5,000

Calculation of Pro-Rata

In the given Question, A person who applied for 1,000 shares, Alloted only 600 shares (i.e.)

For 1,000 : 600 = 10 : 6 (or) 5 : 3 ratios.

∴ Therefore Application money received on 1,000 shares at ₹ 5 per share	$1,000 \times 5 = ₹ 5,000$
Less : Adjusted to Share Application Money on 400 shares of ₹ Search = (400×5)	<u>2,000</u>
Balance (i.e.) excess of Application	3,000
Less : Adjusted towards Allotment Money on 400 Shares of ₹ 5 each = (400×5)	<u>2,000</u>
Balance excess amount	1,000
Less : Adjusted towards first call (400×7.5)	<u>1,000</u>

ILLUSTRATION 20.

Star Ltd., issued 1,00,000 shares of ₹ 10 each payable ₹ 3 on application, ₹ 3 on allotment and balance on first and final call. Applications were received for 2,00,000 shares and allotment were made as follow:

1. Applicants for 1,20,000 shares were allotted 60,000 shares.
2. Applicants for 80,000 shares were allotted 40,000 shares.

Anupam, to whom 1,000 shares were allotted from category (I), failed to pay the allotment money. Pass Journal entries up to allotment.

SOLUTION:**Journal entries in the books of A Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Bank Account ----- Dr. To share Application account (Being share application money received on 2,00,000 shares of ₹ 3 each)		6,00,000	6,00,000
2.	Share Application Account ----- Dr. To share capital account (1,00,000 3) To Calls in advance account (1,00,000 3) (Being share application money transferred to share capital account on 1,00,000 shares of ₹ 3 and on 1,00,000 shares 3 each excess money transferred to calls-in advance account)		6,00,000	3,00,000 3,00,000
3.	Share allotment account ----- Dr. To Share Capital account (Being share Allotment money due on 1,00,000 shares of ₹ 3 each)		3,00,000	3,00,000
4.	Calls in advance account (1,00,000 3) ----- Dr. To Equity Share Allotment account (Being share allotment money duly adjusted from calls-in advance account on (1,00,000) shares of ₹ 3 each)		3,00,000	3,00,000
5.	Share first and final call account ----- Dr. To share Capital account (Being Share first and final call money due on 1,00,000 shares of ₹ 4 each)		4,00,000	4,00,000
6.	Bank account ----- Dr. To Share first and final call account (Being Share first and final call money due on 1,00,000 shares of ₹ 4 each)		4,00,000	4,00,000
	Grand total		20,00,000	20,00,000

ILLUSTRATION 21.

ABC Co, Ltd, issued 5,000 equity shares of ₹ 100 each at a premium of ₹ 5 per share payable ₹ 20 application, ₹ 35 on allotment (including premium) and ₹ 50 on first and final call.

Application was received for 7,000 shares. The Directors allotted 5,000 shares and refunded the money over subscribed. On allotment the money was received in full, but on a call being made a shareholder holding 200 shares failed to pay his call amount. Pass Journal entries and prepare cash book.

(KSLU II Semester 5 year B. Com. L.L.B. Examination, December 2019)

SOLUTION:**Journal entries in the books of Gee Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Bank Account ----- To Equity share Application account (Being share application money received on 7,000 shares of ₹ 20 each)	Dr.	1,40,000	1,40,000
2.	Equity Share application account ----- To Bank account (Being excess of share application on (7,000-5,000) 2,000 shares of ₹ 20 each returned)	Dr.	40,000	40,000
3.	Equity Share Application Account ----- To Equity share capital account (Being share application money transferred to share capital account on 5,000 shares of ₹ 20 each)	Dr.	1,00,000	1,00,000
4.	Equity Share allotment account ----- To Share Premium account To Equity Share Capital account (Being Equity share Allotment money due including ₹ 5 on premium due on 5,000 shares of ₹ 35 each)	Dr.	1,75,000	25,000 1,50,000
5.	Bank Account ----- To Equity Share Allotment account (Being share allotment money including premium duly received on 5,000 shares of ₹ 35 each)	Dr.	1,75,000	1,75,000
6.	Equity Share first and final call account ----- To Equity share Capital account (Being Equity Share first call money due on 5,000 shares of ₹ 50 each)	Dr.	2,50,000	2,50,000
7.	Bank account ----- Calls-in arrears a/c To Share first and final call account (Being Share first and final call money received on 5,000-200) 4,800 shares of ₹ 50 each)	Dr. Dr.	2,40,000 10,000	2,50,000

BANK ACCOUNT			
DR.			CR.
Particulars	Amount	Particulars	Amount
To Share Application account	1,40,000	By Share Application	40,000
To Share Allotment account	1,75,000	By Balance c/d	6,15,000
To Share first and final call account	2,40,000		
	1,00,000		
	6,55,000		6,55,000

ILLUSTRATION 22.

A limited company having an authorized capital of ₹ 7,50,000 in shares of ₹ 10 each issued 50,000 shares of ₹ 10 each payable.

On application ₹ 2

On allotment ₹ 3

On First call ₹ 2

On final call ₹ 3

Applications received from public were 75,000 shares. The Directors allotted as follows:

To the applicant of 35,000 shares -full

To the applicants of 25,000 shares-15,000 shares

To the applicants of 15,000 shares-nil.

All the calls were made and the money duly received except final call money on 1,000 shares. Pass necessary journal entries in the books of the company.

(KSLU II Semester 5 year B.Com. L.L.B. Examination, December 2019)

SOLUTION:**Journal entries in the books of Gee Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Bank Account ----- Dr. To Share Application account (Being share application money received on 75,000 shares of ₹ 2 each)		1,50,000	1,50,000
2.	Equity Share application account----- Dr. To Bank account (Being excess of share application on 15,000 shares of ₹ 2 each returned)		30,000	30,000
3.	Share Application Account----- Dr. To Calls-in advance account To Share capital account (Being share application money transferred to share capital account on 50,000 shares of ₹ 2 each and excess application money on 10,000 shares of ₹ 2 each transferred to call-in advance account)		1,20,000	20,000 1,00,000

2.32

4.	Share allotment account ----- To Share Capital account (Being share Allotment money due on 50,000 shares of ₹ 3 each)	Dr. Dr.	1,50,000	1,50,000
5.	Bank Account ----- Calls-in advance account ----- To Share Allotment account (Being share allotment money duly received on 50,000 shares of ₹ 3 each calls in advance on 15,000 shares adjusted)	Dr. Dr.	1,30,000 20,000	1,50,000
6.	Share first call account ----- To Share Capital account (Being Share first call money due on 50,000 shares of ₹ 2 each)	Dr.	1,00,000	1,00,000
7.	Bank account ----- To Share first call account (Being Share first and final call money received on 50,000 shares of ₹ 2 each)	Dr.	1,00,000	1,00,000
8.	Share final call account ----- To Share Capital account (Being share final call money due on 50,000 shares of ₹ 3 each)	Dr.	1,50,000	1,50,000
9.	Bank account ----- Calls-in arrears account ----- To Share final call account (Being share final money duly received on (50,000-1,000) 49,000 shares of ₹ 3 each)	Dr. Dr.	1,47,000 3,000	1,50,000

ILLUSTRATION 22.

PQR trading company limited issued 10,000 equity shares of ₹ 10 each at a Premium of ₹ 2 per share. The Amount was payable as follows.

- ₹ 2 on application
- ₹ 5 on allotment (including premium)
- ₹ 3 on first call
- ₹ 2 on final call.

All the shares were subscribed and the money duly received except the final call on 1,000 shares. The directors forfeited these shares and re-issued them as fully paid at ₹ 8 per share. Pass the Journal entries.

KSLU III Semester 5 year B.Com L.L.B. Examination, December 2018

SOLUTION:**Journal entries in the books of Gee Limited**

Date	Particulars	L/F No	Debit ₹	Credit ₹
1.	Bank Account ----- To share Application account (Being share application money received on 10,000 shares of ₹ 2 each)	Dr.	20,000	20,000

2.	Share Application Account ----- To Share capital account (Being share application money transferred to share capital account on 10,000 shares of ₹ 2 each)	Dr.	20,000	20,000
3.	Share allotment account ----- To Share Premium account To Share Capital account (Being share Allotment money due including ₹ 2 on premium due on 10,000 shares of ₹ 5 each)	Dr.	50,000	20,000 30,000
4.	Bank Account----- To Share Allotment account (Being share allotment money including premium duly received on 10,000 shares of ₹ 5 each)	Dr.	50,000	50,000
5.	Share first call account ----- To share Capital account (Being Share first call money due on 10,000 shares of ₹ 3 each)	Dr.	30,000	30,000
6.	Bank account ----- To Share first call account (Being Share first call money received on 10,000 shares of ₹ 3 each)	Dr.	30,000	30,000
7.	Share final call account----- To Share Capital account (Being share final call money due on 10,000 shares of ₹ 2 each)	Dr.	20,000	20,000
8.	Bank Account ----- To Share final call account (Being share final call money duly received on (10,000-1000) 9,000x2 each)	Dr.	18,000	18,000
9.	Share capital account ----- To Final call account To Forfeiture shares account (Being 1,000 shares of ₹ 10 each forfeited due to non-payment of ₹ 2 each on final call)	Dr.	10,000	2,000 8,000
10.	Bank account ----- Forfeiture shares account ----- To Share capital account (Being 1,000 forfeited shares of ₹ 10 re-issued ₹ 8 per share fully paid and money duly received)	Dr. Dr.	8,000 2,000	10,000
11.	Forfeited shares account ----- To Capital reserve account (Being Balance on forfeited shares ie., (8,000-2,000) Transferred to capital reserve account)	Dr.	6,000	6,000

ILLUSTRATION 23.

The goodwill company Ltd, issued 20,000 Preference shares of ₹ 100 each. The amount was payable as follows;

₹ 10 on application

₹ 50 on allotment

₹ 40 on first and final call

All the shares were subscribed and the amount was duly received. Pass the necessary journal entries.

SOLUTION

Journal entries in the books of X company Limited

Date	Particulars	L/F No	Debit ₹	Credit ₹
01	Bank Account ----- To Share Application account (Being share application money received on 20,000 shares of ₹ 10 each)	Dr.	2,00,000	2,00,000
02	Share Application Account ----- To Share capital account (Being share application money transferred to share capital account on 20,000 shares of ₹ 10 each)	Dr.	2,00,000	2,00,000
03	Share allotment account ----- To Share Capital account (Being share Allotment money due on 20,000 shares of ₹ 50 each)	Dr.	10,00,000	10,00,000
04	Bank Account ----- To Share Allotment account (Being share allotment money duly received on 20,000 shares of ₹ 50 each)	Dr.	10,00,000	10,00,000
05	Share first and final call account ----- To Share Capital account (Being Share first and final call money due 20,000 shares of ₹ 40 each)	Dr.	8,00,000	8,00,000
06	Bank account ----- To Share first and final call account (Being Share first call money received on 20,000 shares of ₹ 40 each)	Dr.	8,00,000	8,00,000

Exercise

SHORT ANSWER TYPE

1. What do you mean by 'Share'?
2. What is share capital?
3. State different types of shares.
4. What is Preference share ? How are they different from ordinary share?
5. State different types of Shares.
6. What is 'Authorized' share capital?
7. What is 'Issued share Capital'?

8. What is 'Subscribed Share Capital'?
9. What is 'called-up share capital'?
10. What is paid up share capital?
11. What are calls-in arrears?
12. Mention the different types of Preference Shares.
13. What is Initial public Offering?
14. What do you mean by forfeiture of shares?
15. What is Pro-rata allotment of shares?
16. What is Right Issue of shares?

LONG ANSWER TYPE

1. Gopal Ltd, issued 1,00,000 Equity Shares of ₹ 10 each. The company offered for public subscription all the shares. Public applied for 90,000 shares and allotment was made to all the applicants. All the calls were made and were duly received except the final call of ₹ 2 per share on 500 shares. Prepare the journal entries in the books of Gopal Ltd.
2. Akshaya company issued ₹ 50,000 Equity Shares of ₹ 10 each to public. All amounts have been received in lump sum. Pass necessary Journal entries in the books of the company.
3. The authorized capital of ₹ 6,00,000 of XYZ Ltd. is divided into 60,000 Equity Shares of ₹ 10 each. Out of these shares, 40,000 Equity Shares were issued to the public. The full nominal value is payable on application. All the shares were subscribed by the public and total amount was paid for. Give necessary Journal entries in the books of the company.
4. XYZ Ltd. invited applications for 10,000 shares of ₹ 10 each payable as follows: ₹ 2 on application, ₹ 3 on allotment, ₹ 2 on first call and the balance on final call. All the shares were applied and allotted. All the money was duly received. You are required to Journalize these transactions.
5. Jubilee Ltd, was registered with a registered Capital of ₹ 5,00,000 divided into 50,000 shares ₹ 10 each payable ₹ 2 per share on application, ₹ 2 per share on allotment and balance on first and final call. All the shares were taken up and fully paid for by the public. Pass Journal entries to record the issue of shares.
6. Coffee Ltd. invited applications for 1,00,000 Equity Shares of ₹ 10 each issued at par. The whole amount was payable on application. The issue was oversubscribed by 20,000 shares and allotment was made on pro rata basis. Pass necessary Journal entries.
7. ABC Company Ltd. offered for subscription 20,000 shares of ₹ 10 each payable ₹ 2.50 on application and ₹ 5.00 on allotment for each share. Applications were received for 30,000 shares. Letters of regret were issued to applicants for 5,000 shares and their application money was refunded. Application money for other 5,000 shares was applied towards the payment for allotment money and all the 20,000 shares were issued to the public. The balance of allotment money was also received in due time. You are asked to give the Journal, Cash Book, Ledger Accounts and the Balance Sheet of the company.
8. Sanjeev Ltd. issued 10,000 Equity Shares of ₹ 10 each at a premium of ₹ 5 per share. The whole amount, was payable on application. The issue was fully subscribed. Pass necessary Journal entries.

9. A limited company offered for subscription 10,000 shares of ₹ 25 each, payable ₹ 5 per share on application, ₹ 10 per share on allotment (including ₹ 5 per share as premium), ₹ 5 per share as first call on the shares and the balance in two equal amounts at intervals of three months. All the shares were applied for and allotted. All the money was received except the second call and final call moneys on 200 and 400 shares respectively. You are asked to show the entries in the company's Journal, Cash Book and the Ledger. Also show the company's Balance Sheet on completion of the above transactions.
10. X Ltd. was incorporated with a capital of ₹ 2,00,000 divided into shares of ₹ 10 each. 2,000 shares were offered to the public and out of these, 1,800 shares were applied for and allotted. ₹ 3 per share (including 1 premium) was payable on application, ₹ 4 per share (including ₹ 1 premium) on allotment, ₹ 2 per share on first call and ₹ 3 per share on final call. All the money was received. Give necessary Journal entries and the Balance Sheet.
11. Moon Co. Ltd. was registered with a nominal capital of ₹ 1,00,000 in Equity Shares of ₹ 10 each. It offered to the public 6,000 shares for subscription, the applications were, however, received for 8,000 shares. The Directors had to reject the applications for 1,000 shares and to return the money received thereon. The application money received on the other 1,000 shares was adjusted to Allotment Account. The amount payable on shares was: ₹ 2 per share on application, ₹ 4 per share on allotment and the balance on first call. One shareholder holding 100 shares failed to pay the first call money and as a result his shares were forfeited, Pass necessary Journal entries and prepare Cash Book to record the above transactions.



UNIT

3

PROFIT PRIOR AND POST INCORPORATION

Learning Outcomes

After studying this chapter, you will be able to:

- Understand the meaning of Profit and Loss Prior to incorporation
- Treat profits and losses prior to incorporation in the books of accounts of a company.
- Understand the different "ratios" used in ascertaining profit prior to incorporation.
- Apportion various expenses and incomes between pre- and post-incorporation periods using different bases.

Contents

- Meaning of prior and post incorporation Profit/Loss
- Characteristics of Prior and post incorporation Profit/Loss
- Method of Computation of Profits/Loss Prior to Incorporation
- Steps may be suggested for ascertaining profit or loss prior to incorporation
- Basis of allocation of expenses and incomes
- Utilization Pre-incorporation Profit
- Sales Ratio/Time ratio/Illustration
- Calculation of sales for pre incorporation period
- Calculation of sales for Post incorporation period

Abstract: A profit prior to incorporation is a situation wherein A promoter decided to buy well established existing organisation would be more existed to know the financial performance that organisation before it gets incorporated/commences in his name such process is called profit prior and post incorporation.

Meaning of prior and post incorporation Profit/Loss

The profit earned after the date of purchase of business is called "Post-incorporation or Post-acquisition profit" and the profit earned before the date of purchase of business is termed as "Pre-incorporation profit."

Characteristics of Prior and Post incorporation Profit/Loss

- Any profit/loss made before the incorporation is known as "Profit (Loss) Prior to

Incorporation" which is treated as a capital profit and the same cannot be distributed as business profit.

- Any profit made before the incorporation cannot be distributed by way of dividend
- Any profit made before the incorporation is to be transferred to Capital Reserve or may be adjusted against Goodwill.
- Loss prior to incorporation" is treated as a capital loss
- "Loss prior to incorporation is shown under the head "Miscellaneous Expenditure" in the assets side of the Balance Sheet.

Method of Computation of Profits/Loss Prior to Incorporation

In order to ascertain the profit prior to incorporation a Profit and Loss Account is to be prepared at the date of incorporation. But in practice, the same set of books of accounts is maintained throughout the accounting year. Profit and Loss Account is prepared at the end of the year and thereafter the profits (or losses) between the two periods are allocated: (i) From the date of purchase to the date of incorporation or pre-incorporation period; (ii) From the date of incorporation to the closing of the accounting year or post-incorporation period.

Steps may be suggested for ascertaining profit or loss prior to incorporation

Step I: A Trading Account should be prepared at first for the whole period, i.e., between the date of purchase and the date of final accounts, in order to calculate the amount of gross profit.

Step II: Calculate the following two ratios: (i) Sales Ratio: Amount of sales should be calculated for the pre-incorporation and post-incorporation periods. (ii) Time Ratio: It is calculated after considering the time period, i.e., one is required to calculate the period falling between the date of purchase and the date of incorporation and the period between the date of incorporation and the date of presenting final accounts.

Step III: A statement should be prepared for calculating the amount of net profit before and after incorporation separately on the following principle.

Basis of allocation of expenses and incomes

Nature of Expenses and Losses	Basis of allocation
Gross Profit	Sales Ratio
Fixed Expenses or expenses incurred on the basis of time, viz., Rent, Salary, Depreciation, Interest, etc	Time ratio
Certain expenses, viz., partners salary, directors salary, preliminary expenses, interest on debentures, etc.	Post-acquisition
(i) Gross Profit (ii) Selling Expenses (iii) Advertisement (iv) Carriage Outwards (v) Godown Rent (vi) Discount Allowed (vii) Salesmen's Salaries (viii) Commission to Salesmen (ix) Promotion Expenses for Sales (x) Distributions Expenses (Variable Portions) (xi) Free Samples given (xii) Expenses incurred for After-Sale Service,	Sales/Turnover

(i) Office and Administration Expenses (ii) Salaries to Office Staff (iii) Rent, Rates and Taxes (iv) Depreciation on Fixed Assets (v) Printing and Stationery (vi) Insurance (vii) Audit Fees (viii) Miscellaneous Expenses (ix) Distribution Expenses (Fixed Portion) (x) Travelling Expenses (General) (xi) Interest of Debenture (xii) General Expenses (xiii) Expenses Fixed in Nature	Time
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(a) **Utilization Pre-incorporation Profit:** Since "Profit prior to Incorporation" is a Capital Profit the same should be written off against: (i) Preliminary Expenses Account (ii) Formation Expenses Account (iii) Liquidation Expenses Account (iv) Write down the value of Fixed Assets, if any (v) Goodwill Account (vi) Balance, if any, transferred to Capital Reserve.

(b) **Pre-incorporation Loss:** Since "Pre-incorporation Loss" is a Capital Loss the same is adjusted against (i) Any Capital Profit (ii) Debited to Goodwill Account (iii) Writing-off Fictitious Assets (iv) Capital Reserve

(i) **Sales Ratio:** Amount of sales should be calculated for the pre-incorporation and post-incorporation periods

(ii) **Time Ratio:** It is calculated after considering the time period, i.e., one is required to calculate the period falling between the date of purchase and the date of incorporation and the period between the date of incorporation and the date of presenting final account.

ILLUSTRATION 1.

Calculate sales ratio from the following: X company was incorporated on 1-8-2017 and acquired a business with effect from 1-4-2017. Total sales from 1-4-2017 to 31-03-2018 was ₹ 6,00,000. Sales for April and May = $1\frac{1}{2}$ times the average monthly sales. Sales from June to October = $\frac{1}{2}$ of average monthly sales. Sales for November and December = $\frac{1}{4}$ of average monthly sales and sales from January to March = Double the average monthly sales.

Calculation of time Ratio

01-04-2017	01-08-2017	31-03-2018
PRE-INCORPORATION -4 MONTHS	POST INCORPORATION -8 MONTHS	
(April + May + June + July)	(August + September + October + November + December + January + February + march)	

Therefore, Time Ratio=4:8=2:4

Calculation of Sales ratio

Total sales as given in the question = 6,00,000

Average monthly sales = $6,00,000/12 = 50,000$

Particulars		Month	Sales
Average monthly sales	= 50,000		
Sales for the month of April= $1\frac{1}{2}$ times the average monthly sales	= $50,000 \times 1\frac{1}{2}$	April	75,000
Sales for the month of May= $1\frac{1}{2}$ times the average monthly sales	= $50,000 \times 1\frac{1}{2}$	May	75,000
Sales of the month June= $\frac{1}{2}$ of average monthly sales	= $50,000 \times \frac{1}{2}$	June	25,000
Sales of the month July= $\frac{1}{2}$ of average monthly sales	= $50,000 \times \frac{1}{2}$	July	25,000

3.4

Profit Prior and Post Incorporation

Sales of the month August=1/2 of average monthly sales	= 50,000 × ½	August	25,000
Sales of the month September=1/2 of average monthly sales	= 50,000 × ½	September	25,000
Sales of the month October=1/2 of average monthly sales	= 50,000 × ½	October	25,000
Sales for the month of November=1/4 of average monthly sales	= 50,000 × ¼	November	12,500
Sales for the month of December=1/4 of average monthly sales	= 50,000 × ¼	December	12,500
Sales for the month of January= Double the average monthly sales	= 50,000 × 2	January	1,00,000
Sales for the month of February= Double the average monthly sales	= 50,000 × 2	February	1,00,000
Sales for the month of March= Double the average monthly sales	= 50,000 × 2	March	1,00,000
Total sales for the year			6,00,000

Calculation of sales for pre incorporation period

Pre incorporation period= PRE-INCORPORATION -4 MONTHS

(April + May + June + July)

Sales for (April + May + June + July)

Particulars	Month	Sales
Average monthly sales =50,000	April	75,000
Sales for the month of April=1 ½ times the average monthly sales =50,000 × 1 ½	May	75,000
Sales for the month of May=1 ½ times the average monthly sales=50,000 × 1 ½ times the average monthly	June	25,000
Sales of the month June=1/2 of average monthly sales =50,000 × ½	July	25,000
Sales of the month July=1/2 of average monthly sales =50,000 × ½	4 months	2,00,000
Therefore, Sales for pre-incorporation period		

Calculation of sales for Post incorporation period

POST INCORPORATION -8 MONTH

(August + September + October + November + December + January + February+ March) = 8 months

Particulars	Month	Sales
Sales of the month August=1/2 of average monthly sales =50,000 × ½	August	25,000
Sales of the month September=1/2 of average monthly sales =50,000 × ½	September	25,000
Sales of the month October=1/2 of average monthly sales =50,000 × ½	October	25,000
Sales for the month of November=1/4 of average monthly sales =50,000 × 1/4	November	12,500
Sales for the month of December=1/4 of average monthly sales =50,000 × 1/4	December	12,500
Sales for the month of January= Double the average monthly sales= 50,000 × 2	January	1,00,000
Sales for the month of February= Double the average monthly sales= 50,000 × 2	February	1,00,000
Sales for the month of March= Double the average monthly sales= 50,000 × 2	March	1,00,000
Total sales for the Post incorporation		4,00,000

Calculation of sales Ratio

Pre incorporation sales----- ₹ 2,00,000

Post incorporation sales ----- ₹ 4,00,000

Therefore Sales Ratio= 2,00,000:4,00,000 Or 2:4 or 1:2

ILLUSTRATION 2.

Delhi Company, incorporated on 1st April, 2013, took over running business from 1st January, 2013. The company prepares its first final accounts on 31st December 2013. From the following information, you are required to calculate the sale ratio of pre-incorporation and post-incorporation periods. (a) Sales of January, 2013 to December, 2013 ₹ 4,80,000. (b) The sales for the month of January twice of the average sales; for the month of February equal to average sales, sales for fourth months May to August – $\frac{1}{4}$ of the average of each month; and sales for October and November three times the average sales.

(The Institute of Cost Accountants of India MTP_ Intermediate)

SOLUTION:

Calculation of Time Ratio

01-01-2013	01-04-2013	31-12-013
Pre incorporation Period 3 Months (January + February + March (3 months)	Post Incorporation period (9 months (April + May + June + July + August + September + October + November + December)	
Time Ratio 3	9	
1	3	

Calculation of Sales ratio

Total sales as given in the question = ₹ 4,80,000

Average monthly sales = ₹ 4,80,000 / 12 = ₹ 40,000

Particulars	Month	Sales
Average monthly sales = ₹ 40,000		
The sales for the month of January twice of the average sales; Average sales = ₹ 40,000 x 2	January	80,000
The sales for the month February equal to average sales Average Sales ₹ 40,000	February	40,000
The sales for the month March	March	20,000
The sales for the month April	April	20,000
The sales for the month May, $\frac{1}{4}$ of the average of each month Average monthly sales = ₹ 40,000 x $\frac{1}{4}$	May	10,000
The sales for the month June, $\frac{1}{4}$ of the average of each month Average monthly sales = ₹ 40,000 x $\frac{1}{4}$	June	10,000
The sales for the month July, $\frac{1}{4}$ of the average of each month Average monthly sales = ₹ 40,000 x $\frac{1}{4}$	July	10,000
The sales for the month August, $\frac{1}{4}$ of the average of each month Average monthly sales = ₹ 40,000 x $\frac{1}{4}$	August	10,000
The sales for the month September	September	20,000
The sales for the month October, 3 times of the average of monthly Average monthly sales = ₹ 40,000 x 3	October	1,20,000
The sales for the month November, 3 times of the average of monthly Average monthly sales = ₹ 40,000 x 3	November	1,20,000
The sales for the month December	December	20,000
Total sales for the year		4,80,000

3.6

Profit Prior and Post Incorporation

Calculation sales for March, April, September and December

Total sales for the year ended 31 st December	4,80,000
Less: - Sales for 8 months i.e. (80,000+40,000+10,000+10,000+10,000+10,000+1,20,000+1,20,000)	4,00,000
Sales for remaining period (March, April, September and December)	80,000
The Average sales = 80,000/4 = 20,000	
Therefore, sales for the remaining period is ₹ 20,000 each	

Calculation of sales for pre incorporation period

Pre incorporation period = PRE-INCORPORATION - 4 MONTHS
(January + February + March)

Particulars	Month	Sales
The sales for the month of January twice of the average sales; Average sales = 40,000 x 2	January	80,000
The sales for the month February equal to average sales Average Sales 40,000	February	40,000
The sales for the month March	March	20,000
Therefore, sales of pre-incorporation		1,40,000

Calculation of sales for Post incorporation period

Particulars	Month	Sales
The sales for the month April	April	20,000
The sales for the month May, 1/4 of the average of each month Average monthly sales = 40,000 x 1/4	May	10,000
The sales for the month June, 1/4 of the average of each month Average monthly sales = 40,000 x 1/4	June	10,000
The sales for the month July, 1/4 of the average of each month Average monthly sales = 40,000 x 1/4	July	10,000
The sales for the month August, 1/4 of the average of each month Average monthly sales = 40,000 x 1/4	August	10,000
The sales for the month September	September	20,000
The sales for the month October, 3 times of the average of monthly Average monthly sales = 40,000 x 3	October	1,20,000
The sales for the month November, 3 times of the average of monthly Average monthly sales = 40,000 x 3	November	1,20,000
The sales for the month December	December	20,000
Sales for the period of post incorporation		3,40,000

Calculation of sales ratio

Sales pre incorporation = 1,40,000 Sales for post incorporation = 3,40,000

Sales ratio = 1,40,000 : 3,40,000 = 14:34 or 7:17

1. XYZ Co., Ltd took over the business of Suresh on 1-4-2018 and it was incorporated on 1-7-2018. The profit and loss account on 31-3-2019 was as follows:

Profit Prior and Post Incorporation

To Commission	2,625	By Gross profit	98,000
To Advertising	5,250	By Bad debts recovered	500
To MD's remuneration	9,000		
To Depreciation	2,800		
To Salary	18,000		
To Insurance	600		
To Preliminary expenses written off	700		
To Rent and taxes	3,000		
To Discount	350		
To Bad debt	1,250		
To Net profit	54,925		
	98,500		98,500

- (a) The average monthly sales after incorporation were twice the average monthly sales before.
 (b) Rent, which was paid for the first 3 months at ₹ 200 per month, increased by ₹ 50 per month for the balance of the period.
 (c) Bad debts of ₹ 350 related only to the period after 1-9-2018 and the balance related to the sales made up to 1-9-2018.

The bad debts realized belonged to the bad debts which were written off in 2015-16. Find out the profits before and after incorporation.

(KSLU II Semester 5-year B. Com L.L.B. Examination, December 2019)

Calculation of Time Ratio

01-04-2018	01-07-2018	31-3-019
Pre incorporation Period 3 Months (April+ May+ June) (3 months)	Post Incorporation period (July + August + September + October + November + December + January + February + March (9 months))	
Time Ratio 3	9	
1	3	

Calculation of sales ratio

The average monthly sales after incorporation were twice the average monthly sales before.

Therefore:

Let's Assume the Pre-incorporation sales = 1

Then, post incorporation sales were twice the average monthly sales = 2

So, Pre-incorporation sales = 1×3 (3 represents number of month in pre-incorporation period = 3 months i.e (3 Months (April+ May+ June)

Similarly Post incorporation sales = 2×9 (9 represents number of month in pre-incorporation period) = 9 months (July + August + September + October + November + December + January + February + March (9 months)

Therefore $9 \times 2 = 18$

Sales ratio = 3:18 or 1:6

In the books of Mr. Suresh
Income statement for the year ended 31st March 2019

Particulars	Basis of Allocation	Pre-incorporation (₹)	Post incorporation (₹)
Gross Profit (98,000X2:5/7)	Sales ratio (2:5)	16,000	
Bad debts realised	Pre	500	40,000
Total revenue income		16,500	
Less: -expenses and Losses			40,000
Commission	Sales ratio (1:6)	375	
Advertising	Sales ratio (1:6)	750	2,250
MD's remuneration	Post	-	5,500
Depreciation	Time (1:3)	700	9,000
Salary	Time (1:3)	4,500	2,100
Insurance	Time (1:3)	150	13,500
Preliminary expenses W/off	Post	-	480
Rent	Time (1:3)	600	700
taxes	Sales ratio (1:6)	38	2,250
Discount	Sales ratio (1:6)	50	110
Bad debt		386	300
Net Profit transferred to:			864
Capital Reserve a/c		6,951	2,974
Profit and Loss a/c		14,500	40,000

Working Note:-

Calculation of Bad Debts:

Total Bad debts as given in question-----1,250-350=900 Balance

Less:- Bad debts of ₹ 350 related only to the period after 1-9-2018 (post)

and the balance related to the sales made up to 1-9-2018. i.e -----₹ 900

Therefor ₹ 900 should apportioned for both pre- and post-incorporation. =

Pre-incorporation Sales= 1 × 3 months =3

Post incorporation sales= 2 (twice × 2 months =4

So, ratio=3:4

Pre-incorporation bad debts =900 × 3/7 =386

Post incorporation bad debts =900 × 4/7 =864

Calculation of rent and taxes

Rent and taxes as given in the question----- ₹ 3,000

Calculation of Rent

Rent, which was paid for the first 3 months at ₹ 200 per month, increased by ₹ 50 per month for the balance of the period.

ILLUSTRATION 3.

Stalin Wedding Company Limited was incorporated on August 1, 2019. It had acquired a running business of Raj Kamal & Co. with effect from April 1, 2019. During the year 2019-20, 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 August 31, 20 × 1 ₹ 5,000. You are required to ascertain pre-incorporation and post-incorporation profit for the year ended 31st March, 20 × 2¹.

SOLUTION

Statement showing pre and post incorporation profit
for the year ended 31st March, 2020

Particulars	Total Amount ₹	Basis of Allocation	Pre-incorporation ₹	Post-Incorporation ₹
Gross Profit (W.N.3)	5,40,000	2:7	1,20,000	4,20,000
Less: Depreciation	1,23,000	1:2	41,000	82,000
Director's Fees	50,000	Post	-	50,000
Preliminary Expenses	12,000	Post	-	12,000
Office Expenses	78,000	1:2	26,000	52,000
Selling Expenses	72,000	2:7	16,000	56,000
Interest to vendors	5,000	Actual	4,000	1,000
Net Profit (₹ 33,000 being pre-incorporation profit is transferred to capital reserve Account)	2,00,000		33,000	1,67,000

Working Notes:**1. Sales ratio**

The sales per month in the first half year were half of what they were in the later half year. If in the later half year, sales per month is x then it should be $5x$ per month in the first half year. So sales for the first four months (i.e. from 1st April, 2019 to 31st July, 2020) will be $4 \times .50 = ₹ 2$ and for the last eight months (i.e. from 1st August, 2019 to 31st March, 2020) will be $(2 \times .50 + 6 \times 1) = ₹ 7$. Thus sales ratio is 2:7.

2. Time ratio

1st April, 2019 to 31st July, 2020 : 1st August, 2019 to 31st March, 2020

= 4 months : 8 months = 1:2 Thus, time ratio is 1:2.

3. Gross profit

Gross profit = Net profit + All expenses

¹Source: (<https://ca-intermediate.in/wp-content/uploads/2018/08/Chapter-5-Profit-or-Loss-Pre-and-Post-Incorporation.pdf>)

$$= ₹ 2,00,000 + ₹ (1,23,000 + 50,000 + 12,000 + 78,000 + 72,000 + 5,000)$$

$$= ₹ 2,00,000 + ₹ 3,40,000 = ₹ 5,40,000$$

ILLUSTRATION 4.

The partners of Royal Agencies decided to convert the partnership into a private limited company called MA (P) Ltd. with effect from 1st January, 20X2. The consideration was agreed to be ₹ 1,17,00,000 based on the firm's Balance Sheet as at 31st December, 20X1. However, due to some procedural difficulties, the company could be incorporated only on 1st April, 20X2. Meanwhile the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% per annum. The same books of account were continued by the company which closed its account for the first time on 31st March, 20X3 and prepared the following summarised profit and loss account.²

		₹
Sales	1,63,80,000	2,34,00,000
Less: Cost of goods sold	11,70,000	
Salaries	1,80,000	
Depreciation	7,02,000	
Advertisement	11,70,000	
Discounts	90,000	
Managing Director's remuneration	1,20,000	
Miscellaneous office expenses	7,20,000	
Office-cum-show room rent	9,51,000	2,14,83,000
Interest		19,17,000
Profit		

The company's only borrowing was a loan of ₹ 50,00,000 at 12% p.a. to pay the purchase consideration due to the firm and for working capital requirements.

The company was able to double the average monthly sales of the firm, from 1st April, 20 x 2 but the salaries tripled from that date. It had to occupy additional space from 1st July, 20 x 2 for which rent was ₹ 30,000 per month.

Prepare statement of apportioning cost and revenue between pre-incorporation and post-incorporation periods and calculation of profits/losses for such periods

MA (P) Ltd.

Statement showing calculation of profit/losses for pre and post incorporation periods

	Basis of allocation	Pre-inc. ₹	Post-inc. ₹
Sales	Sales ratio	26,00,000	2,08,00,000
Less: Cost of goods sold	Sales ratio	18,20,000	1,45,60,000
Salaries	W.N.4	90,000	10,80,000
Depreciation	Time ratio	36,000	1,44,000
Advertisement	Sales ratio	78,000	6,24,000
Discounts	Sales ratio	1,30,000	10,40,000

Profit Prior and Post Incorporation

3.11

M.D.'s remuneration	Post-inc	—	90,000
Misc. Office Expenses	Time ratio	24,000	96,000
Rent	W.N.5	90,000	6,30,000
Interest	Time ratio	3,51,000	6,00,000
Net Profit/(Loss)		(19,000)	19,36,000

Working Notes:

(1) Calculation of Salesratio:

Let the average sales per month in pre-incorporation period be x . Then the average sales in post-incorporation period are $2x$. Thus total sales are $(3 \times x) + (12 \times 2x)$ or $27x$. Ratio of sales will be $3x : 24x$ or $1:8$.

Time ratio is 3 months : 12 months or $1:4$

(2) Expenses apportioned on turnover ratio basis are cost of goods sold, advertisement, discounts.

(3) Expenses apportioned on time ratio basis are Depreciation, and misc. office expenses.

(4) Ratio for apportionment of Salaries:

If pre-incorporation monthly average is x , for 3 months $3x$. Average for balance 12 months $3x$, for 12 months $36x$.

Hence ratio for division, $1:12$.

Total Rent		7,20,000
Additional rent for 9 months (From 1 st July 20 × 2 to 31 st March, 20×3)		
Rent for old premises for 15 months at ₹ 30,000 p.m.		(2,70,000)
		4,50,000
Old Premises	Pre-inc.	Post-inc.
Additional rent	90,000	3,60,000
	—	2,70,000
	90,000	6,30,000

ILLUSTRATION 5.

Anirudh Company Ltd was incorporated on 30 September 2019 to take over the business of Swati as from 1-4-2019. The financial accounts of the business for the year ended 31 March, 2020 disclosed the following information:

Sales:		
April to September	2,40,000	
October to March	3,60,000	7,00,000
Less-Purchases:		
April to September	1,50,000	
October to March	2,40,000	3,90,000
Gross profit		2,10,000
Less:		49,680
Salaries		1,60,320

3.12

Selling expenses
Depreciation
Directors remuneration
Debenture interest
Administration expenses
Profit for the year

Profit Prior and Post Incorporation

21/11/19
6/11/19
3/11/19
1/11/19
180
9/11/19

You are requested to prepare a statement apportioning the balance of profit between the years prior to after incorporation and show the profit and loss account for the year ended 31 March 2020.

SOLUTION:

In the books of Mr. Anirudh
Income statement for the year ended 31 March 2020

Particulars	Total	Basis of Allocation	Pre-incorporation (₹)	Post incorporation (₹)
Gross Profit (2,40,000X2:3/5)		Sales ratio (2:3)	96,000	1,44,000
Total revenue income				
Less: -expenses and Losses	49,680	Time Ratio(1:1)	24,840	24,840
Salaries(49,680X1:1/2)			12,000	12,000
Selling expenses	30,000	Sales Ratio(2:3)		
(30,000x2:3/5)	6,000	Time Ratio(1:1)	3,000	3,000
Depreciation(6,000X1:1)	3,000	Post-inc	-	3,000
Directors remuneration	1,500	Time Ratio(1:1)	750	750
Debenture interest(1,500X1:1)	180	Time Ratio(1:1)	90	90
Administration expenses (180X1:1)				
Net Profit transferred to:			55,320	
Capital Reserve a/c				94,200
Profit and Loss a/c			40,680	49,200

Calculation of Time Ratio**1. Timeratio**

1st April, 2019 to 30th September 2019 : 1st October, 2019 to 31st March, 2020

= 6months: 6months = 1 : 1 Thus, timeratio is 1:1.

Sales Ratio=

1st April, 2019 to 30th September 2019 : 1st October, 2019 to 31st March, 2020

2,40,000 : 3,60,000
2 : 3 (Sales Ratio=2:3)

ILLUSTRATION 6.

Jeevan Ltd was incorporated on 1-7-2019 to take over the business of Jean enterprise as a going concern with effect from 1-4-2019. Their profit and loss account for the year ended 31-3-2020 is as follows:

Profit Prior and Post Incorporation

3.13

To opening stock	24,000	By Sales (₹ 20,000)	60,000
To Purchases	35,000	By Closing stock	14,000
To Administration expenses	3,600		
To Director's fee	600		
To Selling expenses	7,200		
To Audit fee	200		
To Preliminary expenses	300		
To Net profit	7,000		
	74,000		74,000

Prepare a statement showing profit earned prior to and after incorporation.

SOLUTION:

Statement showing profit earned prior to and after incorporation

Particulars	Total Amount ₹	Basis of Allocation	Pre-incorporation ₹	Post-Incorporation ₹
Gross Profit	15,000	1:2	5,000	10,000
			5,000	10,000
To Administration expenses	3,600	1:3	900	2,700
To Director's fee	600			600
To Selling expenses		Post		4,800
To Audit fee				
To Preliminary expenses	7,200	1:2	2,400	150
To Net profit	200	1:3	50	300
Capital Reserve		Post	4,125	2,875
Profit and Loss Appropriation A/c	300			
			5,000	10,000

Calculation of Gross Profit

Gross Profit = Total Sales - Cost of Goods sold

In the question Sales is given = 60,000

Cost of Goods sold is not given = ?

Therefore first find out the cost of goods sold

Cost of Goods sold = Opening stock + Purchases + Direct expenses - Closing stock

= 24,000 + 35,000 + nil - 14,000 = 45,000

Therefore Cost of goods sold = 45,000

Gross Profit = 60,000 - 45,000 = 15,000

Calculation of Time Ratio

Pre-incorporation = 1-4-2019 to 1-7-2019 = (April, May and June) = 3 months

Post Incorporation period = 1-7-2019 to 31-03-2020 (July, August, September, October, November, December, January, February and March) = 9 months

Therefore Time Ratio = 3:9 or 1:3

Calculation of Sales Ratio=

Total sales for the year -----	60,000
Less:-Pre incorporation sales-----	20,000
Post incorporation sales-----	40,000
Therefore Sales Ratio=20,000:40,000 Or 2:4 Or 1:2	

ILLUSTRATION 7.

V Ltd was incorporated on 1 August 2017, to take over the business of C Ltd, as a going concern from 1-April-2017. The profit and loss account for the year ending on 31-March 2018 is as follows.

To Rent and taxes	24,000	By Gross profit	3,10,000
To Insurance	6,000		
To Electricity	4,800		
To Salaries	72,000		
To Director's fee	6,200		
To Auditor's fee	3,200		
To Commission	12,000		
To Advertisement	8,000		
To Discount	7,000		
To Office expenses	15,000		
To Carriage	6,000		
To Bank charges	3,000		
To Preliminary expenses	13,000		
To Bad debt	4,000		
To Interest on loan	6,000		
To Net profit	1,20,000		
	3,10,000		3,10,000

The total turnover for the year ending 31-03-2018 was ₹ 10,00,000 divided into ₹ 3,00,000 for the period up to 1-8-2017 and ₹ 7,00,000 for the remaining period. Ascertain the profits earned prior and post incorporation period.

(Bangalore University III B.Com.)

SOLUTION

Statement showing profit earned prior to and after incorporation

Particulars	Total Amount ₹	Basis of Allocation	Pre-incorporation ₹	Post-Incorporation ₹
Gross Profit	3,10,000	3:7	93,000	2,17,000
Total			93,000	2,17,000
Less Expenses and Losses				
To Rent and taxes	24,000	1:2	8,000	16,000
To Insurance	6,000	1:2	2,000	4,000
To Electricity	4,800	1:2	1,600	3,200
To Salaries	72,000	1:2	24,000	48,000
To Director's fee	6,200	POST	1,000	5,200
To Auditor's fee	3,000	1:2	1,000	2,000
To Commission	12,000	3:7	2,400	9,600
To Advertisement	8,000	3:7	2,100	5,900

Profit Prior and Post Incorporation

3.15

To Discount	7,000	3:7	5,000	5,600
To Office expenses	15,000	1:2	1,800	4,900
To Carriage	6,000	3:7	1,000	10,000
To Bank charges	3,000	1:2	-	4,200
To Preliminary expenses	13,000	Post	1,200	2,000
To Bad debt	4,000	3:7	2,000	13,000
To Interest on loan	6,000	1:2	37,300	2,800
To Net profit				4,000
To Capital Reserve				82,700
			93,000	2,17,000

Calculation of Time Ratio

Pre-incorporation = 1-4-2017 to 1-8-2017 = (April, May, June and August) = 4 months

Post Incorporation period = 1-8-2017 to 31-03-2018 (August, September, October, November, December, January, February and March) = 8 months

Calculation of Sales Ratio =

Total sales for the year ----- 10,00,000

Less:- Pre incorporation sales ----- 3,00,000

Post incorporation sales - 7,00,000

Therefore Sales Ratio = 3,00,000:7,00,000 Or 3:7

ILLUSTRATION 8.

Sun Ltd was incorporated on 1-04-2019, with an authorized capital of ₹ 1,25,000 and took over the running business of Moon Ltd as from 1-01-2019, the following is the summarized profit and loss account for the year ended 30-12-2019.

Sales:		
1 Jan 2017 to 31 March 2017	1,50,000	
1 April 2017 to 30 December 2017	4,75,000	6,25,000
Cost of sales for the year	3,85,000	
Administrative expenses	44,200	
Selling commission	21,875	
Goodwill written off	5,000	
Interest to vendors (loan repaid on February 2012)	9,325	
Distribution expenses (60% variable)	31,250	
Preliminary expenses	8,250	
Debenture interest	8,000	
Depreciation	11,100	
Directors fee	2,500	5,26,500
Net profit		98,500

The company deals in only one product. The cost of sales per unit was reduced by 10% in the post incorporation period, as compared to pre incorporation period. Prepare a statement showing the net profit of the pre incorporation as well as the post incorporation period, also show the basis of apportionment.