

S.Y.B.Com
ACCOUNTANCY & FINANCIAL
MANAGEMENT II
(SUPPLEMENT)

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Important Instructions

The students taking admission in the academic year 2019-20 have to consider the following Instructions for this particular subject:

1. Below is the revised syllabus and Question paper pattern which is becoming applicable for the IDOL Students from the academic year 2019-20
2. Following **topics from the old syllabus are omitted:**
 - **Accounting with the use of accounting software (Section I)**
 - **Fire Insurance Claim**
 - **Accounting with the use of accounting software (Section II)**

Please not to be prepare for these topic.

3. The **new topics added in the revised syllabus are:**
 - **Conversion / Sale of a Partnership Firm into a Ltd. Company (Section I)**
 - **Introduction to Company Accounts (Section II)**
 - **Ascertainment and Treatment of Profit Prior to Incorporation (Section II)**

For newly entered topics this supplement is provided.



II

**Revised Syllabus of S.Y. B.Com.
With Effect from the Academic Year 2019-2020
Elective Courses (EC)
Discipline Specific Elective (DSE) Courses
Accountancy and Financial Management II**

SECTION I

Modules at a Glance

Sr. No.	Modules
1	Partnership Final Accounts based on Adjustment of Admission or Retirement/Death of a Partner during the year
2	Piecemeal Distribution of Cash
3	Amalgamation of Firms
4	Conversion / Sale of a Partnership Firm into a Ltd. Company

Sr. No.	Modules
1	<p>Partnership Final Accounts based on Adjustment of Admission or Retirement/Death of a Partner during the year</p> <p>i) Simple final accounts questions to demonstrate the effect on final Accounts when a partner is admitted during the year or when partner Retires / dies during the year.</p> <p>ii) Allocation of gross profit prior to and after admission / retirement / death when stock on the date of admission / retirement is not given and apportionment of other expenses based on time / Sales/other given basis.</p> <p>iii) Ascertainment of gross profit prior to and after admission/retirement/death when stock on the date of admission/retirement is given and apportionment of other expenses based on time / Sales / other given basis Excluding Questions where admission / retirement / death takes place in the same year.</p>

III

2	<p>Piecemeal Distribution of Cash</p> <ul style="list-style-type: none">i) Excess Capital Method onlyii) Asset taken over by a partneriii) Treatment of past profits or past losses in the Balance sheetiv) Contingent liabilities / Realization expenses / amount kept aside for expenses and adjustment of actualv) Treatment of secured liabilitiesvi) Treatment of preferential liabilities like Govt. dues / labour dues etc. Excluding : Insolvency of partner and Maximum Loss Method
3	<p>Amalgamation of Firms</p> <ul style="list-style-type: none">i) Realization method onlyii) Calculation of purchase considerationiii) Journal / ledger accounts of old firmsiv) Preparing Balance sheet of new firmv) Adjustment of goodwill in the new firmvi) Realignment of capitals in the new firm by current accounts / cash or a combination thereof Excluding Common transactions between the amalgamating firms
4	<p>Conversion / Sale of a Partnership Firm into a Ltd. Company</p> <ul style="list-style-type: none">i) Realisation method onlyii) Calculation of New Purchase consideration, Journal / Ledger Accounts of old firms.iii) Preparing Balance sheet of new company

IV

SECTION II

Modules at a Glance

Sr. No.	Modules
5	Introduction to Company Accounts
6	Redemption of Preference Shares
7	Redemption of Debentures
8	Ascertainment and Treatment of Profit Prior to Incorporation

Sr. No.	Modules
5	Introduction to Company Accounts i) Introduction of basic terms: Types of companies, nature and formation of companies, Shares, Debentures, Share Capital, Reserves and surplus, types of assets and liabilities, dividend, format of Balance Sheet (Only theory) ii) Issue of shares: Different modes IPO, Private Placements, Preferential, Rights, ESO, SWEAT and ESCROW account, Issue of shares at par, premium and discount, Under subscription and Over subscription of shares, forfeiture and reissue of forfeited shares, issue of shares for consideration other than cash. (Only theory) iii) Issue of Debentures: types of Debentures, Issue of debentures at par, premium and discount, Issue of Debentures with consideration of Redemption, Issue of debentures for cash receivable in installments or at a time Issue of debentures for consideration other than cash. (Only theory)

6	<p>Redemption of Preference Shares</p> <p>i) Provision of the Companies Act for redemption of Preference Shares (Sec 55 of the Companies Act, 2013), Companies (Share and Debentures) Rules.</p> <p>ii) Methods of Redemption of fully paid up Preference Shares as per Companies Act, 2013: The proceed of a fresh issue of shares, the capitalisation of undistributed profits and a combination of both, calculation of minimum fresh issue to provide the fund for redemption,</p> <p>(Question on entries and/or Balance Sheet)</p> <p>Note: Companies governed by Section 133 of the Companies Act, 2013 and comply with the accounting standards prescribed for them. Hence, the balances in security premium account not to be utilised for premium payable on redemption of preference shares.</p>
7	<p>Redemption of Debentures</p> <p>i) Introduction : Provisions of Section 71 (1) and (4) of the Companies Act, 2013, Creation and investment of DRR including The Companies (Share Capital and Debentures) Rules, 2014, the methods of writing-off discount/loss on issue of debentures; Terms of issue of debentures</p> <p>ii) Methods of redemption of debentures: By payment in lump sum and by payment in installments (excluding from by purchase in open market), Conversion.</p> <p>(Question on entries. ledgers and/or Balance Sheet and /or redemption of Debentures)</p>
8	<p>Ascertainment and Treatment of Profit Prior to Incorporation</p> <p>i) Principles for ascertainment</p> <p>(Preparation of separate combined, columnar Profit and Loss A/c including different basis of allocation of expenses and income)</p>



VI

Question Paper Pattern

Question No	Particular	Marks
Q-1	Objective Questions A) Sub Questions to be asked 12 and to be answered any 10 B) Sub Questions to be asked 12 and to be answered any 10 (*Multiple choice / True or False / Match the columns/Fill in the blanks)	20 Marks
Q-2	Full Length Question OR	15 Marks
Q-2	Full Length Question	15 Marks
Q-3	Full Length Question OR	15 Marks
Q-3	Full Length Question	15 Marks
Q-4	Full Length Question OR	15 Marks
Q-4	Full Length Question	15 Marks
Q-5	Full Length Question OR	15 Marks
Q-5	Full Length Question	15 Marks
Q-6	A) Theory questions B) Theory questions OR	10 Marks 10 Marks
Q-6	Explain the terms To be asked 12 To be answered 10	20 Marks



CONVERSION / SALE OF PARTNERSHIP FIRM INTO A LTD. CO.

Unit Structure:

- 1.0 Objectives
- 1.1 Introduction
- 1.2 Company Act 2013
- 1.3 Accounting entries for conversion
- 1.4 Solved practical problems
- 1.5 Exercise

1.0 OBJECTIVES

After studying the unit the students will be able to:

- Understand the concept conversion of partnership firm
- Calculate the Purchase consideration
- Explain the journal entries
- Solve the practical problems.

1.1 INTRODUCTION

Partnership firm in India is a major type of business concern which has led not only to the growth of the economy but also has provided employment and entrepreneur skills to the business. A growth in this business results in a need for tremendous expansion. However, a partnership firm suffers various inherent limitations of insufficient funding, unlimited liability, skills and competence in handling a business and so on under such a situation it becomes very necessary for the firm to change its form. The firm in such a situation may convert itself into either

- 1) A Joint Stock Company or
- 2) Limited Liability Partnership Firm to handle the spurt in the growth of the business.

In case the operations are very voluminous or large scaled a joint stock company becomes the most desirable solution. However it all depends on the partners' argument to change the form of the business.

This change of form may be done by either selling the firm altogether by converting it to a company.

It has to be done through the following stages:

1. Finding out prospective buyer of the partnership firm who will purchase the firm and then form a company.
(In some cases, the partners may take help of the financial service providing firms and themselves complete the formalities)
2. Estimate the Purchase Consideration.
3. Transfer assets and liabilities to the companies.
4. Distribute the purchase consideration to the partners.

In the process of conversion or sale the **students are required to:**

1. Ascertain purchase consideration.
2. Close books of old firms.
3. Preparation of Balance Sheet of the New Firm.

Purchase Consideration (PC): It means the price to be paid to the partners for giving up their ownership rights. The previous chapter has already discussed purchase consideration, a quick reviews is presented here.

It can be calculated as follows:

1. **Net Assets Method:** Here the PC means Difference between the agreed values of assets taken over and liabilities accepted by the new company.
2. **Net Payment Method:** Here the PC means payment made through equity shares, preference shares, debentures, and cash to the partners.
3. **Lump sum Method:** It means large single payment to the partners.

1.2 COMPANY ACT 2013

Section 2(20) of the Act defines a company as, “Any company formed and registered under this Act or any previous Act”. Also through schedule III, the Act has laid down the disclosure requirements of the financial statements. (The Act is detailed in the following chapter - Introduction to Company Accounts)

Payment or settlement of partner's loan
 Partner's Loan A/c Dr.
 To Bank / asset A/c

5. Record the Purchase Consideration
 New Company A/c Dr.
 To Realisation A/c

6. Calculate realization loss or gain and transfer to the capital A/c.

Gain
 Realisation A/c Dr.
 To Partners' Capital A/c

Loss :
 Partners' Capital A/c Dr.
 To Realisation A/c

7. Receiving the purchase consideration
 Shares / Debentures / Cash A/c Dr.
 To New Company A/c

8. Disburse the Purchase Consideration to the Partners
 Partners' Capital A/c Dr.
 To Shares / Debentures / Cash

B. In books of the new company (Not included in the syllabus)

C. Balance sheet of the New Company (as per format discussed earlier)

Check your progress:

i) State whether the following statements are True or False.

- 1) Upon conversion the old partnership firm ceases to exist.
- 2) A company is suitable for the business having large scale operations.
- 3) Purchase consideration on conversion of a company is settled in shares and debentures only.
- 4) Profit or loss on realization should be transferred equally to the partners.
- 5) Asset taken over is debited to the partners capital A/c

(Answers : True - 1, 2, 5 - False - 3, 4)

ii) Fill in the Blanks

- 1) A Joint Stock Company has ----- liability.

- 2) Purchase consideration has to be distributed to the partners in ----- ratio.
- 3) ----- A/c is debited when cash is taken over by a limited company.
- 4) A new company is formed on ----- of a partnership firm.
- 5) ----- method of calculating P.C. = Assets - Liabilities.

(1- limited, 2 - Profit sharing, 3 - Partner capital, 4 - dissolution, 5 - Net assets method)

1.4 SOLVED PRACTICAL PROBLEMS

Illustration 1

A, B and C share profits and losses in the ratio of 3:2:1 respectively. Their Balance sheet as an 31/12/2018 is as follows:

Capital		Goodwill	20,000
A	1,40,000	Land	40,000
B	1,60,000	Building	2,20,000
C	20,000	Machinery	1,00,000
General Reserve	36,000	Vehicles	56,000
Investment Fluctuation loan	8,000	Furniture	24,000
C's Loan	66,000	Investment	36,000
Mrs. A's loan	30,000	Loose Tools	14,000
Creditors	1,52,000	Bills Receivable	40,000
Outstanding Expenses	40,000	Debtors 80,000	
Bills Payable	28,000	Provision <u>4,000</u>	76,000
Bank Over Draft	1,20,000	Cash	38,000
		C's Current A/c	1,12,000
		Profit & Loss A/c	24,000
	8,00,000		8,00,000

Adjustments :

- 1) The partners decided to convert the firm into ABC Ltd. a Joint Stock Company having an authorized capital of 1,00,000 equity shares of ₹10 each.

- 2) The purchase consideration was decided at ₹5,80,000 and settled by paying ₹1,00,000 in cash and balance through equity shares.
- 3) The outstanding expenses was to be settled by the firm.
- 4) Loose Tools, vehicles, furniture and investments are sold by the firm at ₹10,000; ₹50,000; ₹25,000 and ₹42,000 respectively.
- 5) The Partner's and their spouses loan are taken over by the respective partners along with current A/c balances.

Prepare the ledger accounts in the books of the partnership firm.

Solution :

Purchase consideration (P.C.)

P.C. (given)		5,80,000
Settlement		
1) Cash / Bank	1,00,000	
2) Equity shares	4,80,000	5,80,000
	(40,000 shares of ₹10 each)	

Ledger Accounts

Realisation A/c

Dr.		Cr.	
To Assets A/c		By Liabilities A/c	
Goodwill	20,000	Creditors	1,52,000
Land	40,000	Bill Payable	28,000
Building	2,20,000	Provision on Debtors	4,000
Machinery	1,00,000	By ABC Ltd. (PC)	5,80,000
Bills Received	40,000	By Furniture	1,000
Debtors	80,000	By Investments	6,000
To loose tools	4,000		
To Vehicles	6,000		
To P. Capital			
(in A 1,30,500			
PSR) B 87,000			
C 43,500	2,61,000		
(gain on realization)			
	7,71,000		7,71,000

Partners' Capital A/c

	Partners				Partners		
	A	B	C		A	B	C
To Current A/c	-	-	1,12,000	By Balance b/d	1,40,000	1,60,000	20,000
To Profit & Loss A/c (PSR)	12,000	8,000	4,000	By General Reserve (PSR)	18,000	12,000	6,000
To Equity Share in ABC Ltd.	2,40,000	1,60,000	80,000	By Investment fluctuation period (PSR)	4,000	2,667	1,333
To Bank (final payment done)	70,500	93,667	--	By Loan's (adj 5)	30,000	--	66,000
				By Realisation (gain)	1,30,500	87,000	43,500
				By Bank (Cash brought to adj. excess)	--	--	59,167
	3,22,500	2,61,667	1,96,000		3,22,500	2,61,667	1,96,000

ABC Ltd. A/c

To Realisation A/c	5,80,000	By Bank	1,00,000
		By Equity Shares in ABC	4,80,000
	5,80,000		5,80,000

Bank A/c

To Balance b/d (Cash)	38,000	By Balance b/d	1,20,000
To ABC Ltd.	1,00,000	By O/S Expenses	40,000
To loose tools	10,000	By B's Capital	93,667
To Vehicles	50,000	By A's Capital	70,500
To Furniture	25,000		
To Investments	42,000		
To C's Capital	59,167		
	3,24,167		3,24,167

Loose Tools A/c

To Balance b/d	14,000	By Bank	10,000
		By Realisation (Loss)	4,000
	14,000		14,000

Vehicles A/c

To Balance b/d	56,000	By Bank	50,000
		By Realisation (Loss)	6,000
	56,000		56,000

Furniture A/c

To Balance b/d	24,000	By Bank	25,000
To Realisation (gain)	1,000		
	25,000		25,000

Investment A/c

To Balance b/d	36,000	By Bank	42,000
To Realisation	6,000		
	42,000		42,000

Outstanding Expenses A/c

To Bank	40,000	By Balance b/d	40,000
	40,000		40,000

Equity Share in ABC Ltd.

To ABC Ltd.	4,80,000	By Partners' Capital (in PSR)	
		A (3/6)	2,40,000
		B (2/6)	1,60,000
		C (1/6)	80,000
	4,80,000		4,80,000

Illustration 2

Amar, Akbar and Anthony were carrying on a Partnership business sharing profits & losses in the ratio of 4 : 3 : 1. Their business was expanding rapidly and hence they decided to convert their firm to AB Ltd., a joint stock company on 1/4/2018.

The Balance sheet of the firm as on 31/3/2018 was as follows :

Capital		Property	3,60,000
Amar	4,00,000	Equipment	2,40,000
Akbar	3,00,000	Debtors	3,00,000
Anthony	2,60,000	Stock	2,60,000
Bank Loan	80,000	Bank balance	40,000
Creditors	1,60,000		
	12,00,000		12,00,000

Adjustments :

1) The Co. agreed to take the assets & liabilities at the following values :

Property - ₹4,40,000
 Equipment - ₹2,00,000
 Debtors - ₹2,75,000
 Stock - ₹2,50,000
 Creditors - ₹1,45,000

2) The Co. agreed to pay ₹8, 00,000 through equity shares of ₹10 each and balance in cash.

3) The expenses of liquidation of the firm amounted to ₹10,000.

Journalise all the transactions in the books of the partnership firm.

Solution :

I) Calculation of P.C. & its settlement Assets taken over (at agreed values)

Property -	4, 40,000
Equipment -	2, 00,000
Debtors -	2, 75,000
Stock -	2, 50,000
Creditors -	<u>40,000</u>
	12, 05,000

Less : Liabilities

Creditors	1,45,000	
Bank Loan	<u>80,000</u>	<u>2,25,000</u>
P.C		9,80,000

		Dr. Rs.	Cr. Rs.
1.	Realisation A/c Dr. To Property A/c To Equipment A/c To Debtors A/c To Stock A/c To Bank A/c (Being Assets transfer to Realization a/c)	12,00,000	3,60,000 2,40,000 3,00,000 2,60,000 40,000
2.	Creditors A/c Dr. Bank loan A/c Dr To Realisation A/c (Being liabilities transfer to realization A/c)	1,60,000 80,000	2,40,000
3.	AB Ltd. A/c Dr. To Realisation A/c (Being P.C. recorded)	9,80,000	9,80,000
4.	Realisation A/c Dr. To Bank A/c (Being realization expenses paid)	10,000	10,000
5.	Equity Shares in AB Ltd. A/c Dr. Bank A/c Dr. To AB Ltd. A/c (Being P.C. Received)	8,00,000 1,80,000	9,80,000
6.	Realisation A/c Dr. To Amar's Capital A/c To Akbar's Capital A/c To Anthony's Capital A/c (Being Realisation gain transferred to Capital)	20,000	10,000 7,500 2,500
7.	Amar's Capital A/c Dr Akbar Capital A/c Dr Anthony's Capital A/c Dr To Bank A/c (Being Cash paid to Partners)	10,000 7,500 1,62,500	1,80,000
8.	Amar's Capital A/c Dr. Akbar's Capital A/c Dr. Anthony's Capital A/c Dr. To Equity Shares in AB Ltd. A/c (Being equity shares received in P.C. settled to the partners)	4,00,000 3,00,000 1,00,000	8,00,000

Partners Capital A/c**WN1**

	Amar	Akbar	Anthony		Amar	Akbar	Anthony
To Equity Shares (8L in PSR)	4,00,000	3,00,000	1,00,000	By Balance	4,00,000	3,00,000	2,60,000
To Cash	10,000	7,500	1,62,500	By Realisation	10,000	7,500	2,500
(Balance)	4,10,000	3,07,500	2,62,500		4,10,000	3,07,500	2,62,500

WN-2**Realisation A/c**

To Total Assets	12,00,000	By Total Liabilities	2,40,000
To Partners' Capital		By AB Ltd. A/C	9,80,000
Amar 10,000			
Akbar 7,500			
Anthony 2,500	20,000		
	12,20,000		12,20,000

Illustration 3

Kavita and Savita are equal partners. Their Balance sheet as on 31/3/2018 is as follows :

Liabilities	Rs.	Assets	Rs.
Capital			
Kavita	1,50,000	Bank	15,000
Savita	1,40,000	Fixed Assets	2,15,000
Creditors	1,00,000	Stock	1,00,000
Bank overdraft	40,000	Debtors	1,00,000
	4,30,000		4,30,000

The partners sold the business to KS Ltd. a Company on 1/4/2018. The value of goodwill was fixed at ₹15,000 and rest of the assets & liabilities were taken at the Balance sheet values. The company paid the purchase consideration through

- 1) 2500 10% debentures of ₹100 each and
- 2) Equity shares of ₹10 each

Prepare the Balance sheet of the Ltd. Co.

Solution :**I) Calculation of P.C.**

Goodwill -		75,000
Bank -		15,000
Fixed Assets		2,15,000
Stock -		1,00,000
Debtors -		<u>1,00,000</u>
		5,05,000

Less : Liabilities

Creditors	1,00,000	
Bank Overdraft	<u>40,000</u>	1,40,000
P.C		3,65,000

Settlement of P.C.

1) 10% Debenture (2500 x ₹100 each)	2,50,000
2) Equity shares (bal) (11500 shares x ₹10)	<u>1,15,000</u>
Total	3,65,000

II) Balance sheet of KS Ltd. as on 1/4/2018

Particulars	Note no.	₹
A) Capital & Liabilities		
1) Share holders funds		
a) Share Capital	1	1,15,000
b) Reserves & Surplus		--
2) Non Current Liabilities	2	2,50,000
3) Current Liabilities	3	1,40,000
Total		5,05,000
B) Assets		
1) Non Current Assets	4	2,90,000
2) Current Assets	5	2,15,000
Total		5,05,000

Notes to Accounts :**Note 1 : Share Capital**

11,500 equity shares of ₹10 each 1,15,000
 (These shares are issued to vendors for settlement of PC so no consideration has been received hereupon.)

Note 2 : Non Current Liabilities

2500 10% Debenture of ₹100 each 2,50,000
 (There debenture are issued to vendors for settlement of PC o no consideration has been received hereupon.)

Note 3 : Current Liabilities

Creditors 1,00,000
 Bank O/D 40,000
 1,40,000

Note 4 : Non Current Assets

Goodwill 75,000
 Fixed Assets 2,15,000
 2,90,000

Note 5 : Current assets

Stock 1,00,000
 Debtors 1,00,000
 Bank 15,000
 2,15,000

Illustration 4

Abhishek, Aishwarya and Aradhya were partners sharing Profit and Loss in the ratio of 2 : 1 : 1. Their Balance sheet as on 31/12/2018 was as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	60,000	Bank	30,000
Capital		Debtors	60,000
Abhishek	1,80,000	Bills Received	30,000
Aishwarya	1,50,000	Fixed Assets	3,00,000
Aradhya	30,000		
	4,20,000		4,20,000

On 1/1/2019; they formed a Ltd. Co. "Pink Ad Films Ltd." on the following conditions:

- 1) Distribute the bank balance amongst themselves.
- 2) The Company would discharge the P.C. through
 - a) 10% Debentures - ₹60,000
 - b) 15% Preference shares - ₹1,20,000
 - c) 15,000 equity shares of ₹10 each of ₹12 share
- 3) The partners agreed to share the debentures as : Aishwarya - ₹30,000 & Aradhya - ₹30,000
- 4) The Preference shares were to be allotted in the PSR and the equity shares will adjust the remaining capital balances.

Prepare the Realisation A/c and partners capital in the books of the partnership firm and Balance sheet of the new Co.

Solution :

Calculation of P.C.

1) 10% Debentures	60,000
2) 15% Preference shares	1,20,000
3) Equity shares (15,000 x 12)	<u>1,80,000</u>
(Equity Capital - 15,000 x 10 = 1,50,000	3,60,000 (PC)
Sec Premium - 15,000 x 2 = 30,000)	

Realisation A/c

To Debtors	60,000	By Creditors	60,000
To Bill Received	30,000	By Pink Advising Films Ltd. (PC)	3,60,000
To Fixed Assets	3,00,000		
To Partners' Capital*			
Abhishek (2/4) 15,000			
Aishwarya (1/4) 7,500			
Aradhya (1/4) <u>7,500</u>	30,000		
	4,20,000		4,20,000

*(Profit on Realisation = ₹30,000)

Partners Capital A/c

	Abhishek	Aishwarya	Aradhya		Abhishek	Aishwarya	Aradhya
To Bank (PSR)	15,000	7,500	7,500	By Balance b/d	1,80,000	1,50,000	30,000
To 10% Debentures	--	30,000	30,000	By Realisation	15,000	7,500	7,500
To Preference Shares (PSR)	80,000	46,000	--				
To Equity Shares (Balance)	1,00,000	80,000	--				
	1,95,000	1,57,500	37,500		1,95,000	1,57,500	37,500

***Note-** As the capital and dues of Aradhya are settled through Bank and debentures she will not be given preference and equity shares.

Pink Ad Films Ltd.

Balance sheet as on 1/1/2019

Particulars	Note no.	₹
1) Share holders funds		
a) Share Capital	1	2,70,000
b) Reserves & surplus	2	30,000
2) Non Current Liability	3	60,000
3) Current Liabilities	4	60,000
Total		4,20,000
Assets		
1) Non Current Assets	5	3,00,000
2) Current Assets	6	1,20,000
Total		4,20,000

Notes to Accounts

Note 1 : Share Capital

15% Preference Share Capital	1,20,000
Equity Share Capital	<u>1,50,000</u>
	2,70,000

(The entire shares have been issued to the vendors; hence no consideration is received here upon.)

Note 2 : Reserves & Surplus

Security Premium (Refer P.C. Calculation)	30,000
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Note 3: Non Current Liabilities

10% Debentures	60,000
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*(The debentures have been issued to the vendors hence there is no amount received from them.)

Note 4: Current Liabilities

Creditors	60,000
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Note 5: Non Current Assets

Fixed Assets	3, 00,000
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Note 6 : Current Assets

Debtors	60,000
Bills Received	<u>30,000</u>
	90,000

Illustration 5

Following is the Balance sheet of Amar and Naman sharing Profit & Loss in the ratio of 2 : 3.

Liabilities	Rs.	Assets	Rs.
Capital		Plant & Machinery	4,00,000
Aman	4,00,000	Equipment	4,00,000
Naman	5,00,000	Stock	65,000
Bank Loan	75,000	Debtors	50,000
Creditors	50,000	Bills Received	45,000
		Bank	65,000
	10,25,000		10,25,000

Aman & Naman sold their business to Mr. Shaman who formed a new company Namaste Ltd. The Co. took over all the assets at book values excluding equipment which was taken at ₹3,00,000. The Co. settled the P.C. by issuing.

- i) 40,000 equity shares of ₹10 each
- ii) 4000 10% Preference shares of ₹100 each &
- iii) 11% Debentures - ₹1,50,000

Close the books of the partnership firm and prepare the Balance sheet of the Co.

Solution :**Calculation of P.C.**

1) Equity shares (40,000 x ₹10)	4,00,000
2) 10% Preference shares (4000 x ₹100)	4,00,000
3) 11% Debentures	<u>1,50,000</u>
P.C.	9,50,000

Calculation of assets & liabilities taken over for finding out goodwill / Capital reserves**Assets**

Plant & Machinery	4,00,000
Equipment	3,00,000
Stock	65,000
Debtors	50,000
Bills Receive	45,000
Bank	<u>65,000</u>
	9,25,000

Less : Liabilities

Bank Loan	75,000	
Creditors	<u>50,000</u>	1,25,000
Net Assets		8,00,000

****Point to Remember**

- 1) PC > NA = Goodwill
- 2) PC < NA = Capital Reserve

****In this case, the Company will have Goodwill of ₹1,50,000.**

(PC Rs. 9,25,000- Net Assets Rs. 8,00,000= 1,50,000)

Realisation A/c

To Plant & Machinery	4,00,000	By Bank Loan	75,000
To Equipment	4,00,000	By Creditors	50,000
To Stock	65,000	By Namaste Ltd.	9,50,000
To Debtors	50,000	(PC)	
To B / R	45,000		
To Bank	65,000		
To Partners' Capital			
Aman (2/5) 20,000			
Naman (3/5) 30,000	50,000		
	10,75,000		10,75,000

Namaste Ltd. A/c

To Realisation	9,50,000	By Equity Shares	4,00,000
		By Preference Shares	4,00,000
		By Debentures	1,50,000
	9,50,000		9,50,000

Partners Capital A/c

	Amar	Akbar		Amar	Akbar
To Equity Shares	1,60,000	2,40,000	Balance b/d	4,00,000	5,00,000
To Preference Shares	1,60,000	2,40,000	Realization	20,000	30,000
To Debentures (Balance)	1,00,000	50,000			
	4,20,000	5,30,000		4,20,000	5,30,000

Equity Shares in Namaste Ltd. A/c

To Namaste Ltd.	4,00,000	By Aman (2/5)	1,60,000
		By Naman (3/5)	2,40,000
	4,00,000		4,00,000

Preference Shares in Namaste Ltd. A/c

To Namaste Ltd.	4,00,000	By Aman	1,60,000
		By Naman	2,40,000
	4,00,000		4,00,000

Debentures in Namaste Ltd. A/c

To Namaste Ltd.	1,50,000	By Aman	1,00,000
		By Naman	50,000
	1,50,000		1,50,000

Note : As the apportionment ratios are not given, one of the disbursement has to be used for settling the partners capital A/c. (Here debentures are settled based on the partners capital's pending settlement)

Namaste Ltd.
Balance sheet as on _____

I) Capital and Liabilities**1) Share holder's funds**

a) Share Capital	1	8,00,000
b) Reserves & surplus		
2) Non Current Liabilities	2	2,25,000
3) Current Liabilities	3	<u>50,000</u>
Total		10,75,000

Assets

1) Non Current Assets	4	8,50,000
2) Current Assets	5	<u>2,25,000</u>
Total		10,75,000

Notes to Accounts**1) Share Capital**

10% Preference Share of ₹100 each	4,00,000
Equity share of ₹10 each	<u>4,00,000</u>
	8,00,000

(These shares are issued to the vendors hence no consideration is received here upon)

2) Non Current Liabilities

11% Debentures	1,50,000
Bank Loan	<u>75,000</u>
	2,25,000

(The Debentures are issued to the vendor for the settlement of PC hence no consideration is received here upon)

3) Current Liabilities

Creditors	50,000
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4) Non Current Assets**Intangible**

Goodwill (refer **Point to remember)	1,50,000
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Tangible

Plant & Machinery	4,00,000
Equipment	<u>3,00,000</u>
	8,50,000

5) Current Assets

Stock	65,000
Debtors	50,000
Bills Received	45,000
Bank	<u>65,000</u>
	2,25,000

1.5 EXERCISE

1. Akshay and Raveena were equal partners. Their Balance sheet as on 31/12/2018 was as follows :

Liabilities	Rs.	Assets	Rs.
Capital		Bank	1,62,500
Akshay	10,00,000	Debtors	1,75,000
Raveena	12,50,000	Stock	2,25,000
Creditors	1,25,000	L & B	8,00,000
Loans	1,87,500	Plant & Machinery	8,00,000
		Office assets	4,00,000
	25,62,500		25,62,500

Due to continuous differences amongst them, they decided to sell their business to Krafts Ltd. on 1/1/19. The Co. agreed to pay the vendors :

- i) 10,000 Equity shares of ₹100 each
- ii) 10,000 10% Preference shares of ₹100 each
- iii) 12% Debentures amounting to ₹3,75,000

The Co. agreed to take over all assets at book values including office assets that were taken at ₹3,00,000 L & B at 10,00,000 and plant at 3,00,000.

Journalise the transaction in the books of Akshay & Raveena to close their business.

(Hint: Realisation A/c gain - 1,25,000)

2. Amitabh, Jaya & Rekha were partners sharing Profit & Loss as 3 : 2 : 2. Their Balance sheet as on 31/12/2018 was as follows :

Liabilities	Rs.	Assets	Rs.
Capital		Premises	2,40,000
Amitabh	2,42,500	Plant	70,000
Jaya	1,45,000	Inventory	30,000
Rekha	62,500	Debtors	1,50,000
Creditors	40,000		
	4,90,000		4,90,000

The partners decided to convert the business into a private limited company on the above date as per the following terms :

- 1) The Company will issue 3500 equity shares of ₹100 each and pay the balance per capital in cash.
- 2) The Co. agreed to pay ₹96,000 as goodwill
- 3) It assumed all the liabilities and assets except stock which was taken over by Jaya for ₹10,000.

Journalise the transactions in the books of the partners.

(Hint: P.C. - 5,46,000, Realisation gain - 1,06,000)

3. Alia, Anushka and Dipika were in partnership sharing Profit & Loss in the ratio of 2:2:1 respectively. They decided to form a company with immediate effect. The Balance sheet of the firm was as follows.

Liabilities	Rs.	Assets	Rs.
Capital		Premises	6,00,000
Alia	4,00,000	Equipment	1,20,000
Anushka	6,00,000	Plant	4,50,000
Dipika	2,00,000	Stock	3,50,000
Bank Loan	2,00,000	Debtors	4,00,000
Creditors	6,00,000	Bank	80,000
	20,00,000		20,00,000

- 1) The new company 3A Ltd. issued 50,000 equity shares of ₹10 each, 5000 10% Debenture of ₹100 each and cash ₹1,00,000 in settlement of the P.C.
- 2) The Creditors were absorbed to the extent of 90%.
- 3) The equipments were salvaged by the partners at ₹50,000 and plant was valued by the co. at ₹5,00,000.

Calculate the P.C. and prepare the Balance sheet of 3A Ltd.

(Hint: P.C. - 11,00,000, Net Assets - 9,80,000, Goodwill - 1,20,000, B/S Total = 17,80,000)

4. Saqib and Huma were equal partners. To ensure smooth conduct of their expanding business, they decided to convert it to a Ltd. Co. - H.S. International Ltd. The Balance sheet of the firm was as follows :

Liabilities	Rs.	Assets	Rs.
Creditors	6,10,000	Bank	20,000
Capital A/c		Investments	1,50,000
Saqib	5,00,000	Debtors	2,60,000
Huma	3,00,000	Stock	3,30,000
Current A/c		Fixed assets	8,80,000
Saqib	1,40,000		
Huma	90,000		
	16,40,000		16,40,000

- The company revalued the assets as under :
Investments - ₹1,60,000, Debtors ₹2,40,000, Stock ₹4,00,000 & fixed assets - ₹8,40,000.
- The Co. also valued the goodwill of the firm at ₹2,40,000.
- The partners received ₹90,000 cash 1000 12% Debenture of ₹100 each and balance equity shares in full settlement of their claim.

Close the books of the partners by preparing appropriate ledgers.

(Hint: Realisation gain - 2,60,000, P.C. - 12,90,000)

5. Jaquiline & Jennifer were partners sharing Profit & Loss at 60% & 40% respectively. Their Balance sheet as on 1st April 2018 was as follows :

Liabilities	Rs.	Assets	Rs.
Capital		Furniture	2,00,000
Jaquiline	6,60,000	Bank	3,00,000
Jennifer	4,40,000	Debtors	4,80,000
Creditors	3,00,000	Stock	5,20,000
Other liabilities	5,00,000	Investments	4,00,000
	19,00,000		19,00,000

- J2 Ltd. was formed to take over the business from the partners.

- 2) J2 Ltd. valued the assets of the firm as goodwill - ₹4,00,000 and stock ₹3,76,000.
- 3) Investments were not taken over by the company.
- 4) The partners were paid ₹9,56,000 for full settlement of their claim of the firm.
- 5) The P.C. was settled through the issue of equity shares of ₹100 each.

Prepare necessary ledgers in the books of the partnership firm and a balance sheet of J2 Ltd.

(Hint: Realisation gain - 2,56,000 B/S Total - 17,56,000)



INTRODUCTION TO COMPANY ACCOUNTS

Unit structure:

- 2.0 Objectives
- 2.1 Introduction
- 2.2 Formation of Company
- 2.3 Shares
- 2.4 Share Capital
- 2.5 Format of Balance Sheet
- 2.6 Issue Of Shares
- 2.7 Issue of shares on preferential basis
- 2.8 Employee Stock Option (ESO)
- 2.9 Sweat Equity Shares
- 2.10 Escrow Account
- 2.11 Issue of shares at par, at premium and at discount
- 2.12 Exercise

2.0 OBJECTIVES

- After studying the unit students will be able to:
- Know the meaning, features and types of company
- Understand the procedure of Formation of the company.
- Discuss about the meaning, types of shares.
- Know the meaning and classification of share capital.
- Explain the Balance sheet of the company
- Understand the meaning of forfeiture of shares

2.1 INTRODUCTION

2.1.1 Meaning and Definition

Company is a type of commercial organisation, Lord Justice Hanay had said company is an artificial person created by law having perpetual succession and a common seal. It is owned by shareholders and managed by directors.

Definition: Sec 2(20) of the Companies Act 2013 states that, “A company means a company formed and registered under that Act or under any previous Companies Act.”

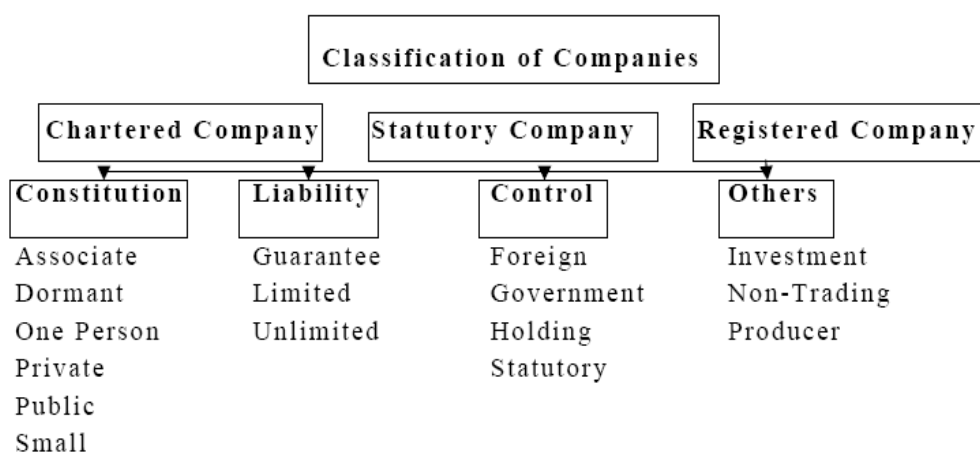
2.1.2 Features of Company:

From above meaning and definition we can identify following features of the company:

- i. **Registered / Incorporation:** The company need to be formed and registered under the Companies Act, this process is known as Incorporation of the company. Without such incorporation company cannot come into existence.
- ii. **Artificial Person:** The Company is considered as artificial person so it has power to acquire, hold and sale all types of properties, it can enter into legal agreements, it can file a case or case can be filed against the company.
- iii. **Separate Legal Entity:** A company is considered as separate legal entity hence its existence is not affected due death, insolvency of its members or transfer of shares by the members. A member of company is not liable for act of the company and vice versa.
- iv. **Perpetual Succession:** A company is created by following process of law and it cease to exist only upon the process of law. It enjoys perpetual (permanent) existence. Companies existence is independent of death, insolvency or changes in membership of the company.
- v. **Common Seal:** It is the most important property, common seal act as signature of company and use to authenticate the documents. If the common seal if affixed on any document by the authorised person it becomes a legal document

2.1.3 Types of Companies

There are various types of companies which are described in following diagram.



Companies are basically classified as Chartered Company, Statutory Company and Registered Company.

1. **Chartered Companies:** These companies come into existence by Royal Charter which is issued by Head of State. For eg. East India Company.
2. **Statutory Companies:** These are formed under special statute of the parliament or the state legislature. These are public undertakings and form with main objective to serve social need not earn profit. For eg. RBI, LIC, SBI UTI etc.
3. **Registered Companies:** These are the companies which are registered under Indian Companies Act 2013, or any other previous Indian Companies Act. These companies are divided on the basis of Constitution Control and Other Liability.
 - **On the basis of Constitution:**
 - a) **Associate Company S2(6):** A company is said to be associate company of other, if other company had control on 20% of total voting power in the company or have control over business decisions of the company under an agreement. However an Associate Company is not subsidiary company.
 - b) **Dormant Company S455:** Where a company is formed for future projects or to hold an asset or intellectual property and do not have significant financial transactions for atleast 2 years may obtain status of Dormant Company by applying to Registrar.
 - c) **One Person Company S2 (62):** It is a new type of company introduced in the Companies Act 2013. It can be formed with only one member and have only one director. However the Act prescribed maximum in respect of amount of Share Capital and Turnover if One Person Company is exceeding that limit it need to be converted into Private or Public Company.
 - d) **Private Company :** It is a types of company which is formed with minimum two shareholders and two directors, Another crucial condition of a private limited company is that it by its articles of association restricts the right to transfer its shares & also prohibits any invitation to the public to subscribe for any securities of the company. A private company is exempted from various provisions of the Companies Act 2013 in comparison with the public company.
 - e) **Public Company S2 (71):** A company which is not a Private Company is a Public Company. A Public Company had minimum 7 members; there is no any restriction for minimum

paid up capital for Public Company. Its shares are freely transferable. It can also invite public to subscribe its shares.

- f) **Small Company S2(85):** Small company means a company other than a public company and should fulfil the following criteria:
- a. Paid-up share capital of which does not exceed 50 Lakh Rupees or anything higher than that as may be prescribed will not be more than five crore rupees, and;
 - b. Turnover of last profit and loss statement should not exceed 2 Crore Rupees or such higher amount as may be prescribed.

- **On the basis of Liability:**

- a) **Company Limited by Guarantee S2(21):** Each member promises to pay a fixed sum of money, specified in Memorandum of Association in the event of liquidation or payment of debt. This promised amount is called as guarantee. If a company insert such clause in its Memorandum the said company is Limited by Guarantee.
- b) **Limited Company:** In these types of companies shareholders are bound to pay a fixed amount per share i.e. face value of shares either at the time of subscription or in instalments.
- c) **Unlimited Liability Company:** If a company does not have any limit for liability of its members then such company is called as unlimited company. In this case members are liable to pay full amount of debt at the time of winding up of the company.

- **On the basis of Control**

- a) **Foreign Company:** It is a company which is incorporated outside India and having its place of business in India has a place of business in India whether by itself or through an agent, physically or through electronic mode; and conducts any business activity in India in any other manner.
- b) **Government Company:** It is the company whose minimum 51% paid up capital is held by government, i.e. State or Central Government or subsidiary of Government Company.
- c) **Holding Company:** It is the company which has control over other company. If any company held more than 51% of the share capital of another company then it is called as holding company.
- d) **Subsidiary Company:** It is the company which is controlled by another company i.e. Holding Company.

- **Other Companies:**

- a) **Investment Company:** It is the company whose main business is to acquire shares, debentures, or other securities.
- b) **Non Trading Company:** This is also called “association not for profit or charitable companies” These companies are registered under special license issued by government. The object of the company is to promote arts, science, sports, education, research, social welfare, religion etc.
- c) **Producer Company:** In generic terms, producer companies can be said to be a way to improve the standard of living of those involved in the agricultural sector. Such companies are deemed to possess the goodness of co-operatives and the dynamicity of companies. A producer company is a company incorporated under Companies Act 2013 (formerly the Companies Act 1956) and shall carry on prescribed activities as mentioned in Section 581B of Companies Act 1956, to name few, Production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the Members or import goods for their benefit. Processing including preserving, drying, distilling, brewing, venting, canning and packaging of produce of its members. Manufacture, sale or supply of machinery, equipment or consumables mainly to its Members. Promoting mutual assistance, financial services and welfare measures of producers or their primary produce.

2.2 FORMATION OF COMPANY

Company is generally formed by the promoters. Promoter is a person who conceives a business idea and to bring it into reality he take initiative to Form and Register the company.

2.2.1 Steps in formation

Following Steps are taken in respect of registration of company.

1. **Name:** The promoter may propose name of the company for registration, they can propose up to six names. If name is available further process is carried out.
2. **Memorandum of Association and Articles of Association:** Promoter should prepare Memorandum of Association and Articles of Association. Promoters should sign both and submit it to Registrar of Companies.
3. **Filling of Documents:** Following documents need to be filled with registrar for the purpose of registration
 - a) Memorandum of Association and Articles of Association

- b) A declaration by advocate or practicing professional (CA, CS etc) regarding compliance.
 - c) Affidavit from each subscriber from each person named as first director.
 - d) Address for correspondence till its registered office is not established
 - e) Details of each subscriber
 - f) Details of first director
 - g) Required amount of registration fees and any other document if required
4. **Incorporation Certificate:** Once all these required documents are received Registrar of the company will issue Incorporation Certificate for the company.

2.3 SHARES

2.3.1 Meaning & Definition:

Share is the smallest part of the share capital of the company. As per section 2(84) of the Companies Act "A Share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied."

Shares are considered as movable property and can be transferred as per procedure laid down in Articles of the company. Each and every share has a predetermined value which is called as face value.

- **Shareholder:**

The owner of the shares is called as shareholder. Company issues a share certificate to the holder having his name along with other details such as no of shares and their distinct no. The share holders are co-owners of the company he has right to attend meeting and to receive dividend. He has right to receive back his capital at the time of winding up of the company.

- **Stock:**

Stock is a bundle of fully paid shares. A limited can company can convert its fully paid shares into stock. Stock can be divided into any fractions and subdivisions regards to the face value.

2.3.2 Types of Shares

There are two types of shares, 1. Equity Shares, 2. Preference Shares

1. **Equity Shares:** Explanation to section 43 It is that part of share capital which is not preference share capital.

Equity shares are of two types:

- a) **With voting rights:** These are normal equity shares having equal rights regards to voting at meeting, dividend and same rights in each and every aspect.
 - b) **With differential voting rights:** Company can issue equity shares with differential rights as to dividend, voting rights etc. However such must can be done subject to Rule 4 of Companies (Share Capital and Debentures) Rules 2014.
2. **Preference Shares:** These are the shares having preferential rights in respect of dividend and receiving back their capital at the time of winding up of the company. Preference Shares will receive dividend at fix rate before any dividend is paid to equity shares and receive back their capital before equity shares.

Types of Preference Shares:

- a) **Cumulative and Non-cumulative Preference Shares:** If any year company does not pay dividend Cumulative preference shares will receive dividend for that year from the profits of following year. However Non-cumulative preference shares do not enjoy such benefits.
- b) **Participating and Non-participating Preference Shares:** Participating Preference Shares are entitled to participate in surplus profits remaining after payment of dividend of both types of shares.
- c) **Convertible and Non-convertible Preference Shares:** Convertible Preference Shares can be converted into equity shares whereas non-convertible preference shares are not converted into equity shares.
- d) **Redeemable and Non-redeemable Preference Shares:** Redeemable preference shares are redeemed (paid back) during life time of the company whereas Non-redeemable Preference shares are not redeemed during life time of the company they are redeemed at the winding up of the company.

2.4 SHARE CAPITAL

2.4.1 Meaning :

Capital of the company is collected by issue of shares, there is no any limit for maximum no of members / shareholders of the company and shares are freely transferable so it's impossible to have separate capital account for each shareholder. The company

maintain a share capital account in its books representing amount collected from all shareholders.

2.4.2 Classification of Share Capital

1. **Authorised Capital:** Authorised Capital or Nominal Capital is capital which is mentioned in memorandum and company cannot issue shares exceeding this amount.
2. **Issued Capital:** It is the no shares issued by the company for subscription. Company can issue full or part of its authorised capital.
3. **Subscribed Capital:** It is the part of issued capital, it refers to the no of shares actually subscribed or taken u by general public.
4. **Called up Capital:** Called up capital is the amount of subscribed capital which is actually called by the company. (demanded by the company)
5. **Paid up Capital:** Paid up capital is the amount received against called up capital amount by the company.
6. **Reserve Capital:** It is the uncalled amount of share subscribed capital which company will demand at the time of emergency or liquidation of company.

2.4.3 Dividend:

Dividend is part of profit distributed among shareholders by the company. Dividend can be classified as final dividend and Interim dividend. The dividend can be paid as % of paid up capital or at a fixed amount per share.

1. **Final Dividend:** Final dividend is proposed by directors and declared at annual general meeting of the company. It should be noted that proposed dividend will be considered as contingent liability and will not be recorded in balance sheet. Once the dividend is declared it will be considered as liability and should be paid off in stipulated time.
2. **Interim Dividend:** Interim dividend is declared by board of directors in between two annual general meetings. Any dividend declared over and above the final dividend will be considered as Interim dividend.

2.5 FORMAT OF BALANCE SHEET

The company need to prepare its financial statements i.e. Profit & Loss A/c and Balance Sheet in the format prescribed by Companies Act 2013. Schedule 3 of Companies Act provide format

for the financial statements. Any requirement of Accounting Standard will override the requirements of the schedule 3 of the Companies Act.

The balance sheet needs to be prepared in vertical format along with notes to accounts.

Part I – Form of Balance Sheet

Name of the Company:- _____

Balance Sheet as at:- _____

(Rupees in _____)

Particulars	Note No	Figures as at the end of the current reporting period	Figures as at the end of the previous reporting period
EQUITY AND LIABILITIES			
Shareholders Fund			
Share Capital			
Reserves Surplus			
Money Received against Share Warrants			
Share Application Money Pending Allotment			
Non Current Liabilities			
Long Term Borrowings			
Differed Tax Liabilities (Net)			
Other Long Term Liabilities			
Long Term Provisions			
Current Liabilities			
Short Term Borrowings			
Trade Payable			
Other Current Liabilities			
Short Term Provisions			
Total			
ASSETS			
Non-Current Assets			
Fixed Assets			

Tangible Assets			
Intangible Assets			
Capital work in Progress			
Intangible Assets under developments			
Non-Current Liabilities			
Differed Tax Assets (Net)			
Long Term Loans and Advances			
Other Long Term Assets			
Current Assets			
Current Investments			
Inventories			
Trade Receivables			
Cash and Cash Equivalents			
Short Term Loans and Advances			
Other Current Assets			
Total			

The balance sheet of the company is presented along with relevant notes to accounts providing detailed information regarding the particular item. The notes accounts are presented as follows.

Notes to accounts	Rs.
<p>A. Share Capital</p> <ul style="list-style-type: none"> • Authorised shares (Par Value per Share : Rs.....) • Issued, subscribed, called up & fully paid shares • Subscribed but not fully paid shares Less : Calls unpaid <ul style="list-style-type: none"> – By Directors – By Officers – By Others • Forfeited Shares • Forfeited Shares reissued • Reconciliation of Shares Outstanding <p>B. Reserves and Surplus</p> <ol style="list-style-type: none"> a. Capital Reserves b. Capital Redemption Reserve c. Securities premium d. Debenture Redemption Reserve e. Revaluation Reserve 	

<ul style="list-style-type: none"> f. Share Options Outstanding Account g. Other Reserves h. General Reserves i. Surplus – Balance b/d Add : Profit for Year Less : Appropriations <p>C.</p> <p>Long Term Borrowings</p> <ul style="list-style-type: none"> a. Bonds / Debentures b. Term Loans <ul style="list-style-type: none"> i. Term Loans from Banks ii. Term Loans from Other Parties c. Deferred Payment Liabilities d. Deposits <ul style="list-style-type: none"> i. Public Deposits (GN) ii. Inter-Corporate Deposits (GN) e. Loans and Advances from Related Parties f. Long Term Maturities of Finance Lease Obligations g. Other Loans and Advances <p>D.</p> <p>Other Long Term Liabilities</p> <ul style="list-style-type: none"> a. Trade Payables b. Other Payables <ul style="list-style-type: none"> i. Trade Deposits (GN) ii. Security Deposits (GN) <p>E.</p> <p>Long Term Provisions</p> <ul style="list-style-type: none"> a. Provision for Employee Benefits b. Others – Provision for Warranties (GN) <p>F.</p> <p>Short Term Borrowings</p> <ul style="list-style-type: none"> a. Loans Repayable on Demand <ul style="list-style-type: none"> i. From Banks ii. From Other Parties b. Loans and Advances from Related Parties c. Deposits d. Other Loans and Advances <p>G.</p> <p>Other Current Liabilities</p> <ul style="list-style-type: none"> a. Current Maturities of Long Term Debt b. Current Maturities of Finance Lease Obligations c. Interest Accrued but not Due on Borrowings d. Interest Accrued and Due on Borrowings e. Income Received in Advance f. Unpaid Dividends g. Application Money Refund and Interest Due 	
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<ul style="list-style-type: none"> h. Unpaid Matured Deposits and Interest Accrued thereon i. Unpaid Matured Debentures and Interest Accrued thereon j. Other Payables <ul style="list-style-type: none"> – Calls-in-Advance (GN) – Non-Trade Payables (GN) – Taxes Payable (GN) <p>H.</p> <p>Short Term Provisions</p> <ul style="list-style-type: none"> a. Provisions for Employee Benefits b. Others <ul style="list-style-type: none"> –Provision for Tax (Net of tax payments) (FAQ) <p>I.</p> <p>Tangible Assets</p> <ul style="list-style-type: none"> a. Land b. Buildings c. Plant and Equipment d. Furniture and Fixtures e. Vehicles f. Office Equipment g. Others (specify nature) <p>J.</p> <p>Intangible Assets</p> <ul style="list-style-type: none"> a. Goodwill b. Brands / Trademarks c. Computer Software d. Mastheads and Publishing Titles e. Mining Rights f. Copyrights, Patents, etc. g. Recipes, Formulae, Models, Designs and Prototypes h. Licenses and Franchise i. Others (specify nature) <p>K.</p> <p>Non-Current Investments</p> <ul style="list-style-type: none"> a. Investments in Property b. Investment in Equity Instruments c. Investments in Preference Shares d. Investments in Government or Trust Securities e. Investments in Debentures or Bonds f. Investments in Mutual Funds g. Investments in Partnership Firms h. Other Non Current Investments <p>L.</p> <p>Long Term Loans and Advances</p> <ul style="list-style-type: none"> a. Capital Advances b. Security Deposits c. Loans and Advances to Related Parties 	
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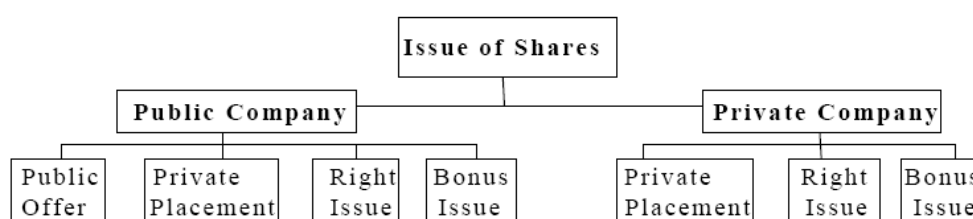
<p>d. Other Loans and Advances</p> <ul style="list-style-type: none"> – Advances Tax (Net of provision) (FAQ) – CENVAT Credit Receivable (GN) – VAT Credit Receivable (GN) – Service Tax Credit Receivable (GN) <p>M.</p> <p>Other Non Current Assets</p> <ul style="list-style-type: none"> a. Long Term Trade Receivables b. Others <p>N.</p> <p>Current Investments</p> <ul style="list-style-type: none"> a. Investments in Equity Instruments b. Investments in Preference Shares c. Investments in Government or Trust Securities d. Investments in Debentures or Bonds e. Investments in Mutual Funds f. Investments in Partnership Firms g. Other Investments <p>O.</p> <p>Inventories</p> <ul style="list-style-type: none"> a. Raw Materials b. Work-in-progress c. Finished Goods d. Stock-in-Trade e. Stores and Spares f. Loose Tools g. Others <p>P.</p> <p>Trade Receivables</p> <ul style="list-style-type: none"> a. Secured, Considered Good b. Unsecured, Considered Good <ul style="list-style-type: none"> i. More than 6 months ii. Other c. Doubtful <p>Less : Provision for Bad and Doubtful Debts</p> <p>Q.</p> <p>Cash and Cash Equivalents</p> <ul style="list-style-type: none"> a. Balances with Banks b. Cheques, Drafts on Hand c. Cash on Hand d. Others (specify nature) <ul style="list-style-type: none"> – Other Bank Balances – Earmarked (Unpaid Dividend A/c) – Margin Money Deposit – Deposits Maturing After 12 Months <p>R.</p> <p>Short Term Loans and Advances</p> <ul style="list-style-type: none"> a. Loans and Advances to Related Parties b. Others 	
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<p>S.</p> <ul style="list-style-type: none"> – Prepaid Expenses (GN) – Tax Refund Receivable vide A.O. (FAQ) <p>Other Current Assets</p> <ul style="list-style-type: none"> • Non-Trade Receivables (GN) • Unamortized Expenditure (GN) • Unbilled Revenue (GN) 	
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2.6 ISSUE OF SHARES

2.6.1 Meaning :

Company issue shares for formation of its on capital. There are several modes for issue of shares such as public offer, private placement, right issue etc. However regulations of Companies Act lay don guidelines in respect of these modes. Depending upon type of company modes of issue will be applicable for issue of shares.



2.6.2 Issue of Shares

1. Public Offer: In this case company offer shares to general public for subscription it need to follow a prescribed procedure laid down by companies act and rules in respect of the issue of shares. Public offers are classified as follows.

- a. **Initial Public Offer (IPO):** When company offer its shares to public for subscription through prospectus for the first time it is called as initial public offer. Generally such offer is made by unlisted companies. This enables listing and trading of companies shares at stock exchange.
- b. **Further Public Offer (FPO):** When an existing listed company makes a fresh issue of securities to the public through an offer document it is called as Further Public Offer.
- c. **Offer for Sale of Securities (OFS):** Offer for sale of securities is different from IPO and FPO. It is used to reduce promoters holding or to provide exit route to

venture capitalist. In this case shares offered to public are shares held by promoters of the company. In this case balance sheet of the company is not affected as new shares are not issued.

- 2. Private Placement:** In case of private placement company does not offer its shares to general public instead it offers its shares to selected group of persons. Such offer is made through issue of a private placement offer letter. However company need to satisfy various conditions mentioned in section 42 of the Companies Act 2013.
- 3. Right Issue:** Right Issue refers to offer given by company to its existing equity shares to subscribe for additional shares. However such offer will be given to the shareholder for limited no of shares in proportion to shares already held by him. Section 62(1) (a) of the Companies Act 2013 provide guidelines for right issue.
- 4. Bonus Shares:** Bonus shares are free gift given by company to its existing equity share holders. In this case company allot fully paid shares to its existing equity share holders for free increasing their shareholding and companies share capital. Company can issue bonus shares by utilising its free reserves, securities premium or capital redemption reserve. Section 63 of the Companies Act provides guidelines for issue of bonus shares.

2.7 ISSUE OF SHARES ON PREFERENTIAL BASIS

2.7.1 Meaning

Section 62(1)(c) of the Companies Act and Rule 13 of Companies (Share Capital and Debentures) Rule 2014 enable the company to issue shares on preferential basis. However the company need to comply with section 42 of the Companies Act while issuing shares on preferential basis. Apart from compliance of various provisions of Companies Act, a special resolution is also required for issue of shares on preferential basis.

“PREFERENTIAL ALLOTMENT” means an issue of shares or other securities, by a Company to any select person or group of persons on preferential basis and

does not include shares or other securities offered through a public issue, right issue, employee stock option scheme, employee stock purchase scheme or a sweat equity issue or bonus issue or depository receipts issued in a country outside India or foreign securities.

2.7.2 Price:

The price of shares or other securities to be issued on preferential basis shall be determined on the basis of valuation report of a registered valuer or Independent Valuer having 10 year of experience.

2.7.3 Consideration other than Cash:

Company can issue shares on preferential basis as consideration for other than cash. However valuation of such consideration shall be done by registered valuer who need to submit a valuation report to the company giving justification for the valuation.

2.8 EMPLOYEE STOCK OPTION (ESO)

2.8.1 Meaning:

Section 2(37) of the Companies Act, 2013 Employees Stock Option means the option given to the directors, officers, or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers nor employees the benefit or right to purchase or to subscribe for the shares of the company at a future date at a predetermined price.

Section 62(1)(b) of the Companies Act enable the company to offer shares to its employees through Employee Stock Option. A special resolution is required for such issue and company also need to comply with Rule 12 of Companies (Share Capital and Debentures) rules 2014.

2.8.2 For this purpose employee means:

1. A permanent employee of the company
2. A director of the company excluding independent director
3. A employee (1 or 2 mentioned above) in subsidiary company of Indian Holding Company.

2.8.3 Employee does not include following:

1. An employee who is promoter of the company or belonging to promoter group

2. A director himself or through his relative hold directly or indirectly more than 10% of share capital of the company.

2.8.4 Following are important point in respect of Employee Stock Option:

1. Company can offer these shares at any price to its employees
2. There should be time gap of atleast 1 year between granting of option and vesting of option.
3. Option granted to employee is non transferable
4. The company need to maintain a separate register for Employee Stock Option in prescribed form.
5. If company is listed on any recognised stock exchange, then Employee Stock Option Scheme shall be issued in accordance with the regulations made by SEBI.

2.9 SWEAT EQUITY SHARES

2.9.1 Meaning:

According to Section 2(88) of the Companies Act 2013, SWEAT equity shares means such equity shares issued by a company to its directors, or employees at a discount or for consideration other than cash, for providing their knowhow or making available rights in the nature of intellectual property or value additions, by whatever name called. It should be noted that SWEAT Equity is different from Employee Stock Option Scheme and Employee Stock Purchase Scheme.

2.9.2 Conditions to be fulfilled by the company:

Section 54 of the Companies Act prescribed conditions to be fulfilled by the company for issue of SWEAT Equity Shares which are as follows

1. A special resolution is required for issue of SWEAT Equity Shares.
2. The resolution must specify no. of shares, market price, consideration and details of directors or employees to whom such shares are issued.
3. The Company must have started its business for at least 1 year not less than that.
4. If the equity shares of the company is listed on recognised stock exchange issue of SWEAT Equity Shares will be done as per guidelines issued by SEBI. If company is not listed it will be issued as per Chapter IV of the Companies Act 2013.

2.10 ESCROW ACCOUNT

2.10.1 Meaning:

Escrow means depositing funds with third party to be used later on compliance of certain conditions. Company use this system at the time of IPO, it is used to put Share Application Money received at the time of receiving applications from public for an IPO.

Escrow account is the dedicated bank account, it is opened with Escrow Collections Bank which is used for collection of application money at the time of public offer. The company need to enter into escrow agreement.

Escrow Agreement is an agreement between issuer company, registrar of issue, and escrow collection bank for collection of application money and its refund whenever applicable.

2.10.2 Escrow Mechanism:

1. Company open one or more escrow account with Escrow Collections Bank for collection of application money. Application money received from public along with applications is deposited in escrow account. The company also open Public Issue Account and Refund Account with Bankers of Issue.
2. The money received will be held by the Escrow Collection Bank on behalf of issuing company till date of allotment.
3. On date of allotment money as per size and terms of issue will be transferred from escrow account to Public Issue Account.
4. The balance left in escrow account will be transferred to refund account. The amount will be refunded to all unsuccessful applicants, and applicants who have paid excess application money after adjusting for allotment money within 15 days from closing date of issue. If it fails to repay on time, company need to pay 15% interest on the amount to the applicants.

2.11 ISSUE OF SHARES AT PAR, AT PREMIUM AND AT DISCOUNT

2.11.1 Issue of Shares :

The company can issue shares at any price. It can issue shares at Par, at Premium or at Discount.

- a. **At par:** When shares are issued at its face value, they are said to be issued at par.
- b. **At premium:** When shares are issued at a price more than its face value, they are said to be issued at premium.
- c. **At Discount:** When shares are issued at price less than its face value, they are said to be issued at discount.

2.11.2 Oversubscription and Under subscription

Public Company issue shares to general public, for this purpose it invites applications from interested investors by issuing prospectus. Interested investors need to subscribe for the shares as per procedure described in prospectus. Oversubscription or Under subscription relates to the response received from general public for companies offer for issue of shares.

Under subscription:

It is the situation in which number of shares subscribed by public is less than no of shares offered by company. In this case shares can be allotted only when minimum subscription received. However applications are received more than minimum subscription shares can be allotted.

Oversubscription:

When no of applications received are more than shares offered by company then it is called as oversubscription. In case of oversubscription shares can be allotted in following ways:

- i. **Partial Allotment:** The directors may decide to fully accept some applications and reject remaining excess applications.
- ii. **Pro-rata Allotment:** Pro-rata allotment means proportionate distribution of shares available for allotment among the applicants for the shares.
- iii. **Combination:** Company can combine both the above methods where it rejects few applications and allots shares on prorata basis among remaining applicants.

2.11.3 Issue of Shares for Consideration Other than Cash:

A company can issue shares for consideration other than cash. Such issue can be at par, at premium or at discount. Following are some of the cases in which company can issue shares for consideration other than cash.

1) Vendors: The vendors may be an individual, a firm or company whose business is taken over by the company. The purchasing company may issue its shares to vendors from whom their business is purchased.

2) Promoters: Shares may be issued to promoters of the company as remuneration for the services rendered for the formation of the company.

3) Underwriters: Shares may be issued to underwriters in lieu of underwriting commission payable to them.

4) Directors or Employees: A company can SWEAT Equity Shares to its directors or employees as consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions.

- **Forfeiture and Re-Issue of Forfeited Shares:**

On issue of shares company can collect entire money at the time of application or it can collect it in instalments, at the time of application, allotment and balance in calls. If any shareholder fails to pay allotment or call money, company can forfeit his shares, i.e. take back his shares without paying any compensation.

2.11.4 Forfeiture of Shares:

Forfeiture of shares can be referred as compulsory termination of membership of shareholder by the company due to non-payment of allotment or call money. In this case shareholder ceases to be member of company and company take back its shares and confiscate any amount paid by the shareholder against those shares. Company need to follow the procedure laid down by Articles of Association of the company to forfeit the shares of any shareholder.

Re-Issue of Forfeited Shares:

A company can re-issue the forfeited shares. Re-issue of shares though called as re-issue it is 'sale' of shares not 'issue' of shares. Company need to follow the procedure laid down in its Articles of Association in respect of re-issue of shares. The company can re-issue the forfeited shares at par, at premium or at discount; however re-issue of shares cannot have allotment, calls etc.

2.12 EXERCISE

Descriptive Questions:

1. What is mean by Company? Explain its features
2. Describe different type of companies.
3. Define Shares? Explain different types of Shares
4. Explain different types of Preference Shares
5. Explain Share Capital
6. Explain different modes for issue of shares.
7. Explain Equity & Liabilities of Balance Sheet as per Schedule-III of Companies Act 2013.
8. Explain Forfeiture and re-issue of forfeited shares.

Short Notes:

1. One Person Company
2. Private Company
3. Public Company
4. SWEAT Equity
5. ESCROW Account
6. Share
7. Bonus Shares
8. Right Shares

Objective Questions:**1) Fill in Blanks.**

1. A Public company may be formed by _____ or more persons.
2. One Person company may have _____ person as director.
3. _____ Preference Shares are converted into equity shares.
4. Profit distributed by the company among shareholders is called as _____
5. Preference Shareholders are entitled to receive dividend at _____ rate.
6. Inventories appear under _____ in Balance Sheet.
7. Creditors are recorded under _____ in Balance Sheet.
8. Forfeiture of shares results in _____ termination of membership.

9. SWEAT Equity shares can be issued to directors & _____ of the company.

10. A share denotes a _____ part of company's share capital.

(seven, one, Redeemable, dividend, fixed, Current Assets, Trade Payable, compulsory, employees, smallest)

2) Match Pairs

Group A	Group B
Authorised Capital	Creditors of the company
One Person Company	Receive dividend at fixed rate
Debenture holders	Can be formed with only 1 member.
Preference Shares	Compulsory termination of membership
Forfeiture of shares	Minimum 7 members
Public Company	Shares issued to vendor for purchase of its business.
Shares issued for consideration other than cash	Memorandum of Association

(a – 7, b – 3, c – 1, d – 2, e – 4, f – 5, g – 6)

3) True or False

1. Only a natural person can form one person company.
2. A stock can be transferred in any fractions.
3. Right issue is made to existing shareholders only.
4. Forfeited shares cannot be reissued.
5. Company can issue bonus shares out of capital reserve.
6. Company has perpetual life.
7. ESCROW is a special bank account used specifically for public offer.
8. Offer for Sale of securities is not fresh issue of shares.
(True – 1, 2, 3, 6, 7, 8) (False – 4, 5)



INTRODUCTION TO COMPANY ACCOUNTS

ISSUE OF DEBENTURES:

Unit Structure:

- 3.0 Objective
- 3.1 Introduction
- 3.2 Types of Debentures
- 3.3 Issue of Debentures
- 3.4 Provisions of the Companies Act, 2013 regarding issue of Debentures
- 3.5 Distinction between Share and Debenture
- 3.6 Model Journal Entries on Issue of Debentures
- 3.7 Summary
- 3.8 Exercise

3.0 OBJECTIVE

After studying the unit students will be able to

- Understand the provisions regarding issue of debentures under the Companies Act, 2013
- Explain the accounting treatment for the same.

3.1 INTRODUCTION

3.1.1 Meaning:

Section 2(30) of the Companies Act, 2013 defines a as 'Debenture' includes debenture stock, bonds or any other securities of a company evidencing a debt whether constituting a charge on *the company's assets or not*. In other words, a debenture is a borrowing or a loan. Schedule III of the Companies Act, 2013 classifies debenture as a Long Term Borrowing. Debentures are issued by the company only if it is authorised by the Articles of Association of the Company. It is in the form of a certificate issued

under the common seal of the company and it creates or acknowledges a debt. Debentures are normally secured against the assets of the company and interest is payable on them which is calculated on the nominal value of the debentures issued by the company. The debenture certificate specifies the date of redemption of the debenture. The persons to whom the debentures are allotted are known as debenture holders

3.1.2 Features of Debentures:

- a. It is a document which creates or acknowledges debt.
- b. It is in the form of certificate issued by company under its common seal.
- c. The certificate will show rate of interest payable.
- d. Normally debentures are secured against assets of the company.

3.2 TYPES OF DEBENTURES

Debentures are classified as follows:

1. Secured debentures and Unsecured debentures:

A. Secured debentures: The debentures which have a charge (security) on the assets of the company are called secured debentures. The charge may be fixed charge or floating charge. The charge is on all assets of the company in general.

i) **Fixed Charge:** In case of fixed charged the debentures are secured on specific assets of the company like Land & Building, Plant & machinery etc. The company cannot sell such assets until the debenture holders are repaid. In this case the debenture holder can recover their dues out of the specific asset of the company which is identified in mortgage deed.

ii) **Floating Charge:** In this case debenture holders do not have charge on specific asset of the company. The charge may be on current assets such as stock, debtors etc. of the company. It is very difficult to pinpoint an asset as value of the current assets keeps changing. Hence company can use these assets for normal business operations however the floating charge become fixed in the event of default by company in respect of interest or redemption of debentures.

B. Unsecured debentures are also known as 'simple' or 'naked' debentures. The debentures which do not have a charge (security) on the assets of the company are called unsecured debentures. In the event of the winding up of company, such debentures are treated as unsecured creditors.

2. Registered debentures and Bearer debentures:

- A. **Registered debenture** must be compulsorily registered with the company and the details of these debentures are recorded by the company in the Register of Debenture holders which is kept by the company.
- B. **Bearer debentures** are not registered with the company. They are transferred by mere delivery.

3. Redeemable debentures and Irredeemable Debentures:

- A. **Redeemable debentures** are redeemed after a specified period of time in future. The date on which the debenture would be redeemed is mentioned on the debenture certificate.
- B. **Irredeemable debentures** are redeemed only when the company is liquidated. They continue to remain in existence as long as the company exists.

3.3 ISSUE OF DEBENTURES

3.3.1 Issue of debentures at Par, Premium and Discount:

- A. **Issue of debentures at Par:** Debentures are said to be issued at par when their issue price is equal to their nominal value. For example debentures of nominal value of ₹100 is issued at ₹100.
- B. **Issue of debentures at Premium:** Debentures are said to be issued at a premium when their issue price is greater than their nominal value. For example debentures of nominal value of ₹100 is issued at ₹101 or more. In this case ₹1 is the premium and would be credited to securities premium account.
- C. **Issue of debentures at Discount:** Debentures are said to be issued at a discount when their issue price is less than their nominal value. For example debentures of nominal value of ₹100 is issued at ₹99 or less. In this case ₹1 is the discount and would be debited to discount on issue of debentures account.

3.3.2 Issue of Debentures with consideration of Redemption

Debentures may be issued with consideration of redemption. Debentures can be redeemed (repaid) at par, premium or discount.

- A. If debentures are redeemed at an amount equal to their face, they are redeemable at par.

- B. If debentures are redeemed at an amount greater than their face value, they are said to be redeemable at a premium. Such premium though payable on redemption, must be provided as a liability at the time of issue itself. Such premium payable on redemption is a capital loss for the company.
- C. If debentures are redeemed at an amount less than their face value, they are said to be redeemable at a discount. Such discount on redemption is a capital profit for the company.

3.3.3 Issue of debentures for cash receivable in instalments or at a time issue of debentures for consideration other than cash

- A. Debentures can be issued for cash or for consideration other than cash. In both these cases, debentures can be issued at par, premium or at a discount. When debentures are issued for cash, the cash may be received in instalments such as application, on allotment and balance in calls. The premium or discount, if any, is adjusted at the time of allotment itself.
- B. Debentures issued for consideration other than cash means that the company issues debenture without receiving money for the debentures issued.

Examples: Debentures issued to vendors for purchase of business, debentures issued to suppliers for purchase of machinery.

- C. Debentures can also be issued to the lender as a collateral security. Collateral security means an additional or parallel security. Such debentures are in the nature of contingent liability. The lender will be the custodian of the debentures. There is no accounting entry (journal entry) passed in the books of accounts of the company for debentures issued as a collateral security, since there is no immediate liability created by the company. Only a note in the balance Sheet has to be given to that effect

3.4 PROVISIONS OF THE COMPANIES ACT, 2013 REGARDING ISSUE OF DEBENTURES

Section 71 of the Companies Act, 2013 provides the manner in which debentures are to be issued by the Company. The features of the provisions are:

1. A company cannot issue any debentures carrying voting rights.
2. A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. Such an issue must be approved by a special resolution at a general meeting.
3. A company shall pay interest and redeem debentures as per the terms and conditions of the issue.
4. Secured debentures shall be issued by a company as per the terms and conditions prescribed in Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014
5. The company shall create a Debenture Redemption Reserve account (DRR A/c) out of company's profits available for dividend and the amount appropriated to DRR account shall be utilised by the company only for redemption of debentures.
6. A debenture trustee shall ensure the protection of Debenture holders' interest and redress their grievances as prescribed by the rules.
7. The debenture trustee can approach the Tribunal for an order, if the assets of the company become insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due.
8. If the company fails to redeem the debentures on due date or it fails to pay the interest on debentures on due date, then the tribunal can direct, by order, the company to redeem the debentures forth with on payment of principal and interest due thereon.
9. If the company fails to comply the tribunal's order, then every officer of the company who is in default shall be punishable with imprisonment upto three years or a fine of at least rupees two lakhs which can be extended to Rupees five lakhs or with both.
10. The Central Government may prescribe procedure for securing the issue of debentures, the form of trust deed and its inspection and to obtain its copies, the amount of DRR to be created and such other matters.
11. Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 provides that a company shall issue secured debentures on the following terms and conditions:

- i. Secured debentures can be issued provided its date of redemption shall not exceed ten years from the date of its issue.
- ii. The following classes of companies can issue secured debentures for a period exceeding ten years but not exceeding thirty years
 - a) Companies who are engaged in setting up infrastructure projects
 - b) Infrastructure Finance Companies
 - c) Infrastructure Debt Fund Non-Banking Financial Companies
- iii. There shall be a creation of charge on the issue of such debentures.
- iv. The company shall appoint a debenture trustee before issue of prospectus or offer letter for subscription of debentures.
- v. The charge or mortgage shall be created in favour of the debenture trustee on any specified movable or immovable property.

3.5 DISTINCTION BETWEEN SHARE AND DEBENTURE

	Share	Debenture
1.	It is an owned capital.	It is a borrowed capital.
2.	A person who holds share is known as shareholder.	A person who holds debenture is known as debenture holder
3.	The shareholder is the owner of the company.	The debenture holder is the creditor of the company.
4.	Earnings on share are in the form of dividend.	Earnings on debentures are in the form of interest.
5.	The rate of dividend fluctuates in case of equity shares	The rate of interest is fixed.
6.	Shares do not have any security. They are unsecured.	Debentures may have security. They are secured.
7.	Shareholders enjoy voting rights	Debenture holders do not have voting rights

8.	Equity shares can never be converted	Debentures can be converted
9.	Share Trust Deed is not required to be executed.	Debenture Trust Deed is required to be executed.
10.	Section 53 of the Companies Act 2013 prohibits issue of shares at a discount.	There are no restrictions in the Companies Act on issue of debenture at discount.

3.6 MODEL JOURNAL ENTRIES ON ISSUE OF DEBENTURES

	Nature of Transaction	Journal Entry	Amount
1.	When debentures are issued at par and redeemable at par	Bank A/c Dr. To Debentures A/c	Amount Received
2.	When debentures are issued at a premium and redeemable at par	Bank A/c Dr. To Debentures A/c To Securities Premium A/c	Amount Received NV of Debentures Amount of Premium
3.	When debentures are issued at a discount and redeemable at par	Bank A/c Dr. Discount on issue of Debentures A/c Dr. To Debentures A/c	Amount Received Amount of discount NV of Debentures
4.	When debentures are issued at par and redeemable at premium	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Premium on redemption of debentures A/c	Amount Received Premium on redemption NV of Debentures Premium on redemption
5.	When debentures are issued at a discount and redeemable at premium	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Premium on redemption of debentures A/c	Amount Received Disc. allowed & POR NV of Debentures Premium on redemption

6.	When debentures are issued at a premium and redeemable at premium	Bank A/c	Dr.	Amount Received Premium on Redemption NV of Debentures Amount of Premium, Premium on redemption
		Loss on issue of Debentures A/c Dr.		
		To Debentures A/c		
		To Securities Premium A/c		
		To Premium on redemption of debentures A/c		

NV = Nominal Value

POR = Premium on Redemption

Illustration:

Ajay Ltd. issues 2,000 8% debentures of ₹100 each

You are asked to give journal entries on issue if:

- the debentures are issued at par and redeemable at par
- they are issued at a premium of 5% but redeemable at par
- they are issued at a discount of 5% but redeemable at par
- they are issued at par but redeemable at a premium of 10%
- they are issued at a discount of 10% but redeemable at a premium of 5%
- they are issued at a premium of 5% but redeemable at a premium of 10%

Solution:

Working Note

	On date of Issue	On date of Redemption
	₹	₹
a. NV 2,000 x of ₹100 (at par)	2,00,000	2,00,000
b. NV + Premium on issue 5%	2,00,000 +10,000	2,00,000 -
c. NV - Discount on issue 5%	2,00,000 -10,000	2,00,000 -
d. NV + Premium on redemption 10%	2,00,000 -	2,00,000 +20,000
e. NV - Discount on issue 5% + Premium on redemption 10%	2,00,000 -20,000 -	2,00,000 - +10,000

f. NV	2,00,000	2,00,000
+ Premium on issue 5%	+10,000	-
+ Premium on redemption 10%	-	+20,000

Journal entries in the books of Ajay on Issue of Debentures

	Nature of Transaction	Journal Entry	Debit □	Credit □
a.	When issued at par and redeemable at par	Bank A/c Dr. To Debentures A/c	2,00,000	2,00,000
b.	When debentures are issued at a premium and redeemable at par	Bank A/c Dr. To Debentures A/c To Securities Premium A/c	2,10,000	2,00,000 10,000
c.	When debentures are issued at a discount and redeemable at par	Bank A/c Dr. Disc. on issue of Deb. A/c Dr. To Debentures A/c	1,90,000 10,000	2,00,000
D.	When debentures are issued at par and redeemable at premium	Bank A/c Dr. Loss on issue of Deb. A/c Dr. To Debentures A/c To Prem. on redemption of deb. A/c	2,00,000 20,000	2,00,000 20,000
e.	When debentures are issued at a discount and redeemable at premium	Bank A/c Dr. Disc. on issue of Deb. A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Prem on redemption of deb. A/c	1,80,000 20,000 10,000	2,00,000 10,000
f.	When debentures are issued at a premium and redeemable at premium	Bank A/c Dr. Loss on issue of Debentures A/c Dr. To Debentures A/c To Securities Premium A/c To Prem. on redemption of deb. A/c	2,10,000 20,000	2,00,000 10,000 20,000

3.7 SUMMARY

1. Debenture is acknowledged as a debt
2. Debenture is a long term borrowing
3. It is given in the form of a certificate under the common seal of the company
4. The terms of issue and redemption of debentures are mentioned in the certificate
5. Debenture can be issued at par, premium or discount
6. Debentures can be issued for consideration other than cash.
7. Debenture can be offered as a collateral security
8. Debentures can be secured or unsecured.
9. Interest is payable on nominal value of debentures.
10. Debentures do not carry voting rights

3.8 EXERCISE

1. Distinguish between a share and debenture?
2. Explain the different types of debentures?
3. What are the provisions of the Companies Act regarding issue of debentures?
4. Write Short Notes on:
 - i. Meaning and features of debentures.
 - ii. Types of Debentures
 - iii. Simple debentures
 - iv. Fixed charge and floating charge on debentures
 - v. Secured debentures and redeemable debentures
 - vi. Issue of debentures
 - vii. Issue of debentures other than cash
 - viii. Issue of debentures as a collateral security

Objective types questions

- A. State whether the following statements are True or False
 - i. Debenture is a short term borrowing
 - ii. Debenture holders are creditors of the company

- iii. Interest on debentures is calculated on the cost of the debentures
- iv. Debentures can be issued as a collateral security
- v. Debentures can be issued for consideration other than cash
- vi. Debentures cannot be issued at a discount
- vii. A charge on all the assets of the company is a fixed charge
- viii. Unsecured debentures are simple debentures
- ix. Bearer debentures are registered with the company
- x. A company cannot issue secured debentures
- xi. Debentures carry voting rights.

Answers:

True : ii, iv, v, viii

False : i, iii, vi, vii, ix, x, xi

B. Fill in the blanks choosing correct alternative

- i. Debenture holders are the _____ of the company (Owners/Creditors)
- ii. Naked debentures are also known as _____ debentures. (Secured/Unsecured)
- iii. Debenture is a _____ capital (Borrowed/Owned)
- iv. Interest is calculated on the _____ of the debentures (Nominal Value/Cost Price)
- v. A charge on specific assets of the company is a _____ charge. (Fixed/Floating)
- vi. Collateral security is a _____ security (Lateral/Parallel)
- vii. The rate of interest on debenture is _____ (Fixed/Fluctuating)
- viii. The maximum tenure for debentures issued by Companies engaged in setting up infrastructure project is _____ years (10/30)
- ix. When debentures of the face value of ₹100 are issued at ₹105, the issue is said to be at _____ (Discount/Premium)
- x. Issue of debentures must be authorised by _____ of Association (Memorandum/Articles)

Answers:

- i. Creditors, ii. Unsecured, iii. Borrowed, iv. Nominal Value,
 v. Fixed, vi. Parallel, vii. Fixed, viii 30 ix. Premium, x. Articles
 C. Match the Columns

Column A	Column B
1. Debenture holders are	a. Simple debentures
2. Unsecured Debentures	b. Collateral Security
3. Bearer Debentures	c. Charge on the assets of the company
4. Secured Debentures	d. Creditors of the company
5. Parallel Security	e. Transfer by mere delivery

Answers:

1- d, 2-a, 3- e, 4-c, 5-b

Illustration

Varun Ltd. issues 1,000 7% debentures of ₹100 each

You are asked to give journal entries on issue if:

- i. the debentures are issued at par and redeemable at par
- ii. they are issued at a discount of 5% but redeemable at par
- iii. they are issued at a premium of 5% but redeemable at par
- iv. they are issued at a discount of 10% but redeemable at a premium of 5%
- v. they are issued at par but redeemable at a premium of 10%
- vi. they are issued at a premium of 5% but redeemable at a premium of 10%



PROFIT PRIOR TO INCORPORATION

Unit Structure :

- 4.0 Objectives
- 4.1 Introduction
- 4.2 Computation of Profit before Incorporation
- 4.3 Solved Problems
- 4.4 Exercise

4.0 OBJECTIVES

After studying the unit the students will be able to :

- Understanding the concept of Profit prior to incorporation
- Understanding the accounting treatment of Profit prior to and Post incorporation.
- Understanding the basis of allocation of various items of Income and Expenses in Pre and Post incorporation periods
- Calculating the Profit/Loss for pre and post incorporation periods separately.

4.1 INTRODUCTION

Prior means before and post means after. Profit prior to incorporation refers to the profit before incorporation. For computing the profit before incorporation, the profit and loss account is to be prepared in a columnar form to arrive at profit earned before and after incorporation separately. Alternatively, a statement in columnar form showing the results in the pre/ post incorporation period may be prepared.

4.1.1 Concept-

The profit earned before incorporation cannot be treated as a business profit and hence is not available for distribution as dividend to the shareholders .It is a capital profit and should be transferred to Capital Reserve. The profit earned after incorporation is available for appropriations.

4.1.2 Utilisation of Profit prior to incorporation:

1. For writing off fixed assets acquired
2. For writing off goodwill, if any

3. For paying interest to vendors, if any on the value of purchase consideration
4. For writing off preliminary expenses.

4.2 COMPUTATION OF PROFIT BEFORE INCORPORATION

Step-1 Calculate the Time ratio and Sales ratio:

- Time ratio refers to the number of months in the accounting period before incorporation and after incorporation.
- Sales ratio refers to the sales in the pre incorporation and post incorporation periods.
- For example- The accounting period is from 1-4-2010 to 31-3-2011(12 months) and the date of incorporation is 1-7-2010 .In this case the accounting period can be divided into two distinct periods- 1-4-2010 to 1-7-2010 (3 months before incorporation) and 1-7-2010 to 31-3-2011(9 months after incorporation) Time ratio is 3 months : 9 months or 1:3.
- Sales during the pre incorporation period is Rs. 150000 and the total sales during the entire accounting year is Rs. 900000 This means that the sales in the post incorporation period is 750000 (900000-150000). Thus the sales ratio is 150000:750000 or 1:5.

Step-2 Prepare profit and loss account in a columnar format and allocate the expenses profit and incomes on a suitable basis:

- If the gross profit is given in the problem, allocate the gross profit in the sales ratio calculated in step 1.
- If the gross profit is not given, then find out the gross profit by preparing trading account as is normally done in final accounts.
- The gross profit can also be worked out by using the formula
Gross profit =Sales- Cost of Goods Sold.

Step 3- Allocate all items appearing on the debit side of Profit and loss account and credit side of Profit and Loss a/c on suitable basis. Generally the expenses are allocated in the following manner-

- All **fixed expenses**, period costs, administration expenses, general expenses **in time ratio**.
- All **selling and distribution expenses**, variable expenses **in sales ratio**

Step 4- There are some items of expenditure and income which are not to be allocated.

- They pertain wholly to the pre incorporation period- for example- Partners salaries, interest on partners' capitals.

- Similarly expenses like preliminary expenses, directors fees , interest on debentures are to be shown in post incorporation only.
- Incomes like share transfer fees will appear on the credit side in the post incorporation column only.
- However, if specific information is given about a particular item of expense, it must be considered while allocating the expense. For example- bad debts are generally allocated on sales ratio but if there is an additional information about bad debts that bad debts relate to sales effected in the pre-incorporation period, then in such case bad debts should not be allocated on sales ratio but it should be shown only in the pre- incorporation column on the debit side of profit and loss account.

Profit and Loss account
For the year ended 31st March 2018

Dr.				Cr			
Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salary	Time	xx	xx	By Gross Profit	Sales	xx	xx
To Rent	Time	xx	xx	By Share transfer fees	Post		xx
To Discount	Sales	xx	xx				
To Directors fees	Post	---	xx				
To Partners salary	Pre	xx	---				
To Advertisement	Sales	xx	xx				
To Commission	Sales	xx	xx				
To Capital reserve		xx					
To net profit			xx				
Total		xx	xx	Total		xx	xx

Alternatively the details of profit before and after incorporation may be presented in a statement format as under –

Statement of Profit and loss account for the year ended 31st March 2018

Particulars	Basis	Pre-incorporation	Post incorporation
Incomes Gross Profit	Sales ratio	xxxxx	xxxxx
Less Expenses			
Salaries	Time ratio	xxxxx	xxxxx
Advertisement	Sales Ratio	xxxx	xxxx

Directors fees	Post	-----	xxxx
Debenture Interest	Post	-----	xxxx
Capital Reserve (Balancing figure)		xxxxxxx	
Profit and Loss account (Balancing figure)			xxxxx
Total		xxxxx	xxxxx

Step-5 Balance the Profit and loss account and find out profit/loss.

- Profit in the pre- incorporation period- is to be transferred to Capital Reserve account.
- Loss in the pre- incorporation period- debited to Goodwill account.
- Profit in the post- incorporation period- Transferred to Profit and loss appropriation account.

Check your progress:

Calculate time ratio and sales ratio from the following information-

The company was incorporated on 1st June 2015 for the purpose of purchasing an established business as from 1st April 2015. The books of account for the year ended 31st March 2016 showed the total sales for the year as Rs 3,21,040 and sales from 1st April to 1st June as Rs 80,260. The gross profit for the year was Rs 41,280

Calculation of TIME RATIO

Accounting period –
Date of incorporation-
Pre incorporation period—
Post incorporation period –
TIME RATIO-

Calculation of SALES RATIO

Total sales during the year –
Sales in the pre incorporation period –
Sales in the post incorporation period –
SALES RATIO

(Answer- TR-1:5, SR -1:3)

4.3 SOLVED PROBLEMS

Illustration 1

Calculate Time ratio and Sales Ratio from the following information-

A limited company was registered on 1st January 2016 to take over a business as on 1st October 2015. The books of

accounts are closed on 30th September 2016. The certificate of commencement of business was obtained on 1st February 2016. The turnover (sales) for the year ending 30th Sept 2016 was Rs 3,00,000 of which Rs 50,000 related to the period from 1st Oct 2015 to 1st January 2016. (Answer: TR 1:3 SR 1:5)

The Trading account showed a total gross profit of Rs 1,20,000 . How will the gross profit be allocated?

Illustration 2

Calculate Time Ratio and Sales Ratio from the following information. –

A limited company was incorporated on 1st July 2017 to take over a business as on 1st January 2017 and the company follows calendar year. The books of accounts were closed on 31st December 2017 and the monthly sales effected from 1st Jan to 31st December 2017 were as follows-

January, February, March and April - Rs 50,000 each month
May, June Rs 75,000 each month and Sales from July to December was uniform at Rs 1,00,000 each month

Solution:

Time Ratio:

Accounting period – 1 January to 31st December 2017

Date of Incorporation 1st July 2017

Pre incorporation period – 1st January to 30th June 2017 – 6 months

Post Incorporation - 1st July to 31st December 2017 – 6 months

Time Ratio 1:1

Sales Ratio

Sales in pre incorporation period January to June -
50,000+50,000+50,000+50,000+75,000+75,000 = **3,50,000**

Sales in the post incorporation period July to December-
1,00,000+1,00,000+1,00,000+1,00,000+1,00,000+1,00,000=
6,00,000

6,00,000

Sales Ratio – 3,50,000 : 6,00,000 or 7:12

Illustration 3

Big Co. Ltd took over the business of Small & Sons, a firm w.e.f. 1-4-2007. The company was registered on 1-11-2007. Profit and loss account for the year ended 31-3-2008 was as under-

Particulars	Amt(Rs.)	Particulars	Amt(Rs.)
To Salaries	2,40,000	By Gross profit b/d	12,60,000
To Rent and rates	1,80,000		
To Printing and stationery	96,000		
To Audit fees	30,000		
To Sundry expenses	24,000		
To Carriage outward	90,000		
To Advertising	63,000		
To Electricity charges	72,000		
To Commission on sales	1,08,000		
To Debenture interest	28,000		
To Depreciation	42,000		
To Interest on purchase consideration	27,000		
To Net profit c/f	2,60,000		
	12,60,000		12,60,000

Additional information:

1. Sales for each of the months July, August, September, January, February and March were twice the sales for each of the months April, May, June, October, November and December.
2. Depreciation shown above includes depreciation on furniture worth Rs. 2,40,000 @ 10% and on delivery van worth Rs.90,000 @ 20%. Both these assets were taken over from Small and sons.
3. Big Co. Ltd. settled Purchase consideration on 1st January,2008
4. Audit fees are payable for the whole year.

Prepare Profit and Loss account for the year ended 31st March, 2008 showing profits for pre- incorporation and post incorporation periods separately.

(University of Mumbai- October 2009)

Solution:--**WN - Time ratio-**

Pre- incorporation period- 1-4-2007 to 1-11-2007(7 months)

Post- incorporation period- 1-11-2007 to 31-3-2008(5 months)

Time ratio - 7:5

Sales ratio-

Let monthly sales be-1

Pre-incorporation period- 1+1+1+2+2+2+1=10

Post- incorporation period-1+1+2+2+2=8

Sales Ratio- 10:8 or 5:4

Interest on purchase consideration-

(payable for 9 months from April to December)

Pre-incorporation- 1-4-2007 to 1-11-2007 (7 months)

Post- incorporation- 1-11-2007 to 31-12-2007(2 months)

Specific ratio- 7:2**Depreciation on assets-** Furniture- 240000x10%= 24,000

Delivery van- 90,000x 20%= 18,000

Total Depreciation (24,000+ 18,000) = 42,000 in Time Ratio 7:5

Profit and Loss account for the year ended 31st March, 2008

Dr.

Cr

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salaries	Time	1,40,000	1,00,000	By Gross profit	Sales	7,00,000	5,60,000
To Rent and taxes	Time	1,05,000	75,000				
To Printing & Stationery	Time	56,000	40,000				
To Audit fees	Time	17,500	12,500				
To Sundry expenses	Time	14,000	10,000				
To Carriage outward	Sales	50,000	40,000				
To Advertising	Sales	35,000	28,000				
To Electricity charges	Time	42,000	30,000				
To Commission on sales	Sales	60,000	48,000				
To Debenture interest	Post	-----	28,000				
To Depreciation	Time	24,500	17,500				
To Interest on purchase consideration	7:2	21,000	6,000				
To Capital Reserve (bal fig)		1,35,000	-----				
To Net Profit (bal fig)		-----	1,25,000				
Total		7,00,000	5,60,000	Total		7,00,000	5,60,000

Note: Alternatively the depreciation on Delivery van may be allocated in sales ratio also. The working note on depreciation will be as follows –

Depreciation on Furniture in Time ratio (Rs 24,000 in Time ratio) and Depreciation on delivery van in sales ratio (Rs 18,000 in sales ratio).

In such case the answer will change and profit before incorporation would be Rs 1,35,500 which will be transferred to

capital reserve and the profit after incorporation would be Rs 1,24,500

Illustration 4

M/s Abani Offshore Ltd took over a running business with effect from 1st April, 2018. The company was incorporated on 1st September, 2018. The summarized Profit and Loss Account for the year ended 31st March, 2019 is as under:

Particulars	Rs.	Particulars	Rs.
To Printing and Stationery	2,40,000	By Gross Profit	1,70,00,000
To Salaries	39,00,000	By Interest on Fixed Deposit	12,00,000
To Directors fees	5,00,000		
To Selling expenses	24,30,000		
To Debenture Interest	5,80,000		
To Auditors Fees	1,00,000		
To Rent and taxes	9,60,000		
To Office Expenses	6,00,000		
To Bad Debts	12,00,000		
To Preliminary Expenses	10,00,000		
To Net Profit	66,90,000		
	1,82,00,000		1,82,00,000
	=====		=====

Additional Information:

1. It is ascertained that monthly sales from October 2018 to March 2019 was twice the average of the monthly turnover from April 2018 to September 2018.
2. Out of bad debts Rs. 2,00,000 relate to debts created prior to incorporation. Remaining bad debts are out of sales affected throughout the year.
3. Rent is doubled from 1st December, 2018.
4. Salaries include salary of three employees at equal monthly remuneration. However one of them was appointed as manager from 1st January, 2019. His salary was doubled from that date.
5. Vendors were entitled to 40% of the profit earned in Pre-incorporation period.
6. Interest on Fixed Deposit was received for the entire year.

Prepare the Statement of Profit and Loss in columnar form, showing distinctly the allocation of profits between pre incorporation and post incorporation periods, indicating the basis of allocation.

Solution:**Working Notes –****Time Ratio 5:7****Sales Ratio 5: 13**

Basis for Allocating Rent 5:11

Salaries 15:24 or 5:8

Bad Debts Rs. 12,00,000

Rs 2,00,000 in pre incorporation (given)

Balance bad debts Rs 10,00,000 to be divided in Sales Ratio:

Pre incorporation: 2, 77,778

Post Incorporation: 7, 22,222

Total Pre Incorporation Bad Debts Amount:2,00,000 + 2,77,778 = **477778****Post Incorporation** Bad Debts=**722222**

Statement of Profit And Loss
For The Year Ended 31ST March 2019

	Pre- Incorporation	Post- Incorporation
INCOMES		
Gross profit (SR)	47,22,222	122,77,778
Interest on FD (TR)	+ 5,00,000	+ 7,00,000
Total Income (A)	52,22,222	129,77,778
EXPENSES		
Printing and Stationery (TR)	1,00,000	1,40,000
Salaries (5:8)	15,00,000	24,00,000
Directors Fees (Post)	-----	5,00,000
Selling Expenses (SR)	6,75,000	17,55,000
Debenture Interest (Post)	-----	5,80,000
Auditors fees (TR)	41,667	58,333
Rent and Taxes (5:11)	3,00,000	6,60,000
Office Expenses (TR)	2,50,000	3,50,000
Bad Debts (WN)	4,77,778	7,22,222
Preliminary expenses (Post)	-----	10,00,000
Total expenses (B)	33,44,445	81,65,555
Capital Reserve (A-B) (bal.fig)	18,77,777	
Net Profit (A-B) (bal.fig)		48,12,223

Illustration 5:

Avenue Ltd was incorporated on 1st August, 2017 to acquire the business of Shah and Bros from 1st April, 2017. The company received the certificate of commencement of business on 1st October, 2017.

The agreement also provided that vendors are entitled to 60% of Profits (or Loss, if any) for the period upto 1st August, 2017.

The following Profit & Loss Account for the year ended 31st March, 2018 is presented as under:

Particulars	Rs.	Particulars	Rs.
To Office Salaries	36,00,000	By Gross Profit	1,20,00,000
To Bad Debts	5,00,000		20,00,000
To Depreciation	18,00,000	By Profit on sale of Investment	
To Office rent	9,00,000		
To Commission on Sales	15,00,000		
To Debenture Interest	8,00,000		
To Directors Fees	8,00,000		
To Interest on Purchase Consideration	6,00,000		
To Net Profit	35,00,000		
	<u>1,40,00,000</u>		<u>1,40,00,000</u>

You obtained the following additional information :

- Monthly Sales for October, 2017 to March, 2018 is 150% of monthly sales for April, 2017 to September, 2017.
- Office rent was increased from Rs. 50,000 per month to Rs. 1,00,000 per month effective from 1st October, 2017.
- Investment was sold on 1st November, 2017.
- Bad debts were in respect of sales affected two years ago.
- Consideration to Vendors was paid on 1st October, 2017.

Prepare the Statement of Profit and Loss in columnar form, showing distinctly the allocation of profits between pre incorporation and post incorporation periods, indicating the basis of allocation.

Working notes-

Time Ratio 1:2

Sales Ratio 4:11

Interest on Purchase Consideration 4: 2 or 2:1

Interest is paid for 6 months from April to September.

(April, May, June, July) **4 months pre incorporation** period

While (August and September) **2 months post incorporation** period.

Office rent	Pre	Post
50,000x4 months	2,00,000	
50,000x2 months		1,00,000
1,00,000x6 months		6,00,000
Total office rent	2,00,000	7,00,000

Statement of Profit and Loss
For the year ended 31st March 2018

	Pre-Incorporation	Post-Incorporation
Incomes		
Gross Profit (SR)	32,00,000	88,00,000
Profit on Investment (Post)	-----	+20,00,000
Total Income (A)	32,00,000	1,08,00,000
Expenses		
Office Salaries(TR)	12,00,000	24,00,000
Bad Debts(Pre)	5,00,000	-----
Depreciation (TR)	6,00,000	12,00,000
Office Rent(WN)	2,00,000	7,00,000
Commission on Sales (SR)	4,00,000	11,00,000
Debenture Interest(Post)	-----	8,00,000
Directors Fees(Post)	-----	8,00,000
Interest on Purchase consideration (2:1)	4,00,000	2,00,000
Total Expenses (B)	33,00,000	72,00,000
Loss(A-B)	1,00,000	
Less Vendors share 60%	(60,000)	
Loss transferred to Goodwill	40,000	
Net Profit (A-B)		36,00,000

Illustration 6

Kalpana Limited was registered on 1st February 2013 to acquire the business of M/s. XYZ as on 1st October 2012. The accounts of the company for the period ended 30th September 2013 disclosed the following facts:

- 1) The turnover for the whole period 1st October 2012 to 30th September 2013 was Rs. 2,40,000 of which 40,000 related to the period from 1st October 2012 to 1st February 2013
- 2) The trading account showed a gross profit of Rs. 96,000
- 3) The following items appeared in the Profit and Loss Account:
 - a. Directors Fees – Rs. 1,500

- b. Auditors fees – Rs. 750
- c. Rent, rates and Taxes – Rs. 4,800
- d. Bad debts (of which Rs. 700 related to book debts created before 1st February 2013) – Rs. 2000
- e. Salaries – Rs. 12,000
- f. Interest on Debentures – Rs. 6,000
- g. Depreciation – Rs. 3,600
- h. Preliminary expenses – Rs. 2,400
- i. General Expenses – Rs. 1,800
- j. Commission on sales – Rs. 3,600
- k. Printing and Stationery – Rs. 2,400
- l. Advertising – Rs. 4,200
- m. Traveller's salaries – Rs. 8,400
- n. Interest to Vendor at 10% p.a. on Rs. 1,00,000 from 1st October 2012 to 31st May 2013 – Rs. 6,667

Prepare a statement showing profits earned by the company prior to incorporation and after incorporation clearly indicating the basis of allocation of expenses. Assume Audit fees is for the entire year.

Solution-

WN 1

Time ratio – 1:2

Sales Ratio 1: 5

Total Turnover for the accounting periods = Rs 2,40,000

Sales in the pre incorporation period (OCT- FEB) = Rs. 40,000

Therefore Sales in post incorporation period = Rs. 2, 00,000

Therefore **SR 1: 5**

WN2

Interest to Vendor

10% on 1,00,000 for 8 months – Rs 6666.66

Rounded off to Rs 6667

Out of which from 1st October 2012 to 1st February 2013 – 4 months will be pre incorporation.

From 1st Feb 2013 to 31st May 2013-

4 months will be post incorporation.

Thus the amount will be allocated in the ratio 4: 4 or equally among the pre and post incorporation periods.

Statement showing Profit and loss
For the year ended 30th September 2013.

Particulars	Basis	Pre-Incorporation		Post-Incorporation	
		Debit	Credit	Debit	Credit
Gross Profit –SR	Turnover		16,000		80,000
Expenses					
Directors fees	Post			1,500	
Auditors fees –TR	1:2	250		500	
Rent , Rates	1:2	1600		3200	
Bad Debts	Given	700		1300	
Salaries	1:2	4000		8000	
Debenture Interest	Post			6000	
Depreciation	1:2	1200		2400	
Preliminary expenses	Post			2400	
General expenses	1:2	600		1200	
Commission on sales	1:5	600		3000	
Printing and Stationery	1:2	800		1600	
Advertising	1:5	700		3500	
Travellers Salary	1:5	1400		7000	
Interest to vendor	4:4	3333		3334	
Total of expenses		15183		44934	
Capital Reserve (Bal. fig)		817			
Net Profit (Bal Fig)				35066	
Total		16,000	16,000	80000	80,000

Illustration 7

Sunderam Brothers was taken over by Sunderam Ltd on 1st May 2017. However the company was incorporated on 1st February 2018. The following was the Profit and Loss a/c for the period from 1st May 2017 to 31st March 2018.

To Salaries	72,000	By Gross Profit	7,00,000
To Rent(Net)	39,000	By Discount	7,000
To Delivery van expenses	14,000		
To General Expenses	22,000		
To Advertisement expenses	3,50,000		
To Bad debts written off	14,000		
To Debenture Interest	70,000		
To Directors meeting fees	10,000		
To Preliminary expenses	4,000		
To Net profit c/d	1,12,000		
Total	7,07,000	Total	7,07,000

You are informed that –

- Salaries in pre- incorporation and post- incorporation period were Rs 6,000 p.m and Rs 9,000 p.m respectively.
- Gross profit percentage is fixed. Average monthly turnover is nine times in May, October and November 2017 as compared to average monthly turnover of remaining months .
- Audit fees Rs 4,400 is to be provided for the above period.
- Rent on the debit side is after subtracting rent received at Rs 4,000 p.m from 1st December 2017.

You are requested to prepare Statement of Profit and Loss in columnar form apportioning various incomes and expenses on suitable basis in the pre and post incorporation period from 1st May 2017 to 31st March 2018.

(Mumbai University April 2010)

Solution:

Working notes1:

Pre incorporation period 1st May 2017 to 1 Feb 2018 = 9 months

post incorporation 1st Feb. 2018 to 31st Mar. 2018 = 2 months

Time ratio (TR) 9:2 and

Sales ratio (SR) 33:2

WN-2 Salaries

Pre incorporation Rs 6,000x 9 months = 54,000

Post incorporation Rs 9,000x 2 months = 18,000

WN- 3 Rent received

Pre incorporation 4000 x 2 months = 8,000

Post incorporation 4,000 x 2 months= 8,000

WN-4 Rent paid

Pre incorporation 5,000x 9 months =45,000 post incorporation

5,000x 2 months =10,000

WN-4 Audit fees to be allocated in the Time ratio 9:2

In the books of Sunderam Ltd –

Profit and Loss a/cFor the period 1st May 2017 to 31st March 2018

Dr.			Cr.		
Particulars	Pre	Post	Particulars	Pre	Post
To Salaries – WN1	54,000	18,000	By Gross Profit -SR	6,60,000	40,000
To Rent –WN 3	45,000	10,000	By Rent received	8,000	8,000
To Delivery van expenses –SR	13,200	800	By Discount – SR	6,600	400
To General Expenses –TR	18,000	4,000	By Net Loss (Bal. Fig)		90,000
To Advertisement expenses - SR	3,30,000	20,000			
To Bad debts written off – SR	13,200	800			
To Debenture Interest- Post		70,000			
To Directors meeting fees- Post		10,000			
To Preliminary expenses –Post		4,000			
To Audit - TR	3,600	800			
To Capital Reserve (Bal Fig)	1,97,600				
	6,74,600	1,38,400		6,74,600	1,38,400

Illustration 8

Abhishek Ltd was incorporated on 1st August 2017 to take over a running partnership business with effect from 1st April 2017. Following are the details of Income and Expenses for the year ended 31st March 2018

Particulars	Amt Rs	Amt Rs
Gross Profit		19,20,000
Less Expenses		
Directors Fees	98,000	
Rent	1,71,000	
Bad debts	24,000	
Salaries	3,66,000	
Interest on Debentures	45,000	
Depreciation	1,32,000	
Preliminary expenses written off	87,000	
General Expenses	98,400	
Commission on Sales	72,000	
Printing and Stationery	1,86,000	
Advertisement Expenses	2,41,000	
Audit Fees	1,17,200	
Carriage Outward	1,45,600	
Electricity charges	88,800	
Insurance Premium	48,000	
Net Profit	NIL	
	19,20,000	19,20,000

Additional information-

- Rent is paid on the basis of floor space occupied .Floor space occupied was doubled in the post incorporation period
- Sales for each month of December 2017 to March 2018 were double the monthly sales of April 2017 to November 2017.
- Audit fees is for entire year
- Bad debts Rs 4,000 is in respect of sales effected two years ago.
- Mr Anil was a working partner in the firm entitled to a remuneration of Rs 24,000 per month From 1st August 2017, he was made the Managing Director of the company and was entitled to salary Rs 30,000 per month. The remaining salary is to two clerks employed during the period from 1st July 2017 to 31November 2017.

Prepare a statement showing profits in the pre and post incorporation period separately.

Solution:

WN 1-

Time ratio- TR 4: 8 or 1: 2

Sales Ratio- SR 4:12 or 1: 3

WN-2

Bad debts total 24,000 to be allocated as under

	Pre	Post
Given	4,000	
Balance Rs. 20,000 in SR	5,000	15,000
TOTAL	9,000	15,000

WN-3

Rent to be allocated on the basis of floor space which was doubled in post incorporation ratio is 1:4

WN-4**Salary to Anil as partner**

24,000 x 4 months= 96,000 in pre incorporation

Salary to Anil as Managing director –

30,000 x 8 months = 2,40,000 in post incorporation

Balance salary

3,66,000 – (96000+240000) = 30,000 to be paid to clerks from 1st July 2017 to 30th November in 1: 4 ratio

Statement Showing Pre and Post Incorporation Profit/ Loss
For The Year Ended 31st March 2018

Particulars	Basis	Pre	Post
Gross Profit	SR(1:3)	4,80,000	14,40,000
Less Expenses			
Directors fees	POST		98,000
Rent	WN 2 (1:4)	34,200	1,36,800
Bad debts	WN 1	9,000	15,000
Salary--- Anil	WN 3	96,000	2,40,000
Clerks	WN 3 (1:4)	6,000	24,000
Interest on Debentures	POST		45,000
Depreciation	TR (1:2)	44,000	88,000
Preliminary expenses written off	POST		87,000
General expenses	TR(1:2)	32,800	65,600
Commission on sales	SR	18,000	54,000
Printing and stationery	TR	62,000	1,24,000
Advertising expenses	SR	60,250	1,80,750
Auditors fees	TR	39,066	78,134

Carriage outward	SR	36,400	1,09,200
Electricity charges	TR	29,600	59,200
Insurance premium	TR	16,000	32,000
Total expenses		4,83,316	14,36,684
Loss transferred to Goodwill (Bal. Fig)		3,316	
Net Profit (Bal. Fig)			3,316

4.4 EXERCISE

Practical Problems:

1. A limited company was incorporated on 1st July 2018 to take over business as a going concern as from 1st April 2018. The profit and loss a/c was drawn as on 31st December 2018. Calculate Time ratio.
(Answer: Time Ratio-3: 6 or 1:2)
2. A limited company was incorporated on 1st April 2018 to take over business with effect from 1st January 2018. The company prepared its Profit and Loss account for the year ended 31st March 2019. The company was able to double the average monthly sales from 1st April 2018. Calculate Time Ratio and Sales Ratio.
(Answer: Time Ratio 3: 12 or 1: 4 Sales Ratio 3: 24 or 1: 8)
3. A limited company took over the business of a partnership firm with effect from 1st January 2018. The company was registered on 1st August, 2018. Details of Income and expenses for the year ended 31st December 2018 is as under –

Particulars	Amt (Rs)	Amt (Rs)
Gross Profit		37,80,000
Less Expenses		
Salaries	7,20,000	
Rates and Insurance	5,40,000	
Printing and Stationery	2,88,000	
Audit Fees	90,000	
Directors Fees	72,000	
Carriage Outward	2,70,000	
Advertising	1,89,000	

Electricity charges	2,16,000	
Commission on sales	3,24,000	
Debenture Interest	84,000	
Depreciation	1,26,000	
Interest on Purchase consideration	81,000	30,00,000
NET PROFIT		7,80,000

Additional Information-

1) Sales for each of the months April, May, June, October, November and December were twice the sales for each of the months January, February, March, July, August and September.

2) The purchase consideration was settled on 1st November 2018.

3) Audit fees are payable for the entire year .Calculate the profits for Pre and post incorporation periods separately.

(Answer – Time Ratio 7: 5 Sales Ratio 5:4)

(Hints- Rs 81,000 Interest on Purchase consideration to be allocated in 7: 3 Ratio. Amount in pre incorporation Rs 56,700 and in post incorporation Rs 24,300 Final answer Profit prior to incorporation transferred to Capital Reserve Rs 453300 and Profit post incorporation Rs 326700)

4. RJ Ltd was incorporated on 1st August 2017 to acquire business as on 1st April 2017. The first accounts were closed on 31st March 20118. The following items appeared in the Profit and Loss Account .

Profit and Loss A/c for the year ended 31st March 2018

Dr

Cr

Particulars	Amt (Rs)	Particulars	Amt(Rs)
To Directors Fees	49,000	By Gross Profit	9,60,000
To Rent	85,500		
To Bad Debts	12,000		
To Salaries	1,83,000		
To Interest on Debentures	24,000		
To Depreciation	66,000		
To Preliminary expenses	42,000		
To General Expenses	49,200		
To Commission on	36,000		

Sales			
To Printing and Stationery	93,000		
To Advertising	1,20,000		
To Audit Fees	58,600		
To Carriage Outward	72,800		
To Electricity charges	44,400		
To Insurance Premium	24,000		
Total	9,60,000	Total	9,60,000

Additional Information-

- 1) Rent is paid on the basis of floor space occupied. The floor space was doubled in the post incorporation period.
- 2) Sales for each month of December 2017 to March 2018 were double the monthly sales of April to November 2017.
- 3) Bad Debts Rs 2,000 were in respect of sales effected two years ago.
- 4) Mr Amit was working partner in the firm entitled to a remuneration @ Rs 12,000 p.m from 1st August 2017. He was Managing Director of a company entitled to salary @Rs 15,000 p.m . The remaining salary is to two clerks employed during the period 1st July to 30th November 2017. You are required to prepare Statement of Profit and Loss for the year ended 31st March 2018 and show the Pre and post incorporation profit or Loss .

(Answer: Time Ratio 1:2 Sales Ratio 1: 3 Pre incorporation loss Rs 1658 Post Incorporation Profit Rs 1658)

(Hints-

- Bad debts Rs 12,000 Rs 2000 old bad debts to be shown in pre incorporation and balance (12000-2000=10,000) to be allocated in the sales ratio 1: 3 Allocation of Bad debts in -Pre incorporation period (2000+ 2500) 4500 and Post incorporation 7500.
- Rent to be allocated in 4: 16 ratio
- Salaries a) Amit pre incorporation 12000x4 months =48,000 post incorporation From August 2017 to March 2018 8 months @ 15,000 per month 15000x8= 1,20,000 Total Salary as per P&L a/c Rs 1,83,000 Total salary to Amit (48000+ 120000) 1,68,000 Therefore balance amount to clerks for 5 months July to November is 183000-168000=15000
b) For clerks pre incorporation 1 month Rs 3000 and post incorporation for 4 months August to November 2017 3000x4 =12,000)

Objective Questions
5. Match the Columns-

GROUP A	GROUP B
1) Sales related expenses	a) Transferred to Profit and loss Appropriation account
2) Time related expenses	b) Transferred to Capital Reserve
3) Share transfer fees	c) Shown in debit side pre incorporation column only
4) Debenture Interest	d) Shown in debit side post incorporation column only
5) Partners Salaries	e) Shown in credit side pre incorporation column only
6) Pre- incorporation profit	f) Shown in credit side post incorporation column only
7) Post incorporation profit	g) Allocated in time ratio
	h) Allocated in Sales ratio

(Answers 1-h 2-g 3-f 4-d 5-c 6-b 7-a)

GROUP A	GROUP B
1) Gross Profit	a) is revenue profit
2) Audit Fees	b) Transferred to Goodwill account
3) Profit prior to incorporation	c) Date of incorporation
4) Profit post incorporation	d) is not available for dividend
5) Loss prior to incorporation	e) Allocated in Sales Ratio
6) Dividing point for pre and post incorporation	f) Allocated in Time ratio
7) Preliminary expenses	g) Shown in pre incorporation only
	h) Transferred to General Reserve
	i) Shown in post incorporation

(Answers - 1— e 2— f 3— d 4— a 5— b 6— c 7— i)

6. State whether the following statements are True or False

- 1) The fixed expenses are normally to be allocated in Time ratio- True
- 2) The variable expenses are normally to be allocated in sales ratio- True
- 3) Gross profit is to be allocated in Sales ratio- True
- 4) Directors fees are to be allocated equally in the Pre and Post incorporation periods –False
- 5) The Profit before incorporation is to be transferred to General Reserve – False

- 6) The Profit after corporation is a revenue Profit- True
- 7) While computing pre and post incorporation profits, Audit fees are allocated on Time basis – True
- 8) Profit prior to incorporation is available for payment of dividend – False
- 9) Loss prior to incorporation is debited to Goodwill account- True
- 10) Preliminary expenses should be debited to pre-incorporation period- False

7. Multiple Choice Questions

- 1) While calculating profit prior to incorporation, the fixed expenses are to be allocated _____
 - a) in Sales ratio
 - b) in Time ratio
 - c) equally
 - d) none of the above
- 2) While calculating profit prior to incorporation, the variable expenses are to be allocated _____
 - a) in Sales ratio
 - b) in Time ratio
 - c) equally
 - d) none of the above
- 3) While calculating profit prior to incorporation, the Directors fees are to be _____
 - a) allocated in sales ratio
 - b) shown as pre incorporation expense
 - c) shown as post incorporation expenses
 - d) ignored
- 4) While calculating profit prior to incorporation, the partners salaries are to be _____
 - a) allocated in sales ratio
 - b) shown as pre incorporation expense
 - c) shown as post incorporation expenses
 - d) ignored
- 5) The profit prior to incorporation is transferred to _____
 - a) Capital Reserve
 - b) General Reserve
 - c) Securities Premium
 - d) Goodwill
- 6) The share transfer fees are _____
 - a) to be shown on the credit side of P&L A/c in the pre-incorporation column
 - b) to be allocated equally
 - c) to be shown on the debit side of P&L A/c in the pre-incorporation column
 - d) to be shown on the credit side of P&L A/c in the post - incorporation column

(Answer: 1- b, 2- a, 3- c, 4- b, 5- a, 6- d.)

8. Short Numerical Objective Questions –

- 1) Kalpana Limited was registered on 1st February 2013 to acquire the business of M/s. XYZ as on 1st October 2012. The accounts of the company for the period ended 30th September 2013 disclosed the following facts:
- 2)
 - a) The turnover for the whole period 1st October 2012 to 30th September 2013 was Rs. 2,40,000 of which 40,000 related to the period from 1st October 2012 to 1st February 2013
 - b) The Trading account showed a Gross profit of Rs. 96,000
Calculate Time Ratio and Sales Ratio. State how the Gross profit will be allocated between the pre and post incorporation periods.

(Answer- Time ratio 4:8 or 1:2 Sales Ratio 1: 5 Gross profit Rs 96,000 to be allocated in Sales Ratio Pre incorporation amount Rs 16,000 post incorporation Rs 80,000)

- 3) Friendship Ltd was incorporated on 1st April 2017 to take over business of the partnership firm with effect from 1st January 2017. The company prepared its Profit and Loss a/c for the year ended 31st March 2018 . The company was able to double the average monthly sales from 1st April 2017. Calculate Time ratio and Sales ratio
(Answer Time Ratio 3:12 or 1:4 Sales Ratio 3:24 or 1:8)
- 4) Indo-Japan Ltd was incorporated on 1st May 2018 to take over a business as a going concern from 1st January of the same year. The total turnover for the year ended 31st December was Rs 2,00,000 namely Rs 60,000 for the first period upto 1st May and Rs 1,40,000 for the remaining period. Calculate Time Ratio and Sales Ratio
(Answer Time ratio 4: 8 or 1:2 and Sales ratio 6:14 or 3: 7)

