MAR GREGORIOS COLLEGE OF ARTS & SCIENCE

Block No.8, College Road, Mogappair West, Chennai – 37

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DEPARTMENT OF COMMERCE (COMPUTER APPLICATION)

SUBJECT NAME: CORPORATE ACCOUNTING

SUBJECT CODE: CPC3A

SEMESTER: III

PREPARED BY: PROF. D. LAKSHMANAN

III SEMESTER

Core Paper V - CORPORATE ACCOUNTING

Unit I: Share Capital

Issue of Shares - Types of Shares – Forfeiture of shares – Reissue of shares Underwriting of shares – Stock split – Meaning of Redemption-Redemption of Preference Shares.

Unit II: Debentures & Acquisition of Business

Meaning-Types of Debentures - Issue- Underwriting of Debentures - Redemption of Debentures. Acquisition of Business – Meaning –Profit Prior to incorporation.

UnitIII: Final Accounts

Final Accounts – Preparation of P&L A/c and Balance Sheet - Managerial Remuneration – Calculation and Legal Provisions.

Unit IV: Valuation of Shares and Goodwill

Valuation of Shares and Goodwill – Meaning – Methods of Valuation of Shares and Goodwill.

Unit V: Alteration of Share Capital

Meaning – Internal Reconstruction – Reduction of Share Capital.

Note: Questions in Sec. A, B & C shall be in the proportion of 20:80 between Theory and Problems.

Suggested Readings

E-Resources

www.accountingcoach.com

www.accountingstudyguide.com

www.futureaccountant.com

www.education.svtuition.org

Unit – I

Share Capital

Share:

A company’s owned is spilt up into numerous of equal parts, each such part being called as a share.

Types of shares:

Equity shares:- An equity share, normally known as ordinary share is a part ownership where each member is a fractional owner and initiates the maximum entrepreneurial liability related with a trading concern. These types of shareholders in any organization possess theright to vote.

Preference Shares:-Preference shares are shares having preferential rights to claim dividends during the lifetime of the company and to claim repayment of capital on wind up. In case of preference shares, the percentage of dividend is fixed i.e. the holders get the fixed dividend before any dividend is paid to other classes of shareholders.

Types of preference shares Cumulative Preference Shares:

Shares having right of dividend even in those years in which it makes no profit are known as cumulative preference shares. In case the companies do not declare dividends for a particular year then they are treated as arrears and are carried forward to next year. When the arrears pertaining to dividend are cumulative in nature and such arrears are cleared before any dividend payment to equity shareholders then it is said to be as cumulative preference shares.

Non-cumulative Preference Shares:

A non-cumulative preference share does not accumulate any dividend. In case the dividend by the company is not paid then they have the right to avail dividends from the profits earned from the particular year. Dividends are paid only from the net profit of each year. In case there is no profit accumulated for a particular year then the arrears of dividends cannot beclaimed in subsequent years.

Participating Preference Shares

These shares have the right to participate in surplus profits of the company during liquidation after the company had paid to other shareholders. The preferential shareholders receive stipulated rate of dividend and also participate in the additional earnings of the

company along with the equity shareholders.

Non-participating Preference Shares:

Preference shares having no right to participate in the surplus profits or in any surpluson liquidation of the company are referred to as non-participating preference shares. Here, preference shareholders receive only stated dividend and nothing more.

Convertible Preference Shares:

These shares are those which are converted into equity shares at a specified rate on the expiry of a stated period. The shareholders have a right to convert their shares into equity shares within a specified period.

Non-convertible Preference Shares:

The shares that cannot be converted to equity are referred to as non-convertible shares. These can also be redeemed.

Redeemable Preference Shares:

Redeemable preference shares are referred to as shares that can be redeemed or repaidafter the fixed period as issued by the company or even before that.

Non-Redeemable Preference Shares:

Non-redeemable preference shares are referred to as shares that cannot be redeemed during the lifetime of the company.

Types of share capital Authorised/Nominal/Registered Capital:

At the time of registration of a company, the Memorandum of Association mentions the amount of capital a company is Authorised to raise from the public by selling shares which is known as Authorised Capital or Normal Capital or Registered Capital.

It is the maximum amount of share capital that a company can issue. In the case of a limited company, the Memorandum shall contain the amount of Capital by which a company is proposed to be registered and the division thereof into shares of fixed amount. In short, it is themaximum amount of capital which a company will have during its lifetime—unless it is increased.

Issued Capital:

Generally, a part of the authorised capital is issued to the public for subscription whichis known as issued capital, i.e., it is the nominal value of the shares which are offered to the public for subscription. Usually, a company does not issue all its capital at a time, i.e., issued capital is less than the authorised capital. If all shares are issued, issued capital and

authorised capital will be the same.

Subscribed Capital:

A part of the issued capital which is subscribed by the public is known as subscribed capital. It does not necessarily mean that all the shares which have been issued will be taken over by the public.

In other words, the share capital of the number of shares which are taken over by the public is called subscribed capital, i.e., the portion of issued share capital which is paid/subscribed by the shareholder is known as subscribed capital.

Called-Up Capital:

Generally, the shareholders pay the price of the shares by installments, viz., application, allotment, First call, Final call etc. Therefore, the portion of the face value of the shares which the shareholders are called upon to pay or the company has demanded to pay is called - up capital.

Uncalled Capital:

The unpaid portion of the subscribed capital is called Uncalled Capital. In other words, it is the remainder of the issued Capital which has not been called. However, the company may call this amount at any time but that must be subject to the terms of issue of shares.

Paid Up Capital:

The amount actually paid by the shareholders is known as Paid-up Capital.

Reserve Capital:

According to Sec. 99 of the Companies Act, 1956, Reserve Capital is that part of uncalled capital of a company which can be called only in the event of its winding-up. A limited company may, by special resolution, determine that any portion of its share capital which has not been called-up, shall be called up, except in the event of the company being wound-up, such capital is known as Reserve Capital.It is available only for the creditors on the winding-up of the company.

What are calls in advance and arrears?

Calls in arrears is when the shareholders fail to pay the amount of share capital called up within the stipulated time. **Calls in advance** is when the shareholders pays the amount for the part of share capital that has not been called up yet.

What forfeited shares?

A forfeited share is a share in a company that the owner loses (forfeits) by failing tomeet the purchase requirements. Requirements may include paying an allotment

or call money owed, or avoiding selling or transferring shares during a restricted period.

Definition of 'Bonus Share'

Bonus shares are additional shares given to the current shareholders without any additional cost, based upon the number of shares that a shareholder owns. These are company's accumulated earnings which are not given out in the form of dividends, but are converted into free shares.

What does right issue mean?

A rights offering (rights issue) is a group of rights offered to existing shareholders to purchase additional stock shares, known as subscription warrants, in proportion to their existing holdings. Rights are often transferable, allowing the holder to sell them in the open market.

Give the meaning of Issue of Shares

A company can issue its shares either at par, at a premium or even at a discount. The shares will be at par is when the shares are sold at their nominal value. Shares sold at a premium cost more than their nominal value, and the amount in excess of the face value isthe premium. The issue of shares at a discount means the issue of the shares at a price less than the face value of the share.

Types of Shares: A public company can issue only two types of shares :-

(1) Preference shares

(2) Equity Shares

(1) **Preference Share:** Preference share is one which carries thefollowing two preferential rights:-

(a) In respect of payment of dividends.

(b) In return of capital if the company being wound up.

Types of Preference Shares:

(i) **Cumulative Preference Shares:** These are those shares on which arrears of dividend accumulate which could not be paid due to insufficient profits in any year.

(ii) **Non-Cumulative Preference Shares:** These shares do not have the privilege of accumulation of the unpaid or arrears of dividends.

(iii) **Participating Preference Shares:** Shares, which carry the right left after paying preference and equity dividends.

(iv) **Convertible Preference Shares:** Shares, which can be converted

into equity shares after a particular period.

(v) **Non-Convertible Preference Shares:** Shares, which don‟t carry the right of conversion into equity shares.

(vi) **Redeemable Preference Shares:** Shares, the capital of which is refunded by the company after a specified duration.

(vii) **Irredeemable Preference Shares:** The capital of which can not be refunded before winding up of the company.

(viii) **Non-Participating Preference Shares:** Shares which do not carry the right of sharing in the surplus left after paying equity dividend.

(ix) **Cumulative Convertible Preference Shares:** Which are cumulative as well as convertible having both the rights.

(2) **Equity shares:** They are such shares which carry no special rights as regards receipt of dividends and return of capital at the time of liquidation. According to sec. 5(2) of companies Act, 1956, equity shares are those which are not preference shares.

When shares are issued for cash at par:

Following are the journal entries to be passed:

Journal Entries

Date	Particulars	L.F.	Debit `	Credit `
	1. On receipt of application money			
	Bank A/c Dr.		xxx	
	To Equity share application A/c			xxx
	2. On allotment of shares, to transfer share application money			
	Share application A/c Dr.		xxx	
	To Equity share capital A/c			xxx
	3. On refund of application money for rejected applications			
	Equity share application A/c Dr.		xxx	
	To Bank A/c			xxx
	4. For allotment money due			
	Equity share allotment A/c Dr.		xxx	

	To Equity share capital A/c			xxx
	5. On receipt of allotment money Bank A/c Dr. To Equity share allotment A/c		xxx	xxx
	6. On making call for the call money due Equity share call A/c Dr. To Equity share capital A/c		xxx	xxx
	7. On receipt of call money Bank A/c Dr. To Equity share call A/c		xxx	xxx

Problem

Thai Ltd. issued 1,00,000 equity shares of ` 10 each, payable ` 5 on application, ` 2 on allotment,` 2 on first call and ` 1 on final call. All the shares are subscribed and amount was duly received. Pass journal entries.

Solution

Journal Entries of Thai Ltd

Date	Particulars	L.F.	Debit `	Credit `
	Bank A/c Dr. To Equity share application A/c (Application money received)		5,00,000	5,00,000
	Equity share application A/c Dr. To Equity share capital A/c (Transfer of share application money to share capital)		5,00,000	5,00,000
	Equity share allotment A/c Dr. To Equity share capital A/c (Share allotment money due)		2,00,000	2,00,000
	Bank A/c Dr. To Equity share allotment A/c (Allotment money received)		2,00,000	2,00,000
	Equity share first call A/c Dr. To Equity share capital A/c (Share first call money due)		2,00,000	2,00,000

	Bank A/c Dr. To Equity share first call A/c (Share first call money received)		2,00,000	 2,00,000
	Equity share second and final call A/c Dr. To Equity share capital A/c (Share second and final call money due)		1,00,000	 1,00,000
	Bank A/c Dr. To Equity share second and final call A/c (Share second and final call money received)		1,00,000	 1,00,000

Problem

S Ltd invited the public to subscribe 10,000 equity shares of Rs.100 each at a premiumof Rs.10 per share. Payment was to be made as follows- on application Rs.20, on allotment 40(including premium), on first call 30, on final call 20.

Applications totaled for 13000 shares, applications for 2000 shares were rejected and allotment was made proportionately to the remaining applicants. The directors made both the calls and all the moneys were received except the final call on 300 shares which were forfeited. Later 200 of these forfeited shares were issued as fully paid at Rs.85 per share. Journalise thesetransactions.

Solution:

Journal Entries of S Ltd

Particulars	Debit	Credit
Bank a/c Dr. To share application a/c (being application money received)	2,60,000	 2,60,000
Share application a/c Dr To share capital a/c (being application money transferred to capital a/c)	2,00,000	 2,00,000
Share application a/c Dr To bank a/c (being application money refunded)	40,000	 40,000
Share allotment a/c Dr To share capital a/c To share premium a/c Being the allotment due	4,00,000	 3,00,000 1,00,000

Bank a/c Dr Share application a/c Dr To share allotment a/c (being cash received and excess application money adjusted)	3,80,000 20,000	4,00,000
Share first call a/c Dr To share capital a/c (being the first call due)	3,00,000	3,00,000
Bank a/c Dr To share first call a/c Being the call money received	3,00,000	3,00,000
Share final call a/c Dr To share capital a/c (being the final call due)	2,00,000	2,00,000
Bank a/c Dr To share final call a/c Being the call money received except 300 shares	2,00,000	2,00,000
Share capital DR To share final all a/c To share forfeited a/c Being 300 shares forfeited	30,000	6,000 24,000
Bank a/c Dr Share forfeited a/c Dr To share capital a/c Being 200 shares reissued	17,000 3,000	20,000
Share forfeited a/c Dr To capital reserve a/c Being the balance of 200 shares forfeited a/c transferred	13,000	13,000

Redemption of preference shares

Redemption of preference shares means returning the preference share capital to the preference shareholders either at a fixed date or after a certain time period during the life time of the company provided company must complied certain conditions.

The following are the details from the records of B Ltd. on 30.6.2017

Equity Shares Fully paid up	Rs.6,00,000
Preference shares fully paid up	Rs.3,00,000
General reserve	Rs.2,00,000
PL account credit balance	Rs.1,25,000
Share premium a/c	Rs.50,000

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

Particulars	Debit	Credit
General reserve a/c Dr P/L a/c a/cDr To capital redemption reserve a/c (Being the amount transferred to CRR)	2,00,000 1,00,000	3,00,000
Share premium a/c Dr To premium on redemption a/c (Being the premium on redemption appropriated)	30,000	30,000
Preference share capital a/c Dr premium on redemption a/c Dr To redeemable preference share capital a/c (Being the share capital and premium transferred to RPS holder a/c)	3,00,000 30,000	3,30,000
Redeemable preference shareholder a/c Dr To bank a/c (Being the final payment made)	3,30,000	3,30,000

Problem

ABC Ltd has 5000, 8% Redeemable preference shares of 100 each fully paid up. When these shares became due to redemption the company issued new 6% 2500 Redeemable preference shares of each at a premium of Rs. 10 and 25,000 equity shares of Rs.10 each at a premium of Ra.2 each. The new issue was fully subscribed and paid for. Then 8 % Redeemable preference shares were redeemed. Show journal entries.

Particulars	Debit	Credit
Bank a/c Dr To 6% redeemable preference share capital a/c To redeemable preference share premium a/c (being the new 6% redeemable preference shares issued)	2,75,000	2,50,000 25,000
Bank a/c Dr To Equity preference share capital a/c To Equity share premium a/c (being the new equity shares issued)	3,00,000	2,50,000 50,000
8% redeemable preference share capital a/c Dr To 8% redeemable preference share holder a/c (being the RPSC transferred)	5,00,000	5,00,000
8% redeemable preference share capital a/c Dr To bank a/c (being the RPS holders paid)	5,00,000	5,00,000

Problem

A company has as part of its share capital 1000 redeemable preference shares of Rs.100 each fully paid up. When these shares became due for redemption, the company had Rs.60,000 in its reserve fund. The company issued necessary equity shares of Rs.25 specifically for the purpose of redemption and received cash in full. Make the necessary journal entries regarding the above transactions.

Particulars	Debit	Credit
Bank a/c Dr To equity share capital a/c (Being the fresh issue made)	40,000	40,000
Reserve fund a/c Dr To capital redemption reserve a/c (Being the amount transferred to CRR)	60,000	60,000
Redeemable preference share capital a/c Dr To redeemable preference shareholder a/c (being the capital transferred)	1,00,000	1,00,000
Redeemable preference shareholder a/c Dr To bank a/c (being the final payment made)	1,00,000	1,00,000

Unit – II

Debentures & Acquisition of Business

Issue of Debentures

The word ‘debenture’ itself is a derivation of the Latin word ‘debere’ which means to borrow or loan. Debentures are written instruments of debt that companies issue under their common seal. They are similar to a loan certificate. Debentures are issued to the public as a contract of repayment of money borrowed from them. These debentures are for a fixed period and a fixed interest rate that can be payable yearly or half-yearly. Debentures are also offered to the public at large, like equity shares. Debentures are actually the most common way for large companies to borrow money.

Types of Debentures Secured Debentures:

These are debentures that are secured against an asset/assets of the company. This means a charge is created on such an asset in case of default in repayment of such debentures. So in case, the company does not have enough funds to repay such debentures, the said asset will be sold to pay such a loan. The charge may be fixed, i.e. against a specific assets/assets or floating, i.e. against all assets of the firm.

Unsecured Debentures: These are not secured by any charge against the assets of the company, neither fixed nor floating. Normally such kinds of debentures are not issued by companies in India.

Redeemable Debentures:

These debentures are payable at the expiry of their term. Which means at the end of a specified period they are payable, either in the lump sum or in installments over a time period. Such debentures can be redeemable at par, premium or at a discount.

Irredeemable Debentures:

Such debentures are perpetual in nature. There is no fixed date at which they become payable. They are redeemable when the company goes into the liquidation process. They can beredeemable after an unspecified long time interval.

Fully Convertible Debentures:

These debentures can be converted to equity shares at the option of the debenture holder. So if he wishes then after a specified time interval all his shares will be convertedto equity shares and he will become a shareholder.

Partly Convertible Debentures:

Here the holders of such debentures are given the option to partially convert their debentures to shares. If he opts for the conversion, he will be both a creditor and a shareholderof the company.

Non-Convertible Debentures:

As the name suggests such debentures do not have an option to be converted to shares or any kind of equity. These debentures will remain so till their maturity, no conversion will takeplace. These are the most common type of debentures.

Problem

Thamiz Ltd offered 20,000, 10% debentures of Rs. 10 each at a premium of 5% werepayable as under

On application Rs. 3 on
Allotment Rs. 4.50
On first and final call Rs. 3

Public applied for 22,000 debentures. The directors allotted 20,000 debentures and rejected the remaining applications. All moneys due were fully received. Give journal entries.

Solution:

Journal Entries of Thamiz Ltd

Particulars	Debit	Credit
Bank a/c Dr To debentures application a/c (being application money received)	66,000	66,000
Debentures application a/c Dr To debentures a/c (being the application money transferred to capital a/c)	60,000	60,000
Debentures application a/c Dr To bank a/c (being the excess application money returned)	6,000	6,000
Debenture allotment a/c Dr To debenture a/c To debenture premium a/c Being the allotment made	90,000	80,000 10,000
Bank a/c Dr To debenture allotment a/c Being the allotment money received	90,000	90,000
Debenture first and final call a/c Dr To debenture a/c Being the first and final call made	60,000	60,000
Bank a/c Dr To Debenture first and final call a/c (being call money received)	60,000	60,000

Underwriting

Underwriting is the process through which an individual or institution takes on financial risk for a fee. The term underwriter originated from the practice of having each risk-taker write their name under the total amount of risk they were willing to accept for a specified premium.

Liability of each underwriter will be decided by following steps:-

(i) At first, shares or debentures of each underwriters as per agreement is mentioned in each column in a table.

(ii) Marked shares of each underwriter will be deducted out of shares as per agreement.

(iii) Unmarked shares will be deducted in proportion of benefit of unmarked shares given to each under writer or the proportion for which under writing agreement is signed.

(iv) In case of firm under writing, underwriters shares can be treated as marked or unmarked. If nothing is given in this regard, such shares can be treated as marked shares.

(v) If after deducting marked or unmarked shares balance liability of under writer is negative, then this negative balance will be apportioned to other under-writers in the ratio of their liability for which underwriting agreement was signed or any other given ratio.

(vi) After adjustment of negative balance liability of each under writer is known as net liability.

(vii) In underwriters agree to take shares of firm underwriting in addition to under writing shares then in last, shares of firm under writing will be added in net liability. It is known as gross liability ofeach underwriter.

Underwriting

STATEMENT SHOWING LIABILITY OF UNDERWRITERSGROSS LIABILITY BASIS

Particular	No. of shares
Gross liability of each underwriters	xxx
(-) unmarked application in the ratio of gross liability	xxx
Balance left	xxx
(-) marked application	xxx
Net liability of the underwriter	xxx

Following entries will be passed on in the books of company for underwriting :-

(i) For Under Writing Commission :

Underwriting Commission A/c Dr.

To Underwriter‟s A/c

(Underwriting commission due to underwriters.)

(ii) To Issue Balance Shares to Underwriters :

Underwriter‟s A/c Dr.

To Equity Share Capital A/c

(Shares allotted to underwriters under underwriting agreement)

(iii) To Receive Final Payment :

Bank A/c Dr.

To Underwriter‟s A/c

(Final payment received from underwriters)

Note : If there is no liability of underwriter to purchase shares or amount of commission exceeds amount of gross liability, then following entry will be passed.

(iv) To Make Final Payment :

Underwriter‟s A/c Dr.

To Bank A/c

(Final payment made to underwriter.)

(v) **To Write Off Commission Account :**

Reserve/Securities Premium/ P&L A/c Dr.

To underwriting commission A/c

(Commission Account written off)

Accounting Treatment in the Books of Underwriter :Journal Entries :

(1) **For Underwriting Commission :**

X Company A/c Dr.

To Underwriting Commission A/c

(Commission due from X Company)

(2) **For Share Received From Company :**

Shares/Debentures (Investment) in X Company A/c Dr.

To X Company A/c (at issue price only)

(Balance shares received from X Company)

(3) **To Transfer Commission into Share Account :**

Underwriting Commission A/c Dr.

To Shares/Debentures (Investment) A/c

(Commission transferred into shares account)

(4) **To Make Final Payment :**

X Company A/c Dr.

To Bank A/c

(Final payment made to company)

(5) **When Underwriters are not Liable to take Shares and Commission is Received :**

Bank A/c Dr.

To X Company A/c

(Commission received from Company)

Note : If amount payable on shares is less than commission thenalso this entry will be passed for the balance of amount.

(6) **To Close Commission A/c when it is not Transferred to Share A/c:**

P&L A/c Dr.

To Underwriting Commission A/c

(Commission transferred to P&L A/c)

FULL UNDERWRITING

Problem

A company issued 20000 shares of Rs.10 Each at per which were underwritten as followsX – 10000 shares Y – 6000 shares Z – 4000 shares application were received & 18000 shareswhich included marked application as follows X – 4000 shares ,Y – 2000 shares ,Z – 10000 shares Prepare a statement showing how many more shares underwriters will have to take under the underwriting contract.

WORKINGS:

No. of shares issued 20000 Application received 18000
(-) application received 18000(-) marked application 16000
(4000+2000+10000)2000Unmarked application 2000

Statement showing liability of underwriters(Gross liability basis)

Particulars	X	Y	Z	Total
Gross liability	10000	6000	4000	20000
(-) unmarked applications (5:3:2) 10000:6000:4000	1000	600	400	2000
Balance left	9000	5400	3600	18000
(-) marked applications	4000	2000	10000	16000
	5000	3400	(-)6400	-
(-) excess of Z shares (5:3)	4000	2400	6400	-
Net liability of underwriters	1000	1000	-	2000

Firm under writing:

Problem

Vijay ltd issued 20,000 shares which were underwritten as follows: X -12000 Shares Y-5000 shares and Z – 3000 shares. The underwriters made applications for him underwriting as X -1600 SharesY-600 shares and Z – 2000 shares. The total subscriptions excluding firm underwriting but including marked applications were for 10000 shares. The marked applications were as X -2000 SharesY-4000 shares and Z – 1000 shares. You are required to show the allocation of liability of the underwriters.

Statement showing liability of underwritersGross liability basis

Particulars	X	Y	Z	Total
Gross liability	12,000	5,000	3,000	20,000
Less unmarked application 12:5:3	1,800	750	450	3,000
Balance	10,200	4,250	2,550	17,000
Less marked + firm under writing	3,600	4,600	3,000	11,200
	6,600	- 350	- 450	-
Less Excess of y and z to	800	350	450	-
XNET LIABLITY	5,800	-	-	5,800
ADD Firm underwriting	1,600	600	2,000	4,200
Total liablity	**7,400**	**600**	**2,000**	**10,000**

Net liability
No. of application issued 20000
Less application received 14200

Net liability 5800
Firm 4200

Total liability 10000
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total application received 14200
less marked and firm 11200
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unmarked application 3000

Problem

A company made a public issue of 125000 shares . The entire issue was undertaken by four parties A 30 % , B 25 % , C 25% AND D 20% respectively. A,B,C,D has agreed on firm underwriting of 4000, 6000, nil, 15000 respectively. The total subscriptions excluding firm underwriting including marked application were for 90000 shares .marked applications receivedwere as underA- 24000 , B-20000 C- 12000 D- 24000. Ascertain the liability of the individual underwriters.

Net liability
1,25,000 No. of application issued
Less application received 1,15,000
(90+25) -------
Net liability 10,000
Firm 25,000

Total liability 35,000
----

total application received
1,25,000
less marked and firm 1,15,000
----
unmarked application 10,000

Statement showing liability of underwriter's Gross liability basis

particulars	A	B	C	D	Total
Gross liability	37,500	31,250	31,250	25,000	1,25,000
Less unmarked application 30:25:25:20	3,000	2,500	2,500	2,000	10,000
	34,500	28,750	28,750	23,000	1,15,000
Less marked application, firm underwriting	28,000	26,000	12,000	39,000	1,05,000
	6,500	2,750	16,750	-16,000	-
Less excess D share 30:25:25	6,000	5,000	5,000	16,000	-
	500	-2,250	11,750	-	-
Less B share 30:25	500	2,250	1,750	-	-
Net liability	-	-	10,000	-	10,000
Add firm underwriting	4000	6,000	-	15,000	25,000

Total liability	4000	6,000	10,000	15,000	35,000

Problem

K ltd has issued 25000 shares. A 15,000 shares (firm underwriting 2500 shares) B 7500 shares (firm underwriting 1000 shares) c 2500 shares (firm underwriting 500 shares). Out ofthe total issue 22,500 shares including firm underwriting were subscribed an 8000 shares B 5000 shares c 2000 shares. Calculate the liability of each underwriter.

Solution

Statement showing liability of underwritersGross liability basis

Particulars	A	B	C	Total
Gross liability	15,000	7,500	2,500	25,000
Less unmarked application 12:5:3	2,100	1,050	350	3,500
Balance	12,900	6,450	2,150	21,500
Less marked + firm under writing	10,500	6,000	2,500	11,900
	2,400	450	- 350	-
Less Excess of y and z to	233	117	350	-
XNET LIABLITY	2,333	167	-	2,500
ADD Firm underwriting	2,500	1,000	500	4,000
Total liablity	**4,667**	**1,333**	**500**	**6,500**

Net liability **total application received**
22500

No. of application issued 25000 **less marked and firm 19000**
Less application received 22500 **-----------**

------- **Unmarked application 3500**
Net liability 2500 **----------**
Firm 4000

Total liability 6,500

Profit prior to incorporation

Profit prior to incorporation is that profit which a company gets between the period of date of buying and date of incorporation. Suppose, A company buys XYZ Company on1st Jan.2010 and it has to incorporate at1st April2010. Then profit between1st Jan.2010 and1st April2010 will be profit prior to incorporation. This profit cannot be used for paying dividend to shareholders. Because current shareholder's capital is not involved for this profit, so this will be capitalized profit and it will be transferred to capital reserve account. If company gets loss prior to incorporation, it will be transferred to goodwill account.

s.no.	Nature of items	Basis of allocation	Examples
a.	Profit / loss	Sales ratio	Gross profit, gross loss
b.	Fixed expenses(incurred on the basis of time)	Time ratio or weighted time ratio	Printing stationery, rent, rates, salary, interest, insurance, depreciation, establishment, bank charges, postage, audit fees *
c.	Variable expenses (connected with sales)	Sales ratio or weighted sales ratio	Discount allowed, bad debts, commission, remuneration to sales man, advertisement, carriage outward
d.	Variable expenses(connected with purchase)	Purchase ratio	Carriage inward
e.	Expenses of company (solely incurred by the company on and after its incorporation)	Wholly to the post incorporation period.	Preliminary expenses, director's fees, debenture interest, directors salary, discount on debentures, good will return off donations given by the company audit fees
f.	Expenses of firm	Wholly to the pre incorporation period.	Partner's salary, drawings.

Steps to Ascertain Profit Prior To and Post Incorporation:

(i) At first, Trading Account will be prepared to ascertain gross profit for the period. Trading account is prepared for whole of the year, the word „for the period ending‟ will be used instead of „for the year ending. So, Trading Account may be prepared for a period less than of more than 12 months.

(ii) Time ratio will be determined between profit prior to incorporation and post incorporation. All expenses shown in P&L account relatedto time such as rent, salary, insurance premium, depreciation etc. will be apportioned on the basis of time ratio.

(iii) Sales ratio will be determined on the basis of sales prior to incorporation and post incorporation. Gross profit for the period will be apportioned on this basis. All expenses related to sales such as advertisement expenses, commission, expenses on agents, bad debts, packing expenses etc. will be apportioned on this basis.

(iv) Some expenses are of different nature which can neither be apportioned on time basis nor it can be apportioned on sale basis. Such expenses can be apportioned as follows:

a) Some expenses are related to post incorporation period only e.g. vendor is an individual or firm then salary to owner, interest on capital, drawing etc. are purely expenses of prior period and no part of it will be apportioned to post incorporation period.

b) Some expenses are related to post incorporation period only e.g., purchases is company and vendor is not a company then interest on debentures, directors fee, share transfer fee (income) and amortization of preliminary expenses relates to post incorporation. No part of it can be charged against profit prior to incorporation.

Note: In case vendor and purchaser both are company Ltd. Then it cannot be said that expenses relates to post incorporation period only. So, in that case such expenses related to company form should be apportioned on time basis.

Profit Prior to Incorporation.

1. Weighted Sales Ratio

Incorporation date is 1.4.2007 accounting period 1.1.2007 to 31.12.2007 the sales of the firm was doubled in the after incorporation period. Find Weighted Sales Ratio?

1.1.2007 1.4.2007 31.12.2007

3:9

3:18 = 1:6

Weighted sales ratio =1:6

Problem

A Company was incorporated on 1.5.1994 to take over a business from 1.1.1994. The accounts were made up to 31.12.1994. As usual and the trading profit and loss account the following result.

Particulars	RS	Particulars	RS
To opening stock	1,40,000	By sales	12,00,000
To purchase To gross profit	9,10,000 3,00,000	By closing stock	1,50,000
	13,50,000		13,50,000

To Rent&Taxes To Director fees To Salaries To Office expenses To Travelling commissionTO Discount TO Baddebts To Audit fees To Depreciation To Debenture Interest To Net profit	18,000 20,000 51,000 48,000 12,000 15,000 3,000 8,500 6,000 4,500 1,14,00	By Gross Profit	3,00,000
	3,00,000		3,00,000

It is ascertained sales for November and December are one and half time of theaverage of those for the year. While those for February and April are only half the average and all remaining month having average sales.

Find the profit and pre and post incorporation period.

Solution

1. 1.1.1994 TO 1.5.1994 : 1.5.1994 to 31.12.1994

4 : 8

Average sales = 12,00,000 /12 =1,00,

January -1,00,000
February – 50,000
March – 1,00,000
April – 50,000
May – 1,00,000
June – 1,00,000
July – 1,00,000
August – 1,00,000
September – 1,00,00
October – 1,00,000
November – 1,50,000
December – 1,50,000

Pre incorporation sales : post 3,00,000 : 9,00,000

3 : 9

particulars		Pre in corporation	Post incorporation	particulars	Basis	Pre incorporation	Post incorporation
To salaries	T	17000	34000	By	Sales	75,000	2,25,000
To debenture		-	4500	gross			
interest	T	2000	4000	profit			
To Depreciation		6000	12000				
To rent	T	-	20000				
To directors fees		16000	32000				
To office	T	3000	9000				
expenses							
Travellers	S	3750	11250				
commission		750	2250				
To discount	S	2833	5667				
To bad debts							
To audit fees	S						
TO		23667					
CAPITAL	T		90333				
RESERVE							
TO NET PROFIT							
		75,000	2,25,000			75,000	2,25,000

Unit – III

Final Accounts

Final Accounts of a Company

To show the profit earned during the year and financial position of company at a particular date. It is compulsory for a company to prepare Profit and loss account and Balance Sheet – called at the end of the year as per section 209 of the Indian Companies Act, 1956. Such accounts are called final account of a company

Managerial Remuneration

The remuneration given to managerial persons including director, managing director, manager for their services is called managerial remuneration

Provisions of Companies Act, 1956 regarding Managerial Remuneration.

The remuneration to directors is governed by the section 198 and 309 of the companies Act. The amount of remuneration is to be determined by the articles or by a resolution passed by the company in the general meeting of shareholder or by a special resolution if the articles so required.

A whole time or managing director or manager may be paid remuneration by way of monthly pay and /or by way of specified percentage of net profits of the company.

Authorised capital of G Ltd is Rs. 5,00,000. 50,000 equity shares of Rs.10 each on 31.12.201225,000 shares were fully called up.

Managerial Remuneration - Maximum Limits :

For Companies Having Profit : Rate %

i)	Overall (excluding fees for attending meeting)	11% of Net profit in all
(ii)	If there is one whole time/ Managing director/ manager	5% of Net profit
(iii)	If there are two or more whole time directors including managing director	10% of Net profit in all
(iv)	Remuneration to part time directors: (a) If there is no managing or whole time director in the company (b) If there is a managing or whole time director	3% of net profit in all 1% of

For Companies Having No Profit or Inadequate Profit :

In case the company has no profits or its profits are inadequate it may pay remuneration to managerial person as per the following option given in schedule XII of companies Act, 1956, based on effective capital of the company:

Where the Effective Capital of Company is	I Option Monthly Remuneration Shall Not Exceed (Rs.)	II Option Monthly Remuneration Shall Not Exceed (Rs.)
(i) > Rs. 1 Crore	75,000	1,50,000

(ii) 1 Crore ≤ Amount ≤ 5 Crore	1,00,000	2,00,000
(iii) Rs. 5 Crore ≤ Amount<Rs. 25 crores	1,25,000	2,50,000
(iv) Rs. 25 crores ≤ Amount <Rs. 50 crores	1,50,000	3,00,000
(v) Rs. 50 crores ≤ Amount <Rs. 100 crores	1,75,000	3,50,000
(vi) Rs. 100 crores ≤Amount	2,00,000	4,00,000

Guidelines for Issue of Bonus Shares : The securities and Exchange Board of India (SEBI) by an order on 27th January, 2000 issued the following guidelines for issue of bonus shares:-

(i) No Company shall, pending conversion of FCDs/PCDs issue any by way of bonus unless similar benefit is extended to the holders of such FCDs through reservation of shares in proportion to suchconvertible part of FCDs or PCDs.

(ii) The shares so reserved may be issued at the time of conversion of debentures on the same terms on which the bonus issues were made.

(iii) The bonus issue is made out of free reserves.

(iv) Revaluation Profits cannot be used to provide bonus shares.

(v) The bonus shares can not be issued, in lieu of dividend.

(vi) The existing shares capital must be fully paid up at the time of bonus issue.

(vii) No bonus can be take up till the full payment of arrears of interest outstanding, repayment of installment on debentures and or on fixed deposits.

(viii) No bonus can be made if the company has defaulted in respect of the statutory payment to employees.

(ix) After declaration of bonus the shares must be issued within 6 months.

(x) Bonus can be issued only if it is provided in Articles of Association.

(xi) If the authorized share capital is increased because of bonus shares, a resolution must be passed in the meeting of shareholders regarding increase in authorized capital.

Problem

Particulars	Rs.
Opening capital	50,000
Sales Purchases	4,25,000
Wages	3,00,000
Discount allowed	70,000
Discount received	4,200
Insurance paid up to 31.3.2013	3,150
Salaries	6,720
Rent	18,500
General expenses	6,000
Printing and stationery	8,950
Advertising	2,400
Bonus	3,800
Sundry debtors	10,500
Sundry creditors	38,700
Plant and machinery	35,200
Furniture	80,500
Cash and bank	17,100
Reserve	1,34,700
Loan from	25,000
M.DBad debts	15,700
Calls in arrears	3,200
P /l a/c credit balance	5,000
	6,220

Additional information:

Closing stock Rs. 91,500
Depreciation on plant and machinery furniture at 10% and 15% respectively
Wages salaries and rent outstanding amounts to Rs.5,200 Rs.1,200 and Rs. 600 respectively.Dividend at 5% on paid up share capital is to be provided
Prepare final account of the company

Solution

1. revenue from operation - sales 4,25,000
2. other income – discount received 3,150
3. cost of goods sold
   Opening stock +purchase-closing stock 50,000+3,00,000-91,500=2,58,500
4. Employee benefits
   Wages+outstanding 70,000+5,200=75,200
   Salary+outstanding 18,500+1,200=19,700
   Bonus 10500
   Total 1,05,400
5. Finance cost ----

6. Depreciation and amortization
   expensesMachinery 80,500x10%
   8050
   Furniture 17,100x15% 2565
   Total 10615

7. Other expenses
   Discount 4200
   Insurance-prepaid6720-1680 5040
   Rent +outstanding 6000+600 6600
   General expenses 8950
   Printing and stationery 2400
   Advertising 3800
   Bad debts 3200
   Total 34190

Statement of profit and loss for the year ended 31.3.2012

Particulars	Note no.	Rs
Income		
Revenue From Operation	1	42500
Other Income	2	3150
Total Revenue A		428150
Expenses		
cost of goods sold	3	258500
Employee benefits	4	105400
finance cost	5	--
depreciation and amortization expenses	6	10615
other expenses	7	34910
total expenses B		408705
Profit For The Period		19445
- Tax Expenses		--
Profit		**19445**

1. Share holders'
   funds Called up
   capital
   250000
   Arrears 5000
   Paid up capital 245000
2. Reserve and
   surplus Reserve 25000
   P/L a/c 6220
   Current year profit 19445
   50665
   Less appropriation proposed dividend 245000x5% 12250
   Dividend tax 17% on 12250 2083----------15333
   Total 36332

II non-current liabilities
3. Long term borrowings- loan to M.D 15700
III current liabilities

4. Trade payable – creditors 35200
5. Other current liabilities
Dividend tax payable
2083 Wags o/s 5200
Salaries o/s 1200
Rent o/s 600------------- 9083
6. Short Term Provisions- Proposed Dividend 12250
Assets
I noncurrent assets
7. Tangible assets
Machinery-depreciation 80500-8050 72450
Furniture-depreciation 17100-2565 14535--------- 86985
II current assets
8. Inventories 91500
9. Trade receivables-debtors 38700
10. Cash and cash equivalents 134700
11. Other current assets- prepaid insurance 1680

Balance sheet of Gltd

Particulars	Note no.	Rs
Equity and liabilities		
1.shareholders' funds		
Share capital	1	24500
Reserves and surplus	2	36332
II noncurrent liabilities		
long term borrowings	3	15700
III current liabilities		
trade payable	4	35200
other current liabilities	5	9083
Short Term Provisions	6	12250
Total		353565
Assets		86985
I.Non current assets	7	
Fixed assets		
Tangible assets		
II current assets		
inventories trade	8	91500
receivables	9	38700
cash and cash equivalents	10	134700
other current assets	11	1680
TOTAL		353565

Problem

The following Trail Balance of Nallis Ltd. As at 30th Dec 1998 is given to you

Debits	Rs	Credits	Rs
Stock(1.1.1998)	80,000	80,000 equity shares of Rs. 100 each, Rs. 75 paid	6,00,000
Bank	17,600	6% Debenture	2,00,000
Patents	60,000	Sundry creditors	1,00,000
Cash – in – hand	20,000	General reserve	80,000
Returns inwards	30,000	Sales	10,00,000
Purchase	7,72,000	Returns outwards	20,000
Wages	1,08,000	P & L A/c (cr)	12,000
Insurance prepaid	400		
Bills receivable	30,000		
Sundry debtors	80,000		
Discount on issue of debentures	10,000		
Plant & Machinery	4,00,000		
Land & Buildings	3,00,000		
Insurance	4,000		
General expenses	40,000		
Establishment expenses	60,000		
	20,12,000		20,12,000

Additional information:

a) The value of stock on 31st Dec 1998 was Rs. 74,000
b) Outstanding wages totaled Rs. 10,000
c) A provision 5% is to be created on sundry debtors for doubtful debts
d) Depreciate patents @ 10% and Plant & Machinery @ 7 ½ % and land & Buildings @ 4%

You are require to prepare statement of profit & Loss for the year ended 31.12.1998 and Balance sheet as on that date.

Solution

Statement of Profit and Loss A/c of Nallis Ltd. for the year ended 31.12.1998

Particulars	Rs	rs
1. Revenue from operation		
Sales	10,00,000	
Less: returns inwards	30,000	9,70,000
2. Cost of goods sold		
Opening stock		80,000
Purchase	7,72,000	
Less: returns outwards	20,000	
	7,52,000	
Less: closing stock	74,000	6,78,000
		7,58,000
3. Employees benefits		
Wages	1,08,000	
Add: outstanding wages	10,000	1,18,000

4. Depreciation		
Patents (60,000 X 10%)	6,000	
Plant and machinery (4,00,000 X 7.5%)	30,000	
Land & buildings (3,00,000 X 4%)	12,000	
		48,000
5. Other expenses		
Insurance	4,000	
Other expenses	40,000	
Establishment expenses	60,000	
Provision for bad and doubtful debts (80,000 X 5%)	4,000	
		1,08,000

Statement of profit and loss A/c

Particulars	Note no	Rs
I. Revenue from operations	**1**	9,70,000
II. Other incomes		Nil
Total Revenue (A)		9,70,000
III. Expenses	**2**	
Cost of goods sold	**3**	7,58,000
Employees benefits	**4**	1,18,000
Finance cost	**5**	Nil
Depreciation	**6**	48,000
Other expenses		1,08,000
Total Expenses (B)		**10,32,000**
Loss (A – B)		**62,000**

Particulars	Rs	Rs
Liabilities:-		
1. Share capital		
Share capital	**6,00,000**	
Less: calls – in – arrears	**20,000**	
		5,80,000
2. Reserve & surplus		
General reserve		**80,000**
Profit & loss A/c	**12,000**	
Less: current loss	**62,000**	**(50,000)**
		30,000
3. Long term borrowings		
6% Debentures		**2,00,000**
4. Trade payable		
Sundry creditors		**1,00,000**
5. Other liabilities		
Outstanding wages		**10,000**
Assets:-		

1. Tangible assets		
Plant and machinery	4,00,000	
Less: Depreciation @7.5%	30,000	3,70,000
Land and buildings	3,00,000	
	12,000	2,88,000

Less: Depreciation @ 4%		6,58,000
2. Intangible assets	60,000	
Patents	6,000	
Less: Depreciation @10%		54,000
3. Trade receivable		30,000
Bills receivable		
4. Current assets		17,600
Bank		400
Prepaid insurance	80,000	
Sundry debtors	4,000	76,000
Less: provision for bad and doubtful debt		74,000
Closing stock		1,68,000
5. Other assets		10,000
Discount on issue of shares		

Balance sheet as on 31.12.1994

Particulars	Note no	Rs
Liabilities:		
Share capital	1	5,80,000
Reserve and surplus	2	30,000
Long term borrowings	3	2,00,000
Trade payable	4	1,00,000
Short term provisions	5	Nil
Other liabilities	6	10,000
Total Liabilities		9,20,000
Assets:		
Tangible assets	1	6,58,000
Intangible assets	2	54,000
Trade receivable	3	30,000
Current assets	4	1,68,000
Other assets	5	10,000
		9,20,000

UNIT – IV
Valuation of Shares and Goodwill

Meaning of Goodwill:-

- Goodwill is simple words, means the 'Good Name' or the 'reputation' of the business which attracts more customers.
- It helps in earning more profits in future.
- It is an intangible asset.

Definition of Goodwill:-

1. According to ***DICKSEE*** define has 'when a man pays for goodwill, he pays for something which places him in the position of being able to earn more money than he would be able to do by his own unaided efforts'.
2. According to ***J. O. MAGEE*** define has 'the capacity of a business to earn profits in future is basically what is meant by the term goodwill'.

Mr. P.D. Leake has classified goodwill as under

- Dog – Goodwill,
  Dogs are attached to the persons and hence, such customers lead to personal goodwill which is not transferable.
- Cat – Goodwill,
  Since cats prefer to live in the old home, similarly such customers give rise to locality goodwill.
- Rat – Goodwill,
  The other variety of customer has attachment neither to the person nor to the place which in other words is known as fugitive goodwill.

Source of Goodwill

a) The location of the business premises *e.g.* a retail shop located in a busy market Centre.
b) The reputation of the articles sold arising from the high standard or quality of the goods.
c) The personality and reputation of the owner or management, arising through his/its skill and influence.
d) Possession of Trade Marks, patents or copyrights.
e) Possession of advantageous contracts or complete or partial monopoly.
f) Development of the business and shopping facilities with the changing conditions of the market.

Need for valuing Goodwill

i. When a new partner is admitted.
ii. When a partner retires or dies.
iii. When there is a change in the profit sharing ratio.
iv. When the business of a company is taken over by another company *e.g.* in case of amalgamation or absorption.
v. When a person wants to purchase a large block of the company's shares with a view to control over the management of the company.
vi. When the business of the company is being taken over by the government.

Factors affecting value of Goodwill

- Profitability
- Normal rate of return
- Capital employed

Methods of valuation of Goodwill

1. Average profit method
2. Normal rate of return method
3. Capitalization method.

I. Calculation of average or adjusted profit

Particulars	Rs	Rs
1990		xxx
1991		xxx
1992		xxx
1993		xxx
Total profit		**XXXX**
$Average\ profit = \frac{Total\ profit}{Total\ years\ of\ profit}$		XXX
Less: Non – recurring income		xxx
		XXXX
Less: income on investment		xxx
		XXXX
Less: manager remuneration		xxx
		XXXX
Less: Income Tax @.....		xxx
Adjusted average profit		XXXX

II. **Calculation of normal profit:**

$$\text{normal profit} = \text{Capital employed } \times \text{Nornal rate of return}$$

III. **Calculation of super profit:**

$$\text{super profit} = Average\ or\ Adjected\ profit - Normal\ Profit$$

IV. **Calculation of value of Goodwill**

$$Goodwill = Super\ Profit\ \times No.of.years\ of\ purchase$$

Problem

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

1994 – Rs. 2,400
1995 – Rs. 3,000
1996 – Rs. 3,400
1997 – Rs. 3,200
1998 – Rs. 4,000

Calculate the amount of goodwill

Solution:

Calculate average profit

Particular	Rs
1994	2,400
1995	3,000
1996	3,400
1997	3,200
1998	4,000
Total profit	16,000

Average profit = $\frac{total\ profit}{No.of\ years\ of\ profit}$

= 16,000/5

= 3,200/-

Calculation of goodwill

Goodwill = average profit x No. of years of purchase

= 3,200 X 3 years

= 9,600/-

Problem

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

1995 – Rs. 10,000
1996 – Rs. 16,000
1997 – Rs. 6,000 (loss)
1998 – Rs. 12,000

Solution:

Calculation of average profit

Particular	Rs
1995	10,000
1996	16,000
1998	12,000
	38,000
Loss: 1997	6,000
Total profit	32,000

1. Calculation of average profit
   = Total profit/ No. of. Years of profit
   = 32,000/4
   = 8,000/-

2. Calculation of Goodwill
   = average profit X No. of. Years of purchase
   = 8,000 X 3 years
   = 24,000/-

Problem

From the following data relating to Padma & co calculate the goodwill on the basis of three years purchase of the average profit.

a) Profits for the years ending 2000, 2001, and 2002 were Rs. 80,000, Rs. 90,000 and Rs. 1,00,000
b) A non – recurring income of Rs. 15,000 is included in the profits of 2000
c) The closing stock for the year 2001 was overvalued by Rs. 30,000.

Solution:

Calculation of average profit

Particulars	Rs	Rs
2000	80,000	
Less: non – recurring income	15,000	
		65,000
2001		90,000
2002		1,00,000
Total profits		2,55,000

I. Calculation of average profit:

= Total profit /total years of profit
= 2,55,000/3 years profit
= 85,000/-

II. Calculation of goodwill

= average profit X no. of. Years of purchase
= 85,000 X 3 years
= 2,55,000/-

Problem

Calculate goodwill, if it is to be calculated at 3 years purchase of the super profit: the firm started business with a capital of Rs. 4,00,000. The normal rate of earning in this class of business is 15%. The firm earned Rs. 74,000 as profits during the year.

Solution:

I. Calculation of normal profit

= capital employed X normal rate return
= 4,00,000 X 15/100
= 60,000/-

II. Calculation of super profit

= Average profit – Normal profit
= 74,000 – 60,000
= 14,000/-

III. Calculation of goodwill

= super profit X No. of. Years of purchase
= 14,000 X 3 years of purchase
= 42,000/-

I. Average profit method

Problem

Madhan& Co. Decided to purchase a business for Rs. 2,40,000. Its profits for the last four years were 1995 Rs. 60,000, 1996 Rs. 75,000, 1997 Rs. 72,000 and 1998 Rs. 69,000. The owner of the business was personally managing it. A manager to replace him has to be paid 9,000 p.a

Calculate the value of goodwill if it is valued on the basis of three year's purchase of the average net profit for the last four years.

Solution:

Calculation of total profit

Particulars	Rs
1995	60,000
1996	75,000
1997	72,000
1998	69,000
Total profits	2,76,000

I. Calculation of average profit

= total profit / total years of profits

=2,76,000 / 4 years

= 69,000/-

Calculation of adjusted profit

Particulars	Rs
Average profit	69,000
Less: manager salary	9,000
Adjusted profit	60,000

II. Calculation of goodwill

= Adjusted profit X No. of. Years of purchase

=60,000 X 3 years

= 1,80,000/-

Problem

The following particulars are available in respect of the business carried on by BalThakrey Ltd.

a) Profit earned: 1996 – R. 50,000, 1997 – Rs. 48,000, and 1998 – 52,000.

b) Profit of 1997 is reduced by Rs. 5,000 due to stock destroyed by firm and profit of the 1996 included a non – recurring income of Rs. 3,000.

c) Profits of 1998 include Rs. 2,000 income on investment.

d) The stock is not insured and it is thought prudent to insured the stock in future. The insurance premium is estimated at Rs. 500 p.a

e) Fair remuneration to the proprietor (not taken in the calculation of profits) is Rs. 10,000 p.a

You are required to calculate the value of goodwill on the basis of 2 years purchase of average profits of the last three years.

Solution:

Calculation of total profit

Particulars	Rs	Rs
1996 Less: non – recurring income	50,000 3,000	47,000
1997 Add: stock destroyed	48,000 5,000	53,000
1998 Less: income on investment	52,000 2,000	50,000
Total profits		1,50,000

I. Calculation of average profit

= total profits / total no. of. Years of profit

= 1,50,000 / 3 years of profit

= 50,000/-

Calculation of adjusted profit

Particulars	**Rs**
Average profit Less: Remuneration	**50,000** **10,000**
Less: insurance premium	**40,000** **500**
Adjusted profit	**39,500**

II. Calculation of goodwill

= Adjusted profit X No.of. Years of purchase

= 39,500 X 2 years of purchase

= 79,000/-

Problem No 3/8.87

A purchased the business of "B" on 1.1.98. The profits of the business were Rs. 80,000, Rs. 86,000 and Rs. 84,000 respectively for the years 1995, 1996 and 1997. It was ascertained that, during 1996, there was a non – recurring income of Rs. 3,000. In 1997, there was loss due to fire of Rs. 2,000, the risk being not insured. It is decided to insure against risk of fire in future at an annual premium of Rs. 500. "A" was employed at a salary of Rs. 1,000 per month before purchasing the business. He will replace the manager of the present businesswho is getting Rs. 750 per month. The goodwill is agreed to be 2 years purchase of the average profit of the last 3 years. You are required to value of goodwill of the business.

Solution

Calculation of total profit

Particulars	Rs	Rs
1995		80,000
1996 Less: non – recurring income	86,000 3,000	83,000
1997 Add: Loss on fire	84,000 2,000	86,000
Total profits		2,49,000

I. Calculation of average profit

= total profits / total no.of years of profits
= 2,49,000 / 3 years of profit
= **83,000/-**

Calculation of adjusted profit

Particulars	Rs
Average profit	83,000
Less: Remuneration (1,000 X 12)	12,000
	71,000
Less: present manager salary (750 X 12)	9,000
	62,000
Less: annual premium	500
Adjusted profit	61,500

II. Calculation of goodwill

= adjusted profit X No. of years of purchase
= 61,500 X 2 years of purchase
= **1,23,000/-**

I. Super profits method

a) Years of purchase of super profit method

Problem

Mr. Viswanath has invited Rs. 4,00,000 in a business. Hte is net profit before tax at 50% is Rs. 1,60,000, out of which Rs. 12,000 annual rent of own building used as business premises and Rs. 24,000 p.a. as his salary were not deducted. For starting this business, he left a job fetching him a monthly salary of Rs. 2,000. Before starting this business, he had invested this amount on 10% securities. Fair compensation for the risk involved is 2%. Calculate the value of goodwill on the basis of three years purchase of the average annual super profits.

Solution:

I. Calculation of adjusted profit

Particulars	Rs
Average profit	1,60,000
Less: Tax rate @ 50% (1,60,000 X 50%)	80,000
Less: Annual rent	80,000
Adjusted profit	12,000
	68,000

I. Calculation of normal profit

= Capital employed X Normal rate of return
= 4,00,000 X 12% (10% + 2%)
= **48,000/-**

II. Calculation of super profit

= Adjusted profit – Normal profit
= 68,000 – 48,000
= 20,000/-

III. Calculation of goodwill

= Super profit X No. of. Years of purchase
= 20,000 X 3 years of purchase
= 60,000/-

Valuation of Shares

The Shares of a Company are to be valued at different occasions. Theseare :-

(i) When shares of one class are to be converted into shares of anotherclass.

(ii) When shares want to take loan against the shares.

(iii) When shares are to be bought and sold.

(iv) When companies are amalgamated and a new company is formed. The new company is to exchange the shares with the shareholder of old companies on the basis of value of shares.

(v) When one or more existing companies are purchased by another existing company.

(vi) Acquisition of interest of dissenting shareholders under a scheme of reconstruction.

(vii) When government wants to compensate the shareholders on the nationalization of a company.

(viii) When shares of a company is not quoted in stock exchange and holder is interested to value them or wants to dispose them.

Problem

From the following information, find out the value of each share:-

Liabilities	Rs	Assets	Rs
Share capital; 20,000 equity shares of Rs. 10 each	2,00,000	Goodwill	1,90,000
		Investment	3,00,000
		Current assets	50,000
Reserve & surplus	2,50,000	Loans & Advances	30,000
Profit & loss A/c	30,000	Miscellaneous expenses	10,000
Unsecured loans	80,000		
Current liabilities	20,000		
	5,80,000		5,80,000

For the purpose of valuation of shares goodwill shall be taken at two years purchase of the average profit of the last five years. The profits for the last five years are Rs. 60,000, Rs. 70,000, Rs. 40,000, Rs. 50,000 and Rs. 50,000.

Solution:

Calculation of average profit

Particulars	Rs
1st year	60,000
2nd year	70,000
3rd year	40,000
4th year	50,000
5th year	50,000
Total profits	2,70,000

1. **Calculation of average profit**

   = total profits / no. of. Years of profit
   = 2,70,000 / 5 years
   = 54,000/-

2. **Calculation of goodwill**

   = average profit X no. of. Years of purchase
   = 54,000 X 2 years of purchase
   =1,08,000/-

Assets		
Goodwill	1,08,000	
Investment	3,00,000	
Current assets	50,000	
Loans & advances	30,000	4,88,000
Less: Liabilities		
Unsecured loans	80,000	
Current liabilities	20,000	1,00,000
Net assets avaliable for equity shareholders		3,88,000

$$\textit{Value per share} = \frac{\textit{Net assets avaliable for equity shareholders}}{\textit{Number of equity shares}}$$

$$\frac{3{,}88{,}000}{20{,}000}$$

Value per share = Rs. 19.40

Yield Method / Earning Capacity method

1. Expected rate of return

$$= \frac{\textit{Profit available for equity dividend}}{\textit{Paidup equity capital}} \times 100$$

2. Yield value per share

$$= \frac{\textit{Expected rate of return}}{\textit{Normal rate of return}} \times \textit{Paidup value per equity shares}$$

3. Yield value per equity shares

$$\textit{Value per share} \times \textit{Equity share holding}$$

Problem

Mr. Share wallah holds 12,000 equity shares in Bharath Ltd. The nominal and paid up capital of which consists of:-

a) 40,000 equity shares of Rs. 1 each
b) 10,000 preference shares of Rs. 1 each, rate of dividend 8%
c) Preference shares do not further participate in profits
d) Usual transfer to Reserve 10% of the profits.

It is ascertained that:-

1) Normal annual profit is Rs. 12,000
2) Normal rate of return 15%

Mr. Share wallah requests you to value his holding based up on the above figures.

Solution:

Calculation of profit available for equity share dividend

Particulars	Rs
Profit	12,000
Less: transfer to reserve @ 10% (12,000 X 10%)	1,200
Profit available for equity share dividend	
	10,800

1. Expected rate of return

$$= \frac{Profit\ available\ for\ equity\ dividend}{Paidup\ equity\ capital} \times 100$$

$$= \frac{10,800}{40,000} \times 100$$

= 27%

2. Yield value per share

$$= \frac{Expected\ rate\ of\ return}{Normal\ rate\ of\ return} \times Paidup\ value\ per\ equity\ shares$$

$$= \frac{0.27\ or\ 27\%}{0.15\ or\ 15\%} \times 1$$

= 1.8 per share

3. Yield value per equity share

$$Value\ per\ share \times Equity\ share\ holding$$

= 1.8 × 12,000

= 21,600/-

Problem

From the following information calculate the value of an equity share:-

a) The subscribed share capital of a company consists of 10,000, 14% preference shares of Rs. 100 each and 2,00,000 equity shares of Rs. 10 each. All the shares are fully paid up.
b) The average annual profits of the company after providing before taxation are Rs. 25,00,000. It is considered necessary to transfer Rs. 1,25,000 to general reserve before declaring any dividend. Rate of taxation is 50%.

c) The normal return expected by investors on equity shares from the type of business carried no by the company is 20%.

Solution:

Calculate the value of equity shares

Particulars	Rs
Annual profit of before tax	25,00,000
Less: rate of tax @ 50% (25,00,000 X 25%)	12,50,000
After tax	12,50,000
Less: transfer to general reserve	1,25,000
	11,25,000
Less: preference shares (10,000 X 100 X 14%)	1,40,000
Profit available for equity dividend	9,85,000

1. Expected rate of return

$$= \frac{Profit\ available\ for\ equity\ dividend}{Paidup\ equity\ capital} \times 100$$

$$= \frac{9,85,000}{20,00,000} \times 100$$

= 49.25%

2. Yield value per share

$$= \frac{Expected\ rate\ of\ return}{Normal\ rate\ of\ return} \times Paidup\ value\ per\ equity\ shares$$

$$= \frac{0.4925\ or\ 49.25\%}{0.20\ or\ 20\%} \times 10$$

= 24.625 per share

3. Yield value per equity share

$$Value\ per\ share \times Equity\ share\ holding$$

= 24.625 ×2,00,000

= 49,25,000/-

Unit V

Alteration of Share Capital

Meaning

It is an arrangement made by the companies whereby the claims of shareholders, debenture holders, creditors and other liabilities are altered/ reduced, so that the accumulated loss are written off, asset are valued at its fair value and the balance sheet shows the true and fair view of the financial statement

Methods of Alteration in Share Capital:

A company Limited by shares can alter its share capital under sec. 94 of companies Act 1956, if articles of Association of company permits it and a resolution has been passed in the general meeting of the company. Share capital can be altered in following ways;

(1) Increase in share capital by issue of new shares

(2) Consolidation of shares

(3) Sub-division of shares

(4) Conversion of shares into stock or stock into shares

(5) Cancellation of unissued shares

(1) **Increase in Share Capital by Issue of New Shares :** When a company requires additional capital, it can increase its share capitalby issuing new shares. If the company has issued all its authorized capital then it can increase its authorized capital by make changes in Memorandum of Association with the permission of S.E.B.I. No accounting entry will be passed for increasing authorized share capital but in relation to issue of new shares some entries will be passed as are generally passed in case of issue of shares.

(2) **Consolidation of Shares :** When the shares of small denominations of a company are changed into shares of big denominations it is called consolidation of shares. The total capital of company does not change by consolidation of shares but the number of shares decreases.

Following entry is passed in this case :-

(Old Denomination) Share Capital A/c Dr.

To (New Denomination) Share Capital A/c

(Being consolidation of … Shares of Rs. …………… Each into…….. share of Rs .... each)

(3) **Sub-Division of Shares :** When the shares of a company are sub- divided in shares of small value, it is known as sub-division of shares. The total capital of the company does not get affected by sub-division of shares but the numbers of shares increases.

(Old denomination) Share capital A/c Dr.

To (New Denomination) Share Capital A/c

(Sub-division of …….. shares of Rs…….. each into...shares of Rs. …..each)

(4) **Conversion of Shares into Stock or Stock into Shares :** A company can convert its fully paid up shares into stock or stock into fully paid up shares. By converting shares into stock, any amount of stock capital can be transferred to any other person. Following entry will be passed for such conversion.

(a) Conversion of Shares into Stock :

Equity Shares Capital A/c Dr.

To Equity Stock A/c

(Equity shares of Rs.............each fully paid up converted into equity stock of Rs................)

(b) Conversion of Stock into Fully Paid Equity Shares :

4. **Cancellation of Unissued Share :** Cancellation of unissued shares by a company does not amount to reduction of paid up share capital. As no accounting entry has been done in the books of company for such shares, therefore no entry is passed for cancellation of such shares, only the authorized capital is adjusted in the balance sheet of the company

Forms of internal reconstruction

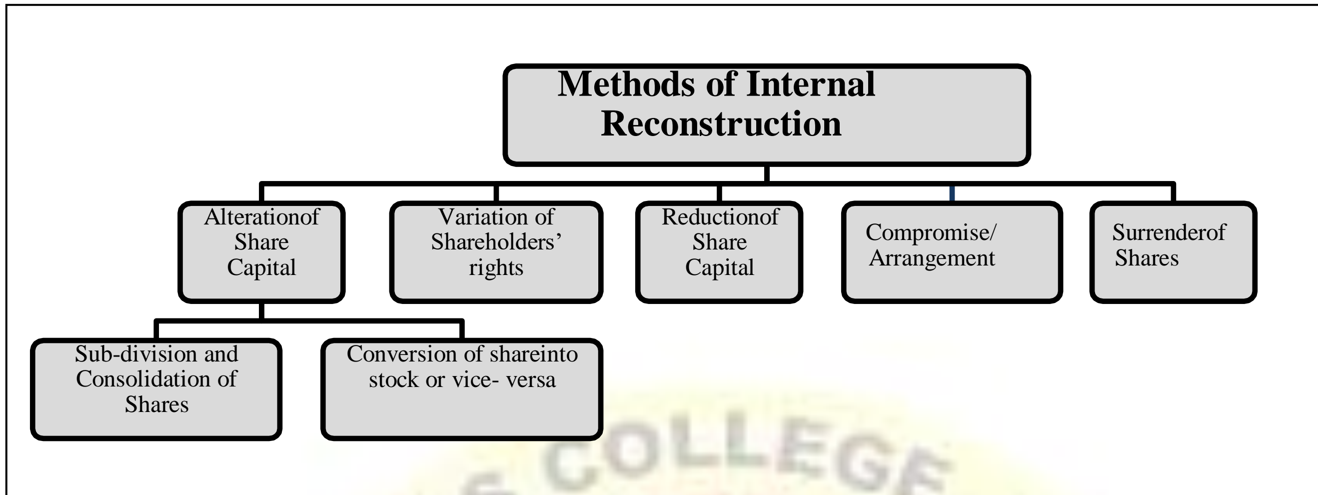
i. Re-organization or alteration of share capital
ii. Reduction of share capital and other liabilities

Objectives of internal reconstruction

1) To resolve the problem of over-capitalization/ huge accumulated losses/ over valuation of assets
2) When the capital structure of a company is complex and is required to make it simple.
3) When change is required in the face value of shares of the company.

Meaning of capital reduction account

It involves sacrifice on the part of shareholders, debenture holders and creditors. The amount sacrificed by them shall be utilized in writing off of losses and to bring down the assets to their real values. An account called capital Reduction also called Internal Reconstruction Account or capital Reorganization Account is opened for this purpose. Amounts sacrificed by various parties are credited to this account. It is generally resorted to write of the past accumulated losses of the company



Difference Between Internal and External Reconstruction

Basis	Internal Reconstruction	External Reconstruction
Liquidation	The existing company isnot liquidated.	The existing company is liquidated.
Formation	No new company is formed but only the rights of shareholders and creditors are changed.	A new company is formed to take over the liquidated company.
Reduction of capital	There is certain reduction of capital and sometimes the outside liabilities like debenture holders may have to reduce their claim.	There is no reduction of capital. In fact there is a fresh share capital of the company.
Legal position	Internal reconstruction is done as per provisions of section 66 of the Companies Act, 2013.	External reconstruction is regulated by section 232 of the Companies Act, 2013.

Problem

On 31-12-20X1, B Ltd. had 20,000, ` 10 Equity Shares as authorised capital and the shares were all issued on which ` 8 was paid up. In June, 20X2 the company in general meeting decided to *sub-divide* each share into two shares of ` 5 with ` 4 paid up. In June, 20X3 the company in general meeting resolved to *consolidate* 20 shares of ` 5, ` 4 per share paid up into one share of ` 100 each, ` 80 paid up.

Pass entries and show how share capital will appear in notes to Balance Sheet ason 31- 12-20X1, 31-12-20X2 and 31-12-20X3.

Solution

Journal Entries

20X2		`	`
June	Equity Share Capital (` 10) A/c Dr.	1,60,000	
	To Equity Share Capital (` 5) A/c		1,60,000
	(Being the sub-division of 20,000 shares of ` 10 each with ` 8 paid up into 40,000 shares ` 5 each with ` 4 paid up by resolution in general meeting dated)		
20X3	Equity Share Capital (` 5) A/c Dr.	1,60,000	
June	To Equity Share Capital (` 100) A/c		1,60,000
	(Being consolidation of 40,000 shares of ` 5 with ` 4 paid up into 2,000 ` 100shares with ` 80 paid up)		

Notes to Balance Sheet

Liabilities:	`
As on 31-12-20X1	
1. Share Capital	
Authorised:	2,00,000
20,000 Equity Shares of ` 10 each	
Issued and Subscribed:	
20,000 Equity Shares of ` 10 each ` 8 per share called up	1,60,000
As on 31-12-20X2	
1. Share Capital	
Authorised:	2,00,000
40,000 Equity Shares of ` 5 each	
Issued and Subscribed:	
40,000 Equity Shares of ` 5 each ` 4 per share called up	1,60,000
As on 31-12-20X3	`
1. Share Capital	
Authorised:	2,00,000
2,000 Equity Shares of ` 100 each	
Issued and Subscribed:	

20,000 Equity Shares of ` 100 each ` 80 per share called up	1,60,000

Problem

C Ltd. had ` 5,00,000 authorised capital on 31-12-20X1 divided into shares of ` 100 each out of which 4,000 shares were issued and fully paid up. In June 220X2 the Company decided to convert the issued shares into stock. But in June, 20X3 theCompany re-converted the stock into shares of ` 10 each, fully paid up.

Pass entries and show how Share Capital will appear in Notes to Balance Sheet as on 31-12-20X1, 31-12-20X2 and 31-12-20X3.

Solution

Journal Entries

20X2			`	`
June	Equity Share Capital A/c	Dr.	4,00,000	
	To Equity Stock A/c			4,00,000
	(Being conversion of 4,000 fully paid Equity Shares of ` 100 into ` 4,00,000 Equity Stock as per resolution in general meeting dated…)			
20X3				
June	Equity Stock A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Being re-conversion of ` 4,00,000 Equity Stock into 40,000 shares of ` 10 fully paid Equity Shares as per resolution in General Meeting dated...)			

Notes to Balance Sheet

Liabilities :	
As on 31-12-20X1	`
1. Share Capital	
Authorised	5,00,000
5,000 Equity Shares of ` 100 each	
Issued and Subscribed	
4,000 Equity Shares of ` 100 each fully called up	4,00,000
As on 31-12-20X2	`
1. Share Capital	
Authorised	5,00,000
5,000 Equity Shares of ` 100 each	
Issued and Subscribed	
Equity Stock-4,000 Equity Shares of ` 100 converted into Stock	4,00,000

As on 31-12-20X3	`
1. Share Capital	
Authorised	
50,000 Equity Shares of ` 10 each	5,00,000
Issued and Subscribed	
40,000 Equity Shares of ` 10 each fully called up	4,00,000

Reduction of Share Capital

Section 66 of the Companies Act, 2013 lays down the procedure in respect ofreduction of share capital. Subject to confirmation by the Tribunal on an application by the company, a company may, by a special resolution, reduce the share capital in the following manner-

(a) Extinguishing or reducing the liability of the shareholders in respect of unpaid amount on the shares held by them; or

(b) Paying off any paid-up share capital which is in excess of its requirements;

(c) Cancelling any paid-up share capital which is lost or is unrepresented by available assets.

Generally reduction in share capital is followed when a company has been suffering losses continuously for a long time, is not truly represented by its assets.In such a case, any scheme for capital reduction should write-off that portion of capital which is already lost.

Problem

Given below is the summarized balance sheet of Rebuilt Ltd. as on 31.3.20X1:

Liabilities	Amount `	Assets	Amount `
Authorised and issued capital:		Building at cost less depreciation	4,00,000
12,000, 7% Preference shares of ` 50 each (Note: Preference dividend is in arrear for five years)	6,00,000	Plant at cost less depreciation	2,68,000
15,000 Equity shares of ` 50 each	7,50,000	Trademarks and goodwill at cost	3,18,000
	13,50,000		
Loan	5,73,000	Inventory	4,00,000
Trade payables	2,07,000	Trade receivables	3,28,000

Other liabilities	35,000	Profit and loss A/c	4,51,000
	21,65,000		21,65,000

The Company is now earning profits short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summaryof the scheme is as follows:

(a) The equity shareholders have agreed that their ` 50 shares should be reducedto ` 2.50 by cancellation of ` 47.50 per share. They have also agreed to subscribe for three new equity shares of ` 2.50 each for each equity share held.

(b) The preference shareholders have agreed to cancel the arrears of dividends and to accept for each ` 50 share, 4 new 5% preference shares of ` 10 each, plus 6 new equity shares of ` 2.50 each, all credited as fully paid.

(c) Lenders to the company for ` 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ` 10 each and 12,000 new equity shares of ` 2.50 each.

(d) The directors have agreed to subscribe in cash for 40,000, new equity shares of ` 2.50 each in addition to any shares to be subscribed by them under (a) above.

(e) Of the cash received by the issue of new shares, ` 2,00,000 is to be used to reduce the loan due by the company.

(f) The equity share capital cancelled is to be applied:

i. to write off the debit balance in the profit and loss A/c; and

ii. to write off ` 35,000 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of the company after reconstruction. The nominal capitalas reduced is to be increased to ` 6,50,000 for preference share capital and ` 7,50,000 for equity share capital.

Solution

In the books of Rebuilt Ltd.

Journal Entries

	Particulars		Debit (`)	Credit (`)
1.	Equity share capital A/c (` 50)	Dr.	7,50,000	
	To Equity share capital A/c (` 2.50)			37,500
	To Capital reduction A/c			7,12,500
	(Being equity capital reduced to nominal valueof ` 2.50 each)			
2.	Bank A/c	Dr.	1,12,500	
	To Equity share capital			1,12,500
	(Being 3 right shares against each share wasissued and subscribed)			

3.	7% Preference share capital A/c (` 50)	Dr.	6,00,000	
	Capital reduction A/c	Dr.	60,000	
	To 5% Preference share capital (` 10)			4,80,000
	To equity share capital (` 50)			1,80,000
	(Being 7% preference shares of ` 50 each converted to 5% preference shares of ` 10 each and also given to them 6 equity shares for every share held)			
4.	Loan A/c	Dr.	1,50,000	
	To 5% Preference share capital A/c			1,20,000
	To Equity share capital A/c			30,000
	(Being loan to the extent of ` 1,50,000 converted into share capital)			
5.	Bank A/c	Dr.	1,00,000	
	To Equity share application money A/c			1,00,000
	(Being shares subscribed by the directors)			
6.	Equity share application money A/c	Dr.	1,00,000	
	To Equity share capital A/c			1,00,000
	(Being application money transferred to capitalA/c)			
7.	Loan A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being loan repaid)			
8.	Capital reduction A/c	Dr.	6,52,500	
	To Profit and loss A/c			4,51,000
	To Plant A/c			35,000
	To Trademarks and Goodwill A/c (Bal.fig.)			1,66,500
	(Being losses and assets written off to the extentrequired)			

Balance sheet of Rebuilt Ltd. (and reduced) as on 31.3.20X1

	Particulars	*Notes*	`
	Equity and Liabilities		
1	**Shareholders' funds**		
	Share capital	1	10,60,000
2	**Non-current liabilities**		
	Long-term borrowings		2,23,000
3	**Current liabilities**		
	Trade Payables		2,07,000

Other current liabilities	35,000

Notes to accounts

			`
1	**Share Capital**		
	Authorised capital:		
	65,000 Preference shares of ` 10 each	6,50,000	
	3,00,000 Equity shares of ` 2.50 each	7,50,000	14,00,000
	Issued, subscribed and paid up:		
	1,80,000 equity shares of ` 2.5 each	4,60,000	
	60,000, 5% Preference shares of ` 10 each	6,00,000	10,60,000
2	**Tangible assets**		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	2,33,000	6,33,000
3.	**Intangible assets**		
	Trademarks and goodwill		1,51,500

4	**Cash and cash equivalents**		
	Bank (1,12,500+1,00,000-2,00,000)		12,500