SCHOOL OF MANAGEMENT STUDIES

UNIT – I – Corporate Acconting -1 – SBAA1301

UNIT-1 ISSUE OF SHARE AND DEBENTURES

Issue of share –various kinds of share – Forfeiture of share –Re-issue of share –issue of Debenture –Underwriting of share –Underwriting of Debenture.

Introduction-Company

A company is an association of persons who contribute money or money's worth to a common stock and uses it for a common purpose. In the words of Justice James, "a company is an association of persons united for a common object". Sec 3(1) (i) of the Companies Act 1956 defines a company as "company formed and registered under this Act or an existing company".

Characteristics of Company

1. It is a voluntary association of persons
2. It has a separate legal entity
3. It has a common seal
4. It has a perpetual succession.

Kinds of Companies

I. On the basis of formation

1. Chartered companies – Those companies which are incorporated under a special charter by the king or sovereign such as East India Company.
2. Statutory companies – These companies are formed by the special Act of legislature or parliament like RBI.
3. Registered companies – Such companies are incorporated under the Companies Act 1956 or were registered under any previous Companies Act.

On the basis of liability

1. Limited companies- In these companies, the liability of each member is limited to the extent of face value of shares held by him.
2. Guarantee companies – The liability of member of such companies are limited to the amount he has undertaken to contribute to the assets of the company in the event of its winding up.
3. Unlimited Companies – In these companies, the liability of the members is unlimited and members are personally liable to the creditors of the company fop making up the deficiency. Such companies are rare these days.

On the basis of public investment

(i) ***Public Company:*** A public company means a company which (a) is not a private company, (b) has minimum paid up capital of Rs. 5 lakh rupees or such higher paid-up capital, as may be prescribed and (c) is a company which is not a subsidiary of a private company.

(ii) ***Private Company:*** A private company is one which has a minimum paid up capital of Rs. 1 Lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles:

(a) restricts the right to transfer its shares;

(b) limits the number of its members to fifty (excluding its employees);

(c) prohibits any invitation to the public to subscribe for any shares in or debentures of the company.

(d) prohibits any invitation or acceptance of deposits from person other than its members, directors, and relatives

Difference between a Public Company and a Private Company

Some of the major distinction between a public company and a private company are as follows:

1. **Minimum number of members:**

   The minimum number of persons required to form a ‘ public company is seven whereas in a private company it is only two.

2. **Maximum number of members**:

   There is no maximum limit on the members of a public company but a private company cannot have more than 50 members excluding employees and ex-employees of the company.

3. **Restriction on name:**

   The name of a public company must end with the word, “limited” But in the case of a private company the word private limited must be used at the end of the name.

4. **Commencement of business:**

   A public company can commence its business only after getting the certificate of commencement of business.

5. **Invitation to the public:**

   A public company must issue a prospectus or statement in lieu of prospectus for inviting public to subscribe to its shares or debentures. A private company on the other hand cannot issue such invitation to the public.

6. **Transferability of shares:**

There is no restriction on the transfer of shares in the case of a public company whereas the articles of a private company must restrict its right to transfer its shares.

7. **Number of its directors:**

A public company must have at least three directors whereas a private company must have at least two directors.

8. **Restrictions on the appointment of directors:**

A director of a public company shall file with the Registrar consent to act as a director or sign the memorandum of association or enter into a contract for their qualification shares. The directors of a private company need not do so.

9. **Statutory meeting:**

A public company must hold a statutory meeting and file with the Registrar a statutory report. But a private company has no such obligations.

10. **Quorum:**

If the articles of a company do not otherwise provide five members personally present in the case of a public company are quorum for a meeting of the company. It is two in the case of a private company.

11. **Issue of share warrants:**

A public company can issue share warrants but such a right is denied to a private company.

12. **Further issue of capital:**

A public company proposing further issue of shares must offer them to the existing members. A private company is free to allot new issue to outsiders.

13. **Managerial remuneration:**

Total managerial remuneration in the case of a public company cannot exceed 11% of the net profits but in the case of inadequacy of profits a minimum of? 50,000 can be paid. These restrictions do not apply to a private company.

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:

1. ***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.
2. ***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.

3. ***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.

4. ***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.
5. ***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.
6. ***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.

7. ***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.

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'.

Categories of Share Capital

From accounting point of view the share capital of the company can be classified as 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 need not 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 and issued capital are the same because if the number of share, subscribed is less than what is offered, the company allot 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. 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 call 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 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, 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 on 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:

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

VARIOUS KINDS OF SHARES

Kinds of shares:-

Under the companies Act 1956 as amended upto date, a company may have three classes of shares. They are.

1. **Preference shares**
2. **Equity shares**
3. **Shares with different rights**

1. Preference shares

A preference shares is one which enjoys certain preferential rights. First, on preference shares a fixed dividend is guaranteed before any payment of dividend is made in respect of equity shares. The second preference enjoyed by the preference shares is in respect of return of capital in the event of winding up of the company. Preference shareholders are paid back their capital before any other classes of shareholders.

Classes of preference shares

The following are the different classes of preference shares:-

(i) **Cumulative preference shares: -** The preference shareholders are paid dividend at a fixed rate, but when dividends go on accumulating in case the dividend is not paid, preference shares are said to be cumulative. In case the dividends in a particular year are not paid, they will be carried forward to the next year or subsequent years. Preference shares are always cumulative unless otherwise stated.

(ii) **Non –cumulative preference shares: -** Shares, in respect of which dividends do not accumulate, are called non-cumulative preference shares. If the company does not declare dividend in any year, the non-cumulative preference shareholder's right to dividend in respect of that year is lost forever.

(iii) Participating preference shares: - The articles of association may contain a provision to the effect that after dividend has been paid on the equity shares at a specified rate, the holders of preference shares will have a right to participate in the remaining profits in addition to the ordinary preference dividend.

(iii) **Redeemable preference shares: -** Money on these shares can be refunded on the expiry of a specified period if the company does not require funds or at the option of the company. Often the commitment is made by the company at the time of issue of these shares. The redemption is subject to certain legal restrictions.

(iv) **Guaranteed preference shares: -** Dividend at fixed rates is guaranteed to such shareholders irrespective of the fact whether the company has earned any profit or not. Such guarantee is not given by the company itself but by some third party like a bank, an individual or an institution.

2. Equity shares:-

Equity shares are those which carry no special rights in respect of annual dividends and return of capital after the company goes into liquidation. The rate of dividend on such shares is not fixed. Dividend on equity shares is paid out of the residual profits left after paying interest on debentures and dividend on preference shares. Their value in stock exchange fluctuates on the basis of the rate of dividends declared. These equity shareholders are paid back at the time of winding up of the company after all debtors and preference shareholders have been paid in full and not at any time during its working life.

3. Shares with differential rights:-

(a) Deferred shares: -

Deferred shares are also known as 'Founder's shares' or 'Management shares'. These are issued to promoters and their friends at the time of formation of a company. These shares enjoy' all the residuary benefits' in profits, after satisfying the preference and equity dividend claims. They also carry disproportionate voting rights, giving enormous powers to promoters.

Companies Act 1956 has prohibited issue of deferred shares from the time it has come into effect by

(a) Public Limited companies

(b) Subsidiaries of Public Limited Co., s and

(c) Private Co., s deemed to be public Ltd companies.

(b) Shares with differential Rights:-

Companies (Amendment) Act, 2000 has provided, under, Section 2(46A), for issue of shares with Differential Rights', in accordance with the provisions of Section 86.

(a) The differential rights can be regarding

(i) Dividend

(ii) Voting rights or

(iii) Otherwise

The issue of such shares should be in accordance with such rules and subject to such conditions as may be prescribed,

These shares have not yet become popular in the corporate sector due to absence of clear cut rules and conditions.

Difference between equity shares and preference shares

Equity shares	Preference shares
1. It is an ownership security 2. Dividend rate is not fixed 3. Capital is repaid only in winding up 4. These shares have voting rights 5. Face value is lower	1. It is a hybrid security 2. Dividend rate is fixed 3. Capital is repaid after a stipulated period 4. These shares generally do not have voting rights 5. Face value is higher

Issue of Share Capital

The shares can be issued either at par, premium or at discount. Shares are said to be issued at par when a shareholder is required to pay the face value of the shares to the company. Shares are said to be issued at premium when a shareholder is required to pay more than the face value to the company. Shares are said to be issued at discount when the shareholder is required to pay less amount than the face value to the company. For example, a company issues the shares having the face value of Rs.10 at Rs.10; it is the issue at par. If it is

issued at Rs. 12, the issue is at premium. If it is issued at Rs.8, the issue is at discount.

The issue price of the shares can be received in one instalment or it can be received in different instalments. If the issue is in different instalments, it may be paid on application, allotment and on one or more calls. The amount on application is called application money, the amount dues on allotment is called allotment money and the rest amount is called call money. As per SEBI guidelines the application money on issue must not be less than 25% of issue .

Allotment of shares

Allotment of shares means the acceptance of offer of the applicant for the purchase of shares. Directors have the discretionary power to reject or accept the applications. But the public company cannot allot its shares unless the minimum subscription has been subscribed by the public and the amount of application has been received. After the allotment of shares to the applicants who will become the shareholders of the company.

Journal Entries for Share Issue

1. On receipt of application money:

   Bank A/c Dr

   To Share Application A/c

2. On acceptance of application:

   Share application A/c Dr

   To Share Capital A/c

3. On allotment money due:

   Share allotment A/c Dr

   To Share Capital A/c

4. On receipt of allotment money:

   Bank A/c Dr

   To Share allotment A/c

5. On making first call due:

   Share first call A/c Dr

   To Share capital A/c

6. On receipt of first call money:

   Bank A/c Dr

   To Share first call A/c

(Note: similar entries may be passed for second call, third call, if any.)

Issue of shares at premium

Shares are said to be issued at premium when a shareholder is required to pay more than the face value to the company. The excess amount received over the face value is called share premium. It is a capital receipt. The share premium shall be transferred to “Securities Premium A/c”. It should be shown on the liability side of balance sheet under the head “Reserves and Surplus”.

Journal entries:

a) If premium is received with application money:

(i) Bank A/c Dr
To Share application A/c

(ii) Share application A/c Dr (with total)
To Share capital A/c (application money)
To Securities premium A/c (premium)

b) If premium is received with allotment money:

(i) Share allotment A/c Dr (total)
To Share capital A/c (allotment money due)
To Securities premium A/c (premium)

(ii) Bank A/c A/c
To Share allotment A/c

Issue of shares at discount

Shares are said to be issued at discount when the shareholder is required to pay less amount than the face value to the company. Discount on issue of shares is a capital loss and it should be debited to a separate account called "Discount on issue of shares A/c". It is shown on the assets side of balance sheet under "Miscellaneous Expenditure". The rate of discount should not exceed 10% of nominal value of shares. Generally the discount on issue is recorded at the time of allotment. It is also noted that a newly registered company cannot issue shares at discount. The journal entry is

Share allotment A/c Dr(allotment money due)
Discount on issue of shares A/c Dr(discount)
To Share capital A/c (Total)

When both Preference and Equity Shares are issued

When a company issues both preference and equity shares the journal entries are written separately for each type of share capital.

Under subscription of shares

Sometimes the applications for shares received will be less than the number of shares issued. This is called under subscription. In such a case, the allotment will be equal to the number of shares subscribed and not to the shares issued.

Over subscription of shares

Sometimes the applications for shares received will be more than the number of shares issued. This is called over subscription. When there is over subscription, it is not possible to

issue shares to all applicants. In such a situation company shall reject some applications altogether, allot in full on some applications and make a pro rata allotment on some applications. Pro- rata allotment means that allotment on every application is made in the ratio which the number of shares allotted bears to number of shares applied. In case of applications fully rejected will be returned to the applicants. In pro rata allotment the excess application will be adjusted either on allotment and or on calls. Any surplus left even after the adjustment will be refunded to the applicants. Journal entries are

1. When application money is returned:

Share application A/c

To Bank A/c

2. When excess application is adjusted towards allotment or call: Share

Application A/c Dr (total)

To share allotment A/c (amount adjusted towards allotment)

To Call (if any) (amount adjusted towards call)

Calls in Arrears and Calls in Advance

Sometimes shareholders may fail to pay the allotment money and or call money. Such dues are called calls in arrears. It is shown in the balance sheet as a deduction from the called up capital. Directors are authorized to charge interest on calls in arrears at a rate as per Articles. In its absence, the interest does not exceed 5% pa. When a shareholder pays more money than called up, the excess money is called calls in advance. The company must pay interest on calls in advance at a rate prescribed by Articles. In its absence, the company is liable to pay interest @6% pa. But the shareholder is not entitled to any dividend on calls in advance.

Forfeiture of shares

The cancellation of shares due to non payment of allotment money or call money within a specified period is called forfeiture of shares. It is the compulsory termination of membership of the defaulting shareholders. He also losses whatever amount he has paid to the company so far. A company can forfeit the shares only if it is authorized by its Articles. The forfeiting is done only after giving 14 days notice to the defaulting shareholders. The balance of forfeited shares A/c should be shown by way of an addition to called up capital on the liability side of balance sheet till the shares are reissued.

Journal entries

1. Forfeiture of shares which were issued at par:

Share Capital A/c	Dr	(amount called up)
To share allotment A/c		(allotment unpaid)
To share call A/c		(call unpaid)
To forfeited shares A/c		(total amount paid)

2. **Forfeiture of shares which were issued at premium:**

a) When allotment money(incl. premium) and call money not paid

Share Capital A/c	Dr	(amount called up)
Security premium A/c	Dr	(premium unpaid)
To share allotment A/c		(allotment unpaid)
To share call A/c		(call unpaid)
To forfeited shares A/c		(total amount paid)

(b) When call money not paid

Share Capital A/c	Dr	(amount called up)
To share call A/c		(call unpaid)
To forfeited shares A/c		(total amount paid)

3. Forfeiture of shares which were issued at discount:

Share Capital A/c	Dr	(amount called up)
To share allotment A/c		(allotment unpaid)
To share call A/		(call unpaid)
To forfeited shares A/c		(total amount paid)
To discount on issue of shares A/c		(amount of discount)

Reissue of forfeited shares

Forfeited shares may be reissued by the company either at pr, premium or discount.

But the discount on reissue should not exceed the amount forfeited.

Journal entries

1. On reissue at par (issued at par or premium):

Bank A/c	Dr	(amount received on reissue)
To share capital A/c	(amount paid up)	

2. On reissue of at a discount (issued at par or premium):

Bank A/c	Dr	(amount received on reissue)
Forfeited shares A/c	Dr	(amount of discount on reissue)
To share capital A/c	(amount paid up)	

3. On reissue at a premium (issued at par or premium):

Bank A/c	Dr	(amount received on reissue)
To share capital A/c	(amount paid up)	
To security premium A/c	(premium on reissue)	

4. On reissue at a discount (issued at a discount):

Bank A/c	Dr	(amount received on reissue)
Discount on issue of shares A/c	Dr	(amount of original discount)
Forfeited shares A/c	Dr	(excess of discount on reissue over original issue)
To share capital A/c	(amount paid up)	

If all forfeited shares have been reissued, the credit balance in forfeited shares A/c (capital profit) shall be transferred to capital Reserve A/c by passing the following entry

Forfeited shares A/c Dr To capital reserve A/c

If all forfeited shares are not reissued, only the profit on shares which are issued is transferred to Capital reserve A/c.

UNDERWRITING

According to the institute of company Secretaries of India," Underwriting may be defined as a contract entered into by the company with persons or institutions, called underwriters, who undertake to take up the whole or a portion of such of the offered shares or debentures as may not be subscribed for by the public, in consideration of remuneration called underwriting commission.

TYPES OF UNDERWRITING

Underwriting agreements can be broadly divided into two types;-

(1)Pure underwriting and (2) Firm underwriting

1. Pure Underwriting: - In this type of contract, the underwriter's liability is purely contingent. He agrees to subscribe for shares or debentures of the company which are not applied for by the public. If the public subscribes for the entire issue, the underwriter has no obligation at all.

Pure underwriting can again be subdivided into two types.

a) Complete and (b) Partial

a) Complete underwriting: - If the whole of the issue of shares or debentures of a company is underwritten, without involving any 'Firm' underwriting it is termed as complete underwriting.

The issue may be fully underwritten by a single underwriter, agreeing to take the entire risk

It may be underwritten by more than one underwriter, each agreeing to take risk only to a limited extent.

b) Partial underwriting: - If only a part of the issue of shares or debentures of a company is underwriting, it is termed as partial underwriting. In case of partial underwriting, the company is treated as 'underwriting' for the remaining part of the issue.

Partial underwriting may be undertaken by a single underwriter or more than one underwriter each agreeing to take risk only to a limited extent.

(2) **Firm underwriting: -** In this type of underwriting contract, the underwriters, liability is partly definite and partly contingent. The contract signifies a definite commitment to

take up a specified number of shares irrespective of the number of shares subscribed by the public. The underwriter gets priority over the general public for such shares in the event of over subscription. The underwriters' liability is computed in addition to the shares firmly underwritten.

The underwriter has to take,

a) The number of shares he has applied for 'firm', and also.

b) The number of shares he is obliged to take up on the basis of the underwriting contract.

PROBLEMS

UNIT – 1

Issue For Cash Consideration

1. Batliboi co.ltd., issued 50000 equity shares of Rs.10 each to the public on condition that full amount of shares will be paid in a lump sum. all these shares were taken up and paid by the public. Pass journal entries in the books of company when

a) Shares are issued at par

b) Shares are issued at premium of 10%

c) Shares are issued at a discount of 10%

Shares Issued For Cash And Non Cash Consideration

1. Walter ltd., purchased land & building costing Rs.2000000 and in payment allotted 20000 equity shares of Rs.100 each as fully paid. further the company issued 40000 equity shares to the public. The shares were payable as follows:

on application Rs.20; on allotment Rs.40; on call Rs.40;

the public applied for all the shares which were allotted. all moneys were received. Give journal entries and the balance sheet of the company

Shares issued at Par

2. A Company invited applications for 10000 equity shares of ` 50 each payable on application `.15, on allotment `. 20, on first call `.10 and second calls `.5. Applications are received for 10000 shares and all the applicants are allotted the number of shares they have applied for and instalment money was duly received by the company. Pass necessary journal entries.

Shares Issued At Par – Over Subscribed – Variable Allotment

3. Nalli & co ltd was registered with an authorized capital of Rs.2000000 dividend into 20000 shares of Rs.100 each. the company offered 12000 shares to the public which were payable: Rs.20 per share on application, Rs. 40 per share on allotment and Rs.40 on call. Application for 18000 shares were received on which the directors allotted as follows:

applicants for 10000 shares – full applicants

for 5000 shares – 2000 shares applicants for

3000 shares – nil

The excess application money was adjusted towards allotment. all the money due on allotment and call was fully received. Make the necessary entries in the company's books.

Pro-Rata Allotment and calculation of Arrears

4. A company invited applications for 15000 shares of ` 10 each at a premium of 10% payable ` 3 on application, ` 4 on allotment and `2 on first and final calls. Applications were received for 18000 shares and shares were allotted on pro-rata basis. Mr. X, who had applied for 900 shares failed to pay allotment and call money. Another shareholder, Mr. Y. who was allotted 1500 shares, also defaulted at the time of payment of allotment and call money. Show the calculation of amount called and not paid by shareholders and amount actually received at the time of allotment.

Shares Issued At Par – Under Subscribed – Calls In Arrears

5. James & co ltd offered 25000 shares of Rs.10 each to the public on the following terms:

Rs.2.50 to be paid on application:

Rs. 3.00 to be paid on allotment:

Rs. 2.00 to be paid two months after allotment and Rs.

2.50 to be paid three months after the first call.

The public applied for 22000 shares which were allotted, the allotment taking place on 1st April 1998. All money due on allotment was received by 15th may 1998. calls were duly made but a shareholder holding 500 shares failed to pay the calls. make entries in the cash book and the journal. also prepare ledger account and balance sheet

Shares Issued At Premium – Over Subscription – Calls In Arrears

6. X co ltd issued 4000 shares of Rs.10 each at premium of Rs,2 per share.

the amount was payable as under:

on application Rs. 3 per share

on allotment Rs. 4 per share (including premium)

on first call Rs. 3 per share on

second call Rs.2 per share

The company received application for 5000 shares and the allotment was made as under:

i) Applicants for 200 shares – Nil

ii) Applicants for 800 shares – full

iii) Applicants for 4000 shares – 3200 shares

All money were duly received except the first call on 200 shares and final call on 300 shares. pass journal entries and prepare balance sheet of X co ltd.

Calls In Arrears And Calls In Advance

7. A company invited applications for 6000 shares of ` 100 each payable as follows: Rs 12.5 on application ` 12.5 On allotment ` Rs 25 three months after allotment and the balance to be called up as and when required. All money up to allotment were duly received but as records the call of Rs 25 , one shareholder holding 200 shares failed to pay the amount due Another share holder who was allotted 300 shares paid them up in full. Show the necessary journal entries and show how capital should appear on the balance sheet.

Call-in-Arrears / Interest on Calls –in-Advance and Calls –in- Arrears

8. A company invited applications for 12000 shares of ` 10 each payable as follows: on application ` 3. On allotment ` 3, on first call ` 2 and on second call ` 2. Applications were received for 32000 shares including an applicant for 2000 shares who duly paid ` 4000 due from him on account of final call. Remaining shares were allotted on pro rata basis. Excess application money after adjustment of allotment and calls was refunded to shareholders. Pass journal entries assuming that one shareholder holding 1000 shares failed to pay the amount due on second call and calls-in-arrears are not opened.

Forfeiture Of Shares and Reissue

9. Mr sentil is a share holder in kiran ltd holding 2000 share of Rs 10 each . He has paid Rs 2 and Rs 3 per share on application and allotment respectively but failed to pay Rs 3 and Rs 2 per share for first and second call respectively. Directors forfeit his share .Give Journal entries

10.The directors of M Ltd resolved on 1st May 2012 that 2000 ordinary shares of ` 10 each, ` 7.50 paid, be forfeited for non-payment of final call of ` 2.50. On June 10, 1800 of the above shares were reissued for ` 6 per share. Show the necessary journal entries.

11. X Ltd invited applications for 10000 shares of Rs. 100 each at a discount of 6% payable as follows: on application ` 25, on allotment ` 34 and on first and final call ` 35. The applications received were for 9000 shares and all of these were accepted. All moneys due were received expect the first and final call on 100 shares which were forfeited. 50 shares were reissued @ ` 90 as fully paid. Pass journal entries and prepare cash book.

12. Ram ltd offered 5000 shares of Rs.100 each to the public on the following terms:

Rs.25 to be paid on application:

Rs. 34 to be paid on allotment:

Rs. 36 on first and final call.

The public applied for 4800 shares and all of these were accepted. . All money due was received except first and final call on 300 shares which were forfeited. 200 of these shares were reissued at Rs 90 as fully paid. Make entries in the cash book and the journal.

UNDERWRITING

1.COMPLETE UNDERWRITING

a) When the entire issue is underwritten by one underwriter

13.A company issued 10000 equity shares of Rs 10 each at par.The issue was underwritten by K &cofor maximum commission permited by law .The public applied for and received 8000 shares.Give journal entries in the companys books and also prepare balancesheet

b) When the whole issue is underwritten by two or more underwriters in an agreed ratio

14. bharat ltd issued 150000 equity shares.The whole of the issue was underwritten as follows X-50% Y-25% and Z-25%

Application for the 120000 shares were received in all,out of which applications for 30000 shares had the stamp of X those for 15000 shares that of Y and those for 30000 shares that of Z.The remaining applications for 45000 shares did not bear any stamp Determine the liability of the underwriters

II. PARTIAL UNDERWRITING

When a part of the issue is underwritten by one underwriter

15. Skylekha ltd issued 30000 equity shares of Rs 100 each.75% of the issue was underwritten by Prakash.Applications for 21000 shares were received in all by the company Determine the liability of Prakash

When a part of the issue is underwritten by two or more underwriters

16. WYZ ltd issued 20000 shares of Rs 10 each .These shares were underwritten by follows X:10000 shares,Y:6000 shares.The public applied for 16000 shares which included marked application as follows

X:2400 shares:Y;600 shares Determine the obligation of the underwriters

III.FIRM UNDERWRITING

(a) Only one underwriter

17. PQR ltd issued 25000 shares of Rs 100 each .The whole issue was underwritten by David .In addition there is a firm underwriting of 3000 shares by David.Applications for 17000 shares were received by the company in all .Calculate the liability of David (b)Two or more underwriters underwriting the full issue

18.T.T ltd issued 50000 equity shares of Rs 10 each at par.The entire issue was underwritten as follows

A- 30000 shares (firm underwriting 4000) B-

15000 shares (firm underwriting 5000) C-

5000 shares (firm underwriting 1000)

The total applications including firm underwriting were for 40000 shares The marked applications including firm underwriting were as follows

A-10000 shares B-7000 shares and C-3000 shares

The underwriting contract provides that credit for unmarke application be given to the underwriters in proporation to thr shares underwritten

Determine the liability of each underwriter and amount of commission payable to them assuming the rate to be 2% on issue price

PART- A

1. Define Company.
2. What is a Share?
3. What are "Calls –in- Arrears"?
4. What is meant by "Calls-in-Advance"?
5. When shares are forfeited?
6. Give journal entries for Reissue of forfeited shares.
7. What is meant by underwriting of shares ?
8. What is firm underwriting?
9. Distinguish between '"Ex- Interest" and "Cum- Interest".
10. X limited issued 200000 equity shares of Rs. 10 each at Rs. 12 per share. Terms of payment:Rs. 2 on application, Rs. 5 on allotment, including premium, Rs. 3 on first call and Rs., 2 on second calls. Give journal entries.
11. X Ltd forfeited 30 shares of 30 shares of Rs. 10 each fully called up held by 'Y' for non- payment of allotment money of Rs. 3 per share and final call of Rs.Rs. 4 per share. He had paid the application money of Rs. 3 per share. These shares were reissued to 'Z' for Rs. 8 per share.
12. Y Ltd issues 20,000 equity shares of Rs..10 each at par. The issue was underwritten by X Ltd. For maximum commission permitted by law. The public applied for and received 16000 shares. Calculate the commission payable to the underwriter.

13. X Ltd issued 60000, 6% debentures of Rs. 100 each. 60% of the issue was underwritten by Balu. Applications for 56,000 debentures were received by the company. Determine the liability of Balu.

14. XCo. Ltd, issued Rs.. 4,00,000, 10% debentures of Rs. 100 each at a discount of 5% which are repayable after 10 years at a premium of 15%. Pass journal entry for the issue.

15. "C" Ltd. acquired the business of A & Co, for a consideration of Rs. 500000. The vendors were paid Rs. 140000 in cash and the balance in 10% debentures of Rs. 100 each, issued at 90%.Give journal entries.

Part- B

1.Define share. Explain the various kinds of shares in detail.

2. Briefly explain the different types of underwriting.

3. Discuss the salient features of a company.

4. Distinguish between public limited company and private limited company.

5. Elucidate the provisions of the company relating to issue of shares.

6. X Ltd invited applications for 40000 shares of Rs. 50 each payable as: on application Rs. 15, on allotment Rs. 15, on first call Rs. 10 and final call Rs. 10. Applications were received for 50000 shares. Applications for 10000 shares were rejected and full allotment was made to remaining applicants. Mr. "X", to whom 2000 shares were allotted, failed to pay two calls and his shares were forfeited. Out of the forfeited shares 1500 shares were reissued @ Rs.30 per share, credited as Rs. 40 called and paid up. Another shareholder, Mr. "Y" holding 1000 shares, failed to pay second and final call money.

7. A limited company issued a prospectus inviting applications for 2000 shares of Rs. 10 each at a premium of Rs. 2 per share payable as: on application Rs. 2, on allotment Rs. 5 (including premium), on first call Rs. 3 and on second and final call Rs. 2. Applications were received for 3000 shares and pro-rata allotment was made on the applications for 2400 shares. Money overpaid on applications was employed on account of sum due on allotment. "X" to whom 40 shares were allotted failed to pay the allotment money and on his subsequent failure to pay the first call his shares were forfeited. "Y" the holder of 60 shares failed to pay the two calls and his shares were forfeited after second call. Of the forfeited, 80 shares were sold to "Z" credited as fully paid for Rs. 9 per share, the whole of "X" share being included. Show the necessary journal entries, cashbook and the balance sheet.

6. Newton Limited incorporated on 1st January, 2012 issued a prospectus inviting applications for 20,000 equity shares of Rs. 10 each. The whole issue was fully underwritten by Adams, Benzamin and Clayton as follows: Adams -10,000 shares, Benzamin - 6,000 shares and Clayton -4,000 shares. Applications were received for 16,000 shares, of which marked applications were as follows: Adams- 8,000 shares, Benzamin-2,850 shares and Clayton- 4,150 shares. Find out the liabilities of individual underwriters.

7. X Ltd. came up with an issue of 20,00,000 equity shares of Rs. 10 each at par. 5,00,000. Shares were issued to the promoters and the balance offered to the public was underwritten by three underwriters Anand, Vijay and Ashok - equally with firm underwriting of 50,000 shares each. Subscriptions totaled 12,97,000 shares including the marked forms which were : Anand-4,25,000 shares, Vijay- 4,50,000 shares and Ashok-3,50,000 shares. The underwriters had applied for the number of shares covered by firm underwriting. The amounts payable on application and allotment were Rs. 2.50 and Rs. 2.00 respectively. The agreed commission was 5%. Pass journal entries for

(a) the allotment of shares to the underwriters; (b) the commission due to each of them; and (c) the net cash paid and or received.

8. Give Journal Entries to the issue of the following debentures in the books of X Ltd (i) 2000, 5% Debentures of Rs100 each at a premium of Rs 10 per debenture, redeemable at par. (ii) 1000, 8% debentures Rs150 each at a discount of Rs 20 per debenture. (iii) 2000, 12 % Debentures of Rs200 each at par, redeemable at a premium of 10%. (iv) 1500, 11% Debentures Rs250 each at a discount of 10% redeemable at a premium of 10%..

SCHOOL OF MANAGEMENT STUDIES

UNIT – II – Corporate Accounting-1-SBAA1301

UNIT-2 REDEMPTION OF PREFERENCE SHARE

Redemption of preference shares – Redemption of Debentures – Acquisition of Business-profit prior Incorporation.

MEANING OF DEBENTURES

A Joint Stock Company may raise funds from different sources for different purposes. Usually, long term financial needs are met by issue of shares. Medium term funds are raised by issue of debentures. Sec.292 (1) of the Companies Act deals with borrowing powers of a company which include the power to issue debentures. The Act defines debentures as “Debentures includes debentures stock, bonds and any other securities of a company, whether constituting a charge on the assets of a company or not”.

Debentures are “Creditorship securities’ issued by a company, usually for a fixed period, at a specified rate of interest payable periodically. The company’s assets may be given as security for the debentures but such security is not mandatory.

CLASSIFICATION OF DEBENTURES

Debentures may be classified in different ways as follows:-

(1) **On the basis of security:** - Debentures may be secured or unsecured. The secured debentures usually have assets mortgaged. So, they are called mortgage debentures. The mortgage can be on specific assets or the companies’ assets in general. In the former case, the debentures are secured by “fixed charge’ and in the latter case, ‘floating charge’. The unsecured debentures are called Naked or Simple debentures.

(2) **On the Basis of Permanence:** - Debentures may redeemable or irredeemable. Redeemable debentures may have a specified future data for redemption or they may be repayable at the company’s option. Irredeemable debentures have no date for redemption and for all practical purpose they may be repayable at the time of winding up of the company.

(3) **On the Basis of Priority:-**Debentures may be termed according to the order of their repayment. For example, ‘first debentures’ are repayable prior to any other debentures.’ Second debentures’ are repayable after

redemption of the first debentures and so on.

(4) **On the Basis of convertibility: -** Debentures may be non convertible, partly convertible or fully convertible. The terms of issue of debentures may specify the manner of their conversion.

Non convertible debentures are repaid in due course, as per the terms of their issue.

Partly convertible debentures (P.C.Ds) and fully convertible debentures (F.C.Ds) have specific time limits at the end of which they are converted into shares. In case of P.C.Ds., the unconvertible portion termed as 'KHOKA' is repaid in cash and the convertible portion alone is converted into shares.

(5) **On the Basis of recording:-** Debentures may be Registered debentures or Bearer debentures. Registered debentures are recorded in the company's register. The holders' names, addresses, etc., are entered therein. Interest is paid and repayment is made on the basis of the register. In case of Bearer debentures no record is maintained for transfers. Coupons are attached to the debentures for the purpose of claiming interest. They can be sold and transferred by mere physical delivery.

DISTINCTION BETWEEN'DEBENTURE'AND SHARE'

(1) **Status: -** A shareholder is part owner of a company. Debenture holder is a creditor of a company.

(2) **Voting: -** A shareholder can vote on different matters related to the company. Debenture holder may vote on any matter relating to his rights when a meeting of debenture holders is convened.

(3) **Management:-** Shareholder can become a director and participate in the management of a company. He can vote in electing the directors. Debenture holders cannot participate in a company's management.

(4) **Return:-**Debenture holders receive interest at periodical intervals. The interest is payable irrespective of the company's profits. Shareholders may receive dividend if the board of directors recommend such dividend.

(5) **Security: -** Usually debenture holders are given the company's assets as security for their claim. Shareholders have no security.

(6) **Repayment: -** Except redeemable preference shares, all other shares are repayable only at the time of liquidation of a company. Debentures are usually repayable as per the terms of issue except irredeemable debentures.

(7) **Tax advantage:-** Debenture interest is a charge against the profits and thus reduces the Company's income tax. Dividend on shares is an appropriation out of profits. Thus, dividend does not provide any tax benefit.

ACCOUNTING FOR DEBENTURES

There are two main stages of accounting for debentures.

(A) Issue of debentures
(B) Redemption of debentures

(A) Issue of Debentures

Entries for recording issue of debentures can be made on the same lines as for issue of shares. The legal restrictions relating to the issue of shares at discount or premium do not apply to the debentures. The accounting treatment for recording issue of debentures is influenced be certain aspects as explained below:

1. **Consideration for issue of debentures**

Consideration for issue of debentures may be cash or assets or the issue may be made as collateral security for loans

(a) **Issue of debentures for cash**

Here, the issue price is receivable in the form of cash. It may be received immediately in one instalment or it may be received in two or more stages like application allotment and calls.

© **Issue of debentures as collateral security**

Debentures may be issued as secondary security or subsidiary security in addition to the main security for a bank loan or mortgage loan. Such an issue is termed as "issue of debentures as collateral security". When the main security's value fluctuates, the bank can fall back on the collateral security. When the principal or interest or both are not paid in due time, the bank can recover its loan and interest not only form the main security, but also from the sale of the debentures issued as collateral security.

II. Terms relating to issue price and condition of redemption of redemption of debentures

Terms of issue of debentures may relate to the price of issue. The issue may be made at 'Par' or at discount' or at 'premium'. Terms of issue may also relate to condition of redemption. Debentures may be repayable at 'par', or repayable at discount 'or 'repayable at premium.

Redemption of debentures

Redemption of debentures is the discharge of liability on account of debentures. The redemption must be according to the terms of issue, as specified in the debentures trust deed.

Three important aspects are to be considered in relation to redemption of debentures.

(1) Amount payable on redemption:- If redemption is carried on at the end of a specified period the amount to be repaid has to be as per the terms agreed at the time of issue. It may be at par or at premium. Similarly, if the terms of issue provide for periodical repayment, amount payable may be predetermined. However, when a company is permitted to buy its own debentures in the market and cancel, the amount payable is determined by the demand and supply forces in the market.

(2) Time of redemption: - The terms of issue of debentures specify the timing of redemption.

Redemption may be at the end of a specified period

Redemption may be in installments which are predetermined over an agreed number of years. The company may be permitted to repay debentures (a) By draw of lots or (b) By distinctive numbers or (c) By purchase in the open market.

Redemption may be at the option of the debenture holders, specially in case of redemption by conversion.

(3) Sources of funds: - Debentures may be redeemed (a) out of profits (b) out of capital(c) out of provision made (d) by conversion into shares or different class of debentures.

Keeping the above aspects in mind, redemption of debentures is discussed under the following classification.

Methods of redemption may be broadly divided into two categories;-

(1) Redemption without any provision made for the purpose and

(2) Redemption out of provision.

(1) Redemption without Provision:-

The debenture trust deed or the debenture issue terms may not provide for creating a sinking fund for redemption of the debntures. The board of directors also may not think it necessary to create such a fund. In such cases, redemption of debentures is carried out without any provision for such redemption.

Redemption without provision may be in the following ways:-

5Redemption on specified due date

(a) Redemption in installments

(b) Redemption by conversion

(a) And (b) above can be out of profits or our of capital

(a)Redemption on Specified Due Date

On specified due date, debentures are repaid, as per the terms of the issue at par or at premium.

(i) If the redemption is out of profits:- Profits equivalent to the debentures, redeemed are transferred from profit and loss account to debenture redemption reserve account. When all the debentures are redeemed the debenture redemption reserve may be closed by transferring to general reserves. Profits transferred to debenture redemption reserve are not used for declaration of dividend to the shareholders.

(ii) If the redemption is out of capital:- When redemption is out of capital, usually, new issue of shares or debentures might have been made for this specific purpose. There is no need to set aside revenue profits for redeeming the debentures. So, the redemption is not expected to be out of profits earned. This method is preferable when the company's liquidity position is good.

(b) Redemption in Installments

When debentures are issued, the terms of issue may provide for the repayment of the debentures. The following different methods can be adopted for redemption in instalments.

(i)Drawings by lot (ii) Open market buying

(i) **Drawing by lot:-** A company may agree to repay every year a predetermined amount of debentures by conducting a lot, using the distinctive numbers of the debentures . The debentures whose numbers are taken out in the lot will have to be repaid by the company by giving the particular debenture holders intimation about the repayment. The redemption may be at par or at premium, as per the terms of the debentures issue agreement.

(ii) **Open market buying:-** The terms of issue of debentures may permit a company to buy its own debentures in the open market and cancel, or retain or reissue them. This provides tremendous flexibility to the company. Whenever surplus funds are available and market price of debentures is favorable, the company can buy its owdebentures as an investment. If there is an annual amount to be redeemed , the required number of debentures can be immediately cancelled. Any extra debentures can be retained as investment in own debentures. They can be resold also whenever need for liquid funds arises.

Cum-interest and Ex-interest Quotation:-

When a company buys and sells its own debentures in the open market, the prices quoted may include or exclude interest accrued till that date on the debentures. If the quoted price includes interest on the debentures from the previous interest date till the date of sale, the price is known as 'cum-interest price'. If the price quoted does not include the interest from the previous interest date till the date of the sale, the price is known as 'ex-interest price'.

When purchase and sale transactions of own debentures are recorded in books, the nature of quotation given-whether the price quoted is 'cum-interest 'or 'ex-interest' should be carefully observed.

©Redemption by conversion

Redemption of debentures by conversion is possible when the debentures were originally issued a s'convertible debentures'. They may be partly convertible debentures or fully convertible debentures.

The exact terms of conversion are mentioned in the debenture issue agreement or trust deed. The prospective buyers of debentures know in advance all the conditions and terms of the conversion.

(i) Conversion on the date of redemption:- When the debentures were issued, a specified redemption date is fixed and on that date the conversion takes place. Technically, instead of repaying cash, shares are given to the debenture holders. In such a case, the actual amount payable to the debenture holders has to be converted into shares. The original

(i) issue price of the debentures is immaterial. Even if the debentures were original issued at discount; the amount payable on redemption is taken as the basis for conversion. Sec.79 of the companies Act, relating to issue of shares at discount does not apply here.

(i) Conversion before redemption due date: - Sometimes, option may be given to the debenture holders to convert their debentures into shares earlier than the due date for redemption. In such cases there is no problem if the debentures were originally issued at par or premium. However, if the original issue of debentures was at discount, provisions of

sec.79 of the companies Act relating to issue of shares at discount are to be satisfied. So, in such cases, the conversion must be only for the actual amount originally collected on the debentures.

(2) Redemption of Debentures out of provision

Redemption of debentures is a very important obligation for a company. If a specified future date is fixed for redemption of debentures, it is essential to see that sufficient cash is available on that date for such redemption. In the normal course, liquid cash may not be available for the redemption.' Marking provision' is the best way to ensure that necessary cash is available on the date of redemption.

Two methods are universally adopted to ensure liquidity for debentures redemption.

(i)Sinking fund method: (ii) Insurance policy method

(i) Sinking fund method

A sinking fund may be created for redemption of debentures. This is different from sinking fund for replacement of assets. The former is created out of revenue profits by debiting the profit and loss appropriation account and is not a charge against the profit. The latter is created by debiting profit and loss account and is a charge against the profit.

(ii) Insurance policy method

This method is an absolutely certain method of providing exact amount of cash for redemption of debentures. However, this method can be followed when debentures are to be repaid on a definite future date only.

Meaning of Acquisition:-

Sometimes a limited company already in operation acquires or takes over the business of some other concern, trading more or less on the same line. Many a time the sole proprietorship or partnership businesses are converted into limited liability companies. These newly formed companies take over the business of sole trader or firm. In all these cases, as the company acquires or purchases the business of other, it is called the purchaser and the seller concern is called the vendor. Purchase price is called purchase consideration.

Reasons for conversion

The sole proprietorship or partnership concerns may be converted into limited companies for the following reasons;

(i) To eliminate the financial limitations of sole proprietorship and partnership concerns

(ii) To secure financial assistance from different financial institutions

(iii) To avoid unlimited liability of the owners in respect of the liabilities of the business ;and

(iv) To enjoy the advantage of perpetual succession, etc.

The conversion requires the following accounting procedures:

(i) To close the books of accounts of the business which is converted

(ii) To open the books of the new limited company on such taking over.

Accounting treatment

The accounting problems arising from acquisition will be discussed under two headings:

i.e., I. When new set of books are opened; and

II. When the same set of books are continued

I. WHEN NEW SET OF BOOKS ARE OPENED

When an existing business of a sole trader or partnership is acquired by a joint stock company, the following factors should be taken into account.

Assets taken over by the purchasing company

In the absence of a contract to the contrary, purchasing company taken over all the assets of the vendor company; cash and bank balances are also included in it, but fictitious assets and miscellaneous expenses like discount on shares and debentures, preliminary expenses, underwriting commission and debit balance of profit and loss account are not taken over by the purchasing company.

Liabilities taken over by the purchasing company

In the absence of a contract to the contrary, all the external liabilities of the vendor company are taken over by the purchasing company. Internal liabilities like share capital, reserve fund, undistributed profits, etc., i.e, the liabilities which belong to the shareholder, are not taken over by the purchasing company.

Determination of purchase consideration

It is a price payable by the purchasing company to the vendor concern as a consideration for business taken over. Such a price may be fixed by agreement between the two parties. Generally purchase consideration is given in the question. If it is not given, the following two methods can be adopted for calculating the amount of purchase consideration.

(i) Net assets method

Under this method, the purchase consideration is arrived at by adding up the various assets at the value taken over less the amount of liabilities taken over by the purchasing company. For example, if the value of the assets taken over are a sum of Rs.2, 50,000 while the liabilities are of Rs.75, 000, the net assets of the business would amount to Rs.1, 75,000.

(ii) Net payment method

Under this method, the purchase consideration is arrived at by adding up the various amounts which the purchasing company agrees to pay to the vendor. Purchase consideration can be paid by the purchasing company in any one or more of the following ways:

(a) In cash (b)In shares (c) In debentures.

For example, if the purchasing company agrees to pay Rs.1,00,000 in shares, Rs.20,000 in debentures and Rs.30,000 in cash , the amount of purchase consideration according to this method ,would be to Rs.1,50,000

Calculation of Goodwill or capital reserve

When the value of the net assets is less than the purchase price agreed to be paid, the excess amount should be debited to goodwill account. Value of net assets will be assets taken over at an agreed value minus liabilities taken over at agreed value. When the value of net assets is more than the purchase price, the company stands to gain and such a gain is credited to capital reserve account.

II. WHEN THE SAME SET OF BOOKS ARE CONTINUED

Sometimes on conversion of business into a limited company no new set of books is opened but the books of the old business are continued. When the purchasing company decides to continue with the same set of books then the following steps may be taken.

(i) Revaluation of Assets and Liabilities

A Revaluation account should be opened where increased and decreased value of assets and liabilities are to be adjusted as in done in case of admission of a partner. The profit or loss on revaluation should be credited to partner's capital accounts in their old profit sharing ratio.

(ii) Closing of assets and liabilities not taken over by the purchasing company

Any assets or liability which is not taken over by the purchasing company should be transferred to capital accounts in profit sharing ration but when an asset is worth its book value, the same can be transferred to capital accounts according to the ration of final claim.

(iii) Distribution of Reserve and Losses

Any balance of accumulated or undistributed profits or reserves should be transferred to capital accounts in profit sharing ratio

(iv) Closing the capital accounts

After making the above adjustments, the capital accounts are closed by debiting the capital accounts and crediting the shares or debentures or cash.

(v) Preparation of revised balance sheet

At this stage, a revised balance sheet can be prepared.

Introduction

Profit Prior to Incorporation

A running business may be acquired by another firm. If one company acquires the business of another, it is called 'Absorption'. When a company acquires the running business of a sole trader or partnership firm, it is termed as 'acquisition' of business. The acquiring company may be an existing company or a newly stated company. In the latter case, the accounting problem of ascertaining profit or loss prior to incorporation arises.

Treatment of Profit or Loss Prior to incorporation

Unless the agreement with the vendor provides otherwise, profit or loss from the date of purchase of business till the date of incorporation belongs to the company. Such profit should not be regarded as' normal trading profit' or' revenue profit' since the company cannot earn profit or incur loss' before it comes into existence'. The profit or loss should be regarded as 'capital' in nature, increasing or decreasing the 'net assets' acquired by the company.

The following are the methods of dealing with profit or loss prior to incorporation in the books of accounts of a company.

(A) Profit Prior to incorporation

(i) Being capital profit in its nature, it cannot be allowed to be a part of profit and loss account.

(ii) It should not be used for payment of dividend to shareholders

(iii) It is preferable to credit it to 'Capital Reserve Account' which may be used to write off capital losses and expenses like' preliminary expenses',' underwriting commission',' discount on issue of debentures',etc . Unutilized portion of such capital reserve appears in the liabilities side of the balance sheet under the heading 'reserve and surplus'.

(B) Loss prior to incorporation

(i) Being a 'capital loss', it should not be allowed to be a part of profit and loss account.

(ii) It can be debited to a separate account called' Loss prior to incorporation account'. This loss can be written off using other capital profits of the company . It appears on the assts side of the balance sheet under the heading 'miscellaneous expenditure'.

(iii) It may be treated as goodwill and debited to goodwill account

(iv) It may be treated as 'deferred revenue expenditure' and may be written off out of the profits of the company over several years.

Relevance of 'Date of Certificate to commence business

A public limited company has to obtain a certificate of commencement of business. This raises the issue of relevant date for ascertaining capital profit or loss in the context of business acquisition. Some accounting experts are of the opinion that all profits or losses before obtaining certificate of commencement of business are 'capital' in their nature. However, a company's power to carry on a business relates back to the date of incorporation, once the certificate to commence business is obtained. Thus, obtaining such a certificate becomes purely a legal formality, without affecting computation of 'profit or loss' of capital nature at the time of acquisition of business.

Methods of ascertaining profit or loss prior to incorporation

There are three possible methods of ascertaining profit or loss prior to incorporation.

(1) Preparation of Trading &Profit &Loss account for the period up to the date of incorporation.

A trial balance has to be prepared as on the date of incorporation of the company by balancing the books of accounts of the business. The closing stock on that date has to be valued. Trading and P&L account has to be prepared in the normal way.

Profit or loss prior to incorporation can be ascertained accurately in this method. At the end of the accounting year, profit or loss of the post incorporation period may be found.

However, balancing of books and stock taking on the date of incorporation may be highly inconvenient and affect the normal functioning of the business. So, this method is not usually adopted in practice.

2.(a) Preparation of Trading and profit and loss account for the whole accounting period and apportionment of the resulting profit or loss between pre and post incorporation periods.

Under this method, Trial Balance is prepared and Trading and Profit and Loss account are prepared at the end of the accounting period. Then, a separate note is prepared, in the form of a statement showing pre and post incorporation profits by apportioning the various expenses between the respective periods. These profit or loss figures are incorporated in the profit and loss account, by transferring the profit prior to incorporation to capital reserve account. Any loss prior to incorporation may be separately shown or it may be debited to goodwill account.

(b) Preparation of Common Trading Account and the Profit and Loss account in 'Columnar form'

Under this method, trading account is prepared at the end of the accounting year form the trial balance in the usual manner. Unless otherwise mentioned, the date of incorporation does not affect the computation of gross profit

The profit and loss account is prepared in columnar form, with separate columns for pre and post incorporation periods. All expenses and the gross profit are divided between the two periods in an appropriate manner.

Under methods (a) and (b) above, profit or loss for the two periods cannot be ascertained as accurately as under the first method. These methods can only give an estimate of the profit or loss of the two periods.

Since the first method involves disruption of work, the other methods seem to be unavoidable.

Basis of Apportionment of Expenses

The various expenses which are shown in profit and loss account should be divided between pre and post incorporation periods on some logical and appropriate basis. The following are the usual bases for such apportionment;

(1) **Time Ratio: -** This is the ratio of months or days before and after incorporation during the accounting period. For example, if business was acquired on 1-1-96, the company was incorporated on 1-5-96 and accounts are closed on 31-12-96, the time ratio is 4:8 or 1:2. Form 1-1-96 till 1-5-96, there are four months before incorporation. Similarly, there are 8 months after incorporation i.e., form 1-5-96 to 31-12-96.

All expenses of a company which can be linked or related to 'time' must be divided between pre and post incorporation periods in Time Ratio. Examples are salaries, rent, stationery, postage, depreciation, bank charges, interest, etc.

(2) **Weighted or 'Adjusted' Time Ratio:-** If any changes were made in the number of employees, or office accommodation, etc., weight age must be given to the changes in arriving at the time ratio. Such a ratio is called weighted time ratio.

Similarly, when some expenditure is incurred only for a part of the accounting period, separate ratio has to be computed, based on the actual months or days in pre and post incorporation periods.

(3) **Sales Ratio:-** This is the ratio of sales or turnover of the company before and after incorporation. For examples, when sales before and after incorporation were Rs.2,00,000 and Rs.6,00,000 respectively, the sales ratio is 1:3

Sales ratio is the logical basis to divide the gross profit earned by the company. Similarly, all expenses related to sales are also to be apportioned in sales ratio. Examples: Advertising, salesman's commission, sales promotion expenses, carriage outwards, bad debts, discount allowed, etc.

(4) **Weighted Sales Ratio:-** If sales were not uniform throughout the accounting period, weight age must be given to the trends observed in the sales. Sales ratio adjusted for the change in trend is called weighted sales ratio

(5) **Allocation of Expenses:-** Specific expenses which can be identified with either period have to be fully allocated to that period. All company related expenses like debenture interest, directors' remuneration or fees, preliminary expenses written off, donations given be the company, etc.,have no connection with the pre incorporation period. So, they must be fully charged to the post incorporation period. Similarly, partners' salaries, interest on purchase price till the date of incorporation may be allocated to the pre incorporation period.

(6) **Actual Expenditure: -** If specific details are available about any particular item of expenditure as to how much was spent in the pre and post incorporation periods, the actual amount should be charged to the respective periods.

Note: - Auditors of a company are appointed only after incorporation. So, audit fee may be shown as post incorporation expenditure. However, the auditors have to audit the accounts of pre incorporation period also. Thus, audit fee can be divided in time ratio also. Whichever way is followed, the alternative may be shown as a note. The later method is used throughout in this chapter.

Steps involved in ascertaining pre and post incorporation profits

Step 1:- Trading account has to be prepared for the accounting periods and gross profit has to be found

Step 2:- After a careful scrutiny of the sales, expenses etc, sales ratio and time ratio have to be computed and a list of expenses which can be allocated to specific periods should be drawn up.

Step3:- If a statement is preferable for ascertaining pre incorporation profit, normal P&L A/c can be prepared. Otherwise, columns for basis of apportionment, total , pre incorporation and post incorporation should be provided on both the sides of the P&L A/c. The gross profit and the expenses can be recorded, dividing them or showing them appropriately. When the P&LA/c is balanced, profit or loss can be found separately for the pre and post incorporation periods

If a statement method is preferable separate statement should be prepared, showing the basis, total pre and post incorporation columns. When the total of the expenses is subtracted from the gross profit, profit or loss for pre and post incorporation periods can be obtained separately.

Step4:- In the profit and loss appropriation A/c (below the line) the amount of pre incorporation profit should be transferred to capital reserve. If there is loss in pre incorporation period, it is carried down form profit and loss account to appropriation account debit side. Then it can be shown on the credit side of the appropriation account as Loss prior to incorporation (or) as goodwill which will appear on Balance sheet asset's side.

Table showing treatment of different items

Nature of Items	Basis of Apportionment
1. Gross profit /loss	Sales ration or weighted sales ratio
2. All fixed expenses like salaries, rent, rates, taxes, insurance, depreciation, postage etc.	Time ratio or weighted or adjusted
3. All variable expense directly varying with turnover like commission, discount, sales men's remuneration, advertisement, carriage outwards	Sales ratio or weighted sales ratio
4. All expenses related to pre incorporation period alone such as vendor's salary till the incorporation date.	Allocation to the pre incorporation period
5. All expenses wholly applicable to post incorporation period like directors' fees, debentures interest, discount on issue of debentures, preliminary expenses or formation expense written off. Donation given by the company etc.	Allocation to the post incorporation period.

PROBLEMS

UNIT 2

Redemption at par our of profits

1. The following extract from the balance sheet of Gayathri Co. Ltd as on 31st dec, 1997 is given to you

   <u>share capital</u>

   200000 equity shares of Rs.10 each – Rs.2000000

   300000 6% redeemable preference shares of Rs.10 each – 3000000

   capital reserve – 1500000

   General Reserve – 900000

   Profit & Loss A/c –

   2550000

   The company exercise its opinion to redeem the preference shares on 1st jan. the company has sufficient cash.

   Give journal entries to record the redemption.

2. The balance sheet of Wallace ltd as on 31st Dec 1997 was as under.

Liabilities	Amount	Assets	Amount
Share capital:		Sundry Assets	365000
1000 redeemable preference shares of Rs.100 each	100000	Bank balance	140000
2000 equity shares of Rs. 100 each fully paid.	200000		
General reserve	80000		
Profit & loss a/c	50000		
Sundry creditors	75000		
	505000		505000

On this date, the preference shares were redeemed at par. Journalise and prepare balance sheet after redemption.

Redemption at premium out of profits

Redemption at premium, party out of profit and partly out of fresh issue.

3. Sterling ltd have part of their share capital in 2500 6% redeemable preference shares of Rs.100 each. The company decided to redeem the preference shares at premium of 10%. The general reserve of the company shows a credit balance of Rs.300000. The directors decide to utilize 60% of the reserve in redeeming the preference shares and the balance is to be met from the proceeds of fresh issue of sufficient number of shares of Rs.10 each. The premium is to be met from the year's profit & loss appropriation account.

   Give journal entries to record the above transactions.

Redemption at a premium and fresh issue at premium

4. A company has 10000 9% redeemable preference shares of Rs.100 each fully paid. The company decides to redeem the shares on 31st Dec. 1997 at premium of 10%. the company makes the following issues:-

   (i) 6000 equity shares of Rs.100 each at a premium of 10%

   (ii) 4000 8% debentures of Rs.100 each.

   The issue was fully subscribed and allotments were made. The redemption was duly carried out. the company has sufficient profits.

   You are required to give the necessary entries.

5. The following balance appear in the ledger of a company as on 30.6.1995

   Share capital:

   equity share (fully paid up) – 600000

   redeemable preference shares (fully paid up) – 300000
   General reserve – 200000

   Profit & loss A/c (cr. balance) – 125000
   Securities premium account – 50000

   The company decided to redeem the preference shares at a premium of 10% out of its general reserve and undistributed profits. Give journal entries relating to redemption of the preference shares.

ISSUE OF DEBENTURES

6. Times ltd issued 1000 8% debentures of Rs.100 each. Give appropriate journal entries in the books of the company, if the debentures were issued as follows:

   (i) issued at par, redeemable at par.

   (ii) issued at a discount of 5%, repayable at par.

   (iii) issued at a premium of 10% repayable at par.

   (iv) issued at par, redeemable at a premium of 10%

   (v) issued at a discount of 5%, repayable at a premium of 10%

   You are also required to show how the items concerned appear in the balance sheet in each of the above cases.

7. M ltd secured an overdraft o fRs.100000 from the bank by issuing 1200, 12% debentures of Rs.100 each as collateral security. Give journal entry and show how it appears in the company's balance sheet.

8. Sindu ltd redeemed 8000 15% debentures of Rs.100 each which were issued at a discount of 5% by converting them into equity shares o f Rs.10 each issued at a discount of 20%.

9. Amount needed after 5 years for debenture redemption :

   6000000. Rate of interest on investment expected : 5%.

   Annual investment needed to get Rs.15 after 5 years Rs. 2.71462.

   Ascertain the annual transfer to sinking fund.

NORMAL ACQUISTION

10. Ganguly ltd. was formed with an authorized capital of Rs.1200000 divided into equity shares of Rs.10 each, to acquire the business of 'A' and 'B' whose balance sheet on the date of acquisition was as follows:

Liabilities	Amount	Assets		Amount
Capital	600000	Free hold premises		700000
General Reserve	400000	Stock		200000
Sundry creditors	200000	Sundry debtors	160000	
		Less : Provision for Bad debts	10000	150000
		Cash at bank		150000
	1200000			1200000

The purchase consideration was agreed upon at Rs. 1400000 to be paid in Rs. 1200000 fully paid equity shares at Rs.11 and the balance in cash.

Give journal entries to record the above and prepare the Balance sheet of Ganguly ltd. Assuming the vendor's account is finally settled.

11. Madras properties ltd was formed to acquire the business from babu for Rs. 500000 payable Rs. 250000 in cash and the balance in shares. The capital of the company was Rs. 1000000 divided into 100000 shares of Rs.10 each. It issued to the public 55000

shares. Rs.3 payable on application. Rs.4 on allotment and the balance on first and final call.

The purchase consideration was fully satisfied. The preliminary expenses Rs. 22000 were paid by the company. Shareholders holding 820 shares failed to pay the final call and after due notice their shares were forfeited according to the articles of association. The shares were reissued subsequently at a price of Rs. 6 per share.

Give the journal entries necessary to record the above transactions.

12. A company was formed with an authorized capital of Rs. 500000 divided into 25000 equity shares of Rs.10 each and 2500 6% preference shares of Rs.100 each to purchase the going concern M/s Ram Gopal & sons the balance sheet of which stood as follows:

Liabilities	Amount	Assets	Amount
Bills payable	3500	Cash	4500
Creditors	6400	Debtors	7500
Capital	132100	Stock	35000
		Machinery	50000
		Buildings	45000
	1200000		1200000

The purchase price was agreed upon at Rs.175000 payable as to Rs.50000 in fully paid equity shares, Rs.50000 in fully paid preference shares, Rs.30000 in redeemable debentures and the balance in cash.

The remaining shares were issued to and paid for by the public with exception of Rs. 3 per share on 600 equity shares which were forfeited and reissued at a discount of 20%.

Give journal entries to record these transactions in the books of the company and prepare the balance sheet.

Ascertaining pre and post incorporation profits through statement method

13. Ganesh ltd., was registered on 1.7.97 to acquire the running business of suneel & co., with effect from 1-1-97. The following was the profit and loss account of the company on 31-12-97.

Particulars	Amount	Particulars	Amount
To office expenses	54000	By Gross profit	225000
To formation expenses (written off)	10000		
To stationery expenses	5000		
To selling expenses	60000		
To directors's fees	20000		
To net profit	76000		

	225000		1200000

You are required to prepare a statement showing profit earned by the company in the pre and post incorporation periods. The total sales for the year took place in the ratio of 1:2 before and after incorporation respectively.

14. Prabu private ltd., was incorporated on 1st july 1994 to take over the running concern of Mr. Rowther with effect from 1st april 1994. The following profit and loss account for the year ended 31st march 1995 was drawn up.

Particulars	Amount	Particulars	Amount
To commission	2625	By Gross profit	98000
To advertisement	5250	By bad debts	500
To managing director's remuneration	9000		
To depreciation	2800		
To salaries	18000		
To insurance	600		
To preliminary expenses	700		
To rent & taxes	3000		
To discount	350		
To bad debts	1250		
To Net profit	54925		
	98,500		---------------- 98,500

The following details are available:

(a) the average monthly turnover from july 1994 onwards was double than that of previous months.

(b) the rent for the first 3 months was paid @ Rs.200 p.m. and thereafter at a rate increased by Rs. 50 p.m.

(c) bad debts Rs. 350 realted to sales effected after 1st September 1994 and the realization of bad debts was in respect of debts written off during 1992.

(d) Advertisement expenses were directly proportionate to the sales.

You are required to find out profit to incorporation and to sales the treatment thereof in the books of the company.

IMPORTANT QUESTIONS

Part- A

1. What is redemption of preference shares?
2. Give the meaning of "proceeds of a fresh issue of shares".
3. How is "premium on redemption of debenture treated in accounts?
4. What is redemption of debentures out of profit?
5. What is meant by acquisition of business?
6. What is profit prior to incorporation?
7. How is profit prior to incorporation treated in accounts?
8. Redemption of 20000 preference shares of Rs100 each was carried out by utilization of reserves and by issue of 8000 equity shares of Rs 100 each at Rs125. How much should be credited to capital redemption reserve?
9. "X" Company Ltd. redeems 20000 8% preference shares of Rs 100 each at a premium of 10% out of profits otherwise available for dividend. Journalise.
10. "Y" Ltd. redeemed Rs 288000 15% debentures of Rs 100 each at 102% by converting them into 16% debentures at 96%. Journalise.
11. X Ltd, was incorporated on I st May 2012 to purchase the running business of Y Ltd, with effect from 1^{st} January 2012. The company obtained certificate of commencement of business on 24^{th} August 2012. Calculate time ratio, if the accounts were finalized on 31^{st} December' 2012.
12. X carrying on a partnership business converted their business into a limited company with effect from 1-1-2012. However, they could complete the legal formalities and incorporate the company only on 1^{st} May 2012. When the accounts were finalized on 31- 12-2012, it was noted that sales went up by 50% on average in each month after incorporation compared to those before that date. Ascertain the sales ratio.
13. Seema Co.Ltd. was incorporated on 30.6.2012 to acquire the business of Bama and Co. as from 01.01.2012 on the basis of B/S dated 31.12.2011. The sales for the year amounted to 6,00,000 out of which Rs.2,70,000 was for the first six months. Calculate time ratio and sales ratio assuming that accounts are closed on Dec31,every year.
14. A Company has power in its Articles to purchase out of profits its own debenture stock in the open market for cancellation On 1^{st} January 2012, the company applied Rs.38,000 for the purchase of its own debentures @ 95% and cancelled them. Show Journal entries to record the above

Part-B

1. State the conditions and procedures for the issue of redeemable preference shares.
2. What is capital redemption reserve account? How is it created? How can it be utilized?
3. Explain the different methods of redemption of debentures.
4. Explain the methods of computing purchase consideration on acquisition of business.
5. How expenses and incomes are apportioned between pre and post incorporations period?
6. 'Y' Ltd. Has issued 90,000, 7% redeemable preference shares of Rs.100 each. According to the terms of the issue of shares, redemption was to take place on1.4.2012 at a premium of 10%. Out of past year's profit, a general reserve has been built up to the extent of Rs.65,25,000. For the purpose of redemption, the company issued 33,750 new 8% redeemable preference shares of Rs.100 each at a premium of Rs.20. The full amount is payable on application. The new issue was fully subscribed and paid for. Then,7% redeemable preference shares were redeemed. Write up to accounts in the company's ledger.
7. The summarized B/S of Successful Ltd., as on 31st Dec.2012 was as under:

	Rs.		Rs.
Share Capital:		Fixed Assets	3,00,000
Equity share capital	4,00,000	Stock	1,90,000
Redeemable pref. share capital	1,00,000	Cash	2,10,000
Profit and Loss A/c	1,30,000		
Creditors	70,000		
	7,00,000		7,00,000

On the above date preference shares are to be redeemed at a premium of 10% . Give Journal entries.

8. Azagu Pvt. Ltd. Was incorporated on 01.04.2012. It took over the running business of Arumbu with effect from 01.10.2011. The sales for the period up to 31.3.2012 was Rs.2,70,000 and the sales from 01.04.2012 to 30.09.2012 amounted to Rs.3,30,3000. The expenses debited to profit and loss account are as follows:

Rs.

(a) Directors fees	15,000
(b)Bad debts	1,800
(c) Advertisement (Rs.500 per month)	6,000
(d) Salaries and general expenses	32,000
(e) Preliminary expenses	3,000

The gross profit for the period from 01.10.2011 to 30.09.2012 was Rs. 2,40,000. Ascertain the profit prior to incorporation.

9. The following balances appeared in the books of X Ltd. on 1.4.2001 : (a) Debenture Redemption Fund Rs 60,000 represented by investments of an equalamount (nominal value Rs. 75,000). (b) The 12% debentures stood at Rs 90,000. The company sold required amount of investments at 90% for redemption of Rs. 30,000 Debentures at a premium of 20% on the above date.Show the : (i) 12% Debenture Account; (ii) Debenture Redemption Fund Account; (iii) Debenture Redemption Fund Investments Accounts; (iv) Debenture-holders account

10. Kayal Ltd. Was incorporated on May 1,2012 to take over business of Raja Co.Ltd. as a going concern from January 1,2012 . The profit and loss a/c for the year ending December 31,2012 is as follows:

Profit and Loss Account

To Rates and Taxes	24,000	By Gross profit	5,00,000
Insurance	6,600		
Electricity charges	3,600		
Salaries	1,20,000		
Directors fees	16,000		
Audit fees	3,000		
Commission	40,000		
Advertisement	30,000		

Discount Office expenses Preliminary expenses Interest on Loan Net profit	15,000 12,800 6,000 24,000 1,99,000		
	5,00,000		5,00,000

Raja Co. Ltd. Has spent Rs.3,000 only on advertisements. Salaries include that of a manager appointed from July 1, 2012 for Rs.3,000 per month. The total turnover for the year was Rs. 25,00,000 and turnover of Raja Co. Ltd. Up to May 1 was Rs.9,00,000. Calculate the profit earned prior to incorporation of the company.

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UNIT – III – Corporate Accounting-1 – SBAA1301

UNIT-3 COMPANY FINAL ACCOUNT

Preparation of Company Final Accounts as per Companies Act 2013 – Computation of Managerial Remuneration

Final Account of companies

The term final account is popularly used to refer to (i) Profit & Loss Account and (ii) Balance sheet. In case of sole proprietorship and partnership firm maintenance of proper books of accounts and preparation of final accounts at the end of an accounting period is desirable but not compulsory. But the companies Act has made it is statutory requirement for a company to keep proper books of accounts for recording financial transactions and preparing its keep proper books of accounts for recording financial transactions and preparing its profit & loss Account and Balance sheet in the prescribed form at the proper time. The principles and methods of preparing final accounts by joint stock companies are the same as in case of other organizations. However, the form and contents of these two statements are governed by the relevant provision of the companies Act.

I. Profit &Loss Account

In the case of a Joint stock company, it is not necessary to split the final accounts into two sections i.e., Trading Account and Profit &Loss Account. There is only one account which is known as profit &Loss account. It consists of trading account, profit &loss account and profit &loss appropriation account. Its first part represents trading account. The items which are shown in trading and profit &Loss are known as items 'above the line' and items which are shown in profit & loss appropriation accounts are known as items' below the line'. An imaginary line' is presumed between P&L A/c and Appropriation A/c.

Every profit &loss account of a company shall give a true and fair view of the profit and loss of the company for the financial year and shall comply with the requirements of part II of schedule VI so far as they are applicable thereto.

Nothing contained in the above para shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity or any other class of company for which a form a profit &loss account has been specified in or under the act governing such class of company.

1. Introdcution:-

The expression dividend has two meanings. Applied to a company, which is a going concern, it ordinarily means that portion of the profits of the company which is allocated to the holders of the shares in the company. In case of a winding up, it means a division of the realized assets among the creditors and contributories according to their respective rights.

The legal provisions relating to dividend are as follows.

(a) Dividend is paid in proportion to the amounts paid up on each share
(b) Calls-in –advance should not be considered for dividend purpose
(c) Dividend should be paid even on calls- in – arrears unless prohibited by the articles; and
(d) Dividend must be paid in cash unless it is capitalized by issuing bonus shares
(e) Dividend must be paid within 42 days of declaration
(f) Dividend is paid only to registered shareholder or on his order to his banker. In case where shares are converted into warrants, the bearer of the warrant is entitled to dividend.

(2)Sources of Divided:

(A) According to section 205, the dividend can be declared or paid by a company for any financial year only;

(a) Out of current year's profits after providing for depreciation, or
(b) Out of previous year's profits after providing for depreciation, or
(c) Out of both or
(d) Out of moneys provided by the central or state govt. for the payment of dividend in pursuance of a guarantee given by that govt.
The central govt. may permit any company to declare or pay dividend for any financial year out of the profit of the company for that year or any previous year or year without providing for depreciation.

Interim Dividend

It is a dividend paid between two annual general meetings,i.e., in the middle of the year, before ascertainment of the profit for the year. Directors have full authority to pay interim dividend in anticipation of profit for the year. However, directors will be personally liable to reimburse the interim dividend paid, if there are no profits at the end of the financial period. This dividend is usually paid for six months and can be declared and paid only if the depreciation for the full year has already been provided. If the interim dividend is paid without sufficient profits then it amounts to payments of dividend out of capital and directors are liable to make good the amounts.

Calculation of interim dividend

Interim dividend is generally paid for six months. The calculation of actual amount depends upon the term used. If the interim dividend on Rs.6,00,000 for six month is 6% p.a. the actual amount is6% of Rs.6,00,000 for six months or 3% of Rs.6,00,000 for the full year i.e., Rs.18,000 . If , however , the rate is mentioned as 6% interim dividend on Rs.6,00,000 the actual amount is simply 6% of Rs.6,00,000=Rs.36,000 .To avoid this confusion , most companies mention the amount, as so many rupees or paisa per share as the interim dividend .

Interim dividend paid should be recorded in the debit side of Profit &Loss Appropriation Account.

Managerial Remuneration

(a)Introduction:-

The companies Act lays down a number of restrictions on managerial remuneration payable by a public company or a private company which is a subsidiary of public company. The term 'managerial remuneration' includes remuneration payable to the (i) Managing Director, (ii)Manager (iii) Part time director, and (iv) whole time directors. It does not include the remuneration payable to technical advisors or secretaries.

According to Section 198 of the companies Act, 1956 the total managerial remuneration payable by a public company or a private company which is subsidiary of a public company to its directors and its manager in respect of any financial year shall not exceed 11% of the net profits of that company for that financial year computed in the manner laid out in section 349,350and 351 except that the remuneration of the directors shall not be deducted from the gross profit. Percentage aforesaid shall be exclusive of any fees payable to directors under sec.309 (2)

Within the limits of maximum remuneration specified above , a company may pay a monthly remuneration to its managing or whole time director in accordance with the provisions of section 309 or to its manager in accordance with the provisions of section 387.

The above limit of 11% does not include any fees payable to directors for attending the meeting of the Board or Committee.

If, in any financial year a company has no profit or its profits are inadequate, it may , subject to the approval of the central government, pay to its directors of manager, by way of minimum remuneration , such sum not exceeding Rs.50,000 per annum.

(b) Perquisites to be included in managerial remuneration

In order to make the limit of managerial remuneration effective, explanation to Section 198 provides that the term”remuneration”includes the following.

(i) Any expenditure incurred by the company in prociding any rent-free accommodation or any other benefit or amenity in respect of accommodation free of charge.
(ii) Any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate.
(iii) Any expenditure incurred by the company in respect of any obligation or service , which but for such expenditure by the company, would have been incurred by any of the persons aforesaid ;and
(iv) Any expenditure incurred by the company to effect any insurance on the life of or to provide any pension, annuity or gratuity for any of the persons aforesaid or his spouse or child.

Under section 200, no company can now pay to any of its officers or employees remuneration free of any tax or varying with any tax payable by him.

c) Remuneration payable to different categories of managerial personnel.

The following are the amount of remuneration payable to different categories of managerial personnel.

1. Manager: - He is an employee of the company , He is the person who has got the control of the whole or substantially the whole of the affairs of the company. A company cannot have more than one manager at a time. The remuneration payable to the manager cannot be more than5% of the net profits of the company.
2. Managing director:- He is a director who has substantial powers of management. It is not possible to have both a managing director as well as a manager at a time. But there can be one or more than one managing directors at a time in a company. The remuneration payable to the managing director shall not exceed 5% of the net profit of the company. If a company has more than one managing director, the total remuneration payable to the managing directors shall not exceed 10% of the net profit of the company.
3. Whole time directors:- He is a director who spends his whole attention for the company . It is permissible to have one or more whole time directors with or without a managing director. The remuneration payable to the whole time director shall not exceed 5% of the net profits of the company. If a company has more than one whole time director, the total remuneration payable to the whole time directors (including managing director, if any) should not exceed 10% of the new profits of the company.

4. Director:- He is the person who guides , directs or manages the affairs of the company . As per the companies act, the term director includes any person occupying the position of director by whatever name called.

A public company must have at least three directors. Whereas in case of private company, it must have atleat two directors.

As per section 309, the remuneration payable to all directors, when not assisted by whole time directors or manager or managing directors, shall not exceed 3% of the net profits of the company. In case, the directors are assisted by whole time directors or manager or managing directors, the remuneration payable to them shall not exceed 1% of the net profits of the company. Of course, this does not include the sitting fees payable to these directors.

The maximum remuneration payable to different categories of managerial personnel, as stated above can be summarized as follows.

Managerial Personnel	Maximum % of new profits
(i) Maximum remuneration to all the managerial personnel	11%
(ii) Manager	5%
(iii) Managing director or whole time director	5%
(iv) Managing director whole time directors when there is more than one	10%
(v) Pat time directors when the company is not having managing directors, whole time director or manager	3%
(vi) Part time directors when assisted by a managing directors, whole time director or manager	1%

PROBLEMS:

1. Determine the maximum remuneration available to the part time directors and manager of Blueprint Co., Ltd, (a manufacturing company) under section 309 and 387 of the companies act, 1956, from the following particulars:

   Before charging and such remuneration the profit & loss A/c showed a credit balance of Rs.660000 for the year ended march 31, 1983 after taking into account the following matters:

   Capital expenditure – 150000
   Subsidy received from Govt – 120000
   Special depreciation – 20000
   Multiple shift allowance – 30000
   Bonus to foreign technicians – 90000
   Provision for taxation – 800000

Compensation paid to injured workman –	20000
Ex – gratia to an employee –	10000
Loss on sale of fixed asset –	20000
Profit on sale of investment –	60000

2. A company carried forward a balance of Rs.120000 in the profit & loss account from the year ended 31st march 1996. During the year 1997 it made a further profit before tax of Rs. 800000. It was decided that following provisions and transfer be carried out :
   - (i) Dividend equalization account Rs. 30000
   - (ii) Provision for taxation Rs. 220000
   - (iii) General reserve Rs. 105000
   - (iv) Development rebate reserve Rs. 110000
   - (v) Dividend at 9% on preference shares of Rs. 500000
   - (vi) Dividend at 15% on 100000 equity shares of Rs.10 each fully paid.

3. The accounts of M.N Prabhu Ltd showed an amount of Rs. 175000 to the credit of Profit & Loss Account on 31st march 1998 out of which the directors decided to place Rs. 25000 to General reserve and Rs. 7000 to debentures redemption fund. At the annual general meeting held on 15th june, 1998, it was decided to place Rs. 12000 to a development reserve and to pay a bonus of 3% of the profit to the directors as additional remuneration. The payment of the Half yearly dividends on Rs.300000 ^% cumulative preference shares on Sep 30 1997 and march 31 1998 was confirmed and a dividend at the rate of 10% was declared on the equity share capital of the face value of Rs. 500000. The balance of Profit & Loss account to be carried forward to next year. Draw up the profit & loss appropriation Account.

Notes to Accounts on Balance Sheet (Format)

		Rs.	Rs.
I.	**Share Capital:**		
	Share capital		XXX
II.	**Reserve & Surplus:**		
	Reserve	XXX	
	Share Premium	XXX	
		XXX	
	Profit for the year	XXX	
		XXX	
	Preliminary Exp	XXX	XXX
III.	**Long term borrowings:**		
	Unsecured Loan	XXX	
	Debenture	XXX	XXX
IV.	**Trade Payable:**		
	Creditors	XXX	
	Bills payable	XXX	XXX
V.	**Other Current Liabilities:**		
	Tax Payable	XXX	
	Outstanding Exp	XXX	XXX
VI.	**Tangible Assets:**		
	Investment	XXX	
	Other fixed Assets-Dep	XXX	
	Stock	XXX	XXX
VII.	**Intangible Assets:**		
	Goodwill		XXX
VIII.	**Trade Receivable:**		
	Debtors	XXX	
	Bills Receivable	XXX	XXX

Balance Sheet as on …..

Particulars	Note No	Rs.
I. Equity and Liabilities:		
Share Capital	1	XXX
Reserve & Surplus	2	XXX
Long term borrowings	3	XXX
Trade Payable	4	XXX
Total		XXX
II. Assets:		
Tangible Assets	5	XXX
Intangible Assets	6	XXX
Trade Receivable	7	XXX
Bank Balance		XXX
Total		XXX

Preparation of Balance sheet

4. From the following balances, prepare the balance sheet of a company in the prescribed format.

   Goodwill Rs.150000; Investments Rs.200000; Share capital Rs.500000; Reserves Rs.110000; Share premium Rs.15000; Preliminary expenses Rs.10000; Profit and loss A/c (cr) Rs.25000; Debenture Rs.2,50,000;Other fixed assets Rs.470000; Stock Rs.80000; Debtors Rs. 60000; Bank balances Rs.30000; Unsecured Loan Rs.65000; Sundry creditors Rs. 35000.

5. From the following balances, prepare the balance sheet of a company in the prescribed format.

   Goodwill Rs.75,000; Investments Rs.1,00,000; Share capital Rs.2,50,000; Reserves Rs.55,000; Share premium Rs.7,500; Preliminary expenses Rs.5,000; Profit and loss A/c (cr) Rs.12,500; Debenture Rs.1,25,000;Other fixed assets Rs.2,35,000; Stock Rs.40,000; Debtors Rs. 30,000; Bank balances Rs.15,000; Unsecured Loan Rs.32,500; Sundry creditors Rs. 17,500

6. Nathiya Ltd., has a credit balance on P&L a/c of Rs.300000 on 1.4.2000 and the net profit for the year 2000-01 is Rs.3000000. It was decided that the following decisions be carried out regarding provisions, reserves and dividends:
   (i) General Reserve Rs.350000
   (ii) Investment Allowance Reserve Rs.350000
   (iii) Provision for taxation @50%
   (iv) Dividend equalization fund a/c Rs.200000

(v) Dividend on 10% preference shares of Rs.2000000

(vi) Dividend at 15% on 300000 equity shares of Rs.10 each fully paid. You are required to give P&L Appropriation A/c and give journal entries for payment of dividend.

Part-A

1. How is provision for taxation treated in the final accounts of a Company?
2. What is managerial remuneration?
3. What is interim dividend?
4. What is contingent liability?
5. The provision for tax at the end of 31-3-2011 stood at Rs. 300000. During 2011-2012, the tax liabilities up to 31-3-2011 were settled for Rs. 2,74,000. Provision required in respect of 2011-2012 is Rs. 82000. How will you show provision for tax in profit and loss a/c.?
6. A company pays interest on 30th June and 31st December on its 100000 15% debentures of Rs.100 each, the books are closed on 31st March. How will the relevant items appear in the company's balance sheet?
7. From the particulars of XLtd, calculate the managerial remuneration assuming there are two whole time directors; a part time director and manager: (i) Net profit before provision for income tax and managerial remuneration but after depreciation- Rs. 870410 (ii) Depreciation provided in the books- Rs 310000 and (iii) Depreciation allowable under schedule XIV- Rs. 260000.

Part-B

1. Explain the law relating to calculation of managerial remuneration.
2. What is the legal requirement as to calculation of 'Divisible profits"?
3. Gokul Ltd., is a company with an authorized capital of Rs. 5,00,000 divided into 5,000 equity shares of Rs.100each. On 31.12.2012 shares were fully called up. The following balances where extracted from the ledger of the company as on 31.12.2012.

	Rs.
Stock	50,000
Sale	4,25,000
Purchases	3,00,000

Wages	70,000
Discount allowed	4,200
Discount received	3,150
Insurance up to 31.3.13	6,720
Salaries	18,500
Rent	6,000
General Expenses	8,950
Profit and loss account(Cr)	6,220
Printing and Stationary	2,400
Advertisement	3,800
Bonus	10,500
Debtors	38,700
Creditors	35,200
Plant and Machinery	80,500
Furniture	17,100
Cash and Bank balance	1,34,700
Reserve	25,000
Loan from Managing Director	15,000
Bad Debts	3,200
Calls-in-arrears	5,000

prepare Trading and Profit and loss account for the year ended 31.12.2012 and the Balance Sheet as on that date. Additional information:

(a) Closing stock Rs. 91,500
(b) Provide depreciation at 15% on plant and machinery and 10% on furniture
(c) Outstanding liabilities : Wages Rs.5,200; Salary Rs.1,200; Rent Rs.600.
(d) Provide 5% dividend on the paid-up share capital

4. A Ltd. Company with an authorized capital of Rs.500000 dividend into 5000 Equity shares of Rs.100each on 31.12.2012, 2500 shares were fully called up. The following balances were extracted from the ledger of the company as on 31.12.2012. Stock Rs.50,000; sales Rs.4,25,000; purchases Rs.3,00,000; Wages(Productive)Rs.70,000; discount allowed Rs.4200; discount received Rs.3150; Insurance upto 31.3.13 Rs.6720; Salaries Rs. 18,500; rent Rs.6,000; general expenses Rs.8950; P&L a/c (credit)Rs.6,220; printing and stationery Rs.2400; advertisement Rs.3,800; bonus Rs.10,500; debtors Rs.38,700; creditorsRs.35,200; plant and machinery Rs.80,500; furnitureRs.17,100; cash and bank balance Rs.1,34,700; reserve Rs.25,000 loan from managing Director Rs.15,700; Bad debtsRs.3,220; calls is arrears Rs.5,000.

   You are required to prepare Trading and Profit and Loss a/c for the year ended 31.12.2012 and balance sheet as on that date.

   Additional information;

   (i) Closing stock Rs.91,500
   (ii) Provide depreciation at 15% on plant and machinery and 10% on furniture.
   (iii) Outstanding liabilities: wages Rs.5,200; Salary Rs.1,200; Rent Rs.600.
   (iv) Provide 5% dividend on the paid up share capital

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SCHOOL OF MANAGEMENT STUDIES

UNIT – IV – Corporate Accounting-1 – SBAA1301

UNIT-4 **VALUATION OF GOODWILL AND SHARES**

Goodwill – Meaning, Definition – Valuation of Goodwill – Methods of Valuation of Goodwill – Valuation of Share – Various Methods of Valuation of Shares.

Definition of goodwill:-

Goodwill in simple words means the 'good name' or the 'reputation' of the business which attracts more customers and therefore, helps in earning more profits in future. It is an intangible real asset and not a fictitious one."It is perhaps the most intangible of intangibles".
"The capacity of a business to each profits in future is basically what is mean by the term goodwill" –J.O.Magee,

Nature of Goodwill

Goodwill is an intangible asset since it cannot be seen or felt. However it is not fictitious in the case of profitable concerns. It can be sold, though a sale will be possible only along with the sale of business itself. Sometimes, good will is more valuable than the tangible assets.

Sources of goodwill

The following are the main sources which generally give rise to goodwill:

(i) The location of the business premises e.g., a retail shop located in a busy market centre
(ii) The reputation of the articles sold arising for the high standard or quality of the goods themselves
(iii) The personality and reputation of the owner or management, arising through his/its skill and influence, as in the case of a professional man. For example , a chartered Accountant
(iv) Possession of trademarks, patents or copy rights
(v) Possession of advantageous contracts or complete or partial monopoly
(vi) Development of the business and shopping facilities with the changing conditions of the market e.g., provision for the visitor's rest room.

(vii) Any government or any legislative or any other special advantage enjoyed by the firm .e.g., inclusion in the list of approved suppliers to Government, Municipal Corporation or C.P.W.D etc.

Goodwill is not generally recorded in the books of accounts even though it does exist in a business firm .In fact, goodwill should not appear in the books of a business unless

(a) It has been purchased and paid for
(b) It is necessary to bring it into the books of accounts in connection with admission of a new partner or retirement or death of an existing partner. Moreover, to write up a created goodwill is regarded as contrary to good accounting practice. In a way it is sort of secret reserve.

Methods of valuation of goodwill

In the case of sale of business , the value of goodwill will depend on mutual agreement between the purchaser, and seller of the business. Normally, the following methods are followed for valuing goodwill:

(1) Average profits method
(2) Super profits method
(3) Capitalization method

1. **Average profits method or certain number of years' purchase of average profits method.**

Under this method, goodwill is valued on the basis of an agreed number of years purchase of the average annual profits , calculated by reference to recent years and having regards to the probable maintenance of such profits in future years. Here there are two important steps in the computation

(a) Average normal profit of the past three or four years must be computed. Any abnormal or non-recurring losses and gains should be removed from the profit. Then any future expected savings or additional expenses should be adjusted from the average profit.
(b) They years of profit should be determined, which depends on the capacity of the firm to maintain future profits.

Calculating of weighted average

Sometimes, instead of the simple average of the adjusted profit as discussed above, weighted average is taken into consideration. Weights are given to each year's profit on the consideration of how each year's profit is likely to influence the future profit trend. Generally, more weight age is to be given to the profit of the later years as compared to the former years. The profit is multiplied by the weight, the products are totaled and them divided by the total of the weights.

2. **Super profit method**

Average profit of the firm is compared with the normal profit on the invested capital in the firm. Excess of average profit over normal profit is known as super Profits. Defined in another way super profit is the excess of profit which can be expected in future years over and above what is necessary for paying a fair return on capital employed, having regard to the risk involved in that class of business and fair managerial remuneration.

This method thus presumes normal profits to cover interest on capital and managerial remuneration and the profits of a business in excess of the normal yield are called super profits.

Calculation of super profits

The following steps are to be taken for calculation of super profits.

(i) The average capital employed during the year should be ascertained

(ii) Normal profit should be calculated. The normal profit is ascertained as follows.
Normal profit = Average capital employed × Normal rate of return
Normal rate of return is the rate of profit generally earned by other similar firms in that industry.

(iii) Then, the expected average (simple or weighted) annual Trading profit after tax, preference dividend and interest on long term loans should be computed [However , transfer to general reserve, dividend equalization fund, sinking fund for redemption of debentures etc.should not be deducted since they, in no way, affect the availability of profits for the equity shareholders]

(iv) Form this expected average profit , reasonable managerial remuneration should be deducted

(v) The profit as obtained after the above adjustments is to be compared with the normal profit . If the expected average profit exceeds the normal profits, the balance represents the super profits.
To sum up:-
Super Profits=Expected average profit –Normal profit
Normal Profits = Average capital employed × Normal rate of return
Expected average profit =Average of the previous three or four years' profits, after adjusting past abnormal losses and gains and also future expected changes in expenses and incomes.
This method is very popular for valuation of goodwill in case of joint stock companies.

Goodwill based on super profits

There are three methods of calculating goodwill based on super profits. The methods and their formulae are given below.

(i) Years of purchase of super profit method

According to this method the value of goodwill is ascertained as follows;- Goodwill= super profit × No. Of years 'purchase.

(ii) Sliding –scale valuation of super profit method

This method of valuation of goodwill is a slight variation of the purchase of super profit method. It has been advocated by A.E. Cut forth. It is based on the logic that the greater is the amount of super profits, the more difficult it is to maintain it. Higher profit will naturally attract competition and soon the firm's ability to make super profit is curtailed.

(iii) Capitalization of super profit method

Under this method the average super profit is capitalized at a certain rate return and this capitalized amount becomes the value of the goodwill. In other words, the method tries to find out the amount of capital needed for earnings the super profit,

(iv) Annuity method

Under this method super profit is being considered as the value of annuity over a certain number of years and for this purpose, compound interest is calculated at a certain respective percentage. The present value of the said annuity will be the value of goodwill. This method is based on the logic that the purchaser should pay now for goodwill only at the present value of super profits calculated at a proper rate of interest.

3. Capitalization method

Under this method, the total value of the business(or) capitalized value of business is found out by capitalizing the expected average profits on the basis of normal rate of return. The value of goodwill is the difference between the capitalized value of the business so found out and the actual capital employed (i.e., net tangible assets) in the business.

The following steps are to be taken in ascertaining the value of goodwill under this method

I. Expected average net profit should be ascertained after providing for reasonable managerial remuneration
II. Capitalized valued of profit is to be calculated on the basis of normal rate of return. Capitalized
III. Net tangible assets(i.e., total tangible assets –liabilities to outsiders)should also be calculated
IV. When the net tangible assets are deducted from the capitalized value of the business , the difference is goodwill .
Goodwill= capitalized value of business-net tangible assets.

Valuation of shares Introduction

Valuation is NOT AN EXACT SCIENCE: It is “Sophisticated Guess work” Bon bright opens his discussion on valuation with the following quotation form decision by Justice Holmes “A word is not a Crystal transparent and unchanged: It is the skin of a living thought and may vary greatly in colour and content according to the circumstances and the time in which it is used.

Need for valuation of shares

Shares of a limited company have to be valued for different purposes:

(a) When share of unquoted private companies should be purchased or sold
(b) When controlling number of shares are purchased by a company in another
(c) When amalgamation or absorption of companies takes places
(d) For settlement of dissenting shareholders in a reconstruction scheme
(e) For assessment of wealth tax, capital gains tax, etc.
(f) For sanctioning loan by financial institutions on the security of shares
(g) For conversion of preference shares into equity shares
(h) For advancing loans on the security of shares
(i) For compensating shareholders on the acquisition of shares, by the government under a scheme of nationalization.

Factors affecting the value of shares

The value of shares of a company is greatly affected by the economic, political and social factors, some of which are noted below.

I. The economic condition of the country
II. The nature of company's business
III. Other political and economic factors(e.g., possibility of nationalization, excise duty on goods
IV. The demand and supply of shares
V. Proportion of liabilities and capital
VI. Rate of proposed dividend and past profits of the company
VII. Yield of other related shares of the stock exchange, etc.

Methods of valuation of shares

The valuation of shares may broadly be classified as under

Methods of valuation

Net asset method
(or)
Asset backing method
(or)
Intrinsic value method
(or)
Breakup value method
(or)
Real value method
(or)
Assets-basis method
(or)
Net worth method (or)
Equity method

Yield method
(or)
market value method
(or)
Earning capacity method
(or)
Dividend yield method

Fair value method
(or)
Average of assets bacl
and yield method

1. **Net assets method (or) intrinsic value method**

This method measures the value of the net assets of the company against each share. Since the valuation is made on the basis of the assets of the company, it is known as assets basis or asset backing method. At the same time, the shares are value on the basis of real internal value of the assets of the company and that is why the method is termed an intrinsic value method or real value method. For the purpose of valuating shares of a company by this method, it is necessary to make a start with the assumption that the company in question is liquidated, its assets are realized and liabilities paid off. That is why this method is also called break-up value method. This method may be made either (i) on a going/continuing concern basis; and (ii) break –up value basis . In the case of former, utility of assets is to be considered for the purpose of arriving at the value of the assets but in the case of latter the realizable value is o be taken.

Under this method the assets of the company at market values are added up.The liabilities including debentures and preference shares are reduced. The balance is net assets. It is divided by the number of shares to find the value of each share. Net assets value may be expressed by the following formula.

Factors to be considered in valuing the assets

I. A proper value should be placed on the goodwill of the business, as explained in the preceding pages. In other words, goodwill should be valued at current cost and therefore any book value appearing as a result of purchase of goodwill must be eliminated

II. Fictitious assets such as debit balance of profit &loss account, discount on issue of shares and debentures, preliminary expenses, etc.should be excluded

III. All other assets(including non-trading assets such as investment) should be taken at their market values. In the absence of information in the question regarding the market values of the different assets, book values may rightly be taken as the market values of the different assets.

IV. While calculating the value of inventories , finished goods may be valued at market price and raw-materials, stocks and work-in –progress should be valued at cost price.

V. In case of book debts, it must be valued after making provision for bad and doubtful debts.

Valuation of liabilities

A. Generally, liabilities are to be taken at book values. However, due consideration is to be given for contingent liabilities, similarly, it is necessary to provide adequate provisions for outstanding expenses

B. It is necessary to provide adequate provision for taxation and dividends so that these are included in the liabilities

C. In case the share capital comprises both equity shares and preference shares, it is necessary to deduct preference share capital from the assets.

D. In case , the preference shares are participating preference shares, their claim f or surplus should also be deducted from the value of the assets.

Treatment of partly paid up equity shares

When there are fully paid up and partly paid – up equity shares, it is necessary to convert partly paid up shares into fully paid up shares by making a national call and uncalled amount should be added to net assets before dividing the same by the number of shares. The value of each partly paid up share will then be the value of each fully paid up share minus the amount due on its.

Different classes of equity shares

Where there are equity shares of different denominations(e.g.,2,000 shares of Rs.100 each fully paid and 2,000 shares of Rs.80 each fully paid) the total assets backing for equity shares being divided by the total amount of paid up equity capital(see that it is not the number of shares but the paid up value of shares which divides the assets backing) gives the value of each Re.1 of the paid up capital , this again being multiplied by the actual paid up value of each class of shares with the asset backing value of that class of shares.

Applicability of the method

I. The method is particularly applicable when the shares are valued at the time of amalgamation, absorption and liquidation of companies; and

II. The permanent investors determine the value of shares under this method at the time of purchasing the shares

III. This method is also applicable when shares are acquired with control motives

1. Yield method /Earning capacity method

Yield is the effective rate of return on the investment made in the shares 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 method. This method of valuation should be used in all but exceptional cases. Since an investor is much concerned with the return that the expects, this method is valuable. While investing funds, the investor's main point of view is the return, although asset backing is also important because it provides the security. A genuine investor who funds that a company has low dividend rate but high asset backing never invests in the company with a view to liquidating the company and getting the benefit of high asset backing

Under this method, the future maintainable profit for equity dividend is estimated by reference to past performance. This is adjusted by eliminating non-recurring incomes, deducting income tax, making allocation to reserves and preference dividend. The adjusted profit is capitalized at the normal rate of return in similar business. Alternatively, the yield value of each share may be calculated by applying the following two formulae.

The yield method is considered better than net assets method

2. Fair value

There are some accountants who do not prefer to use net assets value or yield value for ascertaining the correct values of shares. They however prefer the fair value of shares, which is the average of net assets value and yield value which provides a better indication about the value of shares that the earlier two methods:

1. Calculate the amount of goodwill on the basis of three years purchase of the last five year's average profits. The profits for the last five years are:

	Rs.
I year	4800
II year	7200
III year	10000
IV year	3000
V year	5000

2. Following details are available about the business of Sagar td.

(i) Profits : 1994 – Rs.80000; In 1995 – Rs.100000; In 1996 – Rs.120000;

(ii) Non – recurring income of Rs.8000 is included in the profit of 1995.

(iii) Profits of 1994 have been reduced by Rs.12000 because goods were destroye 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 year;

(v) Reasonable remuneration of the proprietor of the business is Rs.12000 per year but it has not been taken into account for calculation of above mentioned profits;

(vi) Profits of 1996 include Rs.10000 income on investment. Calculate goodwill on the basis of three years purchase of the average profit of last three.

3. Goodwill is to be valued at 3 years purchase of five years average profits. The profits for the last five years of the firm were:

1994 – 2400; 1995 – 3000; 1996 – 3400; 1997 – 3200; 1998 – 4000.

Calculate the amount of goodwill.

4. Sailee Ltd has a paid up capital of Rs. 3,00,000 divided into 20,000 Equity shares of Rs. 10 each and 5%, 1,000 Preference Shares of Rs. 100 each. The company has Rs. 1, 00,000 debentures; the interest payable is 10% p.a. During the year 2008-09 the company earned a profit of Rs. 1, 60,000 before charging interest. The company declared dividend at the rate of Rs. 2 per share for the last year. The normal rate of return is 20%. Assume tax rate of 30%. Calculate value per share under Earning Yield method and Dividend Yield Method.

5. Calculate the amount of goodwill in the following case, on the basis of three years purchase of the last four years average profits. The profits and losses for the last four years are:

	Rs.
1995	10000
1996	16000
1997	6000 (loss)
1998	12000

6. Vatsal who has been carrying on a retail business for the past 20 years, intends selling his business on 31st Dec 1998. It is agreed between vatsal and the buyer that the latter pay Rs.150000 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.

Profits Earned:

1994 – Rs.3000: 1995 – Rs.4000; 1996 – Rs.46000; 1997 – Rs.55000; 1998 – Rs.44000

At the time of acquiring Vatsal's business, the buyer was employed as the manager of a similar business on a salary of Rs.1000 per month. The profit of 1998 included income from investment Rs.3500 and profit or 1995 had been reduced by Rs.4000 being loss on speculation. Similarly, the profit of 1997 had been reduced by Rs.6000 owing to loss from betting.

Weighted average profit

7. The profit of Thilaga Ltd for the last 5 years were as follows:

	Rs.
1994	15000
1995	18000
1996	22000
1997	25000
1998	27000

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.

Super Profit Method

8. A firm earned net profit during the last three years as follows:

	Rs.
I year	36000
II year	40000
III year	44000

The capital investment of the firm is Rs.100000.
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.

9. 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.2000000.
(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. 350400; Rs.280300 and Rs.310100.
(iv) Fair remuneration to the partners for their services is Rs.48000 per annum.
(v) Sundry assets of the firm are Rs.2350400 and current liabilities are Rs.95110.

10. The following particulars are available in respect of the business carried on John.

(a) Capital invested – Rs.5000
(b) Trading results:

	Rs.
1990 profit	12200
1991 profit	15000
1992 profit	2000
1993 profit	21000

(c) Market rate of interest on investment 8%
(d) Rate of risk return on capital invested in business 2%.
(e) Remuneration from alternative employment of the proprietor (if not engaged in business) – Rs.3600 p.a.

Compute the value of goodwill of the business on the basis of 3 years purchase of super profit taking average of last four years.
average super profits for the last five years.

11. The balance sheet of X ltd as on 31.3.1996 is as follows:

Liabilities	Rs.	Assets	Rs.
5000 8% pref shares of Rs.10 each.	50000	Goodwill	10000
		Fixed Assets	180000
10000 equity shares of Rs.10 each.	100000	Investments (5% Govt Loans)	20000
Reserve (including provisions for taxations Rs.10000)	100000	Current Assets	100000
		Preliminary Expenses	10000
		Discount on debentures	5000
8% Debentures	50,000		
Creditors	25,000		
	325000		325000

The average profit of the company (after deducting interest on debentures and taxed) is Rs.30000. The market value of the machinery included in fixed assets is Rs.5000 more. Expected rate of return is 10%. Evaluate the goodwill of the company at 5 times of the super profit.

Capitalization of super profit method

12. From the following information, compute the value of goodwill by capitalizing super profits:
Average capital employed Rs. 200000
Normal rate of profit is 10%
Profit for 1991 Rs. 31000; 1992 Rs.29500; 1993 – Rs/33000
Profit for 1992 has been arrived after writing off abnormal loss of Rs.1000 and profit for 1993 include a non – recurring income of Rs.1500.00

13.Find out goodwill by capitalizing super profits:
Normal rate of return 12%
Profits for the last four years are:
Rs.30000; Rs.40000; Rs.50000 and Rs.45000
Non – earning income of Rs.3000 is included in the above mentioned profit of Rs.30000.
Average capital employed is Rs.300000

14.From the following information, compute the value of goodwill as per annuity method.
Average capital employed Rs.100000
Normal Rate of Profit 10% Profits:
1991 – 140000
1992 – 122000
1993 – 170000
Profits for 1992 have been arrived at after writing off abnormal loss of Rs.10000 and profits of 1993 include a non – recurring income of Rs.22000. Goodwill is to calculated on the basis of annuity of 3 yrs purchase of super profits. The present value of annuity of Re.1 for 3 yrs at 10% is Rs.2.4868.

15.The following is the balance sheet of Alpha Trading Co. Ltd as on 31st Dec 1998.

Liabilities	Rs.	Assets	Rs.
Paid up capital: 2500 equity shares of Rs.100 each.	250000	Goodwill at cost	25000
		Land & Buildings at cost	110000
		Plant & Machinery at cost less depreciation	100000
Profit & Loss A/c	56650	Stock at cost	150000
Bank overdraft	58350	Book debts	90000
Sundry Creditors	90500		
Provision for taxation	19500		
	475000		475000

The company commenced operations in 1994 with a paid up capital of Rs.250000. The profits earned before providing taxation have been as follows:
1994 – 61000; 1995 – 64000; 1996 – 71500; 1997 – 78000; and 1998 – 85000.
You may assume that income tax at the rate of 50% has been payable on these profits. The average dividend paid by the company for four years is 10% which is taken as reasonable return expected on the capital invested in the business. You are required to ascertain the value of goodwill of the company.

QUESTIONS

Part-A

1. Define Goodwill.
2. Enumerate the factors that affect the valuation of goodwill.
3. What is “Super profit” method of evaluating goodwill of a company?
4. How average capital employed is computed?
5. What is normal rate of return?
6. What is intrinsic value of shares?
7. How is fair value of shares determined?

8. Goodwill is valued at 3 years purchase of five years average profits. The profits for the last five of the firm were: 2008- Rs. 2400; 2009- Rs 3000; 2010- Rs. 3400; 2011- Rs 3200 and 2012- Rs 4000. Calculate the amount of goodwill.
9. A total asset of the firm is Rs 840000. The liabilities of the firm are Rs 440000. Normal rate of return in this class of business is 121/2%. The firm earned a profit of Rs.64000. Calculate goodwill, if it is to be valued at 2 years purchase of super profit.
10. A firms earns a profit of Rs. 40000 and has invested capital amounting to Rs. 300000. In the same class of business, normal rate of earning is 10%. Calculate goodwill according to capitalization method.
11. From the following particulars, compute the value per equity share under net assets method: Total assets at market value- Rs 4980000; Total outside liabilities- Rs1900000 and 200000 equity shares of Rs.10 each- Rs 2000000.
12. SKK Ltd declared dividend at 25% on its shares of Rs.10, Rs. 8 paid up. Its shares are quoted in the market at Rs.10. Calculate the normal rate of return

Part-B

1. What are the different methods of calculation of goodwill?
2. Explain the different method of valuation of shares.
3. X Ltd., has 10,000 equity shares of Rs.10each, Rs.8 paid and 1,00,000 6% preference shares of Rs.10 each fully paid. The company has a practice of transferring 20% of the profit to general reserve every year. The expected profit (based on past year's performance) before tax is Rs.2,00,000 and the rate of tax is 50%. You are required to calculate the value of equity share. It may be assumed that normal rate of dividend is 20%.
4. The following information is available from Tina Ltd. as at 31st March,2009: Capital : 1,000, 5% Preference Shares of Rs. 100 each fully paid Rs. 1,00,000 2,000 Equity Shares of Rs. 100 each fully paid Rs. 2,00,000
   Reserve and Surplus Rs. 2,00,000 6% Debentures Rs.1,00,000 Current Liabilities Rs. 1,00,000
   Assets: Fixed Assets Rs. 4,00,000 Current Assets Rs. 3,00,000
   For the purpose of valuation of shares, fixed assets and current assets are to be depreciated by 10% ; Interest on debentures is due for six months; preference dividend is also due for the year. Neither of these has been provided for in the balance sheet. Calculate the value of each equity share under Net Asset Method.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – V – Corporate Accounting-1 – SBAA1301

UNIT-5 **INTERNAL RECONSTRUCTION**

Alteration of Share Capital – Capital Reduction – Internal Reconstruction – Methods of Internal Reconstruction.

Alteration of share capital and internal reconstruction

A change in the number of authorized shares a company may issue. Authorized shares are the total shares a company is permitted by its charter to issue, as opposed to the number it actually has issued. To alter share capital, a company must amend its charter and/or bylaws and register the change with the appropriate regulatory authority

Definition

Increase or decrease in (or rearrangement of) the authorized share capital of a firm, as permitted in its articles of association. Any such change requires (1) passing of a resolution to the effect in the firm's general meeting, and (2) filing of the notice of alteration with the appropriate governmental office

.When a company has been making losses for a number of years, the financial position does not present a true and fair view of the state of the affairs of the company. In such a company the assets are overvalued, the assets side of the balance sheet consists of fictitious assets, useless intangible assets and debit balance in the profit and loss account. Such a situation does not depict a true picture of financial statements and shows a higher net worth than what the real net worth ought to be. In short the company is over capitalized. Such a situation brings the need for reconstruction.

Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares. The object of reconstruction is usually to reorganize capital or to compound with creditors or to effect economies. Such a process is called ***internal reconstruction*** which is carried out without liquidating the company and forming a new one.

However, there may be external reconstruction. Wherever an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is external reconstruction. Such external reconstruction is essentially covered under the category ‘amalgamation in the nature of merger’ in AS-14.

Accounting Entries on Internal Re-Construction

Entry for share capital reduced without changing the face value of the shares

Share Capital A/c

To Capital Reduction/Reconstruction A/c

Entry if face value of the shares is also changed on reduction of capital a new category of share capital is created :

Share Capital A/c (Old)

To Share capital A/c (New) To

Capital reduction A/c

Entry where rate of dividend on preference shares is changed under the scheme of reconstruction:

Preference Share Capital A/c (OLD)

To Preference Share Capital A/c (New)

Entry When debenture holder and creditors are also ready to reduce their claim against company:

Debenture A/c Creditors A/c

To Capital reduction A/c

Entry in case of appreciation in the value of any asset:

Assets A/c

To Capital reduction A/c

Entry if any contingent liability matures and is to be paid immediately the following entry is passed:

Capital reduction A/c To Liability payable A/c Liability Payable A/c

To Bank A/c

Entry for utilising the amount of capital reduction to w/o accumulated losses.

Capital Reduction A/c

To Profit & Loss A/c

To Preliminary Expenses A/c

To Discount on Shares /Debentures A/c

To Goodwill A/c

To Trade Assets A/c

To Patents/Copy rights

To Assets A/c

For transferring any balance left in the capital reduction account to capital reserve account

Capital reduction a/c dr. (with the balance left)

To capital reserve a/c

External reconstruction is effected by liquidating the company. It is just like absorption. In it a new company is formed to acquire the business of an existing company are transferred to the newly formed company. But it is not done in the internal reconstruction.

Capital Reduction

Capital reduction refers to the cancellation of that part of paid up capital which is lost in operations or which is not represented by existing assets. it is generally resorted to write off the past accumulated losses of the company. It is unlawful except when sanctioned by the court because conservation of capital is one of the main principles of the company law. The issued share capital of a company represents the security on which the creditors rely. Companies usually do not call the full value of shares at one time. The uncalled capital act as a future security for the company's creditors. Therefore, any reduction of capital reduces the security of creditor.

A company is permitted to reduce its share capital by section 100 through following ways:

By reducing the uncalled liability of the members

By writing off the part of paid up capital which is lost in operations or which is not represented by available assets.

By returning that part of paid up capital which is in the excess of the need of the company

Accounting procedure for Capital Reduction:

For extinguishing or reducing the uncalled liability of the member:

Equity Share Capital A/c

To Equity share Capital A/c

For writing off the part of paid up capital which is lost in operation or which is not representing by available assets:

Equity Share Capital A/c

To Equity Share Capital A/c To Capital Reduction A/c

If the face value of shares remain unchanged

Equity Share Capital A/c

To Capital Reduction A/c

For reducing the capital by returning the excess capital:

Equity Share Capital A/c

To Equity Share Capital A/c To Equity Shareholders A/c

For payment to Shareholders

Equity Shareholders A/c

To Bank A/c

For uses of Capital reduction A/c

Capital Reduction A/c

To Accumulated Losses A/c To Goodwill A/c

To Fictitious Assets A/c To Other Assets A/c

To Capital Reserve A/c(Balancing Figure)

The company must apply to the court for an order confirming the capital reduction. The court must look after the interests of creditors and shareholders before giving an order confirming the capital reduction.

The court may make an order confirming the capital reduction. The court may make an order confirming the capital reduction on such terms and conditions as it thinks proper, if it is satisfied that every creditor of the company entitled to object capital reduction has consented to the reduction or that his debt has been discharged or secured by the company. The court may also order the company to add the words “and reduced” to the name of the company for such period as it deems fit. The court may also order the company to publish reasons for reduction and all other information in regard there to for public information.

The order of the court confirming the reduction must be produced before the registrar and a certified copy of the order and of the minutes of reduction should be filed with the registrar for registration.

Note: in the following cases, procedure of reduction of capital is not called for:

Where redeemable preference shares are redeemed in accordance with the provisions of section 80.

Where any shares are forfeited for non-payment of calls.

Where there is surrender of shares or a gift is made to a company of its own shares.

Where the nominal share capital of a company is reduced by cancelling any shares which have not been taken or agreed to be taken by any person.

Alteration of share capital

(a) Increase in share capital by issue of new shares
(b) Consolidation of all as part of its existing shares
(c) Sub division of its existing shares
(d) Conversion of fully paid up into stock or vice-versa

In case of consolidation shares of smaller amount converted into shares of larger amount but the value of share capital remain same.

In case of sub division shares of larger amounts converted into shares of smaller amounts but the value of share capital remain same.;

In case of internal reconstruction a capital reduction account is to be opened, which is credited with the amount sacrificed by the shareholders, debenture holders and creditors and also due to increase in the value of any assets. Then the amount of capital reduction is utilised for writing off fictitious assets, past losses and excess value of other assets. If there is any balance of capital reduction account left after writing off the above losses, then it is to be

transferred to capital reserve account.The amount to be written off cannot exceed the amount credited to the capital reduction amount. But if any reserve appears on the liabilities side of the balance sheet, the same way be utilised in writing off the accumulated losses and assets.
If there is any contingent liability (like arrears of preference dividend etc.) and if the same is forgone for the claimant, then no entry will be passed.
If any contingent liability or unrecorded liability (like reconstruction expenses) is to be paid, then the following entry will be passed.

Capital reduction a/c Dr.
To cash /bank/share capital a/c

In case there is any profits or gain occur during the process of internal reconstruction then such profits or gains must be credited to capital reduction account.The case of surrender of shares, shareholders surrender part of their holdings to the company, which are utilised to repay debenture holders, preference shareholders and other creditors of the company. Balance of unused shares surrendered is to be cancelled by transferred to capital reduction account.

Concept of alteration of share capital: according to sec 94 of companies act, a ltd company, if authorised by its articles can be made by passing an ordinary resolutions in general meeting without the approval of court.
The company can increase its share capital by making fresh issue of shares. accounting entries are the same as are made at the time of issue of shares. Consolidation of shares refers to the conversion of existing shares of small amount into shares of large amount. Consolidation does not bring any change in the amount of share capital. It only reduces the no. of shares.

Sub-division of shares defines as the conversion of shares of larger denomination into shares of smaller denomination is called sub-division of shares. sub division also does not bring any change in the amount of share capital. It only increases the no. Of shares.
The company can convert its fully paid up shares into stock and vice versa. Partly paid up shares can never be converted into stock.
The company can cancel only those shares which are not so far taken by public. Since cancellation of unissued capital does not affect the paid up capital in any way, no entry is required at the time of cancellation.

Alteration of share capital:- Problem no:-1

A company which has 2,000 equity shares of Rs.100 each decides to sub-divide them into shares of Rs.10 each. The required journal entry is as follows.

Problem no:-2

A company decides to convert its Rs.10 equity share capital of Rs.8,00,000 into stock. The following is the journal entry to be passed.

Problem no:-3

A company whose capital consists of 5,000 shares of Rs.100 each, Rs.75 called and paid, decides to reduce the shares into 5,000 shares of Rs.75 each fully paid.

Problem no:-4

'X' Co. Ltd has the following shares as a part of its share capital 10,000 8% preference share of Rs.100 each fully paid

50,000 equity shares of Rs.5 each fully paid.

20,000 equity share of Rs.10 each, Rs.8 called up and paid up. The company has decided to alter the share capital as follows:-

To sub-divide the preference share into share of Rs.10 each

To consolidate the equity shares of Rs.5 each into shares of Rs.10 each

To convert the partly paid up equity shares into fully paid up shares of Rs.8 each, with necessary legal sanctions

Journalize the alterations.

Capital reduction

Return of share capital Problem no:-5

Bee Ltd. has 60,000 equity shares of Rs.100 each, Rs.80 per share called up. Now the company decides to pay off Rs.20 per share of the paid up capital and at the same time to reduce the Rs.100 share to Rs.60 share fully paid up by cancelling the unpaid amount. Give journal entries.

Surplus in capital reduction account Problem no:-6

ABC company Ltd. passed resolution and got Court permission for the reduction of its share capital by Rs.5,00,000 for the purposes mentioned as under:-

To write off the debit balances of P&L A/c Rs.2,10,000
To reduce the value of Plant & Machinery by Rs.90,000 and goodwill by Rs.40,000
To reduce the value of investments by Rs.80,000

The reduction was made by converting 50,000 preference share of Rs.20 each fully paid to the same number of preference shares of Rs.15 each fully paid and by converting 50,000 equity shares of Rs.20 each on which Rs.15 is paid up into 50,000 equity shares of Rs.10 each fully paid up.

Pass journal entries to record the share capital reduction.

Problem no:-7

The following scheme of reconstruction has been approved for Divya Ltd.

1. The shareholders to receive in lieu of their present holding of 60,000 shares of Rs.10 each fully paid the following:
   Fully paid new equity shares equal to 1/3red of their holding
   8% preference shares fully paid , to the extent of 1/5th of the above new equity shares
   Rs.60,000 8% secured debentures
2. The debenture holders' total claim of Rs.75,000 to be reduced to Rs.25,000. This will be satisfied by the issue of 2,500 8% preference shares of Rs.10 each fully paid
3. An issue of Rs.50,000 6% first debentures was made and allotted, payment for the same having been received in cash.
4. The goodwill which stood at Rs.3,00,000 was written down to Rs.50,000.Plant& Machinery which stood at Rs.1,00,000 was written down to Rs.75,000
5. The freehold premises which stood at Rs.1,75,000 was written down by Rs.75,000.
   Give journal entries in the books of Divya Ltd. for the above reconstruction scheme.

Problem no:-8

The Balance sheet Kavitha Industries Ltd.as at 31.12.1994 was as follows.

Liabilities	Rs	Assets	Rs
Share capital:-		Goodwill	15,000
2,000 preference shares of		Free hold properties	2,00,000
Rs.100 each	2,00,000	Plant & Machinery	3,00,000
4,000 Equity shares of Rs.100 each 5%	4,00,000	Stock	50,000
mortgage debentures	1,00,000	Debtors	40,000
Bank overdraft	50,000	P&LA/c	2,45,000
Creditors	1,00,000		
	8,50,000		8,50,000

The following reconstruction scheme was approved:

(a) Preference shares be reduced to 8% preference shares of Rs.60 each
(b) Equity shares to be reduced by Rs.80 each.
(c) The amount thus made available to be utilized to write off fictitious assets including goodwill and Rs.50,000 from fixed assets

Give entries for the reconstruction and the final balance sheet.

Part-A

1. What is capital reduction?
2. What is Alteration of share capital?
3. What are surrendered shares?
4. Distinguish between internal and external reconstruction.
5. Write a note on capital reduction account.
6. X. Ltd. With a share capital of 10000 equity shares of Rs. 100 each fully paid carries out by, proper resolution, a subdivision into shares of Rs. 10 each. Show the necessary journal entry to give effect to the above resolution.
7. Y Ltd. has been suffering heavy losses in the past. So, it has decided to go for reconstruction scheme by reducing 22000 Equity shares of Rs. 100 each into Rs. 50 each so as to write off accumulated losses of Rs. 10,70,000. Give journal entries to record the above transaction.
8. In order to eliminate accumulated losses of Rs. 45000 from the balance sheet, a company has decided to convert its 15000 7% preference shares of Rs. 10 each into 6% preference shares of Rs. 10 each, Rs.6 per share paid. Show journal entries in the books of company

Part-B

1. What is the procedure to be followed for reducing share capital?
2. The following scheme of reconstruction was approved by ‘K’ Ltd.;

a. The shareholders to receive in lieu of their present holding of 50,000 shares of Rs.10,the following:
Fully paid equity shares equal to $2/5^{th}$ of their holdings.
5% preference shares to the extent of $1/5^{th}$ of the above equity shares.
Rs. 60,000,6% debentures

b. The goodwill which stood at Rs.3,00,000 was written down to Rs.1,50,000.

c. Plant and Building were written down by Rs.20,000 and Rs.30,000 respectively . Draft journal entries.

3. Balance Sheet of 'S' Ltd. Is given:

liabilities	Rs.	Assets	Rs.
Authorised capital:		Fixed Asset	1,00,000
30,000 Equity shares of Rs.10 each	3,00,000	Stock	60,000
		Debtors	90,000
Paid up Capital:		Bank Balance	2,70,000
20,000 Equity shares of Rs.10 each	2,00,000		
Profit & Loss A/c 6%	1,40,000		
Debentures	1,20,000		
Creditors	60,000		
	5,20,000		5,20,000

It was resolved in the Annual General Meeting:

(a) to pay a dividend of 10%

(b) to issue on bonus share for every four shares held on the date of Balance Sheet given above.

(c) To give existing shareholders the option to buy one Rs.10 share at Rs.14 each for every four shares held prior to the issue of bonus shares.

(d) The debentures are to be redeemed at a premium of 4%

All the shareholders accepted the proposal (c) and exercised it. Pass journal entries and prepare the Balance Sheet after giving effect to the above resolutions.