MANONMANIAM SUNDARANAR UNIVERSITY

DIRECTORATE OF DISTANCE AND CONTINUING

EDUCATIONTIRUNELVELI-627012, TAMILNADU

B.Com – III SEMESTER

CORPORATE ACCOUNTING - I

Corporate Accounting I

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Text books
S.P.Jain and N.L.Narang, Advanced Accounting VolI, Kalyani Publication, New Delhi.
R.L.Gupta and M.Radhaswamy, Advanced Accounts VolI, Sultan Chand, New Delhi.
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Unit -1

A company form of organisation is the third stage in the evolution of forms of organisation. Its capital is contributed by a large number of persons called shareholders who are the real owners of the company. But neither it is possible for all of them to participate in the management of the company nor considered desirable. Therefore, they elect a Board of Directors as their representative to manage the affairs of the company. In fact, all the affairs of the company are governed by the provisions of the Companies Act, 2013. A company means a company incorporated or registered under the Companies Act, 2013 or under any other earlier Companies Acts. According to Chief Justice Marshal, "a company is a person, artificial, invisible, intangible and existing only in the eyes of law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence".A company usually raises its capital in the form of shares (called share capital) and debentures (debt capital.) This chapter deals with the accounting for share capital of companies.

Features of a Company

A company may be viewed as an association of person who contribute money or money's worth to a common inventory and use it for a common

purpose. It is an artificial person having corporate legal entity distinct from its members (shareholders) and has a common seal used for its signature. Thus,it has certain special features which distinguish it from the other forms of organisation. These are as follows:

- ***Body Corporate:*** A company is formed according to the provisions of Law enforced from time to time. Generally, in India, the companies are formed and registered under Companies Law except in the case of Banking and Insurance companies for which a separate Law is provided for.
- ***Separate Legal Entity:*** A company has a separate legal entity which is distinct and separate from its members. It can hold and deal with any type of property. It can enter into contracts and even open a bank account in its own name.
- ***Limited Liability:*** The liability of the members of the company is limited to the extent of unpaid amount of the shares held by them. In the case of the companies limited by guarantee, the liability of its members is limited to the extent of the guarantee given by them in the event of the company being wound up.
- ***Perpetual Succession:*** The company being an artificial person created by law continues to exist irrespective of the changes in its membership. A company can be terminated only through law.

The death or insanity or insolvency of any member of the company in no way affects the existence of the company. Members may come and go but the company continues.

- ***Common Seal:*** The company being an artificial person, cannot sign its name by itself. Therefore, every company is required to have its own seal which acts as official signatures of the company. Any document which does not carry the common seal of the company is not binding on the company.
- ***Transferability of Shares:*** The shares of a public limited company are freely transferable. The permission of the company or the consent of any member of the company is not necessary for the transfer of shares. But the Articles of the company can prescribe the manner in which the transfer of shares will be made.
- ***May Sue or be Sued:*** A company being a legal person can enter into contracts and can enforce the contractual rights against others. It can sue and be sued in its name if there is a breach of contract by the company.

1.1 Kinds of Companies

Companies can be classified either on the basis of the liability of its members or on the basis of the number of members. On the basis of liability of its members the companies can be classified into the

following three categories:

(i) ***Companies Limited** by Shares:* In this case, the liability of its members is limited to the extent of the nominal value of shares held by them. If a member has paid the full amount of the shares, there is no liability on his part whatsoever may be for the debts of the company. He need not pay a single paise from his private property. However, if there is any liability involved, it can be enforced during the existence of the company as well as during the winding up.

(ii) ***Companies Limited by Guarantee:*** In this case, the liability of its members is limited to the amount they undertake to contribute in the event of the company being wound up. Thus, the liability of the members will arise only in the event of its winding up.

(iii) ***Unlimited Companies:*** When there is no limit on the liability of its members, the company is called an unlimited company. When the company's property is not sufficient to pay off its debts, the private property of its members can be used for the purpose. In other words, the creditors can claim their dues from its members. Such companies are not found in India even though permitted by the Companies Act.

On the basis of the number of members, companies can be

divided into three categories as follows:

(i) ***Public Company*:** A public company means a company which (a) is not a private company; (b) is a company which is not a subsidiary of a private company.

(ii) ***Private Company*:** A private company is one which by its articles of association:

(a) Restricts the right to transfer its shares;

(b) A private company must have at least 2 persons, except in case of one person company;

(c) Limits the number of its members to 200 (excluding its employees);

(iii) ***One Person Company (OPC)*:** Sec. 2 (62) of the companies Act, 2013, defines OPC as a "company which has only one person as a member". Rule 3 of the Companies (Incorporation) Rules, 2014 provides that:

(a) Only a natural person being an Indian citizen and resident in India can form one person company,

(b) It cannot carry out non-banking financial investment activities.

(c) Its paid up share capital is not more than Rs. 50 Lakhs

(d) Its average annual turnover of three years does not

exceedRs. 2 Crores.

1.2 Share Capital of a Company

A company, being an artificial person, cannot generate its own capital which has necessarily to be collected from several persons. These persons are known as shareholders and the amount contributed by them is called share capital. Since the number of shareholders is very very large, a separate capital account cannot be opened for each one of them. Hence, innumerable streams of capital contribution merge their identities in a common capital account called as 'Share Capital Account'.

1.3.1 Categories of Share Capital

From accounting point of view the share capital of the company can be classifiedas follows:

- ***Authorised Capital:*** Authorised capital is the amount of share capital which a company is authorised to issue by its Memorandum of Association. The company cannot raise more than the amount of capital as specified in the Memorandum of Association. It is also called Nominal or Registered capital. The authorised capital can be increased or decreased as per the procedure laid down in the Companies Act. It should be noted that the company neednot issue the entire authorised capital for public

subscription at a time. Depending upon its requirement, it may issue share capital but in any case, it should not be more than the amount of authorised capital.

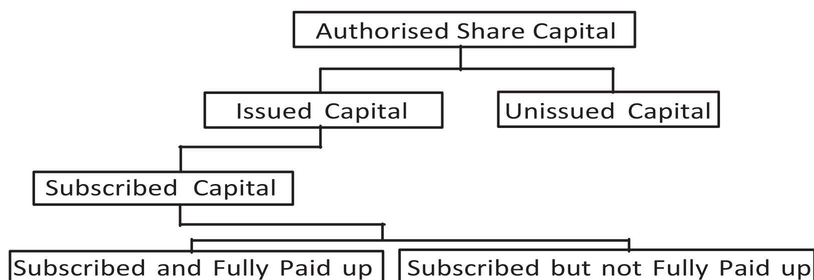
- ***Issued Capital:*** It is that part of the authorised capital which is actually issued to the public for subscription including the shares allotted to vendors and the signatories to the company's memorandum. The authorised capital which is not offered for public subscription is known as 'unissued capital'. Unissued capital may be offered for public subscription at a later date.
- ***Subscribed Capital:*** It is that part of the issued capital which has been actually subscribed by the public. When the shares offered for public subscription are subscribed fully by the public the issued capital and subscribed capital would be the same. It may be noted that ultimately, the subscribed capital may be equal to or less than issued capital. In case the number of shares subscribed is less than what is offered, the company allots only the number of shares for which subscription has been received. In case it is higher than what is offered, the allotment will be equal to the offer. In other words, the fact of over subscription is not reflected in the books.
- ***Called up Capital:*** It is that part of the subscribed capital which

has been called up on the shares, i.e., what the company has asked the shareholders to pay. The company may decide to call the entire amount or part of the face value of the shares, For example, if the face value (also called nominal value) of a share allotted is Rs. 10 and the company has called up only Rs. 7 per share, in that scenario, the called up capital is Rs. 7 per share. The remaining Rs. 3 may be collected from its shareholders as and when needed.

- ***Paid up Capital:*** It is that portion of the called up capital which has been actually received from the shareholders. When the shareholders have paid all the called amount, the called up capital is the same to the paid up capital. If any of the shareholders has not paid amount on calls, such an amount may be called as 'calls in arrears'. Therefore, paid up capital is equal to the called-up capital minus call in arrears.
- ***Uncalled Capital:*** That portion of the subscribed capital which has not yet been called up. As stated earlier, the company may collect this amount any time when it needs further funds.

- ***Reserve Capital:*** A company may reserve a portion of its uncalled capital to be called only in the event of winding up of the

  - **Exhibit. 1.1 :** *Categories of Share Capital*



- company. Such uncalled amount is called 'Reserve Capital' of the company. It is available only for the creditors on winding up of the company.

Let us take the following example and show how the share capital will be shown in the balance sheet. Sunrise Company Ltd., New Delhi, has registered its capital as Rs. 40,00,000, divided into 4,00,000 shares of Rs. 10 each. The company offered to the public for subscription of 2,00,000 shares of Rs. 10 each, to be received as Rs. 2 on application, Rs.3 on allotment, Rs.3 on first call and the balance on final call. The company received applications for 2,50,000 shares. The company finalised the allotment of 2,00,000 shares and rejected applications for 50,000 shares. The company did not make the final call. The company received all the amount except on 2,000 shares where call money has not been received. The above amounts will be shown in the Notes to

Accounts of the balance sheet of Sunrise Company Ltd. as follows:

Notes to Accounts

Share Capital		*(Rs.)*
Authorised or Registered or Nominal Capital:		
4,00,000 Shares of Rs. 10 each		40,00,000
Issued Capital		
2,00,000 Shares of Rs. 10 each		20,00,000
Subscribed Capital		
Subscribed but not fully paid up		
2,00,000 Shares of Rs. 10 each, Rs. 8 called up	16,00,000	
Less : Calls in Arrears	(6,000)	15,94,000

1.3 Nature and Classes of Shares

Shares, refer to the units into which the total share capital of a company is divided. Thus, a share is a fractional part of the share capital and forms the basis of ownership interest in a company. The persons who contribute money through shares are called shareholders.

The amount of authorised capital, together with the number of shares in which it is divided, is stated in the Memorandum of Association but the classes of shares in which the company's capital is to be divided, along with their respective rights and obligations, are prescribed by the Articles of Association of the company. As per The Companies Act, a company can issue two types of shares (1) preference shares, and (2) equity shares (also called ordinary shares).

1.4.1 Preference Shares

According to Section 43 of The Companies Act, 2013, a preference share is one, which fulfils the following conditions :

(a) That it carries a preferential right to dividend to be paid either as a fixed amount payable to preference shareholders or an amount calculated by a fixed rate of the nominal value of each share before any dividend is paid to the equity shareholders.

(b) That with respect to capital it carries or will carry, on the winding up of the company, the preferential right to the repayment of capital before anything is paid to equity shareholders.

However, notwithstanding the above two conditions, a holder of the preference share may have a right to participate fully or to a limited extent in the surpluses of the company as specified in the Memorandum or Articles of the company. Thus, the preference shares can be participating and non- participating. Similarly, these shares can be cumulative or non-cumulative, and redeemable or irredeemable.

1.4.2 Equity Shares

According to Section 43 of The Companies Act, 2013, an equity

share is a share which is not a preference share. In other words, shares which do not enjoy any preferential right in the payment of dividend or repayment of capital, are termed as equity/ordinary shares. The equity shareholders are entitled to share the distributable profits of the company after satisfying the dividend rights of the preference share holders. The dividend on equity shares is not fixed and it may vary from year to year depending upon the amount of profits available or distribution. The equity share capital may be (i) with voting rights; or (ii) with differential rights as to voting, dividend or otherwise in accordance with such rules and subject to such conditions as may be prescribed in the Articles of Association of the company.

1.4 Issue of Shares

A salient characteristic of the capital of a company is that the amount on its shares can be gradually collected in easy instalments spread over a period of time depending upon its growing financial requirement. The first instalment is collected along with application and is thus, known as application money, the second on allotment (termed as allotment money), and the remaining instalments are termed as first call, second call and so on. The word final is suffixed to the last instalment. However, this in no way which prevents a company from calling the full amount on shares right at the time of

application.

The important steps in the procedure of share issue are :

- *Issue of Prospectus:* The company first issues the prospectus to the public. Prospectus is an invitation to the public that a new company has come into existence and it needs funds for doing business. It contains complete information about the company and the manner in which the money is to be collected from the prospective investors.
- *Receipt of Applications:* When prospectus is issued to the public, prospective investors intending to subscribe the share capital of the company would make an application along with the application money

  and deposit the same with a scheduled bank as specified in the prospectus. The company has to get minimum subscription within 120 days from the date of the issue of the prospectus. If the company fails to receive the same within the said period, the company cannot proceed for the allotment of shares and application money should be returned within 130 days of the date of issue of prospectus.
- *Allotment of Shares:* If minimum subscription has been received, the company may proceed for the allotment of shares after

fulfilling certain other legal formalities. Letters of allotment are sent to those whom the shares have been alloted, and letters of regret to those to whom no allotment has been made. When allotment is made, it results in a valid contract between the company and the applicants who now became the shareholders of the company.

Shares of a company are issued either at par or at a premium. Shares are to be issued at *par* when their issue price is exactly equal to their nominal value according to the terms and conditions of issue. When the shares of a company are issued more than its nominal value (face value), the excess amount is called premium.

Irrespective of the fact that shares are issued at par or at a premium, the share capital of a company as stated earlier, may be collected in instalments payable at different stages.

1.5 Accounting Treatment

On application : The amount of money paid with various instalment represents the contribution to share capital and should ultimately be credited to share capital. However, for the sake of convenience, initially individual accounts are opened for each instalment. All money received along with application is deposited with a scheduled bank in a separate account opened for the purpose. The journal entry is as

follows:

Bank A/c   Dr.

To Share Application A/c

(Amount received on application for — shares @ Rs._per share)

On allotment : When minimum subscription has been received and certain legal formalities on the allotment of shares have been duly compiled with, the directors of the company proceed to make the allotment of shares.

The allotment of shares implies a contract between the company and the applicants who now become the allottees and assume the status of shareholders or members.

The journal entries with regard to allotment of shares are as follows:

1. *For Transfer of Application Money*

   Share Application A/c Dr.

   To Share Capital A/c

   (Application money on_____Shares allotted/ transferred to Share Capital)

2. *For Money Refunded on Rejected Application*

   Share Application A/c Dr.

   To Bank A/c

   (Application money returned on rejected application for____shares)

3. *For Amount Due on Allotment*

   Share Allotment A/c Dr.

   To Share Capital A/c

4. *For Adjustment of Excess Application Money*

   Share Application A/c Dr.

   To Share Allotment A/c

   (Application Money on __Shares @ Rs_per shares adjusted to the amount due on allotment).

5. *For Receipt of Allotment Money*

   Bank A/c Dr.

   To Share Allotment A/c

   (Allotment money received on____Shares @ Rs. — per share Combined Account)

Note:- The journal entries (2) and (4) can also be combined as follows:

Share Application A/c

To Share Allotment A/c

To Bank A/c

(Excess application money adjusted to share allotment and balance refunded)

Sometimes *a combined account* for share application and share allotment called 'Share Application and Allotment Account' is opened in the books of a company. The combined account is based on the reasoning that allotment without application is impossible while application without allotment is meaningless. These two stages of share capital are closely inter-related. When a combined

account is maintained, journal entries are recorded in the following manner:

1. *For Receipt of Application and Allotment*

   Bank A/c Dr.

   To Share Application and Allotment A/c

   (Money received on applications for shares @ Rs.___per share).

2. *For Transfer of Application Money and Allotment Amount Due*

   Share Application and Allotment A/c Dr.

   To Share Capital A/c

   (Transfer of application money to Share Capital Account for amount due or allotment of — Share @ Rs.___per share)

3. *For Money Refunded on Rejected Applications*

   Share Application and Allotment A/c Dr.

   To Bank A/c

   (Application money returned on rejected application for_____shares)

4. *On Receipt of Allotment Amount*

   Bank A/c Dr.

   To Share Application and Allotment A/c (Balance of Allotment Money Received)

On Calls : Calls play a vital role in making shares fully paid-up and for realising the full amount of shares from the shareholders. In the event of shares not being fully called up till the completion of allotment, the directors have the authority to ask for the remaining amount on shares as and when they decide about the same. It is also possible that the timing of the payment of calls by the shareholders is determined at the time of share issue itself and given in the prospectus.

Two points are important regarding the calls on shares. First, the amount on any call should not exceed 25% of the face value of shares. Second, there must be an interval of at least one month between the making of two calls unless otherwise provided by the articles of association of the company.

When a call is made and the amount of the same is received, the journal entries are as given below:

1. *For Call Amount Due*

Share Call A/c Dr.

To Share Capital A/c

(Call money due on__________Shares @ Rs.____per share)

2. *For Receipt of Call Amount*

Bank A/c Dr.

To Share

Call A/c (Call

money received)

The word/words First, Second, or Third must be added between the words “Share” and ‘Call’ in the Share Call account depending upon the identity of the call made. For example, in case of first call it will be termed as ‘Share First Call Account’, in case of second call it will be ‘Share Second Call Account’ and so on. Another point to be noted is that the words ‘and Final’ will also be added to the last call, say, if second call is the last call it will be termed as ‘Second and Final Call’ and if it is the third call which is the last call, it will be termed as ‘Third and Final Call’. It is also possible that the whole balance after allotment may be collected in one call only. In that case the first call itself, shall be termed as the ‘First and Final Call’.

Sum 1

Mona Earth Mover Limited decided to issue 12,000 shares of Rs.100 each payable at Rs.30 on application, Rs.40 on allotment, Rs.20 on first call and balance on second and final call. Applications were received for 13,000 shares. The directors decided to reject application of 1,000 shares and their application money being refunded in full. The allotment money was duly received on all the shares, and all sums due on calls are received except on 100 shares.

Record the transactions in the books of Mona Earth Movers Limited

Solution

Books of Mona Earth Mover Limited
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c	Dr.		3,90,000	
	To Share Application A/c				3,90,000
	(Application money on 13,000 shares @ Rs.30 per share received)				
	Share Application A/c	Dr.		3,60,000	
	To Share Capital A/c				3,60,000
	(Application money transferred to share capital)				
	Share Application A/c	Dr.		30,000	
	To Bank A/c				30,000
	(Application money on 1,000 shares returned]				
	Share Allotment A/c	Dr.		4,80,000	
	To Share Capital A/c				4,80,000
	(Money due on allotment of 12,000 shares @ Rs. 40 per share)				

	Bank A/c Dr. To Share Allotment A/c (Money received on 12,000 shares @ Rs. 40 per share on allotment)		4,80,000	4,80,000
	Share First Call A/c Dr. To Share Capital A/c (Money due on 12,000 shares @ Rs. 20 per share on first Call)		2,40,000	2,40,000
	Bank A/c Dr. To Share First Call A/c (First Call money received except for 100 shares)		2,38,000	2,38,000
	Share Second and Final Call A/c Dr. To Share Capital A/c (Money due on 12,000 shares @ Rs. 10 per share on Second and final Call)		1,20,000	1,20,000
	Bank A/c Dr. To Share Second and Final Call A/c (Second and final call money received except for 100 shares)		1,19,000	1,19,000

Sum 2

Eastern Company Limited issued 40,000 shares of Rs. 10 each to the public for the subscription out of its share capital, payable as Rs. 4 on application, Rs. 3 on allotment and the balance on Ist and final call. Applications were received for 40,000 shares. The company made the allotment to the applicants in full. All the amounts due on allotment and first and final call were duly received.

Give the journal entries in the books of the company.

Solution

Books of Eastern Company Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr. To Share Application A/c (Application money on 40,000 shares @ Rs.4 per share received)		1,60,000	1,60,000
	Share Application A/c Dr. To Share Capital A/c (Application money transferred to share capital)		1,60,000	1,60,000
	Share Allotment A/c Dr. To Share Capital A/c (Money due on allotment of 40,000 shares @Rs. 3 per share)		1,20,000	1,20,000
	Bank A/c Dr. To Share allotment A/c (Money received on 40,000 shares @ Rs. 3 per share on allotment)		1,20,000	1,20,000
	Share First and Final Call A/c Dr. To Share Capital A/c (Money due on 40,000 shares @ Rs. 3 per shareon First and final call)		1,20,000	1,20,000
	Bank A/c Dr. To Share First and Final Call A/c (First and final call money received)		1,20,000	1,20,000

1.6.1 Calls in Arrears

It may happen that shareholders do not pay the call amount on due date. When any shareholder fails to pay the amount due on allotment or on any of the calls, such amount is known as 'Calls in Arrears'/'Unpaid Calls'. Calls in Arrears represent the debit balance of all the calls account. Such amount shall appear as 'Note to Accounts (Refer Chapter 3). However, where a company maintains 'Calls in Arrears' Account, it needs to pass the following additional journal entry:

Calls in Arrears A/c Dr.

To Share First Call Account A/c

To Share Second and Final Call Account A/c (Calls in arrears brought into account)

The Articles of Association of a company may empower the directors to charge interest at a stipulated rate on calls in arrears. If the articles are silent in this regard, the rule contained in Table F shall be applicable which states that the interest at a rate not exceeding 10% p.a. shall have to be paid on all unpaid amounts on shares for the period intervening between the day fixed for payment and the time of actual payment thereof.

On receipt of the call amount together with interest, the amount of interest shall be credited to interest account while call money shall be credited to the respective call account or to calls in arrears account. When the shareholder makes the payment of calls in arrears together with interest, the entry will be as follows:

Bank A/c Dr.

To Calls in Arrears A/c

To Interest on Calls in Arrears A/c (Calls in arrears received with interest)

Note: If nothing is specified, there is no need to take the interest on calls in arrears account and record the above entry

Sum 3

Cronic Limited issued 10,000 equity shares of Rs. 10 each payable at Rs. 2.50 on application, Rs. 3 on allotment, Rs. 2 on first call, and the balance of Rs. 2.50 on second and final call. All the shares were fully subscribed and paid except of a shareholder having 100 shares who could not pay for second and final call. Give journal entries to record these transactions.

Solution:

Books of Cronic Limited
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c	Dr.		25,000	
	To Equity Share Application A/c				25,000
	(Money received on applications for 10,000 shares @ Rs. 2.50 per share)				
	Equity Share Application A/c	Dr.		25,000	
	To Equity Share Capital A/c				25,000
	(Transfer of application money on 10,000 shares to share capital)				
	Equity Share Allotment A/c	Dr.		30,000	
	To Equity Share Capital A/c				30,000
	(Amount due on the allotment of 10,000 shares @ Rs. 3 per share)				
	Bank A/c	Dr.		30,000	
	To Equity Share Allotment A/c				30,000
	(Allotment money received)				
	Share First Call A/c	Dr.		20,000	
	To Equity Share Capital A/c				20,000
	(First call money due on 10,000 shares @ Rs. 2 per share)				
	Bank A/c	Dr.		20,000	
	To Equity Share First Call A/c				20,000
	(First call money received)				
	Share Second and Final Call A/c	Dr.		25,000	
	To Equity Share Capital A/c				25,000
	(Final call money due)				
	Bank A/c	Dr.		24,750	
	Call in Arrears A/c	Dr.		250	
	To Equity Share Second and Final Call A/c				25,000
	(Final call money received except that of 100 shares)				

1.6.2 Calls in Advance

Sometimes shareholders pay a part or the whole of the amount of the calls not yet made. The amount so received from the shareholders is known as "Calls in Advance". The amount received in advance is a liability of the company and should be credited to 'Call in Advance Account." The amount received will be adjusted towards the payment of calls as and when they becomes due. Table F of the Companies Act provides for the payment of interest on calls in advance at a rate not exceeding 12% per annum.

The following journal entry is recorded for the amount of calls received in advance.

Bank A/c Dr.

To Calls in Advance A/c

(Amount received on call in advance)

On the due date of the calls, the amount of 'Calls in Advance' is adjusted by the following entry :

Calls in Advance A/c Dr.

To Particular Call A/c

(Calls in advance adjusted with the call money due)

The balance in 'Calls in Advance' account is shown as a separate item under the title Equity and Liabilities in the company's balance sheet under the head 'current liabilities', as sub-head 'others current liabilities'. It is not added to the

amount ofpaid-up capital.

As 'Calls in Advance' is a liability of the company, it is under obligation, if provided by the Articles, to pay interest on such amount from the date of its receipt up to the date when appropriate call is due for payment. A stipulation is generally made in the Articles regarding the rate at which interest is payable. However, if Articles are silent on this account, Table F is applicable which provides for interest on calls in advance at a rate not exceeding 12% per annum.

The accounting treatment of interest on Calls in Advance is as follows:

1. For Payment of Interest

Interest on Calls in Advance A/c Dr.

To Bank A/c

(Interest paid on Calls in Advance)

OR

2. *(a) For Interest due*

Interest on Calls in Advance A/c Dr.

To Sundry Shareholder's A/c

(Interest paid on Calls in Advance)

2. *(b) For Interest Paid*

Sundry Shareholder's A/c Dr.

To Bank A/c

Sum 4

Konica Limited registered with an authorised equity capital of Rs. 2,00,000 divided into 2,000 shares of Rs. 100 each, issued for subscription of 1,000 shares payable at Rs. 25 per share on application, Rs. 30 per share on allotment, Rs. 20 per share on first call and the balance as and when required.

Application money on 1,000 shares was duly received and allotment was made to them. The allotment amount was received in full, but when the first call was made, one shareholder failed to pay the amount on 100 shares held by him and another shareholder with 50 shares, paid the entire amount on his shares. The company did not make any other call.

Give the necessary journal entries in the books of the company to record these share capital transactions.

Solution

Books of Konica Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr.		25,000	
	To Equity Share Application A/c			25,000
	(Money received on application for 1,000 shares @ Rs. 25 per share)			
	Equity Share Application A/c Dr.		25,000	
	To Equity Share Capital A/c			25,000
	(Transfer of application money on 1,000 sharesto share capital)			
	Equity Share Allotment A/c Dr.		30,000	
	To Equity Share Capital A/c			30,000
	(Amount due on the allotment of 1,000 shares @ Rs. 30 per share)			
	Bank A/c Dr.		30,000	
	To Equity Share Allotment A/c			30,000
	(Allotment money received)			
	Equity Share First Call A/c Dr.		20,000	
	To Equity Share Capital A/c			20,000
	(First call money due on 1,000 shares @ Rs. 20 per share)			

	Bank A/c Dr.		19,250	
	Calls in Arrears A/c Dr.		2,000	
	To Equity Share First Call			20,000
	A/cTo Calls in Advance A/c			1,250
	(First call money received on 900 shares, calls in arrears for 100 shares @ Rs.20 per share and calls in advance for 50 shares @ Rs.25 per share.)			

2024-25

Sum 5

Unique Pictures Limited was registered with an authorised capital of Rs. 5,00,000 divided into 20,000, 5% preference shares of Rs. 10 each and 30,000 equity shares of Rs. 10 each. The company issued 10,000 preference and 15,000 equity shares for public subscription. Calls on shares were made as under

	Equity Shares	*Preference Shares*
	Rs.	Rs.
Application	2	2
Allotment	3	3
First Call	2.50	2.50
Second and Final Call	2.50	2.50

All these shares were fully subscribed. All the dues were received except the second and final call on 100 equity shares and on 200 preference shares. Record these transactions in the journal. You are also required to prepare the cash book and balance sheet.

Solution

Books of Unique Pictures Limited

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Equity Share Application A/c Dr.		30,000	
	5% Preference Share Application A/c Dr.		20,000	
	To Equity Share Capital A/c			30,000
	To 5% Preference Share Capital A/c			20,000
	(Transfer of application money)			
	Equity Share Allotment A/c Dr.		45,000	
	5% Preference Share Allotment A/c Dr.		30,000	
	To Equity Share Capital A/c			45,000
	To 5% Preference Share Capital A/c			30,000
	(Amount due on allotment)			
	Equity Share First Call A/c Dr.		37,500	
	5% Preference Share First Call A/c Dr.		25,000	
	To Equity Share Capital A/c			37,500
	To 5% Preference Share Capital A/c			25,000
	(First call money due)			
	Equity Share Second and Final Call A/c Dr.		37,500	
	5% Preference Share Second and final Call A/cDr.		25,000	
	To Equity Share Capital A/c			37,500
	To 5% Preference Share Capital A/c			25,000

Date	Particulars	L.F.	Amount (Rs.)	Amount (Rs.)
	(First call money due)			
	Call in Arrears A/c Dr.		750	
	To Equity Share Second and Final Call			250
	A/cTo 5% Preference Share Final Call A/c			500
	(For Calls in Arrears)			

Cash Book (Bank Column)

Dr. *Cr.*

Date	*Receipts*	*L.F.*	*Amount (Rs.)*	*Date*	*Payments*	*L.F.*	*Amount (Rs.)*
	Equity Share Application A/c		30,000		Balance c/d		2,49,250
	5% Preference Share Application A/c		20,000				
	Equity Share Allotment A/c		45,000				
	5% Preference Share Allotment A/c		30,000				
	Equity Share First Call A/c		37,500				
	5% Preference Share First Call A/c		25,000				
	Equity Share Second and Final Call A/c		37,250				
	5% Preference Share Second and Final Call A/c		24,500				
			2,49,250				**2,49,250**

Balance Sheet of unique pictures as at . . . . .

Particulars	Note No.	Amount (Rs.)
I. Equity and Liabilities		
1. Shareholders' Funds		
a) Share capital	1	2,49,250
		2,49,250
II. Assets		
1. Current assets		
a) Cash and Cash Equivalents	2	2,49,250
		2,49,250

Notes to Accounts

1.Share Capital		
Authorised Capital		
30,000 Equity Shares of Rs. 10 each		3,00,000
20,000 5% Preference Shares of Rs. 10 each		2,00,000
		5,00,000
Issued Capital		
15,000 Equity Shares of Rs. 10 each		1,50,000
10,000 5% Preference Shares of Rs. 10 each		1,00,000
		2,50,000
Subscribed Capital		
Subscribed and fully paid-up		
14,900 Equity Shares of Rs. 10 each	1,49,000	
9,800, 5% Preference Shares of Rs. 10 each	98,000	
		2,47,000
Subscribed but not fully paid-up		
100 Equity Shares of Rs. 10 each	1,000	
Less: Calls in Arreras	-250	750
200, 5% Preference Shares of Rs. 10 each	2,000	
Less : Calls in Arrers	-500	1,500
		2,49,250

Over Subscription

There are instances when applications for more shares of a company are received than the number offered to the public for subscription. This usually happens in respect of shares issue of well-managed and financially strong companies and is said to be a case of 'Over Subscription'.

In such a condition, three alternatives are available to the directors to deal with the situation: (1) they can accept some applications in full and totally reject the others; (2) they can make a pro-rata allotment to all; and (3) they can adopt a combination of the above two alternatives which happens to be the most common course adopted in practice.

The problem of over subscription is resolved with the allotment of shares. Therefore, from the accounting point of view, it is better to place the situation of over subscription within the total frame of application and allotment, i.e. receipt of application amount, amount due on allotment and its receipt from the shareholders, and the same has been observed in the pattern of entries.

First Alternative : When the directors decide to fully accept some applications and totally reject the others, the application money

received on rejected applications is fully refunded. For example, a company invited applications for 20,000 shares and received the applications for 25,000 shares. The directors rejected the applications for 5,000 shares which are in excess of the required number and refunded their application money in full. In this case, the journal entries on application and allotment will be as follows :

The journal entries on application and allotment according to this alternativeare as follows:

1	Bank A/c To Share Application A/c (Money received on application for 25,000 shares @ Rs. _ per share)	Dr.
2	Share Application A/c To Share Capital A/c To Bank A/c (Transfer of application for money 20,000 for shares allotted and money refunded on applications for 5,000 shares rejected)	Dr.
3	Share Allotment A/c To Share Capital A/c (Amount due on the allotment of 20,000 shares @ Rs. _ per share)	Dr.
4	Bank A/c To Share Allotment A/c (Allotment money received)	Dr.

Second Alternative : When the directors opt to make a proportionate allotment to all applicants (called 'pro-rata' allotment), the excess application money received is normally adjusted towards the amount due on allotment. In case, the excess application money received is more than the amount due on allotment of shares, such excess amount may either be refunded or credited to calls in advance.

For example, in the event of applications for 20,000 shares being invited and those received are for 25,000 shares, it is decieded to allot shares in the ratio of 4:5 to all applicants. It is a case of pro-rata allotment and the excess application money received on 5,000 shares would be adjusted towards the amount due on the allotment of 20,000 shares. In this case, the journal entries on application and allotment will be as follows.

1	Bank A/c To Share Application A/c (Application money received on 25,000 shares @ Rs. _ per Share)	Dr.
2	Share Application A/c To Share Capital A/c To Share Allotment A/c (Transfer of application money to share capital and the excess application money on 5,000 shares credited to share allotment account)	Dr.
3	Share Allotment A/c To Share Capital A/c (Amount due on allotment of 25,000 share @ Rs. _ per share)	Dr.
4	Bank A/c To Share Allotment A/c (Allotment money received after adjusting the amount already received as excess application money)	Dr.

Third Alternative : When the application for some shares are rejected outrightly; and pro-rata allotment is made to the remaining applicants, the money on rejected applications is refunded and the excess application money received from applicants to whom pro-rata allotment has been made is adjusted towards the amount due on the allotment of shares allotted.

For example, a company invited applications for 10,000 shares and received applications for 15,000 shares. The directors decided to reject the applications for 2,500 shares outright and to make a pro-rata allotment of 10,000 shares to the applicants for the remaining 12,500 shares so that four shares are allotted for every five shares applied. In this case, the money on applications for 2,500 shares rejected would be refunded fully and that on the remaining 2,500 shares (12,500 shares – 10,000 shares) would be adjusted against the allotment amount due on 10,000 shares allotted and credited to share allotment account, the journal entries on application and allotment recorded as follows:

1	Bank A/c To Share Application A/c (Money received on application for 15,000 shares @ Rs. _ per share)	Dr.
2	Share Application A/c To Share Capital A/c To Share Allotment A/c To Bank A/c (Transfer of application money to share capital, and the excess application amount of pro-rata allottees credited to share allotment and the amount on rejected applications refunded)	Dr.
3	Share Allotment A/c To Share Capital A/c (Amount due on the Allotment of 10,000 shares @ Rs. _ per share)	Dr.
4	Bank A/c To Share Allotment A/c (Allotment money received after adjusting the amount already received as excess application money)	Dr.

Sum 7

Janta Papers Limited invited applications for 1,00,000 equity shares of Rs. 25each payable as under:

On Application	Rs. 5.00 per share

On Allotment	Rs. 7.50 per share
On First Call (due two months after allotment)	Rs. 7.50 per share
On Second and Final Call	Rs. 5.00 per
share(due two months after First Call)	

Applications were received for 4,00,000 shares on January 01, 2017 and allotment was made on February 01, 2017.

Record journal entries in the books of the company to record these share capital transactions under each of the following circumstances:

1 The directors decide to allot 1,00,000 shares in full to selected applicants and the applications for the remaining 3,00,000 shares were rejected outright.

2 The directors decide to make a pro-rata allotment of 25 per cent of the shares applied for to every applicant; to apply the balance of application money towards amount due on allotment; and to refund the amount remaining thereafter.

3 The directors totally reject applications for 2,00,000 shares, accept full applications for 80,000 shares and make a pro-rata allotment of the 20,000 shares to remaining applicants and the excess application money is to be adjusted towards allotment and calls to be made.

Solution

Books of Janta Papers LimitedJournal

First Alternative

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2017 January 01	Bank A/c Dr.		20,00,000	
	To Equity Share Application A/c			20,00,000
	(Money received on applications for 4,00,000 shares @ Rs. 5 per share)			
February 01	Equity Share Application A/c Dr.		20,00,000	
	To Equity Share Capital A/c			5,00,000
	To Bank A/c			15,00,000
	(Transfer of application money on 1,00,000 shares to share capital and money refunded on rejected applications)			
February 01	Equity Share Allotment A/c Dr.		7,50,000	
	To Equity Share Capital A/c			7,50,000
	(Amount due on the allotment of 1,00,000 shares @ Rs 7.50 per share)			
	Bank A/c Dr.		7,50,000	
	To Equity Share Allotment A/c			7,50,000
	(Allotment money received)			
April 01	Equity Share First Call A/c Dr.		7,50,000	
	To Equity Share Capital A/c			7,50,000
	(First call money due on 1,00,000 shares @ Rs. 7.50 per share)			
April 01	Bank A/c Dr.		7,50,000	
	To Equity Share First Call A/c			7,50,000
	(First call money received)			
June 01	Equity Share Second and Final Call A/c Dr.		5,00,000	
	To Equity Share Capital A/c			5,00,000
	(Final Call money due on 1,00,000 shares @ Rs. 5 per share)			
June 01	Bank A/c Dr.		5,00,000	
	To Equity Share Second and Final Call A/c			5,00,000
	(Final call money received)			

Second Alternative

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2017				
January 01	Bank A/c Dr.		20,00,000	
	To Equity Share Application A/c			20,00,000
	(Money received on applications for 4,00,000 shares @ Rs. 5 per share)			
February 01	Equity Share Application A/c Dr.		20,00,000	
	To Equity Share Capital A/c			5,00,000
	To Equity Share Allotment A/c			7,50,000
	To Bank A/c			7,50,000
	(Transfer of application money on Shares allotted to share capital, excess application amount credited to allotment account and money refunded on rejected applications)			
February 01	Equity Share Allotment A/c Dr.		7,50,000	
	To Equity Share Capital A/c			7,50,000
	(Amount due on the allotment of Rs. 1,00,000 shares @ Rs 7.50 per share)			

Note : The entries regarding the two calls would be the same as given in preceding method.

Third Alternative

Date	*Particulars*	*L.F*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2017 January 01	Bank A/c Dr. To Equity Share Application A/c (Money received on applications for 4,00,000 shares @ Rs. 5 per share)		20,00,000	 20,00,000
February 01	Equity Share Application A/c Dr. To Equity Share Capital A/c To Equity Share Allotment A/cTo Calls-in-Advance A/c To Bank A/c (Amount on share application adjusted to share capital, share allotment and calls in advance and the balance refunded including the money on rejected applications)		20,00,000	 5,00,000 1,50,000 2,50,000 11,00,000
February 01	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Transfer of application money on shares allotted to share capital and amount due on the allotment of 1,00,000 shares @ Rs. 7.50 per share)		7,50,000	 7,50,000
	Bank A/c Dr. To Equity Share Allotment A/c (Allotment money received)		6,00,000	 6,00,000
April 01	Equity Share First Call A/c Dr. To Equity Share Capital A/c (First Call money due on 1,00,000 shares @ Rs. 7.50 per share)		7,50,000	 7,50,000
April 01	Bank A/c Dr. Calls in Advance A/c Dr. To Equity Share First Call A/c (Calls-in-advance adjusted against first call and the balance money on call received)		6,00,000 1,50,000	 7,50,000
June 01	Equity Share Second and Final Call A/c Dr. To Equity Share Capital A/c (Final Call money due on 1,00,000 shares @ Rs. 5 per share)		5,00,000	 5,00,000

June 01	Bank A/c	Dr.		4,00,000	
	Calls in Advance A/c	Dr.		1,00,000	
	To Equity Share Second and Final Call A/c				5,00,000
	(Calls-in-advance adjusted against final call and the balance money on call received)				

Note: The balance of excess application money as a result of pro-rata distribution in journal entry 3 above is large enough to meet the demands on allotted shares in respect of the allotment and the two call money, as well as to leave an amount to be refunded along with that on the rejected applications.

Working Notes:

	Rs.	Rs.
Excess Application Money		15,00,000
Less Transfers :		
Share Allotment —		
20,000 shares @ Rs. 7.50	1,50,000	
Share Calls —		
20,000 shares @ Rs. 12.50	2,50,000	4,00,000[1]
Amount to be refunded (including that on the rejected applications)		11,00,000

1.6.3 Under Subscription

Under subscription is a situation where number of shares applied for is less than the number for which applications have been invited for subscription. For example, a comapny offered 2 lakh shares for subscription to the public but the applications were received for 1,90,000 shares, only. In such a situation, the allotment will be confirmed to 1,90,000 shares and entries shall be made accordingly. However, as stated earlier, it must be ensured that the company has received the minimum subscriptions and the company will have to refund the entire subscription amount received.

1.6.4 Issue of Shares at a Premium

It is quite common for the shares of financially strong and well-managed companies to be issued at a premium, i.e. at an amount more than the nominal or par value of shares. Thus, when a share of the nominal value of Rs. 100 is issued at Rs. 105, it is said to have been issued at a premium of 5 per cent.

When the issue of shares is at a premium, the amount of premium may technically be called at any stage of the issue of shares. However, premium is generally called with the amount due on allotment, sometimes with the application money and rarely with the call money. The premium amount is credited to a separate account called 'Securities Premium Account' and is

shown under the title *'Equity and Liabilities'* of the company's balance sheet under the head *'Reserves and Surpluses'*. It can be used only for the following five purposes:

(a) to issue fully paid bonus shares to the extent not exceeding unissued share capital of the company;

(b) to write-off preliminary expenses of the company;

(c) to write-off the expenses of, or commission paid, or discount allowed on any securities of the company; and

(d) to pay premium on the redemption of preference shares or debentures of the company.

(e) Purchase of its own shares (i.e., buy back of shares).

The journal entries for shares issued at a premium are as follows:

1. For *Premium Amount called with Application money*

(a) Bank A/c Dr.

To Share Application A/c

(Money received on application for — shares @ Rs. — per share including premium)

(b) Share Application A/c Dr.

To Share Capital A/c

To Securities Premium Reserve A/c

(Transfer of application money to share capital and securities premium account)

2. *Premium Amount called with Allotment Money*

(a) Share Allotment A/c Dr.

To Share Capital A/c

To Securities Premium Reserve A/c

(Amount due on allotment of shares @ Rs — per share including premium)

(b) Bank A/c Dr.

To Share Allotment A/c

(Allotment money received including premium)

3. *Premium Amount called with Call Money*

(a) Share Application A/c

To Share Capital Reserve A/c

To Securities Premium A/c

(Amount due on Ist/2nd call @Rs— per share including premium)

(b) Bank A/c Dr.

To Share Call A/c

(Call money received including premium)

Sum 8

Jupiter Company Limited issued 35,000 equity shares of Rs. 10 each at apremium of Rs.2 payable as follows:

On Application Rs. 3

On Allotment Rs. 5 (including

premium)Balance on First and Final Call

The issue was fully subscribed. All the money was duly received.Record journal entries in the books of the Company.

Solution:

Books of Jupiter Company Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr.		1,05,000	
	To Equity Share Application A/c			1,05,000
	(Money received on applications for 35,000 shares @ Rs. 3 per share)			
	Equity Share Application A/c Dr.		1,05,000	
	To Equity Share Capital A/c			1,05,000
	(Transfer of application money on allotment to share capital)			
	Equity Share Allotment A/c Dr.		1,75,000	
	To Equity Share Capital A/c			1,05,000
	To Securities Premium Reserve A/c			70,000
	(Amount due on allotment of 35,000 shares @ Rs. 5 per share including premium)			
	Bank A/c Dr.		1,75,000	
	To Equity Share Allotment A/c			1,75,000
	(Money received including premium)			
	Equity Share First and Final Call A/c Dr.		1,40,000	
	To Equity Share Capital A/c			1,40,000
	(Amount due on First and Final Call of Rs. 4 per share on 35,000 shares)			
	Bank A/c Dr.		1,40,000	
	To Equity Share First and Final Call A/c			1,40,000
	(Money received on First and Final Call)			

1.6.5 Issue of Shares at a Discount

There are instances when the shares of a company are issued at a discount, i.e. at an amount less than the nominal or par value of shares, the difference between the nominal value and issue price representing discount on the issue of shares. For example, when a share of the nominal value of Rs. 100 is issued at Rs. 98, it is said to have been issued at a discount of two per cent.

As a general rule, a company cannot ordinarily issue shares at a discount. It can do so only in cases such as 'reissue of forfeited shares' (to be discussed later) and issue of sweat equity shares.

1.6.6 Issue of Shares for Consideration other than Cash

There are instances where a company enters into an arrangement with the vendors from whom it has purchased assets, whereby the latter agrees to accept, the payment in the form of fully paid shares of the company issued to them. Normally, no such cash is received for issue of shares. These shares can also be issued either at par, at premium or at discount, and the number of shares to be issued will depend upon the price at which the shares are issued and the amount payable to the vendor. The number of shares to be issued to the vendor will be calculated as follows:

$$\text{Number of shares to be issued} = \frac{\text{Amount Payable}}{\text{Issue Price}}$$

For example, Rahul Limited purchased building from Handa Limited for Rs.5,40,000 and the payment is to be made by the issue of shares of Rs.100 each. The number of shares to be issued shall be worked out as follows in different situations:

(a) *When shares are issued at par, i.e., at Rs.100*

$$\text{Number of shares to be issued} = \frac{\text{Amount Payable}}{\text{Issue Price}}$$

$$= \frac{\text{Rs. 5,40,000}}{\text{Rs. 100}}$$

$$= \text{5,400 shares}$$

(b) *When shares issued at premium of 20%, i.e., at Rs. 120 (100 + 20)*

$$\text{Number of shares to be issued} = \frac{\text{Amount Payable}}{\text{Issue Price}}$$

$$= \frac{\text{Rs. 5,40,000}}{\text{Rs. 120}}$$

$$= \text{4,500 shares}$$

The journal entries recorded for the shares issued for consideration other than cash in above situations will be as follows :

Books of Rahul Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Building A/c Dr.		5,40,000	
	To Handa Limited			5,40,000
	(Building purchased)			
(a)	*When shares are issued at par*			
	Handa Limited Dr.		5,40,000	
	To Share Capital A/c			5,40,000
	(5,400 Shares issued at par)			
(b)	*When shares are issued at premium of 20%*			
	Handa Limited Dr.		5,40,000	
	To Share Capital A/c			4,50,000
	To Securities Premium Reserve A/c			90,000
	(4,500 shares issued at Rs.120 per share)			

Sum 9

Jindal and Company purchased a machine from High Life Machine Limited for Rs.3,80,000. As per purchase agreement, Rs. 20,000 were paid in cash and balance by issue of shares of Rs.100 each. What will be the entries passed if the shares are issued :

(a) at par
(b) at 20% premium

Solution:

Number of shares will be calculated as follows:

(a) When shares issued at par

$$\frac{\text{Rs. } 3,60,000}{\text{Rs.}100} = 3,600 \text{ shares}$$

(b) When shares issued at premium

$$\frac{\text{Rs. } 3,60,000}{\text{Rs.}120} = 3,000 \text{ shares}$$

Books of Jindal and Company
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Machine A/c	Dr.		3,80,000	
	To Bank A/c				20,000
	To High Life Machine Limited				3,60,000
	(Machine purchased and Rs. 20,000 paid in cash and the balance paid by issue of share)				
(a)	*When shares are issued at par*				
	High Life Machine Limited	Dr.		3,60,000	
	To Share Capital A/c				3,60,000
	(3,600 Shares are Rs.100 each)				
(b)	*When shares are issued at premium*				
	High Life Machine Limited	Dr.		3,60,000	
	To Share Capital A/c				3,00,000
	To Securities Premium Reserve A/c				60,000
	(3,000 shares issued at Rs.120 per share)				

1.6 Forfeiture of Shares

It may happen that some shareholders fail to pay one or more instalments, viz. allotment money and/or call money. In such circumstances, the company can forfeit their shares, i.e. cancel their allotment and treat the amount already received thereon as forfeited to the company within the framework of the provisions in its articles. These provisions are usually based on Table F which authorise the directors to forefeit the shares for non-payment of calls made. For this purpose, they have to strictly follow the procedure laid down in this regard. Following is the accounting treatment of shares issued at par, premium or at a discount. When shares are forefeited all entries relating to the shares forfeited except those relating to premium, already recorded in the accounting records must be reversed. Accordingly, share capital account is debited with the amount called-up in respect of shares are forfeited and crediting the respective unpaid calls accounts's or calls in arrears account with the amount already received. Thus, the journal entry will be as follows:

(a) *Forfeiture of Shares issued at Par:*

Share Capital A/c..........(Called up amount) Dr.

To Share Forfeiture A/c. ....(Paid up amount)

To Share Allotment A/c

To Share Calls A/c (individually)

(......shares forfeited for non-payment of allotment money and calls made)

It may be noted here that when the shares are forfeited, all entries relating to the forfeited shares must be reversed except the entry relating to share premium received, if any. Accordingly, the share capital is debited to the extent to called-up capital and credited to (i) respective unpaid calls

account i.e., calls in arrears and (ii) share forfeiture account with the amount already received on shares.

The balance of shares forfeited account is shown as an addition to the total paid-up capital of the company under the head *'Share Capital'* under title *'Equity and Liabilities'* of the Balance Sheet till the forfeited shares are reissued.

Sum 10

Honda Limited issued 10,000 equity shares of 100 each payable as follows: Rs. 20 on application, Rs. 30 on allotment, Rs. 20 on first call and Rs. 30 on second and final calls 10,000 shares were applied for and allotted. All money due was received with the exception of both calls on 300 shares held by Supriya. These shares were forfeited. Give necessary journal entries.

Solution

Books of Honda Limited
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c	Dr.		2,00,000	
	To Equity Share Application A/c				2,00,000
	(Application money on 10,000 shares @Rs.20 per share received)				
	Share Application A/c	Dr.		2,00,000	
	To Equity Share Capital A/c				2,00,000
	(Application money transferred to share capital)				
	Share Allotment A/c	Dr.		3,00,000	
	To Equity Share Capital A/c				3,00,000
	(Money due on allotment of 10,000 shares @Rs. 30 per share)				
	Bank A/c	Dr.		3,00,000	
	To Equity Share Allotment A/c				3,00,000
	(Allotment Money received on 10,000 shares @ Rs. 30 per share on)				

	Share First Call A/c Dr. To Equity Share Capital A/c (Money due on 10,000 shares @ Rs. 20 per share on Ist Call)		2,00,000	2,00,000
	Bank A/c Dr. To Equity Share First Call A/c (First call money received except for 300 shares)		1,94,000	1,94,000
	Share Second and Final Call A/c Dr. To Equity Share Capital A/c (Money due on 10,000 shares @ Rs. 30 per share on Second and Final Call)		3,00,000	3,00,000
	Bank A/c Dr. To Equity Share Second and Final Call A/c (Second and Final Call money received except for 300 shares)		2,91,000	2,91,000
	Share Capital A/c Dr. To Equity Share First Call A/c To Equity Share Second and Final Call A/c To Share Forfeiture A/c (300 shares forfeited)		30,000	 6,000 9,000 15,000

Forfeiture of Shares issued at a Premium: If shares were initially issued at a premium and the premium amount has been fully realised, but some of the shares are forfeited due to non-payment of call money, the accounting treatment for forfeiture shall be on the same pattern as in the case of shares issued at par. The important point to be noted in this context is that the securities premium account is not to be debited at the time of forfeiture if the premium has been received in respect of the forefeited shares and the amount of forfeiture shall beexcluding premium amount.

In case, however, if the premium amount has not been received, either wholly or partially, in respect of the shares forfeited, the Securities Premium Reserve Account will also be debited with the amount of premium not received along with the Share Capital Account at the time forfeiture. This will usually be the case when even the amount due on allotment has not been received. Thus, the journal entry to record the forfeiture of shares issued at a premium on which premium has not been fully received, will be :

Share Capital A/c   Dr.
Securities Premium Reserve A/c   Dr.
To Share Forfeiture A/c
To Share Allotment A/cand/or
To Share Calls A/c (individually)
(......shares forefeited for non-payment of allotment money and calls made)

Note: If Calls in Arrears Account is maintained, Calls in Arrears Account is credited and not the Share Allotment and/or Share Call/Calls Accounts.

Sum 11

Sahil, a share holder, failed to pay the money for second and final call of Rs. 20 on 1,000 shares issued to him at Rs. 120 (face value of Rs. 100 per share). His shares were forfeited after the second and final call. Give the necessary journal entry for forefeiture of the shares.

Solution:

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Share Capital A/c Dr.		1,00,000	
	To Share second and Final Call A/c			20,000
	To Share Forfeiture A/c			80,000
	(Forfeiture of 1,000 shares for non-payment of the second and final call)			

Sum 12

Sunena, a shareholder holding 500 shares of Rs. 10 each, did not pay the allotment money of Rs. 4 per share (including a premium of Rs. 2) and the first and final call of Rs. 3. Her shares were forfeited after the first and final call. Give journal entry for forefeiture of the shares.

Solution:

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Share Capital Reserve A/c Dr.		5 ,000	
	Securities Premium A/c Dr.		1,000	
	To Share Allotment A/c			2,000
	To Share first and final Call A/c			1,500
	To Share Forfeiture A/c			2,500
	(Forfeiture of 500 shares for non-payment of first and final call)			

Sum 13

Ashok Limited issued 3,00,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share, payable as Rs. 3 on application, Rs. 5 on allotment (including premium) and the balance in two calls of equal amount.

Applications were received for 4,00,000 shares and pro-rata allotment was made to all the applicants. The excess application money was adjusted towards allotment. Mukesh who was allotted 800 shares failed to pay both the calls and his shares were forfeited after the second call. Record necessary journal entries in the books of Ashok Limited and also show the balance sheet.

Solution:

Books of Ashok Limited
Journal

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr.		12,00,000	
	To Equity Share Application A/c			12,00,000
	(Application money received on 4,00,000 shares)			
	Equity Share Application A/c Dr.		12,00,000	
	To Equity Share Capital A/c			9,00,000
	To Equity Share Allotment A/c			3,00,000
	(Application money on 3,00,000 shares transferred to share capital account and the excess amount adjusted to share allotment account)			
	Equity Share Allotment A/c Dr.		15,00,000	
	To Equity Share Capital A/c			9,00,000
	To Securities Premium Reserve A/c			6,00,000
	(Allotment money due on 3,00,000 shares)			
	Bank A/c Dr.		12,00,000	
	To Equity Share Allotment A/c			12,00,000
	(Allotment amount received after adjusting excess money received with application)			
	Equity Share First Call A/c Dr.		6,00,000	
	To Equity Share Capital A/c			6,00,000
	(First Call amount due on 3,00,000 shares)			
	Bank A/c Dr.		5,98,400	
	Calls in Arrears A/c Dr.		1,600	
	To Equity Share First Call A/c			6,00,000
	(First Call amount received on 2,99,200 shares)			
	Equity Share Second and Final Call A/c Dr.		6,00,000	
	To Equity Share Capital A/c			6,00,000
	(Second Call amount due on 3,00,000 Shares)			
	Bank A/c Dr.		5,98,400	
	Calls in Arrears A/c Dr.		1,600	
	To Equity Share Second and Final Call A/c			6,00,000
	(Amount on 2,99,200 shares received)			
	Equity Share Capital A/c Dr.		8,000	
	To Share Forfeiture A/c			4,800
	To Call in Arrears A/c			3,200
	(Forfeiture of 800 shares)			

Balance Sheet of Ashok Limited as on ....

Particulars	Note No.	Amount (Rs.)
I EQUITY AND LIABILITIES		
1. Shareholders' Funds		
(a) Share Capital	1	29,96,800
(b) Reserves and Surplus	2	6,00,000
		35,96,800
II ASSETS		
1. Current Assets		
Cash and Cash Equivalents	3	35,96,800
		35,96,800

Notes to Accounts

		(Rs.)
1. *Share Capital*		
Authorised Capital		
... Equity shares of Rs. 10 each		
Issued Capital		
3,00,000 Equity shares of Rs. 10 each		**30,00,000**
Subscribed Capital		
Subscribed and Fully Paid-up		
2,99,200 Equity shares of Rs. 10 each		29,92,000
Add: Share forfeiture accounts		4,800
		29,96,800
2. *Reserves and Surplus*		
Securities Premium Reserve		**6,00,000**
3. *Cash and Cash Equivalents*		
Cash at bank		**35,96,800**

Sum 14

High Light India Ltd. invited applications for 30,000 Shares of Rs. 100 each at a premium of Rs. 20 per share payable as follows:

On Application	Rs. 40 (including Rs.10 premium)
On Allotment	Rs. 30 (including Rs.10 premium)
On First Call	Rs. 30
On Second and Final Call	Rs. 20

Applications were received for 40,000 shares and pro-rata allotment was made on the application for 35,000 share. Excess application money was utilised towards allotment.

Rohan to whom 600 shares were allotted failed to pay the allotment money and his shares were forfeited immediately after allotment.

Aman who applied for 1,050 shares failed to pay first call and his share were forfeited immediatelyafter first Call.

Second and final call was made. All the money due on second call have been received.

Of the shares forfeited, 1,000 share were reissued as fully paid-up for Rs. 80 per share, which included the whole of Aman's shares.

Record necessary journal entries in the books of High Light India Ltd.

Solution:

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr.		16,00,000	
	To Share Application A/c			16,00,000
	(Application money received on 40,000 shares)			
	Share Application A/c Dr.		14,00,000	
	To Share Capital A/c			9,00,000
	To Securities Premium Reserve A/c			3,00,000
	To Share Allotment A/c			2,00,000
	(Application money transferred to share capital account, securities premium account and the excess money transfered to share allotment account)			
	Share Application A/c Dr.		2,00,000	
	To Bank A/c			2,00,000
	(Amount returned on 500 shares)			
	Share Allotment A/c Dr.		9,00,000	
	To Share Capital A/c			6,00,000
	To Securities Premium Reserve A/c			3,00,000
	(Money due on allotment)			
	Bank A/c Dr.		6,86,000	
	To Share Allotment A/c			6,86,000
	(Amount received in allotment)			
	Share Capital A/c Dr.		30,000	
	Securities Premium Reserve A/c Dr.		6,000	
	To Share Allotment A/c			14,000
	To Share Forfeiture A/c			22,000
	(Forfeiture of 600 shares of Rohan for non-payment of allotment money)			
	Share First Call A/c Dr.		8,82,000	
	To Share Capital A/c			8,82,000
	(First Call money due on 29,400 shares)			
	Bank A/c Dr.		8,55,000	
	To Share First Call A/c			8,55,000
	(First call money received on 28,500 shares)			

Date	Particulars		L.F.	Dr. Amount (Rs.)	Cr. Amount (Rs.)
	Share Capital A/c	Dr.		72,000	
	To Share First Call A/c				27,000
	To Share Forfeiture A/c				45,000
	(Forfeiture of 900 shares of Aman)				
	Share Second and Final Call A/c	Dr.		5,70,000	
	To Share Capital A/c				5,70,000
	(Second and Final Call money due on 28,500 shares)				
	Bank A/c	Dr.		5,70,000	
	To Share Second and Final Call A/c				5,70,000
	(Due money received)				
	Bank A/c	Dr.		80,000	
	Share Forfeiture A/c	Dr.		20,000	
	To Share Capital A/c				1,00,000
	(Reissue of 1,000 forfeited shares)				
	Share Forfeiture A/c	Dr.		28,667	
	To Capital Reserve				28,667
	(Profit on 1,000 reissued shares transferred to capital reverve)				

Working Notes:

(I) Excess amount received on Rohan's application

Rohan has been alloted = 600 Shares

He must have applied for $\frac{\text{Rs. } 35,000}{\text{Rs. } 30,000}$ ´ 600 700 Shares

		Rs.
Amount received from Rohan	= 700 Rs. 40	28,000
Amount Adjusted on Application	= 600 Rs. 40	(24,000)
Amount Adjusted on Allotment		**4,000**
Money due on Allotment	= 600 Rs. 30	18,000
Money Adjusted		(4,000)
Balance due on Allotment		**14,000**

(II) Amount recieved on allotment

Total Amount due on Allotment = Rs. 30,000 Rs. 30	= 9,00,000
Amount received on Application	(2,00,000)
	7,00,000
Amount not received on Rohan's Share	(14,000)
	6,86,000

(III) Money received on First Call

First Call money due on 29,400 shares 29,400 Rs. 30 =	8,82,000
Application money not received on 900 Shares 900 Rs. 30	(27,000)
	8,55,000

(IV) 1000 shares have been reissued including 900 shares of Aman and Balance 100 shares of Rohan

Gain on 100 shares = $\frac{22,000}{600}$ ´ 100 =	3,667
Gain in 900 shares =	45,000
	48,667
Less: Loss on reissue of 1,000 shares	(20,000)
Transferred to Capital Reserve	**28,667**

(V) Balance in Share Forfeiture Account of 500 shares

Rs. $\frac{22,000}{600}$ ´ 500 = Rs. 18,333

Sum 15

X Ltd. issued for public subscription 40,000 equity shares of Rs. 10 each at premium of Rs. 2 per share payable as under :

On application	Rs. 4 per share
On Allotment	Rs. 5 per share (including premium)
On Call	Rs. 3 per share

Applications were received for 60,000 shares. Allotment was made pro-rata to the applicants for 48,000 shares, the remaining applications being rejected. Money overpaid on application was applied towards sums due on allotment.

Shri Chitnis, to whom 1,600 shares were allotted, failed to pay the allotment money and Shri Jagdale, to whom 2,000 shares were allotted, failed to pay the call money. These shares were subsequently forfeited.

Record journal entries in the books of the company to record the above transactions.

Solution:

Books of X Ltd.
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr.		2,40,000	
	To Equity Share Application A/c			2,40,000
	(Money received on applications for 60,000 shares @ Rs. 4 per share)			
	Equity Share Application A/c Dr.		2,40,000	
	To Equity Share Capital A/c			1,60,000
	To Equity Share Allotment A/c			32,000
	To Bank a/c			48,000
	(Application amount transferred to share capital, excess application money under pro-rata distribution credited to share allotment and money refunded on rejected application)			

	Equity Share Allotment A/c Dr.		2,00,000	
	To Equity Share Capital A/c			1,20,000
	To Securities Premium Reserve A/c			80,000
	(Amount due on allotment of 40,000 shares @ Rs. 5 per share including premium)			
	Bank A/c Dr.		1,61,280	
	Calls-in-Arrears A/c Dr.		6,720	
	To Equity Share Allotment A/c			1,68,000
	(Money received consequent upon allotment)			
	Equity Share Call A/c Dr.		1,20,000	
	To Equity Share Capital A/c			1,20,000
	(First call money due on 40,000 shares @ Rs. 3 per share)			
	Bank A/c Dr.		1,09,200	
	Calls-in-Arrears A/c Dr.		10,800	
	To Equity Share Call A/c			1,20,000
	(Money received on first call)			
	Equity Share Capital A/c Dr.		36,000	
	Securities Premium Reserve A/c Dr.		3,200	
	To Share Forfeiture A/c			21,680
	To Call-in-Arrears A/c			17,520
	(Entry for forfeiture of 3,600 shares)			

Working Notes :

I. Amount received on allotment

		Rs.
(a)	Amount due on allotment	2,00,000
	40,000 shares Rs. 5 per share	
(b)	Amount actually due on allotment	2,00,000
	Amount due on allotment	
	Less Excess Application amount applied for allotment	32,000
	Amount actually due	1,68,000
(c)	Allotment amount due from Chitnis	
	Allotment money due on Chitnis's share	
	1,600 shares Rs. 5 per share	8,000
	Less excess application money paid	
	Due to pro-rata distribution –	
	(1,920 shares – 1,600 shares) 320 4	1,280
	Allotment amount due from Chitnis	6,720

According to the ratio of pro-rata distribution (40,000 shares : 48,000 shares), for 1,600 shares to be allotted, Chitnis must have applied for 1,920 shares (1,600 shares 6/5).

(d) Allotment money received

(Amount actually due on Allotment)	1,68,000
Less Amount unpaid by Chitnis	(6,720)
Amount received	1,61,280

II. Balance on Shares Forfeited Account

Amount paid by Chitnis :	
1,920 Shares applied for Rs. 4 per share	7,680
Amount paid by Jagdale :	
2,000 Shares (Rs. 4 + Rs. 3) Rs.7 per share	14,000
Total balance	21,680

Note : Premium amount on Jagdale's shares will not be taken into account as it has been received in full by the company.

Reissue of Forfeited Shares

The directors can either cancel or re-issue the forefeited shares. In most cases, they reissue such shares which may be at par, at premium or at a discount. Forfeited shares may be reissued as fully paid at a par, premium, discount. In this context, it may be noted that the amount of discount allowed cannot exceedthe amount that had been received on forfeited shares at the time of initial issue, and that the discount allowed on reissue of forfeited shares should be debited tothe 'Forfeited Share Account'. The balance, if any, left in the Share-Forfeited Account relating to reissued Shares, should be treated as capital profit and transferred to Capital Reserve Account. For example, when a company forfeits200 shares of Rs. 10 each on which Rs. 600 had been received, it can allow a maximum discount of Rs. 600 on their reissue. Assuming that the company reissues these shares for Rs. 1,800 as fully paid, the necessary journal entry will be:

Bank A/c	Dr.	1,800	
Share Forfeiture A/c	Dr.	200	
To Share Capital A/c			2,000
(Reissue of 200 forfeited shares at Rs. 9 per share as fully paid)			

This shall leave a balance of Rs. 400 in share forfeited account which should be transferred to Capital Reserve Account by recording the following journal entry:

Share Forfeiture A/c	Dr.	400	
To Capital Reserve			400
(Profit on reissue of forfeited shares transferred)			

Another important point to be noted in this context is that the capital profit arises only in respect of the forefited share reissued, and not on all forefeited shares. Hence, when a part of the forfeited shares are reissued, the whole balance of share forfeiture account cannot be transferred to the capital reserve. In such a situation, it is only the proportionate amount of balance that relates to the forefeited shares reissued which should be transferred to capital reserve, ensuring that the remaining balance in share forefeiture account is proportionate to the amount forefeited on shares not yet reissued.

Sum 16

The director of Poly Plastic Limited resolved that 200 equity shares of Rs.100 each be forfeited for non-payment of the second and final call of Rs.30 per share. Out of these, 150 shares were re-issued at Rs.60 per share to Mohit.

Show the necessary journal entries .

Solution:

Books of Poly Plastic Limited
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Share Capital A/c	Dr.		20,000	
	To Shares Forfeiture A/c				14,000
	To Share Second and Final Call A/c				6,000
	(200 shares forfeited for non-payment of final call at Rs.30 per share)				
	Bank A/c	Dr.		9,000	
		Dr.		6,000	

	Shares Forfeiture A/c To Share Capital A/c (Reissue of 150 shares of Rs.100 each, issued as fully paid for Rs.60 each)			15,000
	Shares Forfeiture A/c Dr. To Capital Reserve A/c (Profit on reissue of 150 forfeited shares transferred to capital reserve)		4,500	4,500

Working Notes :

	Rs.
Total amount forfeited on 200 shares	= 14,000 (200 shares × Rs. 70)
Amount forfeited on 150 shares	= 10,500 (150 shares × Rs. 70)
Amount of loss on reissue of 150 shares	= 6,000 (150 shares × Rs. 40)
Amount of profit on reissued shares transferred to capital reserve	= 4,500 (Rs. 10,500 – Rs. 6,000)
Amount forfeited on 50 shares	= 3,500 (50 shares × Rs. 70)
Balance left in share forfeited account (equal to amount forfeited on 50 shares)	= 3,500 (Rs.14,000 – Rs. 6,000 – Rs. 4,500)

Sum 17

On January 1, 2015, the Director of X Ltd. issued for public subscription 50,000equity shares of Rs. 10 each at Rs. 12 per share payable as to Rs. 5 on application (including premium), Rs. 4 on allotment and the balance on call on May 01,2015.

The lists were closed on February 10, 2015 by which date applications for 70,000 shares were received. Of the cash received Rs. 40,000 was returned and Rs.60,000 was applied to the amount due on allotment, the balance of whichwas paid on February 16, 2015.

All the shareholders paid the call due on May 01, 2015 with the exceptionof an allottee of 500 shares.

These shares were forfeited on September 29, 2015 and reissued us fully paid at Rs. 8 per share on November 01, 2015.

The company, as a matter of policy, does not maintain a calls-in-arrearsaccount.

Give journal entries to record these share capital transactions in the booksof X. Ltd.

Solution:

Book of X. Ltd.
Journal

Date 2015	Particulars		L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Feb.10	Bank A/c	Dr.		3,50,000	
	To Equity Share Application A/c				3,50,000
	(Amount received on application for 70,000 shares @ Rs. 5 per share Including Premium)				
Feb.16	Equity Share Application A/c	Dr.		2,50,000	
	To Equity Share Capital A/c				1,50,000
	To Securities Premium Reserve A/c				1,00,000
	(Transfer of application money on 50,000 shares to share capital and premium accounts consequent upon allotment)				
Feb.16	Equity Share Application A/c	Dr.		1,00,000	
	To Bank A/c				40,000
	To Equity Share Allotment A/c				60,000
	(Excess application money credited to share allotment and money refunded on rejected application)				
Feb.16	Equity Share Allotment A/c	Dr.		2,00,000	
	To Equity Share Capital A/c				2,00,000
	(Amount due on allotment of 50,000) Shares @ Rs. 4 per share)				
Feb.16	Bank A/c	Dr.		1,40,000	
	To Equity Share Allotment A/c				1,40,000
	(Money received on allotment)				
May 1	Equity Share First and Final Call A/c	Dr.		1,50,000	
	To Equity Share Capital A/c				1,50,000
	(First call money due)				
May 1	Bank A/c	Dr.		1,48,500	
	To Equity Share First and Final Call A/c				1,48,500
	(Money received on first call)				
Sept. 29	Equity Share Capital A/c	Dr.		5,000	
	To Shares Forfeiture A/c				3,500
	To Equity Share First and Final Call A/c				1,500
	(Forfieted of 500 shares for non-payment of call)				
Nov. 1	Bank A/c	Dr.		4,000	
	Shares Forfeiture A/c	Dr.		1,000	

	To Equity Share Capital A/c (Reissue of 500 forfeited shares as fully paid at Rs. 8 per share)			5,000
Nov. 1	Shares Forfeiture A/c Dr. To Capital Reserve (Profit on reissue of Forfeited Shares Accounts transferred to capital reserve)		2,500	 2,500

Sum

Garima Limited issued a prospectus inviting applications for 3,000 shares of Rs. 100 each at a premium of Rs.20 payable as follows:

On Application	Rs.20 per share
On Allotment	Rs.50 per share (Including premium)
On First call	Rs.20 per share
On Second call	Rs.30 per share

Applications were received for 4,000 shares and allotments made on pro-rata basis to the applicants of 3,600 shares, the remaining applications being rejected, money received on application was adjusted on account of sums due on allotment.

Renuka to whom 360 shares were allotted, failed to pay allotment money and calls money, and her shares were forfeited.

Kanika, the applicant of 200 shares failed to pay the two calls, her shares were also forfeited. All these shares were sold to Naman as fully paid for Rs.80 per share. Show the journal entries in the books of the company.

Solution:

Books of Garima Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr. To Share Application A/c (Application money received on 4,000 shares @ Rs. 20 per share)		80,000	 80,000
	Share Application A/c Dr. To Share Capital A/c To Share Allotment A/c To Bank A/c (Transfer of application money on 3,000 shares to Share Capital Account, on 600 shares to Allotment Account, and on of 400 shares refunded)	80,0	0	 60,000 12,000 8,000
	Share Allotment A/c Dr.		1,50,000	

Date	Particulars	L.F.	Debit Amount	Credit Amount
	To Share Capital A/c			90,000
	To Securities Premium Reserve A/c			60,000
	(Money due on allotment @ Rs. 50 per share on 3,000 shares including Rs.20 on account of share premium)			
	Bank A/c Dr.		1,21,440	
	To Share Allotment A/c			1,21,440
	(Money received on share allotment)			
	Share First Call A/c Dr.		60,000	
	To Share Capital A/c			60,000
	(Money due on call on 3,000 shares @ Rs.20 per share)			
	Bank A/c Dr.		48,800	
	To Share First Call A/c			48,800
	(First call money received on 2,440 shares)			
	Share Second and Final Call A/c Dr.		90,000	
	To Share Capital A/c			90,000
	(Money due on call on 3,000 shares @ Rs.30 per share)			
	Bank A/c Dr.		73,200	
	To Share Second and Final Call A/c			73,200
	(Second and Final Call money received on 2,440 shares)			
	Share Capital A/c Dr.		56,000	
	Securities Premium Reserve A/c		7,200	
	To Share Allotment A/c			16,560
	To Share First Call A/c			11,200
	To Share Second and Final A/c			16,800
	To Share Forfeiture A/c			18,640
	(Forfeiture of 560 shares)			
	Bank A/c Dr.		44,800	
	Shares Forfeiture A/c Dr.		11,200	
	To Share Capital A/c			56,000
	(Reissue of 560 forfeited shares)			
	Shares Forfeiture A/c Dr.		7,440	
	To Capital Reserve			7,440
	(Profit on reissue of 560 forfeited shares transferred to Capital reserve)			

Working Notes :

Amount received on allotment has been calculated as follows:

	Rs.
Total money due on allotment (including premium)	1,50,000

Less :	Application money received on 600 shares adjusted towards allotment money	(12,000)
	Net amount due on allotment on 3,000 shares	1,38,000
Less :	Allotment money due on 360 shares alloted to Renuka, not received $\frac{360}{3,000}$ 1,38,000	(16,560)
	Net amount received on 2,640 shares	1,21,440

Since the allotment money which includes securities premium of Rs. 20 per share has not been received on 360 shares held by Renuka (now forfeited) has been debited to Securities premium account as per rules.

Amount forefeited has been worked out as follows :

Application money received from Renuka: $\left(360 \quad \frac{3,600}{3,000}\right)$ = 432 Rs. 20 = Rs. 8,640

Application and Allotment money received from Kanika on 200 shares	Rs. 10,000
Total amount received on forefeited shares	Rs. 18,640

Sum 20

Sunrise Company Limited offered for public subscription 10,000 shares of Rs.10 each at Rs. 11 per share. Money was payable as follows:

Rs. 3 on application

Rs. 4 on allotment (including premium)

Rs. 4 on first and final call.

Applications were received for 12,000 shares and the directors made *pro-rata* allotment.

Mr. Ahmad, an applicant for 120 shares, could not pay the allotment and call money, and Mr. Basu, a holder of 200 shares, failed to pay the call. All these shares were forfeited.

Out of the forfeited shares, 150 shares (the whole of Mr. Ahmad's shares being included) were issued at Rs. 8 per share. Record journal entries for the above transactions and prepare the share forfeiture account.

Solution:

Books of Sunrise Company Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Bank A/c Dr.		36,000	
	To Share Application A/c			36,000
	(Application money received on 12,000 shares @ Rs. 3 per share)			
	Share Application A/c Dr.		36,000	
	To Share Capital A/c			30,000
	To Share Allotment A/c			6,000
	(Transfer of application money to share capital account on 10,000 shares and the balance to allotment account)			
	Share Allotment A/c Dr.		40,000	
	To Share Capital A/c			30,000
	To Securities Premium Reserve A/c			10,000
	(Money due on allotment @ Rs. 4 per share on 10,000 shares including Rs. 1 on account of premium)			

Date	Particulars		L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c To Share Allotment A/c (Money received on share allotment: *See note 1)*	Dr.		33,660	33,660
	Share first and Final Call A/c Share Capital A/c (Money due on call on 10,000 shares @ Rs. 4 per share)	Dr.		40,000	40,000
	Bank A/c To Share first and Final Call A/c (Call money received on 9,700 shares)	Dr.		38,800	38,800
	Share Capital A/c Securities Premium Reserve A/c To Share Allotment A/c To Share first and Final Call A/c To Share Forfeiture A/c (Forfeiture of 300 shares)	Dr.		3,000 100	340 1,200 1,560
	Bank A/c Shares Forfeiture A/c To Share Capital A/c (Reissue of 150 forfeited shares)	Dr. Dr.		1,200 300	1,500
	Shares Forfeiture A/c To Capital Reserve (Profit on reissue of 150 forfeited shares transferred)	Dr.		360	360

Share Forfeiture Account

Dr. Cr.

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Share Capital		300		Sundries		1,560
	Capital Reserve		360				
	Balance c/d		900				
			1,560				1,560

Working Notes :

1. Amount received on allotment has been calculated as follows:

		Rs.
	Total money due on 10,000 shares @ Rs. 4 per share	40,000
Less:	Application Money Received on 2,000 shares adjusted against allotment money	(6,000)
	Net amount due on allotment	34,000

		Rs.
Less:	Amount due from an applicant for 120 shares who was allotted only 100 shares $\frac{100}{10,000}$ 34,000	(340)
	Amount received on allotment	33,660

2. Securities Premium Account has been debited only with Rs. 100 relating to 100 shares allotted Mr. Ahmad's shares from whom the allotment money (including premium) has not been received.

3. Shares Forfeiture Account represents the money received on forfeited shares excluding Securites premium. This has been worked out as follows:

	Rs.
Mr. Ahmad has paid application money @ Rs. 3 per share on 120 shares	3 6 0
Mr. Basu has paid @ Rs. 6 per share on 200 shares in (application and allotment money excluding premium)	1,200
Total amount received	1,560

	Rs.
4. Amount received from Mr. Ahmad on 100 shares forfeited which have been reissued	360
Amount received from *Mr. Basu* on 50 shares forfeited which have been reissued $\left(\frac{50}{200} \text{ Rs. } 1,200\right)$	300
Total amount received on 150 shares which have been forfeited and later reissued	660
Less: Discount on reissue of forfeited shares (150 Rs. 2)	(300)
Amount of Capital Profit transferred to capital reserve	360

ISSUE OF BONUS SHARES

INTRODUCTION

A bonus share may be defined as issue of shares at no cost to current shareholders in a company, based upon the number of shares that the shareholder already owns. In other words, no new funds are raised with a bonus issue. While the issue of bonus shares increases the total number of shares issued and owned, it does not increase the net worth of the company. Although the total number of issued shares increases, the ratio of number of shares held by each shareholder remains constant.

Bonus issue is also known as 'capitalization of profits'. Capitalization of profits refers to the process of converting profits or reserves into paid up capital. A company may capitalize its profits or reserves which otherwise are available for distribution as dividends among the members by issuing fully paid bonus shares to the members.

If the subscribed and paid-up capital exceeds the authorized share capital as a result of bonus issue, a resolution shall be passed by the company at its general body meeting for increasing the authorized capital. A return of bonus issue along with a copy of resolution authorizing the issue of bonus shares is also required to be filed with the Registrar of Companies.

PROVISIONS OF THE COMPANIES ACT, 2013

Section 63 of the Companies Act, 2013 deals with the issue of bonus shares. According to Sub-section (1) of Section 63, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account:

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Sub-section (2) of Section 63 provides that no company shall capitalise its profits or

reserves for the purpose of issuing fully paid-up bonus shares under sub-section (1), unless—

- it is authorized by its articles;
- it has, on the recommendation of the Board, been authorized in the general meeting of the company;
- it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.
- The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.
- Sub-section (3) of the Section also provides that the bonus shares shall not be issued in lieu of dividend.
- As per Para 39 (i) of Table F under Schedule I to the Companies Act, 2013, a company in general meeting may, upon the recommendation of the Board, resolve—
- (a) that it is desirable to capitalise any part of the amount for the time being standing to the credit of any of the company's reserve accounts, or to the credit of the profit and loss account, or otherwise available for distribution; and (b) that such sum be accordingly set free for distribution in the specified manner amongst the members who would have been entitled thereto, if

distributed by way of dividend and in the same proportions.

- The sum aforesaid shall not be paid in cash but shall be applied, subject to the provision contained in clause (iii), either in or towards— (a) paying up any amounts for the time being unpaid on any shares held by such members respectively; (b) paying up in full, unissued shares of the company to be allotted and distributed, credited as fully paid-up, to and amongst such members in the proportions aforesaid; partly in the way specified in (a) and partly in that specified in (b) above;
- A securities premium account and a capital redemption reserve account may be applied in the paying up of unissued shares to be issued to members of the company as fully paid bonus shares. In other words, securities premium account and capital redemption reserve cannot be applied towards payment of unpaid amount on any shares held by existing shareholders.

SEBI REGULATIONS

A listed company, while issuing bonus shares to its members, has to comply with the following requirements under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018:

Regulation 293- Conditions for Bonus Issue

Subject to the provisions of the Companies Act, 2013 or any other applicable law, a listed issuer shall be eligible to issue bonus shares to its members if:

a) it is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc.:

Provided that if there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve;

b) it has not defaulted in payment of interest or principal in respect of fixed deposits or

debt securities issued by it;

c) it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;

d) any outstanding partly paid shares on the date of the allotment of the bonus shares, are made fully paid-up;

e) any of its promoters or directors is not a fugitive economic offender.

RIGHT ISSUE

INTRODUCTION

Provisions of section 62(1) (a) govern any company, public or private, desirous of raising its subscribed share capital by issue of further shares. Whenever a company intends to issue new shares, the voting and governance rights of the existing shareholders may be diluted, if they are not allowed to preserve them. It may happen because new shareholders may subscribe to the issued share capital. Companies Act, 2013 allows existing shareholders to preserve their position by offering those newly issued shares at the first instance to them. The existing shareholders are given a right to subscribe these shares, if they like. However, if they do not desire to subscribe these shares, they are even given the right to renounce it in favour of someone else (unless the articles of the company prohibits such a right to renounce).

In nutshell, the existing shareholders have a right to subscribe to any fresh issue of shares by the company in proportion to their existing holding for shares. They have an implicit right to renounce this right in favour of anyone else, or even reject it completely. In other words, the existing shareholders have right of first refusal, i.e., the existing shareholders enjoy a right to either subscribe for these shares or sell their rights or reject the offer

A company desirous of issuing new shares has to offer, as per Section 62(1) (a) of Companies Act 2013, the shares to existing equity shareholders through a letter of offer subject to the following conditions, namely:

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

Unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice (referred to in above bullet point) shall contain a statement of this right;

After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company.

Exceptions to the rights of existing equity shareholders

Section 62 recognizes four situations under which the further shares are to be issued by a company, but they need not be offered to the existing shareholders.

The shares can be offered, without being offered to the existing shareholders, provided the company has passed a special resolution and shares are offered accordingly.

Situation 1

To employees under a scheme of employees' stock option subject to certain specified conditions

Situation 2

To any persons, either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to certain specified conditions.

Situation 3

Sometimes companies borrow money through debentures / loans and give their creditor an option to buy equity shares of a company. An option is a right, but not an obligation, to buy equity shares on a future date (expiry date) at a price agreed in advance (exercise price).

According to Section 62(3), nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company.

Provided that the terms of issue of such debentures or loan containing such an option have

been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

Situation 4

It is a special situation where the loan has been obtained from the government, and government in public interest, directs the debentures / loan to be converted into equity shares.

According to Section 62(*4*), notwithstanding anything contained in sub-section (*3*), where any debentures have been issued, or loan has been obtained from any Government by a company, and if that Government considers it necessary in the public interest so to do, it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to the Government to be reasonable in the circumstances of the case even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion.

communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

In determining the terms and conditions of conversion under sub-section (*4*), the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary.

Where the Government has, by an order made under sub-section (4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorized share capital of the company, stand altered and the authorized share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into.

Financial effects of a further issue

The financial position of a business is contained in the balance sheet. Further issue of shares increase the amount of equity (net worth)[2] as well as the liquid resources (Bank).

The amount of equity is the product of further number of shares issued multiplied by issue price. The issue price may be higher than the face value (issue at a premium). Companies Act does not allow issue of shares at a discount, except issue of sweat equity shares under Section 53.

UNDER WRITING OF SHARES

Meaning of Underwriting

Underwriting is an agreement between the underwriters and the company where the underwriters ensure the company that in case the shares and debentures offered to the public are not subscribed by the public then such shares and debentures will be taken up by the underwriters.

Meaning of Underwriters.

The person or institutions underwriting a public issue of shares and debentures are called underwriters.

The underwriters may be individuals, partnership firms, joint stock companies, banks and financial institutions.

Ex : ICICI, SFC's, LIC etc.,

Meaning of underwriting Commission.

The underwriters are entitled to some consideration for the risk they undertake in underwriting the shares or debentures of a public company.

In the words the consideration payable to the underwriters for underwriting the shares and debentures is called underwriting commission.

Maximum Limit for underwriting commission.

For the services rendered by the underwriters : they are entitled to a maximum commission of 5% of the issue price of the shares and debentures at 2.5% on the issue price according to company's act of 1956.

According to SEBI the maximum commission payable to underwriters for underwriting the shares and debentures is 2.5% of the issued price.

Advantages of Underwriting.

1. As underwriters guarantee the sale of shares and debentures, subscription of capital of the company becomes certain.
2. When there is an underwriting arrangement, a company is relieved from the trouble of raising the required capital.
3. When there is an underwriting arrangement, a company can be sure of getting the required capital within a specified period of time.
4. With an underwriting arrangement, a company need not bother about money market conditions.

Types of Underwriting

1. On the basis of number of shares or debentures underwritten:
   According to this basis underwriting contracts are classified in t 2 type they are,
   a) **Complete underwriting :** It is one under which the whole of the issue of shares or debentures of a company is underwritten by one or more underwriters.
   b) Partial Underwriting : It is one under which a part of the issue of shares or debentures of a company is underwritten by one or more underwriters.

2. On the basis of liability of underwriters:
   According to this basis underwriting contracts are classified into 2 types they are,
   a) **Pure / Open Underwriting :** it is an arrangement under which and underwriters or underwriters agree to take up the shares or debentures of a company only when the shares or debentures underwritten by him or them is not fully subscribed by the public.
   b) Firm Underwriting : It is an arrangement where underwriters agrees to buy a definite number of shares and debentures irrespective o f the number of shares or debentures subscribed by the public.
   In case of firm underwriting, the underwriters gets priority over general public if shares / debentures are over subscribed.

Calculation of underwriters liability

Liability of underwriters refer to the number of shares, the underwriters must subscribed on account of underwriting agreement.

Statement showing underwriter's liability

Particulars	**No.of Shares**
Gross liability	XXX
(-) Unmarked application	XXX
	XXX
(-) marked application	XXX
Net liability	XXX
(+) Firm Underwriting	XXX
Total Liability	XXX

Marked and unmarked applications.

The applications received by the company bearing the officials stamp of the individual underwriter or the respective underwriters are called Marked application.

Applications received by the company directly from the public which do not bear the official stamp of the underwriter or underwriters are called unmarked applications.

PROBLEMS :

1. A Ltd issued 100000 equity shares the whole of the issue was underwritten as follows.
   X – 40%, Y-30% , Z-30%
   Applications for 80,000 shares were received in all out of which application for 20,000 shares had the stamp of X those for 10,000 shares that of Y and 20,000 shares that of Z.
   Your required to determine the net liability of each underwriter.

   i. **Calculation of unmarked applications**

Total applications received	80,000
(-)Marked applications	50,000
(X-20,000, Y-10,000, Z-20,000)	
Unmarked application	30,000

   ii. **Statement showing Net Liability of underwriter**

Particulars	X	Y	Z	Total
Gross Liability	40,000	30,000	30,000	1,00,000
(-)unmarked application (30,000*4:3:3)	12,000	9,000	9,000	30,000
	28,000	21,000	21,000	70,000
(-) marked application	20,000	10,000	20,000	50,000
Net Liability	8,000	11,000	1,000	20,000

2. Adithya Co. Ltd was incorporated on 1.01.2014, issued a prospectus inviting applications for 5 lakhs equity shares of Rs.10 each. The whole issue was fully underwritten by A, B, C & D as follows A-2,00,000. B – 1,50,000 C-1,00,000 & D-50,000 shares.

Applications were received for 4,50,000 shares of which marked applications were as follows: A-2,20,000 , B – 1,10,000 , C – 90,000 , D-10,000 you are required to find out the Net liability of each underwriter and also calculate the commission received by each underwriters as per company's Act of 1956.

i. **Calculation of unmarked applications**

Total application received	4,50,000
(-) marked application (2,20,000+1,10,000+90,000+10,000)	4,30,000
Unmarked application	20,000

ii. **Statement showing net liability of underwriters**

Particulars	A	B	C	D	Total
Gross Liability	2,00,000	1,50,000	1,00,000	50,000	5,00,000
(-)unmarked application	8,000	6,000	4,000	2,000	20,000
	1,92,000	1,44,000	96,000	48,000	4,80,000
(-) marked application	2,20,000	1,10,000	90,000	10,000	4,30,000
Liability	-28,000	34,000	6,000	38,000	50,000
(-) Excess of 'A' (3:2:1*28,000)	--	14,000	9,333	4,667	--
	--	20,000	-3,333	33,333	--
(-) Excess of 'C' shared among 'B'&'D' (3,333*3:1)	--	2,500	--	833	--
Net Liability	-	17,500	-	32,500	50,000

iii. **Calculation of underwriters Commission**

A- 2,00,000* 10*5%= Rs.1,00,000

B- 1,50,000*10*5%=Rs.75,000
C- 1,00,000*10*5%=Rs.50,000
D- 50,000*10*5%Rs.25,000

3. A public issue of 10,000 shares of Rs.10 each were offered by a company. These shares were underwritten as follows: A-7,000 B-3,000 the public applied for 8,000 Shares which include marked applications of A-5,000 B-2,000 determine the liability of A & B if unmarked shares were optioned to underwriters on the basis of (a) Gross Liability (b) Remaining Liability.

i. **Calculation of unmarked applications**

Total applications received	8,000
(-)Marked applications (5,000+2,000)	7,000
Unmarked application	1,000

a. **Statement showing Net Liability of underwriter**

Particulars	A	B	Total
Gross Liability (-)unmarked application (1,000*7:3)	7,000 700	3,000 300	10,000 1,000
(-) marked application Net	6,300 5,000	2,700 2,000	9,000 7,000
Liability	1,300	700	2,000

b. **Statement showing Net Liability of underwriter (remaining liability)**

Particulars	A	B	Total
Gross Liability (-)marked application	7,000 5,000	3,000 2,000	10,000 7,000
(-) unmarked application (1,000*2:1)	2,000 667	1,000 333	3,000 1,000
Net Liability	1,333	667	2,000

UNIT – 2

REDEMPTION OF PREFERENCE SHARES

As per the Companies Act, 1956 as amended in 1988, only preference shares which are redeemable within 20 years can be issued. The preference shares may be redeemed at par or at premium. Redemption may be done from the proceeds of fresh issue of shares or undistributed profits. The premium on redemption of preference shares may be adjusted against the Share Premium A/c or the Profit and Loss A/c.

Section 80 of the Companies Act allows a company, if authorised by the articles of association, to issue preference shares which can be redeemed by the company according to terms of the issue subject to the following legal restrictions:

(i) Shares cannot be redeemed unless they are fully paid up.

(ii) Shares can be redeemed only out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of redemption.

(iii) To the extent that the shares are redeemed out of profits, capital redemption account must be credited, debiting the profit and loss account, general reserve or other accounts showing profits otherwise available for distribution of dividends.

(iv) Before the shares are redeemed, the premium, if any, payable on redemption must be provided for out of the profits of the company or out of the share premium account.

Accounting Entries – On Redemption

1. Preference Share Capital A/c Dr.
   To Preference Shareholders A/c
   (Being amount payable on redemption of preference shares transferred to Shareholders A/c)
2. Preference Shareholders A/c Dr.
   To Bank A/c
   (Being the amount due on redemption paid)

For Premium on Redemption

1. Redeemable Preference Share Capital A/c Dr.
   Premium on Redemption of Preference Shares A/c Dr.
   To Preference Shareholders A/c
   (Being the amount payable on redemption transferred to Shareholders A/c)

2. Preference Shareholders A/c Dr.
   To Bank A/c
   (Being the payment made to Preference Shareholders)
3. Profit and Loss A/c Dr.
   or
   Share Premium A/c Dr.
   To Premium on Redemption of Preference Shares A/c
   (Being the premium on redemption adjusted against Profit and Loss A/c and Share Premium A/c)

Capital Redemption Reserve

Where the preference shares are redeemed without there being a corresponding issue of shares and the redemption is made out of distributable profits, the 'gap' created in the capital needs to be filled up. For this purpose, an amount equal to the face value of the shares redeemed is transferred to Capital Redemption Reserve from the undistributed profits such as the credit balances in Profit and Loss account, General Reserve, Dividend Equalization reserve.

The accounting entries for this are as follows:

General Reserve A/c Dr.
P & L A/c Dr.
To Capital Redemption Reserve

(Being the amount transferred to Capital Redemption Reserve A/c) The reasons behind the creation of the Capital Redemption Reserve are:

(a) To keep the capital intact, when the shares are redeemed out of the undistributed profits of the
company.
(b) To protect the interest of the creditors of the company, as the directors may distribute divisible profits by way of dividend

Sum 1: Phoolandevi Ltd. has issued 50,000 12% redeemable preference shares of ₹ 10 each, ₹ 8 paid. In order to redeem these shares now being redeemable, the company issued for cash 30,000 equity shares of ₹ 10 each at a premium of ₹ 2/- per share. Out of the proceeds, preference shares were redeemed, balance being met out of the General Reserve which stood at ₹ 2,50,000. The company then declared the bonus issue of 20,000 ordinary shares to the existing ordinary shareholders out of reserve created for redemption purpose.

Pass the necessary journal entries giving effect to the above transactions.

Solution: **Journal Entries**

	Particulars			Debit	Credit
1	For final call made on partly paid preference shares:				
	Cash/Bank A/c (50,000 × 2)	Dr.		1,00,000	
	To 12% Preference Share Capital A/c				1,00,000
2	For fresh issue of shares:			3,60,000	
	Cash/Bank A/c	Dr.			
	To Share Capital A/c (30,000 × 10)				3,00,000
	To Share Premium A/c (30,000 × 2)				3,00,000
3	For redemption of preference shares:				
	(a) For premium payable			No entry	
	(b) For transfer of preference share capital to holders: 12% Preference Share Capital A/c	Dr.		5,00,000	
	To Preference Shareholders A/c				5,00,000
	(c) For payment:				
	Preference Shareholders	Dr.		5,00,000	
	A/c To Cash/Bank A/c				5,00,000
	(d) For CRR:				
	Normal Value of Preference Shares Redeemed = Fresh Issue + CRR				
	5,00,000 = 3,00,000 + CRR				
	CRR = 2,00,000			2,00,000	
	General Reserve A/c	Dr.			
	To CRR A/c				2,00,000
4	For issue of bonus shares:				

	(a) For appropriation of bonus shares: CRR A/c	Dr.		2,00,000	
	To Bonus to Shareholders A/c (20,000 × 10)				2,00,000
	(b) For actual issue: Bonus to Shareholders A/c	Dr.		2,00,000	
	To Equity Share Capital A/c				2,00,000

Sum 2: Young Turks Ltd. decided to redeem their preference shares as on March, 2015 on which date their position was as under:

Balance Sheet as at 31.3.2015

Liabilities		₹	Assets	₹
Share Capital:			Cash and Bank Balances	1,40,000
4,000 Equity Shares of ₹ 100 each		4,00,000	Others	8,60,000
4,000 6% Redeemable Preference Shares of ₹ 50 each, ₹ 25 per share paid		1,00,000		
2,000 7% Redeemable Preference Shares of ₹ 100 each fully paid		2,00,000		
Reserves and Surplus:				
Securities Premium A/c	10,000			
Capital Redemption Reserve A/c	90,000			
Dividend Equalisation Reserve	1,10,000	2,10,000		
Sundry Liabilities		90,000		
		10,00,000		**10,00,000**

The redemption is to be made at a premium of 5%. The capital redemption reserve appearing in the balance sheet is the reserve brought into being as a result of a redemption which took place in 2004. To enable the redemption to be carried out, the company decides to issue sufficient number of new equity shares at a discount of 10%. The redemption is duly carried out. Show journal entries relating to the redemption and new issue and also the balance sheet after redemption. Ignore the question of dividend upto the redemption.

Solution : **Young Trucks Ltd.**

5% of 2,00,000 = 10,000 Premium payable on Redemption

Free Share

Premium Nominal value = Fresh issue + CRR

2,00,000 = Fresh issue + 1,10,000 (Dividend Equalisation Reserve)

□ Fresh issue = 90,000

₹ 1,00,000 Fresh equity issued at 10% discount

	Issue Price	Proceeds fo Fresh Issue means
At Par	100	100
At Premium	110	100
At Discount	90	90

Journal Entries

	Particulars			Debit	Credit
1	For fresh issue: Cash/Bank A/c Discount on Issue of Shares A/c To Equity Share Capital A/c	Dr. Dr.		90,000 10,000	1,00,000
2	For premium: Share Premium A/c To Premium on Redemption of Preference Shares A/c	Dr.		10,000	10,000
3	For transfer: 7% Preference Share Expenses A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c	Dr. Dr.		2,00,000 10,000	2,10,000
4	For payment: Preference Shareholders A/c To Cash/Bank A/c	Dr.		2,10,000	2,10,000
5	For CRR: Dividend Equalisation Reserve A/c To CRR A/c	Dr.		1,10,000	1,10,000

Balance Sheet as on 31/03/15

	Particulars	₹	₹
[I]	**Equity and Liabilities**		
	1. Share Capital	6,00,000	
	2. Reserves and Surplus	2,00,000	8,00,000
	3. Share Application Allotment Money Pending	–	
	4. Non-current Liability	–	
	5. Current Liability:		
	Sundry Liability	90,000	90,000
	Total		**8,90,000**
[II]	**Assets**		
	1. Non-current Assets		
	(a) Fixed Assets:		
	Tangible		–

	Intangible		–
	(b) Non-current Investment		–
	(c) Other Non-current Assets:		
	Discount on Issue of Shares	10,000	10,000
	2. Current Assets:		
	Inventory		
	Trade Receivable		–
	Cash and Cash Equivalent [1,40,000 + 90,000 – 2,10,000]		20,000
	Other Current Assets	8,60,000	8,60,000
	Total		**8,90,000**

Sum 3: The Balance Sheet of Redemption Limited as at 31st March, 2015 was as under:

Liabilities		₹	Assets	₹
10,000 Equity shares of ₹ 10			Fixed Assets	2,62,000
each fully paid up		1,00,000	Sundry Debtors	90,000
11% Redeemable Preference			Stock	30,000
Shares of ₹ 100 fully called up	1,00,000	1,00,000	Investments	30,000
Less: Calls-in-arrears			Bank Balance	4,000
at the rate of ₹ 20 per share	6,000	94,000		
10% preference shares of ₹ 10				
each fully paid up (Irredeemable)		1,00,000		
General Reserve		40,000		
Profit and Loss Account		20,000		
Share Premium		5,000		
Capital Reserve		30,000		
Sundry Creditors		27,000		
		4,16,000		**4,16,000**

Redeemable preference shares were due for payment on 1st April, 2015 at a premium of 10%.Company sent reminders for the final call on remaining 300 redeemable preference shares and could collect money from shareholders holding 200 shares at the rate of ₹ 20 per share and forfeited the defaulting 100 shares.

Company sold all investments and could recover 90% of the cost of such investments.

Company issued adequate number of new equity shares at par, to the extent, available profits were insufficient to back up the redemption.

One shareholder holding 10 redeemable preference shares could not be traced and payment due to him on redemption could not be made to him.

Draft journal entries. Show your assumptions and prepare the balance sheet of the company after redemption.

Solution: Working Notes

(1)	Total 11% Preference Shares	1,000	(2)	900 × 100 =	90,000	Preference Share Capital
	(–) Forfeited	100		10% Premium =	9,000	Total Payable
					99,000	
	Fully paid up/To be redeemed	900	(4)	N. Value = Fresh issue + CRR 90,000		
				= Fresh Issue + 53,000		
(3)	Total Payable	99,000		∴ Fresh Issue = 37,000		
	(–) Not paid (10 × 110)	1,100				
		97,900				
	General Reserve	40,000				
	P & L A/c	20,000				
		60,000				
	(–) Premium on Redn.	4,000		(9,000 – 5000)		
	(–) Loss on Sale of Invest.	3,000				
	Available for CRR	53,000				

Journal Entries in the Books of Redemption Ltd.

	Particulars			Debit	Credit
1	For final call money received on 200 preference shares: Cash/Bank A/c (200 × 10) To Calls-in-arrears A/c	Dr.		4,000	4,000
2	For forfeiture of 100 shares: 11% Preference Share Capital A/c (100 × 10) To Shares Forfeiture A/c (100 × 80) To CRR A/c (100 × 20)	Dr.		10,000	8,000 2,000
3	For fresh issue: Cash/Bank A/c To Equity Share Capital A/c	Dr.		37,000	37,000
4	For sale of investments: Cash/Bank A/c Profit and Loss A/c (Loss on Sale) To Investments	Dr. Dr.		27,000 3,000	30,000
5	For premium: Share Premium A/c General Reserve A/c To Premium on Redemption A/c	Dr. Dr.		5,000 4,000	9,000
6	For transfer: 11% Preference Share Capital A/c	Dr.		90,000 9,000	

	Premium on Redemption of Preference Share A/c To Preference Shareholders A/c Dr.			99,000
7	For payment: Preference Shareholders A/c Dr. To Cash/Bank A/c		97,900	97,900
8	For CRR:			
	General Reserve A/c (40,000 – 4,000) Dr.		36,000	
	Profit and Loss A/c (20,000 – 3,000) Dr.		27,000	
	To CRR A/c			53,000
9	Share Forfeiture A/c Dr.		8,000	
	To Capital Reserve A/c			8,000

Balance Sheet as on 31/3/2015

	Particulars	₹	₹
[I]	**Equity and Liabilities**		
	1. Shareholder's Fund:		
	Equity Share Capital	1,37,000	
	Preference Share Capital	1,00,000	2,37,000
	2. Reserve and Surplus:		
	Capital Reserve	38,000	
	CRR	53,000	91,000
			–
	3. Share Application Allotment Money Pending		–
	4. Non-current Liability		
	5. Current Liability:		
	Amount due to preference shareholders	1,100	
	Bank overdraft	25,900	
	Creditors	27,000	54,000
	Total		**3,82,000**
[II]	**Assets**		
	1. Non-current Assets:		
	Fixed Assets		2,62,000
	2. Non-current Investment		
	3. Other Non-current Assets		
	4. Current Assets:		
	(a) Inventory	30,000	–
	(b) Trade Receivable:		–
	Sundry Debtors	90,000	1,20,000
	(c) Cash and Cash Equivalent		–
	(d) Other Current Assets		–

	Total		3,82,000

Sum 4: The Bharat Aluminium Co. Ltd. whose issued share capital on 31st December, 2015 consisted of 12,000, 8% Redeemable preference shares of ₹ 100 each fully paid and 40,000 Equity shares of ₹ 100 each ₹ 80 paid up, decided to redeem Preference shares at a premium of ₹ 10 per share. The company's balance sheet as on 31st December, 2015 showed a general reserve of
₹ 18,00,000 and a capital reserve of ₹ 17,00,000. The redemption was effected partly out of profits and partly out of the proceeds of a new issue of 6,000 7½% cumulative preference shares of ₹ 100 each at a premium of 25 per share. The premium payable on redemption was met out of the premium received on the new issue.

On 1st April, 2015, the company at its general meeting resolved that all the capital reserves be applied in the following manner: (i) the declaration of bonus at the rate of ₹ 20 per share on equity shares for the purpose of making the said equity shares fully paid; and (ii) the issue of bonus shares to the equity shareholders in the ratio of one share for every four shares held by them. **(CA Modified)**

Solution: **Bharat Aluminium Ltd.**

(1) Fresh Issue

6,000 × 100 =	6,00,000	Face Value
6,000 × 25 =	1,50,000	Share Premium
	7,50,000	Total Cash Reserve

(3) For CRR

NV = FI + CRR

12,00,000 = 6,00,000 + CRR

□ CRR = 6,00,000

(2)	Premium on Redemption	1,20,000
	12,000 shares × 10/-	Share Premium

Journal Entries

	Particulars		Debit	Credit
1	For fresh issue:			
	Cash/Bank A/c	Dr.	7,50,000	
	To Share Capital A/c (75% Preference Shares)			6,00,000
	To Share Premium A/c			1,50,000
2	For premium:			
	Share Premium A/c	Dr.	1,20,000	
	To Premium on Redemption A/c			1,20,000
3	For transfer:			
	8% Preference Share Capital A/c	Dr.	12,00,000	
	Premium on Redemption of Preference Capital A/c	Dr.	1,20,000	
	To Preference Shareholders A/c			13,20,000

4	For payment: Preference Shareholders A/c To Cash/Bank A/c	Dr.	13,20,000	13,20,000
5	For CRR: General Reserve A/c To CRR A/c	Dr.	6,00,000	6,00,000
6	For appropriation of bonus: (a) To convert partly paid equity shares into fully paid: (i) For final call made: Equity Share Final Call A/c To Equity Share Capital A/c	Dr.	8,00,000	8,00,000
	(ii) For appropriation of bonus amount: General Reserve A/c To Bonus to Shareholders A/c	Dr.	8,00,000	8,00,000
	(iii) For distribution of bonus amount in payment of final call: Bonus to Shareholders A/c To Equity Share Final Call A/c	Dr.	8,00,000	8,00,000
7	(a) For issue of fully paid bonus shares: CRR A/c Share Premium A/c (15,000 – 12,000) Capital Reserve A/c To Bonus to Shareholders A/c	Dr. Dr. Dr.	6,00,000 30,000 3,70,000	10,00,000
	(b) For actual issue: Bonus to Shareholders A/c To Equity Share Capital A/c	Dr.	10,00,000	10,00,000

Sum 5: The following is the summarised Balance Sheet of Apro Engineers Ltd. as at 31st March, 2015:

Balance Sheet

Liabilities		₹	**Assets**	₹
Share Capital			Fixed Assets	27,00,000
Issued, subscribed and paid up		18,00,000	Investment (against Reserve)	2,00,000
Equity shares (fully paid)			Current Assets	11,00,000
9% Redeemable Preference Shares				
of ₹ 100/- fully called	1,80,000			
Less: Calls-in-arrears	2,000	1,78,000		

Revenue Reserve	13,50,000		
Current Liabilities	4,50,000		
Securities Premium	2,22,000		
	40,00,000		**40,00,000**

100 Preference Shares on which the last call of ₹ 20 was not paid, were forfeited by the Board of Directors on 30th April, 2015.

The Directors redeemed the remaining preference shares at a premium of 10% on 30th September, 2015. For this purpose, 10,000 Equity Shares of ₹10 each were issued at a premium of 10% and were fully paid up within 30th July, 2015.

Current assets before redemption of preference shares included ₹ 2,00,000 in current account with bankers. Company closes its accounts on 31st March.

Pass necessary journal entries including those relating to cash for recording the above transactions and show the resultant balance after redemption in the following accounts. (i) Securities Premium, (ii) Revenue Reserve and (iii) Bank Account.

Solution:

	Particulars			Debit	Credit
10.04.15	Forfeiture of Shares:				
	9% Preference Share Capital A/c (100 × 100)	Dr.		10,000	
	To Calls-in-arrears A/c (100 × 20)				2,000
	To Share Forfeiture A/c (100 × 80)				8,000
30.07.15	Fresh Issue of Shares:				
	Cash/Bank A/c	Dr.		1,10,000	
	To Equity Share Capital A/c				1,00,000
	To Share Premium A/c				10,000
30.09.15	Transfer Amount Payable to Profit Shareholders A/c:				
	9% Preference Share Capital A/c	Dr.		1,70,000	
	Premium on Redemption A/c	Dr.		17,000	
	To Preference Shareholders A/c				1,87,000
	Write off premium on Redemption:				
	Share Premium A/c	Dr.		17,000	
	To Premium on Redemption A/c.				17,000
	Transfer to CRR:				
	Revenue Reserve A/c	Dr.		70,000	
	To CRR A/c				70,000
	Payment to preference shareholder:				
	Preference Shareholders A/c	Dr.		1,87,000	
	To Cash/Bank A/c				1,87,000

Premium on Redemption	=	Share Premium + Profit
		(Existing + Expected)
		(2,22,000 + 10,000)
NV of Preference Shares to be redeemed	=	Proceeds of fresh investment + Profit available for dividend
1,70,000	=	1,00,000 + 70,000 (Reserve transferred to CRR)
(1,800 sh. – 100 sh.) × ₹ 100		(10,000 sh. × 10/-)

Bank A/C

Particulars	Amount	Particulars	Amount
To Opening Balance b/d To Fresh Issue	2,00,000 1,10,000	By Preference Shareholders By Balance c/f	1,87,000 1,23,000
	3,10,000		**3,10,000**

Revenue Reserve

Particulars	Amount	Particulars	Amount
To CRR To Balance c/f	70,000 12,80,000	By Opening Balance b/d	13,50,000
	13,50,000		**13,50,000**

Share Premium

Particulars	₹	Particulars	₹
To Premium on Redemption To Balance c/f	17,000 2,15,000	By Balance b/d By Cash/Bank	2,22,000 10,000
	2,32,000		**2,32,000**

Working Notes

1.	Premium on Redemption	=	Share Premium + Profits
			(Existing + Expected) (29,000 + Nil)
	1,500	=	1,500 + Nil
2.	NV of Preference Shares to be redeemed	=	Proceeds of fresh issue + Profit available for dividend
	30,000	=	Nil + 30,000 (General Reserve Transfer to CRR)

Sum 6: The summarised balance sheet of Prudent Company Ltd. on 30th June, 2015 was as follows:

Liabilities	₹	Assets	₹
Share Capital:		Sundry Assets	49,00,000
Authorised, Issued and Paid		Cash at Bank	7,00,000
1,00,000, 9% redeemable preference shares			
of ₹ 10 each	10,00,000		
2,50,000 Equity Shares of ₹ 10 each	25,00,000		
Current Liabilities	15,00,000		
Profit and Loss A/c	6,00,000		
	56,00,000		**56,00,000**

The conditions of issue of the redeemable preference shares provided for their being redeemed on 15th July, 2015, at a premium of 5 per cent. The profits available being not sufficient to redeem the whole issue, the company issued 5,000 10% preference shares of ₹ 100 each at par on 1st July, 2015 which were duly taken up and paid for. The redeemable preference shares were redeemed on the due date.On 1st September, 2015, the company decided to utilise the capital redemption reserve account to issue ₹ 10 equity shares as bonus shares to the old equity shareholders.

Show journal entries to record the above transactions.

Solution: **Journal of Prudent Co. Ltd.**

	Particulars			Debit	Credit
1	Fresh issue of share:				
	Cash/Bank A/c	Dr.		5,00,000	
	To 10% Preference Share Capital				5,00,000
2	Transfer amount payable to Preference Shareholder				
	A/c: 9% Preference Share Capital A/c	Dr.		10,00,000	
	Premium on Redemption A/c	Dr.		50,000	
	To Preference Shareholder A/c				10,50,000
3	Write off premium of redemption:				
	Profit and Loss A/c	Dr.		50,000	
	To Premium on Redemption A/c				50,000
4	Transfer to CRR:				
	Profit and Loss A/c	Dr.		5,00,000	
	To CRR A/c				5,00,000
5	Payment of preference				
	shareholder: Preference	Dr.		10,50,000	
	Shareholders A/c				10,50,000
	To Cash/Bank A/c				
6	CRR A/c	Dr.		5,00,000	
	To Bonus to Equity Shareholders A/c				5,00,000

7	Bonus to Equity Shareholders A/c Dr.		5,00,000	
	To Equity Share Capital			5,00,000
	(50,000 Equity Shares of ₹ 10 issued as Bonus Shares)			

Sum 15: Change Ltd. had an issued share capital of ₹ 65,000 7% Redeemable Cumulative Preference Share of ₹ 10/- each and 22,500 ordinary shares of ₹ 10/- each. The preference shares are redeemable at a premium of 7½% on 1st August, 2015:

As on 31st July, 2015, the company's Balance Sheet showed the following position:

Liabilities	₹	Assets	₹
Issued Share Capital		Sundry Assets	3,46,000
6,500 7% Redeemable Cumulative		Balance at Bank	47,500
Preference Share of ₹ 10 fully paid	65,000		
22,500 Equity Shares of ₹ 10 each fully paid	2,25,000		
Profit and Loss A/c	46,000		
Sundry Creditors	57,500		
	3,93,500		**3,93,500**

In order to facilitate the Redemption of the Preference Shares, it was decided:

(a) to finance part of the redemption from Company Funds, subject to leaving a balance on Profit and Loss Account of ₹ 10,000 and

(b) to issue sufficient number of Equity Shares at a premium of ₹ 2.50 per share to raise the balance of funds required.

The Preference Shares were redeemed on the due date and the issue of ordinary shares was fully subscribed.

You are required to prepare:

(i) the necessary journal Entries to record the above transactions (including cash) and the Balance Sheet as on completion.

Solution: **Journal of Change Ltd.**

	Particulars	Debit	Credit
1	For fresh issue of shares:		
	Bank A/c (2,900 × 12.50) Dr.	36,250	
	To Equity Share Capital A/c		29,000
	To Share Premium A/c (2,900 × 2.50)		7,250
2	For premium on redemption:		
	Share Premium A/c Dr.	4,875	
	To Premium on Redemption A/c		4,875
3	For transfer:		

	7% Preference Share Capital A/c	Dr.	65,000	
	Premium on Redemption A/c	Dr.	4,875	
	To Preference Shareholders A/c			69,875
4	For payment:			
	Preference Shareholders A/c	Dr.	69,875	
	To Bank A/c			69,875
5	For CRR:			
	Profit and Loss A/c	Dr.	36,000	
	To CRR A/c			36,000

NV of Preference Shares	=	Proceeds of Fresh Issue + CRR
65,000 (6,500 × 10)	=	29,000 + 36,000 (P & L) (2,900 × 10) (46,000 – 10,000)
Premium on Redemption	= =	Share Premium + Profits (Existing + Expected) (7250 + Nil)
4875	=	4875 + Nil

Balance Sheet of Change Ltd.

	Particulars	₹	₹
[I]	**Equity and Liabilities**		
	1. Shareholders' Fund:		
	Equity Share Capital		2,54,000
	2. Reserves and Surplus:		
	Profit and Loss	10,000	
	CRR	36,000	
	Securities Premium	2,375	48,375
	3. Share Application Money Pending Allotment		–
	4. Non-current Liabilities		
	5. Current Liabilities:		
	Creditors		57,500
	Total		**3,59,875**
[II]	**Assets**		
	1. Non-current Assets:		
	(a) Fixed Assets:		
	Sundry Assets		3,46,000
	(b) Non-current Investment		–
	(c) Other Non-current Assets		–
	2. Current Assets:		–
	(a) Inventory		–
	(b) Trade Receivable		-

	(c) Cash and Cash Equivalent (d) Other Current Assets		13,875
	Total		**3,59,875**

Sum 1 (Redemption of Preference Shares at Par)

Pass journal entries from the following:

(i) X Ltd redeems its 6,000 Redeemable Preference Shares of Rs. 100 each at par. For this purpose it issued 3,000 Equity shares of Rs. 100 each at 10% premium and for the balance, it utilized Profit and Loss Account which had sufficient balance.

(ii) X Ltd redeems its 10,000 Redeemable Preference Shares of Rs. 10 each at par. For this purpose, it issued 4,000 Equity shares of Rs. 10 each at 10% discount and for the balance, it utilized Profit and Loss A/c which had the sufficient balance.

(iii) X Ltd redeems its 8,000 Redeemable Preference Shares of Rs. 10 each at par. For this purpose, it issued 3,000 Equity shares of Rs. 10 each and for the balance, it utilized Profit and Loss A/c which had the sufficient balance.

Solution:

	Rs.
(i) Amount of Preference Shares to be redeemed	6,00,000
Less : Amount of Equity shares issued	3,00,000
Amount utilised from P & L A/c	3,00,000

Date	Particulars	L.F.	Dr (Rs.)	Cr. (Rs.)
	Bank A/c Dr. To Equity Share Application and Allotment A/c (For application money received on 3,000 Equity Shares @ Rs. 110 each)		3,30,000	3,30,000

	Equity Share Application and Allotment A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (For Transfer of application money on 3000 equity shares @ 110 each)		3,30,000	 3,00,000 30,000
	Profit and Loss Appropriation A/c Dr. To Capital Redemption Reserve A/c (For the amount of profits transferred to Capital Redemption Reserve A/c)		3,00,000	 3,00,000
	Redeemable Pref. Share Capital A/c Dr. To Redeemable Pref. Shareholders A/c (For amount due on redeemable preference shares)		6,00,000	 6,00,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (For amount paid to Redeemable Pref. Shareholders)		6,00,000	 6,00,000

	Rs.
(ii) Amount of Preference shares to be redeemed	1,00,000
Less: Amount of Equity shares issued	36,000
Amount utilized from P & L A/c	64,000

Date	Particulars	L.F.	Dr (Rs.)	Cr. (Rs.)
	Bank A/c Dr. To Equity Share Application and Allotment A/c (For application money received on 4,000 Equity Shares @ Rs. 9 each)		36,000	 36,000
	Equity Share Application and Allotment A/c Dr. Share Discount A/c Dr. To Equity Share Capital A/c (For Transfer of application money on 4000 equity shares @ 9 each)		36,000 4,000	 40,000

	Profit and Loss Appropriation A/c Dr. To Capital Redemption Reserve A/c (For the amount of profits transferred to Capital Redemption Reserve A/c)		64,000	64,000
	Redeemable Pref. Share Capital A/c Dr. To Redeemable Pref. Shareholders A/c (For amount due on redeemable Preference Shares)		1,00,000	1,00,000
	Redeemable Preference Shareholders A/c Dr. To Bank A/c (For amount paid to Redeemable Pref. Shareholder)		1,00,000	1,00,000

(iii) Amount of Preference shares to be redeemed 80,000

Less*:* Amount of Equity shares issued 30,000

Amount utilized from P & L A/c 50,000

Date	Particulars	L.F.	Dr (Rs.)	Cr. (Rs.)
	Bank A/c Dr. To Equity Share Application and Allotment A/c (For application money received on 3,000 Equity Shares @ Rs. 10 each)		30,000	30,000
	Equity Share Application and Allotment A/c Dr. To Equity Share Capital A/c (For Transfer of application money on 3000 equity shares @ 10 each)		30,000	30,000
	Profit and Loss Appropriation A/c Dr. To Capital Redemption Reserve A/c (For the amount of profits transferred to Capital Redemption Reserve A/c)		50,000	50,000
	Redeemable Pref. Share Capital A/c Dr. To Redeemable Pref. Shareholders A/c (For amount due on redeemable preference shares)		80,000	80,000

	Redeemable Preference Shareholders A/c Dr. To Bank A/c (For amount paid to Redeemable Pref. Shareholders)		80,000	 80,000

ISSUE AND REDEMPTION OF DEBENTURES

A company raises its capital by means of issue ofshares. But the funds raised by the issue of shares are seldom adequate to meet their long termfinancial needs of a company. Hence, most companiesturn to raising long-term funds also through debentures which are issued either through the routeof private placement or by offering the same to the public. The finances raised through debentures are also known as long-term debt. This chapter deals withthe accounting treatment of issue and redemption of debentures and other related aspects.

Meaning of Debentures

Debenture: The word 'debenture' has been derived from a Latin word 'debere' which means to borrow. Debenture is a written instrument acknowledging a debt under the common seal of the company. It contains a contract for repayment of principal after a specified period or at intervals or at the option ofthe company and for payment of interest at a fixedrate payable usually either half-yearly or yearly onfixed dates. According to section 2(12) of The Companies Act,1956 'Debenture' includesDebenture Inventory, Bonds and any other securities of a company whether constituting acharge on the assets of the company or not.

Bond: Bond is also an instrument of acknowledgement of debt. Traditionally,the Government issued bonds, but these days, bonds are also being issued by semi-government and non-governmental organisations. The terms 'debentures' and 'Bonds' are now being used inter-changeably.

Distinction between Shares and Debentures

Ownership: A 'share' represents ownership of the company whereas a debenture is only acknowledgement of Debt. A share is a part of the owned capital whereas a debenture is a part of borrowed capital.

Return: The return on shares is known as dividend while the return on debentures is called interest. The rate of return on shares may vary from year to year depending upon the profits of the company but the rate of interest on debentures is prefixed. The payment of dividend is an appropriation of profits, whereas the payment of interest is a charge on profits and is to be paid even if there is no profit.

Repayment: Normally, the amount of shares is not returned during the life of the

company, whereas, generally, the debentures are issued for a specified period and repayable on the expiry of that period. However, in the year 1998, the amendements (Section 77A and 77 B sub Section 2) in the Companies Act, 1956 permitted companies to buy back its shares specially when market value of shares are less than its book value.

Voting Rights: Shareholders enjoy voting rights whereas debentureholders do not normally enjoy any voting right.

Rate of Discount on issue: Both shares and debentures can be issued at a discount. However, shares can be issued at discount in accordance with the provisions of Section 79 of The Companies Act, 1956 which stipulates that the rate of discount must not exceed 10% of the face value while debentures can be issued at any rate of discount.

Security : Shares are not secured by any charge whereas the debentures are generally secured and carry a fixed or floating charge over the assets of the company.

Convertibility: Shares cannot be converted into debentures whereas debentures can be converted into shares if the terms of issue so provide, and in that case these are known as convertible debentures.

Types of Debentures

A company may issue different kinds of debentures which can be classified as under:

From the Point of view of Security

(a) *Secured Debentures*: Secured debentures refer to those debentures where a charge is created on the assets of the company for the purpose of payment in case of default. The charge may be fixed or floating. A fixed charge is created on a specific asset whereas a floating charge is on the general assets of the company. The fixed charge is created against those assets which are held by a company for use in operations not meant for sale whereas floating charge involves all assets excluding those assigned to the secured creditoRs

(b) *Unsecured Debentures*: Unsecured debentures do not have a specific charge on the assets of the company. However, a floating charge may be created on these debentures by default. Normally, these kinds of debentures are not issued.

From the Point of view of Tenure

(c) *Redeemable Debentures:* Redeemable debentures are those which are payable on the expiry of the specific period either in lump sum or in Instalments during the life time of the company. Debentures can be redeemed either at par or at premium.

(d) *Irredeemable Debentures:* Irredeemable debentures are also known as *Perpetual Debentures* because the company does not give any undertaking for the repayment of money borrowed by issuing such

debentures. These debentures are repayable on the winding-up of a company or on the expiry of a long period.

From the Point of view of Convertibility

(e) *Convertible Debentures:* Debentures which are convertible into equity shares or in any other security either at the option of the company or the debentureholders are called convertible debentures. These debentures are either fully convertible or partly convertible.

(f) *Non-Convertible Debentures :* The debentures which cannot be converted into shares or in any other securities are called non-convertible debentures. Most debentures issued by companies fall in this category.

From Coupon Rate Point of view

(g) *Specific Coupon Rate Debentures*: These debentures are issued with a specified rate of interest, which is called the coupon rate. The specified rate may either be fixed or floating. The floating interest rate is usually tagged with the bank rate.

(h) *Zero Coupon Rate Debentures*: These debentures do not carry a specific rate of interest. In order to compensate the investors, such debentures are issued at substantial discount and the difference between the nominal value and the issue price is treated as the amount of interest related to the duration of the debentures.

From the view Point of Registration

(i) *Registered Debentures*: Registered debentures are those debentures in respect of which all details including names, addresses and particulars of holding of the debentureholders are entered in a register kept by the company. Such debentures can be transferred only by executing a regular transfer deed.

(j) *Bearer Debentures*: Bearer debentures are the debentures which can be transferred by way of delivery and the company does not keep any record of the debentureholdeRs Interest on debentures is paid to a person who produces the interest coupon attached to such debentures.

Issue of Debentures

The procedure for the issue of debentures is the same as that for the issue of shares. The intending investors apply for debentures on the basis of the prospectus issued by the company. The company may either ask for the entire amount to be paid on application or by means of instalments on application, on allotment and on various calls. Debentures can be issued at par, at a premium or at a discount. They can also be issued for consideration other than cash or as a collateral security.

Issue of Debentures for Cash

Debentures are said to be issued at par when their issue price is equal to theface value. The journal entries recorded for such issue are as under:

If whole amount is received in one installment:	
On receipt of the application money	
Bank A/c	Dr.
To Debenture Application & Allotment A/c	
On Allotment of debentures	
Debenture Application & Allotment A/c	Dr.
To Debentures A/c	
If debenture amount is received in two installments:	
On receipt of application money	
Bank A/c	Dr.
To Debenture Application A/c	
For adjustment of applications money on allotment	
Debenture Application A/c Dr. To Debentures A/c	
For allotment money due	
Debenture Allotment A/c	Dr.
To Debentures A/c	
On receipt of allotment money	
Bank A/c	Dr.
To Debenture Allotment A/c	
If debenture money is received in more than two installments Additional entries:	
On making the first call	
Debenture First Call A/c	Dr.
To Debentures A/c	
On the receipt of the first call	
Bank A/c	Dr.
To Debenture First Call A/c	

Note: Similar entries may be made for the second call and final call. However, normally the whole amount is collected on application or in two installments, i.e., on application and allotment.

Sum 1

ABC Limited issued Rs 10,000, 12% debentures of Rs 100 each payable Rs 30 on application and remaining amount on allotment. The public applied for 9,000 debentures which were fully allotted, and all the relevant allotment money was duly received. Give journal entries in the books of ABC Ltd., and exhibit the relevant information in the balance sheet.

Solution:

Books of ABC LimitedJournal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr. To 12% Debenture Application A/c (Application money on 9,000 debentures received)		2,70,000	2,70,000
	12% Debenture Application A/c Dr. To 12% Debentures A/c (Application money transferred to debentures Account on allotment)		2,70,000	2,70,000
	12% Debenture Allotment A/c Dr. To 12% Debentures A/c (Amount due on 9,000 debentures on allotment @ Rs 70 per debenture)		6,30,000	6,30,000
	Bank A/c Dr. To 12% Debenture Allotment A/c (Amount received on allotment)		6,30,000	6,30,000

ABC Limited

*Balance Sheet as at ....

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
Non-current liabilities		
Long-term borrowings	1	**9,00,000**
II. Assets		
Current assets		
Cash and cash equivalents	2	**9,00,000**

* Relevant data onlyNotes to

Accounts

Particulars	*Amount (Rs)*
1. Long-term borrowings	
9,000, 12% Debentures of Rs 100 each	**9,00,000**
2. Cash and cash equivalents	
Cash at bank	**9,00,000**

Issue of Debentures at a Discount

When a debenture is issued at a price below its nominal value, it is said to be issued at a discount. For example, the issue of Rs 100 debentures at Rs 95, Rs 5 being the amount of discount. Discount on issue of debentures is a capital loss and over a period of 3 to 5 years or is charged to "Securities Premium Account" as per the guidelines issued by ICAI. The discount on issue of debentures can be written-off either by debiting it to profit and loss or to securitiespremium account.

The Companies Act, 1956 does not impose any restrictions upon the issue of debentures at a discount.

Sum 2

TV Components Ltd., issued 10,000, 12% debentures of Rs 100 each at a discount of 5% payable as follows:

On application Rs 40

On allotment Rs 55

Show the journal entries including those for cash, assuming that all the instalments were duly collected. Also show the relevant portion of the balancesheet.

Solution:

Books of TV Components Ltd.

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr.		4,00,000	
	To 12% Debenture Application A/c			4,00,000
	(Receipt of application money @ Rs 30 per debenture)			
	12% Debenture Application A/c Dr.		4,00,000	
	To 12% Debenture A/c			4,00,000
	(Transfer of application money to debenture account)			
	12% Debenture Allotment A/c Dr.		5,50,000	
	Discount on Issue of Debentures A/c		50,000	
	To 12% Debenture A/c			6,00,000
	(Allotment money due on debentures)			
	Bank A/c Dr.		5,50,000	
	To 12% Debenture Allotment A/c			5,50,000
	(Receipt of allotment money on debentures)			

TV Components Limited Balance Sheet as at.................

Particulars	Note No.	Amount (Rs)
I. Equity and Liabilities		
1. Non-current Liabilities		
Long-term borrowings	1	**10,00,000**
II. Assets		
1. Non-current assets Other non-current assets	2	45,000
2. Current assets		
a) Cash and cash equivalents	3	9,50,000
b) Other current assets	4	5,000
		10,00,000

Notes to Accounts

Particulars	Amount (Rs)
1. Long-term borrowings 10,000, 12% secured debentures of Rs 100 each	10,00,000
2. Other non-current assets Discount on issue of debentures	45,000
3. Cash and cash equivalents Cash at bank	9,50,000
4. Other current assets Discount on issue of debentures (To be written-off within 12 months of the balance sheet date or the period of operating cycle)	5,000

Notes:
1 It is presumed that debentures are redeemable after 10 years.
*Relevant data only.

Debentures issued at Premium

A debenture is said to be issued at a premium when the price charged is morethan its nominal value. For example, the issue of Rs 100 debentures for Rs 110, (Rs 10 is being the premium). The amount of premium is credited to Securities Premium account and is shown on the liabilities side of the balance sheet under the head "Reserves and Surpluses".

Sum 3

XYZ Industries Ltd., issued 2,000, 10% debentures of Rs 100 each, at a premiumof Rs 10 per debenture payable as follows:

On application Rs 50
On allotment Rs 60

The debentures were fully subscribed and all money was duly received. Record the journal entries in the books of a company. Show how the amounts will appear in the balance sheet.

Solution:

Books of XYZ Industries LimitedJournal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr.		1,00,000	
	To 10% Debenture Application A/c			1,00,000
	(Application money Rs 50 per debentures received)			
	10% Debenture Application A/c Dr.		1,00,000	
	To 10% Debentures A/c			1,00,000
	(Transfer of application money) To debenture A/c			
	10% Debenture Allotment A/c Dr.		1,20,000	
	To 10% Debentures A/c			1,00,000
	To Securities Premium A/c			20,000
	(Allotment money due on debentures including the premium)			
	Bank A/c Dr.		1,20,000	
	To 10% Debenture Allotment A/c			1,20,000
	(Allotment money received)			

XYZ Industries Limited

Balance Sheet as at ———

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Shareholders' Funds		
Reserve and Surplus	1	20,000
2. Non-current Liabilities		
Long-term borrowings	2	2,00,000
		2,20,000
II. Assets		
Current Assets		
Cash and cash equivalents		**2,20,000**

Notes to Accounts

Particulars	Amount (Rs)
1. Reserve and surplus Securties Premium	**20,000**
2. Long-term borrowings 2,000, 10% debentures of Rs 100 each	**2,00,000**
3. Cash and cash equivalents Cash at bank	**2,20,000**

Sum 4

A Limited issued 5,000, 10% debentures of Rs 100 each, at a premium of Rs 10 per debenture payable as follows:

On application Rs 25

On allotment Rs 45(including premium) On

first and final call Rs 40

The debentures were fully subscribed and all money was duly received. Record the necessary entries in the books of the company. Show how the amounts will appear in the balance sheet.

Solution:

Books of *A Limited*

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr. To 10% Debenture Application A/c (Application money on 10% debentures received)		1,25,000	1,25,000
	10% Debenture Application A/c Dr. To 10% Debentures A/c (Transfer of application money on allotment)		1,25,000	1,25,000
	10% Debenture Allotment A/c Dr. To 10% Debentures A/c To Securities Premium A/c (Allotment money of due on debentures including the premium)		2,25,000	1,75,000 50,000

	Bank A/c Dr. To 10% Debenture Allotment A/c (Allotment money received)		2,25,000	2,25,000
	10% Debenture First & Final Call A/c Dr. To 10% Debentures A/c (First and final call money due on debentures)		2,00,000	2,00,000
	Bank A/c Dr. To 10% Debenture First & Final Call A/c(First and final call money received)		2,00,000	2,00,000

A Limited Balance Sheet as at ———

Particulars	*Note No.*	*Amount (Rs)*
I. Equity and Liabilities		
1. Shareholders' Funds		
a) Reserve and Surplus	1	50,000
2. Non-current Liabilities		
Long term borrowings	2	5,00,000
Total		**5,50,000**
II. Assets		
1. Current assets		
a) Cash and cash equivalents		**5,50,000**

Notes to Accounts

Particulars	*Amount (Rs)*
1. Reserve and surplus Securities premium	**50,000**
2. Long-term borrowings 5,000, 10% debentures of Rs 100 each	**5,00,000**

2.1 Over Subscription

When the number of debentures applied for is more than the number of debentures offered to the public, the issue is said to be over subscribed. A company, however, cannot allot more debentures than it has invited for subscription. The excess money received on over subscription may, however, be retained for adjustment towards allotment and the respective calls to be made. But the money received from applicants to whom no debentures have been allotted, will be refunded to them.

Sum 5

X Limited Issued 10,000, 12% debentures of Rs 100 each payable Rs 40 on application and Rs 60 on allotment. The public applied for 14,000 debentures. Applications for 9,000 debentures were accepted in full; applications for 2,000 debentures were allotted 1,000 debentures and the remaining applications, wererejected. All money was duly received. Journalise the transactions.

Solution:

Books of X Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Bank A/c Dr.		5,60,000	
	To 12% Debenture Application A/c			5,60,000
	(Receipt of application money on 14,000debentures)			
	12% Debenture Application A/c Dr.		5,60,000	
	To 12% Debentures A/c			4,00,000
	To Debentures Allotment A/c			40,000
	To Bank A/c			1,20,000
	(Debenture Application money transferred to Debenuture A/c, Excess application money credited to Debenture Allotment account and money refunded on rejected application)			
	12% Debenture Allotment A/c Dr.		6,00,000	
	To 12% Debentures A/c			6,00,000
	(Amount due on allotment on 10,000 debentures)			
	Bank A/c Dr.		5,60,000	
	To Debenture Allotment A/c			5,60,000
	(Allotment money received)			

2.2 Issue of Debentures for Consideration other than Cash

Sometimes a company purchase assets from vendors and instead of making payment in cash issues debentures for consideration thereof. Such issue of debentures is called debentures issued for consideration other than cash. In that case also, the debentures may be issued at par, at a premium or at a discount then entries made in such a situation are similar to those of the shares issued for consideration other than cash, which are as follows :

1. *On purchase of assets*

   Sundry Assets A/c Dr.
   To Vendor's

2. *On issue of debentures*

   (a) At par

   Vendors Dr.
   To Debentures A/c

   (b) At premium

   Vendors Dr.
   To Debentures A/c
   To Securities Premium A/c

   (c) At a discount

   Vendors Dr.
   Discount on Issue of Debenture A/c Dr.
   To Debentures A/c

Sum 6

Aashirward Company Limited purchased assets of the book value of Rs 2,00,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs 100 each.

Record the necessary journal entries.

Solution:

Books of Aashirwad Company Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c Dr. To Vendors (Assets purchased from vendors)		2,00,000	 2,00,000
	Vendors Dr. To 10% Debentures A/c (Allotment of debentures to vendors as purchase consideration)		2,00,000	 2,00,000

Sum 7

Rai Company purchased assets of the book value of Rs 2,20,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs 100 each at a premium of 10%.

Record necessary journal entries.

Solution:

Books of Rai Company Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c Dr. To Vendors (Assets purchased from vendors)		2,20,000	 2,20,000
	Vendors Dr. To 10% Debentures A/c To Securities Premium A/c (Allotment of 2,000 debentures of Rs 100 each at a premium of 10% as purchase consideration)		2,20,000	 2,00,000 20,000

Sum 8

National Packaging Company purchased assets of the value of Rs 1,90,000 from another company and agreed to make the payment of purchase consideration by issuing 2,000, 10% debentures of Rs 100 each at a discount of 5%.

Record necessary journal entries.

Solution:

Books of National Packaging Company
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c Dr. To Vendors (Assets purchased from vendors)		1,90,000	 1,90,000
	Vendors Dr. Discount on Issue of Debenture A/c Dr. To 10% Debentures A/c (Allotment of 2,000 debentures of Rs 100 each at a discount of 5% as purchase consideration)		1,90,000 10,000	 2,00,000

Sum 9

G.S.Rai company purchased assets of the book value of Rs 99,000 from another firm. It was agreed that purchase consideration be paid by issuing 11% debentures of Rs 100 each. Assume debentures have been issued.

1. At par
2. At discount of 10%, and
3. At a premium of 10%. Record

necessary journal entries.

Solution:

Books of G.S.Rai Company Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c Dr. To Vendors (Assets purchased from vendors)		99,000	 99,000
In Ist Case	Vendors Dr. To 10% Debentures A/c (Allotment of debentures to vendors as purchase consideration)		99,000	 99,000
In IInd Case	Vendors Dr. Discount on Issue of Debenture A/c Dr. To 10% Debentures A/c (Allotment of 1,100 debenture of Rs 100 issued at discount of 10% to vendor)		99,000 11,000	 1,10,000
In IIIrd Case	Vendors Dr. To 11% Debentures A/c To Securities Premium A/c (Allotment of 900 debentures of Rs 100 issued ata premium of 10% to the vendors)		99,000	 90,000 9,000

Sometimes a company may purchase the assets as well as takeover its liabilities of another concern. It happens usually in case of purchase of the whole business of the other concern. In such a situation, the purchase consideration will be equal to the value of net assets (Assets - Liabilities) taken over, and if the whole amount of the consideration is paid by issue of debentures, the journalentry will be:

Sundry Assets A/c Dr.

To Sundry Liabilities A/cTo Vendors

(Purchase of the Vendors' business)

Sum 10

Romi Ltd. acquired assets of Rs 20 lakh and took over creditors of Rs 2 lakh from Kapil Enterprises. Romi Ltd. issued 8% debentures of Rs 100 each at par as purchase consideration. Record necessary journal entries in the books of Romi Ltd.

Solution:

Books of Romi Ltd.
Journal

Date	*Particulars*	*L. F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c Dr.		20,00,000	
	To Kapil Enterprises			18,00,000
	To Sundry Creditors A/c			2,00,000
	(Purchase of business from Kapil Enterprises)			
	Kapil Enterprises Dr.		18,00,000	
	To 8% Debentures A/c			18,00,000
	(Issue of 18,000, 8% debentures of Rs 100 each)			

In case of the whole business being taken over if the amount of debentures issued is more than the amount of the net assets taken over, the difference (excess)will be treated as value of goodwill and the same shall also be debited while passing the journal entry for the purchase of vender's business (see Sum 10). But if it is the other way round, i.e., the value of debentures is less than the value of the net assets taken over the difference will be credited to capital Reserveaccounts (See Sum 12).

Sum 11

Blue Prints Ltd., purchased building worth Rs 1,50,000, machinery worth Rs 1,40,000 and furniture worth Rs 10,000 from XYZ Co., and took over its liabilities of Rs 20,000 for a purchase consideration of Rs 3,15,000. Blue Prints Ltd., paid the purchase consideration by issuing 12% debentures of Rs 100 each at a premium of 5%. Record necessary journal entries.

Solution:

Books of Blue Prints Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Building A/c Dr. Plant & Machinery A/c Dr. Furniture A/c Dr. Goodwill A/c [1] Dr. To Liabilities (Sundry) To XYZ Co. (Purchase of assets and taking over of liabilities of XYZ Co.)		1,50,000 1,40,000 10,000 35,000	 20,000 3,15,000
	XYZ Co. Dr. To 12% Debentures A/c To Securities Premium A/c (Issue of 3,000 debentures at a premium of 5%)		3,15,000	 3,00,000 15,000

Note: 1. Since the purchase consideration is more than net assets taken over, the difference has been debited to goodwill account.

2. No. of debentures issued = $\frac{\text{Purchase Consideration}}{\text{Issue Price of a Debenture}}$

= $\frac{\text{Rs } 3,15,000}{105}$ = 3,000

Sum 12

A Limited took over the assets of Rs 3,00,000 and liabilities of Rs 10,000 from B & Co. Ltd. for an agreed purchase consideration of Rs 2,70,000 to be satisfied by issue of 15% debentures of Rs 100 at 20% premium. Show the journal entries in the journal of *A Limited*.

Solution:

Books of *A Limited*
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Sundry Assets A/c Dr. To Sundry Liabilities A/c To B & Co. Ltd. To Capital Reserve (Purchased assets and took over liabilities from B Ltd.)		3,00,000	 10,000 2,70,000 20,000

	B & Co. Ltd. Dr. To 15% Debentures A/c To Securities Premium A/c (Issue of 2,250 debentures of Rs 100 each at a premium of 20%)		2,70,000	 2,25,000 45,000

Terms of Issue of Debentures

When a company issues debentures, it usually mentions the terms on which they will be redeemed on their maturity. Redemption of debentures means discharge of liability on account of debentures by repayment made to the debentureholdeRs Debentures can be redeemed either at par or at a premium.

Depending upon the terms and conditions of issue and redemption of debentures, the following six situations are commonly found in practice.

(i) Issued at par and redeemable at par

(ii) Issued at discount and redeemable at par

(iii) Issued at a premium and redeemable at par

(iv) Issued at par and redeemable at a premium

(v) Issued at a discount and redeemable at a premium

(vi) Issued at a premium and redeemable at a premium

In all the above six cases, the following journal entries will be passed:

1. *Issue at par and redeemable at par*

(a) Bank A/c Dr.
  To Debenture Application & Allotment A/c
  (Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.
  To Debentures A/c
  (Allotment of debentures)

2. *Issue at a discount and redeemable at par*

(a) Bank A/c Dr.
  To Debenture Application & Allotment A/c
  (Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.
  Discount on Issue of Debentures A/c Dr.
  To Debentures A/c
  (Allotment of debentures at a discount)

3. *Issue at premium and redemption at par*

(a) Bank A/c Dr.
  To Debenture Application & Allotment A/c
  (Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.To

Debentures A/c

To Securities Premium A/c (Allotment of debentures at a premium)

4. *Issue at par and redeemable at premium*

(a) Bank A/c Dr.

To Debenture Application & Allotment A/c

(Receipt of application money)

(b) Debenture Application & Allotment A/c Dr.

Loss on Issue of Debentures A/c Dr. (with premium on redemption)To

Debentures A/c (with nominal value of debenture)

To Premium on Redemption Debenture A/c (with premium on redemption)of

(Allotment of debentures at par andredeemade at a premium)

5. *Issue at discount and redemption at premium*

Bank A/c Dr.

To Debenture Application & Allotment A/c

(Receipt of application money)

Debenture Application & Allotment A/c Dr.

Loss on Issue of Debentures A/c Dr. (with discount on issue plus premium on redemption)

To Debentures A/c (with nominal value of debenture)

To Premium on Redemption Debentures A/c (with premium on redemption)of

(Allotment of debentures at a discountand redeemable at premium)

6. *Issued at a premium and redeemable at premium*

Bank A/c Dr.

To Debenture Application & Allotment A/c

(Receipt of application money)

Debenture Application & Allotment A/c Dr.

Loss on Issue of Debentures A/c Dr. (with premium on redemption) To

Debentures A/c (with nominal value of debenture) To

Securities Premium A/c (with premium on issue)

To Premium on Redemption of Debentures A/c (with premium on redemption)

Notes: 1. When debentures are redeemable at a premium, a provision has to be made right at the time of the issue by debiting the amount to 'Loss on Issue of Debentures A/c'. It may be noted that when debentures are issued at a discount and are redeemable at a premium, the amount of discount on issue is also debited to 'Loss on Issue of Debentures'. It may be noted that when the debentures are issued at a discount and are redeemable at par, the amount debited to 'Discount on Issue of Debentures A/c' as usual.

2. Premium on redemption is a liability of a company payable in future. It is a provision and is shown under the head Non-current liabilities under sub- head 'Long-term Borrowings' until debentures are redeemed.

3. Loss on issue of debentures is a capital loss and it is to be written-off gradually charged to statement of profit and loss or securities premium account.

Sum 15

Give Journal entries for the following:

1. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at par and redeemable at par.
2. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at premium of5% but redeemable at par.
3. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at discount of5% repayable at par.
4. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at par but repayable at a premium of 5%.
5. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at discount of5% but redeemable at premium of 5%.
6. Issue of Rs 1,00,000, 9% debentures of Rs 100 each at premium of5% and redeemable at premium of 5%.

Solution:

Journal

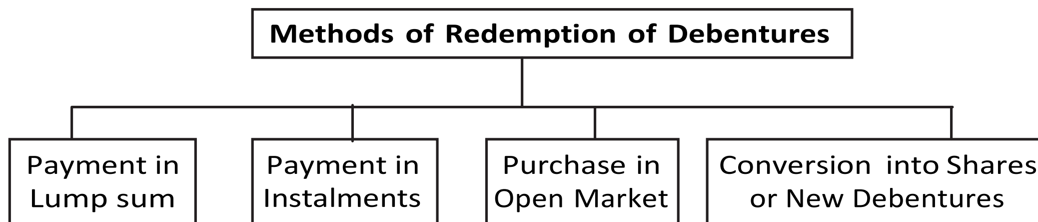
Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
1	Bank A/c Dr. To 9% Debenture Application & Allotment A/c (Debentures Application money received)		1,00,000	1,00,000
	Debenture Application & Allotment A/c Dr. To 9% Debentures A/c (Application money transferred to Debentures Account)		1,00,000	1,00,000
2	Bank A/c Dr. To 9% Debenture Application & Allotment A/c (Debentures application money received)		1,05,000	1,05,000
	Debenture Application & Allotment A/c Dr .To 9% Debentures A/c To Securities Premium A/c (Debentures application money transferred to Debentures & Securities Premium account)		1,05,000	1,00,000 5,000
3	Bank A/c Dr. To 9% Debenture Application & Allotment A/c (Debentures application money received)		95,000	95,000
	9% Debenture Application & Allotment A/c Dr .Discount on Issue of Debentures A/c Dr . To 9% Debentures A/c		95,000 5,000	1,00,000

	(Debentures application money transferredto Debentures account)			
4	Bank A/c Dr. To 9% Debenture Application & Allotment A/c (Debentures Application money received)		1,00,000	1,00,000
	Debenture Application & Allotment A/c Dr .Loss on Issue of Debentures A/c Dr . To 9% Debentures A/c To Premium on Redemption of Debentures A/c (Debentures Application money transferred to Debentures account)		1,00,000 5,000	1,00,000 5,000
5	Bank A/c Dr. To 9% Debenture Application & Allotment A/c (Debentures Application money received)		95,000	95,000
	Debenture Application & Allotment A/c Dr .Loss on Issue of Debentures A/c Dr . To 9% Debentures A/c To Premium on Redemption of Debentures A/c (Debentures application money transferred to debentures and Premium on debenture account)		95,000 10,000	1,00,000 5,000
6	Bank A/c Dr. To 9% Debenture Application & Allotment A/c (Debentures Application money received)		1,05,000	1,05,000
	Debenture Application & Allotment A/c Dr .Loss on Issue of Debentures A/c Dr . To 9% Debenture A/c To Premium on Redemption of Debentures A/c To Securities Premium A/c (Debenture application money transferredto debentures account)		1,05,000 5,000	1,00,000 5,000 5,000

Redemption of Debentures

Redemption of debentures refers to extinguishing or discharging the liability on account of debentures in accordance with the terms of issue. In other words redemption of debentures means repayment of the amount of debentures by the company. There are four ways by which the debentures can be redeemed. These are :

1. Payment in lump sum
2. Payment in installments
3. Purchase in the open market
4. By conversion into shares or new debentures.



Payment in lump sum : The company redeems the debentures by paying the amount in lump sum to the debentureholders at the maturity thereof as per terms of issue.

Payment in instalments **:** Under this method, normally redemption of debenturesis made in instalments on the specified date during the tenure of the debentures.The total amount of debenture liability is divided by the number of years. It is to note that the actual debentures redeemable are identified by means of drawing the requisite number of lots out of the debentures outstanding for payment.

Purchase in open market: When a company purchases its own debentures for the purposes of cancellation, such an act of purchasing and cancelling the debentures constitutes redemption of debentures by purchase in the open market.

Conversion into shares or new debentures : A company can redeem its debentures by converting them into shares or new class of debentures. If debentureholders find that the offer is beneficial to them, they can exercise theirright of converting their debentures into shares or new class of debentures. Thesenew shares or debentures can be issued at par, at a discount or at a premium. It should be noted that only the actual proceeds of debentures are to be taken into account for ascertaining the number of shares to be issued in lieu of the debentures to be converted. If debentures were originally issued at discount,the actual amount realised from them at the time of issue would be used as the basis for computing the actual number of shares to be issued. It may be notedthat this method is applicable only to convertible debentures.

2.11 Redemption by Payment in Lump Sum

When the company pays the whole amount in lump sum, the following journalentries are recorded in the books of the company:

1. *If debentures are to be redeemed at par*
   - (a) Debentures A/c Dr.
     To Debentureholders
   - (b) Debentureholders Dr.
     To Bank A/c
2. *If debentures are to be redeemed at premium*

(a) Debentures A/c Dr.
Premium on Redemption of Debentures A/c Dr.
To Debentureholders

(b) Debentureholders Dr.
To Bank A/c

Sum 19

Give the necessary journal entries at the time of redemption of debentures in each of the following cases.

1. X Ltd. issued 5,000, 9% debentures of Rs 100 each at par andredeemable at par at the end of 5 years out of capital.
2. X Ltd. issued 1,000, 12% debentures of Rs 100 each at par. These debentures are redeemable at 10% premium at the end of 4 years
3. X Ltd. issued 12% debentures of the total face value of Rs 1,00,000 at premium of 5% to be redeemed at par at the end of 4 years
4. X Ltd. issued Rs 1,00,000, 12% debentures at a discount of 5% but redeemable at a premium of 5% at the end of 5 years

Solution:

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
1.	9% Debentures A/c Dr.		5,00,000	
	To Debentureholders A/c			5,00,000
	(Amount due on redemption debentures)			
	Debentureholders A/c Dr.		5,00,000	
	To Bank A/c			5,00,000
	(Payment made to debentureholders)			
2.	12% Debentures A/c Dr.		1,00,000	
	Premium on Redemption of Debentures A/c Dr.		10,000	
	To DebentureholdeRs			1,10,000
	(Amount due on redemption of debentures)			
	Debentureholders A/c Dr.		1,10,000	
	To Bank A/c			1,10,000
	(Payment made to debentureholders)			
3.	12% Debentures A/c Dr.		1,00,000	
	To Debentureholders A/c			1,00,000
	(Amount due on redemption)			
	Debentureholders A/c Dr.		1,00,000	

	To Bank A/c (Payment made to debentureholders)			1,00,000
4.	12% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debentureholders A/c (Amount due on redemption of debentures)		1,00,000 5,000	 1,05,000
	Debentureholders A/c Dr. To Bank A/c (Payment made to debentureholders)		1,05,000	 1,05,000

As per the provisions of the Companies Act, 1956, the company must set aside a portion of profits every year and transfer it to Debenture Redemption Reserve for redemption of debentures until the debentures are redeemed. The journal entry recorded for the purpose is as follows :

As per provisions of Section 117C of the Companies Act, 1956 (as ameded in 2000).

(a) Where a company issued debentures after the commencement of this Act, it shall create a Debenture Redemption Reserve for the redemption of such debentures, to which adequate amount shall be credited, from out of its profit every year until such debentures are redeemed.
(b) The amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

SEBI's Guidelines

Securities and Exchange Board of India (SEBI) has issued guidelines for redemption of debentures. The salient points of these guidelines are:

1. Every company shall create Debenture Redemption Reserve in case of issue of debenture redeemable after a period of more than 18 months from the date of issue.
2. The creation of Debenture Redemption Reserve is obligatory only for non-convertible debentures and non-convertible portion of partly convertible debentures.
3. A company shall create Debenture Redemption Reserve equivalent to at least 50% of the amount of debenture issue before starting the redemption of debenture.
4. Withdrawal from Debenture Redemption Reserve is permissible only after 10% of the debenture liability has already been reduced by the company.

SEBI guidelines would not apply under the following situations:

(a) Infrastructure company (a company wholly engaged in the business of developing, maintaining and operating infrastructure facilities); and
(b) A company issuing debentures with a maturity period of not more than 18 months.

2.11.1 Clarifications regarding creation of Debenture Redemption Reserve

The Department of Company Affairs, Government of India, vide their Circular No.9/2002, dated 18.04.2002 has issued the following clarifications regarding creation of Debenture Redemption Reserve (DRR):

(a) No DRR is required for debentures issued by All India Financial Institutions, regulated by RBI and Banking Companies for both public as well as privately placed debentures.

(b) No DRR is required in case of privately placed debentures.

(c) Section 117C apply to debentures issued and pending to be redeemed and, therefore, DRR will also be created for debentures issued prior to 13.12.2000 and pending redemption.

(d) Section 117C will apply to non-convertible portion of debentures issued whether they are fully or partly paid.

The Debenture Redemption Reserve account appears on the liability side of the Balance sheet under the head "Reserves and Surpluses." When the debentures are redeemed, the requisite amount of Debenture Redemption Reserve is transferred to General Reserve.

Sum 20

XYZ Ltd. issued 200, 15% debentures of Rs 100 each on January 01, 2010 at discount of 10% redeemable at premium of 10% out of profits. Give journal entries at the time of issue and redemption of debentures if debentures are to be redeemed in lump sum at the end of 4th year. The directors decided to transfer the minimum amount to Debenture Redemption Reserve on December 31, 2014.

Solution:

Books of XYZ Ltd.
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
2010 Jan.01	Bank A/c Dr. Loss on Issue of Debenture A/c Dr. To 15% Debentures A/c To Premium on Redemption of Debenture A/c (Issue of debentures at 10% discount and redeemable at 10% premium)		18,000 4,000	 20,000 2,000
2014 Dec.31	Statement of profit and loss Dr. To Debenture Redemption Reserve A/c (Transfer of profits to DRR as per Section 117(C) and SEBI)		10,000	 10,000
2014 Dec.31	15% Debentures A/c Dr. Premium on Redemption of DebentureTo Dr. Debentureholders A/c (Amount due on redemption)		20,000 2,000	 22,000
Dec.31	Debentureholders A/c Dr. To Bank A/c (Amount paid to debentures holders)		22,000	 22,000
Dec.31	Debenture Redemption Reserve A/c Dr.		10,000	

	To General Reserve A/c (Transfer of DRR to General Reserve after total redemption)			10,000

It may be noted that when Debenture Redemption Reserve is created, redemption of debentures is termed as redemption out of profits. Otherwise, it is treated as redemption out of capital.

2.11.2 Redemption by Payment in Instalments

When, as per terms of the issue, the debentures are to be redeemed in instalments beginning from a particular year, the actual debentures to be redeemed are selected usually by draw of lots, and the redemption to be made either out of profits or out of capital. The entries will be:

1. *If redeemed out of profits*
   (a) Statement of profit and loss Dr.
   To Debenture Redemption Reserve A/c
   (b) Debentures A/c Dr.
   To Debentureholders
   (c) Debentureholders Dr.
   To Bank A/c
2. *If redeemed out of capital*
   (a) Debentures A/c Dr.
   To Debentureholders
   (b) Debentureholders Dr.
   To Bank A/c

Sum 21

ABC Ltd. issued 3,000, 14% Debentures of Rs 100 each at a discount of 5% on January 1, 2012. Interest on these debentures is payable annually on December 31 each year. The debentures are redeemable at par in three equal instalments at the end of the third, fourth and fifth year. Prepare 14% Debentures Account, Discount on Issue of Debentures Account and Debenture Interest Account in the books of the company.

Solution:

14% Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2012				2012			
Dec.31	Balance c/d		3,00,000	Jan.01	Debenture Application		2,85,000
				Dec.31	Discount on Issue of Debentures		15,000

			3,00,000				**3,00,000**
2013				2013			
Dec.31	Balance c/d		3,00,000	Jan.01	Balance b/d		3,00,000
			3,00,000				**3,00,000**
2014				2014			
Dec.31	Bank A/c		1,00,000	Jan.01	Balance b/d		3,00,000
Dec.31	Balance c/d		2,00,000				
			3,00,000				**3,00,000**
2015				2015			
Dec.31	Bank A/c		1,00,000	Jan.01	Balance b/d		2,00,000
Dec.31	Balance c/d		1,00,000				
			2,00,000				**2,00,000**
2016				2016			
Dec.31	Balance c/d		1,00,000	Jan.01	Balance b/d		1,00,000
			1,00,000				**1,00,000**

Debentures Interest Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2012 Dec.31	Bank		**42,000**	2012 Dec.31	Statement of Profit and Loss		**42,000**
2013 Dec.31	Bank		**42,000**	2013 Dec.31	Statement of Profit and Loss		**42,000**
2014 Dec.31	Bank		**42,000**	2014 Dec.31	Statement of Profit and Loss		**42,000**
2015 Dec.31	Bank		**28,000**	2015 Dec.31	Statement of Profit and Loss		**28,000**
2016 Dec.31	Bank		**14,000**	2016 Dec. 31	Statement of Profit and Loss		**14,000**

Discount on Issue Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2012 Jan.01	Balance c/d		15,000	2012 Dec.31 Dec.31	Statement of Profit and Loss Balance c/d		3,750 11,250
			15,000				**15,000**
2013 Jan.01	Balance c/d		11,250	2013 Dec. 31 Dec. 31	Statement of Profit and Loss Balance c/d		3,750 7,500
			11,250				**11,250**
2014 Jan.01	Balance c/d		7,500	2014 Dec. 31 Dec. 31	Statement of Profit and Loss Balance c/d		3,750 3,750
			7,500				**7,500**
2015 Jan.01	Balance c/d		3,750	2015 Dec. 31 Dec. 31	Statement of Profit and Loss Balance c/d		2,500 1,250
			3,750				**3,750**
2016 Jan.01	Balance c/d		1,250	2016 Dec. 31	Statement of Profit and Loss		1,250
			1,250				**1,250**

Working Notes:

1. Debenture interest is calculated @ 14% on the amount of debentures outstanding in the beginning of each year. The amount of debentures outstanding on January 1, each year is:

	Debenture Outstanding
	Rs
Beginning of 2012	3,00,000
Beginning of 2013	3,00,000
Beginning of 2014	3,00,000
Beginning of 2015	2,00,000
Beginning of 2016	1,00,000

2. Discount on Issue of Debentures is written-off in the ratio of the amount of debentures outstanding in the beginning of each year. The ratio is 3:3:3:2:1. So amount of discount to be written-off will be

Year	***Rs***	***Amount Rs***
2012	Rs 15,000 $\frac{3}{12}$	3,750
2013	Rs 15,000 $\frac{3}{12}$	3,750
2014	Rs 15,000 $\frac{3}{12}$	3,750
2015	Rs 15,000 $\frac{2}{12}$	2,500
	1	

2016	Rs 15,000 $\frac{}{12}$	1,250

It may be noted that the company will also have to transfer every year an amount equal to the nominal value of debentures redeemed to debenture redemption reserve account and at the end of fifth year (31.12.2016), the same shall be transfered to general reserve.

2.12 Redemption by Purchase in Open Market

When a company purchases its own debentures in the open market for the purpose of immediate cancellation, the purchase and cancellation of such debentures are termed as redemption by purchase in the open market. The advantage of such an option is that a company can redeem the debentures at its convenience whenever it has surplus funds. Secondly, the company can purchase them when they are available in market at a discount.

When the debentures are purchased from the market at a discount and cancelled, the journal entries are recorded as follows :

1. *On purchase of own debentures for immediate cancellation*

   Debentures A/c Dr.

   To Bank A/c

   To Profit on Redemption of Debentures A/c

2. *On transfer of Profit on Redemption*

   Profit on Redemption of Debenture A/c Dr.

   To Capital Reserve

In case, the debentures are purchased from the market at a price which is above the nominal value of debenture, the excess will be debited to loss on redemption of debentures. The journal entry in that case will be

1. Debentures A/c Dr.

   Loss on Redemption of Debentures A/c Dr.

   To Bank A/c

2. Statement of profit and loss Dr.To

   Loss on Redemption of Debentures A/c

Sum 22

X Ltd. purchased its own debentures of Rs 100 each of the face value of Rs 20,000 from the open market for cancellation at Rs 92. Record necessary journalentries.

Solution:

Books of X Limited
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	Debentures A/c Dr.		20,000	
	To Bank A/c			18,400
	To Profit on Redemption of Debentures A/c(Own debentures purchased at Rs 92 from the market)			1,600
	Profit on Redemption of Debenture A/c Dr.		1,600	

	To Capital Reserve (Transfer of profit on cancellation of debentures to capital reserve)			1,600

Sum 23

X Ltd. decided to redeem 250, 12% debentures of Rs 100 each amounting to Rs 25,000. For this purpose, the company purchased debentures amounting to Rs 20000 in the open market at Rs 98.50 each. Expenses of Rs 100 was incurred on it. The balance of debentures amounting to Rs 5000 were reedemed by draw of lots. Journalise.

Solution:

Books of X Ltd.
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	12% Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debentures A/c (Purchase of 200 debentures @ Rs 98.50 plus expenses amounting to Rs 100.)		20,000	 19,800 200
	Profit on Redemption of Debentures A/c Dr. To Capital Reserve (Profit on Redemption transferred to Capital Reserve.)		200	 200
	12% Debentures A/c Dr. To Debenture holders A/c (Redemption due for 50 debentures)		5,000	 5,000
	12% Debentures A/c Dr. To Bank A/c (Redemption of Rs 50 debentures)		5,000	 5,000
	Statement of profit and loss Dr. To Debenture Redemption Reserve A/c (Transfer of profit to Debenture Redemption Reserve)		25,000	 25,000

Note: The balance of Debenture Redemption Reserve is not transferred to general reserve since company still has debt liability to be redeemed in future.

Sum 24

On January 01, 2013, a company made an issue of 1,000, 6% debentures of Rs 1,000 each at Rs 960 per debenture. The terms of issue provided for the redemption of 200 debentures every year starting from the end of 2014 either by purchase or by draw of lot at par at the company's option. Rs 10,000 was written-off as the debenture discount account in years 2013 and 2014. On 31.12.2014, the company

purchased for cancellation debentures of the face value of Rs 80,000 at Rs 950 per debenture and of the face value of Rs 1,20,000at Rs 900 per debenture.

Journalise the above transaction and show the profit on redemption would be treated.

Solution:

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
2013 Jan.01	Bank A/c Dr. To 6% Debentures Application & Allotment A/c (Debentures application money received)		9.60,000	9,60,000
	6% Debenture Application & Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To 6% Debentures A/c (Debentures application money transferred to Debentures A/c)		9,60,000 40,000	10,00,000
Dec.31	Statement of profit and loss Dr. To Discount on Issue of Debenture A/c (Discount on issue of debentures written-off)		10,000	10,000
2014 Dec.31	Statement of profit and loss Dr. To Debenture Redemption Reserve A/c (Transfer of profit to Debenture Redemption Reserve)		2,00,000	2,00,000
Dec.31	6% Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debenture A/c (Redemption of 80 debentures by purchasing @ Rs 950 per debenture)		80,000	76,000 4,000
Dec.31	6% Debentures A/c Dr. To Bank A/c To Profit on Redemption of Debentures A/c (Redemption of 120 debentures @ Rs 900 by purchasing in open market)		1,20,000	1,08,000 12,000
Dec.31	Profit on Redemption of Debentures A/c Dr. To Capital Reserve A/c (Transfer of profits on cancellation of debentures to Capital Reserve A/c)		16,000	16,000
Dec.31	Statement of profit and loss Dr. To Discount on Issue of Debentures A/c (Discount on debentures written-off)		10,000	10,000

2.13 Redemption by Conversion

As stated earlier the debentures can also be redeemed by converting them into shares or new debentures. If debentureholders find that the offer is beneficial to them, they will take advantage of this offer. The new shares or debentures may be issued at par, at a discount or at a premium. It may be noted that no Debenture Redemption Reserve is required in case of convertible debentures because no funds are required for redemption.

Sum 25

Arjun Plastics Limited redeemed 1,000, 15% debentures of Rs 100 each by converting them into equity shares of Rs 10 each at a premium of Rs 2.50 per share. The company also redeemed 500 debentures by utilising Rs 50,000 out of profit. Give the necessary journal entries.

Solution:

Books of Arjun Plastic Limted
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
	15% Debentures A/c Dr.		1,00,000	
	To Debentureholders			1,00,000
	(Amount due to debentureholders)			
	Debentureholders A/c Dr.		1,00,000	
	To Equity Shares Capital A/c			80,000
	To Securities Premium Reserve A/c			20,000
	(Issue of 800 equity shares at a premium of Rs 2.50 per share)			
	Statement of profit and loss Dr.		50,000	
	To Debenture Redemption Reserve A/c			50,000
	(Transfer of profit to Debenture Redemption Reserve)			
	Debentures A/c Dr.		50,000	
	To Debentureholders A/c			50,000
	(Amount due to debentureholders)			
	DebentureholdersTo Dr.		50,000	
	Bank A/c			50,000
	(Payment to debentureholders)			

2.14 Sinking Fund Method

Sufficient funds are required to redeem debentures at the end of a specified period. To meet this requirement, the company may decide to create a sinking fund and invest adequate amount in marketable securities or bonds of other business entities. Normally, a company ensures that an equal amount is set aside every year to arrange the necessary funds at the time of redemption. This is called Sinking Fund method according to which the company makes necessaryarrangements is sets aside a part of divisible profit every year and invest the same outside the business in marketable securities. An appropriate amount is calculated by referring to on Sinking Fund Table depending upon the rate of return on investments and the number of years for which investments are made. The amount thus ascertained is transferred from profits every year to Debenture Redemption Fund and its investment is termed as Debenture Redemption Fund Investment. These investment earn certain amount of income (call it interest) which is reinvested together with the fixed appropriated amount for the purpose in subsequent years In last year, the interest earned and the appropriated fixed amount are not invested. In fact, at this stage the Debenture Redemption Fund Investments are encashed and the amount so obtained is used for the redemption of debentures. Any profit or loss made on the encashment of Debenture Redemption Fund investments is also transferred to Debenture Redemption Fund Account. The creation of Debenture Redemption Fund Account serves the purpose of Debenture Redemption Reserve as required by law and the SEBI guidelines, and is, after redemption is transferred to general reserve.

Thus, the steps involved in the working of sinking fund method are :

1. Calculate the amount of profit to be set aside annually with the help of sinking fund table.
2. Set aside the amount of profit at the end of each year and credit to Debenture Redemption Fund (DRF) Account.
3. Purchase the investments of the equivalent amount at the end of first year and debit Debenture Redemption Fund Investment (DRFI) Account.
4. Receive interest on investment at the end of each subsequent year.
5. Purchase the investments equivalent to the fixed amount of profit set aside and the interest earned every year except last year (year ofredemption).
6. Receive interest on investment for the last year.
7. Set aside the fixed amount of profit for the last year.
8. Encash the investments at the end of the year of redemption.

9. Transfer the profit/loss on sale of investments reflected in the balance of Debenture Redemption Fund Investment Account to Debenture Redemption Fund Account.
10. Make payment to debentureholdeRs
11. Transfer Debenture Redemption Fund A/c balance to General Reserve.

The sinking fund method is used for redemption of debentures by payment in lump sum on maturity, and the journal passed from year to year are asfollows:

1. *At the end of First Year*

(a) For setting aside the fixed amount of profit for redemption Statement

of profit and loss Dr.

To Debenture Redemption Fund A/c

(b) For investing the amount set aside for redemption

Debenture Redemption Fund Investment A/c Dr.

To Bank A/c

2. *At the end of second year and subsequent years other than last year*

(a) For receipt of interest on Debenture Redemption Fund InvestmentsBank

A/c Dr.

To Interest on Debenture Redemption A/c
Fund Investment A/c

(b) For transfer of Interest on Debenture Redemption Fund Investment to Debenture Redemption Fund Account

Interest on Debenture Redemption Fund Investment A/c Dr.

To Debenture Redemption Fund A/c

(c) For setting aside the fixed amount of profit for redemption Statement

of profit and loss Dr

To Debenture Redemption Fund A/c

(d) For investments of the amount set aside for redemption and the interestearned on DRFI

Debenture Redemption Fund Investment A/c Dr.

To Bank A/c

3. At the end of last year

(a) For receipt of interest
Bank A/c Dr.
To Interest on Debenture RedemptionFund Investment A/c

(b) For transfer of interest on Debenture Redemption Fund Investment to
Debenture Redemption Fund Investment A/c Dr
Interest on Debenture Redemption Fund Investment A/c Dr.
To Debenture Redemption Fund A/c

(c) For setting aside the fixed amount of profit for redemption Statement of profit and loss Dr
To Debenture Redemption Fund A/c

(d) For encashment of Debenture Redemption Fund InvestmentsBank A/c Dr
To Debenture Redemption Fund Investment A/c

(e) For the transfer of profit/loss on realisation of Debenture RedemptionFund Investments

(i) In case of Profit
Debenture Redemption Fund Investment A/c Dr.
To Debenture Redemption Fund A/c

Or

(ii) In case of Loss
Debenture Redemption Fund A/c Dr.
To Debenture Redemption Fund Investment A/c

(f) For amount due to debentureholders on redemption Debenture A/c Dr
To DebentureholdeRs A/c

(g) For payment to debentureholders
Debentureholders A/c Dr.
To Bank A/c

(h) For transfer of Debenture Redemption Fund Account balance toGeneral Reserve
Debenture Redemption Fund A/c Dr.
To General Reserve A/c

Sum 26

X Ltd. issued Rs 10,00,000 debentures on January 01, 2012. These were to be redeemed on December 31, 2014. For this purpose, the company established a sinking fund. The investments were expected to earn interest @ 5% p.a. Sinking

fund table shows that Rs 0.317208 invested annually at 5% amount to Re.1 in 3 years On December 31, 2014, the bank balance was Rs 4,20,000 before receipt of interest on Sinking Fund Investments. On that date, the investments were sold for Rs 6,56,000.

Calculate the interest to nearest rupee and investments be made to the nearest of Rs 100. Record necessary journal entries. Show Debentures Account, Debenture Redemption Fund Account and Debenture Redemption Fund Investment Account in the books of the company. Ignore entries for interest on debentures.

Solution:

Books of X Ltd.
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs)*	*Credit Amount (Rs)*
2012 Jan.1,	Bank A/c Dr. To Debentures A/c (Issue of debentures of Rs 10,00,000)		10,00,000	10,00,000
Dec.31,	Statement of profit and loss Dr. To Debenture Redemption Fund A/c (Annual instalment for redemption debited to statement of profit and loss)		3,17,208	3,17,208
	Debenture Redemption Fund Investments A/c Dr. To Bank A/c (Investment purchased)		3,17,200	3,17,200
2013 Dec.31,	Bank A/c Dr. To Interest on DRFI A/c (Interest received @ 5% on investment)		15,860	15,860
	Interest on DRFI A/c Dr. To Debenture Redemption Fund Investment A/c (Interest on DRFI transferred to Debenture Redemption Fund)		15,860	15,860

Date	Particulars	L.F.	Debit	Credit
	Statement of profit and loss Dr. To Debenture Redemption Fund A/c (Annual instalment debited to Profit and Loss Appropriation Account)		3,17,208	3,17,208
	Debenture Redemption Fund Investment A/c Dr. To Bank A/c (Investment purchased for annual instalmentplus interest)		3,33,100	3,33,100
2014 Dec.31,	Bank A/c Dr. To Interest on DRFI A/c (Interest received @ 5% on investment)		32,516	32,516
	Interest on DRFI A/c Dr. To Debenture Redemption Fund A/c (Interest on DRFI transferred to Debenture Redemption Fund)		32,516	32,516
	Statement of profit and loss Dr. To Debenture Redemption Fund A/c (Annual instalment debited to Profit & Loss Appropriation Account)		3,17,208	3,17,208
	Bank A/c Dr. To Debenture Redemption Fund Investment A/c (Sale proceeds of DRFI)		6,56,000	6,56,000
	Debenture Redemption Fund Investment A/c Dr. To Debenture Redemption Fund A/c (Transfer of profit on sale of investments to Debenture Redemption Fund)		5,700	5,700
	Debentures A/c Dr. To Debenturesholders A/c (Debentures amount transferred todebentureholders)		10,00,000	10,00,000
	Debenturesholders A/c Dr. To Bank A/c (Debentures holders paid the money)		10,00,000	10,00,000

	Debenture Redemption Fund A/c Dr . To General Reserve A/c (Transfer of credit balance of Debenture Redemption Fund General Reserve)		10,05,700	10,05,700

Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2012 Dec.31	Balance c/d		10,00,000	2012 Jan.01	Bank		10,00,000
			10,00,000				**10,00,000**
2013 Dec.31	Balance c/d		10,00,000	2013 Jan.01	Balance b/d		10,00,000
			10,00,000				**10,00,000**
2014 Dec.31	Bank		10,00,000	2014 Jan.01	Balance b/d		10,00,000
			10,00,000				**10,00,000**

Debentures Redemption Fund Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2012 Dec.31	Balance c/d		3,17,208	2012 Jan.01	Statement of profit and loss		3,17,208
			3,17,208				**3,17,208**
2013 Dec.31	Balance c/d		6,50,276	2013 Jan.01	Balance b/d Interest on DRFI Statement of profit and loss		3,17,208 15,860 3,17,208
			6,50,276				**6,50,276**

2014				2014			
Dec.31	General Reserve		10,05,700	Jan.01	Balance b/d		6,50,276
					Interest on DRFI		32,516
					Profit & Loss Appropriation		3,17,208
					DRFI		5,700
			10,05,700				**10,05,700**

Debenture Redemption Fund Investment Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2012				2012			
Dec.31	Bank		3,17,200	Dec.31	Balance c/d		3,17,200
			3,17,200				**3,17,200**
2013				2013			
Jan.31	Balance b/d		3,17,200	Dec.31	Balance c/d		6,50,300
Dec.31	Bank		3,33,100				
			6,50,300				**6,50,300**
2014				2014			
Jan.31	Balance b/d		6,50,300	Dec.31	Bank (Sale Proceeds)		6,56,000
Dec.31	DRF		5,700				
			6,56,000				**6,56,000**

Bank Account

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2014				2014			
Dec.31	Balance b/d		4,20,000	Dec.31	Debenture		10,00,000
	DRF		6,56,000	Dec.31	Balance c/d		76,000
			10,76,000				**10,76,000**
2015							
Jan.1	Balance b/d		76,000				

Note : The annual instalment of profit to be set aside for redemption has been worked out as 0.317208 10,00,000 = Rs 3,17,208.

Sum 27

The balance sheet of XYZ Ltd., disclosed the following information as on December, 31 2011.

	Rs
15% debentures	15,00,000
Debenture Redemption Fund	11,63,600
Debenture Redemption Fund Investment	11,63,600 (10%
Govt. Securities)	

The contribution to Debenture Redemption Fund was Rs 1,30,800 p.a. for the year 2012 and 2013. Debentures are due for payment on December 31, 2013. Prepare the above accounts in the books of company assuming that securities were realised on December 31, 2013 for a sum of Rs 13,52,000 and interest on securities on December 31, was immediately invested.

Solution:

Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2012				2012			
Dec.31	Balance c/d		15,00,000	Jan.01	Balance b/d		15,00,000
			15,00,000				**15,00,000**
2013				2013			
Dec.31	Bank		15,00,000	Jan.01	Balance b/d		15,00,000
			15,00,000				**15,00,000**

Debentures Redemption Fund Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2012				2012			
Dec.31	Balance c/d		14,10,760	Jan.01	Balance b/d		11,63,600
				Dec.31	Interest on DRFI		1,16,360
				Dec.31	Statement of profit and loss		1,30,800
			14,10,760				**14,10,760**
2013	Debenture			2013			
Dec.31	Redemption Fund Investment		58,760	Jan.01	Balance b/d		14,10,760
				Dec.31	Interest on DRFI		1,41,076
Dec.31	General Reserve		16,23,876	Dec.31	Statement of profit and loss		1,30,800
			16,82,636				**16,82,636**

Debenture Redemption Fund Investment Account

Dr. *Cr.*

Date	Particulars	J. F.	Amount (Rs)	Date	Particulars	J. F.	Amount (Rs)
2012				2012			
Jan.01	Balance b/d		11,63,600	Dec.31	Balance c/d		14,10,760
Dec.31	Bank		2,47,160*				
			14,10,760				**14,10,760**
2013				2013			
Jan.01	Balance b/d		14,10,760	Dec.31	Bank		13,52,000
					Debenture Redemption Fund		58,760
			14,10,760				**14,10,760**

* (Interest + Instalment = Rs 1,16,360 + Rs 1,30,800 = Rs 2,47,160)

Sum 28

LCM Ltd. purchased for cancellation its own 10,00,000, 9% Debentures of Rs500 each at Rs 480 each. Record necessary journal entries.

Solution:

Books of LCM Ltd.
Journal

Date	Particulars	L.F.	Debit Amount (Rs)	Credit Amount (Rs)
	Own Debentures A/c Dr.		48,00,00,000	
	To Bank A/c			48,00,00,000
	(Purchased its own debentures @ Rs 480 each)			
	9% Debenture A/c Dr.		50,00,00,000	
	To Own Debenture			48,00,00,000
	To Profit on cancellation of debentures A/c			2,00,00,000
	(Own debenture purchased being cancelled)			
	Profit on cancellation of debentures A/c Dr.		2,00,00,000	
	To Capital Reserve			2,00,00,000
	(Profits on cancellation of debentures transferred to capital reserve)			

Sum 29

The following balances appeared in the books of Madhu Ltd. as on April 01,2013:

	(Rs)
12% Debentures	1,50,000
Debenture Redemption Fund	1,25,000
Debenture Redemption Fund Investments	1,25,000

The Debenture Redemption Fund Investments were represented by Rs 1,30,000, 9% Govt. Securities.

The annual instalment added to the fund was Rs 20,600. On March 31 2014, the bank balance before the receipt of interest on investments was Rs 40,000. On the date, all the investments were sold at 84% and the debentureswere duly redeemed.

Prepare Debentures Account, Debenture Redemption Fund Account, Debenture Redemption Fund Investment Account and Bank Account for 2013-2014. The company closes its books on March 31, every year.

Solution:

Books of Madhu Ltd.

Debenture Redemption Fund Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2014 Mar.31	Debenture Redemption Fund Investment (Loss on Sale)			2013 April 1	Balance b/d		1,25,000
Mar.31	General Reserve		15,800	2014 Mar.31	Interest on Debenture Redemption Fund Investment (9% on Rs 1,30,000)		11,700
	(Transfer)		1,41,500	Mar.31	Statement of profit and loss		20,600
			1,57,300				**1,57,300**

Debenture Redemption Fund Investment Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs)*
2013 April 01	Balance b/d (Face value Rs 1,30,000)		1,25,000	2014 Mar.31	Bank (84% of Rs 1,30,000)		1,09,200
					By Debenture Redemption Fund (Loss on Sale)		15,800
			1,25,000				**1,25,000**

Bank Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2014				2014			
Mar.31	Balance b/d		40,000	Mar.31	Debenture		1,50,000
	Interest on D.R.F Investment		11,700	Mar.31	Balance c/d		10,900
Mar.31	Debenture Redemption Fund Investment (Sales Proceeds)		1,09,200				
			1,60,900				**1,60,900**

12% Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2014 Mar.31	Bank A/c		1,50,000	2013 April 31	Balance b/d		1,50,000
			1,50,000				**1,50,000**

Working Notes :

1. Interest on Debenture Redemption Fund Investments of 1,30,000 at 9% will beRs 11,700.
2. Investments realised at 84%. Hence, the investments of Rs 1,30,000 will realise Rs 1,09,200.

Sum 30

The following balances appeared in the books of a company on January 01, 2014:

12% Debentures	Rs 4,00,000
12% Debentures Sinking Fund	Rs 3,00,000
12% Debentures Sinking Fund Investment	Rs 3,00,000

(Represented by 10%, Rs 4,00,000 secured Bonds of Govt. of India) Annual contribution to the sinking fund was Rs 60,000 made on December 31 each year. On December 31, 2014, balance at Bank was Rs 3,00,000 after receipt of interest on Debentures Sinking Fund Investment. The company sold the investment at a loss of 18% and the debentures were paid off. You are required to prepare the following accounts for the year 2014:

(i) Debentures account,

(ii) Debentures sinking fund account,

(iii) Debentures sinking fund investment account,

(iv) Bank account.

Solution:

12% Debentures Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2014 Dec.31	Bank		4,00,000	2014 Jan.01	Balance b/d		4,00,000
			4,00,000				**4,00,000**

12% Debenture Sinking Fund Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2014				2014			
Dec.31	General Reserve		4,28,000	Jan.01	Balance b/d		3,00,000
				Dec.31	Statement of profit and loss		60,000
				Dec.31	Interest on Debenture Sinking Fund Investment		40,000
				Dec.31	Debenture Fund Investment		28,000
			4,28,000				**4,28,000**

12% Debenture Sinking Fund Investment Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2014				2014			
Jan.01	Balance b/d		3,00,000	Dec.31	Bank		3,28,000
Dec.31	To Debenture Sinking Fund		28,000				
			3,28,000				**3,28,000**
	(Profit Transfers)						

Bank Account

Dr. *Cr.*

Date	*Particulars*	*J. F.*	*Amount (Rs)*	*Date*	*Particulars*	*J. F.*	*Amount (Rs)*
2014				2014			
Jan.1	Balance b/d balance includes Rs 40,000, interest @ 10% on Rs 4,00,000)		3,00,000	Dec.31	12% Debentures		4,00,000
					Balance c/d		2,28,000
Dec.31	12% Debentures Sinking Fund Investment		3,28,000				
			6,28,000				**6,28,000**

UNIT - 3

Financial Statements of a company

Having understood how a company raises its capital, we have to learn the nature, objectives and types of financial statements it has to prepare including their contents, format, uses and limitations. The financial statements are the end products of accounting process. They are prepared following accounting policies consistently accounting standards prescribed in the Companies Act and accounting concepts, principles, procedures and also the legal environment in which the business organizations operate. These statements are the outcome of the summarizing process of accounting and are, therefore, the sources of information on the basis of which conclusions are drawn about the profitability and the financial position of a company. Hence, they need to be arranged in a proper form with suitable contents so that the shareholders and other users of financial statements can easily understand and use them in their economic decisions in a meaningful way.

Meaning of Financial Statements

Financial statements are the basic and formal annual reports through which the corporate management communicates financial information to its owners and various other external parties which include investors, tax authorities, government, employees, etc. These refer to: the balance sheet (position statement) as at the end of accounting period, the statement of profit and loss of a company and the cash flow statement.

Nature of Financial Statements

The chronologically recorded facts about events expressed in monetary terms for a defined period of time are the basis for the preparation of periodical financial statements which reveal the financial position as on a date and the financial results obtained during a period. The American Institute of Certified Public Accountants states the nature of financial statements as, "the statements prepared for the purpose of presenting a periodical review of report on progress

by the management and deal with the status of investment in the business and the results achieved during the period under review. They reflect a combination of recorded facts, accounting principles and personal judgements".

The following points explain the nature of financial statements:

1. *Recorded Facts:* Financial statements are prepared on the basis of facts in the form of cost data recorded in accounting books. The original cost or historical cost is the basis of recording transactions. The figures of various accounts such as cash in hand, cash at bank, trade receivables, fixed assets, etc., are taken as per the figures recorded in the accounting books. The assets purchased at different times and at different prices are put together and shown at costs. As these are not based on market prices, the financial statements do not show current financial condition of the concern.
2. *Accounting Conventions:* Certain accounting conventions are followed while preparing financial statements. The convention of valuing inventory at cost or market price, whichever is lower, is followed. The valuing of assets at cost *less* depreciation principle for balance sheet purposes is followed. The convention of materiality is followed in dealing with small items like pencils, pens, postage stamps, etc. These items are treated as expenditure in the year in which they are purchased even though they are assets in nature. The stationery is valued at cost and not on the principle of cost or market price, whichever is less. The use of accounting conventions makes financial statements comparable, simple and realistic.
3. *Postulates:* Financial statements are prepared on certain basic assumptions (pre-requisites) known as postulates such as going concern postulate, money measurement postulate, realisation postulate, etc. Going concern postulate assumes that the enterprise is treated as a going concern and exists for a longer period of time. So the assets are shown on historical cost basis. Money measurement postulate assumes that the value of money will remain the same in different periods. Though there is drastic change in purchasing power of money, the assets purchased at different times will be shown at

the amount paid for them. While, preparing statement of profit and loss the revenue is included in the sales of the year in which the sale was undertaken even though the sale price may be received over a number of years. The assumption is known as realisation postulate.

4. *Personal Judgements:* Under more than one circumstance, facts and figures presented through financial statements are based on personal opinion, estimates and judgements. The depreciation is provided taking into consideration the useful economic life of fixed assets. Provisions for doubtful debts are made on estimates and personal judgements. In valuing inventory, cost or market value, whichever is less is being followed. While deciding either cost of inventory or market value of inventory, many personal judgements are to be made based on certain considerations. Personal opinion, judgements and estimates are made while preparing the financial statements to avoid any possibility of over statement of assets and liabilities, income and expenditure, keeping in mind the convention of conservatism.

Thus, financial statements are the summarised reports of recorded facts and are prepared the following accounting concepts, conventions, accounting policies, accounting standards and requirements of Law.

3.2 Objectives of Financial Statements

Financial statements are the basic sources of information to the shareholders and other external parties for understanding the profitability and financial position of any business concern. They provide information about the results of the business concern during a specified period of time in terms of assets and liabilities, which provide the basis for taking decisions. Thus, the primary objective of financial statements is to assist the users in their decision-making. The specific objectives include the following:

1. To provide information about economic resources and obligations of a business: They are prepared to provide adequate, reliable and periodical information about economic resources and obligations of a business firm to investors and other external parties who have limited authority,

ability or resources to obtain information.

2. To provide information about the earning capacity of the business: They are to provide useful financial information which can gainfully be utilised to predict, compare and evaluate the business firm's earning capacity.
3. To provide information about cash flows: They are to provide information useful to investors and creditors for predicting, comparing and evaluating, potential cash flows in terms of amount, timing and related uncertainties.
4. To judge effectiveness of management: They supply information useful for judging management's ability to utilise the resources of a business effectively.
5. Information about activities of business affecting the society: They have to report the activities of the business organisation affecting the society, which can be determined and described or measured and which are important in its social environment.
6. Disclosing accounting policies: These reports have to provide the significant policies, concepts followed in the process of accounting and changes taken up in them during the year to understand these statements in a better way.

3.3 Types of Financial Statements

The financial statements generally include two statements: balance sheet and statement of profit and loss which are required for external reporting and also for internal needs of the management like planning, decision-making and control. Apart from these, there is also a need to know about movements of funds and changes in the financial position of the company. For this purpose, a cash flow statement is prepard.

Every company registered under The Companies Act 2013 shall prepare its balance sheet, statement of profit and loss and notes to account thereto in accordance with the manner prescribed in the revised Schedule III to the Companies Act, 2013 to harmonise the disclosure requirement with the

accounting standards and to converge with new reforms.

Balance Sheet as at 31st March, 20.....

Particulars	Note No.	Figure as at the end of Current reporting period	Figure as at the end of Previous reporting period
I. EQUITY AND LIABILITIES			
1) Shareholder's Funds			
(a) Share Capital			
(b) Reserves and Surplus			
(c) Money received against share warrants			
2) Share Application money pending allotment			
3) Non-current Liabilities			
(a) Long term borrowings			
(b) Deferred tax liabilities (net)			
(c) Other long term liabilities			
(d) Long term provisions			
4) Current Liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
Total			
II. ASSETS			
1) Non-Current Assets			
(a) Fixed assets			
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital work-in-progress			
(iv) Intangible assets under development			
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long-term loans and advances			
(e) 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			
See accompanying notes to the financial statements			
NOTES:			

Exhibit. 3.1: Form of Balance Sheet

Important Features of Presentation

1. It applies to all Indian companies preparing financial statement as per Schedule III to the Comapnies Act, 2013.
2. It does not apply to (i) Insurance or Banking Company, (ii) Company for which a form of balance sheet or income statement is specified under any other Act.
3. Accounting standards shall prevail over Schedule III of the Companies Act, 2013.
4. Disclosure on the face of the financial statements or in the notes are essential and mandatory.
5. Terms in the revised Schedule III will carry the meaning as defined by the applicable accounting standards.
6. Balance to be maintained between excessive details that may not assist users of financial statements and not providing important information.
7. Current and non-current bifurcation of assets and liabilities is applicable.
8. Rounding off requirements is mandatory (refer box 1).
9. Vertical format for presentation of financial statement is prescribed (refer Exhibit 3.1).
10. Debit balance in the statement of profit and loss to be disclosed as negative figure under the head "Surplus".
11. Mandatory disclosure for share application money pending allotment.
12. 'Sundry Debtors' and 'Sundry Creditors' replaced by terms 'Trade Receivables' and 'Trade Payables'.

Shareholders Fund

The shareholders' funds are sub-classified on the face of the balance sheet.

a) Share Capital
b) Reserves and Surplus
c) Money received against Share Warrants

Share Capital

Disclosures relating to share capital are to be given in notes to accounts. The following additions/modifications are significant:

a) For each class of shares, recognition of the number of shares outstanding at the beginning and at the end of the reporting period is required.

b) The rights, preferences and restrictions attached to each class of shares including restrictions on the distribution of dividends and repayment of capital.

c) In order to bring clarity regarding the identity of ultimate owners of the company:

   i) Disclosure of shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by subsidiaries or associates of holding company or the ultimate holding company in aggregate.

   ii) Disclosure of shares in the company held by each shareholder holding more than 5% shares specifying the number of shares held.

   iii) Disclosure of the following for the period of 5 years immediately preceding the date of the balance sheet:

   - Aggregate number and class of shares allotted as fully paid up pursuant to contracts without payment being received in cash.
   - Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
   - Aggregate number and class of shares bought back.

This may be noted that the information of shareholders funds are presented on the face of financial statements limited only to broad and significant items. Details are given in Notes to Accounts.

d) For each class of share capital:

   i) The number and amount of share authorised.

   ii) The number of shares issued, subscibed, fully paid and subscribed but not fully paid.

   iii) Par value per share.

   iv) Reconciliation of the number of shares outstanding at the beginning and end of the accounting period.

v) Rights, preferences and restrictions attaching each class of shares including restrictions on the distribution of dividends and repayment of capital.

vi) Aggregate number of shares with respect to each class in the company held by its holding company, its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company.

vii) Shares reserved for issue under options and contracts/ commitments for the sale of shares/disinvestment, including terms and amount.

viii) For a period of 5 years immediately proceeding the date at which balance sheet in prepared for:

(a) Shares reserved under contracts/commitments.

(b) Number and class of shares bought back.

(c) Number and class of shares allotted for consideration other than cash and bonus shares.

ix) Terms of any securities convertible into equity/preference shares issued along with earliest date of conversion in descending order, starting from the farthest such date.

x) Calls unpaid (aggregate).

xi) Forfeited shares (amout originally paid up).

Reserve and Surplus

Reserves and Surplus are required to be classified as:

i) Capital Reserve

ii) Capital Redemption Reserve

iii) Securities Premium Reserve

iv) Debenture Redemption Reserve

v) Revaluation Reserve

vi) Share Options Outstanding Account

vii) Other Reserves (Specifying nature and purpose)

viii) Surplus: Balance in statement of profit and loss; disclosing allocations and Appropriation such as dividend, bonus shares, transfer to/from

reserve, etc.

Significant additions/modifications regarding disclosure of reserve and surplus are as follows:

a) A reserve specifically represented by earmarked investments shall be termed as “Fund”.

b) ‘Debit’ balance of statement of profit and loss shall be shown as a negative figure under ‘Surplus’ head.

c) The balance of “Reserve and Surplus” after adjusting negative balance of Surplus, if any, shall be shown under “Reserve and Surplus” read even if the resulting figure is ‘negative’.

d) Share options outstanding account has been recognised as a separate item under ‘Reserve and Surplus’. ICAI’s Guidance Note on Accounting for Employee share based payments requires a credit balance in the *‘Stock option outstanding Account’* to be disclosed in balance sheet under separate heading’ between share capital and reserves and surplus as a part of shareholders fund.

Money Received against share warrants

It is the amount received by the company which are converted into shares at a specified date on a specified rate. The instrument issued against the amount so received as share warrants.

Money received against share warrants’ to be disclosed as a separate line item under ‘shareholder’s fund’.

Illustration 1

Dinkar Ltd. has an authorised capital of Rs. 50,00,000 divided into equity shares of Rs. 100 each. The company invited applications for 40,000 shares, applications for 36,000 shares were received. All calls were made and duly received except for 500 shares on which the final call of Rs. 20 was not received. The company forfeited 200 shares on which final call was not received. Show how share capital will appear in the balance sheet of the company. Also prepare ‘Notes to Accounts’ for the same.

Solution:

Books of Dinkar Limited

Balance Sheet as at ....(Date)

Particulars	*Note No.*	*Amount (Rs.)*

I. Equity and Liabilities 1. Shareholders' funds a) Share capital	1	**35,90,000**

Particulars	*Amount (Rs.)*	*Amount (Rs.)*
1. Share capital		
Authorised share capital		
50,000 equity shares of Rs. 100 each		50,00,000
Issued capital		
40,000 equity shares of Rs. 100 each		40,00,000
Subscirbed and fully paid up capital		
35,500 equity shares of Rs. 100 each fully paid		35,50,000
Subscirbed but not fully paid-up capital		
300 equity shares of Rs. 100 each fully called up	30,000	
Less: Calls-in-arrears (300 20)	6,000	
	24,000	
Add: Share forfeiture A/c (200 shares Rs. 80)	16,000	40,000
		35,90,000

criteria for defining current assets and liabilities has been clearly spelled out with non-current assets and liabilities being the residual items.

Current/Non-current distinction

An item is classified as current:

- if it is involved in entity's operating cycle or,
- is expected to be realised/settled within twelve months or,
- if it is held primarily for trading or,
- is cash and cash equivalent or,
- if entity does not have on unconditional rights to defer settlement of liability for atleast 12 months after the reporting period,
- Other assets and liabilities are non-current.

Illustration 2

Show the following items in the balance sheet of Amba Ltd. as on March 31,

2017:	Rs.
8% Debentures	10,00,000
Equity share capital	50,00,000
Securities premium	20,000
Preliminary expenses	40,000
Statement of Profit & Loss (cr.)	1,50,000

Loose tools	20,000
Bank balance	60,000
Cash in hand	38,000

Solution:

Books of Amba Ltd.

***Balance Sheet as at March 31, 2017**

Particulars		*Note No.*	*Amount (Rs.)*
I. Equity and Liabilities			
1. Shareholders' Funds			
a) Share capital			50,00,000
b) Reserve and surplus		1	1,30,000
2. Non-current Liabilities			
a) Long-term borrowings		2	10,00,000
II. Assets			
Current assets			
a) Inventories		3	20,000
b) Cash and cash equivalents		4	98,000
c) Other current assets		5	10,000

* Relevant items only

Notes to Accounts

Particulars		*Amount (Rs.)*	*Amount (Rs.)*
1. Reserve and surplus			
Securities premium	20,000		
Less: Preliminary expenses	(40,000)		
		(20,000)	
Statement of profit and loss		1,50,000	**1,30,000**
2. Long-term borrowings			
8% debentures			10,00,000
3. Inventory			
Loose tools			20,000
4. Cash and cash equivalents			
Bank balance		60,000	
Cash in hand		38,000	**98,000**
5. Other current assets			
Discount on issue of 8% debentures			**10,000**
(of Rs. 40,000)			

Important points:

- Preliminary expenses are to be written-off completely in the year in which such expenses are incurred. They should be written-off first from securities premium and the balance if any, from statement of profit & loss.

- Borrowing costs such as discount on issue of debentures should be written-off in the same year in which debuntures are issued.

Share application money pending allotment

Share application money not exceeding the issued capital and to the extent non-refundable shall be classified as non-current. It will be shown on this face of balance sheet as share application money pending allotment.

Borrowings

Total borrowings are categorised into long-term borrowings, short-term borrowings and current maturities to long-term debt.

(i) Loans which are repayable in more than twelve months/operating cycle are classified as long-term borrowings on the face of balance sheet.

(ii) Loans repayable on demand or whose original tenure is not more than twelve months/operating cycle are classified as short-term borrowings on the face of balance sheet.

(iii) Current maturities to long-term loan include amount repayable within twelve months/operating cycle under other current liabilities with Note to Account.

Deferred tax assets/liabilities are always non-current. This is in accordance with Schedule III of the Companies Act.

Trade payables

Sundry creditors have been replaced with the term Trade payables and are classified as current and non-current. Trade payables to be settled beyond 12 months from the date of balance sheet or beyond the operating cycle are classified under "other long-term liabilities" with Note to Account. For example, purchase of goods and services in normal course of business. The balance of trade payables are classified as current liabilities on the face of balance sheet.

Proposed Dividend

Proposed dividend is proposed by the Board of Directors and declared (approved) by the shareholders in their Annual General Meeting. Board of Directors propose the dividend after the annual accounts for the year have

been prepared. Annual General Meeting of the shareholders is held thereafter meaning it is held in the next financial year.

Shareholders may reduce the amount of proposed dividend but cannot increase it. Since declaration of proposed (final) dividend is contingent upon shareholders approval, Proposed dividend is shown as contingent liability.

AS-4, Contingencies and Events Occurring after the Balance Sheet Date prescribes that proposed dividend will be shown in the Notes to Accounts.

After the Proposed dividend is declared by the shareholders, it becomes a liability for the company and is accounted in the books. As a consequence, proposed dividend of previous year will be declared (approved) by the shareholders in the current year and this declared (approved) proposed dividend will be accounted during the year. Proposed dividend for the current year will be relevant for the next financial year.

Briefly, proposed dividend of previous year will be accounted in the current year after it is declared (approved) by the shareholders in their annual general meeting.

Provisions

The amount of provision settled within 12 months from balance sheet date or within operating cycle period from date of its recognition is classified as short term provisions and shown under current liabilities on the face of balance sheet. Others are depicted as long-term provisions under non-current liabilities on the face of balance sheet.

Fixed assets

There is no change in the treatment of fixed assets. Both tangible and intangible assets are non-current. This may also be noted if the useful life of the asset is less than 12 months, it will still fall under non-current.

Investments

Investments are also classified into current and non-current categories. Investments expected to realise within twelve months are considered as current investments under current assets. Others are classified as non-current

investments under non-current assets. Both are however shown on the face of the balance sheet.

Inventories

All inventories are always treated as current.

Trade receivables

Trade receivables realised beyond twelve months from reporting date/ operating cycle starting from the date of their recognition are classified as "Other non-current assets" under the head non-current assets with Note to Accounts. For example, sale of goods or services rendered in normal course of business. Others are classified as current assets and shown on the face of the balance sheet.

Cash and cash equivalent

It is always current however, amounts which qualify as cash and cash equivalents as per AS-3 is shown here. The supremacy is accorded to AS over Schedule III, cash and cash equivalents are to the disclosed in accordance to the prescribed standard.

Illustration 3

Show the following items in the balance sheet of Sunfill Ltd. as at March 31, 2017:

Particulars	Amount (Rs.)
General Reserve (since 31 March 2012)	5,00,000
Statement of profit & loss (debit balance) for 2016–17	(3,00,000)

Solution:

Books of Sunfill Ltd.
Balance Sheet as at March 31, 2017

Particulars	Note No.	31st March 2017 *(Rs.)*	31st March 2016 *(Rs.)*
I. Equity and Liabilities			
1. Shareholders' Funds			
Reserve and surplus	1	2,00,000	5,00,000

Notes to Accounts

Particulars	*Amount (Rs.)*
1. Reserve and surplus	
General Reserve (1 April, 2016)	5,00,000
Less: Statement of profit and loss (Dr. balance)	3,00,000
	2,00,000

Illustration 4

Show the following items in the balance sheet of Avalon Ltd., as at March 31, 2017:

	(Rs.) in Lakh
General Reserve (since 31 March 2016)	5
Statement of Profit & Loss (Debit Balance) for 2016–17	(8)

Particulars	*Note No.*	*31 March 2017 (Rs.)*
I. Equity and Liabilities		
1. Shareholders' Funds		
a) Reserve and Surplus	1	(3,00,000)

Particulars	*Amount (Rs.)*
1. Reserve and Surplus	
i) General reserve (1 April, 2012)	**5,00,000**
ii) Less: Statement of profit and loss	**(8,00,000)**
(debit balance)	(3,00,000)

Illustration 5

Arushi Ltd. issued 5,000, 10% debentures of Rs. 100 each at par but redeemable at a premium of 5% after 5 years. Show these items in the balance sheet of the company.

Solution:

Particulars		*Note No.*	*Amount (Rs.)*
I. Equity and Liabilities			
1. Shareholders' Funds			
Reserve and Surplus			(25,000)
a) Long term borrowings		2	5,00,000
b) Other long-term liabilities		3	25,000
Total			**5,00,000**
II. Asset			
1. Current Assets			
a) Cash and Cash Equivalents			5,00,000
Total			**5,00,000**

Notes to Accounts

Particulars	Amount (Rs.)
1. Reserves and Surplus i.e. Balance in Statement of Profit & Loss	(25,000)
2. Long Terms Borrowings	
5000, 10% debenture Rs. 100 each	5,00,000
3. Other long term liabilities	25,000
Premium on Redemption of Debentures	
4. Cash and Cash Equivalents	
Cash at bank.	
	5,00,000

Illustration 6

From the given particulars of Shine and Bright Co. Ltd., as at March 31, 2017, prepare balance sheet in accordance to the Schedule III:

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Preliminary expenses	2,40,000	Goodwill	30,000
10% Debentures	2,00,000	Loose Tools	12,000
Stock in trade	1,40,000	Motor vehicles	4,75,000
Cash at bank	1,35,000	Provision for tax	16,000
Bills receivables	1,20,000		

***Solution*:**

Book of Shine and Bright Ltd.
Balance Sheet as at March 31, 2017

Particulars	*Note No.*	*Figure as at the end of current reporting period*	*Figure as at the end of previous reporting period*
I. Equity and Liabilities			
1. Non-current Liabilities			
a) Long-term borrowings	1	2,00,000	
2. Current liabilities			
a) Short-term provisions	2	16,000	
II. Assets			
1. Non-current assets			
a) Fixed assets			
Tangible assets	3	4,75,000	
Intangible assets	4	30,000	
2. Other non-current assets*	5	2,60,000	
Current assets			
a) Inventories	6	1,52,000	
b) Trade receivables	7	12,000	
c) Cash and cash equivalents		1,35,000	

Particulars		Amount (Rs.)
1. Long-term borrowings:		
10% debentures		2,00,000
2. Short-term provisions:		
Provision for taxation		16,000
3. Fixed assets:		
(i) Tangible assets		
Motor vehicles		4,75,000
(ii) Intangible assets		
Goodwill		30,000
4. Other non-current assets Preliminary		
expenses	2,40,000	
		2,40,000
5. Inventories		
Stock in trade	1,40,000	
Loose tools	12,000	1,52,000
6. Trade receivables		
Bills receivables		12,000
7. Cash & cash equivalents		
Cash at bank		1,35,000

Form of Statement of Profit and Loss

	Particulars	Note No.	Figure as at the end of Current reporting period	Figure as at the end of Previous reporting period
I	Revenue from operations			
II	Other income			
III	Total Revenue (I+II)			
IV	Expenses:			
	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			
	Finance costs			
	Depreciation and amortisation expense Other expenses			
	Total expenses			
V	Profit before extraordinary items and tax (III-IV)			
VI	Exceptional items			
VII	Profit before extraordinary items and tax (V-VI)			
VIII	Extraordinary items			
IX	Profit before tax (VII-VIII)			
X	Tax expense:			
	(1) Current tax			
	(2) Deferred tax			
XI	Profit/(Loss) for the period from continuing operations (IX-X)			
XII	Profit/(Loss) from discontinuing operations			
XIII	Tax expense of discontinuing operations			
XIV	Profit/(Loss) from Discontinuing operations (after tax) (XII-XIII)			
XV	Profit/(Loss) for the period (XI + XIV)			
XVI	Earnings per equity share:			
	(1) Basic			
	(2) Diluted			

Exhibit. 3.2: Form of Statement of Profit and Loss

The items of statement of profit and loss are discussed as follows:

1. Revenue from operations This includes:
   (i) Sale of products
   (ii) Sale of services
   (iii) Other operating revenues

In respect to a finance company, revenue from operations shall include revenue from interest, dividend and income from other financial services.

It may be noted that under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.

2. Other income
   (i) Interest income (in case of a company other than a finance company),
   (ii) Dividend income,
   (iii) Net gain/loss on sale of investments,
   (iv) Other non-operating income (net of expenses directly attributable to such income).
3. Expense

Expenses incurred to earn the income shown under various heads as discussed below:	
(a) Cost of Materials	It applies to manufacturing companies. It consists of raw materials and other materials consumed in manufacturing of goods.
(b)Purchase of Stock-in-trade	It means purchases of goods for the purpose of trading.
(c) Changes in inventories of finished goods, WIP and stock-in-trade	It is the difference between opening inventory (stock) of finished goods, WIP and stock-in-trade and closing inventory
(d)Employees benefit expenses	Expenses incurred on employees towards salary, wages, leave encashment, staff welfare, etc., are shown under this head. Employees benefit expenses may be further

	categorised into direct and indirect expenses.
(e) Finance cost	It is the expenses towards interest charges during the year on the borrowings. Only the interest cost is to be shown under this head. Other financial expenses such as bank charges are shown under "Other Expenses".
(f) Depreciation	Depreciation is the diminution in the value of fixed assets whereas amortisation is writing off the amount relating to intangible assets.
(g) Other expenses	All other expenses which do not fall in the above categories are shown under other expenses. Other expenses may further be categorised into direct expenses, indirect expenses and non-operating expenses.

3.4 Uses and Importance of Financial Statements

The users of financial statements include management, investors, shareholders, creditors, government, bankers, employees and public at large. Financial statements provide the necessary information about the performance of the management to these parties interested in the organisation and help in taking appropriate economic decisions. It may be noted that the financial statements constitute an integral part of the annual report of the company in addition to the directors report, auditors report, corporate governance report, and management discussion and analysis.

The various uses and importance of financial statements are as follows:

1. *Report on stewardship function:* Financial statements report the

performance of the management to the shareholders. The gaps between the management performance and ownership expectations can be understood with the help of financial statements.

2. *Basis for fiscal policies:* The fiscal policies, particularly taxation policies of the government, are related with the financial performance of corporate undertakings. The financial statements provide basic input for industrial, taxation and other economic policies of the government.

3. *Basis for granting of credit:* Corporate undertakings have to borrow funds from banks and other financial institutions for different purposes. Credit granting institutions take decisions based on the financial performance of the undertakings. Thus, financial statements form the basis for granting of credit.

4. *Basis for prospective investors:* The investors include both short-term and long-term investors. Their prime considerations in their investment decisions are security and liquidity of their investment with reasonable profitability. Financial statements help the investors to assess long- term and short-term solvency as well as the profitability of the concern.

5. *Guide to the value of the investment already made:* Shareholders of companies are interested in knowing the status, safety and return on their investment. They may also need information to take decision about continuation or discontinuation of their investment in the business. Financial statements provide information to the shareholders in taking such important decisions.

6. *Aids trade associations in helping their members:* Trade associations may analyse the financial statements for the purpose of providing service and protection to their members. They may develop standard ratios and design uniform system of accounts.

7. *Helps stock exchanges:* Financial statements help the stock exchanges to understand the extent of transparency in reporting on financial

performance and enables them to call for required information to protect the interest of investors. The financial statements enable the Stock brokers to judge the financial position of different concerns and take decisions about the prices to be quoted.

3.5 Limitations of Financial Statements

Though utmost care is taken in the preparation of the financial statements and provide detailed information to the users, they suffer from the following limitations:

1. *Do not reflect current situation:* Financial statements are prepared on the basis of historical cost. Since the purchasing power of money is changing, the values of assets and liabilities shown in financial statement do not reflect current market situation.
2. *Assets may not realise:* Accounting is done on the basis of certain conventions. Some of the assets may not realise the stated values, if the liquidation is forced on the company. Assets shown in the balance sheet reflect merely unexpired or unamortised cost.
3. *Bias:* Financial statements are the outcome of recorded facts, accounting concepts and conventions used and personal judgements made in different situations by the accountants. Hence, bias may be observed in the results, and the financial position depicted in financial statements may not be realistic.
4. *Aggregate information:* Financial statements show aggregate information but not detailed information. Hence, they may not help the users in decision-making much.
5. *Vital information missing:* Balance sheet does not disclose information relating to loss of markets, and cessation of agreements, which have vital bearing on the enterprise.
6. *No qualitative information:* Financial statements contain only monetary information but not qualitative information like industrial

relations, industrial climate, labour relations, quality of work, etc.

7. *They are only interim reports:* Statement of Profit and Loss discloses the profit/loss for a specified period. It does not give an idea about the earning capacity over time similarly, the financial position reflected in the balance sheet is true at that point of time, the likely change on a future date is not depicted.

Managerial remuneration meaning

Managerial remuneration refers to the compensation paid to managerial personnel for their services to a company. This includes not only the base salary but also various additional benefits and perks, often referred to as perquisites. The remuneration is designed to reward managers for their contributions to the organization and can vary based on the company's policies and the individual's role within the company

The features of managerial remuneration typically include:

Base salary:

A fixed amount of money paid to executives regularly, such as monthly or annually.

Performance-based bonuses:

Additional pay-outs tied to specific performance metrics, such as company profits, sales growth, or individual achievements.

Stock options:

The right to purchase company stock at a predetermined price, which can provide executives with a financial stake in the company's success.

Benefits:

Non-monetary compensation, such as health insurance, retirement plans, and other perks.

Alignment with company goals:

The compensation package should be designed to align the interests of executives with those of the company, by tying pay to performance and linking bonuses to specific metrics.

Market competitiveness:

The package should be competitive with industry standards and the pay of other executives in similar roles.

Performance-based evaluations:

The performance of executives should be regularly evaluated and the compensation package should be adjusted accordingly.

Transparency and communication:

The process and reasoning behind executive compensation packages should be transparent and communicated to shareholders and other stakeholders.

Computation of Net Profit

One of the biggest issues for the companies is the calculation of "Net Profit" as put forward in the Companies Act, 2013 for calculating the prescribed amount of Managerial remuneration. There should not be any confusion as the Act is quite clear through Section 198 of the Companies Act, 2013 which defines the calculation of Net Profit of the company in any financial year for the purpose of section 197. Section 197 of the Act uses the term 'Net Profits' in the provision which, means that PAT or Profit After Tax may be used for calculating Managerial remuneration. Section 198 deals with calculation of profit for managerial remuneration and requires specific addition/deduction to be made in the net profit for the year.

Relevant Provision

Section 198(1) In computing the net profits of a company in any financial year for the purpose of section 197,—

"(*a*)	credit shall be given for the sums specified in sub-section (2), and credit shall not be given for those specified in sub-section (3); and
(*b*)	the sums specified in sub-section (4) shall be deducted, and those specified in sub-section (5) shall not be deducted".

Net profit after tax is taken as base and, accordingly, the adjustments need to

be considered for allowing and disallowing the expenses as per section 198 of the Act.

Section 198(2) in making the computation aforesaid, credit shall be given for the bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf by any Government, unless and except in so far as the Central Government otherwise directs. This means that all above said amount will be the part of net profit or we can say that the credit of these shall we added in profit after tax.

Profit after Tax

Add: bounties and subsidies received from any Government

Section 198(3) in making the computation aforesaid, credit shall not be given for the following sums, which means that the said terms shall not be the part of profit after tax and, therefore, will be less from the net profit., i.e.,

Profit after Tax

Less: Credits Disallowed

(*a*)	Premium on shares or debentures
(*b*)	Profit on sale of forfeited shares
(*c*)	Profit on sale of immovable property (Sale Value of Immovable Property–Original Cost)
(*d*)	Surplus in P&L on measurement of asset or liability at fair value

Section 198 (4) Most of the corporates misinterpreted sub-section (4) for calculating the profit. As it mentions many sums which should be deducted whiling computing the net profit of the company. In making the computation aforesaid, the following sums shall be deducted, namely:—

Profit after Tax

Less: Expenses Allowed

(*a*)	all the usual working charges;
(*b*)	directors' remuneration;
(*c*)	bonus or commission paid or payable to any member of the company's staff,

(*d*)	any tax notified by the Central Government;
(*e*)	any tax on business profits imposed for special reasons
(*f*)	interest on debentures issued by the company;
(*g*)	interest on mortgages and loans executed by the company
(*h*)	interest on unsecured loans and advances;
(*i*)	expenses on repairs immovable or movable property,
(*j*)	outgoings inclusive of contributions made under section 181;
(*k*)	depreciation to the extent specified in section 123;
(*l*)	any compensation or damages to be paid by virtue of any legal liability,
(*m*)	any sum paid by way of insurance against the risk of meeting any liability
(*n*)	debts considered as bad and written off or adjusted during the year

We shall mainly focus on following four points in this article

(*a*)	**all the usual working charges what are those charges**
(*b*)	**director's remuneration**
(*c*)	**bonus or commission paid to any member of the company staff**

Depreciation to the extent specified in the section 123

Usual working charges mean all other charges which are essential for day-to-day working of the organisation. These charges should be deducted while making the computation of net profit for the purpose of managerial remuneration.

Director's remuneration, means the salaries and bonuses paid out to directors; directors of a company are compensated, either through fees, salary, or the use of the company's property, with approval from the shareholders and board of directors.

Bonus and commission paid to the any staff of the company as services rendered as per terms of appointment of a company are allowable as business expenditures.

The Hon'ble Delhi High Court in the case of *AMD Mertplast Ltd.* It was a term of an employment on the basis of which he had rendered services. Thus, the amount of commission and bonus paid to the Managing Director was an allowable business expenditure.

Depreciation specified in section 123, though section 123 of the Act talks about the Declaration of the dividend but section 123 sub-section (1) clause (*a*) says that out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or out of both.

When we read the sub-section (2) of section 123 it says that for the purposes of clause (*a*) of sub-section (1) of section 123, depreciation shall be calculated in accordance with the provisions of Schedule II.

Thus, in calculating the depreciation we need to understand the Schedule II of the Act which describes the method to amortization of the assets, method and rates of depreciation. In nutshell we can say that depreciation needs to be calculated as per Schedule II and that amount of depreciation needs to be less than profit after tax for the purpose of calculating the managerial remuneration.

Hence, in this situation, as provided by the Schedule V of the Companies Act, 2013, the **managerial remuneration shall not exceed the higher limit of the following:**

Sl. No	**Where the effective capital is (in rupees)**	**Limit of yearly remuneration payable shall not exceed in case of a managerial person (in Rupees)**	**Limit of yearly remuneration payable shall not exceed in case of other director (in rupees)**
(i)	Negative or less than 5 crores.	60 lakhs	12 lakhs
(ii)	5 crores and above but less than 100 crores.	84 lakhs	17 lakhs

(iii)	100 crores and above but less than 250 crores.	120 lakhs	24 lakhs
(iv)	250 crores and above.	120 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores:	24 Lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores:

UNIT – IV
VALUATION OF SHARES AND GOODWILL

What is Share Valuation?

Valuation of shares is the process of knowing the value of company"s shares. Share valuation is done based on quantitative techniques and share value will vary depending on the market demand and supply. The share price of the listed companies which are traded publicly can be known easily. But w.r.t private companies whose shares are not publicly traded, valuation of shares is really important and challenging.

When is Valuation of shares required?

Listed below are some of the instances where valuation of shares is important:

- One of the important reason is when you are about to sell your business and you wanted to know your business value
- When you approach your bank for a loan based on shares as a security
- Merger, acquisition, reconstruction, amalgamation etc – valuation of shares is very important
- When your company shares are to be converted i.e. from preference to equity
- Valuation is required when implementing an employee stock ownership plan (ESOP)
- For tax assessments under the wealth tax or gift tax acts
- In case of litigation, where share valuation is legally required
- Shares held by an Investment company
- Compensating the shareholders, the company is nationalized

Sometimes, even publicly traded shares have to be valued because the market quotation may not show the true picture or large blocks of shares are under transfer etc.

How to choose the share valuation method?

There are various reasons for adopting a particular method for share valuation; it generally depends upon the purpose of valuation. Using a combination of methods generally provides a more reliable valuation. Let"s see under each approach what the main reason is:

1. Assets Approach

If a company is a capital-intensive company and invested a large amount in capital assets or if the company has a large volume of capital work in progress then asset-based approach can be used. This method is also applicable for valuing the shares during amalgamation, absorption or liquidation of companies.

2. Income Approach

This approach has two different methods namely Discounted Cash Flow (DCF) or Price Earning Capacity (PEC) method. DCF method uses the projection of future cash flows to determine the fair value and if this data is reasonably available, DCF method can be used. PEC method uses historical earnings and if an entity is not in the business for a long time and just started its operations, then this method cannot be applied.

3. Market Approach

Under this approach, the market value of the shares is considered for valuation. However, this approach is feasible only for listed companies whose share prices can be obtained in the open market. If there are set of peer companies which are listed and engaged in the similar business, then such company‟s share public prices can also be used.

What are Methods of Share Valuation?

There is no one valuation method that will fit any purpose, hence there are various methods of share valuation depending upon the purpose, data availability, nature and volume of the company etc.

1. Asset-based

This approach on based on the value of company‟s assets and liabilities which includes intangible assets and contingent liabilities. This approach may be very useful to manufacturers, distributors etc where a huge volume of capital assets are used. This approach is also used as a reasonableness check to confirm the conclusions derived under the income or market approaches.

Here, the company‟s net assets value is divided by the number of shares to arrive at the value of each share. Following are some of the important points to be considered while valuing of shares under to this method:

- All the asset base of the company including current assets and liabilities such as receivables, payables, provisions should be considered.
- Fixed assets have to be considered at their realizable value.
- Valuation of goodwill as a part of intangible assets is important
- Even unrecorded assets and liabilities to be considered
- The fictitious assets such as preliminary expenses, discount on issue of shares and debentures, accumulated losses etc. should be eliminated.

For determination of the net value of assets, deduct all the external liabilities from the total asset value of the company. The net value of assets so determined has to be divided by the number of equity shares for finding out the value of the share. The formula used is as follows:

$$Value\ per\ share = \frac{\text{Net Assets} - \text{Preference share Capital}}{\text{Number of Equity Shares}}$$

2. Income-based

This approach is used when the valuation is done for a small number of shares. Here, the focus is on the expected benefits from the business investment i.e what the business generates in the future. A common method used is the estimate of a business‟s value by dividing its expected earnings by a capitalization rate. There are two other methods used such as DCF and PEC. PEC can be used by an established entity and newly started business or companies with volatile short-term earnings expectations can use the more complex analysis such as discounted cash flow analysis.

Value per share is calculated on the basis of profit of the company available for distribution. This profit can be determined by deducting reserves and taxes from net profit. Listed below are the steps to determine the value per share under the income-based approach:

- Obtain the company‟s profit (available for dividend)
- Obtain the capitalized value data
- Calculate the share value (Capitalized value/ Number of shares)

Capitalized Value is calculated as follows:

$$Capitalized\ value = \frac{\text{Profit available for equity dividend}}{\text{Normal Rate of Return}} X\ 100$$

3. Market-based

The market-based approach generally uses the share prices of comparable public traded companies and the asset or stock sales of comparable private companies. Data related to private companies can be obtained from various proprietary databases available in the market. What is more important is how to choose the comparable companies – a lot of pre-conditions to be kept in mind while selecting such as nature and volume of the business, industry, size, financial condition of the comparable companies, the transaction date etc.

There are two different methods when using the yield method (Yield is expected rate of return on an investment) they are explained below:

1. Earning Yield

Shares are valued on the basis of expected earning and the normal rate of return. Under this method, value per share is calculated using the below formula:

$$\text{Expected rate of Earning} = \frac{\text{Profit after tax}}{\text{Equity Share paid up value}} \text{ X 100}$$

$$\text{Value per share} = \frac{\text{Expected rate of earning}}{\text{Normal rate of return}} \text{ X Paid up Equity Value}$$

2. Dividend Yield

Under this method, shares are valued on the basis of expected dividend and the normal rate of return. The value per share is calculated by applying following formula:

Expected rate of dividend = (profit available for dividend/paid up equity share capital) X 100

$$Expected\ rate\ of\ Dividend = \frac{\text{Profit available for Dividend}}{\text{Equity Shares paid up value}} X100$$

Factors affecting valuation of shares:

Demand and supply

Demand and supply of securities influence price of securities. If the demand of securities is more than the supply (buyers are more than the sellers), prices of securities increase. On the other hand if the demand of securities is less than the supply (buyers are less than the sellers), prices of securities decrease.

2. Bank rate

In case of lower bank rate (lower interest rate), the demand for funds would be higher and the demand for securities would he high. Whereas in case of higher bank rate (high interest rate). the demand for funds would be lower and therefore the demand for securities would be lower.

3. Market players

Security prices are influenced by the market players. If the number of bulls are more than the bears, then the prices of securities would increase. On the other hand, if the bears are more than the bulls, the prices of securities would decline.

4. Dividend announcements

Dividends act as a signalling device for share price movement. Dividend announcements influence share prices. If companies announce dividends, generally share prices of those companies tend to increase. An important point to note is, if the rate of dividend announced is less than what was expected by investors, share prices would decline, whereas if they are up to are more than expectations. share prices would increase.

5. Management profile

Management profile significantly influences success of companies and therefore they have an important influence on share prices. If the management comprises of educated, experienced professionals with a successful track record then share prices would be higher. In case the company is taken over by a management having a poor reputation then the share prices would fall.

6. Trade cycle

Trade cycles refer to cyclical fluctuations in economic activity. During boom conditions the share prices would be at their peak and during depression they would be at their lowest point. Share prices would gradually increase during recovery conditions and would fall during conditions of recession.

7. Speculation

In case speculation in the market is high or in case speculation in a stock is high, then the price of that share would be showing high fluctuations. In case speculation is at a low level then the fluctuations in share price would be lower.

8. Political factors

Political factors such as ideology of the party in power, policies of the government, relations with other countries influence share prices. For e.g. when the UPA government won elections, share prices fell to a great extent because it was felt that the government policies would be influenced by the communist parties.

9. Industrial relations

In case there is good relationship between the workers and the management of a company, the productivity would be high leading to better profits. Therefore share prices would be higher. In case of companies where industrial relations are poor and strikes and lockouts occur regularly, performance of the company would be poor. Therefore share prices would fall.

10. Stability of government

When there is a stable government, businessmen feel confident to invest in new businesses and expand existing businesses. Production, sales and profits are higher and consequently share prices would increase. In case of instability in the government, new investments do not take place. Demand, production and profits are lower and share prices fall.

11. General market sentiments

It is generally said that sentiments move the markets. If there is optimism among market players, more buying would take place leading to increase in share prices. In case market players are pessimistic, then more selling would take place pushing down share prices.

12. Actions of institutional investors

Share prices are influenced by Institutional investors such as mutual funds, investment trusts, pension funds etc. They have large amount of funds at their disposal. When they start buying, share prices would increase and when they sell, share prices decline

13. Level of foreign investment

In recent times, the level of foreign institutional investors (FII"s) have played a significant role in influencing share prices. If the level of foreign investment in the market increases (more buying of shares), then the share prices increase. If the level of foreign investment decreases of if FII"s sell their investments, then the markets fall.

14. Returns offered by other markets

If the Indian markets offer high returns, institutional investors (especially FII"s) would invest in Indian markets. Demand for shares would increase and prices rise. In case returns offered by markets in other countries are attractive, then institutional investors would sell their securities in order to invest in those markets. In such cases, shares would be sold in large quantities lowering prices.

15. Availability of credit

In case credit is available without much restriction, then investors would borrow to invest in the markets. Demand for shares would be more and therefore prices rise. In case credit is restricted, then the level of borrowing would be less and demand for shares would also be lower.

16. Effective regulation

If the stock market is run in a transparent manner with effective regulation then the investors would feel confident to invest. Therefore more buying would take place and share prices increase. But when regulation is ineffective and if scams occur (Harshad Mehta scam, MS Shoes scam, CRB scam, Ketan Parekh scam and the recent IPO scam) investors would lose confidence. They would panic and sell their shares. So prices would fall.

SUM : 1

The following is the Balance Sheet of NSC Ltd. as on 31st Dec 1998.

Liabilities	Rs.	Assets	Rs.
4,000 10% pref. shares of Rs. 100 each 60,000 equity shares of Rs. 10 each Bills Payable Creditors	4,00,000 6,00,000 50,000 1,50,000	Sundry assets at book value	12,00,000
	12,00,000		**12,00,000**

The market value of 60% of the assets is estimated to be 15% more than the book value and that of the remaining 40% at 10% less than the book value. There is an unrecorded liability of Rs. 10,000.

Find the value of each equity share (it is to be assumed that preference shares have no prior claim as to payment of dividend or to repayment of capital).

Solution

Calculation of net assets:

Sundry assets:	Rs.	Rs.
12,00,000 x 60% x 115%		8,28,000
12,00,000 x 40% x 90%		4,32,000
Total		12,60,000
Less: Current Liabilities:		
Bills Payable	50,000	
Creditors	1,50,000	
Unrecorded Liability	10,000	2,10,000
		10,50,000
Less: Preference Share capital		4,00,000
Net assets available for equity shareholders		6,50,000

$$Intrinsic\ value\ per\ share = \frac{\text{Net assets for Equity Shareholders}}{\text{No of Equity shares}}$$

$$= \frac{6{,}50{,}000}{60{,}000} \quad = \quad \text{Rs.}10.83$$

SUM : 2

The balance sheet of Saraswati Co. Ltd. disclosed the following position as on 31st December 1998.

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital		Goodwill	1,65,000
6,000 equity shares of Rs.100	6,00,000	Investments	5,25,000
each	75,000	Stock	6,60,000
Profit & Loss A/c	2,25,000	Sundry Debtors	3,90,000
General Reserve	4,50,000	Cash at Bank	60,000
6% Debentures	1,50,000		
Sundry Creditors	3,00,000		
Workmen"s Savings bank A/c			
	18,00,000		**18,00,000**

i) The profits for the past five years were:

1994 –Rs. 30,000; 1995 – Rs. 70,000; 1996 – Rs. 50,000; 1997 – Rs. 55,000 and 1998- Rs.95,000.

ii) The market value of investments was Rs. 3,30,000.

iii) Goodwill is to be valued at three years purchase of the average annual profits for the last five years. Find the intrinsic value of each share.

Solution:

i) Calculation of value of goodwill

Total profits for 5 years = Rs. 30,000 + Rs. 70,000 + Rs. 50,000 + Rs. 55,000 +Rs. 95,000

= Rs. 3,00,000.

$$\text{Average Profits per year} = \frac{3,00,000}{5} = Rs. 60,000$$

Goodwill	=	Average profits x No. of years purchase
	=	Rs. 60,000 x 3 years
	=	Rs. 1,80,000.

ii) Calculation of Intrinsic value of share

Calculation of Net Assets:

		Rs.
Assets at Market value		
Goodwill		1,80,000
Investments		3,30,000
Stock		6,60,000
Sundry Debtors		3,90,000
Cash at Bank		60,000
		16,20,000
Less: Liabilities		
6% debentures	4,50,000	
Sundry Creditors	1,50,000	
Workmen"s Savings bank A/c	3,00,000	9,00,000
Net assets		7,20,000

iii) Intrinsic Value of each share $= \dfrac{\textbf{Net assets}}{\textbf{No. of Equity shares}}$

$= \dfrac{\text{Rs. } 7{,}20{,}000}{6000 \text{ shares}}$

= Rs. 120.

SUM : 3

On 31st Dec 1998, the Balance Sheet of Ganesh Ltd. was as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital		Land and Buildings	6,60,000
15,000 equity shares of Rs.100		Plant & Machinery	2,85,000
each fully paid	15,00,000	Stock	10,50,000
Profit & Loss A/c	3,09,000	Sundry Debtors	4,65,000
Sundry Creditors	2,31,000		
Bank Overdraft	60,000		
Provision for taxation	1,35,000		
Dividend equalisation fund	2,25,000		
	24,60,000		**24,60,000**

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

1994 – Rs. 2,25,000; 1995 – Rs. 2,88,000; 1996 – Rs. 2,70,000; 1997 – Rs. 3,00,000; and 1998 – Rs. 2,85,000

On 31st Dec. 1998, Land & buildings were valued at Rs. 7,50,000 and Plant & Machinery at Rs.4,50,000.

In view of the nature of the business, it is considered that 10% is a reasonable return on capital.

Calculate the value of the company"s share after taking into account the revised values on fixed assets and your own valuation of goodwill based on four years purchase of the annual super profits.

Solution

i) **Computation of Goodwill:**

Calculation of average capital employed:

		Rs.
Total net assets:		
Land and Buildings		7,50,000
Plant & Machinery		4,50,000
Stock		10,50,000
Sundry Debtors		4,65,000
		27,15,000
Less: External Liabilities		
Sundry Creditors	2,31,000	
Bank Overdraft	60,000	
Provision for taxation	1,35,000	4,26,000
Net assets or capital employed		22,59,000
Less: ½ of net profit of 1998 (2,85,000 x ½)		1,42,500
Average capital employed		21,46,500

ii) **Normal Profit** = Average capital employed x Normal rate of return

$$= 21,46,500 \times \frac{10}{100}$$

= Rs. 2,14,650

iii) **Average Profit**

Total Profits = Rs. 2,25,000 + R. 2,88,000 + Rs. 2,70,000 + Rs. 3,00,000

+ Rs. 2,85,000 = Rs. 13,98,000.

Average Profit = 13,98,0005

	=	Rs. 2,79,600
iv) Super Profit	=	Average profit – Normal Profit
	=	Rs. 2,79,600 – Rs. 2,14,650
	=	Rs. 64,950
v) Goodwill	=	Super profit x No. of years purchase
	=	Rs. 64,950 x 4 years
	=	Rs. 2,59,800.

Valuation of Shares

Net assets (as above)	=	22,89,000
Goodwill		2,59,800
Net assets available for equity sharehodlers		25,48,800

Intrinsic value of shares = $\frac{25,48,800}{1500 \text{ shares}}$ = Rs. 169.92

SUM : 4

On 31st March 1998, the balance sheet of Glorious Ltd. was as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital		Goodwill	1,00,000
8% Preference shares of Rs.		Land and Buildings	2,20,000
100	2,00,000	Machinery	3,00,000
Each fully paid		Furniture	40,000
4,000 equity shares of Rs. 100	4,00,000	Investment in 4% govt.	
each	1,60,000	Securities at cost (face	
fully paid	20,000	value Rs. 80,000)	1,00,000
General Reserve	1,20,000	Stock	3,00,000
Capital Reserve	1,20,000	Bad debts	1,20,000
Profit & Loss A/c	1,80,000	Cash at bank	60,000
5% debentrues	40,000		
Sundry Creditors			
Provision for taxation			
	12,40,000		**12,40,000**

The assets were revalue as under	Rs.
Land & Building	3,00,000
Machinery	2,50,000
Furniture	50,000

The normal return on capital employed for valuation of goodwill is 12%, the basis of valuation being four years purchase of super profits. 50% of investments in building is treated as non-trading asset because a sum of Rs. 15,000 is collected annually as rent from the building. Calculate the value of each equity share assuming that the average annual profit after tax at 50% is Rs. 1, 40,000.

Solution

i) Computation of Goodwill:

Calculation of capital employed:

		Rs.	Rs.
Fixed assets (as revalue)			
	Land and Buildings	3,00,000	
	Machinery	2,50,000	
	Furniture	50,000	6,00,000
Less: Non-trading buildings			
	(i.e. Rs. 3,00,000 x 5%)		1,50,000
			4,50,000
Add: Current Assets:			
	Stock	3,00,000	
	Book Debts	1,20,000	
	Cash in Bank	60,000	4,80,000
			9,30,000
Less: External Liabilities			
	5% debentures	1,20,000	
	Sundry Creditors	1,80,000	
	Provision for taxation	40,000	3,40,000
	capital employed		5,90,000

b) Calculation of average trading profit

	Average annual profit after tax		1,40,000
Less:	Non-trading income (less 50% tax)		
	Rent – 50% of Rs. 15,000	7,500	
Interest on Investment – 50% of Rs. 3,200			
	(80,000 x 4%)	1,600	9,100

	1,30,900

c) Calculation of Super Profit

		Rs.
	Average trading profit	1,30,900
Less:	Normal Profit (5,90,000 x 12%)	70,800
	Super Profit	60,100

d) Calculation of value of goodwill

Goodwill = Super profit x No. of year purchase

= Rs. 60,100 x 4 years

= Rs. 2,40,000

II. Computation of value of each equity share

a) Calculation of net assets

		Rs.	Rs.
	Goodwill		2,40,400
	Land and Building		3,00,000
	Machinery		2,50,000
	Furniture		50,000
	Investments		1,00,000
	Stock		3,00,000
	Book Debts		1,20,000
	Cash at Bank		60,000
			14,20,400
Less:			
	5% debentures	1,20,000	
	Sundry Creditors	1,80,000	
	Provision for taxation	40,000	
	8% preference share capital	2,00,000	5,40,000
	Net Assets		8,80,400

b) Intrinsic Value of share $= \frac{\text{Net asset}}{\text{No. of equity shares}}$

$= \frac{\text{Rs. } 8,80,400}{4000 \text{ shares}}$

=Rs. 220.10

SUM : 5

From the following information, compute the "Intrinsic value" of an equity share of Sunny Ltd.

Liabilities	Rs.	Assets	Rs.
2,000 equity shares of Rs.100		Land & Building	80,000
each, fully paid	2,00,000	Plant & Machinery	80,000
2,000 6% preference shares of		Book debts	10,000
Rs. 10 each	20,000	Stock-in-trade	40,000
General reserve	50,000	Cash & Bank balance	70,000
5% debentures of Rs.100 each	20,000	Investment in 5%	
Sundry creditors		Govt. securities	20,000
		Preliminary expenses	10,000
	3,10,000		**3,10,000**

(i) Fair return on capital employed in this type of business is 10% p.a.

(ii) Goodwill is to be taken at 4 years purchase value of super profits.

(iii) Average of the profits (after deduction of preliminary expenses) for the last seven years is Rs. 38.000. Preliminary expenses to the extent of Rs. 2,000 have been written off every year for the last seven years. Profit is more or less stable over years and the same trend is expected to be maintained in the near future. Ignore taxation.

Solution:

(a) Computation of goodwill

(i) Calculation of capital employed

	Rs.	Rs.
Land & Building		80,000
Plant & Machinery		80,000
Book debs		10,000
Stock-in-trade		40,000
Cash & Bank balance		70,000

		2,80,000
Less : External liabilities		
Sundry creditors	20,000	

5% debentures	20,000	40,000

Capital employed		2,40,000

(ii) **Normal profit** = Rs. 2,40,000 x 10% = Rs. 24,000

(iii) Average profit	38,000
Less : Interest on investments (20,000 x 5%)	1,000
	37,000

iv) Super Profit = Average profit – Normal Profit

= Rs. 37,000 – Rs. 24,000

= Rs. 13,000

v) Goodwill = Super Profit x No. of years purchase

= Rs. 13,000 x 4 years

= Rs. 52,000

b) Computation of value of each equity share

Calculation of net assets

	Rs.	**Rs.**
Investment		20,000
Goodwill		52,000
Land and Building		80,000
Plant &Machinery		80,000
Bad Debts		10,000
Stock in trade		40,000
Cash and Bank balances		70,000
		3,52,000
Less:		
5% debentures	20,000	
Sundry Creditors	20,000	
Preference share capital	20,000	60,000

Net assets available for equity shareholders 2,92,000

c) **Intrinsic Value of share** $= \dfrac{\text{Net asset}}{\text{No. of equity shares}}$

$= \dfrac{\text{Rs. 2, 92,000}}{\text{2000 shares}}$

=Rs. 146

SUM : 6

From the following Balance Sheet of Sweetex Ltd. you are asked to-ascertain the value of each Equity Share of the company:

Liabilities	**Rs**	**Assets**	**Rs**
20,000 Equity Shares of Rs.10 each ,fully paid	2,00,000	Good will	30,000
1,000 ,6% Preference shares of Rs 100 each ,fully paid	1,00,000	Land and building	1,00,000
Reserves	60,000	Plant and machinery	1,20,000
Sundry creditors	40,000	Investments (at cost)	60,000
Provision for Taxation	20,000	Stock	50,000
Other liabilities	10,000	Debtors	40,000
		Cash at bank	24,000
		Preliminary Expenses	6,000
	4,30,000		**4,30,000**

For the purpose of valuing the shares of the company, the assets were revalued as: Goodwill Rs. 50,000; Land and Building at cost plus 50%, Plant and Machinery Rs. 1, 00,000; Investments at book values; Stock Rs. 80,000 and Debtors at book value, less 10%.

Solution

	Rs
Net Assets	
Goodwill	50,000
Land and building	1,50,000
(1,00,000 + 50,000)	
Plant and machinery	1,00,000
Investments	60,000
Stocks	80,000
Debtors (40,000-4000)	36,000
Cash at bank	24,000
	………..
	5,00,000
Less current liabilities	
Sundry creditors 40,000	
Prov.for taxation 20,000	
Other liabilities 10,000	70,000
	4,30,000
Less :	
Preference share capital	1,00,000
Funds available for Equity shareholders	3,30,000

Intrinsic Value of each share = Funds available for Equity Shares/Total Number of Shares

Intrinsic Value of shares = Rs. 3, 30,000/20,000

= Rs. 16.50.

Intrinsic Value of Shares on the Basis of Valuation of Goodwill

B. Yield-Basis Method:
Yield is the effective rate of return on investments which is invested by the investors. It is always expressed in terms of percentage. Since the valuation of shares is made on the basis of Yield, it is called Yield-Basis Method. For example, an investor purchases one share of Rs. 100 (face value and paid-up value) at Rs. 150 from a Stock Exchange on which he receives a return (dividend) @ 20%.

Yield may be calculated as :

$$yield = \frac{\textbf{Normal Profit}}{\textbf{capital Employed}} X\ 100$$

Note :

Practically ,yield may also be termed as expected Yield, normal rate of return /earning rate of fair return, rate of general Expectations, estimated rate for capitalization etc

Under Yield-Basis method, valuation of shares is made on;

(i) Profit Basis;

(ii) Dividend Basis.

(i) Profit Basis:

Under this method, at first, profit should be ascertained on the basis of past average profit; thereafter, capitalized value of profit is to be determined on the basis of normal rate of return, and, the same (capitalized value of profit) is divided by the number of shares in order to find out the value of each share.

The following procedure may be adopted:

$$capitalised\ value\ of\ profit = \frac{\text{profit}}{\text{normal rate of return}} X100$$

$$value\ of\ each\ equity\ share = \frac{\text{capitalised value of profit}}{\text{Number of shares}}$$

OR

$$value\ of\ equity\ share = \frac{\text{profit}}{\text{normal rate of returnX number of equity share}} X100$$

SUM : 9

Two companies, A Ltd. and B. Ltd., are found to be exactly similar as to their assets, reserves and liabilities except that their share capital structures are different:

The share capital of A. Ltd. is Rs. 11,00,000, divided into 1,000, 6% Preference Shares of Rs. 100 each and 1,00,000 Equity Shares of Rs. 10 each.

The share capital of B. Ltd. is also Rs. 11,00,000, divided into 1,000, 6% Preference Shares of Rs. 100 each and 1,00,000 Equity Shares of Rs. 10 each. .

The fair yield in respect of the Equity Shares of this type of companies is ascertained at 8%.

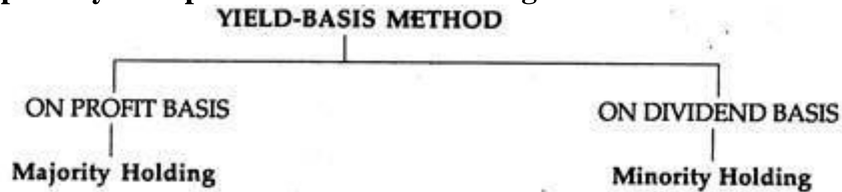
The profits of the two companies for 2009 are found to be Rs. 1, 10,000 and Rs. 1, 50,000, respectively.

Calculate the value of the Equity Shares of each of these two companies on 31.12.2009 on the basis of this information only. Ignore taxation.

Solution

Valuation of shares of A .Ltd	Rs	Valuation of shares of B .Ltd	Rs
$\boldsymbol{Average\ profit\ of\ 2\ years}$ $= \frac{\mathbf{1,10,000 + 1,50,0000}}{\mathbf{2}}$	1,30,000	Average profit	1,30,000
Less : Preference Dividend 6% on 10,00,000	60,000	Less : Pref. Dividend 6% on 1,00,000	6,000
Maintainable Profit	70,000	Maintainable Profit	1,24,000
Capitalized value of profit $=\frac{70,000}{8}\ \boldsymbol{X100}$ = 8,75,000 Value of each Equity share $\frac{\mathbf{8,75,000}}{\mathbf{10,000}} = \mathbf{87.50}$		Capitalized value of profit $=\frac{1,24,000}{8}\ \boldsymbol{X100} =$ $\mathbf{15,50,000}$ Value of each Equity share $\frac{\mathbf{15,50,000}}{\mathbf{1,00,000}} = \mathbf{15.50}$	

The same principle may be represented in the following form:



Note:

Yield-Basis Method may also be termed as:

Market Value Method; Profit Basis/Income Basis Method;Earning Capacity Method etc.

Value of share under yield basis:

SUM : 11

On December 31, 2009 the Balance Sheet of MA KALI Ltd. disclosed the following position:

Liabilities	Rs	Assets	Rs
Issued capital in Rs.10 shares	4,00,000	Fixed assets	5,00,000
Reserves	90,000	Current Assets	2,00,000
Profit and loss account	20,000	Goodwill	40,000
5% Debenture	1,00,000		
Current liabilities	1,30,000		
	7,40,000		**7,40,000**

Net profit for three Years were:	
2007	51,600
2008	52,000
2009	51,650

Of which 20% was placed to 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 share under yield-basis method.

Solution

$$Average\ profit = \frac{51,600 + 52,000 + 51,650}{3} = 51,750$$

less : transfer to reserve @20% = 10,350

....

Maintainable Profit 41,400

....

Here the rate of dividend is not given the same can be found out with the help of the following

$$Rate\ of\ dividend = \frac{\text{profit}}{\text{Equity capital (Paidup)}} X\ 100$$

$$\frac{41,000}{4,00,000} X\ 100 = 10.35\%$$

$$value\ of\ each\ equity\ share = \frac{\text{rate of dividend}}{\text{normal rate of return}} X\ (paid\ up\ value\ of\ each\ equity\ share)$$

$$= \frac{10.35}{10} X\ 10$$

$$= Rs. 10.35$$

SUM : 12

Calculate the value of each Equity Share from the following information:

	Rs
Share capital	
20,000 equity shares of 10 each ,Rs 8 per share paid up	1,60,000
1000 ,10% preference shares of Rs100 each ,fully paid up	1,00,000
Expected profit (before tax and pref .dividend)	1,00,000
Normal rate of return	10%
Rate of tax	50%
Transfer to Reserve	20%

Solution :

Calculation of Rate of Dividend	**Rs**
Profit (before Tax and Pref.Dividend)	1,00,000
Less : income – Tax@ 50%	50,000
	50,000
Less : Transfer to Reserve @20%	10,000
	40,000
Less Pref.Divided @10%	**10,000**
Available for equity shareholders	**30,000**

Rate of Dividend =30,000/ 1,00,000*100

= 30%

Value of each equity share = Rate of dividend/ normal rate of return* paidup value of each equity share

= 30% / 10% * 8

= 24

C. Fair Value Method:

There are some accountants who do not prefer to use Intrinsic Value or Yield Value for ascertaining the correct value of shares. They, however, prescribe the Fair Value Method which is the mean of Intrinsic Value Method end Yield Value Method. The same provides a better indication about the value of shares than the earlier two methods.

$$\boldsymbol{Fair\ value} = \frac{\textbf{intrinsic value + yield value}}{\textbf{2}}$$

SUM : 13

The following is the Balance Sheet of X Co. Ltd. as on 31.12.2009:

Liabilities	**Rs**	**Assets**	**Rs**
Share capital :		Good will	50,000
Equity share of Rs.10 each	1,00,000	Building	1,50,000
12% pref.share of Rs.100 each	1,00,000	Plant	1,00,000
General reserve	60,000	Investment in	
Profit and loss a/c	40,000	10%stock(market value of	48,000
15% debentures	1,00,000	Rs 52,000,Nominal value	
creditors	80,000	Rs.50,000)	
		Stock	60,000
		Debtors	40,000
		Cash	10,000
		Preliminary Expenses	22,000
	4,80,000		**4,80,000**

Ascertain the value of each equity share under Fair Value Method on the basis of the information given:

Assets are revalued as:

Building Rs. 3, 20,000, Plant Rs. 1, 80,000, Stock Rs. 45,000 and Debtors Rs. 36,000. Average Profit of the company is Rs. 1, 20,000 and 12½% of profit is transferred to General Reserve, Rate of taxation being 50%. Normal dividend expected on equity shares is 8% whereas fair return on capital employed is 10%. Goodwill may be valued at 3 years‟ purchase of super-profit.

Calculation of good will	
Total net assets Building Plant Stock Cash	3,20,000 1,80,000 45,000 36,000 10,000
Less: current liabilities: Creditors Capital employed Capital Employed	 80,000 ………… 5,11,000

Normal profit Rs. 51,000 ($\mathbf{5,11,000 = \frac{10}{100}}$)

Actual Profit

Average Profit Non trading income Ie .income from investment @10% on Rs.50,000	1,20,000 5000
 Add: Debenture interest Less: Pref.Dividend Less: Taxation @50% Less : transfer to reserve @12.5%	1,15,000 15,000 ………... 1,30,000 12,000 …………. 1,18,000 59,000 …………. 59,000 7,375 …………… 51,625
Super Profit = Actual profit – Normal Profit = 51,625 – 51,100 = 525 Valuation of goodwill = 525 x 3 = 1575 or 1,600	
Valuation of shares **Asset – backing Method**	
Sundry assets (as above) Add :investments Add:Goodwill	5,11,000 48,000 1,600 5,60,600

Intrinsic value of share	5,60,600/10,000 = 56.06
Yield basis Value of share	$\frac{\text{Rate of Dividend}}{\text{normal rate of return}} X\ paidup\ value\ of\ each\ share$ $\frac{8}{10} X\ 10 = 8$
Fair value **Fair value**	$\frac{\text{intrinsic value} + \text{yield basis}}{2}$ $\frac{56.06 + 8}{2}$ = 32.03

VALUATION OF GOODWILL

Methods of Goodwill Valuation

Goodwill is the value of the reputation of a firm built over time with respect to the expected future profits over and above the normal profits. Goodwill is an intangible real asset which cannot be seen or felt but exists in reality and can be bought and sold. In partnership, goodwill valuation is very important. Thus, we will here discuss the various methods of Goodwill Valuation.

Goodwill Valuation

A well-established firm earns a good name in the market, builds trust with the customers and also has more business connections as compared to a newly set up business. Thus, the monetary value of this advantage that a buyer is ready to pay is termed as Goodwill. The buyer who pays for Goodwill expects that he will be able to earn super profits as compared to the profits earned by the other firms. Thus, goodwill exists only in the case of firms making super profits and not in the case of firms earning normal profits or losses.

Goodwill is recorded in the books only when some consideration in money or money"s worth is paid for it. Thus, in the context of a partnership firm, the need for valuation of goodwill arises at the time of:

1. Change in the profit sharing ratio amongst the existing partners
2. Admission of a new partner
3. The retirement of a partner
4. Death of a partner
5. Dissolution of a firm where business is sold as going concern.
6. Amalgamation of partnership firms

Factors Affecting the Value of Goodwill

- **Nature of business:** A firm that deals with good quality products or has stable demand for its product is able to earn more profits and therefore has more value.
- **Location of business:** A business which is located in the main market or at a place where there is more customer traffic tends to earn more profit and also more goodwill.
- **Owner's reputation:** An owner, who has a good personal reputation in the market, is honest and trustworthy attracts more customers to the business and makes more profits and also goodwill.
- **Efficient management:** An organization with efficient management has high productivity and cost efficiency. This gives it increased profits and also high goodwill.
- **Market situation:** The organization having a monopoly right or condition in the market or having limited competition, enables it to earn high profits which in turn leads to higher value of goodwill.
- **Special advantages:** A firm that has special advantages like import licenses, patents, trademarks, copyrights, assured a supply of electricity at low rates, subsidies for being situated in a special economic zones (SEZs), etc. possess a higher value of goodwill.

Methods of Valuation of Goodwill

The choice of the method of goodwill valuation depends entirely on the partners or the partnership deed when they have made it.

1. Average Profits Method

i] Simple Average: Under this method, the goodwill is valued at the agreed number of years'' of purchase of the average profits of the past years. Goodwill = Average Profit x No. of years'' of purchase

ii] Weighted Average: Under this method, the goodwill is valued at an agreed number of years'' of purchase of the weighted average profits of the past years. We use the weighted average when there exists an increasing or decreasing trend in the profits giving the highest weight to the current year''s profit.

- Goodwill = Weighted Average Profit x No. of years‟ of purchase
- Weighted Average Profit = Sum of Profits multiplied by weights/ Sum of weights

Explore more about Treatment of Goodwill

Treatment of Goodwill

- Accounting Treatment of Goodwill- Death/Retirement of Partner
- Accounting treatment of Goodwill- Change in PSR.
- Accounting Treatment of Goodwill in case of Admission of Partner
- Concept of Goodwill

2. Super Profits Method

(i) The Number of Years Purchase Method: Under this method, the goodwill is valued at the agreed number of years‟ of purchase of the super profits of the firm.

- Goodwill = Super Profit x No. of years‟ of purchase
- # Super Profit = Actual or Average profit – Normal Profit
- # Normal Profit = Capital Employed x (Normal Rate of Return/100)

(ii) Annuity Method: This method considers the time value of money. Here, we consider the discounted value of the super profit.

- Goodwill = Super Profit x Discounting Factor

3. Capitalization Method

(i) Capitalization of Average Profits: Under this method, the value of goodwill is calculated by deducting the actual capital employed from the capitalized value of the average profits on the basis of the normal rate of return.

- Goodwill = Normal Capital – Actual Capital Employed
- # Normal Capital or Capitalized Average profits = Average Profits x (100/Normal Rate of Return)
- # Actual Capital Employed = Total Assets (excluding goodwill) – Outside Liabilities

(ii) Capitalization of Super Profits: Under this method, Goodwill is calculated by capitalizing the super profits directly.

- Goodwill = Super Profits x (100/ Normal Rate of Return)

SUM : 1

M/s Mehta and sons earn an average profit of rupees 60,000 with a capital of rupees 4,00,000. The normal rate of return is 10%. Using capitalization of super profits method calculate the value the goodwill of the firm.

Ans: Goodwill = Super profits x (100/ Normal Rate of Return) = 20,000 x 100/10 = 2,00,000.

Working notes:

(i). Normal Profit = Capital employed x Normal Rate of Return/100 = 4,00,000 x 10/100 = 40,000

(ii) Super Profit = Average Profit – Normal Profit = 60,000 – 40,000 = 20,000

SUM : 2

M/s Joe and John is a partnership firm with Joe and John as its partners. They now decide to admit James in the firm and hence need to value goodwill. Capital employed is 5,00,000 at the end of the 4th year. The normal rate of return is 15%. Assume the interest rate is equal to the Normal Rate of Return. Calculate Goodwill using Annuity Method. Their profits for the last 4 years are:

Year	Profits
1	100000
2	120000
3	150000
4	200000

Ans: Goodwill = Super Profit x Discounting factor = 67500 x 2.855 = 192713

Working notes:

(i) Average Profit = Sum of profits / No. of years = 570000/4 = 142500

(ii) Normal Profit = Capital employed x (Normal Rate of Return/100) = 500000 x (15/100) = 75000

(iii) Super Profit = Average Profit – Normal Profit = 142500 – 75000 = 67500

SUM : 3

Calculate the amount of Goodwill on the basis of three years purchase of the last five years" average profits. The profits for the last five years are:

	Rs.
I year	4,800
II Year	7,200
III Year	10,000
IV Year	3,000
V Year	5,000

Solution:

(i) Average Profit

	Rs.
I year	4,800
II Year	7,200
III Year	10,000
IV Year	3,000
V Year	5,000
Total	**30,000**

Average Profit = $\frac{\text{Rs. } 30,000}{5 \text{ years}}$ = Rs. 6,000

(ii) Goodwill = Average Profit x No. of years of purchase

= Rs. 6,000 x 3

= Rs. 18,000

SUM : 4

The following information is presented for five years ending 31st Dec 1998.

Year	Profits (after Tax) Rs.	Taxation Rs.	Transfer to Reserve Rs.	Director's Remuneration Rs.
1994	25,000	9,000	5,000	2,000
1995	27,500	10,000	6,000	2,250
1996	24,000	7,500	4,000	2,250
1997	32,500	12,500	7,500	2,500
1998	36,000	17,500	7,500	3,000

Fixed assets have been revalued and the same showed an appreciation of Rs.2,50,000 (depreciation to be provided for @ 10%). The company has a 8% preference share capital of Rs. 50,000. The current rate of taxation may be taken @ 50%.

Calculate the value of goodwill on the basis of four years" purchase of the last five years" average profits.

Solution:

i) Calculation of average maintainable profit:

Adjusted Profit	=	Profit (given) Rs.	+	Tax Rs.	+	Director's Remuneration	=	Rs.
1994	=	25,000	+	9,000	+	2,000	=	36,000
1995	=	27,500	+	10,000	+	2,250	=	39,750
1996	=	24,000	+	7,500	+	2,250	=	33,750
1997	=	32,500	+	12,500	+	2,500	=	47,500
1998	=	36,000	+	17,500	+	3,000	=	56,500
						Total		**2,13,500**

	Average Profit = $\frac{2,13,500}{5(\text{Years})}$		=	42,700
Less:	Depreciation @ 10% on Rs.2,50,000 =	25,000		
	Director"s Remuneration	3,000	=	28,000
				14,700
Less:	Income Tax @ 50%			7,350

		7,350
Less:	Preference Dividend	4,000
	Average Maintainable profit	**3,350**

ii) Goodwil = Average maintainable profit x No. of years‟ purchase

= Rs. 3,350 x 4

= Rs. 13,400

Note: Director‟s Remuneration has been considered as Rs. 3000 i.e., the amount prevailing on 31st Dec 1998 and not the average on since the same cannot be paid less than Rs. 3,000 in future.

SUM : 5

Following details are available about the business of Sagar Ltd.

(i) Profits: 1994-Rs. 80,000; In 1995 – Rs. 1,00,000; In 1996 – Rs. 1,20,000;

(ii) Non-recurring income of Rs. 8,000 is included in the profit of 1995.

(iii) Profits of 1994 have been reduced by Rs. 12,000 because goods were destroyed by fire;

(iv) Goods have not been insured but it is thought prudent to insure them in future. The insurance premium is estimated at Rs.800 per year;

(v) Reasonable remuneration of the proprietor of the business is Rs. 12,000 per year but it has not been taken into account for calculation of above mentioned profits;

(vi) Profits of 1996 include Rs. 10,000 income on investment. Calculate goodwill on the basis of three years purchase of the average profit of last three years.

Solution:

Calculation of Average Profits

Year			**Rs.**	**Rs.**
1994		Profits	80,000	
	Add:	Unusual Loss: Stock destroyed by fire	12,000	92,000
1995		Profits	1,00,000	
	Less:	Non- recurring income	8,000	92,000
1996		Profits	1,20,000	
	Less:	Income on investment	10,000	1,10,000
		Total Profit		2.94.000
			Rs. 2,94,000	
			3 (years)	
		Average Profits		98,000
	Less:	Insurance Premium	800	
		Proprietor‟s Remuneration	12,000	12,800
		Average Maintainable Profit		**85,200**

Goodwill = Average maintainable profits x No. of years purchase

= Rs. 85,200 x 3 years

= Rs. 2,55,000

SUM : 6

Vatsal who has been carrying on a retail business for the past 20 years, intends selling his business on 31st December 1998. It is agreed between Vatsal and the buyer that the latter pay Rs. 1,50,000 for goodwill. From the following particulars supplied by vatsal. Calculate the value of goodwill if it were based on four years purchase of the average profits of the last five years including the profit of 1998.

Profit earned:

1994 – Rs. 30,000; 1995 – Rs. 40,000; 1996 – Rs. 46,000; 1997 – Rs. 55,000; 1998 – Rs. 44,000

At the time of acquiring Vatsal‟s business, the buyer was employed as the manager of a similar business on a salary of Rs. 1,000 per month. The profit of 1998 included income

from investment Rs.3,500 and profit of 1995 had been reduced by Rs. 4,000 being loss on speculation. Similarly, the profits of 1997 had been reduced by Rs. 6,000 owing to loss from betting.

Solution:

Calculation of Adjusted Profits

Year			Rs.	Rs.
1994			-	30,000
1995			40,000	
	Add:	Speculation Loss	4,000	44,000
1996			-	46,000
1997			55,000	
	Add:	Loss from betting	6,000	61,000
1998			44,000	
	Less:	Income on investment	3,500	40,500
		Total Profit		**2,21.500**
		Average profit =	Rs. 2,21,500	
			5	44,300
	Less:	Proprietor"s Remuneration (Rs. 1,000 x12)		12,000
		Average Maintainable Profit		**32,300**

Goodwill = Average maintainable profits x No. of years purchase
= Rs. 32,300 x 4 years
= Rs. 1,29,200

SUM : 7

The profits of Thilalga Ltd. For the last 5 years were as follows:

	Rs.
1994	15,000
1995	18,000
1996	22,000
1997	25,000
1998	27,000

Compute the value of goodwill of Thilaga Ltd. on the basis of 4 years purchase of weighted average profit after assigning weights 1, 2, 3, 4 and 5 serially to the profits

Solution:

i) Calculation of weighted average profit

Year (1)	Annual Profits (2) Rs.	Weights (3)	Product (2) x (3) Rs.
1994	15,000	1	15,000
1995	18,000	2	36,000
1996	22,000	3	66,000
1997	25,000	4	1,00,000
1998	27,000	5	1,35,000
		15	3,52,000

Weighted average profits = $\frac{\text{Rs. } 3,52,000}{15}$ = Rs. 23,467

ii) Calculation of value of goodwill:

Goodwill = weighted average profit x No. of years purchase

= Rs. 23,467 x 4

= Rs. 93,868

Note: Weighted average profits may be taken if there is specific instruction in the problem or there is a clear increasing trend in profits from year to year.

SUM : 8

XYCo. Ltd. has agreed to purchase the business carried on by Thilak. For this purpose, goodwill is to be valued at 4 years" purchase of the weighted average profits of the past five years. The profits of the previous years were:

1994 – Rs. 20,000; 1995 – Rs. 22,000; 1996 – Rs. 24,000; 1997 – Rs. 28,000; 1998 – Rs. 30,000.

The appropriate weights to be used are

1994 – 1; 1995 – 2; 1996 – 3; 1997 – 4; 1998 – 5

The accounts of the business revealed that:

i) In the year 1994, a major repair was made in respect of Plant & Machinery and the amount involved was Rs. 5,000. It was agreed that the amount, which was charged to

revenue, was to be capitalised for the purpose of valuing goodwill subject to 10% depreciation on the diminishing balance method.

ii) The closing stock for the same year was over valued by Rs.2,000.

iii)Rs. 2,800 managerial remuneration should be provided for. Calculate the value of goodwill of the business.

Solution:

i) Calculation of adjusted profit

Year	Profit Rs.	+	Capital Expenditure Rs.	-	Depreciation Rs.	+	Over valuation opening stock Rs.	-	Managerial remuneration Rs.	=	Adjusted Profit
1994	20,000	+	5.000	-	500	+	0	-	2,800	=	19,700
1995	22,000	+	0	-	450	+	2,000	-	2,800	=	20,750
1996	24,000	+	0	-	405	+	0	-	2,800	=	20,795
1997	28,000	+	0	-	365	+	0	-	2,800	=	24,835
1998	30,000	+	0	-	328	+	0	-	2,800	=	26,872

ii) Calculation of weighted average profits:

Year (1)	Adjusted Profits (2) Rs.	Weights (3)	Product (2) x (3) Rs.
1994	19,700	1	15,000
1995	20,750	2	36,000
1996	20,795	3	66,000
1997	24,835	4	1,00,000
1998	26,872	5	1,35,000
		15	3,52,000

iii) Average profit $= \frac{3,57,285}{15}$ = Rs. 23,819

iv) Value of goodwill = Rs. 23,819 x 4 = Rs. 95,276

Working Note: Calculation of amount of depreciation

		Rs.
	Capital Expenditure	5,000
Less:	Depreciation for 1994 (5,000 x 10%)	500
		4,500
Less:	Depreciation for 1995 (4,500 x 10%)	450
		4,050
Less:	Depreciation for 1996 (4,050 x 10%)	405
		3,645
Less:	Depreciation for 1997 (3,645 x 10%)	365
		3,280
Less:	Depreciation for 1998 (3,280 x 10%)	328
		2,952

SUM : 9

Purchase of Super Profits method

A firm earned net profits during the last three years as follows:

	Rs.
I year	36,000
II Year	40,000
III Year	44,000

The capital investment of the firm is Rs. 1,00,000

A fair return on the capital, having regard to the risk involved, is 10%.

Calculate the value of goodwill on the basis of 3 years" purchase of super profit.

Solution:

i) Calculation of average expected profit

	Rs.
I year	36,000
II Year	40,000
III Year	44,000
Total Profit	**1,20,000**

Average expected profit = $\frac{\text{Rs. 1, 20,000}}{3}$ = Rs. 40,000

ii) Calculation of normal profit

Normal Profit = Capital employed x Normal rate of return

= 1,00,000 x 10%

= Rs. 10,000

iii) Calculation of Super profits

Super profits = Average expected profit – Normal profit

= Rs. 40,000 – Rs. 10,000

= Rs. 30,000

iv) Calculation of Value of goodwill

Goodwill = Super profits x No. of years‟ purchased

= Rs. 30,000 x 3

= Rs. 90,000

Note: „Capital Investment of the firm‟ is taken as Average Capital employed.

SUM : 10

From the following information calculate the value of goodwill on the basis of 3 years purchase of super profit.

i) Average capital employed in the business is Rs. 20,00,000

ii) Rate of interest expected from capital having regard to the risk involved is 10%

iii) Net Trading profits of the firm for the past three years were Rs. 3,50,400; Rs. 2,80,300; and Rs.3,10,100.

iv) Fair Remuneration to the partners for their services is Rs. 48,000 per annum.

v) Sundry assets of the firm are Rs. 23,50,400 and current liabilities are Rs. 95,110.

Solution

i) Calculation of adjusted average profit

	Rs.
Trading profit for the last three years	3,50,400
	2,80,300
	3,10,100
Total Profits	9,40,800
Average profit = Rs. 9,40,800 / 3 =	3,13,600
Less: Fair Remuneration to partners	48,000

Average Profit	2,65,600

ii) Calculation of Normal Profit

Normal Profit = Average capital employed x Normal rate of return

= Rs. 20,00,000 x 10%

= Rs. 2,00,000

iii) Calculation of Super Profit

Super Profits = Adjusted average profit – Normal profit

= Rs. 2,65,600 – Rs. 2,00,000

= Rs. 65,600

iv) Calculation of Value of goodwill

Goodwill = Super profits x No. of years‟ purchase

= Rs. 65,600 x 3

= Rs. 1,96,800

Note: Information about sundry assets and current liabilities is irrelevant because Average capital Employed is given.

SUM : 11

Healy Ltd. and Moly Ltd. propose to amalgamate

Balance sheet of Healy Ltd. & Moly Ltd. as on 31-12-1998

Liabilities	Healy Ltd Rs.	Moly Ltd. Rs.	Assets	Healy Ltd. Rs.	Moly Ltd. Rs.
Share Capital			Fixed Assets less		
Equity Shares			Depreciation	5,00,000	1,50,000
of	4,00,000	2,00,000	Investments (face		
Rs. 10 each	3,00,000	20,000	value		
General Reserve	1,00,000	30,000	Rs.2,00,000 6%	2,00,000	-
P & L A/c	2,00,000	50,000	G.P. Notes)	3,00,000	1,50,000
Current			Current		
Liabilities			Liabilities		
	10,00,000	**3,00,000**		**10,00,000**	**3,00,000**

Net Profit

Year	Healy Ltd Rs.	Moly Ltd. Rs.
1996	1,50,000	46,000
1997	1,44,000	45,000
1998	1,50,000	56,000

Goodwill for the purpose of amalgamation may be taken as 3 years" purchase of average super profits of trading on the basis of 10% normal profit on closing capital invested. The current assets of Healy Ltd are to be taken as Rs. 4,30,000 and that of Moly Ltd as Rs. 1,75,000. Ascertain the value of goodwill.

Solution

i) Calculation of average trading profits

Year	Healy Ltd Rs.	Moly Ltd. Rs.
1996	1,50,000	46,000
1997	1,44,000	45,000
1998	1,50,000	56,000
	4,44,000	1,47,000

Year	Healy Ltd Rs.	Moly Ltd. Rs.
Average Profit=	4,44,000 / 3	1,47,000 / 3
	1,48,000	49,000
Less: Income from investments		
(Rs. 2,00,000 x 6%)	12,000	-
Adjusted average profit	1,36,000	49,000
ii) Calculation of capital employed	**Healy Ltd.** **Rs.**	**Moly Ltd** **Rs.**
Fixed Assets	5,00,000	1,50,000
Current Assets	4,30,000	1,75,000
Total Assets	9,30,000	3,25,000
Less: Current Liabilities	2,00,000	50,000
Capital Employed	7,30,000	2,75,000

Note: Investments, being non-trading assets, are not included.

Alternatively, capital employed may be calculated as follows:

	Healy Ltd Rs.	Moly Ltd. Rs.
Equity Share Capital	4,00,000	2,00,000
General Reserve	3,00,000	20,000
Profit and Loss account	1,00,000	30,000
Increase in value of current assets	1,30,000	25,000
	9,30,000	2,75,000
Less: Investments	2,00,00	-
Capital Employed	7,30,000	2,75,000
Capital Employed	7,30,000	2,75,000

Less: ½ of current year"s operating profits (1,50,000 – 12,000) = 1,38,000 x ½	69,000	
56,000 x ½		28,000
Average Capital Employed	6,61,000	2,47,000

iii) Normal Profit:

Healy Ltd. : 6,61,000 x 10% = 66,100

Moly Ltd. : 2,47,000 x 10% = 24,700

iv) Super Profits:

Healy Ltd. : 1,36,000 – 66,100 = 69,900

Moly Ltd. : 49,000 – 24,700 = 24,300

v) Goodwill:

Healy Ltd. : 69,900 x 3 = 2,09,700

Moly Ltd. : 24,300 x 3 = 72,900

SUM : 12

Following is the balance sheet of Maruthy Co. Ltd. as on 31st March 1998.

Liabilities	Rs.	Assets	Rs.
60,000 equity shares of Rs.		Goodwill at cost	5,00,000
100 each, fully paid	60,00,000	Plant & Machinery	
Capital Reserve	2,00,000	Less depreciation	17,00,000
General Reserve	13,90,000	Furniture & Fixtures	
Profit & Loss A/c	30,000	Less depreciation	6,00,000
Sundry creditors	25,70,000	Stock	32,00,000
Provision for taxation	15,00,000	Sundry Debtors	20,00,000
Proposed dividend	13,20,000	Cash	49,10,000
		Preliminary expenses	1,00,000
	1,30,10,000		**1,30,10,000**

The following additional information is provided to you:

i) The reasonable return on capital employed in the industry in which Maruthy Co.Ltd is engaged is 18%

ii) The rate of tax is 50%. The balance in provision for taxation account is in respect of profit for the year ended 31st March 1998.

iii) The year 1997-98 was a normal year and the prospects for 1998 -99 are equally good.

Calculate value of goodwill at four years‟ purchase of super profits of the company.

Solution

i) Calculation of capital employed

		Rs.
Equity Share Capital		6,00,000
Capital Reserve		2,00,000
General Reserve before transfer of 10% of net profits in current year = Rs. 13,90,000 – 10% of Rs. 15,00,000		12,40,000
Current years‟ half profit after tax (15,00,000 x ½)		7,50,000
		81,90,000
Less: Goodwill	5,00,000	
Preliminary Expenses	1,00,000	
		6,00,000
Average Capital Employed		**75,90,000**

ii) Calculation of Normal Profit

= Rs. 75,90,000 x 18%

= Rs. 13,66,200

iii) Expected Profits = Rs. 15,00,000

iv) Super Profits = Expected profits – Normal Profits

= Rs. 15,00,000 – Rs. 13,66,200

= Rs. 1,33,800

v) Goodwill = Super profits x No. of years‟ purchase

= Rs. 1,33,800 x 4 years

= Rs. 5,35,200

SUM : 13

From the following information find out Goodwill (a) as per annuity method, (b) as per 4 years" purchase of super profit, and (c) as per capitalisation of super profit method.

Net profits for four years:

I year Rs. 30,000; II year Rs. 40,000 III year Rs. 50,000; IV year Rs. 60,000. The profit includes non-recurring profits on an average basis of Rs. 3,000.

	Rs.
Average capital employed	3,00,000
Normal rate of profit	10%

Present value of annuity of Re. 1 for 4 years at 10% is 2.5.

SOLUTION :

Total profits Rs. 30,000 + 40,000 + 50,000 + 60,000 = Rs. 1,80,000

	Rs.
Average Profit = $\frac{1,80,000}{4}$	= 45,000
Less: Non-recurring profit	= 3,000
	42,000

Normal Profit = $\frac{3,00,000 \times 10}{100}$ = Rs. 30,000

Super profit = Rs. 42,000 – 30,000 = Rs. 12,000

(*a*) Goodwill as per annuity method: 12,000 × 2.5 = Rs. 30,000

(*b*) Goodwill as per purchase of super profit method: 12,000 × 4 = Rs. 48,000

(*c*) Goodwill as per capitalisation method: $\frac{12,000 \times 100}{10}$ =Rs. 1,20,000

SUM : 14

The net profits of a Company, after providing for taxation, for the past five years are Rs. 42,000; Rs. 47,000; Rs. 45,000; Rs. 39,000 and Rs. 47,000. The capital employed in the business is Rs. 4, 00,000 on which a reasonable rate of return of 10% is expected.

Calculate the goodwill under:

(a) Capitalization of Average Profit Method and

(b) Capitalization of Super Profit Method.

Solution:

a) Average Profit = $\frac{\text{Total Profit of 5 years}}{5}$

$= \frac{42,000+47,000+45,000+39,000+47,000}{5}$

$= \frac{2,20,000}{5}$

= 44,000

Capitalised value of the business at 10% = $\frac{44,000*100}{10}$	=	4,40,000
Less capital employed	=	4,00,000
Value of Goodwill		40,000

b) Average profit (as above)	**44,000**
Less normal return on capital employed (at 10% on Rs 4,00,000)	**40,000**
Super Profit	**4000**

Capital value of super profit = $\frac{4,000*100}{10} = 40,000$

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1. Introduction

In recent years the whole world in general, and in recent times India in particular, is warming up to take on IFRSs. Never before such an exercise of this scale was made covering more than 100 countries, in the field of accounting. Although question is being raised from some quarter that whether it was necessary for India to adopt IFRSs at this stage, but one must appreciate that India cannot remain aloof in the globalised world when most of the countries have adopted or are going to adopt IFRSs. In the given situation the burden rests with the accounting professionals and academicians to carry out the implementation process.

2. Evolution of IFRSs

Before establishment of the International Accounting Standards Committee (IASC), accounting policies adopted by different countries differed widely, due to reasons associated with social, economic and legal issues. Even within a particular country the variation was significant. On the other hand the rapid growth of international trade and trans-nationalization of the corporations necessitated global convergence of diverse accounting practices. Worldwide presence through subsidiary companies and entry into global capital market further accelerated the process. Economic decisions based on financial statements are no longer limited to the boundary of a country. With this perspective, leading professional accounting bodies in the world came forward for putting united effort in harmonizing accounting standards and in framing procedures relating to the preparation and presentation of financial statements.

2.1. International Accounting Standards Committee (IASC)

The most remarkable phenomenon in the sphere of promoting global harmonization process in accounting is the emergence of the International Accounting Standards Committee (IASC), which in course of time issued International Accounting Standards (IASs) for adoption by the member countries. The 9th Congress of the International Congress of Accountants in 1973 succeeded in reaching an agreement to establish a committee called International Accounting Standards Committee with the involvement of leading professional accounting bodies of 9 countries. The office of the IASC is located in London.

"IASC was formed in 1973 through an agreement made by professional accounting bodies from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland and the United States of America. Between 1983 and 2001, IASC's members included all the professional accountancy bodies that were members of

the International Federation of Accountants.” (Source-International Accounting Standards 2001- Taxmann).

Before 2001, the IASC was governed by the IASC Board. The Board was also involved in the whole process of pronouncement of International Accounting Standards, i.e. identification of the area, issue of Exposure Draft, consideration of suggestions and finally issue of the International Accounting Standards. Important statements issued by the Board till 2000 are as follows:

Forty-one International Accounting Standards (IASs) (out of these, 27 are live and others have been withdrawn). The first IAS i.e. IAS 1 was issued in January 1975.

Preface to Statements of International Accounting Standards (first published in January 1975 which was superseded by the Preface published in January 1983);

Framework for the Preparation and Presentation of Financial Statements (published in July 1989).

The IASC performed its task efficiently so far as the issue of IASs are concerned. It not only issued IASs but also revised them from time to time. IASC was simply a Committee and not an independent body as such. Therefore, IASC was replaced by IASC foundation.

2.2 International Accounting Standards Committee Foundation (IASC Foundation) and the International Accounting Standards Board (IASB)

In 2000, members of the former IASC approved a new Constitution. The new Constitution was activated in February 2001. It was revised in 2002 and 2005. The said Constitution provides that the name of the organisation shall be the International Accounting Standards Committee Foundation (IASC Foundation) and the International Accounting Standards Board (IASB) shall be standard setting body of the IASC Foundation. The IASC Foundation is now an independent body. The governance of the IASC Foundation rests with the Trustees comprising twenty-two individuals (six from North America, six from Europe, six from Asia/Oceania region and four from any area). The term of office of a Trustee is three years. The Trustees are responsible for filling all the vacancies in the posts of Trustees.

IASB

The IASB is responsible for all technical matters including preparation and issue of Exposure Drafts and International Financial Reporting Standards (IFRSs), revising

International Accounting Standards (IASs), and for giving final approval of the Interpretations by the International Financial Reporting Interpretations Committee.

IFRSs

International Financial Reporting Standards (IFRSs) are a set of accounting standards developed and issued by the IASB for application by the member bodies for preparation of Financial Statements. The IASB has adopted all of the IASs issued by former IASC and simultaneously announced a new set of accounting standards called, International Financial Reporting Standards (IFRSs). The term IFRSs includes the following Standards and Interpretations (IAS 1.7)-

International Financial Reporting Standards (IFRSs);

International Accounting Standards (IASs) (those are live);

Interpretations issued by the IFR Interpretation Committee (IFRIC)

Interpretations issued by the Standards Interpretation Committee (SIC)

Conceptual Framework

In addition to the abovementioned Standards and Interpretations, the IASC /IASB issued the Conceptual Frameworks also. In 1989, the IASC issued the Framework and in 2001 the IASB adopted it. In 2010 it was revised.

The Conceptual Framework sets out the concepts that underlie the preparation and presentation of financial statements for external users.

The Preface

The revised Preface, adopted in 2002, explains the 'Scope and authority of International Financial Reporting Standards'. Some of them are-

(i) IFRSs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in general purpose financial statements.

(ii) IFRSs are designed to apply to all general purpose financial statements and other financial reporting of all profit seeking entities.

(iii) *General purpose financial statements* are directed towards the common information needs of a wide range of users, i.e. shareholders, creditors, employees and the public at large. *Other financial reporting* comprises information provided outside

financial statements that assists in the interpretation of a complete set of financial statements.

(iv) *A complete set of financial statements* includes a balance sheet, an income statement, a statement showing change in equity, a cash flow statement, and accounting policies and explanatory notes.

(v) The IASB's objective is to require like transactions and events to be accounted for and reported in a like way and unlike transactions and events to be accounted for and reported differently, both within an entity over time and among entities. Consequently, the IASB intends not to permit choices in accounting treatment. Also, the IASB has reconsidered and will continue to reconsider those transactions and events for which IASs permit a choice of accounting treatment, with the objective of reducing the number of those choices.

The Preface also outlines the international *due process* (i.e. the procedure to be followed normally) for development of IFRSs and interpretations thereof.

2.3 Current IAS/IFRS

As of now, there are 27 live IASs (out of total 41 IASs issued) and 15 IFRSs. Other IASs have been withdrawn. The complete list as at 01.07.2014 is given below:

1. IAS 1: *Presentation of Financial Statements*
2. IAS 2: *Inventories*
3. IAS 7 :*Cash Flow Statements*
4. IAS 8 :*Accounting Policies, Changes in Accounting Estimates and Errors*
5. IAS 10: *Events After the Balance Sheet Date*
6. IAS 11 :*Construction Contracts*
7. IAS 12 :*Income Taxes*
8. IAS 16 :*Property, Plant and Equipment*
9. IAS 17 :*Leases*
10. IAS 18 :*Revenue*
11. IAS 19 :*Employee Benefits*

12. IAS 20 :*Accounting for Government Grants and Disclosure of Government Assistance*
13. IAS 21 :*The Effects of Changes in Foreign Exchange Rates*

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14. IAS 23 :*Borrowing Costs*
15. IAS 24 :*Related Party Disclosures*
16. IAS 26 :*Accounting and Reporting by Retirement Benefit Plans*
17. IAS 27 : Separate Financial Statements
18. IAS 28 :*Investments in Associates*
19. IAS 29 :*Financial Reporting in Hyperinflationary Economies*
20. IAS 32 :*Financial Instruments: Presentation*
21. IAS 33 :*Earnings per Share*
22. IAS 34 :*Interim Financial Reporting*
23. IAS 36 :*Impairment of Assets*
24. IAS 37 :*Provisions, Contingent Liabilities and Contingent Assets*
25. IAS 38 :*Intangible Assets*
26. IAS 39 :*Financial Instruments: Recognition and Measurement*
27. IAS 40 :Investment Property
28. IAS 41 :Agriculture
29. **IFRS 1:** *First-time Adoption of International Financial Reporting Standards*
30. IFRS 2: *Share-based Payment*
31. IFRS 3: *Business Combinations*
32. IFRS 4: Insurance Contracts
33. IFRS 5: *Non-current Assets Held for Sale and Discontinued Operations*
34. IFRS 6: *Exploration for and Evaluation of Mineral Resources*
35. IFRS 7: *Financial Instruments: Disclosures*

36. IFRS 8: *Operating Segments*

37. IFRS 9: *Financial Instruments (w.e.f. 01.01.2015)*

38. IFRS 10: *Consolidated Financial Statements (w.e.f. 01.01.2013)*

39. IFRS 11: *Joint Arrangements (w.e.f. 01.01.2013)*

40. IFRS 12: *Disclosure of Interest in Other Entities (w.e.f. 01.01.2013)*

41. IFRS 13: *Fair Value Measurement (w.e.f. 01.01.2013)*

42. IFRS 14: *Regulatory Deferral Accounts (w.e.f. 01.01.2016)*

43. IFRS 15- *Revenue from Contracts with Customers (w.e.f. 01.01.2017)*

3. IFRSs Adoption in Other Countries

- 112 countries require IFRS for all or most domestic publicly accountable entities (listed companies and financial institutions).
- Bhutan and Colombia will begin using IFRS in 2021, and 2015 respectively..
- The Mainland China has substantially converged with IFRS (but not adopted).
- Russian Federation requires IFRS for consolidated financial statements of listed companies.
- India, USA, Japan, Switzerland, Malaysia etc. are planning to adopt IFRSs in near future.

4. IFRSs Adoption in India

Issue of converged accounting standards -During the year 2010, the ICAI drafted 35 **Ind ASs** (which are substantially converged with IFRSs) and had sent to NACAS for final decision. After receiving clearance from NACAS, MCA has notified those 35 Ind ASs in February 2011. It mentioned that date of implementation would be notified later on.

In 2015 the **Companies (Indian Accounting Standards) Rules, 2015** was issued, under the Companies Act 2013. 39 Standards have been included in these Rules (i.e. except IAS 11, IAS 18, IAS 26, IAS 39 from the above list).

As per this Rule, roadmap of implementation is as follows:

(i) The following companies shall comply with the Indian Accounting Standards (Ind AS) f~~or the accounting periods beginning on or after 1st~~ April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely:-

(a) compani~~es whose equity or debt securities are listed or are in the proces~~s of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more;

(b) companies other than those covered by sub-clause (a) above and having net worth of rupees five hundred crore or more;

(c) holding, subsidiary, joint venture or associate companies of companies covered by sub-clause (a) and sub-clause (b) above as the case may be;

and

(ii) The following companies shall comply with the Indian Accounting Standards (Ind AS) for ~~the accounting periods beginning on or after 1st April, 2017,~~ with the comparatives for the periods ending on 31st March, 2017, or thereafter, namely:-

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore;

(b) unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore.

(c) holding, subsidiary, joint venture or associate companies of companies covered under sub-clause (a) and sub-clause (b) above, as the case may be:

Provided that nothing in this sub-rule, except clause (i), shall apply to companies whose securities are listed or are in the process of being listed on SME exchange as referred to in Chapter XB or on the Institutional Trading Platform without initial public offering in accordance with the provisions of Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Explanation 1. - SME Exchange shall have the same meaning as assigned to it in Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Explanation 2. - “Comparatives” shall mean comparative figures for the preceding accounting period.

Accounting Standards (AS)

Accounting Standards (AS) are basic policy documents. Their main aim is to ensure transparency, reliability, consistency, and comparability of the financial statements. They do so ~~by standardizing accounting policies and principles of a nation/economy~~. So the transactions of all companies will be recorded in a similar manner if they follow these accounting standards.

These Accounting Standards (AS) are issued by an accounting body or a regulatory board or sometimes by the government directly. In India, the Indian Accounting Standards are issued by the Institute of Chartered Accountants of India (ICAI).

Accounting Standards mainly deal with four major issues of accounting, namely

i. Recognition of financial events

ii. Measurement of financial transactions

iii. Presentation of financial statements in a fair manner

iv. Disclosure requirement of companies to ensure stakeholders are not misinformed

Objectives of Accounting Standards

Accounting is often considered the language of business, as it communicates to others the financial position of the company. And like every language has certain syntax and grammar rules the same is true here. These rules in the case of accounting are the Accounting Standards (AS). They are the framework of rules and regulations for accounting and reporting in a country. Let us see the main objectives of forming these standards.

The main aim is to improve the reliability of financial statements. Now because the financial statements have to be made following the standards the users can rely on them. They know that not conforming to these standards can have serious consequences for the companies.

Then there is comparability. Following these standards will allow for inter-firm and intra-firm comparisons. This allows us to check the progress of the firm and its position in the market.

It also looks to provide one set of accounting policies that include the necessary disclosure requirements and the valuation methods of various financial transactions.

Benefits of Accounting Standards

Accounting Standards are the ruling authority in the world of accounting. It makes sure that the information provided to potential investors is not misleading in any way. Let us take a look at the benefits of AS.

1] Attains Uniformity in Accounting

Accounting Standards provides rules for standard treatment and recording of transactions. They even have a standard format for financial statements. These are steps in achieving uniformity in accounting methods.

2] Improves Reliability of Financial Statements

There are many stakeholders of a company and they rely on the financial statements for their information. Many of these stakeholders base their decisions on the data provided by these financial statements. Then there are also potential investors who make their investment decisions based on such financial statements.

So it is essential these statements present a true and fair picture of the financial situation of the company. The Accounting Standards (AS) ensure this. They make sure the statements are reliable and trustworthy.

3] Prevents Frauds and Accounting Manipulations

Accounting Standards (AS) lay down the accounting principles and methodologies that all entities must follow. One outcome of this is that the management of an entity cannot manipulate with financial data. Following these standards is not optional, it is compulsory.

So these standards make it difficult for the management to misrepresent any financial information. It even makes it harder for them to commit any frauds.

4] Assists Auditors

Now the accounting standards lay down all the accounting policies, rules, regulations, etc in a written format. These policies have to be followed. So if an auditor checks that the policies have been correctly followed he can be assured that the financial statements are true and fair.

5] Comparability

This is another major objective of accounting standards. Since all entities of the country follow the same set of standards their financial accounts become comparable to some extent. The users of the financial statements can analyze and compare the financial performances of various companies before taking any decisions.

Also, two statements of the same company from different years can be compared. This will show the growth curve of the company to the users.

6] Determining Managerial Accountability

The accounting standards help measure the performance of the management of an entity. It can help measure the management's ability to increase profitability, maintain the solvency of the firm, and other such important financial duties of the management.

Management also must wisely choose their accounting policies. Constant changes in the accounting policies lead to confusion for the user of these financial statements. Also, the principle of consistency and comparability are lost.

Limitations of Accounting Standards

There are a few limitations of Accounting Standards as well. The regulatory bodies keep updating the standards to restrict these limitations.

1] Difficulty between Choosing Alternatives

There are alternatives for certain accounting treatments or valuations. Like for example, stocks can be valued by LIFO, FIFO, weighted average method, etc. So choosing between these alternatives is a tough decision for the management. The AS does not provide guidelines for the appropriate choice.

2] Restricted Scope

Accounting Standards cannot override the laws or the statutes. They have to be framed within the confines of the laws prevailing at the time. That can limit their scope to provide the best policies for the situation.

Formulation of Accounting Standards in India

Since 1977 after the government passed a statute, the Accounting Standard Board (ASB) a committee of the ICAI has been responsible for the formulation of accounting

standards in India. Let us take a brief look at the functioning of the ASB and the procedure behind the formulation of accounting standards in India.

Accounting Standard Board

ICAI is the highest accounting body in the country. And the ASB is a committee of the ICAI. But to ensure maximum transparency and independence, the ASB is a completely independent body.

The ASB formulates all the accounting standards for the Indian companies. This process is fully transparent, very thorough and completely independent of any government involvement. While framing the standards the ASB will try and incorporate the IFRS and its principles in the Indian standards. While India does not plan to adopt the IFRS, this process will help the convergence of the two standards. So the ASB will modify the IFRS to suit the laws, customs and common usage in the country.

The ASB is composed of various members. There are representatives of industries like the FICCI and ASSOCHAM. There are also certain government officials, a few academics, and regulators from various departments. The idea is to make the ASB as inclusive and representative as possible.

Procedure for Formulation of Accounting Standards

Let us take a brief look at the procedure setting process that the ASB follows

- First, the ASB will identify areas where the formulation of accounting standards may be needed

- Then the ASB will constitute study groups and panels to discuss and study the topic at hand. Such panels will prepare a draft of the standards. The draft normally includes the definition of important terms, the objective of the standard, its scope, measurement principles and the representation of said data in the financial statements.

- The ASB then carries out deliberations of the said draft of the standard. If necessary changes and revisions are made.

- Then this preliminary draft is circulated to all concerned authorities. This will generally include the members of the ICAI, and any other concerned authority like the Department of Company Affairs (DCA), the SEBI, the CBDT, Standing Conference of Public Enterprises (SCPE), Comptroller and Auditor General of India etc. These members and departments are invited to give their comments.

- Then the ASB arranges meetings with these representatives to discuss their views and concerns about the draft and its provisions
- The exposure draft is then finalized and presented to the public for their review and comments
- The comments by the public on the exposure draft will be reviewed. Then a final draft will be prepared for the review and consideration of the ICAI
- The Council of the ICAI will then review and consider the final draft of the standard. If necessary they may suggest a few modifications.
- Finally, the Accounting Standard is issued. In the case of standard for non-corporate entities, the ICAI will issue the standard. And if the relevant subject relates to a corporate entity the Central Government will issue the standard.

Indian Accounting Standard 1 — Presentation of Financial Statements

Objective

This Standard prescribes the basis for presentation of general purpose financial statements to ensure comparability

- both with financial statements of previous periods and
- with the financial statements of other entities.
- It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

Scope

- An entity shall apply this Standard in preparing and presenting general purpose financial statements in accordance with Indian Accounting Standards (Ind ASs).
- Consolidated Financial Statements in accordance with Ind AS 110 ‘Consolidated Financial Statements’
- Separate financial statements in accordance with Ind AS 27 ‘Separate Financial Statements’.
- This Ind AS does not apply to interim Financial Statements prepared in accordance with Ind AS 34 except para 15 to 35 of Ind AS 1.

Definitions

General purpose financial statements (referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

Impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

Indian Accounting Standards (Ind ASs) are Standards prescribed under Section 133 of the Companies Act, 2013.

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances.

Notes contain information in addition to that presented in the balance sheet (including statement of changes in equity which is a part of balance sheet), statement of profit and loss and statement of cash flows.

Owners are holders of instruments classified as equity**.**

Profit or Loss is the total of income less expenses, excluding comprehensive income.

Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.

Purpose of financial statements

The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity's:

(a) assets; (b) liabilities; (c) equity; (d) income and expenses, including gains and losses;

(e) contributions by and distributions to owners in their capacity as owners; and (f) cash flows.

This information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

A complete set of financial statements comprises:

- **(a)** a balance sheet as at the end of the period ;
- **(b)** a statement of profit and loss for the period;
- **(c)** statement of changes in equity for the period;
- **(d)** a statement of cash flows for the period;
- **(e)** notes, comprising a summary of significant accounting policies and other explanatory information; and
- **(f)** comparative information in respect of the preceding period;
- **(g)** a balance sheet as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements
- **(h)** An entity shall present a single statement of profit and loss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed directly by the other comprehensive income section.

General features

- Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of

Ind ASs, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.

- An entity whose financial statements comply with Ind ASs shall make an explicit and unreserved statement of such compliance in the notes.

- An entity shall not describe financial statements as complying with Ind ASs unless they comply with all the requirements of Ind ASs.

- An entity **cannot** rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.

- In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

When an entity departs from a requirement of an Ind AS, it should be a part of its disclosure. It should disclose:

(a) that management has concluded that the financial statements present a true and fair view ;that it has complied with applicable Ind ASs, except that it has departed from a particular requirement to present a true and fair view;

(b) the title of the Ind AS from which the entity has departed, the nature of the departure, including the treatment that the Ind AS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and

(c) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

(d) When an entity has departed from a requirement of an Ind AS in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures.

In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:

(a) the title of the Ind AS in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in the Framework; and

(b) for each period presented, the adjustments to each item in the financial statements hat management has concluded would be necessary to present a true and fair view.

Going concern

An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

When management is aware, of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Frequency of reporting

An entity shall present a complete set of financial statements (including comparative information) at least annually.

When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:

(a) the reason for using a longer or shorter period, and

(b) the fact that amounts presented in the financial statements are not entirely comparable.

Comparative information

Except when Ind ASs permit or require otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements.

Any narrative or descriptive information should be included if it is relevant to under standard the financial statements.

An entity shall present, as a minimum, two balance sheets , two statements of profit and loss, two statements of cash flows and two statements of changes in equity, and related notes.

Additional comparative information

An entity may present comparative information in addition to the minimum comparative financial statements required by Ind ASs, as long as that information is prepared in accordance with Ind ASs.For example, an entity may present a third statement of profit and loss (thereby presenting the current period, the preceding period and one additional comparative period). However, the entity is not required to present a third balance sheet, a third statement of cash flows or a third statement of changes in equity (ie an additional financial statement comparative). The entity is required to present, in the notes to the financial statements, the comparative information related to that additional statement of profit and loss.

Change in accounting policy, retrospective restatement or reclassification

An entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if:

(a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and

(b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the circumstances described in paragraph 40A, an entity shall present three balance sheets as at:

(a) the end of the current period;

(b) the end of the preceding period; and

(c) the beginning of the preceding period.

If an entity changes the presentation or classification of items in its financial statements, it shall reclassify comparative amounts unless reclassification is impracticable. When an entity reclassifies comparative amounts, it shall disclose (including as at the beginning of the preceding period):

(a) the nature of the reclassification;

(b) the amount of each item or class of items that is reclassified; and

(c) the reason for the reclassification.

When it is impracticable to reclassify comparative amounts, an entity shall disclose:

(a) the reason for not reclassifying the amounts, and

(b) the nature of the adjustments that would have been made if the amounts had been reclassified.

Consistency of presentation

An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

- it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Ind AS 8; or
- an Ind AS requires a change in presentation.

Structure and content

Identification of the financial statements

- An entity shall clearly identify the financial statements and distinguish them from other information in the same published document. Ind ASs apply only to financial statements, and not necessarily to other information presented in an annual report, a regulatory filing, or another document. Therefore, it is important that users can distinguish information that is prepared using Ind ASs

from other information that may be useful to users but is not the subject of those requirements.

- An entity shall display the following information prominently, and repeat it when necessary for the information presented to be understandable:
  - the name of the reporting entity or other means of identification;
  - whether the financial statements are of an individual entity or a group of entities;
  - the date of the end of the reporting period;
  - the presentation currency; and
  - the level of rounding used in presenting amounts in the financial statements.

Balance Sheet

As a minimum, the balance sheet shall include line items that present the following amounts:

(a) property, plant and equipment;

(b) investment property;

(c) intangible assets;

(d) financial assets (excluding amounts shown under (e), (h) and (i));

(e) investments accounted for using the equity method;

(f) biological assets within the scope of Ind AS 41 Agriculture;

(g) inventories;

(h) trade and other receivables;

(i) cash and cash equivalents;

(j) the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations;

(k) trade and other payables;

(l) provisions;

(m) financial liabilities (excluding amounts shown under (k) and (l));

(n) liabilities and assets for current tax, as defined in Ind AS 12, Income Taxes;

(o) deferred tax liabilities and deferred tax assets, as defined in Ind AS 12;

(p) liabilities included in disposal groups classified as held for sale in accordance with Ind AS 105;

(q) non-controlling interests, presented within equity; and

(r) issued capital and reserves attributable to owners of the parent.

Current/non-current distinction

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet in accordance with paragraphs that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.

Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

(a) not more than twelve months after the reporting period, and

(b) more than twelve months after the reporting period.

For some entities, such as financial institutions, a presentation of assets and liabilities in increasing or decreasing order of liquidity provides information that is reliable and more relevant than a current/non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.

An entity is permitted to present some of its assets and liabilities using a current/non-current classification and others in order of liquidity when this provides information that is reliable and more relevant. The need for a mixed basis of presentation might arise when an entity has diverse operations.

Current assets

An entity shall classify an asset as current when:

(a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the reporting period; or

(d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

(e) An entity shall classify all other assets as non-current.

(f) This Standard uses the term 'non-current' to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.

The **operating cycle** of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal

operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading and the current portion of non-current financial assets.

Current liabilities

An entity shall classify a liability as current when:

(i) it expects to settle the liability in its normal operating cycle;

(ii) it holds the liability primarily for the purpose of trading;

(iii) the liability is due to be settled within twelve months after the reporting period; or

(iv) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

- An entity shall classify all other **liabilities as non-current.**

- Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period.

- Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading. Financial liabilities that provide financing on a long-term basis and are not due for settlement within twelve months after the reporting period are **non-current liabilities.**

- An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:

  (a) the original term was for a period longer than twelve months, and

  (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are approved for issue.

If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity , the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

Information to be presented either in the balance sheet or in the notes

- An entity shall disclose, either in the balance sheet or in the notes, further sub-classifications of the line items presented, classified in a manner appropriate to the entity's operations.
- An entity shall disclose the following, either in the balance sheet or the statement of changes in equity, or in the notes:

i. for each class of share capital:

  - the number of shares authorised;
  - the number of shares issued and fully paid, and issued but not fully paid;
  - par value per share, or that the shares have no par value;
  - a reconciliation of the number of shares outstanding at the beginning and at the end of the period;
  - the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;

ii. shares in the entity held by the entity or by its subsidiaries or associates; and shares reserved for issue under options and contracts for the sale of shares, including terms and amounts; anda description of the nature and purpose of each reserve within equity.

An entity whose capital is not limited by shares e.g., a company limited by guarantee, shall disclose information showing changes during the period in each category of equity interest, and the rights, preferences and restrictions attaching to each category of equity interest.

Statement of Profit and Loss

The statement of profit and loss shall present, in addition to the profit or loss and other comprehensive income sections:

(a) profit or loss;

(b) total other comprehensive income;

(c) comprehensive income for the period, being the total of profit or loss and other comprehensive income.

An entity shall present the following items, in addition to the profit or loss and other comprehensive income sections, as allocation of profit or loss and other comprehensive income for the period:

(a) profit or loss for the period attributable to:

  i. non-controlling interests, and

  ii. owners of the parent.

(b) comprehensive income for the period attributable to:

  i. non-controlling interests, and

  ii. owners of the parent.

Information to be presented in the profit or loss section of the statement of profit and loss

In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:

(a) revenue, presenting separately interest revenue calculated using the effective interest method;

(b) gains and losses arising from the derecognition of financial assets measured at amortised cost;

(c) finance costs;

(d) impairment losses ;

(e) share of the profit or loss of associates and joint ventures accounted for using the equity method;

(f) if a financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through profit or loss, any gain or loss arising from a difference between the previous amortised cost of the financial asset and its fair value at the reclassification date;

(g) if a financial asset is reclassified out of the fair value through other comprehensive income measurement category so that it is measured at fair value through profit or loss, any cumulative gain or loss previously recognised in other comprehensive income that is reclassified to profit or loss;

(h) tax expense;

(i) a single amount for the total of discontinued operations.

Information to be presented in the other comprehensive income section

The other comprehensive income section shall present line items for amounts of other comprehensive income in the period, classified by nature (including share of the other comprehensive income of associates and joint ventures accounted for using the equity method) and grouped into those that, in accordance with other Ind ASs:

(a) will not be reclassified subsequently to profit or loss; and

(b) will be reclassified subsequently to profit or loss when specific conditions are met.

An entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance.

An entity shall not present any items of income or expense as extraordinary items, in the statement of profit and loss or in the notes.

Profit or loss for the period

An entity shall recognise all items of income and expense in a period in profit or loss unless an Ind AS requires or permits otherwise.

Other comprehensive income for the period

An entity shall disclose the amount of income tax relating to each item of other comprehensive income, including reclassification adjustments, either in the statement of profit and loss or in the note.

An entity shall disclose reclassification adjustments relating to components of other comprehensive income.

Other Ind ASs specify whether and when amounts previously recognised in other comprehensive income are reclassified to profit or loss. Such reclassifications are referred to in this Standard as reclassification adjustments.

A reclassification adjustment is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss.

These amounts may have been recognised in other comprehensive income as unrealised gains in the current or previous periods. Those unrealised gains must be deducted from other comprehensive income in the period in which the realised gains are reclassified to profit or loss to avoid including them in total comprehensive income twice.

Information to be presented in the statement of profit and loss or in the notes

- **When items of income or expense are material, an entity shall disclose their nature and amount separately.**
- Circumstances that would give rise to the separate disclosure of items of income and expense include:

  (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;

  (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

  (c) disposals of items of property, plant and equipment;

  (d) disposals of investments;

  (e) discontinued operations;

  (f) litigation settlements; and

  (g) other reversals of provisions.

An entity shall present an analysis of expenses recognised in profit or loss using a classification based on the nature of expense method.

Statement of Changes in Equity

An entity shall present a statement of changes in equity. The statement of changes in equity includes the following information:

- total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests;

- for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Ind AS 8;

- for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately (as a minimum) disclosing changes resulting from:

  - profit or loss;

  - other comprehensive income;

  - transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control; and

  - any item recognised directly in equity such as amount recognised directly in equity as capital reserve.

Information to be presented in the statement of changes in equity or in the notes

- For each component of equity an entity shall present, either in the statement of changes in equity or in the notes, an analysis of other comprehensive income by item..

- An entity shall present, either in the statement of changes in equity or in the notes, the amount of dividends recognised as distributions to owners during the period, and the related amount of dividends per share.

- Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners in their capacity as owners and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period.

- Ind AS 8 requires retrospective adjustments to effect changes in accounting policies, to the extent practicable, except when the transition provisions in another Ind AS require otherwise. Ind AS 8 also requires restatements to correct errors to be made retrospectively, to the extent practicable. Retrospective adjustments and retrospective restatements are not changes in equity but they are adjustments to the opening balance of retained earnings, except when an Ind AS requires retrospective adjustment of another component of equity.

- Paragraph 106(b) requires disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting from changes in accounting policies and, separately, from corrections of errors. These adjustments are disclosed for each prior period and the beginning of the period.

Capital

An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Qualitative information about its objectives, policies and processes for managing capital, including:

i. a description of what it manages as capital;

ii. when an entity is subject to externally imposed capital requirements, the nature of those requirements and how those requirements are incorporated into the management of capital; and

iii. how it is meeting its objectives for managing capital.

Summary quantitative data about what it manages as capital. Some entities regard some financial liabilities as part of capital. Other entities regard capital as excluding some components of equity.

Puttable financial instruments classified as equity

For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):

- Summary quantitative data about the amount classified as equity;

- its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;
- the expected cash outflow on redemption or repurchase of that class of financial instruments; and
- information about how the expected cash outflow on redemption or repurchase was determined.

Other disclosures

- An entity shall disclose in the notes the amount of dividends proposed or declared before the financial statements were approved for issue but not recognised as a distribution to owners during the period, and the related amount per share; and
- the amount of any cumulative preference dividends not recognised.

An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:

- the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office);
- a description of the nature of the entity's operations and its principal activities; the name of the parent and the ultimate parent of the group; and
- if it is a limited life entity, information regarding the length of its life.

Indian Accounting Standard 2 — Inventories

Objective

The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

This Standard applies to all inventories, except:

a. financial instruments ; and

b. biological assets (i.e living animals or plants) related to agricultural activity and agricultural produce at the point of harvest.

This Standard does not apply to the measurement of inventories held by:

a. producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change.

b. commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Broker-traders are those who buy or sell commodities for others or on their own account.

Inventories are assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

In case of service providers, inventories include the cost of service for which the entity has not yet recognised the revenue.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. It refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business.

Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date.

The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

Measurement of inventories

Inventories shall be measured at the lower of cost and net realisable value.

Cost of inventories comprises

- all costs of purchase,
- costs of conversion and
- other costs incurred in bringing the inventories to their present location and condition.

Costs of purchase of inventories includes

- purchase price,
- import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and
- transport, handling and
- other costs directly attributable to the acquisition of finished goods, materials and services.
- Trade discounts, rebates and other similar items are deducted in determining the costs of purchase

Costs of conversion of inventories include

- costs directly related to the units of production, such as direct material, direct labour and other direct expenses; and
- systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods
- Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as

depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration.

- Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

- The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities.

- Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance.

- The actual level of production may be used if it approximates normal capacity.

- The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred.

- In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost.

Indian Accounting Standard 7 — Statement of Cash Flows

Objective

- Providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.
- Assessing the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.
- The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents.

Scope

- **An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.**

- **This standard requires all entities to present a cash flow statement.**

- Users of an entity's financial statements are interested in how the entity generates and uses cash and cash equivalents. This is the case regardless of the nature of the entity's activities and irrespective of whether cash can be viewed as the product of the entity, as may be the case with a financial institution. Entities need cash for essentially the same reasons however different their principal revenue- producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors. Accordingly, this Standard requires all entities to present a statement of cash flows even the Banks and Financial Institutions.

Benefits of cash flow information

- A statement of cash flows, when used in conjunction with the rest of the finance statements, provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities.
- Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities.
- It also enhances the comparability.
- Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

Definitions

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

Cash and cash equivalents

Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, **three months or less** from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preference shares acquired within a short period of their maturity and with a specified redemption date.

Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents.

Presentation of a statement of cash flows

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

Operating activities

Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

1. cash receipts from the sale of goods and the rendering of services;
2. cash receipts from royalties, fees, commissions and other revenue;

3. cash payments to suppliers for goods and services;
4. cash payments to and on behalf of employees;
5. cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;
6. cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
7. cash receipts and payments from contracts held for dealing or trading purposes.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities.

The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

Investing activities

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities.

Examples of cash flows arising from investing activities are:

1. cash payments to acquire property, plant and equipment, intangibles and other long-term assets.
2. cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
3. cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
4. cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
5. cash advances and loans made to other parties (other than advances and loans

made by a financial institution);

6. cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
7. cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
8. cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Financing activities

The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity.

Examples of cash flows arising from financing activities are:

1. cash proceeds from issuing shares or other equity instruments;
2. cash payments to owners to acquire or redeem the entity's shares;
3. cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
4. cash repayments of amounts borrowed; and
5. cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Reporting cash flows from operating activities

An entity shall report cash flows from operating activities using either:

- **the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or**
- **the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.**

Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash

payments may be obtained either:

(a) from the accounting records of the entity; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial institution) and other items in the statement of profit and loss for:

   i. changes during the period in inventories and operating receivables and payables;

   ii. other non-cash items; and

   iii. other items for which the cash effects are investing or financing cash flows.

- **Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:**

   - changes during the period in inventories and operating receivables and payables;
   - non-cash items such as depreciation, provisions, deferred taxes, unrealised foreign currency gains and losses, and undistributed profits of associates; and
   - all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Reporting cash flows from investing and financing activities

An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows are permitted to be reported on a net basis.

Reporting cash flows on a net basis

If nothing is mentioned as per Ind AS 7, cash flows will be presented on Gross Basis. Gross basis means the receipts would be shown separately and the payments will be shown separately.

Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

- **cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and**

Examples are:

- the acceptance and repayment of demand deposits of a bank;
- funds held for customers by an investment entity; and
- rents collected on behalf of, and paid over to, the owners of properties.
- **cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.**

Examples are advances made for, and the repayment of:

- principal amounts relating to credit card customers;
- the purchase and sale of investments; and
- other short-term borrowings, for example, those which have a maturity period of three months or less.

Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:

- cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
- the placement of deposits with and withdrawal of deposits from other financial institutions; and

cash advances and loans made to customers and the repayment of those advances and loans.

Indian Accounting Standard (Ind AS) 8

Accounting Policies, Changes in Accounting Estimates and Errors

*(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

Objective

1 The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The Standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.

2 Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in Ind AS 1, *Presentation of Financial Statements*.

Scope

3 **This Standard shall be applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.**

4 The tax effects of corrections of prior period errors and of retrospective adjustments made to apply changes in accounting policies are accounted for and disclosed in accordance with Ind AS 12, *Income Taxes*.

Definitions

5 **The following terms are used in this Standard with the meanings specified:**

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

A *change in accounting estimate* is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Indian Accounting Standards (Ind ASs) are Standards prescribed under Section 133 of the Companies Act, 2013.

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were approved for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had

always been applied.

Retrospective restatement is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

Impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

(a) the effects of the retrospective application or retrospective restatement are not determinable;

(b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or

(c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:

  (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and

  (ii) would have been available when the financial statements for that prior period were approved for issue from other information.

Prospective application of a change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

(a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and

(b) recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.

6 Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The *Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards* issued by the Institute of Chartered Accountants of India states in paragraph 25 that 'users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.' Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

Accounting policies

Selection and application of accounting policies

7 **When an Ind AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Ind AS.**

8 Ind ASs set out accounting policies that result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from Ind ASs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

9 Ind ASs are accompanied by guidance that is integral part of Ind AS to assist entities in applying their requirements. Such guidance is mandatory.

10 In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and

(b) reliable, in that the financial statements:

(i) **represent faithfully the financial position, financial performance and cash flows of the entity;**

(ii) **reflect the economic substance of transactions, other events and conditions, and not merely the legal form;**

(iii) **are neutral, ie free from bias;**

(iv) **are prudent; and**

(v) **are complete in all material respects.**

11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements in Ind ASs dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework*.

12 **In making the judgement described in paragraph 10, management may also first consider the most recent pronouncements of International Accounting Standards Board and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.**

Changes in accounting estimates

13 As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgements based on the latest available, reliable information. For example, estimates may be required of:

(a) bad debts;

(b) inventory obsolescence;

(c) the fair value of financial assets or financial liabilities;

(d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and

(e) warranty obligations.

14 The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

15 An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.

16 A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

17 **The effect of change in an accounting estimate, other than a change to which paragraph 37 applies, shall be recognised prospectively by including it in profit or loss in:**

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

18 **To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the**

period of the change.

19 Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods

Disclosure

20 An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.

21 If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.

Errors

22 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

23 Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Limitations on retrospective restatement

24 **A prior period error shall be corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.**

25 **When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).**

26 **When it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity shall restate the comparative information to correct the error prospectively from the earliest date practicable.**

27 The correction of a prior period error is excluded from profit or loss for the period in which the error is discovered. Any information presented about prior periods,

including any historical summaries of financial data, is restated as far back as is practicable.

28 When it is impracticable to determine the amount of an error (eg a mistake in applying an accounting policy) for all prior periods, the entity, in accordance with paragraph 45, restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities and equity arising before that date. Paragraphs 50–53 provide guidance on when it is impracticable to correct an error for one or more prior periods.

29 Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency is not the correction of an error.

Disclosure of prior period errors

30 **In applying paragraph 42, an entity shall disclose the following:**

(a) the nature of the prior period error;

(b) for each prior period presented, to the extent practicable, the amount of the correction:

(i) **for each financial statement line item affected; and**

(ii) if Ind AS 33 applies to the entity, for basic and diluted earnings per share;

(c) the amount of the correction at the beginning of the earliest prior period presented; and

(d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Indian Accounting Standard (Ind AS) 16

Property, Plant and Equipment

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, whichhave equal authority. Paragraphs in bold type indicate the main principles.)

Objective

1 The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope

2 This Standard shall be applied in accounting for property, plant and equipment except when another Standard requires or permits a different accounting treatment.

3 This Standard does not apply to:

(a) property, plant and equipment classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations.

(b) biological assets related to agricultural activity other than bearer plants (See Ind AS 41, Agriculture). This Standard applies to bearer plants but it does not apply to the produce on bearer plants.

(c) the recognition and measurement of exploration and evaluation assets (see Ind AS 106, Exploration for and Evaluation of Mineral Resources).

(d) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

However, this Standard applies to property, plant and equipment used to developor maintain the assets described in (b)–(d).

4 Other Indian Accounting Standards may require recognition of an

item of property, plant and equipment based on an approach different from that in this Standard. For example, Ind AS 17, Leases, requires an entity to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

5 An entity accounting for investment property in accordance with Ind AS 40,
Investment Property, shall use the cost model in this Standard.

Definitions

6 The following terms are used in this Standard with the meanings specified:

A bearer plant is a living plant that:

(a) is used in the production or supply of agricultural produce;

(b) is expected to bear produce for more than one period; and

(c) has a remote likelihood of being sold as agricultural produce, exceptfor incidental scrap sales.

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Indian Accounting Standards, eg Ind AS 102, Share-based Payment.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113, Fair Value Measurement.)

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Property, plant and equipment are tangible items that:

(a) **are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and**

(b) **are expected to be used during more than one period.**

Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

(a) the period over which an asset is expected to be available for use by an entity; or

(b) the number of production or similar units expected to be obtained from the asset by an entity.

Recognition

7 **The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:**

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

8 . Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

9 This Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate

to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value.

10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.

Initial costs

11 Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the entity is unable to manufacture and sell chemicals. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with Ind AS 36, Impairment of Assets.

Subsequent costs

12 Under the recognition principle in paragraph 7, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day- to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.

13 Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement. Under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 67–72).

14 A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Measurement at recognition

15 An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

Elements of cost

16 The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

17 Examples of directly attributable costs are:

(a) costs of employee benefits (as defined in Ind AS 19, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) professional fees.

18 An entity applies Ind AS 2, Inventories, to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with Ind AS 2 or Ind AS 16 are recognised and measured in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

19 Examples of costs that are not costs of an item of property, plant and equipment are:

(a) costs of opening a new facility;

(b) costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(d) administration and other general overhead costs.

20 Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:

(a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

(b) initial operating losses, such as those incurred while demand for the item's output builds up; and

(c) costs of relocating or reorganising part or all of an entity's operations.

21 Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.

22 The cost of a self-constructed asset is determined using the same

principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see Ind AS 2). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. Ind AS 23, Borrowing Costs, establishes criteria for the recognition of interest as a component of the carrying amount of a self- constructed item of property, plant and equipment.

22A Bearer plants are accounted for in the same way as self-constructed items of property, plant and equipment before they are in the location and condition necessary to be capable of operating in the manner intended by management. Consequently, references to 'construction' in this Standard should be read as covering activities that are necessary to cultivate the bearer plants before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Measurement of cost

23 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with Ind AS 23.

24 One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non- monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired item is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

25 An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's

operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.

26 The fair value of an asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

27 The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with Ind AS 17.

Depreciation

28 Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

29 An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease. Similarly, if an entity acquires property, plant and equipment subject to an operating lease in which it is the lessor, it may be appropriate to depreciate separately amounts reflected in the cost of that item that are attributable to favourable or unfavourable lease terms relative to market terms.

30 A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

31 To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that

faithfully represents the consumption pattern and/or useful life of its parts.

32 An entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.

33 The depreciation charge for each period shall be recognised in profit or loss unless it is included in the carrying amount of another asset.

34 The depreciation charge for a period is usually recognised in profit or loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see Ind AS 2). Similarly, depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with Ind AS 38, Intangible Assets.

Depreciable amount and depreciation period

35 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

36 The residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

37 Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset do not negate the need to depreciate it.

38 The depreciable amount of an asset is determined after deducting its residual value. In practice, the residual value of an asset is often insignificant and therefore immaterial in the calculation of the depreciable amount.

39 The residual value of an asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's depreciation charge is zero

unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

40 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105 and the date that the

asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

41 The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

42 The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets.

43 Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

44 If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Depreciation method

45 The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

46 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.

47 A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

62A A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed.

Indian Accounting Standard (Ind AS) 38

Intangible Assets

Objective

1 The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

Scope

2 This Standard shall be applied in accounting for intangible assets, except:

(a) intangible assets that are within the scope of another Standard;

(b) financial assets, as defined in Ind AS 32, Financial Instruments: Presentation;

(c) the recognition and measurement of exploration and evaluation assets (see Ind AS 106, Exploration for and Evaluation of Mineral Resources); and

(d) ~~expenditure on the development and extraction of minerals, oil, natural~~ gas and similar non-regenerative resources.

3 If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:

(a) intangible assets held by an entity for sale in the ordinary course of business (see Ind AS 2, Inventories).

(b) deferred tax assets (see Ind AS 12, Income Taxes).

(c) leases that are within the scope of Ind AS 17, Leases.

(d) assets arising from employee benefits (see Ind AS 19, Employee Benefits).

(e) financial assets as defined in Ind AS 32. The recognition and measurement of some financial assets are covered by Ind AS 110, Consolidated Financial Statements, Ind AS 27, Separate Financial Statements, and Ind AS 28, Investments in Associates and Joint Ventures.

(f) goodwill acquired in a business combination (see Ind AS 103, Business Combinations).

(g) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of Ind AS 104, Insurance Contracts. Ind AS 104 sets out specific disclosure requirements for those deferred acquisition costs but not for those intangible assets. Therefore, the disclosure requirements in this Standard apply to those intangible assets.

(h) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations.

(i) assets arising from contracts with customers that are recognised in accordance with Ind AS 115, Revenue from Contracts with Customers.

4 Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a licence or patent) or film. In determining whether an asset that incorporates both intangible and tangible elements should be treated under Ind AS 16, Property, Plant and Equipment, or as an intangible asset under this Standard, an entity uses judgement to assess which element is more significant. For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating

system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

5 This Standard applies to, among other things, expenditure on advertising, training, start-

up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (eg a prototype), the physical element of the asset is secondary to its intangible component, ie the knowledge embodied in it.

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6 In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard. Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are excluded from the scope of Ind AS 17, and are within the scope of this Standard.

7 Exclusions from the scope of a Standard may occur if activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the accounting for expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of insurance contracts. Therefore, this Standard does not apply to expenditure on such activities and contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries or by insurers.

7AA The amortisation method specified in this Standard does not apply to an entity that opts to amortise the intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period as per the exception given in paragraph D22 of Appendix D to Ind AS 101.

Intangible assets

8 Entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights,

motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.

9 Not all the items described in paragraph 9 meet the definition of an intangible asset, ie identifiability, control over a resource and existence of future economic benefits. If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date (see paragraph 68).

Identifiability

10 The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognised in a business combination is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements.

11 An asset is identifiable if it either:

(a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Control

12 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a

necessary condition for control because an entity may be able to control the future economic benefits in some other way.

13 Market and technical knowledge may give rise to future economic benefits. An entity controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.

14 An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

15 An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (eg portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

Future economic benefits

16 The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and measurement

17 The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

(a) the definition of an intangible asset (see paragraphs 8–17); and

(b) the recognition criteria (see paragraphs 21–23).

This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it.

18 Paragraphs 25–32 deal with the application of the recognition criteria to separately ac~~quired intangible assets, and paragraphs 33–43 deal with their application to int~~angible assets acquired in a business combination. Paragraph 44 deals with the initial measurement of intangible assets acquired by way of a government grant, paragraphs 45–47 with exchanges of intangible assets, and paragraphs 48–50 with the treatment of internally generated goodwill. Paragraphs 51–67 deal with the initial recognition and measurement of internally generated intangible assets.

19 The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in this Standard. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset—be recognised in the carrying amount of an asset. Consistently with paragraph 63, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally acquired or internally generated) is always recognised in profit or loss as incurred. This is because such expenditure cannot be distinguished from expenditure to develop the business as a whole.

20 An intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

21 An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

22 An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.

23 An intangible asset shall be measured initially at cost.

Separate acquisition

Acquisition as part of a business combination

24 In accordance with Ind AS 103, Business Combinations, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for intangible assets acquired in business combinations. If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably

the fair value of the asset. Thus, the reliable measurement criterion in paragraph 21(b) is always considered to be satisfied for intangible assets acquired in business combinations.

25 In accordance with this Standard and Ind AS 103, an acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination.

This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset. An acquiree's in-process research and development project meets the definition of an intangible asset when it:

(a) ~~meets the definition of an asset; and~~

(b) is identifiable, ie is separable or arises from contractual or other legal rights.

Intangible asset acquired in a business combination

26 If an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities that uncertainty enters into the measurement of the asset's fair value.

27 An intangible asset acquired in a business combination might be separable, but only together with a related contract, identifiable asset or liability. In such cases, the acquirer recognises the intangible asset separately from goodwill, but together with the related item.

28 The acquirer may recognise a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives. For example, the terms 'brand' and 'brand name' are often used as synonym for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complimentary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.

Cost of an internally generated intangible asset

42 The cost of an internally generated intangible asset for the purpose of paragraph 24 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57. Paragraph 71 prohibits reinstatement of expenditure previously recognised as an expense.

43 The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:

(a) costs of materials and services used or consumed in generating the intangible asset;

(b) costs of employee benefits (as defined in Ind AS 19) arising from the generation of the intangible asset;

(c) fees to register a legal right; and

(d) amortisation of patents and licences that are used to generate the intangible asset.

Ind AS 23 specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.

Measurement after recognition

44 An entity shall choose either the cost model in paragraph 74 or the revaluation model in paragraph 75 as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.

45 A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. The items within a class of intangible assets are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.

Cost model

46 After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Revaluation model

47 After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be measured by reference to an active market. Revaluations shall be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.

48 The revaluation model does not allow:

(a) the revaluation of intangible assets that have not previously been recognised as assets; or

(b) the initial recognition of intangible assets at amounts other than cost.

49 The revaluation model is applied after an asset has been initially recognised at cost. However, if only part of the cost of an intangible asset is recognised as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 65), the revaluation model may be applied to the whole of that asset.

50 It is uncommon for an active market to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable taxi licences, fishing licences or production quotas. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Moreover, prices are often not available to the public.

51 The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

52 When an intangible asset is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

(a) the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated amortisation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or

(b) the accumulated amortisation is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated amortisation forms part of the increase or decrease in the carrying amount that is accounted for in accordance with paragraphs 85 and 86.

53 If ~~an intangible asset in a class of revalued intangible assets cannot be revalued~~ because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortisation and impairment losses.

54 If the fair value of a revalued intangible asset can no longer be measured by reference to an active market, the carrying amount of the asset shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

55 The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested in accordance with Ind AS 36.

56 If the fair value of the asset can be measured by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.

57 If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

58 If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

59 The cumulative revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised. The whole surplus may be realised on the retirement or disposal of the asset. However, some of the surplus may be realised as the asset is used by the entity; in such a case, the amount of the surplus realised is the difference between amortisation based on the revalued carrying amount of the asset and amortisation that would have been recognised based on the asset's historical cost. The transfer from revaluation surplus to retained earnings is not made through profit or loss.

Useful life

60 An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

61 The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised (see paragraphs 97–106), and an intangible asset with an indefinite useful life is not (see paragraphs 107–110).

62 Many factors are considered in determining the useful life of an intangible asset, including:

(a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;

(c) technical, technological, commercial or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors;

(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the entity.

63 The term 'indefinite' does not mean 'infinite'. The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating

the asset's useful life, and the entity's ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

64 Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it will often be the case that their useful life is short. Expected future reductions in the selling price of an item that was produced using an intangible asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

65 The useful life of an intangible asset may be very long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

66 The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.

67 There may be both economic and legal factors influencing the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

68 Existence of the following factors, among others, indicates that an entity would be able to renew the contractual or other legal rights without significant cost:

(a) there is evidence, possibly based on experience, that the contractual or other legal rights will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;

(b) there is evidence that any conditions necessary to obtain renewal will be satisfied; and

(c) the cost to the entity of renewal is not significant when compared with the future economic benefits expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits expected to flow to the entity from renewal, the 'renewal' cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.

Intangible assets with finite useful lives

Amortisation period and amortisation method

69 The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105 and the date that the asset is derecognised. The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.

70 A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.

98A There is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:

(a) in which the intangible asset is expressed as a measure of revenue, as described in paragraph 98C; or

(b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

98B In choosing an appropriate amortisation method in accordance with paragraph 98, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an intangible asset might specify the entity's use of the intangible asset as a predetermined number of years (i.e. time), as a number of units produced or as a fixed total amount of revenue to be generated. Identification of such a predominant limiting factor could serve as the starting point for the identification of the appropriate basis of amortisation, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits.

98C In the circumstance in which the predominant limiting factor that is inherent in an intangible asset is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortisation. For example, an entity could acquire a concession to explore and extract gold from a gold mine. The expiry of the contract might be based on a fixed amount of total revenue to be generated from the extraction (for example, a contract may allow the extraction of gold from the mine until total cumulative revenue from the sale of gold reaches Rs.2 billion) and not be based on time or on the amount of gold extracted. In another example, the right to operate a toll road could be based on a fixed

total amount of revenue to be generated from cumulative tolls charged (for example, a contract could allow operation of the toll road until the cumulative amount of tolls generated from operating the road reaches Rs.100 million). In the case in which revenue has been established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue that is to be generated might be an appropriate basis for amortising the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortisation is to be determined.

71 Amortisation is usually recognised in profit or loss. However, sometimes the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the amortisation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see Ind AS 2, Inventories).

Residual value

72 The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market (as defined in Ind AS 113) for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

73 The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.

74 An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each financial year-end. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

75 The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortisation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

Review of amortisation period and amortisation method

76 The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with Ind AS 8.

77 During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.

78 Over time, the pattern of future economic benefits expected to flow to an entity from an intangible asset may change. For example, it may become apparent that a diminishing

balance method of amortisation is appropriate rather than a straight-

line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

Intangible assets with indefinite useful lives

79 An intangible asset with an indefinite useful life shall not be amortised.

80 In accordance with Ind AS 36, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount

(a) annually, and

(b) whenever there is an indication that the intangible asset may be impaired.

Review of useful life assessment

81 The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.

82 In accordance with Ind AS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with Ind AS 36, with its carrying amount, and recognising any excess of the carrying amount over the recoverable amount as an impairment loss.

Indian Accounting Standard (Ind AS) 103 Business Combinations

I Ind AS 103 - Summary Objective of Ind AS 103

Ind AS 103 provides principles and requirements for how the acquirer:

- recognises and measures identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
- recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
- disclosure requirements

Scope

Ind AS 103 does not apply to the following:

- the formation of a joint arrangement.
- the acquisition of an asset or group of assets that is not a business as defined acquisition by an investment entity.

(Though IFRS 3, Business Combinations scopes out the accounting for combination of entities or business under common control but Ind AS 103 has included this in Appendix C).

Identifying a business combination

An entity shall determine whether a transaction or other event is a business combination in accordance with this Ind AS, which requires that the assets acquired and liabilities assumed constitute a business.

If the assets acquired are not a business, then the same shall be accounted for as an asset acquisition.

Business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this Ind AS.

An acquirer might obtain control of an acquiree in a variety of ways, for example by transferring cash, cash equivalents or other assets, by incurring liabilities, by issuing equity interests, by providing more than one type of consideration; or without transferring consideration, including by contract alone.

A business combination may be structured in a variety of ways for legal, taxation or other reasons.

A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

The three elements of a business are defined as follows:

Input: Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include non- current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes.

Output: The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

A business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

Acquisition Method

Business combinations are accounted for using the acquisition method which requires:

(a) identifying the acquirer (the acquirer is the entity that obtains control of another entity);

(b) determining the acquisition date (the date on which the acquirer obtains control);

(c) recognise and measure the identifiable assets acquired and the liabilities assumed and any non-controlling interest; and

(d) recognise and measure any goodwill or bargain purchase.

For each business combination, one of the combining entities shall be identified as the acquirer. The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

Recognition and Measurement Principle

As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree.

To qualify for recognition, the identifiable assets acquired and liabilities assumed by the acquirer must meet the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standard at the acquisition date.

The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-

date fair values.

Recognising particular assets acquired and liabilities assumed

Operating leases- The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquiree is the lessee.

The acquirer shall recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms.

Intangible assets- The acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion.

Reacquired rights- An acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or

unrecognised assets. A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill.

Assembled workforce and other items that are not identifiable

The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date.

Exceptions to the Recognition Principles

(a) Contingent Liabilities

- the acquirer shall recognise if it is a present obligation that arises from past events and its fair value can be measured reliably.

(b) Exceptions to the Recognition and Measurement Principles

- Income taxes
  - deferred tax assets or liabilities arising from acquired assets or liabilities accounted in accordance with Ind AS 12.
- Employee benefits
  - accounted in accordance with Ind AS 19.
- Indemnification assets
  - shall be measured and recognised on the basis of the indemnified item.

(c) Exceptions to the Measurement Principles

- Reacquired rights
  - measured at fair value based on remaining contractual term ignoring the fair value effect of renewal.
- Share-based payment transactions
  - measured in accordance with Ind AS 102 (Market Based Measure).
- Assets held for sale
  - measured in accordance with Ind AS 105 (i.e., fair value less costs to sell).

Recognition and measurement of Goodwill or Bargain Purchase

Goodwill is measured as the difference between the consideration transferred in exchange for the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

Bargain purchase

In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination,

where the value of acquired identifiable assets and liabilities exceeds the consideration transferred; the acquirer shall recognise a gain (bargain purchase). The gain shall be recognised by the acquirer in Other Comprehensive Income on the acquisition date and accumulate the same in equity as capital reserve, if there exists a clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.

If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognised directly in equity as capital reserve.

Reverse Acquisitions

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition.

In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer.

Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition.

Consideration transferred

The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer.

Contingent consideration

The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

Applying the acquisition method to particular types of business combinations

(I) A business combination achieved in stages

The acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss in profit or loss or other comprehensive income, as appropriate.

(II) A business combination achieved without the transfer of consideration

The acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognised in accordance with this Ind AS. In other words, the equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the non-controlling interest.

Measurement Period

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized and additional assets and liabilities that existed at the acquisition date to reflect new information obtained.

The measurement period ends as soon as the acquirer receives the information it was seeking or learns that more information is not obtainable.

The measurement period shall not exceed one year from the acquisition date.

Subsequent measurement and accounting

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable Ind AS for those items, depending on their nature. However, Ind AS 103 provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:

(a) reacquired rights;

(b) contingent liabilities recognised as of the acquisition date;

(c) indemnification assets; and

(d) contingent consideration.

Disclosures

The acquirer shall disclose information of a business combination that occurs either:

- during the current reporting period; or
- after the end of the reporting period but before the financial statements are approved for issue.

The acquirer shall disclose information for each business combination that occurs during the reporting period such as:

- the name and a description of the acquiree.
- the acquisition date.
- the percentage of voting equity interests acquired.
- the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- a qualitative description of the factors that make up the goodwill recognised.
- the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration.
- and other disclosures as prescribed in the standard.

Business combinations of entities under common control

Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interests method.

The pooling of interest method is considered to involve the following:

(a) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(b) No adjustments are made to reflect fair values, or recognise any new assets or liabilities. The only adjustments that are made are to harmonise accounting policies.

(c) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

(d) The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

(e) The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.

(f) The difference, if any, between the amounts recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes.

Ind AS 110: Consolidated Financial Statements

1. **Objective:**

The objective of this Indian Accounting Standard (Ind AS110) is to establish principles for the presentation and preparation of consolidated financial statements when an entity controlsone or more other entities. For this purpose this Ind AS: (a) requires an entity (the parent) that controls one or more other entities (subsidiaries) to **present consolidated financial statements**;

(b) **defines the principle of control**, and establishes control as the basis for consolidation; (c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee; (d) **sets out the accounting requirements for the preparation of consolidated financial statements**; and (e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of aninvestment entity.

2. **Scope:**

An entity that is a parent shall present consolidated financial statements, with certain exceptions as specified in the standard.

3. **Principle of Control:**

An investor shall determine whether it is a parent by assessing whether it controls the investee. An investor controls an investee if and only if the investor has all the following: (a) power over the investee; (b) exposure, or rights, to variable returns from its involvement withthe investee; and (c) the ability to use its power over the investee to affect the amount ofthe investor's returns

4. **Accounting Requirements:**

A) A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. Consolidation ofan investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.

B) A parent shall present non-controlling interests in the consolidated balance sheet within equity, separately from the equity of the owners of the parent. Changes in a parent's ownership interest in a

subsidiary that do not result in the parent losing control of thesubsidiary are equity transactions (i.e. transactions with owners in their capacity as owners).

C) Consolidation procedures:

(I) Consolidated financial statements:

(a) combine like items of assets, liabilities, equity, income, expenses and cash flows ofthe parent with those of its subsidiaries.

b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (Note that Ind AS 103 explains how to account for any related goodwill).

(c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements.

(II) An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controllinginterests having a deficit balance.

Note: Thus, measurement for Goodwill/ Bargain Purchase is done as per Ind AS 103 at the time of acquirement of control. However, the measurement of Non-Controlling Interest is done on the date of consolidation.

5. Investment Entity:

(I) A parent shall determine whether it is an investment entity. An investment entity is anentity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s)with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returnsfrom capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on afair value basis.

(II) An investment entity shall not consolidate its subsidiaries or apply Ind AS 103 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS109.

However, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities it shall consolidate that subsidiary in accordance with paragraphs of this Ind AS and apply the requirements of Ind AS 103 to the acquisition of any such subsidiary.

(III) A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is aninvestment entity.

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