

ગુજરાત રાજ્યના શિક્ષણવિભાગના પત્ર-ક્રમાંક  
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# ELEMENTS OF ACCOUNTS

## (Part 2)

### Standard 12



#### PLEDGE

India is my country.

All Indians are my brothers and sisters.

I love my country and I am proud of its rich and varied heritage.

I shall always strive to be worthy of it.

I shall respect my parents, teachers and all my elders and treat everyone with courtesy.

I pledge my devotion to my country and its people.

My happiness lies in their well-being and prosperity.

રાજ્ય સરકારની વિનામૂલ્યે યોજના હેઠળનું પુસ્તક



**Gujarat State Board of School Textbooks**  
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**Subject Adviser**

Shri R. H. Vyas

**Authors**

Dr H. C. Sardar (Convener)

Shri Pankajbhai C. Raval

Dr Dipak R. Raste

Dr R. K. Patel

Dr Jayesh A. Thakkar

Shri Sureshchandra J. Sahu

Shri Raghubhai T. Socha

**Translators**

Dr H. C. Sardar

Shri Pankajbhai C. Raval

Dr Dipak R. Raste

Dr R. K. Patel

**Reviewers**

Prof H. N. Patel

Prof Saifee A.Kundanpurwala

Shri Prakash S.Patel

Shri Shreya N. Parikh

Shri Bhavna N. Thakkar

Prof Dharmendra A. Patel

Shri Saurin M. Patel

Shri Manan K. Shah

Shri Neel A. Shastri

Shri Arvind B. Acharya

Shri Aliasgar T. Bookwala

Shri Maulik B. Shah

**Language Reviewers**

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Dr Pavan C. Pandit

**Co-ordinator**

Dr Chirag N. Shah

(Subject Co-ordinator : Commerce)

**Preparation and Planning**

Shri Haren Shah

(Dy. Director : Academic)

**Lay-out and Planning**

Shri Haresh S. Limbachiya

(Dy. Director : Production)

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**PREFACE**

The Gujarat Secondary and Higher Secondary Board has prepared new syllabi in accordance with the syllabi at the national level. These syllabi are approved by the Government of Gujarat.

The Gujarat State Board of School Textbooks takes pleasure in presenting this textbook to the students. It is prepared according to the new syllabus of **Elements of Accounts (Part 2)** for **Standard 12**.

This textbook is written and reviewed by expert teachers and professors. This textbook is published after incorporating the necessary changes suggested by the reviewers.

The Board has taken ample care to make this textbook interesting, useful and free of errors. However, suggestions are welcome to improve the quality of this book from persons taking interest in education.

**P. bharathi (IAS)**

Director

Executive President

Date : 13-12-2019

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## FUNDAMENTAL DUTIES

**It shall be the duty of every citizen of India\*:**

- (a) to abide by the Constitution and respect its ideals and institutions, the National Flag and the National Anthem;
- (b) to cherish and follow the noble ideals which inspired our national struggle for freedom;
- (c) to uphold and protect the sovereignty, unity and integrity of India;
- (d) to defend the country and render national service when called upon to do so;
- (e) to promote harmony and the spirit of common brotherhood amongst all the people of India transcending religious, linguistic and regional or sectional diversities; to renounce practices derogatory to the dignity of women;
- (f) to value and preserve the rich heritage of our composite culture;
- (g) to protect and improve the natural environment including forests, lakes, rivers and wild life, and to have compassion for living creatures;
- (h) to develop the scientific temper, humanism and the spirit of inquiry and reform;
- (i) to safeguard public property and to abjure violence;
- (j) to strive towards excellence in all spheres of individual and collective activity so that the nation constantly rises to higher levels of endeavour and achievement;
- (k) to provide opportunities for education to his child, or a ward between the age of 6 to 14 years as the case may be.

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\* Constitution of India : Section 51-A

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# Accounting for Share Capital

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## 1. Introduction

Company form came into existence after industrial revolution due to limitations of proprietorship and partnership firms in carrying out business on a large scale.

In the modern age capital is required for the business. So, company collects its own capital from several persons. Joint stock company is an association of persons and has an objective of carrying out some business for profit.

Company has a separate legal existence by law. Incorporation, management and winding up of company are governed by the provisions of companies Act.

In India, first time a separate act for company was made in 1956, it's known as Companies Act, 1956. Recently Indian Government has incorporated New **Companies Act, 2013** after necessary amendments in previous Act.

This chapter deals how a company raises the capital, it discusses several points in this reference and their accounting effects in the company's books as per Companies Act, 2013.

## 2. Types of Companies

Based on establishment, the companies are mainly of two types :

(1) **Statutory Companies or Corporations** : These companies or corporations are created by the special act of state or central legislature. For example, Life Insurance Corporation of India, The New India Assurance Company Limited, Gujarat State Finance Corporation, Gujarat State Civil Supplies Corporation etc.

(2) **Registered Companies** : The companies which are registered and formed under the companies act are called registered companies. Most of the companies are formed under this type.

As per the Indian Companies Act, 2013, there are two main types of companies : Private Company and Public Company.

**Private Company :** A private company is one which by its Articles of Association (i) restricts the right to transfer its shares; (ii) limits the number of its members to 200; (iii) prohibits any invitations to the public to subscribe for any securities i.e. shares or debentures of the company (iv) must have at least 2 members.

The name of a private company ends with the words, 'Private Limited'. e.g. Panchvilla Cotton Private Limited, Apex Hydro Private Limited.

As per new Companies Act one person can form a company, under the necessary legal provisions any one person can form a One Person Company – OPC which has only one member. It is a company incorporated as a private company.

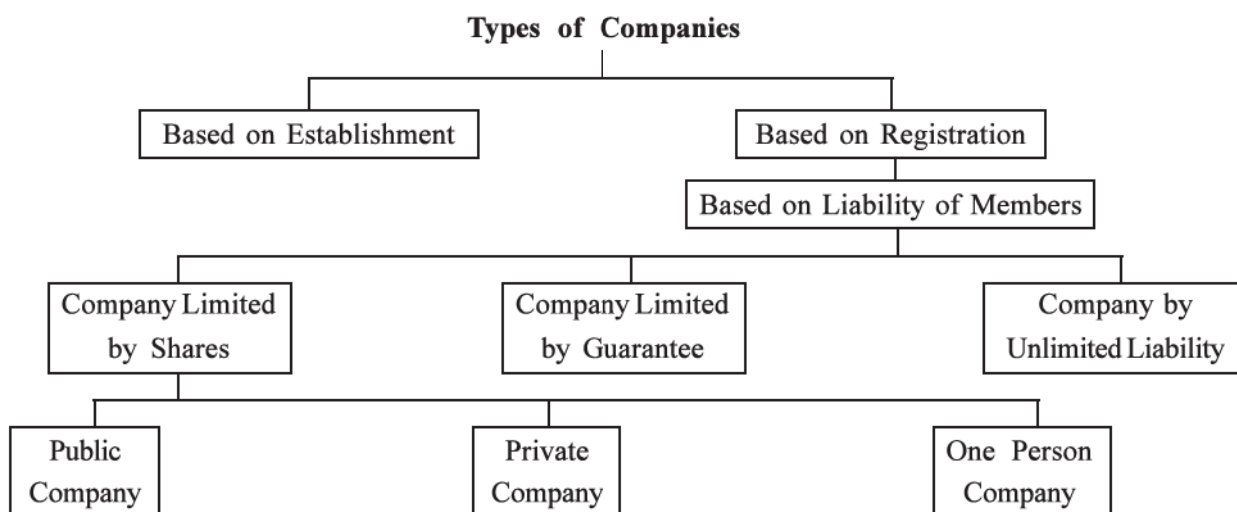
**Public Company :** A company which is not a private company is called public company. A public company must have at least 7 members. There is no restriction on the maximum number of members. The name of a public company ends with the word 'Limited'. e.g. Karnavati Textiles Limited, Infosys Technologies Limited.

Based on liability of members or shareholders, the companies are mainly of three types :

(1) **Company Limited by Shares :** In these companies, liability of the shareholders is limited upto the extent of the face value of shares held by them. Most of the companies are of this kind.

(2) **Company Limited by Guarantee :** In such companies, at the time of liquidation, the liability of shareholders is limited to a specified amount as guaranteed. Usually, such companies are not for the purpose of earning profit but it is formed for the purpose of promoting different activities like arts, science, sports, culture, social welfare etc. e.g. Board of control for cricket in India.

(3) **Company by Unlimited Liability :** In this type of company there is no limit on the liability of its members. It means, when a company suffers loss and the company's property is not sufficient to pay off its debts, the private property of its members will be used to meet the claims of creditors. As the risk involved in such companies is too high, such companies are not found in India even though permitted by the companies act.



### 3. Share and Share Capital : Meaning, Nature and Types

Capital of company is called Share Capital, which can be divided into transferable small denominations. Each such unit of denomination is known as Share.

To raise capital, company issues prospectus as required by law and invites public to purchase its shares. Those who purchase shares of company are called members or shareholders of company. As long as the share(s) are held by this person, he is called shareholder or co-owner of the company. For shareholders, who has purchased or is in possession of the shares, indicate the proportion (ratio) of his ownership in the company. Each share is allotted a distinctive number. Share is an asset which is movable and transferable.

According to the companies act, a company may issue two types of shares : (1) Preference share and (2) Equity share.

**(1) Preference Share :** Preference share is one which gives preferential right to its holder for receiving the dividend at a specified rate before any dividend paid to equity share holder. When the company goes into liquidation the preference share holder has the preferential right for repayment of capital before the equity shareholder.

Types of preference shares are as under :

**(i) Cumulative and Non-cumulative Preference Share :** In case of cumulative preference shares, if in any year the dividend on preference shares is not paid due to insufficient profit, such arrears of dividend shall be paid together with current year dividend in the year when there is sufficient profit.

As against this, in case of non-cumulative preference shares, such arrears of dividend are not accumulated and are not paid in future.

**(ii) Redeemable and Irredeemable Preference Share :** If the amount of preference share is to be repaid (redeemed) by the company at the end of the stipulated period or after giving proper notice to the holder of the preference shares, such shares are called redeemable preference shares.

A preference share which are redeemed only at the time of liquidation of company are called Irredeemable preference shares. After the implementation of Companies Act, 2013, company limited by share does not issue irredeemable preference shares.

**(iii) Participating and Non-participating Preference Share :** Preference shareholders who hold participating preference shares get fixed rate of dividend as decided by the company. In addition to this, they also have a right to participate in surplus profit remaining after distribution of specified dividend to equity shareholders subject to terms of participation. In the event of winding up of the company, if after paying the capital amount of both the preference and equity shareholders, there is still some surplus left, such shareholders are entitled to receive a proportion of surplus. This type of preference shares are called participating preference shares.

Preference shareholder's of non-participating preference shares get only a fixed rate of dividend and do not carry a right to participate in the surplus profits or in any surplus capital.

**(iv) Convertible and Non-convertible Preference Share :** The preference shares which can be converted partly or fully into equity shares as per agreed terms at the time of issue are known as convertible preference shares.

The preference shares which are not convertible into equity shares are known as non-convertible preference shares. Usually, the preference shares are non-convertible.

**(2) Equity Share or Ordinary Share :** The shares, which are not preference shares, are known as equity shares. Equity shareholders have voting rights in the company's meeting. Dividend on equity shares which is decided by the board of directors and approved by the shareholders in the general meeting is given only out of the profit remaining after distribution of dividend on preference shares at fixed rate.

Company gives a dividend on equity shares every year on the basis of current year's profit, profit of the previous years, accumulated reserves, possibilities of future profits and also management policy of the company.

At the time of liquidation of company, from the balance funds equity shareholders have right of repayment of capital only after returning preference share capital.

Equity share capital is known as principal share capital of the company. According to current provisions of the companies act, the equity share should have a minimum face value of ₹ 1. In the present scenario, most of the company have face value of each share is ₹ 1 or ₹ 10 or ₹ 100.

**Distinction Between Preference Share and Equity Share :**

	<b>Basis of Distinction</b>	<b>Preference Shares</b>	<b>Equity Shares</b>
(1)	Rate of dividend	Dividend on preference shares are paid at a fixed rate.	The rate of dividend on equity shares is not fixed. It may vary from year to year depending upon the availability of profits.
(2)	Arrears of dividend	If dividend is not paid on cumulative shares in any year, the arrears of dividend is paid against company's profit in future.	Arrears of dividend on equity shares can not be accumulated and so it is not paid against company's profit in future.
(3)	Preferential right as to the payment of dividend	They have a right to receive dividend before any dividend is paid on equity shares.	Payment of dividend on equity shares is made after the payment of preference dividend.
(4)	Preferential right as to the payment of capital	Preference shareholders have a right to return of preference share-capital in the case of winding up, before any capital is returned to equity shareholders.	Equity share capital is paid only when preference share capital is paid out fully.
(5)	Voting rights	Preference shareholders do not have any voting rights.	Equity shareholders have voting rights.
(6)	Right to participate in management	They do not have a right to participate in management of the company.	They have full right to participate in management of the company.



### **Types of Share Capital :**

(i) **Authorised/Nominal/Registered Capital** : The maximum amount which a company can accumulate by share capital during its lifetime, is called authorised share capital. It is stated in the memorandum of association and also stated at the time of registration. Hence, it's called registered capital. If there is a need to increase the authorised capital of a company in future, the same can be increased by passing a resolution in the general meeting of shareholders of company and also as per provisions of companies act.

Authorised capital is also called nominal capital. For example, authorised capital of ABC limited is ₹ 1,00,00,000 (one crore) divided into 10,00,000 equity shares of ₹ 10 each.

(ii) **Issued Capital** : The share capital issued by issue of shares out of authorised capital based on the need of the company in full or part is known as issued capital. For example, if 7,00,000 shares are issued out of authorised capital of 10,00,000 shares of ₹ 10 each, ₹ 70,00,000 is known as issued capital of the company, being 7,00,000 shares of ₹ 10 each. Issued capital should not be more than authorised capital.

(iii) **Subscribed Capital** : The value of shares for which applications are received out of issued share capital is known as subscribed capital. Subscribed share capital can be equal to or less than the issued capital. Even if share applications are received for more number of shares than the issued shares, company can allot shares only to the extent of share issued.

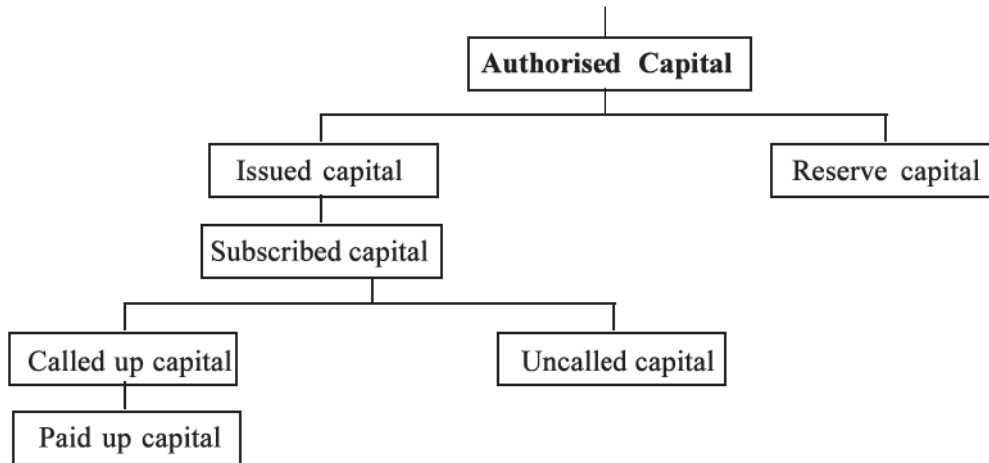
(iv) **Called up Capital** : Company can call up an amount equal to face value of shares or lesser amount from the applicants to whom the share are allotted. When company calls for lesser amount of the share, the balance amount can be called in future from the shareholders. Such amount called up on shares is known as called-up capital. For example, if company has called up ₹ 6 per share on 7,00,000 share of ₹ 10 each, the called up capital will be ₹ 42,00,000.

(v) **Uncalled Capital** : It is a part of subscribed capital. A capital which is not yet called from the shareholders by the board of directors of the company is called uncalled capital. Uncalled capital is difference between subscribed capital and called up capital. E.g. If the company has called for ₹ 6 per share on a share of face value of ₹ 10 each than ₹ 4 per share is considered as uncalled capital.

(vi) **Paid up Capital** : The amount received by the company from shareholders out of called up capital is known as paid up capital. If shareholder does not pay the amount called for any reason, there will be difference between the called up capital and paid up capital. For example, called up capital is ₹ 42,00,000 (7,00,000 share × ₹ 6 per share). If a shareholder holding 1000 shares could not pay first called money of ₹ 2 per share, than paid up capital shall be ₹ 41,98,000 (₹ 42,00,000 – ₹ 2000).

(vii) **Reserve Capital** : When management of the company feels that the called up capital is sufficient for the business requirement of the company and no further capital is required in future, the uncalled capital is converted into reserve capital by passing special resolution in the meeting of shareholders. Capital so reserved is known as **Reserve capital**. Such reserved capital can be called up from shareholders only when the company goes into liquidation. Special resolution passed to this effect can not be cancelled.

### Classification of Share Capital



**Capital Reserve :** Capital reserve are those reserves which are created out of capital profit. Capital profits are those profits which are not earned in the normal course of the business. These reserves can not be utilised for the distribution of dividends. Following transactions give rise to capital profit, which is to be transferred to capital reserved :

- (1) Profit on sale of fixed assets
- (2) Profit on revaluation of fixed assets
- (3) Profit prior to incorporation of company
- (4) Premium on issue of shares and debentures
- (5) Profit on redemption of debentures
- (6) Profit on re-issue of forfeited shares

#### 4. Steps for Issue of Equity Shares

Company raises its capital by issuing equity share to public or by private placement. Detailed discussion/information about this is as under :

##### (A) For Shares Issued for Public :

(i) **Permission for Issue :** Government of India made an important amendment in 1991 by repealing capital issues (control) act, 1947 and established Securities and Exchange Board of India - SEBI. Earlier, the companies were required to seek prior approval of government for public issue of shares but now such company will have to prepare an offer document in accordance with SEBI guidelines and other legal requirements and submit the same to SEBI. Only after verification of the offer document by SEBI, they give permission for public issue of shares to the company.

(ii) **Details of Proposal to be sent to SEBI :** In the offer document or proposal, the company has to disclose the number of shares issued, type of the share issued and issue price of each share. In addition to this, details regarding full amount to be paid at the time of application or amount to be called up in installments is also provided.

(iii) **Offer to Public :** After complying with the formalities relating to public issue, the company invites public for subscription to shares by issue of prospectus. Company informs the details about subscription of shares to public by newspapers, by T.V. or by hoardings.

(iv) **Details Shown in Prospectus :** Normally following contents are shown in prospectus : Name and address of the registered office of the company, name and address of the directors, objects of the

company, risks involved in the company, consent from SEBI, authorised and issued capital of the company and the number of shares now offered for subscription, dates of opening and closing of the issue, name and address of the merchant's bank, guidelines about past year's and future working of the company, etc.

**(v) For Share Application :** After reading the prospectus, the public applies for shares in the company on a prescribed form. Each application must accompany the number of shares applied, name and address of applicant, their bank account number, their name and number of demat account and also amount of total application money.

The amount of share application money by cheque or draft with application form must be deposited by the applicant in the scheduled bank which is specified by the company. The name of the scheduled bank is mentioned in the prospectus.

Provision for amount to be called up on application are as under :

- (i) According to section 39 of Companies Act, 2013 application money on shares should be minimum 5 % of face value of shares.
- (ii) As per the present rules of SEBI, the amount to be paid with application of shares by applicant, should not be less than 25 % of issued price of the share.

As per section 24 of Companies Act, 2013 SEBI provisions are applicable for issue of any securities and its transfer, provision as per company law board has not been applicable.

In the present scenario, according to SEBI guidelines new arrangement has been established for share application in the public issue of the company. It's known as ASBA. To make the students familiar about this arrangement a detailed information is given at the end of the chapter.

**(vi) When Shares are Allotted :** When the company receives the application forms, the shares are either fully or partially allotted to the applicant. Those applicants who are allotted shares, are sent 'Letters of Allotment' by the company, in which number of shares allotted by the company to them are indicated. Those who are not allotted any single share by the company are sent 'Letter of Regret' along with a cheque for the refund of application money and now it is directly deposited in the applicant's bank account.

If company receives more or less number of share applicants than total number of issued shares from the applicant then provision for this has been discussed in the next point of this chapter.

**(vii) Balance Amount by Instalments :** Generally company calls for the full amount with share application or allotment. If company has not called up full amount with share application or allotment, the balance can be called up in one or more installments. Calls must be made strictly in accordance with the provisions of the Articles of Association. In the absence of the Articles of Association, the provisions of table F of schedule I of the companies act, 2013 shall apply.

**(viii) Other Important Points :** When shares are issued by company, the company has to necessarily contract with minimum one merchant bank or scheduled bank for its arrangement, for its transparency and also for financial transactions.

Before issue of shares, company has to compulsorily contract with depository for demat of shares. Sometimes company give an option to shareholders to get the shares in demat form or in physical form. In present circumstances it is compulsory to open demat account.

Any person can open or keep the demat account in any bank or any financial institution who holds legal permission to keep the demat accounts.



Demat account is just like saving account or current account in the bank. Entry for money transactions are kept in saving a/c or current a/c. In the same manner entry for purchase and sales transactions of the shares are kept in demat account.

When any person purchases the shares, then number of purchased shares are credited means added to his demat account and when any number of shares are sold then it is debited means deducted from his account.

#### **(B) Shares Issued by Private Placement :**

As per the Companies Act, 2013 a company may issue shares on private placement basis also. Sometimes the promoters of a public company are confident of raising capital through private sources and contacts. In such a case the company does not invite the public to subscribe for its shares, but make private placement of shares to promoters, their friends, their relatives, mutual funds, shareholders of group companies, non-resident Indians, financial institutions like Life Insurance Corporation of India (LIC), Unit Trust of India (UTI), Industrial Credit and Investment Corporation of India (ICICI), etc.

When the shares are not offered to the public, the company need not issue a prospectus. Instead of issuing a prospectus, the promoters are required to prepare a draft prospectus known as a 'Statement in Lieu of Prospectus' and must file it with the registrar at least 3 days before the first allotment of either shares or debentures.

In case of private placement of shares, the allottees will not sell their shares for a certain minimum period from the date of allotment. This period is known as 'lock-in-period'.

#### **5. Over Subscription and Under Subscription of Shares**

If applications are received for more number of shares than the shares issued for public subscription, it is known as over subscription. As company cannot allot more shares than the shares issued, it has to refund excess application money to applicants of shares.

In these circumstances, company may (i) allot full number of shares or (ii) not allot any share or (iii) allot partially number of shares to the share applicants against their share application.

If applications are received for less number of shares than the shares issued, it is known as under subscription. According to the SEBI guidelines, company must get share application money for at least 90 % of the amount called up by public subscription. This minimum amount of subscription should be received within 30 days from the date of issue of prospectus. If company fails to get minimum subscription then company can not allot any share and within 15 days total amount should be returned to the applicants. If company fails to return this amount within 15 days then interest at the rate of 15 % p.a. has to be paid for each day.

#### **6. I.P.O. and F.P.O.**

An initial public offering (IPO) is the first time that the share/stock of a private company is offered for purchase to the public.

If a company has already issued the shares to the public through IPO process and wants to increase the capital fund, then "Follow-on Public Offer" (F.P.O.) is issued by the company to public or to investors.

#### **7. Methods for Issue of Shares by Company**

Company can issue its shares by three ways :

(1) **At par** : If the total amount payable by share subscribers to company is equal to the total face value of shares, the shares are said to be issued at par. For example, share of face value of ₹ 10 issued at a price of ₹ 10.

(2) **At premium** : If the total amount payable by share subscribers to company is more than the total face value of shares, the shares are said to be issued at premium. For example, if share of face value of ₹ 10 issued at a price of ₹ 14, the additional amount of ₹ 4 shall be considered as premium.

Present provisions as per Companies Act, 2013 and accounting effects of shares issued at premium has been discussed in detail in the following point in this chapter.

(3) **Issue of Shares at Discount** : If the total amount payable by share subscribers to a company is less than the total face value of shares, the shares are said to be issued at discount. For example, if share of face value of ₹ 10 is issued at a price of ₹ 9, the amount of ₹ 1 shall be considered as discount.

**As per section 53 of Companies Act, 2013, companies would no longer be permitted to issue shares at a discount.**

The only shares that could be issued at a discount are sweat equity wherein shares are issued to employees or directors in lieu of their services under section 54 of 2013 Act.

## 8. Share Capital Transactions and Its Accounting Effects

The following journal entries shall be passed in the books of the company in respect of share capital transactions :

### ● On Share Application :

(1) When share application money is received,

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr To Share application A/c [Being receipt of share application money on ..... shares at ₹ ..... per share.]		.....	.....

(2) When applications are received for more shares than the shares issued and excess application money is to be refunded to share applicants,

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share application A/c Dr To Bank A/c [Being refund of share application money at ₹ ..... per share on ..... shares due to non-allotment of shares.]		.....	.....

(3) When board of directors of the company approves the allotment of shares, then share application money in respect of share allotted is transferred to share capital account.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share application A/c Dr To Share capital A/c [Being transfer of share application money at ₹ ..... per share to share capital account in respect of ..... shares allotted.]		.....	.....

● **On Share Allotment :**

- (4) The applicants who are allotted shares become shareholders of the company. When share allotment money is called from shareholders then...

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share allotment A/c Dr To Share capital A/c [Being amount due on allotment on ..... shares at the rate of ₹ ..... per share.]		.....	.....

- (5) When the amount due on allotment is received

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr To Share allotment A/c [Being amount received on allotment on ..... shares at the rate of ₹ ..... per share.]		.....	.....

● **On Share First Call :**

- (6) When the first call is made after receiving the allotment money

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share first call A/c Dr To Share capital A/c [Being first call due on ..... shares at the rate of ₹ ..... per share.]		.....	.....

- (7) When the share first call money is received

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c Dr To Share first call A/c [Being first call money received.]		.....	.....

When the share second and third calls are made and when the call money is received, journal entries will be passed in the same manner as shown in entries (6) and (7) as above. In such case, in place of 'share first call', share second call or third call or final call shall be written.

**Illustration 1 :** Shailja company ltd. issued 2,40,000 equity shares of ₹ 10 each, on which the amounts called up was as under :

On application	₹ 3 per share
On allotment	₹ 3 per share
On first call	₹ 2 per share
On final call	₹ 2 per share

Amounts called on allotment and calls were received in full on time. Applications were received for all shares. Pass journal entries in the books of company.

Also prepare equity share capital account, equity share application account, equity share allotment account, equity share first call account and equity share final call account.

**Ans. :**

**Journal Entries in the Books of Shailja Company Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being money received on application for 2,40,000 shares at ₹ 3 per share.]		7,20,000	7,20,000
2	Equity share application A/c Dr To Equity share capital A/c [Being transfer for share application money to share capital account in respect of share allotted.]		7,20,000	7,20,000
3	Equity share allotment A/c Dr To Equity share capital A/c [Being allotment money due on 2,40,000 equity shares at ₹ 3 per share.]		7,20,000	7,20,000
4	Bank A/c Dr To Equity share allotment A/c [Being allotment money received.]		7,20,000	7,20,000
5	Equity share first call A/c Dr To Equity share capital A/c [Being amount due on first call at ₹ 2 per share on 2,40,000 equity shares.]		4,80,000	4,80,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
6	Bank A/c Dr To Equity share first call A/c [Being amount received on first call.]		4,80,000	4,80,000
7	Equity share final call A/c Dr To Equity share capital A/c [Being amount due on final call at ₹ 2 per share on 2,40,000 equity shares.]		4,80,000	4,80,000
8	Bank A/c Dr To Equity share final call A/c [Being amount received on final call.]		4,80,000	4,80,000
	<b>Total</b>		<b>48,00,000</b>	<b>48,00,000</b>

**Ledger of Shailja Company Ltd.**  
**Equity Share Capital Account**

Dr				Cr			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
				2	By Equity share application A/c		7,20,000
				3	By Equity share allotment A/c		7,20,000
				5	By Equity share first call A/c		4,80,000
				7	By Equity share final call A/c		4,80,000
	To balance b/f		24,00,000				
			<b>24,00,000</b>				<b>24,00,000</b>

**Equity Share Application Account**

Dr				Cr			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
2	To Equity share capital A/c		7,20,000	1	By Bank A/c		7,20,000
			<b>7,20,000</b>				<b>7,20,000</b>

**Equity Share Allotment Account**

Dr				Cr			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
3	To Equity share capital A/c		7,20,000	4	By Bank A/c		7,20,000
			<b>7,20,000</b>				<b>7,20,000</b>



### Equity Share First Call Account

Dr

Cr

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
5	To Equity share capital A/c		4,80,000	6	By Bank A/c		4,80,000
			<b>4,80,000</b>				<b>4,80,000</b>

### Equity Share Final Call Account

Dr

Cr

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
7	To Equity share capital A/c		4,80,000	8	By Bank A/c		4,80,000
			<b>4,80,000</b>				<b>4,80,000</b>

**Note :** In the example dates are not given, so serial number is given to each transaction to understand the posting of each journal entry.

**Illustration 2 :** Authorised capital of a limited company is divided into 25,00,000 equity shares of ₹ 10 each. Out of this, the company offered 20,00,000 equity shares for public subscription. Company received applications for 19,00,000 equity shares against the public subscription. Company called up total ₹ 8 per share and all the called up amounts were duly received. From the above information, show classification of share capital.

**Ans. :**

<b>Authorised capital :</b>	₹
25,00,000 equity shares of ₹ 10 each	2,50,00,000
<b>Issued capital :</b>	
20,00,000 equity shares of ₹ 10 each	2,00,00,000
<b>Subscribed capital :</b>	
19,00,000 equity shares of ₹ 10 each	1,90,00,000
<b>Called up and paid up capital :</b>	
19,00,000 equity shares of ₹ 10 each,	
₹ 8 per share called up and paid up	1,52,00,000

\* Friends, till now we have discussed simple transactions, relating to share capital, their accounting treatment and their illustrations. In the next part of this chapter, we shall study some special transactions, their accounting treatment and their illustrations.

### 9. Calls-in-Arrears

When company makes call for allotment money or call money and if some shareholder fails to pay such money on due date, such unpaid amount is transferred to "Calls-in-arrears" account. In such case, there are two methods to deal with accounting effect of calls-in-arrears.

(i) **Without opening calls-in-arrears account :** Under this method, there is no need to open calls-in-arrears account. When company calls for installment amount on any call, then the actual amount received from the shareholders is debited to bank account and is credited to relevant call account.

So, the respective call account will show a debit balance equal to the unpaid amount of the call. When the unpaid amount is received from shareholder in future, the bank account is debited and the relevant call A/c is credited.

**(ii) By Opening Calls-in-Arrears Account :** Under this method, 'Calls in Arrears Account' is opened. Any amount received from shareholders against any call is debited to bank account and amount which is not received from shareholders is debited to calls in arrears account.

On a later date, when the arrears amount on call is received, bank account is debited and the calls-in-arrears account is credited. So, at the end call-in-arrears is closed.

Now, let us understand the above two methods by following illustration.

**Illustration 3 :** Jay Limited, made a first call of ₹ 2 per share on its 50,000 shares. One shareholder holding 1000 shares did not pay the first call, but he paid due amount on first call after one month. Remaining all shareholders were paid all the amounts due on due dates.

Write journal entries in respect of above transactions in the books of company.

**Ans. :**

Any one method can be adopted from the following :

(i) Without Opening Calls-in-Arrears A/c	(ii) By Opening Calls-in-Arrears A/c
(1) When amount due on first call, Share first call A/c ...Dr 1,00,000 To Share capital A/c 1,00,000	(1) When amount due on first call, Share first call A/c ...Dr 1,00,000 To Share capital A/c 1,00,000
(2) On receipt of first call, Bank A/c ...Dr 98,000 To Share first call A/c 98,000	(2) On receipt of first call, Bank A/c ...Dr 98,000 Call-in-arrear A/c ...Dr 2000 To Share first call A/c 1,00,000
(3) On receipt of arrears of call money from shareholders, Bank A/c ...Dr 2000 To Share first call A/c 2000	(3) On receipt of arrears of call money from shareholders, Bank A/c ...Dr 2000 To Call-in-arrear A/c 2000

**Note :** (1) Balance of call-in-arrears account is shown in the balancesheet as a deduction from the amount of 'subscribed but not fully paid up' under 'subscribed share capital'.

(2) The company if authorised by its Articles of Association may charge interest at the specified rate on calls-in-arrears from the due date to the date of payment.

(3) In case, the Articles of Association of the company is silent, table F of the companies act, 2013 shall apply which provides for interest at 10 % p.a. However, the directors have the right to waive the interest on calls-in-arrears.

● **Calculation and Accounting Effects of Interest on Calls-in-Arrears is not in syllabus.**

**Illustration 4 :** Pranav Limited of Bhavnagar issued 18,00,000 equity shares of ₹ 10 each. The company received applications for 20,00,000 shares. Shares were allotted at meeting of board of directors.



Excess shares applications were rejected and the application money thereon was refunded to the applicants. Amount on shares was called up as under :

On application	₹ 3 per share
On allotment	₹ 2.50 per share
On first call	₹ 2 per share
On final call	₹ 2.50 per share

Yogesh who was allotted 1600 shares, could not pay first and final call money. Where, Nilam who was allotted 1400 shares could not pay final call money. Except this, all the amounts due from all the shareholders were received on due dates. Yogesh and Nilam paid calls-in-arrears amounts at a later date.

Pass necessary journal entries relating to above transactions in the books of the company.

**Ans. :**

**Journal Entries in Books of Pranav Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being the application money received for 20,00,000 equity shares at ₹ 3 per share.]		60,00,000	60,00,000
2	Equity share application A/c Dr To Equity share capital A/c To Bank A/c [Being transfer of share application money in respect of 18,00,000 equity shares allotted to equity share capital account and refund of share application money in respect of 2,00,000 equity shares for rejected applications.]		60,00,000	54,00,000 6,00,000
3	Equity share allotment A/c Dr To Equity share capital A/c [Being allotment money due on 18,00,000 allotted equity shares at ₹ 2.50 per share.]		45,00,000	45,00,000
4	Bank A/c Dr To Equity share allotment A/c [Being full amount received of equity share allotment money.]		45,00,000	45,00,000
5	Equity share first call A/c Dr To Equity share capital A/c [Being the amount due on first call at ₹ 2 per share on 18,00,000 equity shares.]		36,00,000	36,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
6	Bank A/c (17,98,400 shares × ₹ 2) Dr Calls-in-arrears A/c (1600 shares × ₹ 2) Dr To Equity share first call A/c [Being full amount received on equity share first call money except on 1600 shares of Yogesh.]		35,96,800 3200	36,00,000
7	Equity share final call A/c Dr To Equity share capital A/c [Being amount due on final call at ₹ 2.50 per share on 18,00,000 equity shares.]		45,00,000	45,00,000
8	Bank A/c (17,97,000 shares × ₹ 2.50) Dr Calls-in-arrears A/c Dr (3000 shares × ₹ 2.50) To Equity share final call A/c [Being full amount received of equity share final call money on all shares except on 1600 shares of Yogesh and 1400 shares of Nilam.]		44,92,500 7500	45,00,000
9	Bank A/c Dr To Calls-in-arrears A/c [Being receipt of arrears of call money from Yogesh and Nilam.]		10,700	10,700
	<b>Total</b>		<b>3,72,10,700</b>	<b>3,72,10,700</b>

#### 10. Calls-in-Advance

If there is provision in the Articles of Association, a company can receive in advance a part or whole of the uncalled amount. In such cases, since the uncalled amount is received by company in advance from shareholders, the same is credited to "calls-in-advance" account.

When amount is received with application as advance of allotment or call money, the journal entry shall be as under :

Share application A/c ...Dr	[Number of shares application × Amount called per share on application]
To share capital A/c	[Number of shares allotted × Amount called per share on application]
To share allotment A/c	[Amount of allotment money received in advance]
To calls-in-advance A/c	[Amount of call money received in advance]

When share call money is received in advance with share allotment money, the following entry shall be passed :

	Bank A/c	Dr	.....	
	To Share allotment A/c			.....
	To Calls-in-advance A/c			.....

When the respective call is made due, then entry for calls-in-advance shall be passed as under :

	Calls-in-advance A/c	Dr	.....	
	To Respective call A/c			.....

**Note :** (1) Calls-in-advance is not share capital of the company, hence dividend can not be given on it.

(2) Balance of calls-in-advance account is shown in the equity and liabilities part of the balance sheet under the head current liabilities and sub-head other current liabilities.

(3) It is compulsory to pay interest on calls-in-advance from the date of receipt till the date when the call is due for payment as per rate specified in the articles of the company. However, if the articles do not contain such rate, table F of schedule I of the Companies Act, 2013 shall be applicable, which leaves the matter to directors of company subject to a maximum rate of 12 % p.a. The interest on calls-in-advance is payable compulsorily even if there are no profits.

**Interest calculation and its accounting effects is not in syllabus.**

**Illustration 5 :** Kena Chemical Company of Vadodara issued for public subscription 3,00,000 equity shares of ₹ 100 each. The company decided to collect ₹ 40 per share with application, ₹ 35 per share on allotment and ₹ 25 per share on first and final call.

Company received applications for total 3,20,000 equity shares. Out of the applications, the company rejected applications for 20,000 equity shares and refunded application money thereof. Pranav, a shareholder of the company who was allotted 3000 equity shares by the company, had paid amount due on first and final call in advance along with allotment money.

Except this, allotment money and call money were called up at appropriate times and were all paid on due dates. Show journal entries in respect of above transactions in books of the company.

**Ans. :**

**Journal Entries in the Books of Kena Chemicals Company**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being receipt of share application money for 3,20,000 equity shares at ₹ 40 per share.]		1,28,00,000	1,28,00,000
2	Equity share application A/c Dr To Equity share capital A/c To Bank A/c [Being transfer of share application money in respect of 3,00,000 equity shares allotted to equity shares capital account and refund the money to applicants in respect of 20,000 equity shares for rejected applications.]		1,28,00,000	1,20,00,000 8,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
3	Equity share allotment A/c Dr To Equity share capital A/c [Being allotment money of ₹ 35 per share due on 3,00,000 equity shares allotted.]		1,05,00,000	1,05,00,000
4	Bank A/c Dr To Equity share allotment A/c To Calls-in-advance A/c [Being receipt of full amount of 3,00,000 equity share allotment money and advance money from Pranav for first and final call at ₹ 25 per share on his 3000 equity shares.]		1,05,75,000	1,05,00,000 75,000
5	Equity share first and final call A/c Dr To Equity share capital A/c [Being amount due on first and final call at ₹ 25 per share on 3,00,000 equity shares.]		75,00,000	75,00,000
6	Bank A/c Dr Calls-in-advance A/c Dr To Equity first and final call A/c [Being receipt of amount called up on first and final call except the amount received in advance from Pranav.]		74,25,000 75,000	75,00,000
	<b>Total</b>		<b>6,16,75,000</b>	<b>6,16,75,000</b>

**Illustration 6 :** Paresh Company of Palanpur issued 2,00,000 equity shares of ₹ 10 each for public subscription. Company decided to call ₹ 3.50 per share on application, ₹ 4 per share on allotment and ₹ 2.50 per share on first and final call.

Applications were received from public for 2,30,000 equity shares, of which applications for 30,000 equity shares were rejected and their application money was refunded to applicants.

Nitin who had applied for 2500 shares had paid entire amount of ₹ 10 per share at the time of applications. Company has allotted him all the shares applied by him. Piyush, who was allotted 1500 shares had paid his first and final call money in advance along with the share allotment money.

Except this, all the amounts due on allotment and call were received on due dates. Write journal entries for above transactions in the books of company.

Ans. :

**Journal Entries in the Books of Paresh Company**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity Share application A/c [Being receipt of share application money for 2,30,000 equity shares at ₹ 3.50 per share and advance payment from Nitin at ₹ 6.50 per share on 2500 equity shares.]		8,21,250	8,21,250
2	Equity share application A/c Dr To Equity share capital A/c (2,00,000 shares × ₹ 3.50) To Equity share allotment A/c (2500 shares × ₹ 4) To Call-in-advance A/c (2500 shares × ₹ 2.50) To Bank A/c (30,000 shares × ₹ 3.50) [Being transfer of share application money in respect of allotted 2,00,000 equity shares and amount paid in advance by Nitin to respective amount, where refund of share application money in respect of 30,000 shares for rejected applications.]		8,21,250	7,00,000 10,000 6250 1,05,000
3	Equity share allotment A/c Dr To Equity share capital A/c [Being allotment money of ₹ 4 per share due on 2,00,000 equity shares.]		8,00,000	8,00,000
4	Bank A/c Dr (Called up on allotment ₹ 8,00,000 – ₹ 10,000 (Advance of Nitin) + ₹ 3750 (First and final call received in advance from Piyush.) To Equity share allotment A/c To Call-in-advance A/c (1500 shares × ₹ 2.50) [Being receipt of full amount of equity share allotment money due less advance of ₹ 10,000 from Nitin plus call money of ₹ 3750 received in advance from Piyush.]		7,93,750	7,90,000 3750



Date	Particulars	L.F.	Debit (₹)	Credit (₹)
5	Equity share first and final call A/c Dr To Equity share capital A/c [Being amount due on first and final call at ₹ 2.50 per share on 2,00,000 equity shares.]		5,00,000	5,00,000
6	Bank A/c Dr (₹ 5,00,000 called – ₹ 10,000 received in advance) Calls-in-advance A/c Dr (₹ 6250 of Nitin + ₹ 3750 of Piyush) To Equity share first and final call A/c [Being receipt remaining money of first and final call on all shares except advance paid by Nitin and Piyush towards call.]		4,90,000  10,000	5,00,000
	<b>Total</b>		<b>42,36,250</b>	<b>42,36,250</b>

#### 11. For Issue of Shares at Premium

When company has good reputation in market, has high profitability, internal and external factors are favourable and also if company has already issued shares in the past and the market price of its shares was more than the face value of shares, then company can issue shares at a price more than its face value or nominal value. When company issues shares at a price higher than the face value, the shares are said to be issued at premium.

When shares are issued at premium, the amount received in excess of face value of shares is credited to a separate account. As per companies act, such amount is carried to '**Securities Premium Account**' or '**Securities Premium Reserve Account**'.

##### ● Points to be kept in mind relating to securities premium :

- (1) Amount of premium on share can be called along with share application or at the time of share allotment or at the time of application and allotment or at the time of share call separately or all together.
- (2) There is no legal restriction on issue of shares at a premium.
- (3) The premium on issue of shares is a capital profit and not a revenue profit.
- (4) The balance of securities premium account is shown in the equity and liabilities part of balance sheet under the head 'Reserve and Surplus' as 'Securities Premium Reserve'.
- (5) Amount of securities premium cannot be utilised for payment of dividend in cash.

##### ● Under section 52(2) of the Companies Act, 2013, the amount of securities premium reserve may be used only for the following purposes :

- (1) In writing off the preliminary expenses of the company;
- (2) For writing off the expenses, commission or discount allowed on issue of shares or debentures of the company;
- (3) For issuing fully paid bonus shares to the shareholders of the company;
- (4) For providing the premium payable on redemption of redeemable preference share
- (5) For buy back of its own shares.

- When shares are issued at premium, the accounting entries in the books of company will be as under :

**(I) With application :**

- (1) When amount of share premium is called with application money,

Bank A/c ...Dr To Share application A/c	Amount called per share (including share premium amount)
--	---

- (2) When allotment is made against applications received,

Share application A/c ...Dr To Share capital A/c To Securities premium A/c	(Number of shares allotted × Amount of premium per share called with application)
--	---

**(II) On allotment :**

- (1) When amount of share premium is called with allotment money,

Share allotment A/c ...Dr To Share capital A/c To Securities premium A/c	(Number of shares allotted × Amount of premium per share called with allotment)
--	---

- (2) When allotment money is received,

Bank A/c ...Dr To Share allotment A/c	Amount called on allotment (with premium) × Number of shares allotted
--	---

**(III) On share call :**

- (1) When amount of share premium is called with share call money,

Share call A/c ...Dr To Share capital A/c To Securities premium A/c	(Number of shares allotted × Amount called per share towards premium at the time of call.)
---	--

- (2) When call money is received,

Bank A/c ...Dr To Share call A/c	Amount called up (with premium) × Number of allotted shares
-------------------------------------	---

**Illustration 7 :** Nisarg Pharma Ltd. of Gandhinagar issued 80,000 equity shares of ₹ 10 each at a premium of ₹ 40 per share. The amount was called up as under :

With application ₹ 14 per share (Including premium of ₹ 10)

With allotment of ₹ 33 per share (Including premium ₹ 30)

With final call ₹ 3 per share

Company received applications for 85,000 equity shares. Excess applications received were rejected and amount received with applications on this was refunded.

Amount due on allotment and final call were duly called up. All the amount due on all the shares were duly received except allotment money and final call money on 2000 shares held by Devami.

Pass necessary journal entries in the books of company for above transactions.



Ans. :

**Journal Entries in the Books of Nisarg Pharma Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being share application money received for 85,000 shares at ₹ 14 per share.]		11,90,000	11,90,000
2	Equity share application A/c Dr To Equity share capital A/c (80,000 shares × ₹ 4) To Securities premium A/c (80,000 shares × ₹ 10) To Bank A/c (5000 shares × ₹ 14) [Being transfer for share application money in respect of 80,000 equity shares allotted to share capital account and securities premium account and refund of application money in respect of rejected application to applicants.]		11,90,000	3,20,000 8,00,000 70,000
3	Equity share allotment A/c Dr To Equity share capital A/c To Securities premium A/c [Being allotment money of ₹ 3 per share on share capital and ₹ 30 per share on premium is due on 80,000 equity shares allotted.]		26,40,000	2,40,000 24,00,000
4	Bank A/c Dr To Equity share allotment A/c [Being receipt of amount of equity share allotment money on 78,000 shares, except ₹ 66,000 on 2000 shares of Devami at ₹ 33 per share]		25,74,000	25,74,000
5	Equity share final call A/c Dr To Equity share capital A/c [Being amount due on final call at ₹ 3 per share on 80,000 equity shares.]		2,40,000	2,40,000
6	Bank A/c Dr To Equity share final call A/c [Being receipt of call money on 78,000 equity shares except non-receipt of call money of ₹ 6000 on 2000 shares of Devami at ₹ 3 per share.]		2,34,000	2,34,000
	<b>Total</b>		<b>80,68,000</b>	<b>80,68,000</b>

**Note :** Devami has not paid allotment money and final call money on her 2000 equity shares. Such amount not received can be recorded by debiting to calls-in-arrears account in entry number 4 and 6 above. Alternatively, journal entries can also be made as shown above without creating calls-in-arrears account.

**Illustration 8 :** Authorised capital of Dishita plastic company is 5,00,000 equity shares of ₹ 10 each. On 11th July, 2017, company issued 4,00,000 equity shares at a premium of ₹ 80 per share for public subscription. Share amount was called up as under :

On 11th July, 2017 with application ₹ 84 per share (including premium of ₹ 80 per share)

On 11th September, 2017 with allotment ₹ 3 per share

On 11th November, 2017 with final call ₹ 3 per share

The subscription was closed after receiving full subscription of shares on 11th July, 2017. On 21st July, 2017 directors made allotment of all the shares applied for. Sum due on allotment, except on 4000 shares was received on 21st September, 2017. Where amount due on final call was fully received by 21st November, 2017 except additional 2000 shares.

Pass necessary journal entries in respect of above transactions except bank transactions and prepare bank account only.

**Ans. :**

**Journal Entries in the Books of Dishita Plastic Company**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2017 July, 21	Equity share application A/c Dr To Equity share capital A/c To Securities premium A/c [Being transfer of ₹ 4 per share to equity share capital account and ₹ 80 per share to securities premium in respect of 4,00,000 equity shares allotted.]		3,36,00,000	16,00,000 3,20,00,000
Sept., 11	Equity share allotment A/c Dr To Equity share capital A/c [Being allotment money of ₹ 3 per share due on 4,00,000 equity shares.]		12,00,000	12,00,000
Sept., 21	Calls-in-arrears A/c Dr To Equity share allotment A/c [Being amount not received on allotment on 4000 equity share at ₹ 3 per share.]		12,000	12,000
Nov., 11	Equity share final call A/c Dr To Equity share capital A/c [Being amount due on final call at ₹ 3 per share on 4,00,000 equity shares.]		12,00,000	12,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
Nov., 21	Calls-in-arrears A/c Dr To Equity share final call A/c [Being amount not received on final call on 6000 (4000 + 2000) equity shares at ₹ 3 per share]		18,000	18,000
	<b>Total</b>		<b>3,60,30,000</b>	<b>3,60,30,000</b>

**Bank Account in the Books of Dishita Plastic Company**

Dr

Cr

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
2017 July, 11	To Equity share application A/c (Receipt of application money at ₹ 84 per share on 4,00,000 shares)		3,36,00,000				
Sept., 21	To Equity share allotment A/c (Receipt of allotment money on 3,96,000 shares except 4000 shares at ₹ 3 per share)		11,88,000				
Nov., 21	To Equity share final call A/c (Receipt of final call money on 3,94,000 shares except 6000 shares at ₹ 3 per share)		11,82,000				

## 12. Forfeiture of Shares

Due to any reason, if any shareholder fails to pay the amount due on allotment or on any call within the informed specified period by company, then company can forfeit his share by completing due formalities.

In normal situation (usually), directors of the company are empowered by articles of association of company to forfeit the shares. Follow the rules laid down in the Articles of Association for the procedure of forfeiture of shares or if no rules are given in Articles for this the provisions of table F of schedule I of the Companies Act, 2013 shall apply. So, a process of forfeiture or cancelation of shares by directors of company is called Forfeiture of shares.

After the forfeiture, the name of shareholder is removed from the register of members. It means now this person is not called a shareholder of the company.

For forfeited shares, the amount already paid by the shareholder to the company, is forfeited by the company it means this amount is not returned to the shareholders.

**Number of shares decreases due to forfeiture of shares and hence 'Share Capital Account' is debited. The amount already paid by shareholder in the company also gets forfeited with forfeiture of share and the same is credited to 'Share Forfeiture Account'.**

- **When shares are forfeited, the following entries are passed in the books of company under different situations :**

(I) When shares are issued at par or at premium and full amount of premium is received,

Share capital A/c ...Dr	[Number of shares forfeited × Amount called up per share on capital account]
To Forfeited shares A/c	[Amount received on forfeited shares towards capital account excluding premium]
To Share allotment A/c	[Amount called on allotment but not received]
To First and final share call A/c	[Amount called on call but not received]

(II) When shares are issued at premium and share premium amount is not received,

Share capital A/c ...Dr	[Number of shares forfeited × Amount called up per share on capital account]
Securities premium A/c ...Dr	[Number of shares forfeited × Amount of premium called up but not received]
To Forfeited shares A/c	[Total amount received]
To Share allotment A/c	[Amount called on allotment but not received]
To Share call or calls-in-arrears A/c	[Amount called on call but not received]

Let us understand above transactions with the following illustrations :

#### **Illustration 9 :**

- (1) M Ltd. forfeited 600 equity shares of one shareholder Govind for non-payment of final call of ₹ 3 per share. Company had called up ₹ 10 per share as face value of share from shareholders. Govind had paid ₹ 4 per share on application and ₹ 3 per share on allotment. Pass journal entry for forfeiture of shares.
- (2) N Ltd. forfeited 2400 equity shares of ₹ 10 each of Shri Premabhai for non-payment of ₹ 2 per share on share first call. An amount of ₹ 3 per share on application and ₹ 3 per share on allotment is received by company from Shri Premabhai. The company has called up ₹ 8 per share till date. Pass journal entry for forfeiture of shares in the books of company.
- (3) Q Ltd. had called total ₹ 22 per share (including premium of ₹ 12 per share) from the shareholders. Kinjal had paid ₹ 15 per share (including premium of ₹ 12 per share) on application and ₹ 4 per share on allotment on her 500 shares. Kinjal failed to pay ₹ 3 per share on final call on her 500 shares, so company forfeited her shares. Pass the journal entries in the books of company for forfeiture of shares.
- (4) P Ltd., had issued shares of ₹ 10 each at 50 % premium. Company had called ₹ 4 with application, ₹ 8 (including premium) on allotment and ₹ 3 on first and final call. Shri Jigar who holds 600 shares, paid only application money to company. The company forfeited his shares after first and final call.

Give a journal entry in books of company for forfeiture of shares.

Ans. :

(1) Journal Entry in the Books of M Limited

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity share capital A/c Dr (600 shares × ₹ 10)		6000	
	To Share forfeiture A/c (600 share × ₹ 7)			4200
	To Share final call A/c (600 share × ₹ 3)			1800
	[Being forfeiture of 600 shares of Govind.]			

**Explanation :** Company forfeited shares of Govind, so his shares are cancelled. Amount called up per share on capital account ₹ 10 per share will be debited to share capital account. Amount of ₹ 7 per share paid by Govind will be credited to share forfeiture account and amount not paid towards capital account for final call at ₹ 3 per share will be credited to share final call account.

(2) Journal Entry in the Books of N Limited

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity share capital A/c Dr (2400 shares × ₹ 8)		19,200	
	To Forfeiture A/c (2400 shares × ₹ 6)			14,400
	To Share first call A/c or call-in-arrears A/c (2400 shares × ₹ 2)			4800
	[Being non-payment of first call money on 2400 shares by Premabhai, his shares forfeited after first call.]			

**Explanation :** Company forfeited Premabhai's shares immediately after first call. So, in above journal entry, equity share capital account is debited with ₹ 19,200 (Number of share forfeited 2400 shares × ₹ 8 per share called up on capital account).

(3) Journal Entry in the Books of Q Limited

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity share capital A/c Dr (500 shares × ₹ 10)		5000	
	To Share forfeiture A/c (500 shares × ₹ 7)			3500
	To Share final call A/c (500 shares × ₹ 3)			1500
	[Being non-payment of final call amount by Kinjal, her shares are forfeited.]			



**Explanation :** Kinjal has already paid premium amount at the time of application, so that would not be given any effect of securities premium on forfeiture. Amount paid on application ₹ 3 per share and on allotment ₹ 4 per share, total ₹ 7 per share for face value of share will be credited to share forfeiture account.

**(4) Journal Entries in the Books of P Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Equity share capital A/c Dr (600 shares × ₹ 10)		6000	
	Securities premium account A/c Dr (600 shares × ₹ 5)		3000	
	To Share forfeiture A/c (600 shares × ₹ 4)			2400
	To Share allotment A/c (600 shares × ₹ 8)			4800
	To Share first and final call A/c (600 shares × ₹ 3)			1800
	[Being forfeiture of 600 shares of Jigar for non-payment of allotment money and call money after paying share application money.]			

**Explanation :** Shri Jigar has not paid total ₹ 8 per share on allotment with premium. So here, total amount of ₹ 3000 (600 shares × ₹ 5) debited to securities premium A/c, where total amount ₹ 4800 (600 shares × ₹ 8) has been credited to share allotment A/c.

**13. For Reissue of Forfeited Shares**

Company can reissue forfeited shares. For this, directors of the company have the full authority by law. Directors can reissue these shares at par, at premium or at discount.

On reissue of shares, the company must get at least an amount equal to the amount not received on capital account on forfeited shares. It means, at the time of reissue of forfeited shares, company can give maximum discount to new shareholders upto the amount forfeited.

So, the maximum discount that can be given on reissue of forfeited shares is equal to the amount forfeited on capital account which was received on these shares. In such case, there is no need for any sanction for the discount amount. e.g. a shareholder has paid ₹ 7 per share on face value of ₹ 10 per share and has not paid ₹ 3 per share. If his shares are forfeited and reissued thereafter, maximum discount upto ₹ 7 per share can be given on reissue thereof.

On reissue of forfeited shares, amount received from new shareholder (purchaser) is debited to '**Bank account**'. If these shares are issued at discount then amount of discount is debited to '**Share Forfeiture Account**'. Here, due to reissue of shares, amount of face value of shares is credited to '**Share Capital Account**'.

- **Following journal entries are passed for reissue of forfeited shares under different situations :**

(I) If the forfeited shares are reissued at par,

	Bank A/c	Dr	.....	
	To Share capital A/c			.....

(II) If the forfeited shares are reissued at premium,

	Bank A/c	Dr	.....	
	To Share capital A/c			.....
	To Securities premium A/c			.....

(III) If the forfeited shares are reissued at discount,

Bank A/c ...Dr	[Number of share reissued × Amount per share at which shares are issued.]
Share forfeited A/c ...Dr	[Number of shares reissued × Discount amount per share]
To Share capital A/c	[Number of shares reissued × paid up amount per share]

- **Balance of share forfeiture account :**

After the reissue of forfeited shares, the credit balance left in the share forfeiture account for those shares is transferred to 'Capital Reserve Account'.

Share forfeiture is not day-to-day business transaction of a company. Any surplus or profit on account of forfeiture of share is a capital profit. Therefore, the amount of forfeited shares is transferred to capital reserve account. The following entry will be passed in the book of company.

Share forfeiture A/c	Dr	.....	
To Capital reserve A/c			.....
[Being transfer of balance of forfeited share account in respect of reissued shares to capital reserve account.]			

- **Other points to be kept in mind while reissuing forfeited shares :**

- (I) Unless the forfeited shares are reissued, the balance of the forfeited shares' account is added to paid-up capital under subscribed share capital in the note to accounts on 'share capital'.
- (II) When a part of forfeited shares is only reissued, the proportionate amount only in respect of forfeited shares which are reissued, will be transferred to capital reserve account. Credit balance of forfeited shares will continue on other shares which are not yet reissued.
- (III) Shares in respect of which any amount is not paid can be forfeited by board of directors by passing a resolution at any time after allotment or first call or final call. Such forfeited shares can be reissued immediately after forfeiture that means after allotment or after first call or after final call.



- Let us understand journal entries for forfeiture and reissue of forfeited shares in the books of company under different situations with the help of following illustration.

**Illustration 10 :** Pass necessary journal entries in the books of company relating to forfeiture and reissue of shares in respect of following transactions :

- (A) On 1-3-2017, company forfeited 500 equity shares of ₹ 10 each of Harnish. Harnish did not pay ₹ 3 per share in respect of share final call. On 2-4-2017, company reissued forfeited shares at ₹ 8 per share, which were purchased by Sanjay.
- (B) On 10-7-2017, company forfeited 350 equity share of Avadh of face value of ₹ 10 each for non-payment of ₹ 3 per share on first call and ₹ 2 per share on second and final call. On 12-8-2017, all 350 forfeited shares are reissued at ₹ 7 per share which were bought by Dharmesh.
- (C) On 14-9-2017, company forfeited 1200 equity share of Dhrumal of face value of ₹ 10 each for non payment of ₹ 3 per share on final call. Dhrumal had paid ₹ 4 per share on application and ₹ 8 per share (including premium of ₹ 5 per share) on allotment. Out of forfeited shares, company reissued 800 equity shares to Minesh on 16-10-2017 at a discount of ₹ 5 per share.
- (D) On 1-8-2017 company forfeited 700 equity shares of ₹ 10 each of Hetansh for non-payment of share allotment money of ₹ 54 per share (including premium of ₹ 50 per share) and ₹ 3 per share on final call money. Out of forfeited shares, company reissued 500 equity shares on 10-9-2017 at ₹ 35 per share (including premium of ₹ 25 for each share) to Hiren.
- (E) Company forfeited 2000 equity shares of Girish on 11-10-2017 for non-payment of ₹ 3 per share on first call and ₹ 2 per share on final call. Company had originally issued this share at face value of ₹ 10 per share.
- Out of forfeited shares, company reissued 1200 equity shares to Neel on 4-11-2017 at ₹ 8 per share and remaining equity shares were reissued on 22-11-2017 to Harsh at ₹ 7 per share.

**Ans. :**

**Journal Entries in the Books of Company**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
10(A) 1-3-2017	<div style="display: flex; justify-content: space-between;"> <div>Equity share capital A/c (500 shares × ₹ 10)</div> <div>Dr</div> </div> <div style="display: flex; justify-content: space-between;"> <div>To Share forfeiture A/c (500 shares × ₹ 7)</div> <div></div> </div> <div style="display: flex; justify-content: space-between;"> <div>To Share final call A/c (500 shares × ₹ 3)</div> <div></div> </div> <div>[Being forfeited 500 shares of Harnish due to non-payment of share final call amount.]</div>		5000	3500  1500

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2-4-2017	Bank A/c Dr (500 shares × ₹ 8) Share forfeiture A/c Dr (500 shares × ₹ 2) To Equity share capital A/c (500 shares × ₹ 10) [Being reissue of 500 forfeited shares at ₹ 8 per share.]		4000  1000	5000
2-4-2017	Share forfeiture A/c Dr To Capital reserve A/c [Being balance of share forfeiture A/c ₹ 3500 credit – ₹ 1000 debit = ₹ 2500 transfer to capital reserve A/c.]		2500	2500
<b>10(B)</b> 10-7-2017	Equity share capital A/c Dr (350 shares × ₹ 10) To Share forfeiture A/c (350 shares × ₹ 5) To Shares' first call A/c (350 shares × ₹ 3) To Shares' second and final call A/c (350 shares × ₹ 2) [Being forfeiture of 350 shares of Avadh for non-payment of share first call and share second and final call.]		3500	1750  1050  700
12-8-2017	Bank A/c Dr (350 shares × ₹ 7) Share forfeiture A/c Dr (350 shares × ₹ 3) To Equity share capital A/c (350 shares × ₹ 10) [Being reissue of 350 forfeited shares at ₹ 7 per share.]		2450  1050	3500

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
12-8-2017	Share forfeiture A/c Dr To Capital reserve A/c [Being balance of share forfeiture account ₹ 700 (₹ 1750 credit – ₹ 1050 debit) transfer to capital reserve A/c]		700	700
<b>10(C)</b> 14-9-2017	Equity share capital A/c Dr (1200 shares × ₹ 10) To Share forfeiture A/c (1200 shares × ₹ 7) To Shares final call A/c (1200 shares × ₹ 3) [Being forfeiture of 1200 shares of Dharmal for non-payment of final call amount.]		12,000	8400 3600
16-10-2017	Bank A/c Dr (800 shares × ₹ 5) Share forfeiture A/c Dr (800 shares × ₹ 5) To Equity share capital A/c (800 shares × ₹ 10) [Being reissue of 800 shares at a discount of ₹ 5 per share out of 1200 forfeited shares.]		4000 4000	8000
16-10-2017	Share forfeiture A/c Dr To Capital reserve A/c [Being transfer of proportionate credit balance of share forfeiture account in respect of 800 shares out of 1200 shares of Dharmal to capital reserve A/c.] *Credit balance of share forfeiture is ₹ 8400 for 1200 shares. Out of this 800 shares are reissued, so proportionate credit balance of share forfeiture is ₹ 5600. From this subtract debit balance of share forfeiture ₹ 4000, credit balance of share forfeiture of ₹ 1600 transfer to capital reserve account. Credit balance of share forfeiture a/c of ₹ 2800 will continue on 400 shares, which are not reissued.		1600	1600

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
<b>10(D)</b>				
1-8-2017	Equity share capital A/c Dr (700 shares × ₹ 10)		7000	
	Securities premium A/c Dr (700 shares × ₹ 50)		35,000	
	To Share forfeiture A/c (700 shares × ₹ 3)			2100
	To Share allotment A/c (700 shares × ₹ 54)			37,800
	To Shares final call A/c (700 shares × ₹ 3)			2100
	[Being forfeited 700 shares of Hetansh for non-payment of amount on share allotment and share final call.]			
10-9-2017	Bank A/c Dr (500 shares × ₹ 35)		17,500	
	To Equity share capital A/c (500 shares × ₹ 10)			5000
	To Securities premium A/c (500 shares × ₹ 25)			12,500
	[Being reissue of 500 share at ₹ 35 per share (including premium of ₹ 25) out of 700 forfeited shares.]			
10-9-2017	Share forfeiture A/c Dr		1500	
	To Capital reserve A/c			1500
	[Being transfer of proportionate amount of ₹ 1500 to capital reserve account on reissued 500 shares against credit balance of share forfeiture a/c of ₹ 2100 on 700 forfeiture shares.]			
	* Credit balance of share forfeiture account			
	(700 shares × ₹ 3)	= ₹ 2100		
	Less : Credit balance of share forfeiture a/c on reissued forfeited shares (500 shares × ₹ 3)			
		= ₹ 1500		
	Balance of share forfeiture account			
	will continue of balance 200 shares	= ₹ 600		

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
<b>10(E)</b> 11-10-2017	Equity share capital A/c Dr (2000 shares × ₹ 10) To Share forfeiture A/c (2000 shares × ₹ 5) To Shares' first call A/c (2000 shares × ₹ 3) To Shares' final call A/c (2000 shares × ₹ 2) [Being forfeiture of 2000 shares of Girish for non-payment of share first call and share final call.]		20,000	10,000 6000 4000
4-11-2017	Bank A/c Dr (1200 shares × ₹ 8) Share forfeiture A/c Dr (1200 shares × ₹ 2) To Equity share capital A/c (1200 shares × ₹ 10) [Being reissue of 1200 shares to Neel at ₹ 8 per share out of 2000 forfeited shares.]		9600 2400	12,000
4-11-2017	Share forfeiture A/c Dr To Capital reserve A/c [Being balance of share forfeiture for 1200 equity shares transfer to capital reserve A/c.] Calculation : Proportional amount of share forfeiture for 1200 shares ₹ 6000 Less : Amt. debited to share forfeiture A/c ₹ 2400 Capital reserve A/c ₹ 3600		3600	3600
22-11-2017	Bank A/c Dr (800 shares × ₹ 7) Share forfeiture A/c Dr (800 shares × ₹ 3) To Equity share capital A/c (800 shares × ₹ 10) [Being reissue of balance 800 shares to Harsh at ₹ 7 per share out of 2000 forfeited shares.]		5600 2400	8000



Date	Particulars	L.F.	Debit (₹)	Credit (₹)
22-11-2017	Share forfeiture A/c Dr To Capital reserve A/c [Being balance of share forfeiture A/c of 800 equity shares' transfer to capital reserve A/c.] Calculation : Proportional amount of share forfeiture for 800 shares ₹ 4000 Less : Amt. debited to share forfeiture A/c ₹ 2400 To capital reserve A/c ₹ 1600		1600	1600

**Illustration 11 :** Naznin Textiles Limited issued 12,00,000 equity shares of ₹ 10 each. On which amount was payable as under :

On application ₹ 4 per share

On allotment ₹ 4 per share and

On final call ₹ 2 per share

Company received application for 15,50,000 equity shares from public. Excess applications were rejected and amount paid on application thereon was refunded.

Harun, who was allotted 8000 shares, had not paid allotment and final call amount.

Salim, who was allotted 2000 shares, had not paid amount on final call. Company forfeited shares of Harun and Salim and all the forfeited shares were reissued at ₹ 7.50 per share as fully paid up. All these shares were purchased by Shahrukh.

Pass necessary journal entries in the books of company to record above transactions and also prepare share forfeiture account.

**Ans. :**

**Journal Entries in the Book of Naznin Textiles Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being amount received on 15,50,000 equity shares' application at ₹ 4 per share.]		62,00,000	62,00,000
2	Equity share application A/c Dr To Equity share capital A/c To Bank A/c [Being application money on rejected 3,50,000 shares at ₹ 4 per share refunded to share applicants after allotting 12,00,000 shares.]		62,00,000	48,00,000 14,00,000



Date	Particulars	L.F.	Debit (₹)	Credit (₹)
9	Share forfeiture A/c Dr To Capital reserve A/c [Being credit balance of share forfeiture account transfer to capital reserve account.] * Credit balance of share forfeiture account ₹ 48,000 less debit balance ₹ 25,000 = ₹ 23,000 credit balance		23,000	23,000
	<b>Total</b>		<b>2,70,23,000</b>	<b>2,70,23,000</b>

**Note :** Sometimes, when amount is not received on called amount on allotment or calls for shares, then amount which was not received, is transferred to 'Calls-in-Arrears A/c.' In case 'Calls-in-Arrears' account is maintained by a company, then at the time of forfeiture of shares, 'Calls-in-Arrears A/c' would be credited instead of respective calls account. Same effect is given in above illustration.

#### Share Forfeiture Account

Dr

Cr

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
8	To Equity share capital A/c		25,000	7	By Equity share capital A/c		48,000
9	To Capital reserve A/c		23,000				
			<b>48,000</b>				<b>48,000</b>

**Illustration 12 :** Dhyani Ceramic Limited issued 3,00,000 equity shares of ₹ 10 each at a premium of ₹ 150 per share. Amount called up per share was as under :

On application ₹ 74 (Including ₹ 70 for premium)

On allotment ₹ 44 and (Including ₹ 40 for premium)

On final call ₹ 42 (Including ₹ 40 for premium)

Company received application for 3,00,000 shares. All amounts due were received except final call on 2000 shares held by Vishal. Company forfeited Vishal's shares after carrying out necessary formalities and reissued those shares to Avani as full paid up at ₹ 80 per share.

Pass necessary journal entries for above transaction in the books of company and also prepare securities premium account.

**Ans. :**

#### Journal Entries in the Books of Dhyani Ceramic Limited

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being receipt of share application money on 3,00,000 equity shares at ₹ 74 per share.]		2,22,00,000	2,22,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2	Equity share application A/c Dr To Equity share capital A/c To Securities premium A/c [Being transfer of ₹ 4 per share to share capital account and ₹ 70 per share to securities premium account out of total share application money on 3,00,000 allotted shares.]		2,22,00,000	12,00,000 2,10,00,000
3	Equity share allotment A/c Dr To Equity share capital A/c To Securities premium A/c [Being allotment money of ₹ 44 per share (including premium of ₹ 40) due on 3,00,000 shares.]		1,32,00,000	12,00,000 1,20,00,000
4	Bank A/c Dr To Equity share allotment A/c [Being receipt of full amount of share allotment.]		1,32,00,000	1,32,00,000
5	Equity shares final call A/c Dr To Equity share capital A/c To Securities premium A/c [Being final call of ₹ 42 (including premium of ₹ 40) per share due on 3,00,000 shares.]		1,26,00,000	6,00,000 1,20,00,000
6	Bank A/c Dr To Equity shares' final call A/c [Being receipt of share final call amount on 2,98,000 shares except 2000 shares of Vishal.]		1,25,16,000	1,25,16,000
7	Equity share capital A/c Dr (2000 shares × ₹ 10) Securities premium A/c Dr (2000 shares × ₹ 40) To Share forfeiture A/c (2000 shares × ₹ 8) To Equity shares final call A/c (2000 shares × ₹ 42) [Being forfeiture of 2000 shares of Vishal for non-receipt of final call.]		20,000 80,000	16,000 84,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
8	Bank A/c Dr To Equity share capital A/c (2000 shares × ₹ 10) To Securities premium A/c (2000 shares × ₹ 70) [Being reissue of 2000 shares at ₹ 80 per share.]		1,60,000	20,000 1,40,000
9	Share forfeiture A/c Dr To Capital reserve A/c [Being balance of share forfeiture account transfer to capital reserve account.]		16,000	16,000
	<b>Total</b>		<b>9,61,92,000</b>	<b>9,61,92,000</b>

**In the Ledger of Dhyani Ceramic Limited  
Securities Premium Account**

Debit

Credit

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
7	To Equity shares final call A/c To Balance c/d		80,000 4,50,60,000	2	By Equity share application A/c		2,10,00,000
				3	By Equity shares allotment A/c		1,20,00,000
				5	By Equity shares' final call A/c		1,20,00,000
				8	By Bank A/c		1,40,000
			<b>4,51,40,000</b>				<b>4,51,40,000</b>

**Illustration 13 :** A limited company issued 18,00,000 equity shares of ₹ 10 each. Amount called up per share was as under :

₹ 3 per share on application

₹ 3 per share on first call

₹ 2 per share on allotment

₹ 2 per share on final call

All amounts due were received on due dates except from the following persons.

Ami, who was holding 1200 shares did not pay money due on allotment, first call and final call.

Rami, who was holding 800 shares did not pay money due on first call and final call.

Gami, who was holding 1600 shares did not pay amount due on final call.

After necessary formalities, all the shares of these three persons were forfeited and were reissued at ₹ 8 per share.

Write journal entries in the books of company for forfeiture and reissue of forfeited shares.



**Ans. :** Calculation of amount which is received and which is not received on shares forfeited.

(Note : Amount not received is shown in brackets.)

	No. of shares	On application ₹ 3 per share	On allotment ₹ 2 per share	On first call ₹ 3 per share	On final call ₹ 2 per share	Total Amt. Received (₹)
Ami	1200	3600	(2400)	(3600)	(2400)	<b>3600</b>
Rami	800	2400	1600	(2400)	(1600)	<b>4000</b>
Gami	1600	4800	3200	4800	(3200)	<b>12,800</b>
Amt. not received		—	(2400)	(6000)	(7200)	—
Amt. received →		10,800	4800	4800	—	<b>20,400</b>
Total no.of shares	3600					

**Journal Entries in Books of Company**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Equity share capital A/c <span style="float: right;">Dr</span> (3600 shares × ₹ 10) To Forfeited shares' A/c (Total amount received) To Share allotment A/c To Shares first call A/c To Shares final call A/c [Being total 3600 shares of Ami, Rami and Gami which were forfeited because of non-receipt of full amount due on shares.]		36,000	20,400  2400 6000 7200
2	Bank A/c <span style="float: right;">Dr</span> (3600 shares × ₹ 8) Forfeited shares' A/c <span style="float: right;">Dr</span> (3600 shares × ₹ 2) To Equity share capital A/c (3600 shares × ₹ 10) [Being reissue of forfeited shares at ₹ 8 per shares.]		28,800  7200	36,000
3	Forfeited share' A/c <span style="float: right;">Dr</span> To Capital reserve A/c [Being balance of forfeited share a/c ₹ 13,200 (₹ 20,400 — ₹ 7200) transferred to capital reserve account.]		13,200	13,200

**Illustration 14 :** Dipak Limited issued 5,00,000 equity shares of ₹ 10 each at a premium of ₹ 25 per share. Amount payable on shares was as under :

On application ₹ 13 per share (Including premium ₹ 10)

On allotment ₹ 17 per share (Including premium ₹ 15)

On first call ₹ 2 per share

On final call ₹ 3 per share

Applications were received for total 5,80,000 shares. Excess applications were rejected and amount paid thereon was refunded.

Anup, who was allotted 4000 shares, could not pay allotment money hence shares were forfeited after allotment.

Purvi, who was allotted 3000 shares, could not pay first call money and hence her shares were forfeited after first call.

Amount due on final call on remaining shares was received in full.

Pass necessary journal entries in books of company for recording above transactions.

**Ans. :**

**Journal Entries in Books of Dipak Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c <span style="float: right;">Dr</span> To Share application A/c [Being share application money received on 5,80,000 shares at ₹ 13 per share.]		75,40,000	75,40,000
2	Share application A/c <span style="float: right;">Dr</span> To Equity share capital A/c To Securities premium A/c To Bank A/c [Being ₹ 3 per share to share capital account and ₹ 10 per share to securities premium account on 5,00,000 allotted shares and refund ₹ 13 per shares on rejected 80,000 shares.]		75,40,000	15,00,000 50,00,000 10,40,000
3	Share allotment A/c <span style="float: right;">Dr</span> To Equity share capital A/c To Securities premium A/c [Being allotment money due on 5,00,000 shares at ₹ 17 per share (including ₹ 15 for premium)]		85,00,000	10,00,000 75,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
4	Bank A/c Dr To Share allotment A/c [Being receipt of full amount of share allotment money on balance 4,96,000 shares except 4000 shares of Anup.]		84,32,000	84,32,000
5	Equity share capital A/c Dr (4000 shares × ₹ 5) Securities premium A/c Dr (4000 shares × ₹ 15) To Share forfeiture A/c (4000 shares × ₹ 3) To Share allotment A/c (4000 shares × ₹ 17) [Being non receipt of allotment amount on 4000 shares of Anup, these shares were forfeited after allotment.]		20,000 60,000	12,000 68,000
6	Shares first call A/c Dr To Equity share capital A/c [Being amount called on first call on 4,96,000 shares at ₹ 2 per share.] * Due to forfeited 4000 shares of Anup, first call has not been called.		9,92,000	9,92,000
7	Bank A/c Dr To Shares' first call A/c [Being receipt of full amount on share first call on balance 4,93,000 shares except 3000 shares of Purvi.]		9,86,000	9,86,000
8	Equity share capital A/c Dr (3000 shares × ₹ 7) To Share forfeiture A/c (3000 shares × ₹ 5) To Shares first call A/c (3000 shares × ₹ 2) [Being non-receipt of first call amount on 3000 shares of Purvi, these shares were forfeited after first call.]		21,000	15,000 6000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
9	Shares final call A/c Dr To Equity share capital A/c [Being amount due on final call on 4,93,000 shares at ₹ 3 per share.]		14,79,000	14,79,000
10	Bank A/c Dr To Shares final call A/c [Being receipt of full amount called on share final call.]		14,79,000	14,79,000
	<b>Total</b>		<b>3,70,49,000</b>	<b>3,70,49,000</b>

**Note :** In transaction no. 9, final call on 4000 forfeited shares of Anup and 3000 shares of Purvi has not called.

#### 14. Pro-rata Allotment of Shares

We have seen in previous point that, when the number of shares applied for is more than the number of shares offered for subscription by company is said to be over subscribed. In this situation, shares can be allotted by the company by any of the following alternatives :

- Full allotment of shares against shares applied by applicants. e.g. allotment of 500 shares to applicants of 500 shares.
- Not a single share allotted to shares applicants against their application. e.g. not to allot single share to applicants of 200 shares.
- Allotted shares in proportion to share applicants against their application. e.g. Allotment to 300 shares to applicants of 500 shares.

So, as per (iii) situation, some shares are allotted on pro-rata basis to share applicants against their share application.

In this situation, the excess amount received on application from applicants is utilised towards the even amount due on allotment. After this, even if there is any surplus amount, then it will be adjusted towards share calls. If still any surplus amount remains, then it will be refunded to share applicants. Let us understand the above points by following illustration.

**Illustration 15 :** Bharti Food Products Ltd. issued 80,000 equity shares to the public at ₹ 10 per share.

Company called up the amount as under :

On application ₹ 4 per share, on allotment ₹ 3 per share and on final call ₹ 3 per share.

Applications were received from public for 1,20,000 shares, its allotment was made by company as under :

Full allotment was made to applicants of 32,000 shares.

Not a single share was allotted to applicants of 24,000 shares.

48,000 shares were allotted to applicants of 64,000 shares.

All amounts were received in time. Pass journal entries in book of the company from above information.

Ans. :

**Journal Entries in the Books of Bharti Food Product Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being application money received on 1,20,000 shares at ₹ 4 per share.]		4,80,000	4,80,000
2	Equity share application A/c Dr To Equity share capital A/c (80,000 shares × ₹ 4) To Equity allotment A/c (16,000 shares × ₹ 4) To Bank A/c (24,000 shares × ₹ 4) [Being transfer share application money to equity share capital account for 80,000 allotted shares at ₹ 4 per share, refund money on 24,000 shares at ₹ 4 per share and excess amount of applicants of 16,000 shares to share allotment account at ₹ 4 per share.]		4,80,000	3,20,000 64,000 96,000
3	Equity share allotment A/c Dr To Equity share capital A/c [Being allotment money due on 80,000 shares at ₹ 3 per share.]		2,40,000	2,40,000
4	Bank A/c Dr To Equity share allotment A/c [Being after deducting ₹ 64,000 of advance allotment money, balance amount fully received on allotment.]		1,76,000	1,76,000
5	Shares' final call A/c Dr To Equity share capital A/c [Being amount due on final call at ₹ 3 per share.]		2,40,000	2,40,000
6	Bank A/c Dr To Shares final call A/c [Being full amount is received on final call..]		2,40,000	2,40,000
	<b>Total</b>		<b>18,56,000</b>	<b>18,56,000</b>



**Calculation :**

	Number of share application	Amount paid on application (₹)	Share allotted	Transfer to share application (₹)	Transfer to share allotment (₹)	Transfer to share final call (₹)	Amount refunded (₹)
	32,000	1,28,000	32,000	1,28,000	—	—	—
	24,000	96,000	—	—	—	—	96,000
	64,000	2,56,000	48,000	1,92,000	64,000	—	—
<b>Total</b>	<b>1,20,000</b>	<b>4,80,000</b>	<b>80,000</b>	<b>3,20,000</b>	<b>64,000</b>	<b>—</b>	<b>96,000</b>

**Illustration 16 :** Bhadresh Diamond Ltd. of Surat issued 3,00,000 equity shares of ₹ 10 per share.

Amount called up on application at ₹ 3 per share, on allotment ₹ 2.50 per share, on first call at ₹ 2.50 per share and on final call at ₹ 2 per share.

Applications were received from public of 4,56,000 shares. Allotment of 3,00,000 shares was made pro-rata to 4,50,000 applicants. Application for 6000 shares were rejected. Full amounts were received from all shareholders except from a shareholder named Daxa. Daxa who was allotted 600 shares, did not pay final call money. Her shares were forfeited. Total shares of Daxa were reissued as fully paid up at ₹ 9 per share.

Pass journal entries in the books of company for the above transactions.

**Ans. :**

**Journal Entries in the Book of Bhadresh Diamond Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being application money received on 4,56,000 shares at ₹ 3 per share.]		13,68,000	13,68,000
2	Equity share application A/c Dr To Equity share capital A/c (3,00,000 shares × ₹ 3) To Equity share allotment A/c (1,50,000 shares × ₹ 3) To Bank A/c (6000 shares × ₹ 3) [Being from application money, amount transfer to share capital account of allotted shares, excess amount of share application transfer to share allotment account and amount refunded to applicants of 6000 shares.]		13,68,000	9,00,000 4,50,000 18,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
3	Equity share allotment A/c Dr To Equity share capital A/c [Being allotment amount due on 3,00,000 shares at ₹ 2.50 per share.]		7,50,000	7,50,000
4	Bank A/c Dr To Equity share allotment A/c [Being amount received on share allotment.]		3,00,000	3,00,000
5	Equity shares first call A/c Dr To Equity share capital A/c [Being first call amount due on 3,00,000 shares at ₹ 2.50 per share.]		7,50,000	7,50,000
6	Bank A/c Dr To Equity shares first call A/c [Being full amount received on amount due on first call.]		7,50,000	7,50,000
7	Equity shares final call A/c Dr To Equity share capital A/c [Being final call amount due on 3,00,000 shares at ₹ 2 per share.]		6,00,000	6,00,000
8	Bank A/c Dr To Shares' equity shares final call A/c [Being amount received on final call except 600 shares of Daxa at ₹ 2 per shares total ₹ 1200.]		5,98,800	5,98,800
9	Equity share capital A/c Dr (600 shares × ₹ 10) To Share forfeiture A/c (600 shares × ₹ 8) To Final call A/c (600 shares × ₹ 2) [Being forfeited 600 shares of Daxa.]		6000	4800 1200
10	Bank A/c (600 shares × ₹ 9) Dr Share forfeiture A/c (600 shares × ₹ 1) Dr To Equity share capital A/c [Being reissue of 600 forfeited shares of Daxa.]		5400 600	6000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
11	Share forfeiture A/c Dr To Capital reserve A/c [Being balance of share forfeiture account transfer to capital reserve account.]		4200	4200
	<b>Total</b>		<b>65,01,000</b>	<b>65,01,000</b>

**Illustration 17 :** Nupur Limited issued 5,00,000 equity shares of ₹ 10 each at a premium of 100 %.

Amount called up per share is as under :

On application ₹ 5

On allotment ₹ 2 + premium

On first and final call ₹ 3

Applications were received two and half times. Out of which  $\frac{2}{5}$ th share applications were rejected fully and pro-rata allotment was made to the remaining applications. Excess application money were credited to allotment money and still if any surplus then credited to share calls.

Write necessary journal entries in the books of Nupur Limited.

**Ans. :**

**Calculation :** 100 % premium on ₹ 10 per share means ₹ 10.

Total application received	Share allotment
$12,50,000 \times \frac{2}{5} = 5,00,000$	—
7,50,000	5,00,000 (3:2 ratio)
<u>12,50,000</u>	<u>5,00,000</u>

**Working of amount received by company on allotment :**

Amount received on application = ₹ 37,50,000

[7,50,000 shares × ₹ 5]

Less : Application amount of allotted shares

Amt. [5,00,000 shares × ₹ 5] = ₹ 25,00,000

Surplus amount transfer to share allotment

= ₹ 12,50,000

• Amount called on share allotment = ₹ 60,00,000

[5,00,000 shares × ₹ 12]

Less : Advance amount received

on share allotment

= ₹ 12,50,000

Amount received on share allotment = ₹ 47,50,000

### Journal Entries in the Books of Nupur Limited

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Equity share application A/c [Being amount received on 12,50,000 shares at ₹ 5 per share for application.]		62,50,000	62,50,000
2	Equity share application A/c Dr To Equity share capital A/c (5,00,000 shares × ₹ 5) To Equity share allotment A/c (Surplus amount) To Bank A/c (Refund to applicants) [Being amount on 5,00,000 allotted shares to share capital account, surplus amount to share allotment account where amount refunded on 5,00,000 rejected shares to applicants.]		62,50,000	25,00,000 12,50,000 25,00,000
3	Equity share allotment A/c Dr To Equity share capital A/c To Securities premium A/c [Being amount called on 5,00,000 shares at ₹ 12 per share (including premium of ₹ 10.)]		60,00,000	10,00,000 50,00,000
4	Bank A/c Dr To Equity share allotment A/c [Being amount received for share allotment.]		47,50,000	47,50,000
5	Equity first and final call A/c Dr To Equity share capital A/c [Being amount called on 5,00,000 shares at ₹ 3 per share.]		15,00,000	15,00,000
6	Bank A/c Dr To Equity first and final call A/c [Being amount received on call.]		15,00,000	15,00,000
	<b>Total</b>		<b>2,62,50,000</b>	<b>2,62,50,000</b>

● **For Opening Share Application and Allotment Account :**

Now-a-days it is a practice to keep a common account for application and allotment instead of two separate accounts. In such a case a joint account named "Share Application and Allotment Account" is opened. Then all entries relating to application and allotment are made in this account.

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

(i) **On receipt of application money :**

Bank A/c ...Dr	[No. of shares applied × Application money
To share application and allotment A/c	per share]

(ii) **On transfer of application money to share capital and allotment money due :**

Share application and allotment A/c ...Dr	[No. of shares allotted × (Application
To share capital A/c	money per share + Allotment money per share)]

(iii) **On refund of money to applicants on rejected applications :**

Share application and allotment A/c ...Dr	[No. of shares rejected × Application
To bank A/c	money per share]

(iv) **On receipt of allotment money :**

Bank A/c ...Dr	[Actual amount received from
To share application and allotment A/c	shareholders on allotment.]

**Illustration 18 :** The authorised capital of Sanjay Limited of Patan is 1,60,000 shares of ₹ 5 each. On April 3, 2017, company issued 1,20,000 shares at a premium of ₹ 200 per share to public. Amount payable per share was as follows :

On application	₹ 102 per share (including premium of ₹ 100)
On allotment	₹ 103 per share (including premium ₹ 100) (As on May 1, 2017)

Upto April 5, 2017, company received application for 1,84,000 shares from public, from these applications 4000 shares were rejected and on balance share application 1,20,000 shares were allotted.

All called up amount were received in proper time. Company maintains the combined 'Share application and allotment account'.

Journalise the above mentioned transactions.

**Ans. : Calculation :** (₹)

Total amount received on share application (1,84,000 shares × ₹ 102)	1,87,68,000
Less : Amount on rejected share application (4000 shares × ₹ 102)	4,08,000
	<hr/> 1,83,60,000
Less : Amount of share application on allotted shares (1,20,000 shares × ₹ 102)	1,22,40,000
	<hr/> 61,20,000
Amount due on share allotment (1,20,000 shares × ₹ 103)	1,23,60,000
Less : Advance of allotment	61,20,000
<b>Amount received on allotment</b>	<b>62,40,000</b>



**Journal Entries in the Books of Sanjay Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2017 April, 5	Bank A/c Dr To Share application and allotment A/c [Being application money received on 1,84,000 shares at ₹ 102 per share.]		1,87,68,000	1,87,68,000
May, 1	Share application and allotment A/c Dr To Share capital A/c (1,20,000 shares × ₹ 5) To Securities premium A/c (1,20,000 shares × ₹ 200) [Being application amount on allotted shares at ₹ 2 per share and amount called on allotment at ₹ 3 per share transfer to share capital account, where amount on application ₹ 100 per share and called up amount on allotment ₹ 100 per share transfer to securities premium account.]		2,46,00,000	6,00,000 2,40,00,000
May, 1	Share application and allotment A/c Dr To Bank A/c [Being amount refunded on rejected application of 4000 shares at ₹ 102 per share.]		4,08,000	4,08,000
May, 1	Bank A/c Dr To Share application and allotment A/c [Being balance amount received on amount due on allotment (as per working).]		62,40,000	62,40,000
	<b>Total</b>		<b>5,00,16,000</b>	<b>5,00,16,000</b>

**15. Issue of Shares for Consideration Other Than Cash**

Usually, when company issue shares, it gets cash against such issue of shares. However, in some circumstances, company does not get cash against issue of shares. Such situations could be as under :

- (i) When company does not pay cash and issues shares for purchases of any assets or business.
- (ii) When company issues shares in lieu of remuneration payable to promoters.
- (iii) When company issues shares towards under-writing commission to underwriters.
- (iv) When company issues bonus shares to existing shareholders.

**Note :** Shares issued for consideration other than cash has to be shown separately in balance sheet of company under the heading 'Share capital'.

(i) **Shares issued against purchase of assets or business :**

When company purchases any assets or purchases any business, it may issue shares against consideration instead of giving cash. e.g. company issued some of equity shares in consideration of machinery purchased of ₹ 2,00,000. Here, following journal entries are made.

(I)	Machinery A/c ...Dr	2,00,000	
	To Vendor's A/c		2,00,000

(II)	Vendor's A/c ...Dr	2,00,000	
	To Equity share capital A/c		2,00,000

If company issues equity shares of ₹ 1,50,000 and balance amount by cheque in consideration of machinery purchased of ₹ 2,00,000, the entry will be as under :

Vendor's A/c ...Dr	2,00,000	
To Equity share capital A/c		1,50,000
To Bank A/c		50,000

When company purchases any business and shares are issued for consideration then, if value of issued shares is higher than the net assets of business, the amount of difference is transferred to 'Goodwill account', but if the value of issued shares is less than the net assets of business, the difference is transferred to 'Capital Reserve Account'.

**Illustration 19 :** Aakash Limited issued 8,00,000 equity shares of ₹ 10 each towards purchase of business of Patel Brothers. Company purchased following assets and liabilities of the firm.

	(₹)		(₹)
Land and building	28,00,000	Creditors	8,00,000
Plant and machinery	16,00,000	Stock	8,00,000
Vehicles and furniture	20,00,000	Bills receivable	8,00,000
Debtors	4,00,000		

Write journal entries in the books of company.

If company issue 3,50,000 shares of ₹ 10 each at a premium of ₹ 10 per share towards purchase of business of Patel Brother, then pass journal entries in the books of company.

**Ans. :** Net assets of business purchased by the company shall be calculated as under :

	(₹)
Land and building	28,00,000
Plant and machinery	16,00,000
Vehicles and furniture	20,00,000
Debtors	4,00,000
Stock	8,00,000
Bills receivable	8,00,000
	<hr/>
	84,00,000
Less : Creditors	8,00,000
	<hr/>
Net assets	76,00,000

Purchase consideration = 8,00,000 equity shares × ₹ 10 = ₹ 80,00,000

**Purchase consideration – Net assets = Goodwill**

₹ 80,00,000 – ₹ 76,00,000 = ₹ 4,00,000

**Journal Entries in the Books of Aakash Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Land and building A/c Dr Plant and machinery A/c Dr Vehicle and furniture A/c Dr Debtors A/c Dr Stock A/c Dr Bills receivable A/c Dr Goodwill A/c Dr To Creditors A/c To Patel Brothers A/c [Being purchase of business of Patel Brothers' firm.]		28,00,000 16,00,000 20,00,000 4,00,000 8,00,000 8,00,000 4,00,000	8,00,000 80,00,000
2	Patel Brothers A/c Dr To Equity share capital A/c [Being issue of 8,00,000 equity shares of ₹ 10 each against purchase consideration.]		80,00,000	80,00,000

Here, if company issues 3,50,000 shares, face value of share is ₹ 10 at a premium of ₹ 10 per share to Patel Brother then,

$$\begin{aligned}
 \text{Purchase consideration} &= 3,50,000 \text{ shares} \times ₹ 10 = ₹ 35,00,000 \\
 &\quad (\text{share capital A/c}) \\
 3,50,000 \text{ shares} \times ₹ 10 &= ₹ 35,00,000 \\
 &\quad (\text{premium A/c}) \\
 \text{Total purchase consideration} &= ₹ 70,00,000
 \end{aligned}$$

Net assets = ₹ 76,00,000

New assets – Purchase consideration = Capital reserve

₹ 76,00,000 – ₹ 70,00,000 = ₹ 6,00,000

**Journal Entries in the Books of Aakash Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Land and building A/c Dr Plant and machinery A/c Dr Vehicles and furnitue A/c Dr Debtors A/c Dr Stock A/c Dr Bills receivable A/c Dr To Creditors A/c To Capital reserve A/c To Patel Brothers A/c [Being purchase of business of Patel Brothers' firm.]		28,00,000 16,00,000 20,00,000 4,00,000 8,00,000 8,00,000	8,00,000 6,00,000 70,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2	Patel Brothers A/c Dr To Equity share capital A/c To Securities premium A/c [Being issue of 3,50,000 shares of ₹ 10 each, with a premium of ₹ 10 per share against purchase consideration.]		70,00,000	35,00,000 35,00,000

**(ii) Company may issue shares as remuneration to promoters or others who render their services :**

Sometimes, company issues shares to its promoters for their services. Similarly, company may issue shares towards remuneration to other persons who render managerial services or any other services.

For example, company issue 12,000 equity shares of ₹ 10 each to its promoter for his services. In this case, the journal entry will be as under :

Incorporation or formation expenses A/c ...Dr	1,20,000
To Equity share capital A/c	1,20,000

For example, company issue equity shares of ₹ 80,000 towards remuneration to a person who render services for company, in such case the journal entry will be as under :

Remuneration to respective service A/c ...Dr	80,000
To Equity share capital A/c	80,000

**(iii) Issue of shares to underwriters towards underwriting commission :**

Public company issues their shares in the public after getting certificate of incorporation. As per company act, at least 90 % subscription should be received from the issued shares. It is known as minimum subscription.

If company does not receive minimum subscription, company can not commence business or total subscription would be cancelled. To avoid such situation, underwriting agreement is entered into so that if shares are not fully subscribed, the brokers underwriting the shares will purchase the remaining shares. For this work, underwriters are paid some fixed commission.

Sometimes, such commission is given by issue of shares instead of paying the same in cash. In such case, journal entry in the books of company shall be passed as under :

- (I) When liability to pay commission to underwriters has been decided,

Underwriting commission A/c ...Dr	.....
To Underwriters A/c	.....

- (II) When company pays such commission by issue of shares,

Underwriters A/c ...Dr	.....
To Equity share capital A/c	.....

**(iv) Issue of bonus shares to existing shareholders :**

Shares issued without any consideration by a company to its present shareholders out of accumulated profits are known as bonus shares. The following two journal entries are written when bonus shares are issued by company :

(I) For providing for bonus out of general reserve or profit and loss account,

General reserve A/c ...Dr	.....
Profit and loss A/c ...Dr	.....
To Bonus to shareholder's A/c	.....

(II) For issue of bonus shares,

Bonus to shareholder's A/c ...Dr	.....
To Equity share capital A/c	.....

**Important notes :** Following,

- (i) Point no. 16 is given here only for information for the students. Items related to share capital in balance-sheet of company is presented here. This point is not expected for examination.
- (ii) In point no. 17, some important issues are given here only with the object that students can know present scenario of this chapter. This point (information) is also not expected for examination.

**16. Presentation of Share Capital in Company's Vertical Balance Sheet**

As per schedule III of Companies Act, 2013, share capital is to be disclosed in a company's balance sheet in the following manner.

**Company's Balance Sheet of ..... Company as on .....**

Particulars	Note No.	Amount current year (₹)	Amount previous year (₹)
<b>1. Equity and Liabilities :</b>			
<b>Shareholder's Fund :</b>			
(a) Share capital	1	.....	.....
(b) Reserve and surplus	2	.....	.....
(c) Money received against share warrants		.....	.....
<b>Non-current Liabilities :</b>			
<b>Current Liabilities :</b>			
<b>Other Current Liabilities :</b>			
Balance of calls-in-advance		.....	.....

As per schedule III disclosure requirements pertaining to share capital are to be provided in notes to accounts.



**Notes to Accounts :**

**(1) Share Capital :**

	(₹)	(₹)
<b>Authorised Capital :</b>		
..... equity shares of ₹ ..... each	.....	
..... preference shares of ₹ ..... each	.....	.....
<b>Issued Capital :</b>		
..... equity shares of ₹ ..... each	.....	
..... preference shares of ₹ ..... each	.....	.....
<b>Subscribed Capital :</b>		
<b>Subscribed and Fully Paid Capital :</b>		
..... equity shares of ₹ ..... each	.....	
..... preference shares of ₹ ..... each	.....	
(Of the above shares ..... shares are allotted as fully paid up pursuant to a contract without payments being received in cash.)		
<b>Subscribed But Not Fully Paid Capital :</b>		
..... shares of ₹ ..... each		
₹ ..... per share called-up	₹ .....	
<b>Less : Calls in arrears :</b>		
(i) By directors and officers of the company ₹ .....		
(ii) By others	₹ .....	
<b>Add : Forfeited shares</b>	₹ .....	.....

**(2) Reserve and Surplus :**

	(₹)	(₹)
Securities premium reserve	.....	
Capital reserve	.....	.....

**17. Some Important Issues**

**(1) Preferential Allotment :** Preferential allotment means allotment of shares at a predetermined price to the pre-identified people. Here preferential people means who are interested in taking a strategic stake in the company such as promoters, venture capitalists, financial institutions, buyers of company's products or its suppliers. The company is required to pass special resolution in the meeting of shareholders before proceeding with preferential allotment.

**(2) Sweat Equity Shares :** A company may issue sweat equity shares as per sec. 54 of Companies Act, 2013. Sweat equity shares means equity shares issued by the company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available intellectual property rights.

The issue of such shares is authorised by a special resolution passed by the company. The class of such shares should be of the class already issued earlier. The resolution so passed should specify the number of shares issued, what is current market price of it, how much consideration is decided against this issue, if any other matter and classes of directors or employees to whom such shares are to be issued.

If this type of shares are listed on a stock exchange then it should be issued in accordance with the regulations made by the SEBI. Company may issue this type of shares at a price lower than the nominal value of equity share. Such shares cannot be resold by their holders within a period of 3 years from the date of shares received, this is called lock-in-period.

The entries for issue of sweat equity shares are the same as for issue of other equity shares.

**(3) Employees Stock Option Plan - ESOP :** Employees Stock Option Plan means option granted by the company to its employees and to subscribe the shares at a price that is lower than the market price, i.e. fair value. It is option or right granted by the company in good faith but it is not an obligation on the employee to subscribe it. The employees may or may not exercise the option.

These shares are of the same class of shares already issued. It is authorised by a special resolution passed by the company. Employees stock option plan is a category of sweat equity shares.

**(4) Applications Supported by Blocked Amount - ASBA :** ASBA is a process developed by the Indian stock market regulator SEBI for applying to IPO. In ASBA, an IPO applicant's account doesn't get debited until shares are allotted to them.

Earlier Qualified Institutional Buyers (QIBs) were not allowed to participate in IPOs through ASBA facility.

Currently as per SEBI guidelines, non-retail investors i.e. Qualified Institutional Buyers and Non-institutional Investors, making application in public/rights issue shall mandatory make use of ASBA facility.

ASBA process facilitates retail individual investors bidding at a cut-off, with a single option, to apply through Self Certified Syndicate Banks (SCSBs), in which the investors have bank accounts. SCSBs are those banks which satisfy the conditions laid by SEBI. SCSBs would accept the applications, verify the application, block the fund to the extent of bid payment amount, upload the details in the web based bidding system of NSE, unblock once basis of allotment is finalized and transfer the amount for all shares to the issuer.

ASBA means "Applications Supported by Blocked Amount". ASBA is an application containing an authorization to block the application money in the bank account, for subscribing to an issue. If an investor is applying through ASBA, his application money on allotted shares shall be debited from the bank account only if his/her application is selected for allotment after the basis of allotment is finalized or when shares is not allotted, then control on block amount is withdrawn.

ASBA is stipulated by SEBI and available from most of the banks operating in India. This allows the investors money to remain with the bank till the shares are allotted after the IPO. This amount cannot be utilised by applicants. When shares are allotted only then required amount is transferred out of the investors account to the company's account. This eliminates the need for refunds on shares not being allotted.

In present scenario, investors may submit their ASBA applications to these SCSBs in order to apply for public issues. The list of SCSBs include banks likes Axis Bank, HDFC Bank, ICICI Bank, State Bank of India, Punjab National Bank, IDBI Bank and others.

There is no difference in both the methods of application, by ASBA and without ASBA for allotment of shares.

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### EXERCISE

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1. Select right answer for each question :

- (1) At what minimum price per share company can issue shares according to current provisions of Companies Act ?  
(a) ₹ 100 (b) ₹ 1000  
(c) ₹ 1 (d) ₹ 0.50
- (2) For public issue of shares company has to take a permission from whom ?  
(a) Central government (b) SEBI  
(ca) State government (d) Reserve Bank
- (3) As per SEBI guidelines, the minimum amount on each share called by company on application must be at least ..... % of the issue price.  
(a) 25 (b) 30  
(c) 5 (d) 20
- (4) If the company does not receive subscription for at least ..... of the public issue, then share issue would be cancelled.  
(a) 50 % (b) 75 %  
(c) 90 % (d) 100 %
- (5) At what maximum rate of percentage for premium on the face value of shares can be declared by the company on their issue shares ?  
(a) 10 % (b) 100 %  
(c) 25 % (d) No limit
- (6) When shares are forfeited then amount called up on forfeited shares is ..... .  
(a) debited to share forfeiture A/c (b) credited to share forfeiture A/c  
(c) credited to share capital A/c (d) debited to share capital A/c
- (7) What is the maximum rate of interest charged by company on calls-in-arrears as per schedule I of Table F ?  
(a) at 15 % p.a. (b) at 10 % p.a.  
(c) at 2 % p.m. (d) at 1 % p.m.

- (8) When all the forfeited shares are reissued then balance of share forfeiture account is transferred to ..... account.
- (a) share capital (b) profit-loss  
(c) capital reserve (d) general reserve
- (9) If premium amount has not been received on forfeited shares then proportionate amount of premium is ..... .
- (a) debited to securities premium account  
(b) credited to securities premium account  
(c) credited to capital reserve account  
(d) debited to share capital account
- (10) Which of the following is not shown under the heading 'Share Capital' in a balance sheet ?
- (a) Authorised capital (b) Issued capital  
(c) Reserve capital (d) Subscribed capital

**2. Write answer in two or three sentences :**

- (1) What is share and share capital ?  
(2) What is securities premium ?  
(3) What is meant by share forfeiture ?  
(4) In which circumstances do companies issue shares for consideration other than cash ?  
(5) Under which circumstances do companies issue shares for consideration other than cash ?  
(6) What is under-subscription and over-subscription of shares ?  
(7) What is pro-rata allotment of shares ?  
(8) Give any two uses of amount of securities premium reserve.

**3. Give differences :**

- (1) Over-subscription and under-subscription  
(2) Preference share and equity share  
(3) Reserved capital and capital reserve

**4. Give answer of the following questions in detail :**

- (1) What do you mean by share capital ? State the types of share capital.  
(2) What is a share ? State the types of shares.  
(3) Explain in details the method of issuing shares by private placement.  
(4) Write a short note on calls-in-arrears.  
(5) What is meant by calls-in-advance ? State the provisions of it under companies act.  
(6) What is meant by securities premium ? State the points to be kept in mind relating to securities premium.



5. Vaidya Limited of Nadiad company issued 7,50,000 equity shares of ₹ 10 each and the amount thereon was payable as under :
- ₹ 3 per share on application
  - ₹ 4 per share on allotment
  - ₹ 3 per share on first and final call
- Company received applications for 7,50,000 shares and all the applicants were allotted shares. Amounts due on allotment and calls were called at appropriate time and were all received on due dates.
- Pass journal entries for above transactions in the books of company.
6. Authorised capital of Mewada Ltd. of Himatnagar was divided into 4,00,000 equity shares of ₹ 10 each. Out of this, company issued 3,00,000 equity shares. Amount called up per share was as under :
- ₹ 4 on application
  - ₹ 3 on allotment
  - ₹ 3 on final call
- Company received applications for 3,60,000 shares. Excess applications were rejected and money paid thereon was refunded to applicants. All the sums due on allotment and final call were received in full except final call on 2000 equity shares held by Aasha.
- Pass journal entries in the books of company to record above transactions. Also prepare equity share capital account, equity share application account, equity share allotment account and equity share final call account.
7. Pagedar Sugar Limited of Nagpur issued 12,00,000 equity shares in the public of ₹ 10 each. Company received applications for 13,50,000 shares. Shares were allotted at a meeting of board of directors. Excess share applications were rejected and amount received thereon was refunded.
- Amount called up against shares was as under :
- On application ₹ 2.50 per share
  - On allotment ₹ 2.50 per share
  - On first call ₹ 2 per share
  - On final call ₹ 3 per share
- Aishwarya, who was allotted 960 shares, could not pay first call and final call money, where Vinay, who was allotted 1200 shares, could not pay final call money. Except this, all sums due from other shareholders were received. Aishwarya and Vinay had paid their arrears amount to company afterwards. Pass necessary journal entries to record above transactions in the books of company without giving effect of interest.
8. Chaudhari Agro Company of Vyara issued 5,00,000 equity shares of ₹ 10 each to public. Company called ₹ 3 per share on application, ₹ 4 per share on allotment and ₹ 3 per share on first and final call.



Company received application for 5,75,000 equity shares from public. Excess applications were rejected and money paid on them was refunded.

Viral, who had applied for 2000 shares, had paid full amount ₹ 10 per share along with application. Company had allotted him all the shares applied for. Yagnesh, who was allotted 2500 shares, had paid amount due on first and final call along with share allotment money. Except this, amount due on allotment and calls were duly received from time to time.

Pass necessary journal entries in the books of company for above transactions.

9. Nanavati Limited of Junagadh issued 3,00,000 equity shares of ₹ 10 each at a premium of ₹ 5 per share. Amount was called up as under :

On application ₹ 4 per share

On allotment ₹ 8 per share (including premium)

On final call ₹ 3 per share

Company received application for 3,50,000 shares. Excess applications were rejected and money paid thereon was refunded to applicants. All the sums due were received in full except allotment and final call on 3000 equity shares held by Ishira.

Pass journal entries in books of company.

10. Vala Manuf. Limited of Dhandhuka issued 4,00,000 equity shares of ₹ 10 each at a premium of ₹ 60 per share. Amount was called up per share as under :

On application ₹ 23 (including premium ₹ 20)

On allotment ₹ 34 (including premium ₹ 30)

On final call ₹ 13 (including premium ₹ 10)

Company received applications for 6,00,000 shares. Excess applications were rejected and money paid thereon was refunded. Amount due on allotment and final call were called up in time. All amounts due on allotment and call were received except allotment and final call money on 500 shares held by Himmatbhai and final call money on 300 shares held by Hima.

Pass necessary journal entries in books of company for above transactions.

11. Authorised capital of Mansuri Limited of Dahod was 7,00,000 equity shares of ₹ 10 each. On 4th July, 2017, company issued 4,50,000 equity shares at a premium of ₹ 16 per share for public subscription. Amount was called up for share as under.

On 4th July, 2017 ₹ 10 per share (including premium of ₹ 6 per share) with application.

On 4th August, 2017 ₹ 14 per share (including premium of ₹ 10 per share) with allotment.

On 4th September, 2017 ₹ 2 per share with first and final call.

The subscription was closed on 6th July, 2017 as it was fully subscribed. Board of directors allotted all the shares of share application.

Abdul holding 600 shares did not pay money due on allotment and first and final call. Where, Harun holding 400 shares had not paid first and final call money.

Except this, all the sums due were received by the following dates.

Share allotment money by 7th August, 2017.

Share first and final call money by 7th September, 2017.

Pass necessary journal entries except for cash in the books of company for above transactions and also prepare bank account.

12. Write journal entries in the books of company for forfeiture and reissue of forfeited shares from the following information :
- (i) Company forfeited 800 equity shares of ₹ 10 each of a shareholder for non-payment of allotment money of ₹ 4 per share and call money of ₹ 3 per share. This shareholder had paid ₹ 3 per share with application. Forfeited shares were reissued at ₹ 8 per share.
  - (ii) R. K. Company Limited forfeited 600 shares of ₹ 10 each of Sunil. Sunil had paid application and allotment money of ₹ 5 per share, but had not paid ₹ 3 per share and ₹ 2 per share on first call and second call respectively. Out of the forfeited shares, 400 shares were reissued at ₹ 6 per share to Mittal.
  - (iii) A shareholder holding 3000 equity shares of ₹ 10 each has paid application money at ₹ 13 per share (including premium ₹ 10) and allotment money at ₹ 13 per share (including premium ₹ 10), his shares were forfeited for non-payment of call of ₹ 4 per share. Forfeited shares were reissued at ₹ 7 per share.
13. Write journal entries in the books of company for forfeiture and reissue of forfeited shares from the following information :
- (i) Company forfeited 1200 equity shares of ₹ 10 each held by Katara for non-payment of allotment money of ₹ 14 per share (including premium ₹ 10) and first and final call money of ₹ 3 per share. Company reissued all the forfeited shares after giving maximum permissible discount. These shares were purchased by Kanu.
  - (ii) Ramesh holds 600 equity shares of ₹ 10 each in company. He had paid application money at ₹ 3 per share and allotment money at ₹ 2.50 per share but could not pay first call money of ₹ 2 per share. Company forfeited above shares before making final call after necessary formalities. Company reissued all these shares at a discount of ₹ 4 per share.
  - (iii) Company forfeited 400 equity shares of ₹ 100 each, issued at a premium of 20 % on face value. ₹ 80 per share (including premium) are called up on these shares. For non-payment of allotment money at ₹ 50 (including premium) these shares were forfeited before making share first and final call. These shares reissued before first and final call at ₹ 36,000 as fully paid up.
14. Raj Machine Limited issues 12,00,000 equity shares of ₹ 10 each on which amount was payable as under :
- ₹ 3 per share on application
  - ₹ 4 per share on allotment
  - ₹ 3 per share on first and final call
- Company received application for 14,70,000 shares from public. Excess applications were rejected and money paid on them was refunded.

Aakash, who was allotted 2000 shares, did not pay allotment and final call money. Sunny, who was allotted 1200 shares, did not pay final call money.

Company forfeited all the shares on which calls were unpaid and reissued all forfeited shares at ₹ 7 per share as fully paid up.

Pass necessary journal entries in the books of company for above transactions.

15. Rustom Limited of Valsad issued 2,40,000 equity shares of ₹ 10 each at a premium of ₹ 70 per share. Amount called up per share was as under :

₹ 38 on application (including premium of ₹ 35)

₹ 28 on allotment (including premium of ₹ 25)

₹ 14 on final call (including premium of ₹ 10)

All the sums due were duly received except money due on allotment and final call on 2000 shares held by Jahangir. After carrying out necessary formalities, company forfeited Jahangir's shares. These shares were reissued to Joshef at 40 % premium as fully paid up.

Pass journal entries for above transactions in the books of company.

16. Dharam Metals Ltd. of Jamnagar issued 8,00,000 equity shares of ₹ 10 each at a premium of ₹ 30 per share. The amount was payable as under :

₹ 13 (including premium of ₹ 10) per share on application

₹ 23 (including premium of ₹ 20) per share on allotment

₹ 4 per share on final call

Company received share application for 8,00,000 shares and all the applications were allotted shares. Vipul, who was allotted 1500 shares, did not pay money due on allotment and hence his shares were forfeited by company after allotment. Company reissued all these 1500 shares before final call at ₹ 5 per share.

Hema, who was allotted 500 shares, did not pay money due on final call and therefore her shares were forfeited by company. Company reissued these 500 shares at maximum permissible discount. Pass journal entries for above transactions in the books of company.

17. Siddhapur Isabgul Limited issued 6,00,000 equity shares of ₹ 10 each at a premium of ₹ 7 per share. The amount was payable as under :

₹ 10 per share on application (including premium)

₹ 4 per share on allotment

₹ 3 per share on final call

Applications were received for 9,00,000 shares. Excess applications were rejected and money paid thereon was refunded.

Siddharaj, who was allotted 6000 shares, did not pay money due on allotment and hence his shares were forfeited after allotment. Jaysinh, who was allotted 4000 shares, did not pay money due on final call and hence his shares were forfeited after final call. Allotment and final call amount was received on remaining shares.

Company reissued 6000 shares of Siddharaj at ₹ 7 per share to Minal and 4000 shares of Jaysinh at ₹ 6 per share to Rudra.

Pass necessary journal entries in the books of company to record above transactions and also prepare shares forfeiture account.

18. Kapoor Media Limited issued 1,20,000 equity shares of ₹ 10 each at a premium of ₹ 80 per share for public subscription. Company called up the amount including share premium in four equal installments it means on application, on allotment, on first call and on final call. Company received application for 1,60,000 equity shares. Excess applications were rejected and money paid thereon was refunded. Shahid, who was holding 4000 shares, failed to pay first call and final call on shares held by him. His shares were forfeited after due formalities. These forfeited shares were issued to Ranbir at a premium of ₹ 70 per share and the amount on this was received by the company. Write necessary journal entries in the books of company to record above transactions and also prepare securities premium account.
19. Sheetal Electronics Limited issued 1,20,000 equity shares to the public at ₹ 10 per share. Company called up the amount as under :  
On application ₹ 3 per share  
On allotment ₹ 3 per share and on final call ₹ 4 per share  
Applications were received from public for 1,80,000 shares, in this reference allocation was made by company as under :  
Full allotment was made to applicants of 48,000 shares.  
Not a single share was allotted to applicants of 36,000 shares.  
72,000 shares were allotted to applicants of 96,000 shares.  
All amounts were received in time. From the above information, pass necessary journal entries in the books of the company.
20. Gujarat Fertilizers Ltd. of Bharuch issued 4,50,000 shares of ₹ 10 per share. Amount called up on application ₹ 3 per share, on allotment ₹ 3 per share, on first call ₹ 2 per share and on final call ₹ 2 per share.  
Applications were received from public of 6,20,000 shares. Allotment of 4,50,000 shares was made pro-rata to 5,40,000 share applicants. Amount paid on applications by remaining applicants were refunded by company.  
Mahesh, to whom 1000 shares were allotted failed to pay the final call, his shares were forfeited and all these shares were reissued at ₹ 5 per share.  
Pass journal entries for the above transactions in the books of company.
21. Sharda Limited issued 6,00,000 equity shares at ₹ 10 each, at a premium of ₹ 4 per share. Amount called up per share is as under :  
On application ₹ 4  
On allotment ₹ 3 + premium  
On share first and final call ₹ 3  
Subscription were received 3.5 times, out of which  $\frac{4}{7}$ th the share applications were rejected fully and pro-rata allotment was made to the remaining applicants. Excess application money were credited to share allotment and share calls.  
Write the necessary journal entries in the books of Sharda Limited.



22. The authorised capital of Shubha Limited of Mumbai is 18,00,000 shares of ₹ 1 each. Company issued 12,00,000 shares at a premium ₹ 580 per share to public. Amount payable on this was as under :

On application ₹ 290.50 per share (including premium of ₹ 290)

On allotment ₹ 290.50 per share (including premium of ₹ 290)

Company received 16,50,000 share application from public, out of this applications of 1,50,000 shares were rejected and on balance share application 12,00,000 shares were allotted.

All called up amount were received in proper time. Company maintains the combined 'Share Application and Allotment Account'.

Pass journal entries in the books of company for above transactions.

23. Panchvilla Manuf. Limited issued 7,50,000 equity shares at ₹ 10 each, at a premium of 20 % for public. Amount called up per share is as under :

With application ₹ 5

On allotment ₹ 4 (including premium)

On final call ₹ 3

Applications received for 11,25,000 shares. Applications for 75,000 shares were rejected and amount paid on them was refunded. Pro-rata allotment was made for 7,50,000 shares to the remaining applicants and excess application money were adjusted against the amount due on allotment.

A shareholder, Vishal could not pay final call money on his 7500 allotted shares.

Vishal's shares were forfeited by company and reissued at 10 % discount.

Pass necessary journal entries in the books of the company for the above transactions. **or**

Write journal entries in the books of the company for following :

- (i) For share forfeiture
- (ii) For reissue of shares
- (iii) For close of the share forfeiture account.

24. Ahmedabad Chemical Limited issue 1,50,000 equity shares of ₹ 100 each at a premium of ₹ 30 per share. Amount payable was as under :

On share application and allotment ₹ 85 per share (including premium)

On share first and final call - balance amount.

Applications were received for 2,55,000 shares. Applications for 55,000 shares were rejected and allotment was made pro-rata to the remaining applicants. The excess share application and allotment money was to be credited to share first and final call. Amount was called on calls. Entire called up amount was received in time.

Pass necessary journal entries for recording the above transactions in the books of Ahmedabad Chemical Ltd.





## Accounting for Debentures

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|--|--|
| 1. Introduction  | 8. Interest on Debentures  |
| 2. Important Points Relating to Debentures               | 9. For Redemption of Debentures                                      |
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| 7. Issue of Debentures as Collateral Security            | — Exercise   |

### 1. Introduction

Normally the company issues share capital for the requirement of long term funds. Sometimes, in addition to share capital, if company requires more fund then these fund can be met by loan or borrowed amount. Financially sound companies get long term loan from bank or financial institutions. Mostly instead of borrowing such loan from financial institutions or in addition to borrowing such loan for large investments, company can raise funds from public by issue of securities. Such a security is popularly known as **Debenture or Bond**.

Companies carrying on business have the inherent power or authority to borrow money. Based on this inherent power, companies borrow long term funds from the public. Against the money so borrowed or investment, the company issues a document or certificate acknowledging its debt to the investor. Such a certificate is known as debenture.

Those who get the debentures by giving money to the company or have purchased from the market are known as holder of the debenture or debentureholder. Debentureholder is not considered as the owner of the company.

Debenture is a document that confirms the debt of the company and its acknowledgement of the debt. It is issued under the common seal of the company. Company has to pay interest at a specified rate and on specified time on the amount invested by debentureholders in the company in accordance with the agreed terms, it is an expense for the company and is income for debentureholder. The company repays the money borrowed against a debenture at a future date as per the terms of issue of debentures to the holders of the debentures.

A certificate which is issued to debentureholder by company contains Name of debentureholder, Number of debenture, Amount per debenture, Serial number of debentures, Rate of interest payable, Time for payment of interest and also shows when the debenture money will be paid at a future date.

In present scenario, a debenture certificate is issued to debentureholders in dematerialisation form instead of physical copy. It means, purchase of debentures is directly credited to demat account of debentureholders. By allotment letter company informs the debentureholders about how many debentures are allotted to them, its number and amount and also conditions for debentures.

## 2. Important Points Relating to Debenture

- (1) Debenture is a document relating to the money lent or given as a loan to the company. It means debenture is a document that confirms the debt of the company.
- (2) Debenture is a security that bears a fixed rate of interest on which the interest is payable on a predetermined date. Company has to pay the interest on the debentures even if it has earned profit or not earned a profit.
- (3) Interest on debentures is payable at a fixed rate and so debentures are known by that rate. e.g. If interest is payable at the rate 8 % p.a. on debentures then it is known as or written as 8 % debentures.
- (4) When debentures are issued for a fixed term, the money borrowed against such debentures is repaid at the end of a fixed term in accordance with the agreed terms.
- (5) As per Companies Act, 2013, no company is allowed to issue debentures having a maturity date of more than 10 years from the date of issue. However, a company engaged in infrastructure projects can issue debentures for more than 10 years but not exceeding 30 years.
- (6) Debentures can be issued with or without charge on the assets of the company. Charge on the assets means mortgage or hypothecation.
- (7) Usually, debentures are listed on the stock exchange after the issue thereof and purchase or sales of debentures are traded at the stock exchanges. The market value of such debentures could be more or less than the price of the issue.
- (8) If the terms of the issue of debentures so provide, the debentures can be converted into shares.
- (9) Debentures are shown as long term borrowings under the heading 'Non-current Liabilities' on 'Equity and Liabilities' side in the balance sheet.
- (10) Debentureholders do not have any voting right in any matter of the company.
- (11) Debentures can not be forfeited if any debentureholder does not pay any amount on debentures.
- (12) In the event of the liquidation of a company, the debentureholders are repaid their money before the payment to equity shareholders.

## 3. Types of Debenture

Classification of debentures is made as under :

### (A) On the Basis of Security :

- (i) **Secured or Mortgage Debenture** : When this type of debentures are issued, some or all of the assets of the company are given as security. In other words, a charge is created on the assets of the company. Such a charge could be of two types : Fixed charge, in this, only some assets of company are given as security and floating charge, in which usually all the assets of company are given as security. If the company is unable to repay the debentures on the due date then the debentureholders are repaid the amount from the money realised on the sale of mortgaged assets.

**First Mortgage Debentures** are those that have a first claim on the assets charged.

**Second Mortgage Debentures** are those having a second claim (after first mortgage debentures) on the assets charged.

- (ii) **Unsecured or Simple or Naked Debenture** : Such debentures are issued without giving any security or creating any charge on the assets of the company. From the investor's viewpoints, such debentures are risky. So, such type of debentures are not very common. The holders of such debentures are treated as unsecured creditors at the time of liquidation of the company.

**(B) As per Negotiability and Procedure for Redemption :**

- (i) **Registered Debenture** : The company maintains a register of debentureholders. The register contains the name, address and other particulars related to debentureholders. The transfer of such debentures requires the execution of a proper transfer deed to give entry in company's register. Principal amount and interest on such a debenture is paid to the person whose name appears in the company's register.
- (ii) **Bearer Debenture** : There is no need for any procedure for the transfer of such debentures with the company. The purchaser has to make a payment to the seller of the debentures and take the delivery of the debentures. Thus, bearer debentures are like currency notes and can be transferred by mere delivery. The person who possesses such debentures enjoys all the rights thereof. The interest coupons are attached with debentures certificate for periodic interest payments on such debentures and such coupons are like cheques or orders for payment of interest which can be encashed by debentureholder through the prescribed bank by the company on due dates for the payment of the interest.

**(C) As per Conditions of Redemptions :**

- (i) **Redeemable Debenture** : The debentures which are issued with a condition that the amount of debentures can be repaid after a certain period are known as redeemable debentures. This amount will be repaid in lump sum or by installments. The period of redemption is stated in the Debenture or Trust deed.
- (ii) **Perpetual or Irredeemable Debenture** : Irredeemable debentures are those debentures which are not repayable by the company during its life time. Generally, these type of debentures are repayable only at the time of liquidation of the company.

**(D) On the Basis of Conditions for Convertibility :**

- (i) **Convertible Debenture** : Convertible debentures are those debentures which are convertible into equity shares or other securities at a stated rate of exchange either at the option of debentureholders or at the option of the company after a specified period.  
When only a part of the amount of debenture is convertible into shares, such debentures are called 'Partly Convertible Debentures'. When the full amount of debenture is convertible into shares, such debentures are called 'Fully Convertible Debentures'.  
Convertible debentures are very popular in present time, as they provide liquidity, safety, capital appreciation and assured return to the investors.
- (ii) **Non-convertible Debenture** : Such debentures cannot be converted into shares or any other securities.

**4. Procedure for Issue of Debentures**

- (i) When company has decided to issue debentures, a resolution is passed at the meeting of Board of Directors of the company. The resolution should state the number of debentures,



amount per debenture and also total amount of debenture issued, rate of interest thereon, date of redemption and other terms related to the issue of the debentures.

- (ii) Companies Act and provisions of SEBI should be consider at the time of issue of debenture. A company should issue a prospectus or a statement in lieu of the prospectus with proper information inviting the public to subscribe for debentures.
- (iii) The procedure for the issue of debentures is very much similar to that of the issue of shares. Company has to prepare a separate application form for the public to subscribe for debentures.
- (iv) Allotment of debentures should be equal the numbers of issued debentures against the number of debentures application received. For this, company has to open seperate bank account in any scheduled bank.
- (v) As per rule of Companies Act, 2013, minimum subscription should be 90 % of the issued amount.
- (vi) Full amount of debentures may be called by the company on application or may be called in installments.
- (vii) When debentures are issued to the public subscription, then money received on this has to be kept in a scheduled bank in a separate account. So, money received on application at the time of debentures subscription has to be kept directly in a separate bank account like subscription of shares. After subscription or issue is closed, allotment letter is sent to applicants to whom debentures were allotted and debenture application money is refunded to those applicants to whom debentures were not allotted.
- (viii) Debentures may be issued either at par, at a premium or at a discount. Shares can not be issued at discount except sweat equity share but debentures can be issued at a discount. The rate of premium or discount is to be decided by the directors.

## 5. Accounting Effects for Issue of Debentures

Procedure, Transactions and Name of accounts for issue of debentures are the same as share capital transactions. Such as, Debenture Application Account, Debenture Allotment Account, Debenture Calls Account etc.

Debenture percentage is always mentioned before the word debenture.

Following accounting entries will be passed in the books of company on the issue of debentures under different circumstances.

### (A) Issue of Debentures at Par :

#### ● When the full amount of the debentures is called up at a time :

- (i) Bank A/c ...Dr .....  
To .... % debentures application and allotment A/c .....
- (ii) .... % debenture application and allotment A/c ...Dr .....  
To .... % debentures A/c .....

For example, a company issued 8000, 9 % debentures of ₹ 100 each. The full amount on debenture was called up on application, it was received.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	Bank A/c Dr To 9 % debenture application and allotment A/c [Being application money fully received on 8000 debentures at ₹ 100 per debenture.]		8,00,000	8,00,000

(ii)	9 % debenture application and allotment A/c Dr To 9 % debentures A/c [Being application money transfer to debentures A/c.]		8,00,000	8,00,000
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**Note :** When the full amount of the debentures is called up at the time of application then that amount will be credited to 'Debenture Application and Allotment A/c'.

● **When the amount of debentures is called up in installments :**

Following entries will be passed on the issue of debentures (Here, assume that the debentures carry 9 % interest).

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	<b>On receipt of application money,</b> Bank A/c ... Dr To 9 % debenture application A/c [Being application money received.]		.....	.....
(ii)	<b>On transfer of application money to debenture account it means allotment of debentures,</b> 9 % debenture application A/c ... Dr To 9 % debenture A/c [Being allotment of debentures.]		.....	.....
(iii)	<b>On refund of money to applicants of rejected applications,</b> 9 % debenture application A/c ... Dr To Bank A/c [Being application money returned to applicants on rejected applications.]		.....	.....
(iv)	<b>On the transfer of surplus application money on partially accepted application,</b> 9 % debenture application A/c ... Dr To 9 % debenture allotment A/c [Being excess application money transfer to allotment account.]		.....	.....
(v)	<b>When allotment money due,</b> 9 % debenture allotment A/c ... Dr To 9 % debenture A/c [Being allotment money due.]		.....	.....
(vi)	<b>On receipt of allotment money,</b> Bank A/c ... Dr To 9 % debenture allotment A/c [Being allotment money received.]		.....	.....



(vii)	<b>When amount due on call,</b> 9 % debenture call A/c ... Dr To 9 % debenture A/c [Being respective call amount due on debentures.]		.....	.....
(viii)	<b>On receipt of call money,</b> Bank A/c ... Dr To 9 % debenture call A/c [Being money received on calls on debentures.]		.....	.....

Let us understand the above journal entries with the help of following illustration :

**Illustration 1 :** Ashok Mills Limited issued 8000 debentures of ₹ 100 each for public subscription. Interest is to be paid at the rate 8 % p.a. on debentures. The amount were called up per debenture as under :

With application ₹ 30

On allotment ₹ 40

On call ₹ 30

Application were received by company of 10,000 debentures. After allotment of 8000 debentures, rejected excess applications of debentures and refunded the money to applicants. All the amounts due on allotment and call were duly received.

Write journal entries in the books of the company.

**Ans. :**

**Journal Entries in the Books of Ashok Mills Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To 8 % debenture application A/c [Being receipt of applicaiton money on 10,000 debentures at ₹ 30 per debenture.]		3,00,000	3,00,000
2	8 % debenture application A/c Dr To 8 % debenture A/c To Bank A/c [Being transfer money to debenture account on the allotment of 8000 debentures and refund money on rejected 2000 debentures.]		3,00,000	2,40,000 60,000
3	8 % debenture allotment A/c Dr To 8 % debenture A/c [Being allotment money due on 8000 debentures at ₹ 40 per debenture.]		3,20,000	3,20,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
4	Bank A/c Dr To 8 % debenture allotment A/c [Being receipt of full amount of allotment money.]		3,20,000	3,20,000
5	8 % debenture call A/c Dr To 8 % debenture A/c [Being call money due on 8000 debentures at ₹ 30 per debenture.]		2,40,000	2,40,000
6	Bank A/c Dr To 8 % debenture call A/c [Being receipt of full amount on call money on debentures.]		2,40,000	2,40,000
	<b>Total</b>		<b>17,20,000</b>	<b>17,20,000</b>

**(B) Issue of Debentures at Premium :**

When the debentures are issued at more than their face value, they are said to have been issued at premium. For example, if a debenture of ₹ 100 is issued at ₹ 130, then it is called, this debenture issued at premium of ₹ 30.

As per Companies Act, 2013, premium amount on debentures is transferred to 'Securities Premium Reserve Account'.

Like share premium, debenture premium is also a capital profit and hence the same can not be used for distribution of dividend but can be used for writing off capital expenses or loss like discount on issue of debentures, premium on redemption of debentures, preliminary expenses, goodwill, patent etc.

"Securities Premium Reserve A/c" is shown on the equity and liabilities side of the balance sheet under the head "Reserve and Surplus".

● **When the full amount of the debentures is called up at a time :**

For example, a company issued 6000 10 % debentures of ₹ 100 each at a 'premium of ₹ 20 per debenture. The full amount of the debenture was called up on application on all the debentures and the same was received. The journal entry in the books of the company will be as under :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	Bank A/c Dr To 10 % debenture application and allotment A/c [Being receipt of application money on 6000 debentures at ₹ 120 per debenture.]		7,20,000	7,20,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(ii)	10 % debenture application and allotment A/c Dr To 10 % debenture A/c To Securities premium reserve A/c [Being application money transfer to debenture account and premium account.]		7,20,000	6,00,000 1,20,000

- When the amount of the debentures is called up in installments :

**Illustration 2 :** Gujarat Limited issued 5000; 10 % debentures of ₹ 200 each at premium of 20 %. On which the amount per debenture was called up as under :

₹ 60 on application

₹ 100 on allotment (including premium)

₹ 80 on final call

Applications were received for a total of 8000 debentures, from this excess applications were rejected and refunded the money received thereon. All the amounts due on allotment and call were duly received. Pass journal entries in the books of the company.

**Ans. :**

#### Journal of Gujarat Limited

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To 10 % debenture application A/c [Being application money received on 8000 debentures at ₹ 60 per debenture.]		4,80,000	4,80,000
2	10 % debenture application A/c Dr To 10 % debenture A/c To Bank A/c [Being money on 5000 allotted debentures transfer to debenture account and money on 3000 rejected debentures refunded to applicants.]		4,80,000	3,00,000 1,80,000
3	10 % debenture allotment A/c Dr To 10 % debenture A/c To Securities premium reserve A/c [Being amount due on allotment including premium ₹ 100 per debenture.]		5,00,000	3,00,000 2,00,000
4	Bank A/c Dr To 10 % debenture allotment A/c [Being receipt of full amount of allotment money due.]		5,00,000	5,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
5	10 % debenture final call A/c Dr To 10 % debenture A/c [Being amount due on final call at ₹ 80 per debenture.]		4,00,000	4,00,000
6	Bank A/c Dr To 10 % debenture final call A/c [Being full amount received on final call.]		4,00,000	4,00,000
	<b>Total</b>		<b>27,60,000</b>	<b>27,60,000</b>

### (C) Issue of Debentures at Discount :

When the company issues debentures at a price which is less than their face value or nominal value, the debentures are said to have been issued at a discount. For example, a debenture of ₹ 100 face value is issued at ₹ 90, here ₹ 10 would be discount.

Amount of discount on debentures is debited to '**Discount on Debentures A/c**'.

- There is no restriction in the companies act as regards the maximum discount which can be given on the issue of the debentures. If there is no restriction in the Articles of Association of the company, debentures can be issued at a discount.

If there is no clarification, discount on debenture is recorded at the time of debenture allotment entry.

- Amount of debenture discount or loss on issue of debenture is shown in the balance sheet as per Accounting Standard 26. Debenture discount amount is shown under different heads, which depends on terms of debentures. Let us understand this by an illustration.

Example : Amount of discount on debenture is ₹ 2,40,000, it is to be written off in 6 years.

Here, ₹ 2,40,000 ÷ 6 years = ₹ 40,000 for each year.

₹ 40,000 debited to current year statement of profit and loss.

Remaining amount of ₹ 2,00,000 is shown under the head 'Non-current Assets' and sub head 'Other non-current Assets' in the balance sheet.

**Note :** How to show amount of discount on debentures in the balance sheet is not in syllabus (This type of questions are not to be asked in the exam).

- For writting off discount on issue of debentures :**

Discount or loss on issue of debentures is a capital loss. It should be written off as early as possible but within the lifetime of the debentures. e.g. If debenture issued at discount with a condition that debentures are redeemed after 6 years, then the period of writing off total amount of discount, should not be more than 6 years. Usually this amount is written off against securities premium reserve account or statement of profit or loss. For this, following journal entries is to be passed :

	Securities premium reserve A/c ...Dr		.....	
	or Statement of profit or loss A/c ...Dr		.....	
	To Discount on debentures or			
	Loss on issue of debentures A/c			.....

● **When the full amount of the debentures is called up at a time :**

For example, a company issued 2000, 8 % debentures of ₹ 100 each at a price of ₹ 80 per debenture, on which the full amount was called up and the same was received.

The journal entry in the books of the company will be as under :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	Bank A/c Dr To Debenture application and allotment A/c [Being application money received on 2000 debentures at ₹ 80 per debenture.]		1,60,000	1,60,000
(ii)	Debenture application and allotment A/c Dr Discount on debenture A/c Dr To 8 % debentures A/c [Being issue of 2000, 8 % debentures of ₹ 100 each at a discount of ₹ 20 per debenture.]		1,60,000 40,000	2,00,000

● **When the amount of the debentures is called up in installments :**

**Illustration 3 :** Rajkot Oil Limited issued 8000 10 % debentures of ₹ 100 each at a price of ₹ 90 per debenture. The amount per debenture was payable as under :

₹ 30 with application

₹ 40 on allotment (after discount)

₹ 20 on call

The company received application of 8000 debentures. The company received the full money called on allotment. Except on 300 debentures, the company received full amount 'due on call'.

Pass necessary journal entries in the books of company.

**Ans. :**

**Journal Entries in Books of Rajkot Oil Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To 10 % debenture application A/c [Being allotment money received on 8000 debentures at ₹ 30 per debenture.]		2,40,000	2,40,000



Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2	10 % debenture application A/c Dr To 10 % debenture A/c [Being application money transfer to debenture amount.]		2,40,000	2,40,000
3	10 % debenture allotment A/c Dr Discount on debentures A/c Dr To 10 % debenture A/c [Being allotment money due at ₹ 40 per debenture, after a discount of ₹ 10.]		3,20,000 80,000	4,00,000
4	Bank A/c Dr To 10 % debenture allotment A/c [Being receipt of full amount of allotment money due.]		3,20,000	3,20,000
5	10 % debenture final call A/c Dr To 10 % debenture A/c [Being final call amount due on 8000 debentures at ₹ 20 per debenture.]		1,60,000	1,60,000
6	Bank A/c Dr Call-in-arrears on debenture A/c Dr To 10 % debenture call A/c [Being call money received on 7700 debentures and call money not received on 300 debentures.]		1,54,000 6000	1,60,000
	<b>Total</b>		<b>15,20,000</b>	<b>15,20,000</b>

**Illustration 4 :** Punjab Limited issued 25,000, 11 % debentures of ₹ 100 each, the money per debenture was payable as under :

₹ 30 on application; ₹ 35 on allotment and ₹ 35 on first and final call.

All the debentures were applied. Jogindar, the holder of 800 debentures paid the entire amount on his holding on allotment. Where, Harjitsinh, the holder of 200 debentures failed to pay the allotment and call amount.

All the amount on allotment and call were duly received on all remaining debentures.

Pass necessary journal entries for the above transactions in the books of company.

Ans. :

**Journal Entries in the Book of Punjab Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To 11 % debenture application A/c [Being application money received on 25,000 debentures at ₹ 30 per debenture.]		7,50,000	7,50,000
2	11 % debenture application A/c Dr To 11 % debenture A/c [Being application money on debenture transfer to debenture account.]		7,50,000	7,50,000
3	11 % debenture allotment A/c Dr To 11 % debenture A/c [Being allotment amount due on debenture at ₹ 35 per debenture.]		8,75,000	8,75,000
4	Bank A/c Dr Calls-in-arrears on debenture A/c Dr To 11 % debenture allotment A/c To Calls-in-advance A/c [Being allotment money received on 24,800 debentures and call amount received in advance on 800 debentures at ₹ 35 per debenture.]		8,96,000 7000	8,75,000 28,000
5	11 % debenture first and final call A/c Dr To 11 % debenture A/c [Being call amount due on debentures at ₹ 35 per debenture.]		8,75,000	8,75,000
6	Bank A/c Dr Call-in-arrears on debentures A/c Dr Call-in advance on debentures A/c Dr To 11 % debenture first and final call A/c [Being balance amount received on final call after deducting calls-in-advance on 800 debentures and also amount not paid on 200 debentures on final call.]		8,40,000 7000 28,000	8,75,000
	<b>Total</b>		<b>50,28,000</b>	<b>50,28,000</b>

**Illustration 5 :** Mohan Krishna Limited issued 80,000, 10 % debentures at the face value of ₹ 500 each at a premium of 10 %. Amount was payable as under :

₹ 250 on application (including premium) and balance amount on allotment.

These debentures are redeemable after 8 years. Applications are received by company for 1,00,000 debentures and the allotment of 80,000 debentures is made on pro-rata basis.

Excess amount on application is credited to allotment account. Amount due on allotments is fully received. Pass journal entries on the issue of debentures in the books of company.

**Ans. :**

**Journal Entries in the Books of Mohan Krishna Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To 10 % debenture application A/c [Being amount received on applications for 1,00,000 debentures at ₹ 250 per debenture.]		2,50,00,000	2,50,00,000
2	10 % debenture application A/c Dr To 10 % debenture A/c (80,000 debentures × ₹ 200) To Securities premium reserve A/c (80,000 debentures × ₹ 50) To 10 % debenture allotment A/c (20,000 debentures × ₹ 250) [Being money on debenture application transfer to debenture A/c and premium A/c, money on excess application transfer to debenture allotment A/c.]		2,50,00,000	1,60,00,000 40,00,000 50,00,000
3	10 % debenture allotment A/c Dr To 10 % debenture A/c [Being allotment money due on 80,000 debentures at ₹ 300 per debenture.]		2,40,00,000	2,40,00,000
4	Bank A/c Dr To 10 % debenture allotment A/c [Being allotment money received.]		1,90,00,000	1,90,00,000
	<b>Total</b>		<b>9,30,00,000</b>	<b>9,30,00,000</b>

**Illustration 6 :** Kaveesh Limited issued 20,000, 8 % debentures of ₹ 100 each at a premium of ₹ 30 per debenture. The full amount was payable on application. Applications were received by company for 24,000 debentures. Applications for 4000 debentures were rejected and amount thereon was refunded to the applicants. Debentures were allotted to the remaining applications.

Pass necessary journal entries for the above transactions in the books of Kaveesh Limited.

**Ans. :**

**Note :** When company called up full amount of debentures at the time of application then, this amount is to be credited to 'Debenture Application and Allotment Account' instead of 'Debenture Application Account'.

**Journal of Kaveesh Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To 8 % debenture application and allotment A/c [Being receipt of application money on 24,000 debentures at ₹ 130 per debenture.]		31,20,000	31,20,000
2	8 % debenture application and allotment A/c Dr To 8 % debenture A/c (20,000 debentures × ₹ 100) To Securities premium reserve A/c (20,000 debentures × ₹ 30) To Bank A/c (4000 debentures × ₹ 130) [Being on 20,000 debentures, ₹ 100 per debenture transfer to debenture A/c and ₹ 30 per debenture transfer to premium A/c. Amount refunded on non-allotted 4000 debentures at ₹ 130 per debenture.]		31,20,000	20,00,000 6,00,000 5,20,000

**Illustration 7 :** Ankush Limited of Amreli issued 5000, 9 % debentures of ₹ 100 each at a discount of 10 % as on 1-4-2017. The money were payable on debenture as follows :

₹ 25 on application;

₹ 25 on allotment and the balance amount on final call.

Applications were received for 5000 debentures and the allotment was made. All the money due on debentures were duly received. Expenses on issue of debentures amounted to ₹ 16,000. Directors decided to write off  $\frac{1}{5}$ th amount of "Expenses on Issue A/c" and "Discount on Debentures A/c" from statement of profit and loss each year.

Write journal entries for first year only from the above transactions in the books of company.

**Ans. :**

**Journal Entries in the Books of Ankush Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To 9 % debenture application A/c [Being application money received on 5000 debentures at ₹ 25 per debenture.]		1,25,000	1,25,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2	9 % debenture application A/c Dr To 9 % debenture A/c [Being application amount on allotted debentures transfer to debenture account.]		1,25,000	1,25,000
3	9 % debenture allotment A/c Dr (5000 debentures × ₹ 25) Discount on debentures A/c Dr (5000 debentures × ₹ 10) To 9 % debenture A/c (5000 debentures × ₹ 35) [Being amount due on allotment (after discount) of ₹ 25 per debenture.]		1,25,000 50,000	1,75,000
4	Bank A/c Dr To 9 % debenture allotment A/c [Being receipt of full amount on allotment.]		1,25,000	1,25,000
5	9 % debenture final call A/c Dr To 9 % debenture A/c [Being amount due on final call at ₹ 40 per debenture.]		2,00,000	2,00,000
6	Bank A/c Dr To 9 % debenture final call A/c [Being receipt of full amount on final call.]		2,00,000	2,00,000
7	Expenses on issue A/c Dr To Bank A/c [Being expenses paid on issue of debentures.]		16,000	16,000
8	Statement of profit and loss A/c Dr To Discount on debenture A/c ( $\frac{1}{5}$ th of 50,000) To Expenses on issue of debentures A/c ( $\frac{1}{5}$ th of 16,000) [Being $\frac{1}{5}$ th of 'Discount on Debenture' and $\frac{1}{5}$ th of "Expenses on Issue" written off by transfer to statement of profit and loss for the current year.]		13,200	10,000 3200
	<b>Total</b>		<b>9,79,200</b>	<b>9,79,200</b>



## 6. Issue of Debentures for Consideration Other than Cash

Like shares, debentures are also sometimes issued for consideration other than cash. For example, the issue of debentures to vendor against the purchase of assets like land-building, plant and machinery etc. Similarly issue of debentures to vendor's against purchase consideration at the time of purchase of business. Debentures can be issued to vendors at par, at a premium or at a discount.

Following entries will be passed for this purpose :

(1)	<b>At the time of purchase of any business,</b>			
	(i) Sundry assets A/c ...Dr (Business assets taken over) To Sundry liabilities A/c (Business liabilities taken over) To Vendor's A/c (Purchase consideration) [Being business assets and liabilities taken over on purchase of business.]		.....	.....
(2)	(ii) Vendor's A/c ...Dr To Debentures' A/c [Being issue of debentures by the company for purchase consideration.]		.....	.....
	<b>When any asset is purchased then,</b>			
(1)	(i) On purchase of asset, Asset A/c ...Dr To Vendor's A/c [Being purchase of asset.]		.....	.....
	(ii) Vendor's A/c ...Dr To Debenture A/c [Being issue of debentures to vendor for asset.]		.....	.....

**Illustration 8 :** Mansi Limited purchased machinery worth ₹ 6,00,000 from Suman Manufacturing Ltd. on 1-12-2017. ₹ 2,00,000 were paid immediately and the balance was paid by issue of ₹ 3,70,000 11 % debentures in Mansi Limited. Pass the necessary journal entries in the books of Mansi Limited. If the balance will be paid by issue of ₹ 4,20,000, 11 % debentures by Mansi Limited, then how to write journal entry for this ?

**Ans. :**

### Journal Entries in the Book of Mansi Limited

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2017 Dec. 1	Machinery A/c Dr To Suman Manufacturing Ltd. A/c [Being purchase machinery from Suman Manuf. Ltd.]		6,00,000	6,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
Dec. 1	Suman Manuf. Ltd. A/c Dr To Bank A/c [Being ₹ 2,00,000 paid immediately against purchase of machinery.]		2,00,000	2,00,000
Dec. 1	Suman Manuf. Ltd. A/c Dr To 11 % debentures A/c To Securities premium reserve A/c [Being issue of debentures of ₹ 3,70,000 against balance amount of ₹ 4,00,000. So, difference amount transfer to premium account.]		4,00,000	3,70,000 30,000

If Mansi Ltd. issued 11 % debentures of ₹ 4,20,000 for the balance amount, then only last entry will be changed in the above illustration.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2017 Dec. 1	Suman Manuf. Ltd. A/c Dr Discount on debenture A/c Dr To 11 % debenture A/c [Being issue of debentures of ₹ 4,20,000 against balance amount of ₹ 4,00,000.]		4,00,000 20,000	4,20,000

**Illustration 9 :** Nitin Metals Limited purchased assets worth ₹ 8,80,000 and also took over the liabilities (creditors) of ₹ 1,60,000 of Patel Traders. Decided to pay for a purchase consideration of ₹ 7,68,000. Nitin Metals Ltd. paid the purchase consideration by issuing 12 % debentures of ₹ 100 each at a premium of 20 %.

Pass journal entries in the books of company.

**Ans. : Necessary working :**

Purchase consideration = ₹ 7,68,000 it is given.

Net assets = Total assets – Liabilities  
= ₹ 8,80,000 – ₹ 1,60,000  
= ₹ 7,20,000

Purchase consideration – Net assets = Goodwill

₹ 7,68,000 – ₹ 7,20,000 = ₹ 48,000 (Goodwill)

Here, purchase consideration of ₹ 7,68,000 is paid by issuing 12 % debentures of ₹ 100 each at a premium of 20 %. Number of debentures is not given.

Number of debentures =  $\frac{\text{Purchase consideration}}{\text{Amount per debenture}} = \frac{7,68,000}{120 (100 + 20)}$   
= 6400 debenture

### Journal Entries in the Books of Company

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	<div style="display: flex; justify-content: space-between;"> <div>Sundry assets A/c</div> <div>Dr</div> </div> <div style="display: flex; justify-content: space-between;"> <div>Goodwill A/c</div> <div>Dr</div> </div> <div style="display: flex; justify-content: space-between;"> <div>To Liabilities (creditors) A/c</div> <div></div> </div> <div style="display: flex; justify-content: space-between;"> <div>To Patel Traders A/c</div> <div></div> </div> <div>[Being purchase of assets and liabilities of Patel Traders.]</div>		<div>8,80,000</div> <div>48,000</div>	<div>1,60,000</div> <div>7,68,000</div>
2	<div style="display: flex; justify-content: space-between;"> <div>Patel Traders A/c</div> <div>Dr</div> </div> <div style="display: flex; justify-content: space-between;"> <div>To 12 % debenture A/c</div> <div></div> </div> <div style="display: flex; justify-content: space-between;"> <div>(6400 debentures × ₹ 100)</div> <div></div> </div> <div style="display: flex; justify-content: space-between;"> <div>To Securities premium reserve A/c</div> <div></div> </div> <div style="display: flex; justify-content: space-between;"> <div>(6400 debentures × ₹ 20)</div> <div></div> </div> <div>[Being issue of 6400 debentures at 20 % premium for purchase consideration.]</div>		<div>7,68,000</div>	<div>6,40,000</div> <div>1,28,000</div>

#### 7. Issue of Debentures as Collateral Security

When a company takes a loan from a bank or from some other party, the company may have to issue debentures as a subsidiary or secondary security in addition to the principal security. The debenture so issued are known as debentures issued as collateral security.

If the company repays its dues to the bank in right time, the bank will return the debentures to the company and the debentures received this way are cancelled by the company.

However, if the company fails to repay the amount of loan or interest on this in proper time then, the lender will first realise its debt from the principal security. But if the full amount of debt is not realised from the principal security then lender may claim all the rights of a debentureholder on the debentures received as a secondary security. It means lender can recover balance amount from the sale of debentures.

There are two methods of dealing with such issued debentures in the books of account :

- (1) Debentures given to a bank as security are only for the safety of the loan. No entry is passed for the issue of debentures in the books of accounts. Entry is passed only for bank loan. On the equity and liabilities side of the balance-sheet, it is shown under "Long term Borrowings" under the main heading "Non-current Liabilities". It is shown in illustration 10.
- (2) In this method, the entry for issuing debentures as collateral security is recorded in the books of company. This entry will be as under :

<div style="display: flex; justify-content: space-between;"> <div>Debenture suspense A/c</div> <div>Dr</div> </div> <div style="display: flex; justify-content: space-between;"> <div>To debentures A/c</div> <div></div> </div> <div>[Being issue of debentures as collateral security against loan.]</div>			<div>.....</div>	<div>.....</div>
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In the balance sheet, debentures suspense A/c will be shown as a deduction from the debentures account on the equity and liabilities side. As and when the loan is repaid by the company then, bank will return all the debentures to the company and this debentures will be cancelled by the company. Entry passed above is reversed.

**Illustration 10 :** A company had ₹ 14,00,000 issued 11 % debentures as on 1st April, 2017. During the year company took a loan of ₹ 3,00,000 from the bank as on 15 July, 2017. Against this, company issued new 11 % debentures of ₹ 2,00,000 as collateral security.

Pass necessary journal entries under both the methods from the above transactions in the books of the company. Show the details about debentures and bank loan in the company's balance sheet as at 31st March, 2018.

**Ans. : (As per first method)**

**Journal Entry in the Books of Company**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
20-7-2017	Bank A/c To Bank loan A/c [Being loan taken from the bank.]		3,00,000	3,00,000

In this method, no entry is passed for the issue of debentures as security against loan.

**Balance Sheet as on 31st March, 2018**

Particulars	Note No.	31st March 2018	31st March 2017
(I) Equity and liabilities :			
Shareholders' funds :			
Non-current liabilities :			
Long-term borrowings :			
11 % debentures (Above this debentures of ₹ 2,00,000 issued as collateral security)		14,00,000	
Bank loan (Debentures of ₹ 2,00,000 as collateral security)		3,00,000	

**(As per second method)**

**Journal of Company**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c To Bank loan A/c [Being loan obtain from the bank.]		3,00,000	3,00,000
2	Debenture suspense A/c To 11 % debenture A/c [Being issue 11 % debentures of ₹ 2,00,000 as collateral security against a loan from the bank.]		2,00,000	2,00,000

**Balance Sheet as on 31st March, 2018**

Particulars	Note No.	31st March 2018	31st March 2017
<b>(I) Equity and liabilities :</b>			
<b>Shareholders' funds :</b>			
<b>Non-current liabilities :</b>			
<b>Long-term borrowings :</b>			
<b>11 % debentures</b> <span style="float: right;">14,00,000</span>		14,00,000	
11 % debentures issued as collateral security <span style="float: right;">2,00,000</span>			
<b>Less : Debenture suspense A/c</b> <span style="float: right;">2,00,000</span>		—	
<b>Bank loan</b> (On collateral security of debentures ₹ 2,00,000)		3,00,000	

### 8. Interest on Debenture

Interest on debentures is usually paid half-yearly. Interest on debentures is recorded in statement of profit and loss. This interest is expense against profit. Interest on debentures has to be paid regularly even if the company suffers a loss or does not earn a profit. The rate of interest payable on debentures is prefixed on debentures. For example, 9 % debentures. Here, interest is to be calculated at the rate of 9 % on debentures.

As per Income Tax Act, a company is required to deduct income tax at the prescribed rate from the gross amount of debenture interest before any amount is paid to the debentureholders. This tax amount is to be deposited with the income tax department on behalf of the debentureholders. It's called as TDS means Tax Deducted at Source.

While preparing the final accounts for an accounting period, provision or effects must be made for any accrued interest on debentures due to variation of the dates.

Methods of accrued interest :

(1) **Interest Accrued and Due** : If a company pays interest on debentures half-yearly on 30th June and 31st December, while preparing the balance sheet on 31st March, 2018, if the interest for the period ending 31st December, 2017 remains unpaid, it will be called "Interest accrued and due".

(2) **Interest Accrued but Not Due** : As per above (1), the interest on debentures for the period from 1st January, 2018 to 31st March, 2018 will be called "Interest accrued but not due".

**Illustration 11** : Sinoy Limited issued 15,000, 11 % debentures of ₹ 100 each as on 1st April, 2017.

Interest on these debentures is paid on 30th September and 31st March.

Pass journal entries of the above transactions for the year ended on 31st March, 2018. Assuming income tax rate is 20 % on the amount of interest.



Ans. :

**Journal Entries in the Book of Sinoy Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2017	Bank A/c Dr To Debentures' application and allotment A/c [Being application money received on 15,000 debentures at ₹ 100 per debenture.]		15,00,000	15,00,000
1-4-2017	Debenture application and allotment A/c Dr To 11 % debenture A/c [Being debenture application money transfer to debenture account.]		15,00,000	15,00,000
30-9-2017	Interest on debenture A/c Dr To Debentureholders A/c To TDS payable A/c [Being interest due on 30st September on 11 % debentures and income tax deducted at source.]		82,500	66,000 16,500
30-9-2017	Debentureholders A/c Dr To Bank A/c [Being payment of interest.]		66,000	66,000
30-9-2017	TDS payable A/c Dr To Bank A/c [Being TDS deposited in income tax department.]		16,500	16,500
31-3-2018	Interest on debenture A/c Dr To Debentureholders A/c To TDS payable A/c [Being interest due on 31st March on 11 % debentures and income tax deducted at source.]		82,500	66,000 16,500
31-3-2018	Debentureholders A/c Dr To Bank A/c [Being payment of interest.]		66,000	66,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31-3-2018	TDS payable A/c Dr To Bank A/c [Being TDS deposited in income tax department.]		16,500	16,500
31-3-2018	Statement of profit and loss A/c Dr To Interest on debentures A/c [Being amount of interest for the full year transfer to statement of profit and loss.] (82,500 + 82,500)		1,65,000	1,65,000
	<b>Total</b>		<b>34,95,000</b>	<b>34,95,000</b>

### 9. For Redemption of Debentures

Following entries are passed for the redemption of debentures :

(i)	At the time of redemption of debentures, the debenture account should be closed and transferred to the debentureholder's account, Debenture A/c ...Dr To Debentureholders A/c		.....	.....
(ii)	To repay money to the debentureholders, Debentureholders A/c ...Dr To Bank A/c		.....	.....

### 10. Accounting Effects at the Time of Issue of Redeemable Debentures

Debentures are issued at par, at a premium or at a discount, but when debentures are to be redeemed to the debentureholders then it is redeemed at par or at a premium only. Debentures can not be redeemed at a discount.

● **When debentures are to be redeemed at par**, at that situation no other journal entry for additional effect is given at the time of issue of debentures. This point can be learnt by following table.

Situation (Condition)	Entry at the time of Issue	Entry at the time of Redemption	Entry at the time of debentureholders are paid
(1) When debentures are issued at par and redeemable at par	(i) Bank A/c ...Dr To debenture application and allotment A/c (ii) Debenture application and allotment A/c...Dr To debenture A/c	Debenture A/c ...Dr To Debentureholders A/c	Debentureholders A/c ...Dr To bank A/c

Situation (Condition)	Entry at the time of Issue	Entry at the time of Redemption	Entry at the time of debentureholders are paid
(2) When debentures are issued at premium and redeemable at par	(i) Bank A/c ...Dr To Debenture application and allotment A/c  (ii) Debenture application and allotment A/c...Dr To Debenture A/c To Security pre. reserve A/c	Debenture A/c ...Dr To Debentureholders A/c	Debentureholders A/c ...Dr To Bank A/c
(3) When debentures are issued at discount and redeemable at par	(i) Bank A/c ...Dr To Debenture application and allotment A/c  (ii) Debenture application and allotment A/c...Dr Discount on debenture A/c ...Dr To Debenture A/c	Debenture A/c ...Dr To Debentureholders A/c	Debentureholders A/c ...Dr To Bank A/c

- **When debentures are issued at par or at a premium or at a discount and are redeemable at a premium then,**

Premium payable at the time of redemption of debentures is a loss for the company. Hence, that amount is debited to 'Loss on Issue of Debentures Account'. Such premium payable at a future date is a liability to the company. So, this amount of premium is credited to '**Premium on redemption of debentures account.**'

Here, students should keep in mind that the premium called or received at the time of issue of debentures and transferred to 'securities premium reserve account' is a gain or profit for the company. Whereas, premium payable on redemption of debentures which is transferred to 'premium on redemption of debentures account' is a liability to the company. When debentures are redeemable at a premium, then following entries will be written under different situation.

- (1) **When debentures are issued at par and are redeemable at a premium,**

- (i) **At the time of issue of debentures :**

(a) Bank A/c ...Dr To Debenture application and allotment A/c	(At face value of debentures) (At face value of debentures)
(b) Debenture application and allotment A/c ...Dr Loss on issue of debentures A/c ...Dr  To Debentures A/c To Premium on redemption of debentures A/c	(At face value of debentures) (Premium amount to be paid at the time of redemption) (At face value of debentures) (Premium amount to be paid at the time of redemption of debentures)

(ii) **At the time of redemption :**

Debenture A/c ...Dr	(At face value of debentures)
Premium on redemption of debentures A/c ...Dr	(Premium amount to be paid at redemption)
To Debentureholders A/c	(Total payable amount)

(iii) **When amount paid to debentureholders :**

Debentureholders A/c ...Dr	(Total payable amount)
To Bank A/c	

(2) **When debentures are issued at a premium and are redeemable at a premium,**

(i) **At the time of issue of debentures :**

(a) Bank A/c ...Dr	(Face value + premium amount)
To Debentures' application and allotment A/c	
(b) Debenture application and allotment A/c...Dr	(Face value + premium amount)
Loss on issue of debentures A/c...Dr	(Premium amount to be paid at the time of redemption of debentures)
To Debenture A/c	(Face value of debentures)
To Securities premium reserve A/c	(Premium received at the time of issue of debentures)
To Premium on redemption of debenture A/c	(Premium amount to be paid at the time of redemption of debentures)

Journal entries at the time of redemption of debentures and payment to debentureholders will be passed as above point 1(ii) and 1(iii).

(3) **When debentures are issued at discount and are redeemable at premium,**

(i) **At the time of issue of debentures :**

(a) Bank A/c ...Dr	(Face value less amount of discount)
To debentures application and allotment A/c	
(b) Debentures application and allotment A/c ...Dr	(Face value less amount of discount)
Discount on debentures A/c ...Dr	(Discount at the time of issue)
Loss on issue of debentures A/c ...Dr	(Premium amount to be paid at the time of redemption of debentures)
To debentures A/c	(Face value of debentures)
To premium on redemption of debentures A/c	(Premium amount to be paid at the time of redemption of debentures)

Journal entries at the time of redemption of debentures and payment to debentureholders will be passed as above point 1(ii) and 1(iii).

● **Position in the balance-sheet of company :**

From the amount of discount on debentures account and from the amount of loss on issue of debentures account, some amount is written off every year as per terms of debentures against statement of profit and loss or securities premium reserve account.

Statement of profit and loss A/c	Dr	.....	
or securities premium reserve A/c	Dr	.....	
To discount on debentures A/c			.....
To loss on issue of debentures A/c			.....

The balances of both the accounts namely, discount on debenture account and loss on issue of debenture account are shown as "Other non-current assets" on the assets side of the balance sheet in every year.

"Premium on redemption of debentures A/c" is a personal account and shows a credit balance. It is a liability of the company. It appears under the head "Non-current liabilities" under sub-head "Other long term liabilities" on the equity and liability side of the balance sheet each year, until the debentures are repaid.

When debentures are redeemed then premium on redemption of debentures account is debited and debentureholders account is credited. So, this account is closed off.

**Illustration 12 :** Write the journal entries only for the issue of debentures from the following transaction (without narration).

- (1) Issued 5000, 10 % debentures of ₹ 100 each at par, redeemable also at par.
- (2) Issued 5000, 10 % debentures of ₹ 100 each at a discount of 5 %, redeemable at par.
- (3) Issued 5000, 10 % debentures of ₹ 100 each at a premium of 8 %, redeemable at par.

**Ans. :**

#### Journal of Company

- (1) Debentures issued price of ₹ 100 each, redeemable at ₹ 100 each.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	Bank A/c Dr To Debenture application and allotment A/c (5000 debentures × ₹ 100)		5,00,000	5,00,000
(ii)	Debenture application and allotment A/c Dr To 10 % Debenture A/c (5000 debentures × ₹ 100)		5,00,000	5,00,000

- (2) Debentures issued price of ₹ 95 each, redeemable at ₹ 100 each.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	Bank A/c Dr To Debenture application and allotment A/c (5000 debenture × ₹ 95)		4,75,000	4,75,000
(ii)	Debenture application and allotment A/c Dr Discount on debenture A/c Dr (5000 debenture × ₹ 5 discount A/c) To 10 % debenture A/c		4,75,000 25,000	5,00,000



(3) Debentures issued price of ₹ 108 each, redeemable at ₹ 100 each.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	Bank A/c Dr To Debenture application and allotment A/c (5000 debenture × ₹ 108)		5,40,000	5,40,000
(ii)	Debenture application and allotment A/c Dr To 10 % debenture A/c To Security premium reserve A/c (5000 Debenture × ₹ 8)		5,40,000	5,00,000 40,000

In the above three situations the journal entries for redemption of debentures and payment to debentureholders will be passed same as under.

● **At the time of redemption of debentures :**

	10 % debentures A/c Dr To Debentureholders A/c		5,00,000	5,00,000
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● **On payment to debentureholders :**

	Debentureholders A/c Dr To Bank A/c		5,00,000	5,00,000
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● **Debentures were issued at par and redeemed at a premium :**

**Illustration 13 :** On 1-8-2017 Namaskar Limited issued 8000, 9 % debentures of ₹ 100 each at par.

These debentures are to be redeemed on 31-7-2022 at ₹ 120 per debenture.

Pass the necessary journal entries in the books of the company for the issue and redemption of debentures (without narration).

**Ans. :**

**Journal of Namaskar Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-8-2017	Bank A/c (8000 debentures × ₹ 100) Dr To Debentures' application and allotment A/c		8,00,000	8,00,000
1-8-2017	Debenture application and allotment A/c Dr (8000 debentures × ₹ 100) Loss on issue of debentures A/c Dr (8000 Debentures × ₹ 20) To 9 % debentures A/c (8000 debentures × ₹ 100) To Premium on redemption of debentures A/c (8000 Debentures × ₹ 20)		8,00,000 1,60,000	8,00,000 1,60,000
31-7-2022	9 % debentures A/c Dr Premium on redemption of debentures A/c Dr To Debentureholders A/c		8,00,000 1,60,000	9,60,000
31-7-2022	Debentureholders A/c Dr To Bank A/c		9,60,000	9,60,000

● **Debentures issued at a discount and redeemed at a premium :**

**Illustration 14 :** On 1-4-2017 Prathana Limited issued 6000, 11 % debentures of ₹ 100 each at a discount of 5 %. All the debentures are to be redeemed after 6 years as on 31-3-2023 at a premium of 10 %. Pass the necessary journal entries in the books of the company. (Without narration).

**Ans. :**

**Journal of Prathana Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2017	Bank A/c Dr To debenture application and allotment A/c (6000 Debentures × ₹ 95)		5,70,000	5,70,000
1-4-2017	Debenture application and allotment A/c Dr Discount on debentures A/c Dr (6000 debentures × ₹ 5) Loss on issue of debentures A/c Dr (6000 debentures × ₹ 10) To 11 % debentures A/c (6000 debentures × ₹ 100) To Premium on redemption of debentures A/c (6000 debentures × ₹ 10)		5,70,000 30,000 60,000	6,00,000 60,000
31-3-2023	11 % debentures A/c Dr Premium on redemption of debentures A/c Dr To Debentureholders A/c		6,00,000 60,000	6,60,000
31-3-2023	Debentureholders A/c Dr To Bank A/c (6000 debentures × ₹ 110)		6,60,000	6,60,000

● **Debentures are issued at premium and are redeemable at a premium :**

**Illustration 15 :** On 1-6-2017 Vandana Limited issued 10,000, 8 % debentures of ₹ 200 each at a premium of 5 %. The debentures are redeemed on 31-5-2022 at ₹ 220 per debenture. Write the necessary journal entries in the books of company (without narration).

**Ans. :**

**Journal of Vandana Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-6-2017	Bank A/c Dr To Debentures' application and allotment A/c (10,000 debenture × ₹ 210)		21,00,000	21,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-6-2017	Debenture application and allotment A/c Dr Loss on issue of debentures A/c Dr (10,000 debentures × ₹ 20) To 8 % debentures A/c (10,000 Debentures × ₹ 200) To Securities premium reserve A/c (10,000 Debentures × ₹ 10) To Premium on redemption of debentures A/c (10,000 Debentures × ₹ 20)		21,00,000 2,00,000	20,00,000 1,00,000 2,00,000
31-5-2022	8 % debentures A/c Dr Premium on redemption of debentures A/c Dr To Debentureholders A/c (10,000 Debentures × ₹ 220)		20,00,000 2,00,000	22,00,000
31-5-2022	Debentureholders A/c Dr To Bank A/c (10,000 Debentures × ₹ 220)		22,00,000	22,00,000

**Illustration 16 :** On 1-7-2017 Natasha Cosmetics Limited issued 50,000 8 % debentures of ₹ 1000 each, are to be redeemed after 8 years at a premium of 10 %. As per conditions in prospectus the amount is payable on application ₹ 400 per debenture and balance amount at the time of allotment. Write the necessary journal entries for the issue of debentures in the books of the company.

**Ans. :**

**Journal of Natasha Cosmetics Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To 8 % debenture application A/c [Being application money received on 50,000 debentures at ₹ 400 per debenture.]		2,00,00,000	2,00,00,000
2	8 % debenture application A/c Dr To 8 % debenture A/c [Being application money on allotted 50,000 debentures transfer to debentures A/c.]		2,00,00,000	2,00,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
3	8 % debenture allotment A/c Dr Loss on issue of debentures A/c Dr To 8 % debenture A/c To Premium on redemption of debentures A/c [Being amount called on 50,000 debentures at ₹ 600 per debenture and debentures to be redeemed at 10 % premium.]		3,00,00,000 50,00,000	3,00,00,000 50,00,000
4	Bank A/c Dr To 8 % debenture allotment A/c [Being receipt of allotment money.]		3,00,00,000	3,00,00,000

**Illustration 17 :** Dixit Electric Limited issued 7000, 7 % debentures as on 1-1-2017 of ₹ 500 each at a discount of 6 %. All the debentures are redeemable at a premium of 5 % after six years. The amount was payable as follows :

On application ₹ 300 per debenture; On allotment balance amount per debenture.

Pass the necessary journal entries for issue of debentures in the books of company.

**Ans. :**

**Journal of Dixit Electrical Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1 (1-1-2017)	Bank A/c Dr To 7 % debentures' application A/c [Being application money received on 7000 debentures at ₹ 300 per debenture.]		21,00,000	21,00,000
2 (1-1-2017)	7 % debenture application A/c Dr To 7 % debenture A/c [Being application money transfer to debenture A/c.]		21,00,000	21,00,000
3	7 % debenture allotment A/c Dr Discount on debentures A/c Dr Loss on issue of debentures A/c Dr To 7 % debenture A/c To Premium on redemption of debentures A/c [Being ₹ 170 called after discount on allotment of debenture, discount amount became ₹ 30 (500 × 6 %) and premium on redemption of debenture became ₹ 25 (500 × 5 %) per debenture.]		11,90,000 2,10,000 1,75,000	14,00,000 1,75,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
4	Bank A/c Dr To 7 % debenture allotment A/c [Being receipt of allotment money.]		11,90,000	11,90,000

### 11. Provision of finance for the Redemption of Debentures

Debentures are the liabilities of the company. The repayment of debentures to the debentureholders is made by the company in accordance with the terms and conditions, as stated in the prospectus at the time of issue of debentures. When debentures are to be redeemed after a fixed period, the company is aware about the time and amount of money required for such redemption.

In this reference, there are some new provisions under Companies Act, 2013. Earlier before this act, there was a system for arrangement of Debenture Redemption Fund and Debenture Redemption Fund Investment by the company. To increase the effectiveness of this system, there are new provisions introduced under section 71(4) of the Companies Act, 2013 along with Rule 18(7)(C) of the companies (share capital and debentures) Rules, 2014. Explanation is given according to this provisions.

Amount required for the redemption of debentures may be managed by a company from the following sources :

- (1) Redemption of debentures from the fresh issue of shares and debentures
- (2) Redemption of debentures out of capital
- (3) Redemption of debentures out of profit

#### (1) Redemption of Debentures from the Proceeds of Fresh Issue of Shares and

**Debentures** : When a company is in need of additional funds for the redemption of debentures, it may decide to issue new equity shares, preference shares or debentures. The proceeds of the fresh issue of share capital and debentures are utilised for redeeming the old debentures. In such type of redemption, the financial position of the company is not adversely affected.

(2) **Redemption of Debentures out of Capital** : When no profits are set aside for redemption of debentures it is called redemption out of capital. But according to section 71(4) of the Companies Act, 2013 and as per SEBI - Securities and Exchange Board of India guidelines requiring creation of **Debenture Redemption Reserve Account** equivalent to at least 25 % of the total face value of issued debentures before redemption commences. This amount is transferred from **Surplus in Statement of Profit and Loss**. So, full amount for redemption of debentures is not purely out of capital, but balance amount payable from capital of company after compliance of the above provisions.

(3) **Redemption of Debentures out of Profits** : Redemption out of profits means provision for an amount equal to debentures issued is transferred from surplus in statement of profit and loss by the company. This provision is to be executed before redemption commences.

For this, company has to create one new 'Debenture Redemption Reserve Account'. In which required full amount for redemption of debentures is transferred from surplus in statement of profit and loss to Debenture Redemption Reserve Account.

Due to this effect, company reduces the amount of profits available for dividend and it is used for redemption of debentures. This amount is not available for payment of dividend. Thus, existing liquid resources of the company are not affected by the redemption of debentures.



- **SEBI guidelines for redemption of debentures :**

- (1) The creation of debenture redemption reserve is obligatory only for non-convertible debentures and non-convertible portion of partly convertible debentures.
- (2) A company shall create Debenture Redemption Reserve equivalent to at least 25 % of the amount of debentures issued **before starting the redemption of debentures.**

Following categories of companies are exempted from creating 'Debenture Redemption Reserve' :

- (1) All India Financial Institutions (AIFIs) regulated by Reserve Bank of India.
  - (2) Other financial institutions regulated by Reserve Bank of India.
  - (3) Banking companies for both public as well as privately placed debentures.
  - (4) Housing finance companies registered with the National Housing Bank.
- (Note : This is given only for information to the students, not expected in the exam.)

- Balance of Debenture Redemption Reserve is shown on the 'Equity and Liabilities' part of the balance sheet under the head 'Reserve and Surplus'.

When all the debentures have been redeemed, then Debenture Redemption Reserve Account is closed by transferring the amount to 'General Reserve Account'.

	Debenture redemption reserve A/c Dr		.....	
	To General reserve A/c			.....

- **For Debentures Redemption Investment :**

As per Rule 18(7)(C) of the companies (share capital and debentures) Rules 2014, company required to deposit or invest, a sum which shall not be less than 15 % of the total face value of the debentures to be redeemed at the end of the year. i.e. during the year ending on 31st March, on or before 30th April i.e. at the beginning of the year. This investment is called '**Debenture Redemption Investment Account.**'

The amount so deposited or invested can be utilized only for the purpose of repayment of debentures maturing during the year.

The amount should be invested in the specified securities which are mentioned in the companies act for the redemption of debentures. The amount invested or deposited shall not be used for any purpose other than for redemption of debentures.

Securities specified for investment :

- (1) In deposit with any scheduled bank, free from any charge
- (2) In unencumbered securities of the central government or any state government
- (3) In unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of Indian Trust Act, 1882.
- (4) In unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of Indian Trust Act, 1882.

## 12. Methods of Redemption of Debentures

The methods of redemption of debentures are as under :

- (1) Lump-sum payment at the end of fixed period
- (2) Payment in installments by drawing of lots

- (3) By purchase of own debentures in the open market
- (4) By conversion into shares

To understand above all methods by different illustrations :

**(1) Lump-sum Payment at the End of Fixed Period :**

Under this method, the company redeems whole of its debentures in one lump-sum at the expiry of a specified period or earlier at the option of the company.

Such redemption may be made at par or at premium, according to the terms of issue. Here, debentures are to be redeemed according to provisions of Companies Act and also as per SEBI guidelines.

The journal entries in this method are as follows :

(I)	<b>At the beginning of financial year (Upto 30th April) :</b> (Note : The year in which debentures are redeemed.) <b>On making investment at 15 % of the face value of debentures to be redeemed,</b> Debenture redemption investment A/c ... Dr To Bank A/c .....		
(II)	<b>At the time of redemption :</b> <b>(i) When debentures are to be sold,</b> Bank A/c ... Dr To Debenture redemption investment A/c .....		
(ii)	<b>On transfer of profits from surplus in statement of profit and loss at the rate of 25 % of the face value of debentures issued :</b> Surplus in statement of profit and loss A/c ...Dr To Debenture redemption reserve A/c .....		
(III)	<b>On redemption of debentures :</b> (i) Debenture A/c ... Dr To Debentureholders A/c ..... (ii) Debentureholders A/c ... Dr To Bank A/c .....		
(IV)	<b>When all the debentures are redeemed then,</b> Debenture redemption reserve A/c ... Dr To General reserve A/c .....		

● **When the provision of money for the redemption of debentures is out of capital :**

**Illustration 18 :** Shailja Limited issued 12,000, 8 % debentures of ₹ 100 each at a premium of 5 % on 1st April, 2011, redeemable on March 31, 2017. The issue was fully subscribed. The board of directors decided to transfer the required amount to Debenture Redemption Reserve as on March 31, 2017 and debentures to be redeemed out of capital. They also decided to invest required amount into Debenture Redemption Investment on 30th April, 2016.

Investments were sold on the date of redemption of debentures and required amount for redemption of debentures were paid to debentureholders.

Pass necessary journal entries for issue and redemption of debentures in the books of company and also prepare debenture redemption investment A/c and debenture redemption reserve A/c.

Ans. :

**Journal of Shailja Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-11	Bank A/c Dr To 8 % debenture application and allotment A/c [Being application money received on 12,000 debentures at ₹ 105 per debenture.]		12,60,000	12,60,000
1-4-11	8 % debentures application and allotment A/c Dr To 8 % debenture A/c To Securities premium reserve A/c [Being application money transfer to debenture A/c and premium A/c.]		12,60,000	12,00,000 60,000
30-4-16	Debenture redemption investment A/c Dr To Bank A/c [Being investment made 15 % of the face value (12,00,000) of debentures.]		1,80,000	1,80,000
31-3-17	Bank A/c Dr To Debentures redemption investment A/c [Being investment for the redemption of debentures is sold.]		1,80,000	1,80,000
31-3-17	Surplus in statement of profit and loss A/c Dr To Debenture redemption reserve A/c [Being transfer of profits equal to 25 % of the nominal value of debentures issued to debenture redemption reserve account.] (12,00,000 × 25 %)		3,00,000	3,00,000
31-3-17	8 % debenture A/c Dr To Debentureholders A/c [Being amount due on redemption of debentures.]		12,00,000	12,00,000
31-3-17	Debentureholders A/c Dr To Bank A/c [Being due amount paid to debentureholders.]		12,00,000	12,00,000
31-3-17	Debenture redemption reserve A/c Dr To General reserve A/c [Being after redemption of all the debentures, amount of debenture redemption reserve A/c transfer to general reserve A/c.]		3,00,000	3,00,000
	<b>Total</b>		<b>58,80,000</b>	<b>58,80,000</b>

**Note :** Interest on investments and its effect is not calculated because rate of interest on debenture redemption investments is not given.

Dr **Debenture Redemption Investment A/c** Cr

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30-4-16	To Bank A/c		1,80,000	31-3-17	By Bank A/c		1,80,000
			1,80,000				1,80,000

Dr **Debenture Redemption Reserve A/c** Cr

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
31-3-17	To General reserve A/c		3,00,000	31-3-17	By Surplus in statement of profit & loss		3,00,000
			3,00,000				3,00,000

**Illustration 19 :** Nirja Limited issued ₹ 7,00,000, 9 % debentures of ₹ 100 each on April 1, 2013 at a premium of 5 %, which redeemable at a premium of 10 % on 31st March, 2018. According to provisions of Companies Act, the required investment was made in 8 % government securities on April 30 of the financial year in which redemption is due. Debentures were redeemed on the due date. Pass journal entries at the time of issue and redemption of debentures in the books of company. Also prepare debenture redemption investments account and debenture redemption reserve A/c.

**Ans. :**

**Journal of Nirja Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-13	Bank A/c Dr To 9 % debenture application and allotment A/c [Being application money received on 7000 debentures at ₹ 105 per debenture.]		7,35,000	7,35,000
1-4-13	9 % debenture application and allotment A/c Dr Loss on issue of debentures A/c Dr To 9 % debenture A/c To Securities premium reserve A/c To Premium on redemption of debentures A/c [Being transfer to debentures account and securities premium account from application money and also to give an effect of premium on redemption of debentures account.]		7,35,000 70,000	7,00,000 35,000 70,000
30-4-17	Debenture redemption investment A/c Dr To Bank A/c [Being investment made in 8 % government securities at the rate of 15 % of the face value of debentures (7,00,000 × 15 %).]		1,05,000	1,05,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31-3-18	Bank A/c Dr To Debentures redemption investment A/c To Interest earned A/c [Being investment for debenture redemption is sold and on this interest received for 11 months.]		1,12,700	1,05,000 7700
31-3-18	Surplus in statement of profit and loss A/c Dr To Debenture redemption reserve A/c [Being 25 % of total face value of debentures transfer to debenture redemption reserve A/c (7,00,000 × 25 %).]		1,75,000	1,75,000
31-3-18	9 % debentures A/c Dr Debenture on redemption of debentures A/c Dr To Debentureholders A/c [Being amount due for redemption of debentures.]		7,00,000 70,000	7,70,000
31-3-18	Debentureholders A/c Dr To Bank A/c [Being payment of amount due to debentureholders.]		7,70,000	7,70,000
31-3-18	Debenture redemption reserve A/c Dr To General reserve A/c [Being transfer amount of debenture redemption reserve to general reserve account after the redemption of the debentures.]		1,75,000	1,75,000
31-3-18	Interest earned A/c Dr To Statement of profit and loss A/c [Being interest transfer to statement of profit and loss.]		7700	7700

Dr				Cr			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30-4-17	To Bank A/c		1,05,000	31-3-18	By Bank A/c		1,05,000
			1,05,000				1,05,000



Dr				Debenture Redemption Reserve A/c				Cr	
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)		
31-3-18	To General reserve A/c		1,75,000	31-3-18	By Surplus in statement of profit and loss A/c		1,75,000		
			1,75,000				1,75,000		

**Note :** (1) As per section 17(4) with Rule 18(7) a banking company is not required to create Debenture Redemption Reserve.

(2) As per new guidelines, infrastructure companies are also required to create debenture redemption reserve at 25 % of the nominal value of debentures. (Not expected in the exam)

● **When the provision of money for the redemption of debentures is out of profit :**

**Illustration 20 :** Pragna Limited redeemed 7 % debentures of ₹ 34,00,000 (face value) at a premium of 8 % as on 31-3-2018. For this, provision for money was made out of profit of the company. The company invested the required amount as on 30th April, 2017.

Pass journal entries for the redemption of debentures in the book of company with the assumptions that its full provisions of Companies Act. Also prepare Debenture Redemption Investment A/c and Debenture Redemption Reserve A/c.

**Ans. :**

**Journal of the Pragna Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
30-4-17	Debenture redemption investment A/c Dr To Bank A/c [Being investment made at 15 % on ₹ 34,00,000, before redemption of debentures.]		5,10,000	5,10,000
31-3-18	Bank A/c Dr To Debenture redemption investment A/c [Being investment encashed for redemption of debentures.]		5,10,000	5,10,000
31-3-18	Surplus in statement of profit and loss A/c Dr To Debenture redemption reserve A/c [Being amount to create debenture redemption reserve A/c from profits, amount equal to the nominal value of redeemable debentures.]		34,00,000	34,00,000
31-3-18	7 % debentures A/c Dr Premium on redemption of debentures A/c Dr To Debentureholders A/c [Being amount due on redemption of debentures with premium.]		34,00,000 2,72,000	36,72,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31-3-18	Debentureholders A/c Dr To Bank A/c [Being payment of amount due to debentureholders.]		36,72,000	36,72,000
31-3-18	Debenture redemption reserve A/c Dr To General reserve A/c [Being transfer of balance of debenture redemption reserve A/c to general reserve A/c on the redemption of all the debentures.]		34,00,000	34,00,000

**Debenture Redemption Investment A/c**

Dr

Cr

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30-4-17	To bank A/c		5,10,000	31-3-18	By bank A/c		5,10,000
			<b>5,10,000</b>				<b>5,10,000</b>

**Debenture Redemption Reserve A/c**

Dr

Cr

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
31-3-18	To general reserve A/c		34,00,000	31-3-18	To surplus in statement of profit and loss A/c		34,00,000
			<b>34,00,000</b>				<b>34,00,000</b>

**Illustration 21 :** Morbi Tiles Limited had issued 8 % debentures of ₹ 16,00,000, which are due to be redeemed out of profits on 1-11-2017 at a premium of 5 %. The company had a Debenture Redemption Reserve of ₹ 5,60,000. It was decided to invest the required amount in proper time in Debenture Redemption Investment.

Pass necessary journal entries for the redemption of debentures in the books of company and also prepare debenture redemption reserve A/c and debenture redemption investment A/c.

**Ans. :**

**Journal Entries in the Books of Morbi Tiles Ltd.**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31-3-17	Surplus in statement of profit and loss A/c Dr To Debenture redemption reserve A/c [Being necessary amount out of profit transfer to debenture redemption reserve A/c. (Working note no. 1)]		10,40,000	10,40,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
30-4-17	Debenture redemption investment A/c Dr To Bank A/c [Being investment made at 15 % on ₹ 16,00,000 i.e. total face value of the redeemable debentures.]		2,40,000	2,40,000
1-11-17	Bank A/c Dr To Debenture redemption investment A/c [Being amount received on investment for the redemption of debentures.]		2,40,000	2,40,000
1-11-17	8 % debentures A/c Dr Premium on redemption of debentures A/c Dr To Debentureholders A/c [Being amount due on redemption of debentures.]		16,00,000 80,000	16,80,000
1-11-17	Debentureholders A/c Dr To Bank A/c [Being payment of amount due to debentureholders.]		16,80,000	16,80,000
1-11-17	Debenture redemption reserve A/c Dr To General reserve A/c [Being transfer amount of debenture redemption reverse account to general reserve account on the redemption of all the debentures.]		16,00,000	16,00,000

#### Debenture Redemption Reserve A/c

Dr				Cr			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
1-11-17	To General reserve A/c		16,00,000	1-4-16	By Balance b/d		5,60,000
				31-3-17	By Surplus in statement of profit and loss A/c		10,40,000
			<b>16,00,000</b>				<b>16,00,000</b>

#### Debenture Redemption Investment A/c

Dr				Cr			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30-4-17	To Bank A/c		2,40,000	1-11-17	By Bank A/c		2,40,000
			<b>2,40,000</b>				<b>2,40,000</b>

**Working note no. 1 :** Here, required amount for the redemption of debentures is allocated out of company's profit.

Total face value = ₹ 16,00,000

	₹
Required amount to create debenture redemption reserve A/c (100 %)	16,00,000
<b>Less :</b> Balance of debenture redemption reserve A/c, was in books of company	<u>5,60,000</u>
Balance amount transfer from surplus in statement of profit and loss	10,40,000

**Note :** (1) When debentures are redeemable at the end of the financial year then, at the end of the year amount transferred to debenture redemption reserve A/c is from surplus in statement of profit and loss of the respective year.

(2) If payment of redemption of debentures is to be done from capital then, an amount transferred from surplus in statement of profit and loss to debenture redemption reserve A/c is 25 % of total face value or nominal value of redemption of debentures.

(3) If payment of redemption of debentures is to be done from profit then, an amount transferred from surplus in statement of profit and loss to Debenture Redemption Reserve A/c is 100 % of total face value or nominal value of redemption of debentures.

(4) When debentures are redeemable during any time in between the financial year then, required amount is to be transferred from surplus in statement of profit and loss of the previous year to Debenture Redemption Reserve A/c. The amount to be transferred to Debenture Redemption Reserve Account has to be calculated as per note. no. 2 and no. 3.

(5) Required amount for Debenture Redemption Reserve can be transferred from surplus in statement of profit and loss of the current financial year or previous financial year by the company but before starting the redemption of debentures.

(6) If there is no clarification regarding required amount of redemption of debentures which is out of capital or out of profit then, calculate with the assumption that company has paid out of capital.

## **(2) Redemption of Debentures in Installments by Drawing of Lots : (Only theoretical)**

According to this method, the debentures are redeemed by the company in annual installments. For example, if total debentures of ₹ 25,00,000 then from this ₹ 5,00,000 may be redeemed every year. The serial number of debentures which should be redeemed each year are selected by lottery. This procedure is known as "drawings by lots". Debentures are redeemed at par or at a premium, according to the terms of issue. Required amount is transferred to debenture redemption reserve account for redemption of debentures. For this, necessary rules are depicted earlier.

## **(3) Redemption of Debentures by the Purchase of Own Debentures in the Open Market :**

According to the Companies Act, if authorised by company's articles of association, a company can purchase the own debentures in the open market. i.e. from recognised stock exchange instead of to redeem the debentures. This procedure is usually adopted by the company only when its debentures are quoted at a less price or at a discount on the stock exchange as compare to face value of debenture or amount of redemption of debenture.

After purchasing the debentures from the open market, the company may use either of the following two options :

- (1) Company may immediately cancel the debentures purchased, after passing the resolution by Board of Directors.
- (2) Company may not cancel the debentures but may keep with them. Company can issue them in future. When the company purchases own debentures in the market then, that debentures shall be treated as an '**Investment in the Own Debentures**' by the company.

**(1) When own debentures are purchased for immediate cancellation :**

In this situation, the following entries will be passed in the books of company :

- **When debentures are purchased at less price as compare to face value of the debentures :**

For example, if a company purchased its own 700 debentures of ₹ 100 each at ₹ 97 in the open market and immediately cancel them after purchase.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Own debentures A/c Dr To Bank A/c [Being 700 debentures purchased in the open market at ₹ 97 per debenture.]		67,900	67,900
	Debenture A/c Dr To Own debentures A/c To Profit on redemption of debentures A/c [Being cancellation of own purchased debentures.]		70,000	67,900 2100

- Profit on redemption of debenture is a capital profit. This capital profit should be used to write off any capital loss in the company. e.g. discount on issue of debentures, premium on redemption of debentures etc.
- This capital profit if it is not used to write off any capital loss or if it is not used fully then, the balance will be transferred to capital reserve. The entry will be as under :

Profit on redemption of debentures A/c Dr	.....
To Capital reserve A/c	.....
To Capital loss A/c (if any)	.....

- **When debentures are purchased at more price as compared to face value of the debentures :**

For example, if a company purchases its own 8000 debentures of ₹ 100 each at ₹ 104 in the open market and immediately cancels them after purchase then its accounting effects are shown here under :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Own debentures A/c Dr To Bank A/c [Being purchased 8000 debentures from the market at ₹ 104 per debenture.]		8,32,000	8,32,000
	Debenture A/c Dr Loss on redemption of debentures A/c Dr To Own debentures A/c [Being cancellation of own purchased debentures.]		8,00,000 32,000	8,32,000



- ❑ 'Loss on Redemption of Debentures A/c' is a capital loss. This capital loss is written off against capital profit or in the absence of capital profit is written off from statement of profit and loss :

Capital profit (if any) A/c	Dr		.....	
or Statement of profit and loss A/c	Dr		.....	
To loss on redemption of debentures A/c				.....

**Note :** When the company purchases own debentures in the open market and cancels this debentures then, as per the discussion in the earlier points, the required amount should be transferred to Debentures Redemption Reserve A/c and also to make debentures redemption investment according to provisions of Companies Act and SEBI guidelines.

If there is no clarification about this matter in an example or question, then give the effect for the given transaction with the assumption that company has made both these provisions.

**(2) When the company purchases own debentures in the open market and these debentures are kept as 'Investment' :**

Own debentures are purchased by the company from the open market and kept as investment instead of cancellation of these debentures. When a company has surplus funds, instead of investing these funds in the securities of other companies or any other securities, it buys its own debentures as investment. Due to this following are the advantages :

- Sometimes, the own debentures are available in the open market at discount i.e. at less than the face value.
- Company has not to pay interest on own purchased debentures. Because company itself became a debentureholder.
- Such debentures are kept alive and can again be sold off in the market.

**Accounting effects :**

For example, if a company purchases ₹ 80,000 of its own debentures at ₹ 76,000 from open market and kept this debentures as investment then, the entry will be :

Investment in own debentures A/c	Dr		76,000	
To Bank A/c				76,000

Here, investment will be shown at the same price i.e. price for the purchase of debentures. Profit or loss on the purchase is not recorded.

Investments in the own debentures will be shown normally as non-current assets on the assets side in the balance sheet as follows :

**Balance Sheet of the Company**

<b>(II) Assets</b>	<b>(₹)</b>
<b>Non-current Assets :</b>	
Own debentures (Face value ₹ 80,000)	76,000

Own debentures will be shown in the balance sheet as current or non-current assets depending on the time of cancellation.

**Investment in own debentures used for debentures cancellation :** When the company uses its investment in the own debentures for the cancellation of debentures in future then journal entries are to be passed as in following illustration :

For example, a company issued 9 % debentures of ₹ 1,60,000. The company purchased this debentures at ₹ 1,55,000 from the market for the investment.

The company has used this investment in the own debentures for the cancellation of issued debentures. Journal entries for cancellation of the debentures will be as under :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	9 % debentures A/c Dr To Investment in own debentures A/c To Profit on redemption of debentures A/c		1,60,000	1,55,000 5000
(ii)	Profit on redemption of debentures A/c Dr To Capital reserve A/c		5000	5000

**When investment in own debentures may be sold by company in open market :**

When investment is done in the own debentures by the company itself and these debentures may be sold by the company in the open market then profit or loss realised from it, is treated as revenue profit or revenue loss. Which is transferred to statement of profit and loss.

**Effect in statement of profit and loss :** Profit on sale of "Investment in own debentures" in the market is shown under "Other Income" in the statement of Profit and loss.

**Illustration 22 :** Poojan Motors Limited issued 4000, 8 % debentures of ₹ 250 each. The board of directors purchased 1500 own debentures from the market at a price of ₹ 225 each for investment purpose. After few months, company sold these purchased debentures at ₹ 270 per debenture in the market.

Record necessary entries from the above transactions.

**Ans. :**

**Journal of Poojan Motors Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Bank A/c Dr To Debenture application and allotment A/c [Being application money received on 4000 debentures at ₹ 250 per debenture.]		10,00,000	10,00,000
2	Debenture application and allotment A/c Dr To 8 % debenture A/c [Being application money transferred to debenture A/c.]		10,00,000	10,00,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
3	Investments in own debentures A/c Dr To Bank A/c [Being purchase of 1500 debentures at ₹ 225 each from the market for investment.]		3,37,500	3,37,500
4	Bank A/c Dr To Investment in own debentures A/c To Profit on sale of investment A/c [Being investment in own debentures sold at ₹ 270 each.]		4,05,000	3,37,500 67,500
5	Profit on sale of investment A/c Dr To Statement of profit and loss A/c [Being profit on sale of investment, due to revenue profit transferred to statement of profit and loss.]		67,500	67,500

**Note :** The company is not required to create debenture redemption reserve and also there is no need to invest the 15 % amount because the debentures are purchased for investment and not for cancellation.

#### (4) Conversion of Debentures into Shares :

This is a method of redemption of debentures, where debentures can be redeemed by the issue of shares in lieu of debentures. As per the terms of the issue of debentures, a company can issue its equity or preference shares in lieu of debentures to the debentureholders.

When debentures are converted into shares, the following journal entries are passed :

(i)	Debenture A/c Dr To Debentureholders A/c		.....	.....
(ii)	Debentureholders A/c Dr To Equity share capital A/c or To Preference share capital A/c		.....	..... .....

**Note :** When debentures are converted into shares by the company then shares may be issued to debentureholders at par or at a premium. It means, when debentures are converted into shares then these shares may not be issued at a discount, otherwise it violates the provisions of Companies Act.

**Illustration 23 :** Prakhar Limited issued 8000; 7.5 % convertible debentures of ₹ 200 each at par as on April 1, 2014. As per the terms of issue of debentures, all the debentures will be converted into shares after 4 years and for this one equity share of ₹ 10 each will be issued at a premium of 25 % against each debenture.

As per the agreed terms, all the debentures are converted into shares as on April 1, 2018. Write necessary journal entries in the books of company.

**Ans. : Calculation :**

Total amount received on issue of debentures

$$8000 \text{ debentures} \times ₹ 200 = ₹ 16,00,000$$

Price of each equity share to be issued against debentures

$$= ₹ 10 \text{ original price} + ₹ 2.50 \text{ premium}$$

$$= ₹ 12.50$$

No. of equity share to be issued against debentures

$$= \frac{16,00,000}{12.50} = 1,28,000 \text{ shares}$$

**Journal Entries in the Books of Company**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2014	Bank A/c Dr To Debentures application and allotment A/c [Being receipt of application money on 8000 debentures of ₹ 200 each.]		16,00,000	16,00,000
1-4-2014	Debentures application and allotment A/c Dr To 7.5 % debentures A/c [Being application money transfer to debenture A/c.]		16,00,000	16,00,000
1-4-2018	7.5 % debentures A/c Dr To Debentureholders A/c [Being 8000 debentures to be converted at face value into equity shares.]		16,00,000	16,00,000
1-4-2018	Debentureholders A/c Dr To Equity share capital A/c (1,28,000 shares × ₹ 10) To Securities premium reserve A/c (1,28,000 shares × ₹ 2.50) [Being 1,28,000 shares at ₹ 10 each at a premium of 25 % on it issued against 8000 debentures.]		16,00,000	12,80,000 3,20,000

● **Redemption of debentures by different considerations :**

A company normally redeemed its debentures by cash payment to the debentureholders at the time of redemption of debentures. However, sometimes, instead of paying cash for the redemption of debentures, the company might give consideration other than cash to debentureholders. For example, issue of new shares or new debentures as consideration to debentureholders. Thus, amount due on redemption of the debentures can be discharged by different considerations. For this, necessary terms should be mentioned at the time of issue of debentures.

**Illustration 24 :** On 1st January, 2014 R. K. P. Ltd. issued 30,000, 9 % debentures of ₹ 100 each. According to the terms of the issue of debentures, the debentures were to be redeemed at 5 % premium by giving 6 months notice at any time after 5 years. The redemption was to be made by cash or by issue of new shares or by issue of new debentures as per the option to be exercised by the debentureholders.

On 1st March, 2019 the company issued the required notice to the debentureholders for the redemption of the debentures. The company gave three options for the redemption of the debentures on 1st September, 2019 : (1) Redemption money will be paid in cash (2) Equity shares of ₹ 10 each will be issued at ₹ 12 per share (3) New 8 % debentures of ₹ 100 each will be issued at a price of ₹ 96 per debenture.

Holders of 9000 debentures accepted equity shares, holders of 12,000 debentures accepted the new 8 % debentures and the rest of debentureholders opted for cash as consideration.

With the assumption that company has fulfilled the provisions of Companies Act and SEBI guidelines, write the necessary journal entries to record the above transactions in the books of the company.

**Ans. :**

**Journal Entries in the Books of R. K. P. Limited**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-1-2014	Bank A/c Dr To Debentures application and allotment A/c [Being application money received on 30,000 debentures.]		30,00,000	30,00,000
1-1-2014	Debenture application and allotment A/c Dr Loss on issue of debentures A/c Dr To 9 % debentures A/c To Premium on redemption of debentures A/c [Being application money transfer to debentures A/c and premium to be paid on redemption of debentures.]		30,00,000 1,50,000	30,00,000 1,50,000
1-9-2019	9 % debenture A/c Dr Premium on redemption of debentures A/c Dr To Debentureholders A/c [Being amount due on 30,000 debentures with 5 % premium.]		30,00,000 1,50,000	31,50,000
1-9-2019	Debentureholders A/c Dr To Equity share capital A/c To Securities premium A/c [Being issue of 78,750 equity shares of ₹ 12 each to holders of 9000 debentures. (Note 1)]		9,45,000	7,87,500 1,57,500



Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-9-2019	Debentureholders A/c Dr Discount on debentures A/c Dr To 8 % debentures A/c [Being issue of 13,125 new debentures of ₹ 96 each to holders of 12,000 debentures. (Note 2)]		12,60,000 52,500	13,12,500
1-9-2019	Debentureholders A/c Dr To Bank A/c [Being cash paid to holders of remaining 9000 debentures. (Note 3)]		9,45,000	9,45,000

**Note :** (1) The amount payable to holders of 9000 debentures at the time of redemption  
 $= 9000 \times ₹ 105 = ₹ 9,45,000$ . Against this equity shares are issued at ₹ 12 (₹ 10 + ₹ 2 premium) per share.

$$\text{No. of equity shares} = \frac{9,45,000}{12} = 78,750.$$

(2) The amount payable at the time of redemption to holders of 12,000 debentures.  
 $= 12,000 \times ₹ 105 = ₹ 12,60,000$ . Against this new 8 % debentures are issued at ₹ 96 (₹ 100 – ₹ 4 discount) per debenture.

$$\text{No. of new debentures} = \frac{12,60,000}{96} = 13,125.$$

(3) The amount payable at the time of redemption to holders of 9000 debentures in cash  
 $= 9000 \times ₹ 105 = ₹ 9,45,000$ .

### 13. Difference Between Share and Debenture

Point of Distinction	Shares	Debenture
(1) Type of capital	Share is a capital showing ownership and is called ownership security. A shareholder is considered as an owner of company.	Debenture is a borrowed capital. It is called creditorship security. The debentureholder is a creditor of the company.
(2) Certainty of return	No return will be available to the shareholder if the company does not make any profit. Moreover, even if the company makes a profit, dividend will be paid to the shareholders only if the board of directors recommend the dividend. Thus, there is no surety of the return.	Debentureholders are to be paid interest as per the terms of issue of the debentures irrespective of the fact whether the company makes a profit or loss.
(3) Charge or Security	Share being an ownership security, the company has not to offer any security against this.	Debenture being creditorship security, the company is generally required to create a fixed or floating charge on assets.

Point of Distinction	Shares	Debenture
(4) Rights	The shareholders have a right to take part in the administration of the company and have voting right.	Debentureholders do not have voting rights or the right to take part in the administration of the company.
(5) Restriction on issue at discount	Except SWEAT equity shares, Shares cannot be issued at discount. (As per companies act, 2013)	Debentures can be issued at a discount.
(6) Convertibility	Shares cannot be converted into debentures. So, this type of shares can not be issued.	Debentures can be converted into shares. So, this type of debentures can be issued.
(7) For redemption	A company is not required to return the share capital during its life time.	Generally, proceeds of debentures are to be repaid after a fixed period.
(8) At the time of liquidation	In case of liquidation or winding up of a company, the shareholders are paid any sum only if any amount is left after paying off all outside liabilities.	In case of liquidation of a company, the debentureholders are paid in priority to the shareholders.

### EXERCISE

#### 1. Select the correct option for each equation :

- (1) Debenture is ..... for a company.
  - (a) capital
  - (b) receivable
  - (c) liability
  - (d) asset
- (2) Company gives ..... on their debentures to debentureholders.
  - (a) dividend
  - (b) interest
  - (c) share in profit
  - (d) both interest and dividend
- (3) At what rate debentures would be issued at discount ?
  - (a) 10 %
  - (b) 5 %
  - (c) 20 %
  - (d) rates as decided by board of directors
- (4) The issued debentures by the company are shown under which head in the balance sheet ?
  - (a) Non-current liabilities
  - (b) Share capital and reserves
  - (c) Current liabilities
  - (d) Investments
- (5) The amount of premium received on issuing debentures at premium is transferred to which account ?
  - (a) Capital reserve A/c
  - (b) General reserve A/c
  - (c) Securities premium reserve A/c
  - (d) Statement of profit and loss A/c
- (6) The amount of premium received on issuing debentures at premium is ..... .
  - (a) revenue profit
  - (b) capital loss
  - (c) revenue loss
  - (d) capital profit

- (7) When full amount of the debenture is called on application by the company then, that amount is credited to which account ?  
 (a) Debenture application A/c (b) Debenture application and allotment A/c  
 (c) Debenture allotment A/c (d) Debentureholders A/c
- (8) Before the company decides to redeem the debentures out of capital, the company has to transfer ..... % of total face value of issued debentures to debenture redemption reserve A/c.  
 (a) 10 (b) 25  
 (c) 100 (d) 15
- (9) Before the company decides to redeem the debentures out of profit, the company has to transfer ..... % of total face value of issued debentures to debenture redemption reserve A/c.  
 (a) 10 (b) 25  
 (c) 100 (d) 15
- (10) As per companies rules 2014, the amount that is at least ..... % of face value of the debentures to be redeemed by the end of financial year. i.e. 31st March, should be invested at the beginning of the year i.e. upto 30th April.  
 (a) 25 (b) 15  
 (c) 100 (d) 10

**2. Give answer in two or three sentences :**

- (1) What is debenture ?
- (2) Who is called debentureholder ?
- (3) According to Companies Act, 2013, for what duration can a company issue debentures ?
- (4) Under which head 'Securities premium reserve account' appears in the balance sheet ?
- (5) What is meant by debenture discount ?
- (6) Give the provision for writing off the amount of discount on debentures.
- (7) What is meant by 'Issue of debentures for consideration other than cash' ?
- (8) What is meant by 'Loss on issue of debentures' ?
- (9) What are the arrangements by the company to fulfil the required amount for the redemption of debentures.
- (10) Explain the methods of redemption of debentures.

**3. Give answer of the following questions in detail :**

- (1) Explain the types of debentures.
- (2) Explain the procedure for issue of debentures.
- (3) Write a note on 'Debentures issued at a premium'.
- (4) Write a note on 'Debentures issued at a discount'.
- (5) Explain the accounting treatment of debentures issued as collateral security.
- (6) Write a note on – 'Interest on debentures'.
- (7) Write a note on – 'Redemption of debentures by the purchase of own debentures in the open market'.
- (8) Distinguish between shares and debentures.

4. Sachin Marbel Limited issued 12,000 debentures of ₹ 100 each for public subscription. Interest is to be paid at the rate of 10 % p.a. The amount were called up per debenture as under :
- with application ₹ 30
  - on allotment ₹ 45
  - on call ₹ 25

Application were received by company of 15,000 debentures. After allotment of 12,000 debentures, rejected excess application of debentures and refunded the money to applicants. All the amounts due on allotment and call were duly received. Write journal entries in the books of the company.

5. Garvi Cotton Limited issued 6000; 10 % debentures of ₹ 500 each at a premium of 40 %. On which the amount per debenture was payable as under :
- with application ₹ 200
  - on allotment ₹ 300 (including premium)
  - on final call ₹ 200

Applications were received for a total of 9000 debentures, from this excess applications were rejected and refunded the money received thereon. All the amounts due on allotment and call were duly received. Pass journal entries in the books of the company.

6. Pasvadal Steel Limited issued 15,000, 9 % debentures of ₹ 100 each at a price of ₹ 80 per debenture. The amount per debenture was payable as under :
- ₹ 25 with application
  - ₹ 35 on allotment (after discount)
  - ₹ 20 on call

The company received application for 15,000 debentures and all are sanctioned. The company received the full money called on allotment and received full amount on call. Except call on 800 debentures. Pass necessary journal entries in the books of company.

7. Dynamic Limited of Ankleshwar issued 30,000, 12 % debentures of ₹ 100 each, on which the amount per debenture was payable as under :
- with application ₹ 35
  - on allotment ₹ 40
  - on first and final call ₹ 25

All the debentures were applied. Palak, the holder of 1000 debentures paid the entire amount on his holding on allotment. Where, Akash, the holder of 400 debentures failed to pay the allotment and call amount.

All the amount on allotment and call were duly received on all remaining debentures.

Pass necessary journal entries for the above transactions in the books of company.

8. Charmi Fashion Limited issued 1,20,000, 10 % debentures at the face value of ₹ 200 each at a premium of 10 %. Amount was payable as under :
- with application ₹ 100 (including premium) and balance amount on allotment.

These debentures are redeemable after 7 years.

Applications are received by company for 1,50,000 debentures and the allotment of 1,20,000 debentures is made on pro-rata basis.

Excess amount on application is credited to allotment account. Amount due on allotment is fully received. Pass journal entries on the issue of debentures in the books of company.



9. Janki Marbal Ltd. of Palanpur issued 50,000, 11 % Debentures of ₹ 100 each at a premium of ₹ 20 per debenture. The full amount was payable on application. Applications were received by company for 60,000 debentures. Application for 10,000 debentures were rejected and the amount thereon was refunded to the applicants. Debentures were allotted to the remaining applications. Pass necessary journal entries for the above transactions in the books of Janki Marbal Ltd.
10. Mansuri Limited of Dahod issued 8000, 10 % debentures of ₹ 100 each at a discount of 10 % as on 1-4-2017. The amount were payable as under :
- ₹ 30 with application;  
₹ 35 on allotment and balance amount on final call.
- Company received application of 10,500 debentures, of which 8000 debentures are allotted. Amount was refunded to the applicants on rejected applications. All the moneys due on debentures were duly received.
- Expenses on issue of debentures amounted to ₹ 22,000. Directors decided to write off  $\frac{1}{5}$ th amount of "Expenses on Issue A/c" and "Discount on debentures A/c" from statement of profit and loss each year.
- Write journal entries for first year only from the above transactions in the books of company.
11. Aadinath Limited purchased machinery worth ₹ 18,00,000 from Shikhar Machinery Ltd. on 10-9-2017. ₹ 3,00,000 were paid immediately and the balance was paid by issue of ₹ 15,80,000, 9 % debentures in Aadinath Limited. Pass necessary journal entries in the books of Aadinath Ltd. If for the balance amount Adinath Ltd. pays ₹ 14,10,000 by 9 % debentures, then how will they write journal entry.
12. Voltas Electric Limited purchased following assets and liabilities from Navrang Traders :
- |               |            |           |            |
|---------------|------------|-----------|------------|
| Land-Building | ₹ 8,00,000 | Stock     | ₹ 2,25,000 |
| Machinery     | ₹ 2,75,000 | Debtors   | ₹ 80,000   |
| Furniture     | ₹ 1,20,000 | Creditors | ₹ 80,000   |
- Decided to pay for a purchase consideration of ₹ 15,36,000. Voltas Electric Ltd. paid the purchase consideration by issuing 11 % debentures of ₹ 100 each at a premium of 20 %.
- Pass journal entries in the books of company.
13. A company had ₹ 21,00,000 issued 10.5 % debentures as on 1st April, 2017. During the year company took a loan of ₹ 5,50,000 from the bank as on 10th August, 2017. Against this company issued new 10.5 % debentures of ₹ 5,00,000 as collateral security.
- Pass necessary journal entries under following methods from the above transactions in the books of the company.
- If debentures are issued as collateral security : (1) is recorded in the books of company and (2) is not recorded in the books of company.
- Show the details about debentures and bank loan in the company's balance sheet as on 31st March, 2018.
14. Alibaba Limited issued 18,000, 12 % debentures at the face value of ₹ 100 as on 1st April, 2017. Interest on these debentures is paid on 30th September and 31st March.
- Pass journal entries of the above transactions for the year ended 31st March, 2018. Assuming income tax rate is 20 % for the calculation.



15. Write the journal entries only for the issue of debentures from the following transactions. (Without narration)
- (1) Issued 8500, 9.5 % debentures of ₹ 100 each at par, redeemable also at par.
  - (2) Issued 9500, 9.5 % debentures of ₹ 100 each at discount of 10 %, redeemable at par.
  - (3) Issued 8000, 10 % debentures of ₹ 200 each at a premium of 10 %, redeemable at par.
16. Satyam Limited issued 12,000, 8 % debentures of ₹ 100 each at par as on 1-7-2017. These debentures are to be redeemed on 30-6-2023 at ₹ 115 per debenture.
- Pass the necessary journal entries in the books of the company for issued and redemption of debentures (without narration).
17. On 1-4-2017 Shivam Limited issued 8000, 7.5 % debentures of ₹ 250 each at a discount of 5 %. All the debentures are to be redeemed after 5 years as on 31-3-2022 at a premium of 10 %. Write the necessary journal entries in the books of company (without narration).
18. On 1-7-2017 Sundaram Limited issued 14,000, 8 % debentures of ₹ 300 each at a premium of 5 %. These debentures are redeemed on 30-6-2023 at ₹ 330 per debenture.
- Write the necessary journal entries in the books of company (without narration).
19. On 1-7-2017 Paras Pharma Limited issued 20,000, 9 % debentures of ₹ 400 each, are to be redeemed after 7 years at a premium of 12 %. As per conditions in prospectus the amount is payable on application ₹ 125 per debenture and balance amount at the time of allotment.
- Pass the necessary journal entries for the issue of debentures in the books of the company.
20. Star Technology Limited issued 16,000, 8.5 % debentures of ₹ 100 each at a discount of 10 % as on 1-9-2017. All the debentures are redeemable at a premium of 8 % after 6 years. The amount was payable as follows :
- On application ₹ 60 per debenture;  
on allotment balance amount per debenture.
- Pass the necessary journal entries for issue of debentures in the books of company.
21. Nupur Limited issued 16,000, 9 % debentures of ₹ 100 each at a premium of 10 % on 1st April, 2013, redeemable on 31st March, 2018. The issue was fully subscribed. The board of directors decided to transfer the required amount to Debenture Redemption Reserve as on 31st March, 2018 and debentures to be redeemed out of capital. They were also decided to invest required amount into Debenture Redemption Investment on 30th April, 2017.
- Investments were sold on the date of redemption of debentures and required amount for redemption of debentures were paid to debentureholders.
- Pass necessary journal entries for issue and redemption of debentures in the books of company and also prepare Debenture Redemption Investment A/c and Debenture Redemption Reserve A/c.
22. Hiteshi Limited issued 10,000, 11 % debentures of ₹ 200 each on April 1, 2014 at a premium of 6 %, which redeemable at a premium of 10 % on March 31, 2020.
- According to provisions of Companies Act, the required investment was made in 7 % Gujarat State Government unencumbered securities on April 30 of the financial year in which redemption is due. For the redemption of debentures, the provision for money is to be made out of capital. Debentures were redeemed on the due date.

Pass journal entries for issue and redemption of debentures. Also prepare Debenture Redemption Investment A/c and debenture redemption reserve A/c.

23. Parth Engineering Limited redeemed 9 % debentures at face value of ₹ 30,00,000 at a premium of 12 % as on 31-3-2018. For this, provision for money was made out of profit of the company. The company invested the required amount as on 30th April, 2017.

Pass journal entries for the redemption of debentures in the books of company with the assumption that company has fulfilled provisions of Companies Act. Also prepare Debenture Redemption Investment A/c and Debenture Redemption Reserve A/c.

24. Munj software Limited redeemed ₹ 24,00,000, 12 % debentures at a premium of 8 % out of profit on 1-10-2017. The company had a Debenture Redemption Reserve of ₹ 11,00,000. It was decided to invest the required amount in proper time in debenture redemption investment as per companies act.

Pass necessary journal entries for the redemption of debentures in the books of company.

25. A company purchased its own 1500 debentures of ₹ 100 each at ₹ 96 in the open market and immediately cancels them after purchase. Pass journal entries in the books of company.
26. A company purchased its own 6000 debentures of ₹ 400 each at ₹ 415 in the open market and immediately cancels them after purchase. Pass journal entries in the books of company.
27. Jaspreet Aperals Limited issued 6000, 12 % debentures of ₹ 300 each. The board of directors was purchased 2500 own debentures from the market at a price of ₹ 280 each for investment purpose. After few months, company sold these purchased debentures at ₹ 310 per debenture in the market.

Record necessary journal entries from the above transactions.

28. As on 1st April, 2014, Ravindra Copper Limited issued 12,000, 12.5 % convertible debentures of ₹ 400 each at par. As per the terms of issue of debentures, all the debentures will be converted into equity shares of ₹ 10 each at a premium of 50 % after 5 years.

On 1st April, 2019, debentures were converted into equity shares as per the agreed terms. Pass the necessary journal entries in the books of company.

29. On 1st January, 2014, Rajan Limited issued 8000, 11 % debentures of ₹ 100 each. According to terms of the issue of debentures, the debentures were to be redeemed at 6 % premium by giving 6 months notice at any time after 4 years. The redemption of debentures was to be made by cash or by preference shares or by new debentures as per the option to be exercised by the debentureholders.

On 1st March, 2018, the company issued the required notice to the debentureholders for the redemption of the debentures.

The company gave three option for the redemption of the debentures on 1st March, 2018.

- (1) Amount will be paid in cash.
- (2) 9 % preference shares of ₹ 100 each will be issued at ₹ 130 per share.
- (3) New 7 % debentures of ₹ 100 each will be issued at ₹ 96 each.

Holders of 3600 debentures accepted new debentures, holders of 3315 debentures accepted preference shares and rest opted for cash.

Write the necessary journal entries to record above transactions.



# 3

## Company Final Accounts

- |  |  |
|--|--|
| 1. Introduction                                      | 6. Form of Balance Sheet and General Instructions                |
| 2. Meaning of Financial Statements                   |  |
| 3. Financial Year                                    | 7. Form of Statement of Profit and Loss and General Instructions |
| 4. Characteristics of Financial Statements           |  |
| 5. Objectives of Preparation of Financial Statements | – Exercise   |

### 1. Introduction

Financial statements of a company are of utmost importance for its shareholders, tax authorities, analysts, management and other stakeholders. They give information about financial performance and position of a company. Section 129(1) of the Companies Act, 2013 lays down that the financial statements shall give a true and fair view of the statement of affairs of the company or companies. They should also comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in schedule III. Items contained in such financial statements shall be in accordance with the accounting standards. Section 129(1) also provides that nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity or to any other class of company for which a form of financial statement has been specified in or under the act governing such class of company.

In this chapter, we shall discuss about preparation of balance sheet and statement of profit and loss of company as per Companies Act, 2013.

### 2. Meaning of Financial Statements

Financial statements are statements presenting accounting information in brief at the end of accounting process for an accounting period. Financial statements provide information regarding financial results to its internal and external users.

As per section 2(40) of the Companies Act, 2013, "Financial statement" in relation to company includes –

- (i) A balance sheet as at the end of the financial year
- (ii) A profit and loss account or in case of a entity carrying on any activity not for profit, an income and expenditure account for the financial year
- (iii) Cash flow statement for the financial year
- (iv) A statement of changes in equity, if applicable
- (v) Notes related to the accounts

It should be noted that balance sheet shows the financial position as at a particular point of time and hence its title should be "Balance Sheet as at .....". Profit and loss statement shows financial performance for the period ended on a particular date which is usually a year end hence its title should



be "Profit and Loss Statement for the Year Ended .....". If profit and loss account is prepared for any period, shorter or longer than a year, the word "Period" issued. For example, a company is incorporated on 1st October, 2016 and its first profit and loss statement is prepared for 6 months upto 31-3-2017. In this case the title should be "Profit and Loss Statement for Period Ended 31-3-2017" or "Profit and Loss Statement for Six Months Ended 31-3-2017".

### **3. Financial Year**

According to section 2(41) of the Companies Act, 2013, "Financial year" in relation to any company or body corporate, means the period ending on the 31st March of every year. If company is incorporated on or after the 1st day of January of a year, the financial period ends on the 31st day of March of the following year. Generally financial year is of 12 months for the period starting from 1st April and ending on 31st March.

### **4. Characteristics of Financial Statements**

Following are some of the characteristics of financial statements :

- (1) Financial statements are called historical statements as they are related to past period.
- (2) Figures stated in financial statements are expressed in terms of money.
- (3) Financial statements are based on recorded facts and do not include even significant facts which are not recorded in the books. For example, self generated goodwill of the company is not recorded as no cost is incurred for acquisition thereof.
- (4) Profit and Loss Account shows profit or loss for a given period and thus gives idea about the financial performance of a company.
- (5) Balance sheet shows position of equity, liabilities and assets as at a particular point in time, thus gives an idea about the financial position of a company.
- (6) Financial statements are prepared based on generally accepted accounting principles.
- (7) Preparation of financial statement involves personal judgement in respect of some items where options are available under law for different treatments. For example, the person preparing accounts is free to select any alternative out of alternatives available for method of valuation of inventory and method of providing depreciation.

### **5. Objectives of Preparing Financial Statements**

Following are some of the objectives of preparation of financial statements :

- (1) To know about true and fair view of financial performance of a company.
- (2) To know the true and fair view of financial position of a company.
- (3) To comply with legal requirements.
- (4) To communicate financial information of the company to various interested parties.

### **6. Form of Balance Sheet and General Instructions**

Part I of schedule III to the Companies Act, 2013 gives form of Balance sheet. Balance sheet of a company must be prepared as per this format. Schedule III gives only vertical format. The format of balance sheet is given on page no. 118.

## Balance Sheet

Name of the company .....

Balance Sheet as at : .....

Particulars  (1)	Note No.  (2)	Figures as at the end of current year (₹) (3)	Figures as at the end of previous year (₹) (4)
<b>I Equity and Liabilities :</b>			
<b>(1) Shareholders' funds :</b>			
(a) Share capital			
(b) Reserves and surplus			
(c) Money received against share warrants			
<b>(2) Share Application Money Pending Allotment</b>			
<b>(3) Non-current Liabilities</b>			
(a) Long term borrowings			
(b) Deferred tax liabilities (net)			
(c) Other long term liabilities			
(d) Long-term provisions			
<b>(4) Current Liabilities</b>			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
<b>Total</b>			
<b>II Assets :</b>			
<b>(1) Non-current Assets :</b>			
(a) Fixed assets			
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital work in progress			
(iv) Intangible assets under development			
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long-term loans and advances			
(e) Other non-current assets			



(2) <b>Current Assets :</b> (a) Current investments (b) Inventories (c) Trade receivables (d) Cash and cash equivalents (e) Short-term loans and advances (f) Other current assets <b>Total</b>			

**Note :** There are four columns in vertical profit and loss account of a company. Balance sheet has two main headings : (i) Equity and Liabilities (ii) Assets. Equity and liabilities and assets and their sub heads are shown in first column of particulars. Every head has subheads. Subheads also comprise of various items. The size of balance sheet becomes abnormal if all items are shown at one place. Therefore subheads are shown under main head. Notes to the accounts are prepared for every number shown against subhead to show various items of each such subhead. Which is explained later on. Third column shows figures for current year and figures for previous year are shown in fourth column, so that the figures of two years can be compared by a person who wants to study financial statements. Statements of profit and loss is prepared in the same manner by preparing same columns.

● **General Instructions for Preparation of Balance Sheet :**

- (1) An asset shall be classified as current if it satisfies any of the following criteria :
  - (a) When it is expected to be realised in, or is intended for sale or consumption in, the company's normal operating cycle.
  - (b) If it is held primarily for the purpose of being traded.
  - (c) If it is expected to be realised within 12 months after the reporting date.

**The process of conversion of cash into raw material, conversion of raw material into finished goods, conversion of finished goods into debtor and finally conversion of debtor into cash is called as operating cycle.**

Assets other than current assets are classified as non-current assets.

- (2) A liability shall be classified as current, if it satisfies any of the following criteria :
  - (a) If it is expected to be settled in the company's normal operating cycle.
  - (b) If it is held primarily for the purpose of being traded.
  - (c) If it is due to be settled within twelve months after the reporting date.
 All other liabilities except current liabilities are classified as non-current liabilities.
- (3) A receivable shall be classified as a "Trade receivable" if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
- (4) A payable shall be classified as a "Trade payable" if it is in respect of the amount due on account of goods purchased or services received in normal course of business.
- (5) A company shall disclose the following in the notes to accounts.

**(I) Equity and liabilities :**

**(1) Shareholders' funds :**

**(A) Share capital :**

For each class of share capital (Different classes of preference shares to be treated separately.)

- (a) the number and amount of shares authorised
- (b) the number of shares issued, subscribed and fully paid and subscribed but not fully paid
- (c) Par value per share

- (d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period
- (e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital
- (f) shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held
- (g) terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date
- (h) calls unpaid
- (i) forfeited shares (amount originally paid-up)

**(B) Reserves and surplus**

- (i) Reserves and surplus shall be classified as :
  - (a) Capital reserves
  - (b) Capital redemption reserves
  - (c) Securities premium reserve
  - (d) Debenture redemption reserve
  - (e) Revaluation reserve
  - (f) Share options outstanding account
  - (g) Other reserves like dividend equalisation reserve, investment reserve etc.
  - (h) Surplus i.e. balance in statement of profit and loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc.
- (ii) A reserve specifically represented by earmarked investments shall be termed as a "fund".
- (iii) Debit balance of statement of profit and loss shall be shown as a negative figure under the head "surplus". Similarly, the balance of "Reserves and surplus", after adjusting negative balance of surplus, if any, shall be shown under the head "Reserves and surplus" even if the resulting figure is in the negative.

**(C) Money received against share warrants :**

**(2) Share application money pending allotment :**

**(3) Non-current liabilities :**

**(a) Long-term borrowings :**

- (i) Long-term borrowings shall be classified as :
  - (a) Bond/debentures
  - (b) Term loans : (A) from banks (B) from other parties
  - (c) Deferred payment / liabilities
  - (d) Deposits
  - (e) Loans and advances from related parties
  - (f) Long term maturities of financial lease obligations
  - (g) Other loan and advances
- (ii) Borrowings shall further be sub-classified as secured and unsecured.
- (iii) Where loans and advances have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
- (iv) Bonds/debentures along with the rate of interest and particulars of redemption or conversion shall be stated in descending order of maturity.
- (v) Terms of repayment of term loans
- (vi) Particulars of default in repayment of loans and interest, as on the balance sheet date.



**(ii) Intangible assets :**

Intangible assets shall be classified as :

- (a) Goodwill
- (b) Brand / Trademark
- (c) Computer software
- (d) Publishing rights
- (e) Mining rights
- (f) Copyrights and Patents
- (g) Recipes, formulae and technical know-how
- (h) Licenses and franchise
- (i) Others

**(iii) Capital work in process :**

**(iv) Intangible assets under development :**

**(b) Non-current investments :**

Intangible assets shall be classified as :

- (a) Investments in property
- (b) Investments in equity instruments
- (c) Investments in preference shares
- (d) Investments in government and trust securities
- (e) Investments in debentures and bonds
- (f) Investments in mutual funds
- (g) Investments in partnership firms
- (h) Other non-current investments

**(c) Deferred tax assets (Net) :**

**(d) Long-term loans and advances :**

(i) Long-term loans and advances shall be classified as :

- (a) Capital advances
- (b) Loans and advances to related parties
- (c) Other loans and advances

(ii) The above loans and advances shall also be separately sub-classified as :

- (a) Secured
- (b) Unsecured
- (c) Doubtful

**(e) Others non-current assets :**

Other non-current assets shall be classified as :

- (a) Long-term trade receivables
- (b) Others

**(2) Current assets :**

**(a) Current investments :**

Current investments shall be classified as :

- (a) Investments in equity instruments
- (b) Investments in preference shares
- (c) Investments in government and trust securities
- (d) Investments in debentures or bonds
- (e) Investments in mutual funds
- (f) Investments in partnership firms
- (g) Other investments e.g. short-term investments

**(b) Inventories :**

Inventories shall be classified as :

- (a) Raw materials
- (b) Work-in-progress
- (c) Finished goods
- (d) Stock-in-trade
- (e) Stores and spares
- (f) Loose tools
- (g) Others e.g. goods in transit

**(c) Trade receivables :**

Trade receivables shall be classified as :

- (a) Debtors
- (b) Bills receivables

**(d) Cash and cash equivalents :**

Cash and cash equivalents shall be classified as :

- (a) Balances with banks
- (b) Cheques, drafts on hand
- (c) Cash on hand
- (d) Others

**(e) Short-term loans and advances :**

Loans and advances given for a period of less than 12 months shall be included in short-term loans and advances.

**(f) Other current assets :**

Prepaid expenses, income due but not received, tax paid in advance, deferred revenue expenditure or fictitious assets to be written off during 12 months after the date of balance sheet. e.g. Debenture discount, Advertisement suspense account etc.

● **Contingent liabilities (To the extent not provided for)**

Contingent liabilities shall be classified as :

- (a) Claims against the company not acknowledged as debt
- (b) Guarantees given by the company
- (c) Unpaid calls on shares purchased as investments
- (d) Liabilities of incomplete contract



**Note :** Money received against share warrant, share application money pending allotment, deferred tax liability and deferred tax assets etc. are not expected to be asked in the exam in the question of preparation of balance sheet. These balances are mentioned here as they are given in the format of balance sheet as per schedule III of Companies Act, 2013.

**7. Form of Profit and Loss Statement and General Instructions :**

Part II of schedule III to the Companies Act, 2013 gives form of statement of profit and loss. Profit and loss account of a company must be prepared as per this format. Schedule III gives only vertical format. This form is as under :

**Statement of Profit and Loss**

**Name of the Company .....**

**Profit and Loss Statement for the Year Ended .....**

<b>Particulars</b>	<b>Note</b>	<b>Figures of current year</b>	<b>Figures of previous year</b>
<b>(1)</b>	<b>(2)</b>	<b>(₹)</b>	<b>(₹)</b>
<b>(3)</b>		<b>(4)</b>	
<b>I Revenue from Operations (Sales)</b>			
<b>II Other Income</b>			
<b>III Total Revenue (I + II)</b>			
<b>IV Expenses</b>			
Cost of material consumed			
Purchase of stock-in-trade			
Changes in inventories work-in-progress, finished goods and stock-in-trade.			
Employee benefit expense			
Finance costs			
Depreciation and amortisation expense			
Other expenses			
<b>Total expenses</b>			
<b>V Profit before exceptional and extraordinary items and tax (III – IV)</b>			
<b>VI Exceptional items</b>			
<b>VII Profit before extraordinary items and tax (V – VI)</b>			
<b>VIII Extraordinary items</b>			
<b>IX Profit before tax (VII – VIII)</b>			
<b>X Tax expense :</b>			
(a) Current tax			
(b) Deferred tax			

<b>XI Profit (loss) for the period from continuing operations (IX – X)</b>			
<b>XII Profit (loss) from discontinuing operations</b>			
<b>XIII Tax expense of discontinuing operations</b>			
<b>XIV Profit (loss) from discontinuing operations</b>			
<b>XV Profit (loss) for the period (XI – XIV)</b>			
<b>XVI Earning per equity share :</b>			
(a) Basic			
(b) Diluted			

● **General Instructions for Preparation of Statement of Profit and Loss :**

- (1) This instructions shall apply to the income and expenditure account in the similar manner as they apply to a statement of profit and loss.
- (2) (A) In respect of a company other than a finance company revenue from operations shall disclose seperately in the notes revenue from :
  - (a) Sale of product
  - (b) Sale of services
  - (c) Other operating revenues
 (B) In respect of finance company, revenue from operations shall include revenue from
  - (a) Interest and
  - (b) Other financial services
- (3) **Finance Expenses :**  
 Finance costs shall be classified as :
  - (a) Interest expense
  - (b) Other borrowing costs
  - (c) Applicable net gain/loss on foreign currency transactions and translation
- (4) **Other Income :**  
 Other income shall be classified as :
  - (a) Interest income
  - (b) Dividend income
  - (c) Net gain/loss on sale of investments
  - (d) Other non-operating income e.g. bad debt return
- (5) **Employee Benefit Expenses :**  
 Employee benefit expenses shall be classified as :
  - (a) Salary and wages
  - (b) Contribution to provident fund
  - (c) Expense on employee stock option scheme
  - (d) Staff welfare expenses

**(6) Finance Cost :**

Interest paid and outstanding interest on loan, debentures, public deposits, bonds and bank overdraft shall be shown as finance cost.

**(7) Depreciation and Amortisation Expenses :**

Depreciation on fixed assets for current year, intangible assets written off, leasehold assets written off and fictitious assets written off like research and developemnt expenses, advertisement campaign expenses, debenture discount etc. shall be shown as depreciation and amortisation expenses.

**(8) Other Expenses :**

Office and administrative expenses, selling and distribution expenses, audit fee, bad debt, provision for bad debt for current year, loss on sale of assets, bank charges and commission etc. shall be shown as other expenses.

**Note : Exceptional items, extraordinary items, deferred tax, profit or loss of continuing and discontinuing operations and earning per share is not expected in the question of preparation of statement of profit and loss and hence these items will not be asked in the examination. These items are shown here because they are given in schedule III of Companies Act, 2013.**

Balance sheet and statement of profit and loss as per schedule III of Companies Act, 2013 are given only for explanation. For the purpose of examinations, balance sheet and statement of profit and loss and their subheads shown below are to be considered.

**Balance Sheet**

**Name of Company**

**Balance sheet as at .....**

<b>Particulars</b>	<b>Note No.</b>	<b>As at ..... (₹)</b>
<b>I Equity and Liabilities :</b>		
<b>(1) Shareholder's funds :</b>		
(a) Share capital	1	
(b) Reserves and surplus	2	
<b>(2) Non-current liabilities :</b>		
(a) Long-term borrowings	3	
(b) Other long-term liabilities	4	
(c) Long-term provisions	5	
<b>(3) Current liabilities :</b>		
(a) Short-term borrowings	6	
(b) Trade payables	7	
(c) Other current liabilities	8	
(d) Short-term provisions	9	
<b>Total</b>		

<b>II Assets :</b>		
<b>(1) Non-current Assets :</b>		
(a) Fixed assets		
(i) Tangible assets	10	
(ii) Intangible assets	11	
(b) Non-current investments	12	
(c) Long-term loans and advances	13	
(d) Others non-current assets	14	
<b>(2) Current Assets :</b>		
(a) Current investments	15	
(b) Inventories	16	
(c) Trade receivables	17	
(d) Cash and cash equivalents	18	
(e) Short-term loans and advances	19	
(f) Others current assets	20	
<b>Total</b>		

Following information is expected to be studied as notes on heads and subheads of balance sheet.

<b>1. Share Capital :</b>		
Authorised share capital :		
..... Equity shares of ₹ ..... each		✓
..... Preference shares of ₹ ..... each		✓
Issued share capital :		
..... Equity shares of ₹ ..... each		✓
..... Preference shares of ₹ ..... each		✓
Subscribed share capital :		
<b>(i) Subscribed and fully paid up share capital :</b>		
..... Equity shares of ₹ ..... each		✓
..... Preference shares ₹ ..... each		✓
<b>(ii) Subscribed but not fully paid up share capital :</b>		
..... Equity shares of ₹ ..... each		
₹ ..... per share called up	✓	
<b>Less : Calls in arrears</b>	✓	✓
..... Preference shares of ₹ ..... each		
₹ ..... per share called up	✓	
<b>Less : Calls in arrears</b>	✓	✓
<b>(iii) Forfeited shares account :</b>		✓
		✓✓✓

<b>2. Reserves and Surplus :</b>		
Surplus : As per statement of profit-loss	✓	
<b>Less :</b> Appropriation of profit		
General reserve	✓	
Proposed dividend	✓	✓
Security premium reserve		✓
General reserve	✓	
+ Appropriation	✓	✓
Capital reserve		✓
Debenture redemption reserve		✓
Dividend equalisation fund		✓
Reserve fund		✓
Workers' accident compensation fund		✓
Investment fluctuation reserve		✓
Loss as per statement of profit and loss		(✓)
		✓
<b>3. Long-Term Borrowings :</b>		
Debenture		✓
Long-term loan or term loan		✓
Bond		✓
Public deposit		✓
		✓
<b>4. Other Long-Term Liabilities :</b>		
Premium on redemption of debentures		✓
Premium on redemption of preference shares		✓
		✓
<b>5. Long-Term Provisions :</b>		
Provident fund, gratuity fund		✓
Pension fund		✓
Workers' profit sharing fund		✓
Workers' savings account		✓
		✓
<b>6. Short-Term Borrowings :</b>		
Short-term loans (for less than 12 months)		✓
Bank overdraft, cash credits		✓
		✓



<b>7. Trade payables :</b>	
Creditors	✓
Bills payable	✓
	✓
<b>8. Other Current Liabilities :</b>	
Outstanding expenses, income received in advance	✓
Unclaimed dividend	✓
Debenture and premium on redemption payable during next 12 months	✓
Calls in advance, advance received from customers, outstanding interest on debentures	✓
	✓
<b>9. Short-Term Provisions</b>	
Provision for tax	✓
Proposed dividend	✓
	✓
<b>II Assets :</b>	
<b>10. Fixed assets : Tangible :</b>	
Land-building	✓
Plant-machinery	✓
Furniture and fixtures	✓
Vehicles	✓
Tools and equipments	✓
Lease hold asset	✓
	✓
<b>11. Fixed assets : Intangible :</b>	
Goodwill	✓
Patents	✓
Trademark	✓
Copyright	✓
Licence	✓
Software	✓
Frenchise	✓
	✓

<b>12. Non-Current Investments :</b>	
Provident fund investments	✓
Debenture redemption fund investments	✓
Shares of subsidiary company	✓
Shares and debentures of other company (for more than 12 months)	✓
Fixed deposit with bank (for more than 12 months)	✓
Government securities (for more than 12 months)	✓
Units of mutual fund (for more than 12 months)	✓
	✓
<b>13. Long-Term Loans and Advances :</b>	
Loan to employee (for more than 12 months)	✓
Custom deposit	✓
Telephone deposit	✓
Electricity deposit	✓
	✓
<b>14. Other Non-Current Assets :</b>	
Debenture discount (to be written off after next 12 months)	✓
Advertisement campaign expenditure (to be written off after next 12 months)	✓
Research and development expenditure (to be written off after next 12 months)	✓
	✓
<b>15. Current Investments :</b>	
Shares and debentures of other company (for less than 12 months)	✓
Marketable securities (for less than 12 months)	✓
Government securities (for less than 12 months)	✓
Units of mutual fund (for less than 12 months)	✓
	✓
<b>16. Inventories :</b>	
Stock of raw material	✓
Stock of semi finished goods	✓
Stock of finished goods	✓
Stock in trade	✓
Loose tools	✓
Spare parts	✓
Consumable stores	✓
Goods in transit	✓
	✓

<b>17. Trade Receivables :</b>	
Debtors	✓
Bills receivables	✓
	✓
<b>18. Cash and Cash Equivalentents :</b>	
Cash on hand	✓
Bank balance	✓
Cheques and drafts on hand	✓
	✓
<b>19. Short-Term Loans and Advances :</b>	
Loan advanced for less than 12 months	✓
Advances to suppliers (for less than 12 months)	✓
	✓
<b>20. Other Current Assets :</b>	
Prepaid expenses	✓
Income due but not received	✓
Advertisement campaign expenditure to be written off during next 12 months	✓
Debenture discount to be written off during next 12 months	✓
Research and development expenditure to be written off during next 12 months	✓
	✓

Statement of profit and loss for the purpose of examination is to be prepared containing following details :

**Name of Company .....**

**Statement of Profit and Loss for the Year Ending .....**

<b>Particulars</b>	<b>Note No.</b>	<b>As on ..... (₹)</b>
I Revenue from operations (sales)	1	
II Other incomes	2	
III Total revenue (I + II)		
IV Expenses		
Purchase	3	
Changes in stock	4	
Direct expenses	5	
Employee benefit expenses	6	
Finance cost	7	

Depreciation and amortisation	8	
Others expenses	9	
<b>Total expenses</b>		
V Profit before tax (III – IV)		
VI Provision for tax		
VII Profit after tax (V – VI)		

Following particulars of revenue and expenses in the statement of profit and loss are to be considered for the purpose of examination :

Particulars	(₹)
<b>(1) Revenue From Operation :</b>	
Sales	✓
Less : Sales return	✓
	✓
<b>(2) Other Incomes :</b>	
Interest and dividend received	✓
Bad debt recovered	✓
Profit on sale of asset	✓
	✓
<b>(3) Net Purchases :</b>	
Total purchases	✓
Less : Purchase return	✓
	✓
<b>(4) Change in Stock :</b>	
Opening stock	✓
Less : Closing stock	✓
	✓
<b>(5) Direct Expenses :</b>	
Wages	✓
Carriage inward, freight	✓
	✓
<b>(6) Employee Benefit Expenses :</b>	
Salary	✓
Bonus, Commission	✓
Contribution to provident fund	✓
	✓
<b>(7) Finance Cost :</b>	
Interest on bond or debenture	✓
Interest on loan or public deposit	✓
Interest on bank overdraft	✓
Interest on short-term loan	✓
	✓

<b>(8) Depreciation and Amortisation :</b> Depreciation on fixed assets Goodwill, Patents, Trademark etc. intangible assets written off Debenture discount written off Advertisement campaign expenses written off Research and development expenses written off  <b>(9) Others Expenses :</b> Postage, stationery Rent Audit fee Office and administrative expenses Sales expenses Bad debt written off	✓
	✓
	✓
	✓
	✓
	✓
	✓
	✓
	✓
	✓
	✓
	✓

**Illustration 1 :** How will you show following balances in balance sheet of a company as per shedule III of Companies Act, 2013.

- |                              |  |
|------------------------------|--|
| (1) Equity share capital     | (6) General reserve                          |
| (2) Calls in arrears         | (7) Debenture                                |
| (3) Forfeited shares account | (8) Creditors                                |
| (4) Calls in advance         | (9) Loss as per statement of profit and loss |
| (5) Securities premium       | (10) Public deposit                          |

**Ans. :**

Particulars	Balance sheet head	Main head	Sub head
(1) Equity share capital	Equity and liabilities	Shareholders' funds	Share capital
(2) Calls in arrears	Equity and liabilities	Shareholders' funds	Deducted from share capital
(3) Forfeited shares A/c	Equity and liabilities	Shareholders' funds	Share capital
(4) Calls in advance	Equity and liabilities	Current liabilities	Other current liabilities
(5) Securities premium	Equity and liabilities	Shareholders' funds	Reserves and surplus
(6) General reserve	Equity and liabilities	Shareholders' funds	Reserves and surplus
(7) Debentures	Equity and liabilities	Non-current liabilities	Long-term borrowings
(8) Creditors	Equity and liabilities	Current liabilities	Trade payables
(9) Loss as per statement of profit and loss	Equity and liabilities	Shareholders' funds	Reserves and surplus (Deducted from sum of reserve balances.)
(10) Public deposit	Equity and liabilities	Non-current liabilities	Long-term borrowings



**Illustration 2 :** How will you show following balances in balance sheet of a company as per schedule III of Companies Act, 2013 ?

- |                                  |  |
|----------------------------------|--|
| (1) Proposed dividend            | (6) Term loan                          |
| (2) Unclaimed dividend           | (7) Reserve fund                       |
| (3) Bond                         | (8) Advance received from customers    |
| (4) Bills payable                | (9) Outstanding interest on debentures |
| (5) Debenture redemption reserve | (10) Bank overdraft                    |

**Ans. :**

Particulars	Balance sheet head	Main head	Sub head
(1) Proposed dividend	Equity and liabilities	Current liability	Short-term provisions
(2) Unclaimed dividend	Equity and liabilities	Current liability	Other current liability
(3) Bond	Equity and liabilities	Non-current liability	Long-term borrowings
(4) Bills payable	Equity and liabilities	Current liability	Trade payables
(5) Debenture redemption reserve	Equity and liabilities	Shareholders' funds	Reserves and surplus
(6) Term loan	Equity and liabilities	Non-current liability	Long-term borrowings
(7) Reserve fund	Equity and liabilities	Shareholders' funds	Reserves and surplus
(8) Advance received from customers	Equity and liabilities	Current liability	Others current liabilities
(9) Outstanding interest on debentures	Equity and liabilities	Current liability	Others current liabilities
(10) Bank overdraft	Equity and liabilities	Current liability	Short-term borrowings

**Illustration 3 :** How will you show following balances in balance sheet of a company as per schedule III of Companies Act, 2013 ?

- |   |   |
|---|---|
| (1) Debenture redeemable during next year | (7) Workmen accident compensation fund                  |
| (2) Cash credit from bank                 | (8) Preference share capital                            |
| (3) Provision for tax                     | (9) General reserve                                     |
| (4) Rent received in advance              | (10) Premium on debentures, redeemable during next year |
| (5) Short-term loan (credit balance)      | (11) Calls in advance on shares                         |
| (6) Provision for gratuity                |   |

**Ans. :**

Particulars	Balance sheet head	Main head	Sub head
(1) Debentures redeemable during next year	Equity and liabilities	Current liability	Other current liability
(2) Cash credit from bank	Equity and liabilities	Current liability	Short-term borrowings
(3) Provision for tax	Equity and liabilities	Current liability	Short-term provision
(4) Rent received in advance	Equity and liabilities	Current liability	Other current liability

Particulars	Balance sheet head	Main head	Sub head
(5) Short-term loan (credit balance)	Equity and liabilities	Current liability	Short-term borrowings
(6) Provision for gratuity	Equity and liabilities	Non-current liability	Long-term provisions
(7) Workmen accident compensation fund	Equity and liabilities	Shareholders' funds	Reserves and surplus
(8) Preference share capital	Equity and Liabilities	Shareholders' funds	Share capital
(9) General reserve	Equity and liabilities	Shareholder's funds	Reserves and surplus
(10) Premium on redemption of debentures, redeemable during next year	Equity and liabilities	Current Liability	Other current liability
(11) Calls in advance on shares	Equity and liabilities	Current Liability	Other current liability

**Illustration 4 :** Prepare statement indicating equity and liabilities of balance sheet as per schedule III of Companies Act, 2013 from the following balances :

Trade payables	₹ 30,000	Share capital	₹ 2,00,000
Long-term provisions	₹ 60,000	Short-term provisions	₹ 35,000
Reserves and surplus	₹ 80,000	Long-term borrowings	₹ 1,20,000
Other Current Liabilities	₹ 25,000	Other long-term liabilities	₹ 76,000
Short-term borrowings	₹ 24,000		

**Ans. :**

#### Balance Sheet

Particulars	Note No.	Amt. (₹)	As on .....(₹)
<b>Equity and Liabilities :</b>			
<b>(1) Shareholders' funds :</b>			
(a) Share capital		2,00,000	
(b) Reserves and surplus		80,000	2,80,000
<b>(2) Non-current Liabilities :</b>			
(a) Long-term borrowings		1,20,000	
(b) Other long-term liabilities		76,000	
(c) Long-term provisions		60,000	2,56,000
<b>(3) Current Liabilities</b>			
(a) Short-term borrowings		24,000	
(b) Trade payables		30,000	
(c) Other Current Liabilities		25,000	
(d) Short-term provisions		35,000	1,14,000
<b>Total</b>			<b>6,50,000</b>

**Illustration 5 :** Following balances are extracted from books of Shaan Ltd. on 31-3-2017. From these balances, prepare statement indicating equity and liabilities of balance sheet as per schedule III of Companies Act, 2013.

Particulars	(₹)
26,000 equity shares of ₹ 10 each	2,60,000
9 % loan from Bank of Baroda	50,000
Proposed dividend	18,000
Bills payable	10,000
Surplus as per statement of profit and loss	50,000
Provident fund	70,000
Bank overdraft	17,000
Outstanding salary	30,000

**Ans. :**

**Balance Sheet of Shaan Ltd. as on 31-3-2017**

Particulars	Note No.	Amt. (₹)	Amt. (₹)
<b>Equity and Liabilities :</b>			
<b>(1) Shareholders' funds :</b>			
(a) Share capital (Equity share capital)		2,60,000	
(b) Reserves and surplus (Surplus as per statement of profit and loss)		50,000	3,10,000
<b>(2) Non-current liabilities :</b>			
(a) Long-term borrowings (9 % loan from Bank of Baroda)		50,000	
(b) Other long-term liabilities		—	
(c) Long-term provisions (Provident fund)		70,000	1,20,000
<b>(3) Current liabilities :</b>			
(a) Short-term borrowings (Bank overdraft)		17,000	
(b) Trade payables (Bills payable)		10,000	
(c) Other Current Liabilities (Outstanding salary)		30,000	
(d) Short-term provisions (Proposed dividend)		18,000	75,000
<b>Total</b>			<b>5,05,000</b>

**Illustration 6 :** Following balances are taken from books of Kuber Limited as on 31-3-2017. State how these balances will be shown as per schedule III of Companies Act, 2013.

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>(1) Land-building</li> <li>(2) Shares of subsidiary company</li> <li>(3) Debtors</li> <li>(4) Closing stock</li> <li>(5) Short-term investments</li> <li>(6) Bank balance</li> </ul> | <ul style="list-style-type: none"> <li>(7) Goodwill</li> <li>(8) Furniture</li> <li>(9) Custom deposit</li> <li>(10) Trademark</li> <li>(11) Prepaid insurance premium</li> <li>(12) Bills receivable</li> </ul> |
|---|--|

- (13) Stores and spare parts  
 (14) Loan to employees  
 (15) Government securities  
 (Maturity date 30-6-2017)  
 (16) Prepaid taxes

- (17) Fixed deposit with bank  
 (Maturity date 31-3-2020)  
 (18) Loose tools  
 (19) Loan to directors (Temporary)  
 (20) Investments in provident fund

Ans. :

Particulars	Balance sheet head	Main head	Sub head
(1) Land-building	Assets	Non-current assets	Fixed assets - tangible
(2) Share of subsidiary	Assets	Non-current assets	Non-current investments
(3) Debtors	Assets	Current assets	Trade receivables
(4) Closing stock	Assets	Current assets	Inventories
(5) Short-term investments	Assets	Current assets	Current investments
(6) Bank balance	Assets	Current assets	Cash and cash equivalents
(7) Goodwill	Assets	Non-current assets	Fixed assets - intangible
(8) Furniture	Assets	Non-current assets	Fixed assets - tangible
(9) Custom deposit	Assets	Non-current assets	Long-term loan and advances
(10) Trademark	Assets	Non-current assets	Fixed assets - intangible
(11) Prepaid insurance premium	Assets	Current assets	Others Current Assets
(12) Bills receivable	Assets	Current assets	Trade receivables
(13) Stores and spare parts	Assets	Current assets	Inventories
(14) Loan to employees	Assets	Non-current assets	Long-term loans and advances
(15) Government securities (Maturity date 30-6-2017)	Assets	Current assets	Current investments
(16) Prepaid Taxes	Assets	Current assets	Other current assets
(17) Fixed deposit with bank (Maturity date 31-3-2020)	Assets	Non-current assets	Non-current Investments
(18) Loose tools	Assets	Current assets	Inventories
(19) Loan to director (Temporary)	Assets	Current assets	Short-term loans and advances
(20) Investment in provident fund	Assets	Non-current assets	Non-current investments

**Illustration 7 :** How will you show following balances in balance sheet of a company as per Schedule III of Companies Act, 2013 ?

- (1) Loose tools
- (2) Leasehold Assets
- (3) Debenture redemption fund investments
- (4) Electricity deposit
- (5) Debentures of other company (Redeemable during next year)
- (6) Advance given to creditors
- (7) Copyrights
- (8) Debenture discount (To be written off during next year)
- (9) Debenture discount (To be written off after next year)
- (10) Units of mutual fund (For short period)
- (11) Shares of other company (For long term)
- (12) Work-in-progress
- (13) Vehicles
- (14) Chque received from debtors
- (15) Interest accrued on investment
- (16) Computer
- (17) Computer software
- (18) Rent paid in advance
- (19) Machinery
- (20) Machinery (To be sold during next year)

**Ans. :**

Particulars	Balance sheet head	Main head	Sub head
(1) Lose tools	Assets	Current assets	Inventories
(2) Leasehold assets	Assets	Non-current assets	Fixed assets - tangible
(3) Debenture redemption fund investments	Assets	Non-current assets	Non-current investments
(4) Electricity deposit	Assets	Non-current assets	Long-term loans and advances
(5) Debentures of other company (Redeemable during next year)	Assets	Current assets	Current investments
(6) Advance given to creditors	Assets	Current assets	Short-term loans and advances
(7) Copyrights	Assets	Non-current Assets	Fixed assets - intangible



Particulars	Balance sheet head	Main head	Sub head
(8) Debenture discount (To be written off during next year)	Assets	Current assets	Others current assets
(9) Debenture discount (To be written off after next year)	Assets	Non-current assets	Others non-current assets
(10) Units of mutual fund (for short-term)	Assets	Current assets	Current investments
(11) Shares of other company (for long-term)	Assets	Non-current assets	Non-current investments
(12) Work-in-progress	Assets	Current assets	Inventories
(13) Vehicles	Assets	Non-current assets	Fixed assets - tangible
(14) Cheque received from debtors	Assets	Current assets	Cash and cash equivalents
(15) Interest accrued on investment	Assets	Current assets	Others current assets
(16) Computer	Assets	Non-current assets	Fixed assets - tangible
(17) Computer software	Assets	Non-current assets	Fixed assets - intangible
(18) Rent paid in advance	Assets	Current assets	Other current assets
(19) Machinery	Assets	Non-current assets	Fixed assets - tangible
(20) Machinery (To be sold next year)	Assets	Current assets	Other current assets

**Illustration 8 :** Following balances are taken from books of Vijay Ltd. as on 31-3-2017. Prepare statement indicating assets of balance sheet as on 31-3-2017 as per scheduled-III of Companies Act, 2013.

Balances	(₹)
(1) Fixed assets - tangible	8,00,000
(2) Cash and cash equivalents	60,000
(3) Long-term loans and advances	34,000
(4) Inventory	43,000
(5) Other non-current assets	31,000
(6) Non-current investments	27,000
(7) Current investments	29,000
(8) Trade receivables	56,000
(9) Short-term loans and advances	40,000
(10) Other current assets	10,000
(11) Fixed assets - intangible	50,000

Ans. :

**Balance Sheet of Vijay Ltd. as at 31-3-2017**

Particulars	Note No.	Amt. (₹)	As on 31-3-2017 (₹)
<b>Assets :</b>			
<b>(1) Non-current assets :</b>			
(a) Fixed assets			
(i) Tangible		8,00,000	
(ii) Intangible		50,000	
(b) Non-current investments		27,000	
(c) Long-term loans and advances		34,000	
(d) Others non-current assets		31,000	9,42,000
<b>(2) Current assets :</b>			
(a) Current investments		29,000	
(b) Inventories		43,000	
(c) Trade receivables		56,000	
(d) Cash and cash equivalents		60,000	
(e) Short-term loans-advances		40,000	
(f) Other current assets		10,000	2,38,000
<b>Total</b>			<b>11,80,000</b>

**Illustration 9 :** Following balances are extracted from books of Gujarat Ltd. as on 31-3-2017. Prepare statement indicating assets of balance sheet as per schedule-III of Companies Act, 2013.

Balances	(₹)
(1) Interest accrued	3000
(2) Plant-machinery	6,00,000
(3) Cash on hand	37,000
(4) Trademark	20,000
(5) Debtors	42,000
(6) 10 % Narmada bond	70,000
(7) Loose tools	18,000
(8) Telephone deposit	30,000
(9) Units of mutual fund (Temporary)	10,000

Ans. :

**Balance Sheet of Gujarat Ltd. as at 31-3-2017**

Particulars	Note No.	Amt. (₹)	Amt. (₹)
<b>Assets :</b>			
<b>(1) Non-current assets :</b>			
(a) Fixed assets			
(i) Tangible (Plant-machinery)		6,00,000	
(ii) Intangible (Trademark)		20,000	
(b) Non-current investments (10 % Narmada bond)		70,000	
(c) Long-term loans and advances (Telephone deposit)		30,000	
(d) Other non-current assets		—	7,20,000
<b>(2) Current assets :</b>			
(a) Current investments (Units of mutual fund - Temporary)		10,000	
(b) Inventory (Loose tools)		18,000	
(c) Trade receivables (Debtors)		42,000	
(d) Cash and cash equivalents (Cash on hand)		37,000	
(e) Short-term loans and advances		—	
(f) Other current assets (Interest accrued)		3000	1,10,000
<b>Total</b>			<b>8,30,000</b>

**Illustration 10 :** Following balances are extracted from books of Star Ltd. Prepare balance sheet as per Schedule-III of Companies Act, 2013 as at 31-3-2017.

Balances	(₹)
(1) Accrued commission	20,000
(2) Land-building	10,00,000
(3) Equity share capital	10,00,000
(4) Bank balance	45,000
(5) General reserve	20,000
(6) Closing stock	1,80,000
(7) Creditors	4,00,000
(8) Debtors	2,30,000
(9) 10 % Debentures	1,30,000
(10) Debenture redemption fund investments	30,000
(11) Custom deposit	1,25,000
(12) Gratuity fund	20,000
(13) Provision for taxation	60,000

Ans. :

**Balance Sheet of Star Ltd. as at 31-3-2017**

Particulars	Note No.	Amt. (₹)	Amt. (₹)
<b>I Equity and Liabilities :</b>			
<b>(1) Shareholders' funds :</b>			
(a) Share capital (Equity share capital)		10,00,000	
(b) Reserves and surplus (General reserve))		20,000	10,20,000
<b>(2) Non-current liabilities :</b>			
(a) Long-term borrowings (10 % Debentures)		1,30,000	
(b) Other long-term liabilities		—	
(c) Long-term provisions (Gratuity fund)		20,000	1,50,000
<b>(3) Current liabilities</b>			
(a) Short-term borrowings		—	
(b) Trade payables (Creditors)		4,00,000	
(c) Others Current Liabilities		—	
(d) Short-term provisions (Provision for tax)		60,000	4,60,000
<b>Total</b>			<b>16,30,000</b>
<b>II Assets :</b>			
<b>(1) Non-current assets :</b>			
(a) Fixed assets			
(i) Tangible (Land-building)		10,00,000	
(ii) Intangible		—	
(b) Non-current investments		30,000	
(Debenture redemption fund investments)			
(c) Long-term loans-advances (Custom deposit)		1,25,000	
(d) Other non-current assets		—	11,55,000
<b>(2) Current assets :</b>			
(a) Current investments		—	
(b) Inventory (Closing stock)		1,80,000	
(c) Trade receivables (Debtors)		2,30,000	
(d) Cash and cash equivalents (Bank balance)		45,000	
(e) Short-term loans and advances		—	
(f) Other current assets		20,000	4,75,000
<b>Total</b>			<b>16,30,000</b>

**Illustration 11 :** Under which head will you show following balances in statement of profit and loss as per schedule III of Companies Act, 2013 ?

- |                                    |                          |
|------------------------------------|--------------------------|
| (1) Sales                          | (6) Telegram and postage |
| (2) Salary                         | (7) Interest on loan     |
| (3) Interest and dividend received | (8) Bonus                |
| (4) Income from scrap              | (9) Bank charges         |
| (5) Depreciation                   | (10) Sales expenses      |

**Ans. :**

Balance	Head
(1) Sales	Revenue from operation
(2) Salary	Employee benefit expenses
(3) Interest and dividend received	Other incomes
(4) Income from scrap	Other incomes
(5) Depreciation	Depreciation and amortisation
(6) Telegram and postage	Other expenses
(7) Interest on loan	Finance costs
(8) Bonus	Employee benefit expenses
(9) Bank charges	Other expenses
(10) Sales expenses	Other expenses

**Illustration 12 :** Prepare statement of profit and loss of Paras Ltd. from the following information for the year ended on 31-3-2017 as per schedule-III of Companies Act, 2013.

Particulars	Amt. (₹)
Cost of material consumed	6,25,000
Change in stock of finished goods	40,000
Employees salary and provisions for employees	2,60,000
Sales	12,70,000
Interest paid	30,000
Office and sales expenses	52,000
Depreciation on fixed assets	28,000
Profit on sale of asset	35,000
Provision for tax, 50 % of profit	



Ans. :

**Statement of Profit and Loss for the Year Ended on 31-3-2017**

Particulars	Note No.	Amt. (₹)	For the year ended on 31-3-2017 (₹)
<b>I</b> Revenue from operation		12,70,000	
<b>II</b> Other incomes		35,000	
<b>III Total revenue (I + II)</b>			<b>13,05,000</b>
<b>IV Expenses :</b>			
Cost of material consumed		6,25,000	
Change in stock of finished goods		40,000	
Employee benefit expenses		2,60,000	
Finance costs		30,000	
Depreciation		28,000	
Other expenses		52,000	
<b>Total expenses</b>			<b>10,35,000</b>
<b>V Profit before tax (III – IV)</b>			2,70,000
<b>VI Provision for tax</b>			1,35,000
<b>VII Profit after tax (V – VI)</b>			1,35,000

**Illustration 13 :** Prepare statement of profit and loss of Shree Sahjanand Ltd. from the following balances for the year ending on 31st March, 2017 as per schedule-III of Companies Act, 2013.

Particulars	Amt. (₹)
Office and sales expenses	40,000
Sales	16,00,000
Salary	5,00,000
Wages	40,000
Purchase	7,10,000
Opening stock	60,000
Debenture interest	20,000
Profit on sale of investments	26,000
Closing stock	70,000
Provision for tax	1,63,000

**Ans. : Statement of Profit and Loss of Shree Sahjanand Ltd. for the Year Ending on 31-3-2017**

Particulars	Note No.	Amt. (₹)	Amt. (₹)
<b>I</b> Revenue from operation (Sales)		16,00,000	
<b>II</b> Other incomes (Profit on sale of investments)		26,000	
<b>III</b> Total revenue (I + II)			<b>16,26,000</b>
<b>IV</b> Expenses :			
Purchase		7,10,000	
Change in stock of finished goods (Opening stock ₹ 60,000 – Closing stock ₹ 70,000)		(10,000)	
Employee benefit expenses (Salary + Wages)		5,40,000	
Finance costs (Debenture interest)		20,000	
Depreciation		—	
Other expenses (Office and sales expenses)		40,000	
<b>Total expenses</b>			<b>13,00,000</b>
<b>V</b> Profit before tax (III – IV)			3,26,000
<b>VI</b> Provision for tax			1,63,000
<b>VII</b> Profit after tax (V – VI)			<b>1,63,000</b>
(Transferred to Balance sheet)			

**Illustration 14 :** Following is the trial balance of Shivam Ltd. as on 31-3-2017 :

Particulars	Debit (₹)	Credit (₹)
Inventories	1,10,000	
Fixed assets - tangible	8,00,000	
5000 equity shares of ₹ 100 each		5,00,000
Sales		7,50,000
Other incomes		20,000
Employee benefit expenses	1,30,000	
Long-term borrowings		3,50,000
Finance costs	17,500	
Trade payables		1,00,000
Trade receivables	40,000	
Cash and bank balance	60,000	
Depreciation	22,500	
Cost of goods sold	4,00,000	
Non-current investments	1,40,000	
	<b>17,20,000</b>	<b>17,20,000</b>

**Additional Information :** Provision for tax ₹ 80,000.

Prepare final accounts of the company as per schedule-III of Companies Act, 2013.

**Ans. : Statement of Profit and Loss of Shivam Ltd. for the Year Ending on 31-3-2017**

Particulars	Note No.	Amt. (₹)	Amt. (₹)
<b>I</b> Revenue from operation (Sales)		7,50,000	
<b>II</b> Other income		20,000	
<b>III</b> Total incomes (I + II)			<b>7,70,000</b>
<b>IV</b> Expenses :			
Cost of goods sold		4,00,000	
Employee benefit expenses		1,30,000	
Finance costs		17,500	
Depreciation		22,500	
Other expenses		—	
<b>Total expenses</b>			<b>5,70,000</b>
<b>V</b> Profit before tax (III – IV)			2,00,000
<b>VI</b> Provision for tax			80,000
<b>VII</b> Profit after tax (V – VI)			<b>1,20,000</b>
(Transferred to Balance sheet)			

**Balance Sheet of Shivam Ltd. as at 31-3-2017**

Particulars	Note No.	Amt. (₹)	Amt. (₹)
<b>I</b> Equity and Liabilities :			
(1) Shareholders' funds :			
(a) Share capital		5,00,000	
(b) Reserves and surplus (Net profit)		1,20,000	6,20,000
(2) Non-current liabilities :			
(a) Long-term borrowings		3,50,000	3,50,000
(3) Current liabilities			
(a) Trade payables		1,00,000	
(b) Short-term Provision		80,000	1,80,000
<b>Total</b>			<b>11,50,000</b>

Particulars	Note No.	Amt. (₹)	Amt. (₹)
<b>II Assets :</b>			
<b>(1) Non-current assets :</b>			
(a) Fixed assets : Tangible		8,00,000	
(b) Non-current investments		1,40,000	9,40,000
<b>(2) Current assets :</b>			
(b) Inventory		1,10,000	
(c) Trade receivables		40,000	
(d) Cash and cash equivalents (Cash and bank balance)		60,000	2,10,000
<b>Total</b>			<b>11,50,000</b>

**Explanation :**

- (1) As cost of goods sold is given in the question, purchase and change in stock will not be recorded in statement of profit and loss because cost of goods sold = purchase + opening stock – closing stock.
- (2) Provision for tax ₹ 80,000 is given as an adjustment, therefore it will have two effects : (i) Deducted from profit before tax in the statement of profit and loss (ii) Shown as short-term provision in balance sheet.
- (3) Other expenses, other long-term liabilities, long-term provisions, other current liabilities, intangible fixed assets, long-term loans and advances, other non-current assets, short-term loan are not given in the question.

**Exercise**

**1. Select correct alternative for each question :**

- (1) Financial statements of a company includes ..... .
  - (a) statement of profit and loss and balance sheet
  - (b) cash flow statement and statement showing changes in equity
  - (c) notes to the accounts
  - (d) all of above
- (2) It is compulsory to prepare statement of profit and loss and balance sheet in ..... form as per schedule III of Companies Act, 2013.
  - (a) horinzontal or T
  - (b) vertical
  - (c) statement of profit and loss is horizontal and balance sheet vertical
  - (d) statement of profit and loss is vertical and balance sheet horizontal
- (3) ..... is/are compulsory to prepare in specified form as per schedule III of Companies Act, 2013.
  - (a) Balance sheet
  - (b) Statement of profit and loss
  - (c) Balance sheet and statement of profit and loss both
  - (d) Neither balance sheet nor statement of profit and loss

- (4) For ..... it is compulsory to prepare statement of profit and loss and balance sheet in specified vertical form.
- sole proprietorship
  - partnership
  - all companies
  - companies except insurance company, electricity company and banking company
- (5) Balance sheet is prepared ..... while statement of profit and loss is prepared ..... .
- for a particular accounting period, as at particular date
  - as at particular date, for a particular accounting period
  - as at particular date, as at particular date
  - for a particular accounting period, for a particular accounting period
- (6) ..... shows financial position of a company while ..... shows financial performance of a company.
- Statement of profit and loss, cash flow statement
  - Balance sheet, cash flow statement
  - Statement of profit and loss, balance sheet
  - Balance sheet, statement of profit and loss
- (7) Assets and liabilities of a company are classified into ..... and ..... as per Companies Act, 2013.
- current, fixed
  - fixed, fixed
  - for short-term, for long-term
  - current, non-current
- (8) ..... assets is considered as current asset.
- Convertible into cash during 12 months after the date of balance sheet
  - Realisable during 12 months after the date of balance sheet
  - Consumable within 12 months after the date of balance sheet
  - All of above
- (9) A machine to be sold during 12 months after the date of balance sheet is considered as ..... as per Companies Act, 2013.
- fixed asset
  - non-current asset
  - current asset
  - expense

**2. Answer in two or three sentences :**

- What is financial statements ?
- What is included in financial statements ?
- State characteristics of financial statements.
- State objectives of preparing financial statements.
- State main headings of equity and liabilities side of balance sheet as per schedule-III of Companies Act, 2013.
- Show the classification of non-current liabilities.
- Show the classification of current liabilities as per schedule-III of Companies Act, 2013.



- (8) What is current asset and non-current asset ?
- (9) What is current liability and non-current liability ?
- (10) Show the classification of current assets as per schedule-III of Companies Act, 2013.
3. How will you show following balances in the balance sheet of a company as per schedule-III of Companies Act, 2013 ?
- |  |  |
|--|--|
| (1) Creditors  | (2) Security premium                             |
| (3) Bond   | (4) Goodwill                                     |
| (5) Bank overdraft   | (6) Bills receivable                             |
| (7) Equity share capital                                       | (8) Copyright                                    |
| (9) Debenture discount<br>(To be written off during next year) | (10) Calls in advance                            |
| (11) Cash  | (12) Provident fund                              |
| (13) Debentures  | (14) Trademark                                   |
| (15) Loose tools   | (16) Loan (Repayable during next year)           |
| (17) Bills payable   | (18) General reserve                             |
| (19) Public deposit  | (20) Debtors                                     |
| (21) Patent  | (22) Calls in arrears                            |
| (23) Debenture redemption fund investment                      | (24) Stores and spare parts                      |
| (25) Licence   | (26) Closing stock                               |
| (27) Bank balance  | (28) Surplus as per statement of profit and loss |
| (29) Deposit in electricity company                            | (30) Premium on redemption of preference shares  |
4. Following balances are taken from the books of Seema Ltd. on 31-3-2017. Prepare statement indicating assets of balance sheet as at 31-3-2017 as per schedule-III of Companies Act, 2013.

Balance	(₹)
(1) Current investments	12,000
(2) Short-term loans and advances	16,000
(3) Other current assets	7200
(4) Fixed assets - tangible	5,60,000
(5) Cash and cash equivalents	14,000
(6) Inventory	46,000
(7) Trade receivables	15,800
(8) Other non-current assets	18,000
(9) Non-current investments	26,000
(10) Fixed assets - intangible	1,20,000
(11) Long-term loans and advances	22,000

5. Following balances are taken from the books of Yuva Ltd. on 31-3-2017. Prepare statement indicating equity and liabilities of balance sheet as at 31-3-2017 as per schedule-III of Companies Act, 2013.

Balance	Amt. (₹)
(1) 1,30,000 equity shares of ₹ 5 each	6,50,000
(2) General reserve	70,000
(3) Provident fund	3,60,000
(4) Creditors	86,000
(5) Public deposit	3,26,000
(6) Outstanding rent	13,000
(7) Provision for tax	68,000
(8) Other long-term liabilities	15,000
(9) Temporary loan (Credit balance)	12,000

6. Following balance are taken from the books of Moon Ltd. Prepare balance sheet as at 31-3-2017 as per schedule-III of Companies Act, 2013.

Balance	Amt. (₹)
(1) Interest accrued	30,000
(2) Plant-machinery	15,00,000
(3) Equity share capital	15,00,000
(4) Bank balance and cash	67,500
(5) General reserve	30,000
(6) Closing stock	2,70,000
(7) Creditors	6,00,000
(8) Debtors	3,45,000
(9) Provision for tax	90,000
(10) 12 % bank loan	1,95,000
(11) Non-current investments	45,000
(12) Electricity deposit	1,87,500
(13) Provident fund	30,000

7. Under which head, will you show following balances in the statement of profit and loss as per schedule III of Companies Act, 2013 ?

- |                                 |                                     |
|---------------------------------|-------------------------------------|
| (1) Sales                       | (2) Salary                          |
| (3) Depreciation                | (4) Bad debt recovered              |
| (5) Debenture interest          | (6) Audit fee                       |
| (7) Income from scrap           | (8) Profit on sale of asset         |
| (9) Advertisement expenses      | (10) Contribution to provident fund |
| (11) Interest on bank overdraft | (12) Bank charges                   |
| (13) Bonus to employees         | (14) Debenture discount written off |

8. Following balance is taken from the books of Patel Ltd. Prepare statement of profit and loss for the year ending 31-3-2017 as per schedule-III of Companies Act, 2013.

Balance	Amt. (₹)
(1) Sales of scrap	10,500
(2) Cost of material consumed	1,87,500
(3) Salary	78,000
(4) Interest paid	9000
(5) Sales	3,81,000
(6) Change in stock of finished goods	12,000
(7) Office and administration expenses	15,600
(8) Depreciation	84,000
(9) Provision for tax on profit is 30 %	

9. Following is the balance sheet of Keyur Ltd. as on 31-3-2017 :

Particulars	Debit (₹)	Credit (₹)
Equity share capital		2,40,000
Office and sales expenses	24,000	
Purchase	4,26,000	
10 % Debenture		1,20,000
Sales		9,60,000
Software	1,20,000	
Wages	24,000	
Debenture interest	12,000	
Salary	3,00,000	
Bank overdraft		14,400
Land-building	2,28,000	
Opening stock	36,000	
Discount received		15,600
Debtors	1,80,000	
	<b>13,50,000</b>	<b>13,50,000</b>

**Other information :**

- (1) Closing stock ₹ 42,000
- (2) Make provision for tax at 50 % of net profit.

From the above information, prepare final accounts of the company for the year ending on 31st March, 2017 as per schedule-III and Companies Act, 2013. Notes to the accounts are not required.

10. Following is the trial balance of Parth Ltd. as on 31-3-2017 :

Particulars	Debit (₹)	Credit (₹)
Sales		11,25,000
Employee benefit expenses	1,95,000	
Inventories	1,65,000	
Finance costs	26,250	
Security premium		60,000
Fixed assets - tangible	12,00,000	
Trade payables		90,000
Equity share capital		7,50,000
Trade receivables	60,000	
Other income		30,000
Long-term borrowings		5,25,000
Cash and bank balance	90,000	
Depreciation	33,750	
Cost of goods sold	6,00,000	
Non-current investments	2,10,000	
	<b>25,80,000</b>	<b>25,80,000</b>

From the above information, prepare final accounts of the company for the year ended on 31-3-2017 as per schedule-III of Companies Act, 2013. Notes to the accounts are not required.



# 4

## Analysis of Financial Statements

- |   |  |
|---|--|
| 1. Introduction                                 | 9. Users of Financial Analysis                       |
| 2. Meaning of Financial Statements              | 10. Limitations of Analysis of Financial Statements  |
| 3. Objectives and Types of Financial Statements | 11. Significance of Comparative Financial Statements |
| 4. Significance of Financial Statements         | 12. Stages of Analysis of Financial Statements       |
| 5. Meaning of Financial Analysis                | 13. Tools of Analysis of Financial Statements        |
| 6. Types of Financial Analysis                  | 14. Comparative statements                           |
| 7. Objectives of Financial Analysis             | 15. Common Size statements                           |
| 8. Uses of Financial Analysis                   | — Exercise   |

### 1. Introduction

Business and non-business enterprise undertakes financial transactions. These financial transactions are recorded as per rules and principles of accounting. These financial transactions pass through different stages of accounting. The commencement of these stages is from journal entry. At the end of these stages, final accounts are prepared. We have undertaken that study in 11th standard in this regard. In previous chapter we have studied final accounts of company. The components of final accounts are trading account, profit and loss account (which is also known as income statement) and balance sheet. These three are financial statements. Besides, cash flow statement, fund flow statement are included in financial statements. These financial statements disclose the results of financial transactions of particular period of time. e.g. What is the amount of gross profit ? What is the amount of net profit ? What is the amount of non-current liability ? This kind of information can be ascertained from them. Financial statements represent historical information. These financial statements represent results of financial transactions of accounting period. In brief, profit and loss account discloses result of business enterprise and balance sheet discloses financial status of the business. Cash flow statement related discussion is undertaken in subsequent chapter. (Cash flow statement also discloses the result of difference between cash inflow and cash outflow of financial activities of the business.)

Financial statements disclose what is the result of business; but do not disclose why this result ? Factors responsible to such result can not be ascertained. What type of relationship is there between different components of financial statements also can not be ascertained from financial statements. (However, the objectives of financial statements are pre determined and for respective objectives financial statements are prepared.) E.g. sale of a company is ₹ 80,000. Closing stock is ₹ 20,000. Opening stock is ₹ 10,000. Purchase is ₹ 50,000, consequently gross profit of the company will be ₹ 40,000. The computation is shown on page no. 154 :



### Trading Account

Dr			Cr
Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Opening stock	10,000	By Sales	80,000
To Purchase	50,000	By Closing stock	20,000
To Gross profit	40,000		
	<b>1,00,000</b>		<b>1,00,000</b>

Here, gross profit is the result of purchase-sales transactions. Trading account discloses information about result of ₹ 40,000.

These transactions can be represented in the following form. The information presented in this form, can be interpreted. The process of interpretation and analysis is given below.

Particulars	(₹)
Sales	80,000
<b>Less : Cost of goods sold</b>	
Opening stock	10,000
+ Purchase	50,000
	<hr/> 60,000
– Closing stock	20,000
	<hr/> 40,000
<b>Gross profit</b>	<b>40,000</b>

Here, (i) There is a profit of ₹ 40,000 because goods of ₹ 40,000 are sold for ₹ 80,000. ₹ 40,000 is result. But the factors of this result creation are sales, closing stock, purchase and opening stock. Even a small change in one factor leads to the change in result. e.g. in above mentioned problem if the value of closing stock is ₹ 24,000 instead of ₹ 20,000, the cost of goods sold will be ₹ 36,000 instead of ₹ 40,000. Consequently gross profit will be ₹ 44,000 instead of ₹ 40,000. So through analysis the information pertaining to affecting factors is ascertainable.

(ii) The creation of gross profit is from sales. Therefore, the proportion of gross profit to sales will be  $\frac{40,000 \text{ Gross profit}}{80,000 \text{ Sales}} \times 100 = 50 \%$ .

Gross profit has relation with sales. The gross profit increases due to the increase in sales if other factors remain constant. Hence, quantum of gross profit would increase. In case of above mentioned illustration if sales is ₹ 1,00,000 and there is no change in other factors i.e. cost of goods sold remains ₹ 40,000, this will give gross profit of ₹ 60,000. So, there is direct effect of change in sales on gross profit. This kind of information can be availed through analysis.

How the gross profit of ₹ 40,000 is earned ? What is the proportion of gross profit to sales ? This is ascertained through the interpretation of information disclosed in financial statements or by presenting the results in a different manner. This process of interpretation is known as an analysis.

Thus, the interpretation of the information or result given in financial statements is known as analysis.

- **Analysis of financial statements :**

Which tools are used ?

Which procedure is used for analysis ?

To whom, is it useful ?

What are its objectives ?

Answers pertaining to these questions are to be studied in this chapter.

In the previous chapter we have studied the financial statements of company. In the 11th standard also the study of entities is done in chapter 5 of part 2. So we do not discuss it again here.

The information in the content of financial statements analysis is as follows :

## **2. Meaning of Financial Statements**

Business or non-business entities maintain their accounts. For preparation of these accounts, rules, principles, traditions and assumptions of accounting are considered.

Financial statements are those statements which provide the results of different financial aspects of the entity .

Financial statements are an organised report which disclose detailed financial condition of the business entity .

## **3. Objectives and Types of Financial Statements**

- **Objectives :**

Different financial statements are prepared under the accounting system. Every financial statement has its own, independent existence and use. Financial statements like income statement, balance sheet and cash flow statements are prepared. (There are some other financial statements also, that are not included in syllabus). Each financial statement is prepared with specific purpose. It's explanation in brief is as follows :

**(1) To know the profit or loss of the business entity :** Business entity undertakes revenue activities through out the year. These activities are of two types. Receipt and Payment. If receipts are more than payments, difference is known as profit. If payments are more than receipts, difference it is known as loss. The information for such profit or loss is available from the prescribed financial statement. This statement is called as income statement. Therefore the first objective of the financial statement is to ascertain the profit or loss of the business.

**(2) To know the financial position of the business entity :** The financial position of the business entity is determined on the basis of difference of assets and liabilities. When the value of assets are more than liabilities, it is called as good financial position. When the value of assets is less than liabilities it is called as weak financial position. This information is available from the prescribed statement. Which is known as balance sheet. The second objective of preparation of financial statements is to know financial position.

**(3) To know the cash position of the business entity :** The business undertakes transactions of cash receipt and payment during the year. The information about different sources of cash and application of cash is available from the prescribed statement. This statement is known as cash flow statement. The third objective of preparing the financial statement is to know cash inflow and outflow of the business.

In brief,

Sr.	Financial Statement	Objective
(1)	Income statement (Profit and loss account)	To know the profit or loss of any specific period of the business entity, this statement is prepared.
(2)	Balance sheet	To know the financial position on a specific day of the business, this statement is prepared.
(3)	Cash flow statement	To know the cash inflow and outflow of any specific period of the business entity, this statement is prepared.

#### 4. Significance of Financial Statements

The information disclosed in the financial statements is useful to the existing and potential stakeholders. The financial statements are prepared to satisfy the different types of requirements of management, existing and potential investors, fund providers, short-term creditors, employees, customers, governments and other different agencies. The financial statements are important for these stakeholders but the analysis of financial statements accelerates the significance of these statements.

#### 5. Meaning of Financial Analysis

The objectives of preparing the financial statements are predetermined. Financial statements represent information and results. But "after preparation of financial statements, they are rearranged in such a way that they become comparable. The different stakeholders take their decisions on the basis of financial statements, which are prepared in a comparable form". This entire process is known as analysis.

#### 6. Types of Financial Analysis

Financial analysis is done for internal and external purpose. This can be done in the horizontal form, vertical form, for short-term and for long-term. Discussion pertaining to this is as follows :

We can present different types of financial analysis :

- (1) On the basis of stakeholders :
  - (i) External analysis
  - (ii) Internal analysis
- (2) Horizontal-vertical form :
  - (i) Horizontal analysis
  - (ii) Vertical analysis
- (3) On the basis of duration :
  - (i) Long-term analysis
  - (ii) Short-term analysis

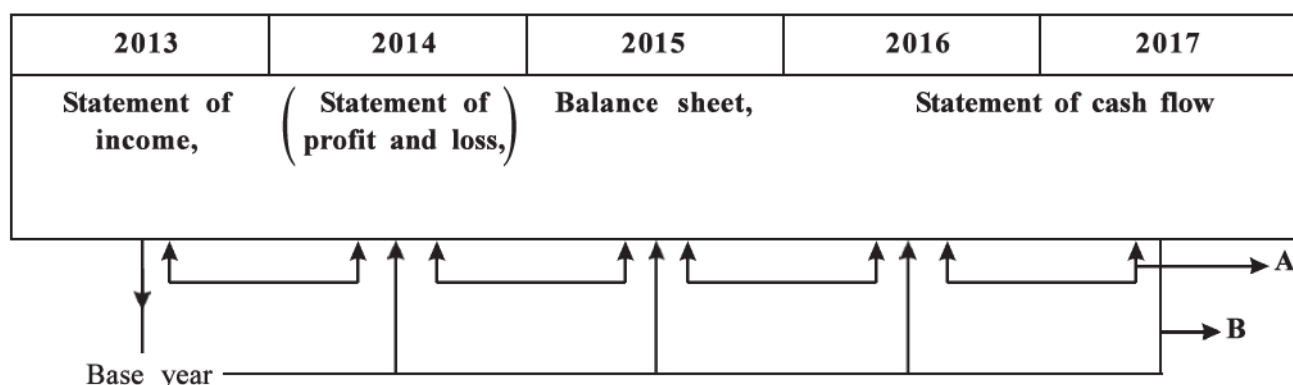
(1) **On the Basis of Stakeholders** : Financial statements of a business entity are used by various stakeholders. These stakeholders can be categorised into two categories : (i) External party (ii) Internal party.

(i) **External analysis** : When published accounts like income statement, balance sheet, report of an auditor or directors are analysed by external parties like potential investors, financial institutions, government agencies, credit rating agencies, researchers etc for their investment related decision or for any other decision, it is known as external analysis.

(ii) **Internal analysis** : The management of the business take their decision from accounts prepared by them. The base of these decisions is analysis. When financial statements are analysed by the management for their decisions is known as internal analysis. The information available for this kind of analysis is accurate and elaborate.

(2) **Horizontal or Vertical Form** : This kind of analysis can be done in two ways : (i) In the horizontal form and (ii) In the vertical form.

(i) **Horizontal analysis** : Financial statements are prepared every year. The comparison of financial statements of different years is known as horizontal analysis. This analysis is done for long term planning. This analysis is useful to know the current trend. This analysis is known as time series analysis.



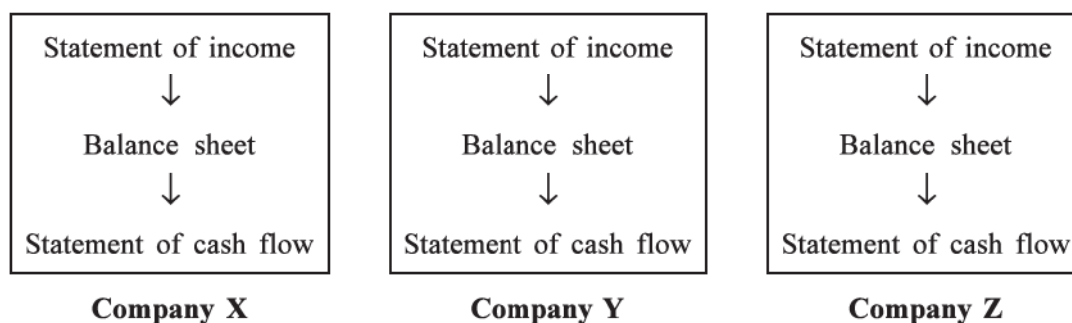
From the figure above under A type analysis year 2013 can be compared with 2014 and year 2014 with 2015. i.e. performance of each current year can be compared with its previous year.

In the same manner under B type analysis, the year 2013 is treated as base year and the performance of each subsequent year is comparable with the base year 2013.

Both the above mentioned types of analysis are horizontal analysis. e.g. As compared to 2013 whether the profit of 2014 is increased or decreased ? Whether assets are increased or decreased ? This kind of trend can also be checked. The comparison of the statement of one year with the others known as horizontal analysis.

(ii) **Vertical analysis** : This kind of analysis is used to compare financial statements of one year. This analysis is used to compare the performance of different units or departments of one year with the help of different pre determined ratios.

Financial statements of different units for the year 2017 :



The comparative analysis for one year among different units of different financial statements can be called as vertical analysis.



**(3) On the Basis of Duration :** One significant concept of accounting is Going Concern. As per this concept the existence of business entity is permanent. While preparing the accounts the concept of periodicity is also considered. It is generally of 12 months. We have acquired information about this in 11th standard, chapter no. 6 of part II. The analysis of accounts of business can be done for short-term and long-term. It's explanation is as follows :

**(i) Long-term analysis :** Many stakeholders like debenture holders, financial institutions, potential investors undertake long-term analysis of financial statements before investing their funds in the corporate form of business. For this analysis information of more than one year is needed. Under this analysis, these stakeholders determine the present and future long-term solvency, profitability, liquidity and efficiency of the borrowers. In brief, under long-term analysis the evaluation of above mentioned dimensions is done with the help of financial statements of more than one year.

**(ii) Short-term analysis :** This kind of analysis is used to measure short-term solvency or liquidity of the business entity. This kind of analysis is done by the short-term lenders as well as the suppliers of raw materials.

As discussed above, the analysis of financial statements is done in different ways for different purposes. For analysis of financial statements, financial statements of one year or more than one years are considered. On the basis of analysis, different stakeholders make their rational decisions. Now, we will study the objectives of financial statements analysis.

## **7. Objectives of Financial Analysis**

Financial analysis has different objectives for different stakeholders. Important objectives of financial analysis are as follows :

**(1) Evaluation of Earning Capacity :** Generally, financial statements are prepared for the duration of 12 months. What is the earning capacity of entity during this period ? This analysis is made with the help of different accounting ratios. Besides this, the future earning capacity of the entity also can be forecasted. Mostly all stakeholders for their investment decisions, gather information of present and future earning through analysis.

**(2) Efficiency Evaluation :** Business entity acquires different assets as per the nature of business. With the help of these assets production and sales are done and services are provided. The use of these assets should be at maximum level. Maximum use of assets, generate more earning. Through financial analysis, the evaluation of the efficient use of assets can be done.

**(3) Solvency Evaluation :** Solvency of the entity is categorised into two types, which we have studied in 11th standard : Short-term solvency and long-term solvency. Different parties provide goods and services to business entities on credit. The payment of these goods and services is to be made in short-term period. Therefore the providers of goods and services measure the short-term solvency of the business. Financial institutions and banks also provide long-term advances to the business entities. They undertake evaluation and forecast of long-term solvency of business entities. Through financial analysis evaluation of short-term and long-term solvency of that business can be done.



**(4) Evaluation of Managerial Efficiency :** The owners and the management are two different entities in the company form of business. Funds of shareholders are managed by the board of directors. Besides, officers execute the decisions taken by the board of directors. Therefore, through financial analysis evaluation of effectiveness and fairness of the decisions of the board of directors can be done. The performance evaluation of the officers can also be done through this analysis.

**(5) Planning for Budget :** Budget means the quantitative planning or statistical planning of future objectives in present. What will be the future sales ? How much purchase is required ? How much will be the production ? How much cash will be required ? What will be the revenue expenses ? What will be the capital expenses ? etc. are estimated. Analysis of financial statement is useful to make the process of budget effective.

**(6) Comparative Study :** Two types of comparisons can be done through financial analysis. In the first comparison, the business entity can compare its current accounts with the accounts of past. Different aspects of business entity like profitability, liquidity, solvency and efficiency etc. of the current year can be compared with the previous years to know the growth of the above mentioned aspects. In the second comparison all these aspects of business entity are compared with the results of competitors. This is known as interfirm comparison. Whether business entity is strong or weak as compared to its competitors can be ascertained through financial statement analysis.

**(7) Simplicity to Understand Accounts :** Financial accounts are prepared on the basis of determined rules, principles and terminology. It is possible that all the users of financial accounts may not have full knowledge pertaining to financial accounts. Under these circumstances, financial statements analysis helps to understand the financial accounts. In financial analysis the presentation of financial accounts is done in various ways. It provides simplicity to the users to understand financial accounts. Therefore, they can make their investments and other decisions. In brief, the financial analysis assists to understand the financial accounts.

Due to the analysis of financial statements different objectives can be achieved. These objectives explain the significance of the analysis of financial statements.

## **8. Uses of Financial Analysis**

Generally four different aspects are analysed from the analysis of financial statements :

- (1) Analysis of profitability : This discloses the earning capacity of business entity.
- (2) Analysis of liquidity : This discloses the short-term solvency of business entity.
- (3) Analysis of solvency : This discloses the long-term solvency of business entity.
- (4) Analysis of efficiency : This explains the degree of use of assets.

(The discussion in detail about this is done in next chapter of ratio analysis.)

From the above studied objectives different stakeholders make their different decisions, that can be described in brief, as under :

**(1) For Dividend Decision :** In the company form dividend decision is analysed by different stakeholders - like existing investors, potential investors and company itself. What amount of dividend can be paid is decided by the management of the company. What amount of dividend will be received is estimated by the investors. The dividend decision is determined through profitability analysis.

The payment of dividend is based on earning capacity. This can be decided by profitability analysis. For dividend payment decision, financial statement analysis is useful.

**(2) For Investment Decision :** Investors invest their funds in a company for two purposes :

(i) To receive regular income of dividend or interest (ii) For capital appreciation. The information pertaining to both the purposes can be availed from profitability and solvency analysis respectively. Thus, investors use this analysis for their decisions.

**(3) For Lending Decision :** Short-term and long-term loan and advances are provided to the business entities by banks and financial institutions. To know how far their advances are safe, the analysis for examination of short-term and long-term solvency is useful.

**(4) For Borrowing Decision :** This decision is useful to the business entity itself. From their analysis of financial statements, business entity can estimate its own borrowing capacity to borrow funds from the market. On the basis of this evaluation, the opportunities for new investment can be explored.

## **9. Users of Financial Analysis**

The information disclosed in the financial statements can be used directly by the stakeholders. But after having analysis of financial statements, the information of financial statements become more precise and understandable. Therefore, all the stakeholders can take their appropriate decisions. This analysis is :

- ☐ For internal purpose
- ☐ For external users
- ☐ For short-term decisions
- ☐ For long-term decisions
- ☐ For existing investors
- ☐ For potential investors

## **10. Limitations of Analysis of Financial Statements**

The analysis of financial statements is done in various ways. This is useful to different parties. Different stakeholders acquire appropriate information about good and weak aspects of business entity, through this analysis. However, there are some limitations of financial statement analysis. Thus, as and when financial statement analysis is undertaken, the following limitations should also be considered.

**(1) Historical Data :** Financial accounts are prepared on the basis of past transactions. Thus, financial accounts are known as historical accounts. The analysis of financial statements is based on historical information. From this analysis the future can be forecasted. The shareholders and other parties are more concerned with the future of business entity. Which cannot be availed from this analysis but the estimation of future can be made.

**(2) Ignorance of Inflation :** Due to inflation information disclosed in financial statement does not represent the real status. Specifically, at the time of the valuation of assets the impact of inflation is ignored in financial statements. Assets are disclosed at their old value and replacement cost which is higher is not considered. Income statement is prepared at current prices and balance sheet discloses

actual prices of past. Thus, one statement is prepared as per current price and other financial statement is prepared as per the historical price. In brief the value of money is not considered comprehensively. Therefore the result as per financial statement analysis might fail to provide guidance.

**(3) Absence of Qualitative Aspect :** During financial statement analysis only quantifiable items are considered. But factors like contribution of workers for development of business and loyalty of management towards business entity, honesty, expertise etc. are not considered. All these factors have relation with efficiency of business. But these are ignored. This can also be considered as a limitation of financial statements analysis.

**(4) Based on Presentation of Financial Statements :** The operation of analysis is done on the basis of information provided in financial statements. The correct and fair analysis and interpretation are entirely based on information disclosed in the financial statement. There is a direct relation between true and fair information and effective and efficient analysis. Thus, if information of financial statements is incorrect or inadequate, the true and fair analysis of information can not be done. Here, the financial analysis is a dependent variable, which is based on the appropriateness of financial statements.

**(5) Personal Opinion :** There are options in accounting for preparing the accounts. e.g. use of depreciation method, inventory valuation method. Thus there is a possibility of personal opinion. Due to these options there is a room for subjectivity in preparation of accounts. This also creates hurdle for financial analysis. Thus it can be considered as a limitation.

**(6) Window Dressing :** As stated earlier fair financial analysis is based on the truthfulness of the financial statements. Many a times, the information disclosed in financial statements is not found to be correct. Accounts are prepared on the basis of incorrect information rather than correct information. Thus, decisions made by the stakeholders stand incorrect. This is also a limitation of financial analysis.

**(7) Discloses only Symptoms of Problem :** Financial analysis provides information of causes of the problems but does not provide the solution of it. For example, if company has expected 30 % of gross profit and company earns 20 % gross profit, the reduced gross profit rate can be seen through financial statement analysis. But why gross profit is reduced can not be ascertained. The management has to find out the solutions and has to frame strategy accordingly.

From the above discussion it is concluded that the limitations of financial analysis are the result of limitations of financial statements. If the limitations of financial statements are eliminated, the limitations of financial analysis will be removed automatically.

## **11. Significance of Comparative Financial Statements**

As stated earlier, financial statements are prepared on the basis of the principles and rules of accounting, and in the pre determined form. So that the financial accounts represent results with consistence base. To understand accounts easily by the stakeholders, financial statements are presented in rearranged form. Due to this process, the utility of financial statements increases. The importance of comparative statements can be described as under :



**(1) Intrafirm Comparison :** Every year financial statements are prepared by business enterprises. When the accounts of business entity of current year are compared with the accounts of previous years, it is known as intrafirm comparison. As compared to previous year whether the efficiency is increased or not ? Profitability is increased or not ? Whether the solvency is increased or not ? can be analysed. Besides, when one business entity has various departments, their financial performance evaluation is also done. This is also included in the category of intrafirm comparison.

**(2) Interfirm Comparison :** An industry comprises of various business entities. When financial statements of various business entities are compared with each other, it is known as interfirm comparison. Which business unit is financially strong or weak as compared to the other business unit can be ascertained. This information is ascertained through interfirm comparison. Different stakeholders may rethink on their investment decisions due to the interfirm comparison. So to undertake the financial condition comparison between two units, financial statements analysis is useful.

**(3) Indicates Trend :** Due to comparison of financial statements of different years and different sections of a business unit, the information of trend pertaining to financial position and profitability is ascertained. On the basis of this trend, different stakeholders undertake forecasting of their decisions. The trend of different aspects is disclosed by financial statements analysis. The trend helps to make decisions.

**(4) Useful to Creditors :** Creditors of business units are of long-term and short-term. Creditors determine creditworthiness of business units through analysis of financial statements. So it is also useful to the creditors.

**(5) Simple and Comparable Presentation of Information :** The information disclosed in the financial statements is prepared on the basis of rules of accounting. But when the information of the financial statements is rearranged it becomes simple to understand and analyse the financial statements. Generally, the information of financial statements is rearranged in the form of table. Thus, it becomes useful and simple to understand.

## **12. Stages of Analysis of Financial Statements**

There are legal rules for the preparation of financial statements. Financial statements are prepared on the basis of rules. In the company form, financial accounts are prepared as per Companies Act, 2013. There is a provision for structure and nature of financial statements. Different stages are developed for the analysis of financial statements. Due to these stages an organised and scientific analysis can be done. These stages are as under :

**(1) New Structural Arrangement of Financial Statements :** Different tools are used for the analysis of financial statements which are prepared as per the legal provisions. Where common size financial statements, comparative statements, ratio analysis etc. are included. The information disclosed in financial statements is reclassified and rearranged to undertake use of these tools. This arrangement makes use of tools more favourable. e.g. to know the trend of net profit of last five years, the net profit rate is used. It's formula is  $\frac{\text{Net profit}}{\text{Sales}} \times 100$ .

For this analysis sales and profit of last five years is arranged in the form of table, which is as follows :

**Table of Net Profit Rate**

Year	Net Profit (₹)	Sales (₹)	Net Profit Rate (%)
1	60,000	5,00,000	12 %
2	77,000	5,50,000	14 %
3	1,10,500	8,50,000	13 %
4	80,000	5,00,000	16 %
5	84,000	5,60,000	15 %
Total	4,11,500	29,60,000	
÷ Years	5	5	
=Average	82,300	5,92,000	14 %

In the first stage of analysis, required information is to be obtained from the financial statement and subsequently to be reclassified and rearranged as mentioned above. To know the trend of net profits of the last five years, this information can be presented in this form.

**(2) Comparison :** In the second stage of financial analysis, reclassified and rearranged information is compared. The sales and net profit which are shown in above mentioned table, are compared with sales and net profit of its previous year i.e. the comparison of the results of the second year with the first year. Profit, sales and net profit rate are increased as compared to the first year in the second year. In this way, the results of the second year with the third year, of the third year with the fourth year and of the fourth year with the fifth can be compared. Analysis and interpretation is done on the basis of comparison.

**(3) Analysis and Interpretation :** Under point no. (2), the information is compared. Under this stage an attempt is made to explain information in quantitative manner along with quantitative form. Analysis means appropriate examination or evaluation of information, where information is categorised into different components and their relationship is tested. Interpretation gives explanation of this relationship. Net profit and sales shown in the above table are the components of the financial statements (income statement). There are two variables for computation of net profit rate and both are interrelated. Theoretically, the increase in sales leads to the increase in net profit. It means the sales and the net profit has positive relationship. As compared to the first year sales is increased from ₹ 5,00,000 to ₹ 5,50,000 in the second year and the profit is also increased from ₹ 60,000 to ₹ 77,000. In the third year, sales is increased - profit is also increased. In the fourth year sale is reduced - profit is also reduced. Again in the fifth year sales is increased, profit is also increased. (In practice it is possible that inspite of having increase in sales, there may be reduction in profit; or despite the decrease in sales the profit increases). This process is known as analysis.

As compared to the first year, net profit rate of second year is increased from 12 % to 14 %. It is good for the company. But in the third year sales is increased as compared to the second year; profit is also increased, but rate of net profit is reduced, which is 13 %. It can be said that profit earning capacity of the company is reduced during the third year as compared the second year. From the information of five years the total sales of five years is ₹ 29,60,000 and profit is ₹ 4,11,500. Their average respectively is ₹ 5,92,000 and ₹ 82,300. This is a kind of interpretation. In this way, the interpretation can be done each year. This process is known as interpretation.



Performance evaluation of a company is done on the basis of analysis and interpretation. From this evaluation it can be ascertained that whether company has good financial health or not. Different stakeholders make their decisions on the basis of this analysis and interpretation.

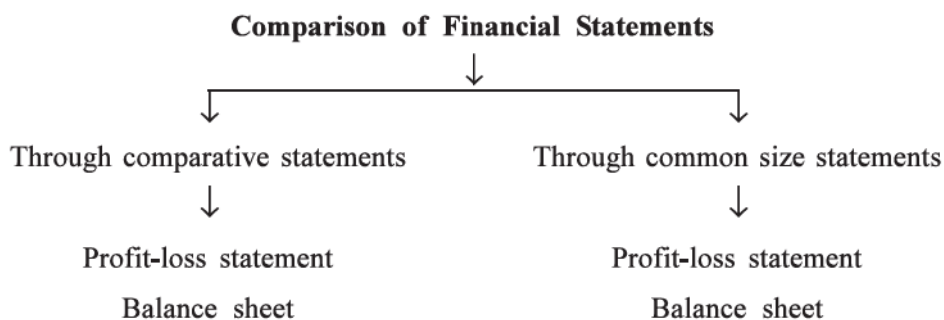
Now, let us take information on different tools of financial statement analysis where study pertaining to common size financial statements, comparative statements and ratio analysis is to be done.

### 13. Tools of Analysis of Financial Statements

The preparation of financial statements is the last stage under the financial accounting. In this stage the preparation of income statement and balance sheet are included. In the company form cash flow statement is also prepared. In these statement details of expense, income, assets, liability are disclosed in the form of rupees (In the form of currency of respective country). All these details are shown in the financial statements in legal form. Many a times it is difficult for a common man to understand them. In order to resolve this problem and to make information of financial statements more understandable the analysis of statement is done. For this analysis information of more than one years is used. For this process, different tools are developed in accounting; and analysis process is done with the use of them. Where common size financial statements, comparative statements and ratio analysis are included (Ratio analysis is discussed in separate chapter). The explanation of comparative statements and common size statements is as follows :

**Comparison of Financial Statements :** The financial information of atleast two years is required. for comparison process. The development details of predetermined period is obtained through comparison. It can be known that which period shows good results and which shows weak results.

In comparative statements the details of income statements and/or balance sheets of two or more than two years are compared.



Financial statements are compared in two ways :

**(1) Through Comparative Statements :** Under this comparative statements, comparative balance sheet and comparative profit-loss statement (income statement) are prepared. This comparison is done in horizontal form. Thus, it is known as horizontal analysis of financial statements. Under this comparison, it can be ascertained that as compared to previous year what is increase/decrease in terms of rupees and in terms of percentage during the current year. The development trend of business entity can be seen from this kind of analysis.

e..g Equity share capital in the year 2016 was ₹ 3,00,000 and in the year 2017 it is ₹ 4,50,000. It means equity share capital is increased by ₹ 1,50,000 and in the form of percentage equity share capital is increased by 50 % as compared to previous year  $\left( \frac{4,50,000 - 3,00,000}{3,00,000} \times 100 \right)$ . The statements which are prepared in this form are known as comparative statements.

**(2) Through Common Size Statements :** Balance sheets and profit-loss statements are considered for this kind of comparative statements also. This analysis is done in the vertical form, thus it is known as vertical analysis of financial statements. Under this comparison one base is used. For balance sheet, the total of balance sheet is considered as base. For profit-loss statement sales is considered as base. e.g. the total of balance sheet of 2016 is ₹ 1,00,000, where non-current assets are of ₹ 60,000 and current assets are of ₹ 40,000. While in the year 2017, the total of balance sheet is ₹ 1,50,000 and where non-current assets are of ₹ 75,000 and current assets are of ₹ 75,000. It's analysis and interpretation is as follows :

**Analysis :** During 2016 non-current assets are  $60\% \left( \frac{60,000}{1,00,000} \times 100 \right)$  of total assets and current assets are  $40\% \left( \frac{40,000}{1,00,000} \times 100 \right)$  of total assets.

During 2017 non-current assets are  $50\% \left( \frac{75,000}{1,50,000} \times 100 \right)$  of total assets and current assets are also  $50\% \left( \frac{75,000}{1,50,000} \times 100 \right)$  of total assets.

**Interpretation :** As compared to the previous year the proportion of the non-current assets is reduced from 60 % to 50 %, while the proportion of the current assets is increased from 40 % to 50 %.

The above explained analysis and the interpretation can be done with the help of comparative statements.

● **Characteristics of Comparative and Common Size Financial Statements :**

- (1) There is information for two or more than two years.
- (2) The comparison of the results of two or more than two years can be disclosed in the form of rupees.
- (3) The comparison of the results of two or more than two years can be disclosed in the form of percentage.
- (4) This comparison discloses either increase or decrease.
- (5) The trend of any component of statement can be known through this comparison (e.g. the trend of share capital increase / decrease / no change).
- (6) It can be presented in ratio form.
- (7) Profit-loss statement and balance sheet of the previous year are compared respectively with the profit-loss statement and balance sheet of the current year. It means the comparison is done. The detailed information of tools of comparison of financial statements are as under :
  - (i) Comparative statements :
    - (a) Comparative statement of profit-loss statement
    - (b) Comparative statement of balance sheet
  - (ii) Common size statements :
    - (a) Common size statement of profit-loss statement
    - (b) Common size statement of balance sheet

**14. Comparative Statements**

**(a) Comparative Profit and Loss Statement :** The structure of comparative profit and loss statement is similar comparative balance sheet. There are total 6 columns. But the content of profit-loss

statement and balance sheet are different. This analysis is known as the analysis of comparative statements. The comparison of details of two years of two components of annual accounts profit-loss statement and balance sheet are done. The growth of business entity can be seen through this analysis.

Explanation of comparative statement of profit-loss and comparative balance sheet is as under :

### Structure of Comparative Profit-Loss Statement

#### Comparative Profit-Loss Statements for the Year Ending on 31-3-2016 and 31-3-2017

Particulars  1	Note No. 2	Previous Year (₹) 3	Current Year (₹) 4	Increase/ decrease (₹) 5(4 – 3)	Increase/ decrease (%) 6 $\left(\frac{5}{3} \times 100\right)$
(I) Sales revenue					
(II) Other income					
(III) Total revenue (I + II)					
(IV) Expenses :					
(i) Cost of goods consumed					
(ii) Net purchase of resale					
(iii) Changes in stock					
(iv) Employees benefit expenses					
(v) Financial cost					
(vi) Depreciation and Amortized expenses					
(vii) Other expenses					
<b>Total expenses</b>					
(V) Profit before tax (III – IV)					
(VI) Less : Income tax					
(VII) Profit after tax (V – VI)					

**Note :** A detailed information of profit-loss statement is obtained in the previous chapter.

There are two important components of profit and loss statement : (i) Total revenue and (ii) Total expenses. The result of earnings made during the year is available from the profit-loss statement. The increase in revenue indicates the increase in earning and the reduction in expenses also indicates the increase in earning. The reduction in revenue and increase in expenses indicate decrease in earning.

**What is disclosed by the analysis of Profit and Loss Statement ?** Profit-loss statement provides information of profitability of business entity. During the current year as compared to previous year what degree of profitability increase or decrease can be seen from comparative profit-loss statement. A detailed discussion regarding this is done in the chapter of ratio analysis.

In brief, during two periods how much total revenues and total expenses have changed (increase/decrease) in terms of rupees and percentage can be ascertained from comparative profit-loss statement.

Whether the trend of all components of comparative profit-loss statement is

- fixed ?
- flexible ?
- decreasing ?
- increasing ? can be known through the comparative profit-loss statement.

The explanation of comparative profit-loss statement is given in illustrations :

**Illustration 1 :** Prepare comparative profit-loss statements from the following profit-loss statements of Vivekanand Ltd. for the year ending on 31-3-2016 and 31-3-2017.

**Summarised Profit-Loss Statements for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue		16,00,000	14,00,000
Other income		3,00,000	2,50,000
Expenses		9,60,000	7,20,000

**Ans. :**

**Comparative Profit-Loss Statement of Vivekanand Ltd.  
for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 – 3)	Increase/ Decrease (%) 6 ( $\frac{5}{3} \times 100$ )
(I) Sales revenue		14,00,000	16,00,000	2,00,000	14.29
(II) Other income		2,50,000	3,00,000	50,000	20.00
(III) <b>Total income (I + II)</b>		<b>16,50,000</b>	<b>19,00,000</b>	<b>2,50,000</b>	<b>15.15</b>
(IV) Expenses :		7,20,000	9,60,000	2,40,000	33.33
(V) Profit before income tax (III – IV)		9,30,000	9,40,000	10,000	1.08

**Illustration 2 :** Profit-loss statements of Bright Ltd. for the year ending on 31-3-2016 and 31-3-2017 are as follows. On the basis of them prepare comparative profit-loss statement.

**Summarised Profit-Loss Statements for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue		16,00,000	14,00,000
Other income		3,00,000	2,50,000
Expenses		9,60,000	7,20,000

Income tax rate is 30 %.



Ans. :

**Comparative Profit-Loss Statement of Bright Ltd.  
for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars  1	Note No.  2	31-3-2016 (₹)  3	31-3-2017 (₹)  4	Increase/ Decrease (₹)  5(4 – 3)	Increase/ Decrease (%)  6 $\left(\frac{5}{3} \times 100\right)$
(I) Sales revenue		14,00,000	16,00,000	2,00,000	14.29
(II) Other income		2,50,000	3,00,000	50,000	20.00
(III) <b>Total income (I + II)</b>		<b>16,50,000</b>	<b>19,00,000</b>	<b>2,50,000</b>	<b>15.15</b>
(IV) Expenses :		7,20,000	9,60,000	2,40,000	33.33
(V) Profit before tax (III – IV)		9,30,000	9,40,000	10,000	1.08
(VI) Less : Income tax (30 %)		2,79,000	2,82,000	3000	1.08
(VII) Profit after tax (V – VI)		6,51,000	6,58,000	7000	1.08

**Note :** When tax rate is identical for given both years, in this case increase/decrease in column no. 6 would remain the same. in case of

- Profit before tax
- Income tax
- Profit after tax

**Illustration 3 :** Summarised profit and loss statements of Gujarat Ltd. for the year ending of 31-3-2016 and 31-3-2017 are as follows. Prepare comparative profit-loss statement.

**Profit-Loss Statement of Gujarat Ltd.  
for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue		9,00,000	8,00,000
Other income		2,00,000	1,00,000
Cost of goods consumed		3,30,000	3,00,000
Financial expenses		60,000	60,000
Depreciation		40,000	40,000
Other expenses		1,80,000	2,00,000

Income tax rate is 30 %



Ans. :

**Comparative Profit-Loss Statement of Gujarat Ltd.  
for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 ( $\frac{5}{3} \times 100$ )
(I) Sales revenue		8,00,000	9,00,000	1,00,000	12.50
(II) Other income		1,00,000	2,00,000	1,00,000	100.00
(III) <b>Total income (I + II)</b>		<b>9,00,000</b>	<b>11,00,000</b>	<b>2,00,000</b>	<b>22.22</b>
(IV) Expenses :					
(i) Cost of goods consumed		3,00,000	3,30,000	30,000	10
(ii) Financial expenses		60,000	60,000	—	—
(iii) Depreciation		40,000	40,000	—	—
(iv) Other expenses		2,00,000	1,80,000	(20,000)	(10)
<b>Total expenses</b>		<b>6,00,000</b>	<b>6,10,000</b>	<b>10,000</b>	<b>1.67</b>
(V) Profit before tax (III - IV)		3,00,000	4,90,000	1,90,000	63.33
(VI) Less : Income tax (30 %)		90,000	1,47,000	57,000	63.33
(VII) Profit after tax (V - VI)		<b>2,10,000</b>	<b>3,43,000</b>	<b>1,33,000</b>	<b>63.33</b>

**Note :** Decrease is shown in bracket.

**Illustration 4 :** From profit-loss statements of Bhavna Ltd. for the year ending on 31-3-2016 and 31-3-2017, prepare comparative profit-loss statement.

**Profit-Loss Statement of Bhavna Ltd.  
for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue		20,00,000	16,00,000
Other income		3,00,000	4,00,000
Expenses :			
Cost of goods consumed		9,00,000	8,00,000
Net purchase for resale		1,10,000	90,000
Changes in stock		50,000	50,000
Employees benefit expense		1,20,000	90,000
Financial cost		40,000	60,000
Depreciation and amortized amount		2,70,000	1,80,000

Income tax rate is 30 %.

Ans. :

**Comparative Profit-Loss Statement of Bhavna Ltd.  
for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2016 (₹)	31-3-2017 (₹)	Increase/ Decrease (₹)	Increase/ Decrease (%)
1	2	3	4	5(4 – 3)	6 ( $\frac{5}{3} \times 100$ )
(I) Sales revenue		16,00,000	20,00,000	4,00,000	25
(II) Other income		4,00,000	3,00,000	(1,00,000)	(25)
(III) <b>Total income (I + II)</b>		<b>20,00,000</b>	<b>23,00,000</b>	<b>3,00,000</b>	<b>15</b>
(IV) Expenses :					
(i) Cost of goods consumed		8,00,000	9,00,000	1,00,000	12.5
(ii) Net purchase for resale		90,000	1,10,000	20,000	22.22
(iii) Changes in stock		50,000	50,000	—	—
(iv) Employees benefit expenses		90,000	1,20,000	30,000	33.33
(v) Financial cost		60,000	40,000	(20,000)	(33.33)
(vi) Depreciation and amortized amount		1,80,000	2,70,000	90,000	50
<b>Total expenses</b>		<b>12,70,000</b>	<b>14,90,000</b>	<b>2,20,000</b>	<b>17.32</b>
(V) Profit before tax (III – IV)		7,30,000	8,10,000	80,000	10.96
(VI) Less : Income tax (30 %)		2,19,000	2,43,000	24,000	10.96
(VII) Profit after tax (V – VI)		<b>5,11,000</b>	<b>5,67,000</b>	<b>56,000</b>	<b>10.96</b>

**Illustration 5 :** From the following information prepare comparative profit-loss statement :

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue	15,00,000	9,00,000
Net purchase for resale	9,00,000	6,00,000
Changes in stock	50,000	50,000
Other Expenses (% of cost of sales)	10	12
Income tax	30 %	30 %

**Note :** Changes in stock means difference of opening and closing stock

(Changes in stock = Opening stock – Closing stock)

If difference is positive, will be added to cost of sales or will be deducted from revenue. If difference is negative, will be deducted from cost of sales or will be added to revenue.

**Relation of opening stock and closing stock with cost of sales and revenue**

<b>Circumstances</b> <b>Cost of sales and revenue</b>	<b>Opening stock &gt; Closing stock</b> <b>(Positive difference)</b>	<b>Opening stock &lt; Closing stock</b> <b>(Negative difference)</b>
Cost of sales	will be added	will be deducted
Revenue	will be deducted	will be added

e.g. Purchase ₹ 5,00,000 and opening stock and closing stock respectively ₹ 60,000 and ₹ 40,000. In this case cost of sales will be ₹ 5,00,000 + (₹ 60,000 – ₹ 40,000) = ₹ 5,20,000.

If opening and closing stock is respectively ₹ 40,000 and ₹ 60,000. In this case cost of sales will be ₹ 5,00,000 (₹ 40,000 – ₹ 60,000) = ₹ 4,80,000.

**Ans. :**

**Comparative Profit-Loss Statement for the Year Ending on 31-3-2016 and 31-3-2017**

<b>Particulars</b>	<b>Note No.</b>	<b>31-3-2016</b> <b>(₹)</b>	<b>31-3-2017</b> <b>(₹)</b>	<b>Increase/ Decrease (₹)</b>	<b>Increase/ Decrease (%)</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5(4 – 3)</b>	<b>6 (<math>\frac{5}{3} \times 100</math>)</b>
(I) Sales revenue		9,00,000	15,00,000	6,00,000	66.67
(II) Expenses :					
(i) Net purchase for resale		6,00,000	9,00,000	3,00,000	50
(ii) Changes in stock		50,000	50,000	—	—
(iii) Other expenses		78,000	95,000	17,000	21.79
<b>Total expenses</b>		<b>7,28,000</b>	<b>10,45,000</b>	<b>3,17,000</b>	<b>43.54</b>
(III) Profit before tax		1,72,000	4,55,000	2,83,000	164.53
(IV) Less : Income tax (30 %)		51,600	1,36,500	84,900	164.53
(V) Profit after tax		<b>1,20,400</b>	<b>3,18,500</b>	<b>1,98,100</b>	<b>164.53</b>

**Explanation :** Other Expenses = % of cost of sales

∴ Cost of sales = Net purchase of resale + Changes in stock

**2016** = 6,00,000 + 50,000

= 6,50,000

× 12 %

= ₹ 78,000

**2017** = 9,00,000 + 50,000

= 9,50,000

× 10 %

= ₹ 95,000

**Illustration 6 :** Prepare comparative profit and loss statements from the given details.

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue	15,00,000	18,00,000
Net purchase for resale	6,00,000	5,00,000
Changes in stock	1,60,000	1,00,000
Other expenses (% of sales)	45	40
Other income (% of sales)	12	10
Income tax rate	30 %	30 %

**Ans. :**

**Comparative Profit and Loss Statement**

Particulars	Note No.	31-3-2016 (₹)	31-3-2017 (₹)	Increase/ Decrease (₹)	Increase/ Decrease (%)
1	2	3	4	5(4 – 3)	6 ( $\frac{5}{3} \times 100$ )
(I) Sales revenue		18,00,000	15,00,000	(3,00,000)	(16.67)
(II) Other income		1,80,000	1,80,000	—	—
(III) Total income (I + II)		19,80,000	16,80,000	(3,00,000)	(15.15)
(IV) Expenses :					
(i) Net purchase for resale		5,00,000	6,00,000	1,00,000	20
(ii) Changes in stock		1,00,000	1,60,000	60,000	60
(iii) Other Expenses		7,20,000	6,75,000	(45,000)	(6.25)
<b>Total Expenses</b>		<b>13,20,000</b>	<b>14,35,000</b>	<b>1,15,000</b>	<b>8.71</b>
(V) Profit before tax		6,60,000	2,45,000	(4,15,000)	(62.88)
(VI) Less : Income tax (30 %)		1,98,000	73,500	(1,24,500)	(62.88)
(VII) Profit after tax		<b>4,62,000</b>	<b>1,71,500</b>	<b>(2,90,500)</b>	<b>(62.88)</b>

**Explanation :**

Expenses \ Years	2016	2017
(1) Other expenses (% of sales)	₹ 18,00,000 × 40 % = ₹ 7,20,000	₹ 15,00,000 × 45 % = ₹ 6,75,000
(2) Other income (% of sales)	₹ 18,00,000 × 10 % = ₹ 1,80,000	₹ 15,00,000 × 12 % = ₹ 1,80,000

(b) Comparative Balance Sheet :

Format of Comparative Balance Sheet

Balance Sheet as on .....

Particulars	Note No.	Previous Year (₹)	Current Year (₹)	Increase/ Decrease (₹)	Increase/ Decrease (%)
1	2	3	4	5(4 - 3)	6 $\left(\frac{5}{3} \times 100\right)$
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital					
(i) Equity share capital					
(ii) Preference share capital					
(b) Reserves and surplus					
(2) Non-current liabilities					
(i) Long-term borrowings					
(ii) Long-term provisions					
(3) Current liabilities					
(i) Short-term borrowings					
(ii) Trade payable					
(iii) Other current liabilities					
(iv) Short-term provisions					
<b>Total</b>					
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets					
(ii) Intangible assets					
(b) Non-current investments					
(c) Long-term loan and advances					
(d) Other non-current assets					
(2) Current assets :					
(i) Current investments					
(ii) Inventories					
(iii) Trade receivables					
(iv) Cash and cash equivalent					
(v) Short-term loans and advances					
(vi) Other Current assets					
<b>Total</b>					



**Note :** Only important heads of balance sheet are included so that students can undertake analysis and interpretation easily. No additional information is expected from students. The detailed study about structure of balance sheet is done in the previous chapter.

**Analysis of balance sheet :** There are two important components of balance sheet.

(1) Equity and liabilities and

(2) Assets

In the context of interpretation about these two components, following explanation can be given. This explanation makes the interpretation process simple.

Sr.No.	Equity and Liabilities	Assets
1.	It shows sources of finance.	It shows application of finance.
2.	It shows that from where finance is created.	It shows that where finance is applied.
3.	It is known as procurment of funds.	It shows investment in assets.
4.	Increase in amount shows addition in funds.	Increase in amount shows additional investment.
5.	Reduction in amount shows refund of funds or reduction in provisions.	Reduction in amount shows reduction in non-current assets or current assets.

**What is Disclosed by Balance Sheet Analysis ?** Balance sheet provides the information about the solvency status of the business enterprise. As compared to the previous long-term and short-term solvency of the business entity the current solvency is increased or decreased, can be known with the help of comparative balance sheet.

This is discussed in detail in the chapter of ratio analysis. Besides, the status of business expansion also is ascertained with the help of the analysis of balance sheet.

In brief, during two periods how much (i) Share capital, (ii) Reserves and surplus, (iii) Non-current liabilities, (iv) Current liabilities as well as (i) Non-current assets, (ii) Current assets are changed (increase/decrease) in terms of rupee and percentage can be ascertained from comparative balance sheets.

Whether the trend of all the components of comparative balance sheet is

- fixed
- flexible
- decreasing
- increasing etc. can be known through comparative balance sheet.

**Illustration 7 :** From balance sheets of Start up India Co. Ltd. of 31-3-2016 and 31-3-2017, prepare comparative balance sheet.

**Balance Sheet as on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
<b>(I) Equity and Liabilities :</b>			
(1) Shareholders' fund :			
(a) Share capital			
(i) Equity share capital		12,00,000	10,00,000
(ii) Preference share capital		5,00,000	5,00,000
(b) Reserves and surplus			
Profit-loss account		1,80,000	1,00,000
(2) Non-current liabilities			
10 % debentures		2,50,000	2,00,000
(3) Current liabilities			
(i) Short-term borrowings		62,500	50,000
(ii) Trade payable		40,000	40,000
(iii) Short-term provisions		72,000	60,000
<b>Total</b>		<b>23,04,500</b>	<b>19,50,000</b>
<b>(II) Assets :</b>			
(1) Non-current assets :			
(a) Fixed assets			
(i) Tangible assets		10,00,000	8,00,000
(ii) Intangible assets		6,25,000	5,00,000
(b) Long-term investments		3,79,500	4,00,000
(2) Current assets		3,00,000	2,50,000
<b>Total</b>		<b>23,04,500</b>	<b>19,50,000</b>

**Ans. :**

**Comparative Balance Sheet of Start Up India Co. Ltd. as on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2016 (₹)	31-3-2017 (₹)	Increase/ Decrease (₹)	Increase/ Decrease (%)
1	2	3	4	5(4 - 3)	6 ( $\frac{5}{3} \times 100$ )
<b>(I) Equity and Liabilities :</b>					
(1) Shareholders' funds :					
(a) Share capital					
(i) Equity share capital		10,00,000	12,00,000	2,00,000	20
(ii) Preference share capital		5,00,000	5,00,000	—	—
(b) Reserves and surplus					
Profit-loss account		1,00,000	1,80,000	80,000	80

Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 – 3)	Increase/ Decrease (%) 6 $\left(\frac{5}{3} \times 100\right)$
(2) Non-current liabilities					
10 % debentures		2,00,000	2,50,000	50,000	25
(3) Current liabilities					
(i) Short-term borrowings		50,000	62,500	12,500	25
(ii) Trade payables		40,000	40,000	—	—
(iii) Short-term provisions		60,000	72,000	12,000	20
<b>Total</b>		<b>19,50,000</b>	<b>23,04,500</b>	<b>3,54,500</b>	<b>18.18</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets		8,00,000	10,00,000	2,00,000	25
(ii) Intangible assets		5,00,000	6,25,000	1,25,000	25
(b) Long-term investments		4,00,000	3,79,500	(20,500)	(5.13)
(2) Current assets :		2,50,000	3,00,000	50,000	20
<b>Total</b>		<b>19,50,000</b>	<b>23,04,500</b>	<b>3,54,500</b>	<b>18.18</b>

**Note :** Reduced amount is shown in bracket. It shows negative trend.

**Explanation :** (1) Balance sheet has two sides : Equity-liabilities and Assets. From where funds are raised and where funds are applied respectively can be seen from balance sheet. Thus total of both the sides remain identical. Likewise the total amount of changes of liability side and total amount of changes of assets side also remains identical. (2) If the change is negative, it will be negative on both the sides and if it is positive, it will be positive on both the sides. Here the change is of ₹ 3,54,500, which is a positive change. It indicates an increase in the current year as compared to the previous year. Both the sides it is ₹ 3,54,500. (3) The change in percentage form and is also equal at both the sides. Here the change in percentage form is 18.18 %. (4) The process of analysis is from the left side to the right side. Thus, it is known as the horizontal analysis.

**Illustration 8 :** The balance sheet of Skill India Company Ltd. as at 31-3-2016 and 31-3-2017 are as follows. Prepare comparative balance sheet.

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
<b>(I) Equity and Liabilities :</b>			
(1) Shareholders' funds :			
(a) Share capital			
(i) Equity Share capital		30,00,000	25,00,000
(ii) Preference Share capital		10,00,000	15,00,000



Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 $(\frac{5}{3} \times 100)$
(2) Non-current liabilities					
10 % bank loan		10,00,000	12,00,000	2,00,000	20
(3) Current liabilities					
(i) Short-term borrowings		3,00,000	1,50,000	(1,50,000)	(50)
(ii) Trade payables		1,00,000	70,000	(30,000)	(30)
(iii) Other Current liabilities		1,00,000	1,80,000	80,000	80
<b>Total</b>		<b>68,00,000</b>	<b>65,00,000</b>	<b>(3,00,000)</b>	<b>(4.411)</b>
(II) Assets :					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible :					
Land-Building		20,00,000	13,50,000	(6,50,000)	(32.5)
Machines		18,00,000	22,50,000	4,50,000	25
(ii) Intangible :					
Patent		12,00,000	14,00,000	2,00,000	16.67
(b) Non-current investments		8,00,000	10,00,000	2,00,000	25
(2) Current assets :					
(i) Materials		4,00,000	2,00,000	(2,00,000)	(50)
(ii) Current investments		3,00,000	1,50,000	(1,50,000)	(50)
(iii) Trade receivables		2,00,000	50,000	(1,50,000)	(75)
(iv) Cash - cash equivalent		1,00,000	1,00,000	—	—
<b>Total</b>		<b>68,00,000</b>	<b>65,00,000</b>	<b>(3,00,000)</b>	<b>(4.411)</b>

#### Illustrations of balancing figures for comparative statements :

Two types of balancing figures are required to calculate :

- (1) To find out amount and change in amount of current year on the basis of amount and percentage change of previous year. The following formula can be used.

$$\text{Amount of current year} = \text{Amount of previous year} \times \frac{(100 + \text{change in percentage})}{100} \text{ or}$$

$$\text{Change in amount} = \text{Amount of previous year} \times \frac{\text{change in percentage}}{100}$$

- (2) To find out amount and change in amount of previous year on the basis of amount and percentage change of current year. The following formulas can be used.

$$\text{Amount of previous year} = \text{Amount of current year} \times \frac{100}{(100 + \text{change in percentage})} \text{ or}$$

$$\text{Change in amount} = \text{Amount of current year} \times \frac{\text{change in percentage}}{(100 + \text{change in percentage})}$$



**Illustration 9 :** Find out balancing figures of comparative statement of Firoz Ltd. and prepare new comparative statement.

Particulars  1	Note No.  2	31-3-2016 (₹)  3	31-3-2017 (₹)  4	Increase/ Decrease (₹)  5(4 – 3)	Increase/ Decrease (%)  6 $\left(\frac{5}{3} \times 100\right)$
(I) Sales revenue		7,20,000	?	?	35
(II) Expenses :					
(i) Purchase		4,00,000	?	?	100
(ii) Changes in stock		40,000	?	?	(200)
(iii) Depreciation		40,000	?	?	55
<b>Total Expenses</b>		<b>4,80,000</b>	<b>?</b>	<b>?</b>	<b>71.25</b>
(III) Profit before tax		2,40,000	?	?	(37.50)
(IV) Less : Income tax (30 %)		72,000	?	?	(37.50)
(V) Profit after tax		<b>1,68,000</b>	<b>?</b>	<b>?</b>	<b>(37.50)</b>

**Ans. :**

**Note :** The balancing figures are to be ascertained on the basis of amount and change in percentage of previous year.

$$\text{Amount of current year} = \text{Amount of previous year} \times \frac{(100 + \text{change in percentage})}{100}$$

$$(i) \text{ Sales revenue} = 7,20,000 \times \frac{(100 + 35)}{100} = ₹ 9,72,000$$

$$(ii) \text{ Purchase} = 4,00,000 \times \frac{(100 + 100)}{100} = ₹ 8,00,000$$

$$(iii) \text{ Stock} = 40,000 \times \frac{(100 - 200)}{100} = ₹ (-40,000)$$

$$(iv) \text{ Depreciation} = 40,000 \times \frac{(100 + 55)}{100} = ₹ 62,000$$

$$(v) \text{ Profit before tax} = 2,40,000 \times \frac{(100 - 37.5)}{100} = ₹ 1,50,000$$

$$(vi) \text{ Income tax} = 72,000 \times \frac{(100 - 37.5)}{100} = ₹ 45,000$$

$$(vii) \text{ Profit after tax} = 1,68,000 \times \frac{(100 - 37.5)}{100} = ₹ 1,05,000$$

**Comparative Profit-Loss Statement of Firoz Ltd. for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 $\left(\frac{5}{3} \times 100\right)$
(I) Sales revenue		7,20,000	9,72,000	2,52,000	35
(II) Expenses :					
(i) Purchase		4,00,000	8,00,000	4,00,000	100
(ii) Changes in stock		40,000	(40,000)	(80,000)	(200)
(iii) Depreciation		40,000	62,000	22,000	55
<b>Total Expenses</b>		<b>4,80,000</b>	<b>8,22,000</b>	<b>3,42,000</b>	<b>71.25</b>
(III) Profit before tax		2,40,000	1,50,000	(90,000)	(37.5)
(IV) Less : Income tax (30 %)		72,000	45,000	(27,000)	(37.5)
(V) Profit after tax		<b>1,68,000</b>	<b>1,05,000</b>	<b>(63,000)</b>	<b>(37.5)</b>

**Illustration 10 :** Complete the comparative profit and loss statements of Dolly Limited for the year ending on 31-3-2016 and 31-3-2017.

Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 $\left(\frac{5}{3} \times 100\right)$
(I) Sales revenue		?	10,00,000	?	25
(II) Other income		?	4,00,000	?	100
(III) <b>Total income (I + II)</b>		<b>?</b>	<b>14,00,000</b>	<b>?</b>	<b>40</b>
(IV) Expenses		?	4,00,000	?	100
(V) Profit before tax		?	10,00,000	?	25
(VI) Less : Income tax (30 %)		?	3,00,000	?	25
(VII) Profit after tax		<b>?</b>	<b>7,00,000</b>	<b>?</b>	<b>25</b>

**Note :** The balancing figures are to be ascertained on the basis of amount and change in percentage of current year.

$$\text{Amount of previous year} = \text{Amount of current year} \times \frac{100}{(100 + \text{change in percentage})}$$

$$(i) \text{ Sales revenue} = 10,00,000 \times \frac{100}{(100 + 25)} = ₹ 8,00,000$$

$$(ii) \text{ Other income} = 4,00,000 \times \frac{100}{(100 + 100)} = ₹ 2,00,000$$

- (iii) Total income  $= 14,00,000 \times \frac{100}{(100 + 40)} = ₹ 10,00,000$
- (iv) Expenses  $= 4,00,000 \times \frac{100}{(100 + 100)} = ₹ 2,00,000$
- (v) Profit before tax  $= 10,00,000 \times \frac{100}{(100 + 25)} = ₹ 8,00,000$
- (vi) Income tax  $= 3,00,000 \times \frac{100}{(100 + 25)} = ₹ 2,40,000$
- (vii) Profit after tax  $= 7,00,000 \times \frac{100}{(100 + 25)} = ₹ 5,60,000$

or

$$\text{Amount of change} = \text{Amount of current year} \times \frac{\text{Change in percentage}}{(100 + \text{Change in percentage})}$$

$$\text{Sales revenue} = 10,00,000 \times \frac{25}{125} = ₹ 2,00,000$$

$$\begin{aligned} \therefore \text{Amount of previous year} &= \text{Amount of current year} - \text{Amount of change} \\ &= 10,00,000 - 2,00,000 \\ &= ₹ 8,00,000 \end{aligned}$$

The amount of each component can be calculated as mentioned above.

**Comparative Profit and Loss Statements of Dolly Limited  
for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2016 (₹)	31-3-2017 (₹)	Increase/ Decrease (₹)	Increase/ Decrease (%)
1	2	3	4	5(4 - 3)	6 ( $\frac{5}{3} \times 100$ )
(I) Sales revenue		8,00,000	10,00,000	2,00,000	25
(II) Other income		2,00,000	4,00,000	2,00,000	100
(III) <b>Total income</b>		<b>10,00,000</b>	<b>14,00,000</b>	<b>4,00,000</b>	<b>40</b>
(IV) Expenses		2,00,000	4,00,000	2,00,000	100
(V) Profit before tax		8,00,000	10,00,000	2,00,000	25
(VI) Less : Income tax		2,40,000	3,00,000	60,000	25
(VII) Profit after tax		<b>5,60,000</b>	<b>7,00,000</b>	<b>1,40,000</b>	<b>25</b>

**Illustration 11** : Complete the comparative statement of balance sheets of Reshma Company Limited for the year ending on 31-3-2016 and 31-3-2017.

Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 $\left(\frac{5}{3} \times 100\right)$
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital					
(i) Equity share capital		?	12,00,000	?	20
(ii) Preference share Capital		?	10,50,000	?	50
(b) Reserves and surplus		?	5,00,000	?	66.67
(2) Non-current liabilities					
10 % debentures		?	4,50,000	?	12.5
(3) Current liabilities		?	2,00,000	?	33.33
<b>Total</b>		<b>?</b>	<b>34,00,000</b>	<b>?</b>	<b>33.33</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets		12,00,000	?	?	41.67
(ii) Intangible assets		11,00,000	?	?	18.18
(2) Current assets		2,50,000	?	?	60
<b>Total</b>		<b>25,50,000</b>	<b>?</b>	<b>?</b>	<b>33.33</b>

**Ans. :**

- (I) Equity and liabilities side : The balancing figures are to be ascertained on the basis of amount and change in percentage of current year.

$$\text{Amount of previous year} = \text{Amount of current year} \times \frac{100}{(100 + \text{Change in percentage})}$$

$$(i) \text{ Equity Share capital} = 12,00,000 \times \frac{100}{100 + 20} = ₹ 10,00,000$$

$$(ii) \text{ Preference Share capital} = 10,50,000 \times \frac{100}{100 + 50} = ₹ 7,00,000$$

$$(iii) \text{ Reserves and surplus} = 5,00,000 \times \frac{100}{100 + 66.66} = ₹ 3,00,000$$

$$(iv) \text{ 10 \% debentures} = 4,50,000 \times \frac{100}{100 + 12.50} = ₹ 4,00,000$$

$$(v) \text{ Current liabilities} = 2,00,000 \times \frac{100}{100 + 33.33} = ₹ 1,50,000$$

- (II) Assets side : The balancing figures are to be ascertained on the basis of amount of previous year and change in percentage.

$$\text{Amount of current year} = \text{Amount of previous year} \times \frac{(100 + \text{Change in percentage})}{100}$$

(i) Tangible assets  $= 12,00,000 \times \frac{(100 + 41.66...)}{100} = ₹ 17,00,000$

(ii) Intangible assets  $= 11,00,000 \times \frac{(100 + 18.1818...)}{100} = ₹ 13,00,000$

(iii) Current assets  $= 2,50,000 \times \frac{(100 + 60)}{100} = ₹ 4,00,000$

**Comparative Balance Sheets of Reshma Company Ltd.**

**as on 31-3-2016 and 31-3-2017**

Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 $(\frac{5}{3} \times 100)$
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital					
(i) Equity share capital		10,00,000	12,00,000	2,00,000	20
(ii) Preference share capital		7,00,000	10,50,000	3,50,000	50
(b) Reserves and surplus		3,00,000	5,00,000	2,00,000	66.67
(2) Non-current liabilities					
10 % debentures		4,00,000	4,50,000	50,000	12.5
(3) Current liabilities		1,50,000	2,00,000	50,000	33.33
<b>Total</b>		<b>25,50,000</b>	<b>34,00,000</b>	<b>8,50,000</b>	<b>33.33</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets		12,00,000	17,00,000	5,00,000	41.67
(ii) Intangible assets		11,00,000	13,00,000	2,00,000	18.18
(2) Current assets		2,50,000	4,00,000	1,50,000	60
<b>Total</b>		<b>25,50,000</b>	<b>34,00,000</b>	<b>8,50,000</b>	<b>33.33</b>

**Illustration 12 :** Complete comparative balance sheets of Bharat Company Ltd. for the year ending on 31-3-2016 and 31-3-2017.



Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 $\left(\frac{5}{3} \times 100\right)$
<b>(I) Equity and Liabilities :</b>					
(1) Shareholders' funds :					
(a) Share capital		15,00,000	?	?	(20)
(b) Reserves and surplus		6,00,000	?	?	33.33
(2) Non-current liabilities					
Bank loan		8,00,000	?	?	(25)
(3) Current liabilities		2,00,000	?	?	25
<b>Total</b>		<b>31,00,000</b>	<b>?</b>	<b>?</b>	<b>?</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets		?	8,00,000	?	(33.33)
(ii) Intangible assets		?	8,00,000	?	33.33
(b) Non-current investments		?	8,50,000	?	(15)
(2) Current assets		?	4,00,000	?	33.33
<b>Total</b>		<b>?</b>	<b>28,50,000</b>	<b>?</b>	<b>?</b>

**Ans. :**

- (I) Equity-liabilities side : The balancing figures are to be ascertained on the basis of amount and change in percentage of previous year.

$$\text{Amount of current year} = \text{Amount of previous year} \times \frac{(100 + \text{Change in percentage})}{100}$$

$$(i) \text{ Share capital} = 15,00,000 \times \frac{(100 + (-20))}{100} = ₹ 12,00,000$$

$$(ii) \text{ Reserves and surplus} = 6,00,000 \times \frac{(100 + 33.33)}{100} = ₹ 8,00,000$$

$$(iii) \text{ Non-current liabilities} = 8,00,000 \times \frac{(100 + (-25))}{100} = ₹ 6,00,000$$

$$(iv) \text{ Current liabilities} = 2,00,000 \times \frac{(100 + 25)}{100} = ₹ 2,50,000$$

- (II) Assets side : The balancing figures are to be ascertained on the basis of amount and change in percentage of current year.

$$\text{Amount of previous year} = \text{Amount of current year} \times \frac{100}{(100 + \text{Change in percentage})}$$

$$(i) \text{ Tangible assets} = 8,00,000 \times \frac{100}{100 + (-33.33)} = ₹ 12,00,000$$

$$(ii) \text{ Intangible assets} = 8,00,000 \times \frac{100}{100 + 33.33} = ₹ 6,00,000$$

$$(iii) \text{ Non-current investments} = 8,50,000 \times \frac{100}{100 + (-15)} = ₹ 10,00,000$$

$$(iv) \text{ Current assets} = 4,00,000 \times \frac{100}{100 + 33.33} = ₹ 3,00,000$$

**Comparative Balance Sheets of Bharat Company Ltd.**  
**as on 31-3-2016 and 31-3-2017**

Particulars 1	Note No. 2	Previous Year (₹) 3	Current Year (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 $(\frac{5}{3} \times 100)$
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital		15,00,000	12,00,000	(3,00,000)	(20)
(b) Reserves and surplus		6,00,000	8,00,000	2,00,000	33.33
(2) Non-current liabilities					
Bank loan		8,00,000	6,00,000	(2,00,000)	25
(3) Current liabilities		2,00,000	2,50,000	50,000	(20)
<b>Total</b>		<b>31,00,000</b>	<b>28,50,000</b>	<b>(2,50,000)</b>	<b>(8.06)</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets		12,00,000	8,00,000	(4,00,000)	(33.33)
(ii) Intangible assets		6,00,000	8,00,000	2,00,000	33.33
(b) Non-current investments		10,00,000	8,50,000	(1,50,000)	(15)
(2) Current assets		3,00,000	4,00,000	1,00,000	33.33
<b>Total</b>		<b>31,00,000</b>	<b>28,50,000</b>	<b>(2,50,000)</b>	<b>(8.06)</b>

### 15. Common Size Statements

The analysis of financial statements can be done through this tool also. Profit and loss statements and balance sheets of two years or more than two years can be compared with the financial statements of current year with the help of this method. Under this method the profit and loss statements of the current year are compared with the profit and loss statements of the previous years and the balance sheet of the current year is compared with the balance sheet of the previous years. This analysis is a vertical analysis.

Under this method one base is used. 100 is considered as the base. Net sales is the base for profit and loss statement. The main objective of every business unit is to earn maximum profit. The enhancement in profit is based on maximum sales and minimum cost. For generation of sales, expenses are incurred.

What is the proportion for each expense of sales can be availed from this analysis. Under this method the statements of two years are used, therefore it can be ascertained whether the proportion of expenses against sales is increased or reduced or remained stable ? Necessary causes are identified if the proportion of expenses is increased against the sales and necessary actions are taken so that the objective of maximization of profit can be achieved. Sales = 100 % is used for the profit and loss statement of every year. Here the percentage of all the items of profit and loss statement with sales are determined. e.g. During 2016 the sales is ₹ 20 lakhs. The purchase is of ₹ 8 lakhs and the other expenses are of ₹ 4 lakhs. So, here, the percentage of purchase and the other expenses with sales will be  $(\frac{8}{20} \times 100 = 40\%$  for purchase),  $(\frac{4}{20} \times 100 = 20\%$  for other expenses) 40 % and 20 % respectively. Assume sales of 2017 is ₹ 18 lakhs. Where the purchase and the other expenses are ₹ 6 lakhs and 3 lakhs respectively. The percentage against sales will be  $(\frac{6}{18} \times 100 = 33\frac{1}{3}\%$  and  $\frac{3}{18} \times 100 = 16.67\%$ ) 33 $\frac{1}{3}\%$  and 16.67 % respectively for purchase and other expenses.

In case of balance sheet as a base, the total of balance sheet is considered. This total is assumed 100 %. The total of balance sheet of every year has the base of 100 %. e.g. the total of the assets side of 2016 is ₹ 50 lakhs. Where non-current assets are of ₹ 35 lakhs and the current assets are of ₹ 15 lakhs, the percentage respectively are 70 % and 30 % ( $\frac{35}{50} \times 100 = 70\%$  and  $\frac{15}{50} \times 100 = 30\%$ ). If the total of 2017 is of ₹ 55 lakhs and the non-current assets are of ₹ 35 lakhs and the current assets are of 20 lakhs, their proportion will be  $(\frac{35}{55} \times 100 = 63.64\%$  and  $\frac{20}{55} \times 100 = 36.36\%$ ) 63.64 % and 36.36 % respectively.

**The Structure of Common Size Statement :** This statement also has six columns like comparative statement. In the first column the information of different components of profit and loss statement and balance sheet are disclosed.

The third and the fourth columns disclose the amount of expenses / revenues / liabilities / assets of the previous and the current years.

In the fifth and sixth columns of profit and loss statements, the percentage of revenues / expenses of two years are calculated and disclosed. In the same manner in case of balance sheet the percentage of assets / liabilities of two years are calculated and disclosed. The difference between these two percentages of two years are used for the analysis and interpretation.

The formula to determine percentage :

$$(1) \text{ For profit and loss statement : } \frac{\text{Amount of expense / revenue}}{\text{Amount of net sales}} \times 100$$

$$(2) \text{ For balance sheet : } \frac{\text{Amount of liability / assets}}{\text{Total of balance sheet}} \times 100$$

**Common size statement of profit and loss statement :** The structure for this is given below. All details of profit and loss statements are disclosed as it is. The amounts of two years are disclosed. The comparison is feasible if the information of two or more than two years is available. As stated earlier the percentage of every revenue and expenses to sales are calculated and disclosed. Here, the proportion is determined in the vertical form. This will be clarified from illustration no. 13.

The specimen of common size statement of profit and loss statement :

**Common Size Statement of Profit and Loss Statement for the Year Ending on ..... and .....**

Particulars	Note No.	Amount (₹)		Percentage to Sales	
		Figures of previous year (₹)	Figures of current year (₹)	Percentage of previous year	Percentage of current year
(I) Sales revenue					
(II) Other income					
(III) Total income (I + II)					
(IV) Expenses :					
(i) Cost of goods sold					
(ii) Net purchase for resale					
(iii) Changes in stock					
(iv) Employees' benefit expenses					
(v) Financial cost					
(vi) Depreciation and amortized amount					
(vii) Other expenses					
<b>Total Expenses</b>					
(V) Profit before tax					
(VI) Less : Income tax					
(VII) Profit after tax					

**Illustration 13 :** Prepare common size profit and loss statement from the given profit and loss statement.

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
(I) Sales revenue		37,50,000	30,00,000
(II) Expenses :			
(i) Purchase for resale		20,62,500	15,00,000
(ii) Employees' benefit expenses		2,50,000	3,00,000
(iii) Financial expenses		2,25,000	1,80,000
(iv) Depreciation and amortized amount		3,00,000	2,70,000
<b>Total Expenses</b>		<b>28,37,500</b>	<b>22,50,000</b>
(III) Profit before tax		9,12,500	7,50,000
(IV) Less : Income tax 30 %		2,73,750	2,25,000
(V) Profit after tax		<b>6,38,750</b>	<b>5,25,000</b>

Ans. :

**Common Size Statements of Profit and Loss Statement  
for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	Amount (₹)		Percentage to Sales	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016	31-3-2017
(I) Sales revenue		30,00,000	37,50,000	100	100
(II) Expenses :					
(i) Net purchase for resale		15,00,000	20,62,500	50	55
(ii) Employee benefit Expenses		3,00,000	2,50,000	10	6.67
(iii) Financial cost		1,80,000	2,25,000	6	6
(vi) Depreciation and amount amortized		2,70,000	3,00,000	9	8
<b>Total Expenses</b>		<b>22,50,000</b>	<b>28,37,500</b>	<b>75</b>	<b>75.67</b>
(III) Profit before tax		7,50,000	9,12,500	25	24.33
(IV) Less : Income tax 30 %		2,25,000	2,73,750	7.5	7.30
(V) <b>Profit after tax</b>		<b>5,25,000</b>	<b>6,38,750</b>	<b>17.5</b>	<b>17.03</b>

**Note :** In this illustration no other incomes are given except sales revenue. Thus, the total percentages of expenses and percentage of profit before tax will be equal to 100 % (In 2016  $75 + 25 = 100$  and in 2017  $75.67 + 24.33 = 100$ ). If other incomes along with sales are given, the total will not be equal to 100 %. This is explained in the subsequent illustration.

**Explanation :** (1) Purchase for resale : This expense is increased by 5 % as compared to the previous year. This increase in the expense affect the profit and the profit get decreased. Necessary steps are taken, to arrest the increase in the expense.

(2) The percentage in employee benefit expenses : Depreciation and amount amortized are reduced. Due to the reduction in the expense, the profit is increased. No change in the percentage of the financial cost.

(3) There is an insignificant increase in the total expenses by 0.67 %.

(4) Since the proportion of expenses is increased, the profit is reduced. Consequently, the percentage of tax also is reduced from 7.5 % to 7.3 %.

(5) Finally, the percentage of profit after tax is reduced due to the increase in the proportion of expense. The profit after tax is reduced from 17.5 % to 17.03 %.

The above stated analysis can be done as per the common size profit and loss statement.

**Illustration 14 :** The profit and loss statements of two years of Himani Limited are given as follows.

On the basis of these statements, prepare common size profit and loss statements.



Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
(I) Sales revenue		32,00,000	28,00,000
(II) Other income		6,00,000	4,00,000
(III) <b>Total income</b>		<b>38,00,000</b>	<b>32,00,000</b>
(IV) Expenses :			
(i) Cost of goods consumed		16,80,000	14,50,000
(ii) Net purchase for resale		3,00,000	2,80,000
(iii) Changes in stock		(70,000)	3,70,000
(iv) Employees' benefit expense		2,00,000	1,80,000
(v) Financial cost		1,40,000	90,000
(vi) Depreciation and amount amortized		1,00,000	1,00,000
<b>Total expenses</b>		<b>23,50,000</b>	<b>24,70,000</b>
(V) Profit before tax		14,50,000	7,30,000
(VI) Less : Income tax 30 %		4,35,000	2,19,000
(VII) Profit after tax		<b>10,15,000</b>	<b>5,11,000</b>

Ans. :

**Common Size Profit and Loss Statement for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	Amount (₹)		Percentage to Sales	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016	31-3-2017
(I) Sales revenue		28,00,000	32,00,000	100	100
(II) Other income		4,00,000	6,00,000	14.29	18.75
(III) <b>Total income</b>		<b>32,00,000</b>	<b>38,00,000</b>	<b>114.29</b>	<b>118.75</b>
(IV) Expenses :					
(i) Cost of goods consumed		14,50,000	16,80,000	51.79	52.50
(ii) Net purchase for resale		2,80,000	3,00,000	10.00	9.38
(iii) Changes in stock		3,70,000	(70,000)	13.21	(2.19)
(iv) Employees' benefit expense		1,80,000	2,00,000	6.43	6.25
(v) Financial cost		90,000	1,40,000	3.21	4.38
(vi) Depreciation and amount amortized		1,00,000	1,00,000	3.57	3.13
<b>Total expenses</b>		<b>24,70,000</b>	<b>23,50,000</b>	<b>88.21</b>	<b>73.44</b>
(V) Profit before tax		7,30,000	14,50,000	26.07	45.31
(VI) Less : Income tax 30 %		2,19,000	4,35,000	7.82	13.59
(VII) <b>Profit after tax</b>		<b>5,11,000</b>	<b>10,15,000</b>	<b>18.25</b>	<b>31.72</b>

**Note :** (1) The percentage of the other income is also ascertained against sales.

(2) The changes in stock is (–70,000). It indicates that the closing stock is higher than the opening stock. The closing stock is always credited to trading account, which reduces the cost.

(3) Other incomes are included in the profit before income tax as the sales and other incomes are given in this illustration.

Particulars	2016	2017
Profit before tax	7,30,000	14,50,000 (including other income)
– Other income	4,00,000	6,00,000
Profit before tax	3,30,000	8,50,000 (excluding other income)
÷ Sales × 100	28,00,000	32,00,000
Percentage of profit before income	11.79	26.56
+ Total percentage of expenses	88.21	73.44
Total percentage	100	100

Therefore, the total of the percentage of the total expense and the percentage of net profit before tax is not 100 %. The explanation regarding this is as under.

**Common Size Statement of Balance Sheet :** Its structure is as follows. All the details of balance sheet are disclosed as it is. The amount of two years are disclosed. The comparison is possible only if the details of two or more than two years are available. The total of balance sheet is considered as the base, and liabilities and assets of respective year are disclosed in their proportion to total of balance sheet. Here, the proportions are determined in vertical form. This will be clarified from illustration no. 15.

Format of common size statement of balance sheet.

**Common Size Statement of Balance Sheets as on ..... and .....**

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		Figures of previous year (₹)	Figures of current year (₹)	Percentage of previous year	Percentage of current year
(I) <b>Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital					
(i) Equity share capital					
(ii) Preference share capital					
(b) Reserves and surplus					
(2) Non-current liabilities					
(i) Long-term borrowings					
(ii) Long-term provisions					

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		Figures of previous year (₹)	Figures of current year (₹)	Percentage of previous year	Percentage of current year
(3) Current liabilities					
(i) Short-term payables					
(ii) Trade payables					
(iii) Other current liabilities					
(iv) Short-term provisions					
<b>Total</b>					
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets					
(ii) Intangible assets					
(b) Non-current investments					
(c) Long-term loan and advance					
(2) Current assets :					
(i) Current assets					
(ii) Stock					
(ii) Trade receivables					
(iv) Cash - cash equivalent					
(v) Short-term loan and advances					
(vi) Other Current assets					
<b>Total</b>					

**Illustration 15 :** From the following given abridge balance sheet as on 31-3-2016 and 31-3-2017.  
Prepare common size statement of balance sheet.

**Balance Sheet as on 31-3-2016 and 31-3-2017**

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
<b>(I) Equity and Liabilities</b>			
(1) Shareholders' funds :			
(a) Share capital		8,00,000	12,00,000
(b) Reserves and surplus		4,00,000	3,00,000
(2) Non-current liabilities			
Long-term borrowings		6,00,000	4,00,000
(3) Current liabilities			
Trade payables		2,00,000	1,00,000
<b>Total</b>		<b>20,00,000</b>	<b>20,00,000</b>

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
<b>(II) Assets :</b>			
(1) Non-current assets :			
Fixed assets – tangible assets		16,00,000	18,00,000
(2) Current assets :			
(i) Stock		2,50,000	1,25,000
(ii) Cash and cash equivalent		1,50,000	75,000
<b>Total</b>		<b>20,00,000</b>	<b>20,00,000</b>

Ans. :

**Common Size Statements of Balance Sheet as on 31-3-2016 and 31-3-2017**

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016 (%)	31-3-2017 (%)
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital		12,00,000	8,00,000	60	40
(b) Reserves and surplus		3,00,000	4,00,000	15	20
(2) Non-current liabilities					
Long-term borrowings		4,00,000	6,00,000	20	30
(3) Current liabilities					
Trade payables		1,00,000	2,00,000	05	10
<b>Total</b>		<b>20,00,000</b>	<b>20,00,000</b>	<b>100</b>	<b>100</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
Fixed assets – tangible assets		18,00,000	16,00,000	90	80
(2) Current assets :					
(i) Stock		1,25,000	2,50,000	6.25	12.50
(ii) Cash - cash equivalent		75,000	1,50,000	3.75	7.50
<b>Total</b>		<b>20,00,000</b>	<b>20,00,000</b>	<b>100</b>	<b>100</b>

**Explanation :**

- (1) Total of balance sheet of both the years is identical.
- (2) As compared to the previous year the proportion of share capital is reduced from 60 % to 40 %.
- (3) As compared to the previous year the reserves and surplus, the long-term borrowings and the current liabilities are increased.
- (4) The proportion of the non-current assets is reduced but the proportion of current assets is increased.

Prepare common size statement of balance sheets.

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
<b>(I) Equity and Liabilities</b>			
(1) Shareholders' funds :			
(a) Share capital			
(i) Equity share capital		15,00,000	12,00,000
(ii) Preference share capital		10,00,000	10,00,000
(b) Reserves and surplus			
(i) General reserve		6,00,000	5,00,000
(ii) Profit-loss account		7,00,000	6,00,000
(2) Non-current liabilities			
Long-term borrowings		4,00,000	5,00,000
(3) Current liabilities			
(i) Short-term borrowings		5,00,000	4,00,000
(ii) Other current liabilities		3,00,000	3,00,000
<b>Total</b>		<b>50,00,000</b>	<b>45,00,000</b>
<b>(II) Assets :</b>			
(1) Non-current assets :			
(a) Fixed assets			
(i) Tangible assets : Land-building		12,00,000	8,00,000
Plant-machines		8,00,000	9,00,000
(ii) Intangible assets : Patent		6,00,000	7,00,000
Trademark		9,00,000	7,00,000
(b) Non-current investments		5,00,000	5,00,000
(2) Current assets :			
(i) Current investments		5,00,000	4,00,000
(ii) Stock		3,00,000	3,00,000
(ii) Trade receivables		1,00,000	1,00,000
(iv) Cash and cash equivalent		1,00,000	1,00,000
<b>Total</b>		<b>50,00,000</b>	<b>45,00,000</b>



Ans. :

**Common Size Statement of Balance Sheet of Ahmedabad Limited**  
**as on 31-3-2016 and 31-3-2017**

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016 (%)	31-3-2017 (%)
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital					
(i) Equity share capital		12,00,000	15,00,000	26.67	30.00
(ii) Preference share capital		10,00,000	10,00,000	22.22	20.00
(b) Reserves and surplus					
(i) General reserve		5,00,000	6,00,000	11.11	12.00
(ii) Profit-loss account		6,00,000	7,00,000	13.33	14.00
(2) Non-current liabilities					
Long-term borrowings		5,00,000	4,00,000	11.11	8.00
(3) Current liabilities					
(i) Short-term borrowings		4,00,000	5,00,000	8.89	10.00
(ii) Other current liabilities		3,00,000	3,00,000	6.67	6.00
<b>Total</b>		<b>45,00,000</b>	<b>50,00,000</b>	<b>100</b>	<b>100</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets :					
Land-building		8,00,000	12,00,000	17.77	24.00
Plant-machines		9,00,000	8,00,000	20.00	16.00
(ii) Intangible assets :					
Patent		7,00,000	6,00,000	15.56	12.00
Trademark		7,00,000	9,00,000	15.56	18.00
(b) Non-current investments		5,00,000	5,00,000	11.11	10.00
(2) Current assets :					
(i) Current investments		4,00,000	5,00,000	8.89	10.00
(ii) Stock		3,00,000	3,00,000	6.67	6.00
(ii) Trade receivables		1,00,000	1,00,000	2.22	2.00
(iv) Cash - cash equivalent		1,00,000	1,00,000	2.22	2.00
<b>Total</b>		<b>45,00,000</b>	<b>50,00,000</b>	<b>100</b>	<b>100</b>

Illustrations of balancing figures for common size statements.

**Illustration 17 :**

**Common Size Profit and Loss Statement of Shri Ram Limited**  
**Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	Amount (₹)		Percentage to sales	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016 (%)	31-3-2017 (%)
(I) Sales revenue		25,00,000	30,00,000	100	100
(II) Expenses :					
(i) Cost of goods consumed		?	?	75	78
(ii) Financial expenses		?	?	9.6	8
(iii) Depreciation		?	?	3	4
<b>Total expenses</b>		<b>21,90,000</b>	<b>27,00,000</b>	<b>87.6</b>	<b>90</b>
(III) Profit before tax		3,10,000	3,00,000	12.4	10
(IV) Less : Income tax 30 %		?	90,000	3.72	3
(V) <b>Profit after tax</b>		<b>?</b>	<b>2,10,000</b>	<b>8.68</b>	<b>7</b>

Complete the above mentioned common size statements.

**Ans. :**

**Explanation :** The sales is the base of all the revenues and expenses for the common size profit and loss statement. The proportion of the other income and expenses to sales is ascertained. It's formula is as follows :

$$\text{Proportion of revenue/expense to sales} = \frac{\text{Amount of revenue/expense in rupees}}{\text{Amount of sales in rupees}} \times 100$$

Here, in place of the amount of expenses their percentages to sales are given. On the basis of percentage, the amount will be determined, This will be calculated as follows :

$$\text{Revenue/expense amount in rupees} = \frac{\text{Net sales} \times \text{Percentage of revenue/expense/tax}}{100}$$

No.	Particulars	2016	2017
(1)	Cost of goods consumed	$\frac{25,00,000 \times 75}{100} = ₹ 18,75,000$	$\frac{30,00,000 \times 78}{100} = ₹ 23,40,000$
(2)	Financial cost	$\frac{25,00,000 \times 9.6}{100} = ₹ 2,40,000$	$\frac{30,00,000 \times 8}{100} = ₹ 2,40,000$
(3)	Depreciation	$\frac{25,00,000 \times 3}{100} = ₹ 75,000$	$\frac{30,00,000 \times 4}{100} = ₹ 1,20,000$
(4)	Income tax	$\frac{25,00,000 \times 3.72}{100} = ₹ 93,000$	—
(5)	Profit after tax	$\frac{25,00,000 \times 8.68}{100} = ₹ 2,17,000$	—

**Common Size Statement of Profit and Loss**  
for the Year Ending on 31-3-2016 and 31-3-2017

Particulars	Note No.	Amount (₹)		Percentage to sales	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016 (%)	31-3-2017 (%)
(I) Sales revenue		25,00,000	30,00,000	100	100
(II) Expenses :					
(i) Cost of goods consumed		18,75,000	23,40,000	75	78
(ii) Financial cost		2,40,000	2,40,000	9.6	8
(iii) Depreciation		75,000	1,20,000	3	4
<b>Total expenses</b>		<b>21,90,000</b>	<b>27,00,000</b>	<b>87.6</b>	<b>90</b>
(III) Profit before tax		3,10,000	3,00,000	12.4	10
(IV) Less : Income tax 30 %		93,000	90,000	3.72	3
(V) <b>Profit after tax</b>		<b>2,17,000</b>	<b>2,10,000</b>	<b>8.68</b>	<b>7</b>

**Illustration 18 :** Following are the common size statement of profit and loss for the year ending on 31-3-2016 and 31-3-2017 of Shahnawaz Limited. Prepare complete common size statement by ascertaining balancing figures.

**Common Size Statement of Profit and Loss for the Year Ending on 31-3-2016 and 31-3-2017**

Particulars	Note No.	Amount (₹)		Percentage to sales	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016 (%)	31-3-2017 (%)
(I) Sales revenue		9,00,000	16,00,000	100	100
(II) Other income		?	2,40,000	10	15
(III) <b>Total income (I + II)</b>		<b>?</b>	<b>18,40,000</b>	<b>110</b>	<b>115</b>
(IV) Expenses :					
(i) Net purchase		?	11,20,000	68	70
(ii) Changes in stock		?	(1,12,000)	(05)	(07)
(iii) Depreciation		?	1,92,000	7	12
(iv) Other expenses		?	1,60,000	8	10
<b>Total expenses</b>		<b>?</b>	<b>13,60,000</b>	<b>78</b>	<b>85</b>
(V) Profit before tax		2,88,000	?	32	30
(VI) Less : Income tax 30 %		86,400	?	9.6	9
(VII) <b>Profit after tax</b>		<b>2,01,600</b>	<b>?</b>	<b>22.4</b>	<b>21</b>

Ans. :

**Explanation :** Necessary calculation :

No.	Particulars	2016	No.	Particulars	2017
(1)	Other income	$\frac{9,00,000 \times 10}{100}$ = ₹ 90,000	(1)	Profit before tax	$\frac{16,00,000 \times 30}{100}$ = ₹ 4,80,000
(2)	Net purchase	$\frac{9,00,000 \times 68}{100}$ = ₹ 6,12,000	(2)	Income tax	$\frac{16,00,000 \times 9}{100}$ = ₹ 1,44,000
(3)	Changes in stock	$\frac{9,00,000 \times (5)}{100}$ = (₹ 45,000)	(3)	Profit after tax	$\frac{16,00,000 \times 21}{100}$ = ₹ 3,36,000
(4)	Depreciation	$\frac{9,00,000 \times 7}{100}$ = ₹ 63,000			
(5)	Other expenses	$\frac{9,00,000 \times 8}{100}$ = ₹ 72,000			
(6)	Total expenses	$\frac{9,00,000 \times 78}{100}$ = ₹ 7,02,000			

**Common Size Statement of Profit and Loss for the Year Ending 31-3-2016 and 31-3-2017  
of Shahnawaz Limited**

Particulars	Note No.	Amount (₹)		Percentage to sales	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016 (%)	31-3-2017 (%)
(I) Sales revenue		9,00,000	16,00,000	100	100
(II) Other income		90,000	2,40,000	10	15
(III) <b>Total income (I + II)</b>		<b>9,90,000</b>	<b>18,40,000</b>	<b>110</b>	<b>115</b>
(IV) Expenses :					
(i) Net purchase		6,12,000	11,20,000	68	70
(ii) Change in stock		(45,000)	(1,12,000)	(05)	(07)
(iii) Depreciation		63,000	1,92,000	7	12
(iv) Other expenses		72,000	1,60,000	8	10
<b>Total expenses</b>		<b>7,02,000</b>	<b>13,60,000</b>	<b>78</b>	<b>85</b>
(V) Profit before tax		2,88,000	4,80,000	32	30
(VI) Less : Income tax 30 %		86,400	1,44,000	9.6	9
(VII) <b>Profit after tax</b>		<b>2,01,600</b>	<b>3,36,000</b>	<b>22.4</b>	<b>21</b>

**Note :** To check whether all the calculations are correct or not, ascertain figure of any component on the basis of amount of another component. e.g. the percentage of net purchase of 2017 is 70 % and which is ₹ 11,20,000. On the basis of the percentage of income tax, the amount of income tax can be determined as follows :

$$= \frac{\text{Amount of net purchase}}{\text{Percentage of net purchase}} \times \text{Percentage of income tax}$$

$$= \frac{11,20,000}{70} \times 9 = ₹ 1,44,000$$

Likewise the amount of depreciation can be calculated.

$$= \frac{11,20,000}{70} \times 12 = ₹ 1,92,000$$

**Illustration 19 :** The common size balance sheets as at 31-3-2016 and 31-3-2017 with balancing figures of Amarnath Limited are as follows. Ascertain balancing figures and complete common size balance sheet.

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016 (₹)	31-3-2017 (₹)	31-3-2016 (%)	31-3-2017 (%)
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital		14,00,000	?	50	50
(b) Reserves and surplus		3,50,000	?	12.5	10
(2) Non-current liabilities					
Long-term borrowings		7,00,000	?	25	30
(3) Current liabilities					
(i) Trade payables		2,00,000	?	7.14	8
(ii) Other liabilities		1,50,000	?	5.36	2
<b>Total</b>		<b>28,00,000</b>	<b>42,00,000</b>	<b>100</b>	<b>100</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets		?	20,00,000	45	47.62
(ii) Intangible assets		?	15,70,000	40	37.38
(2) Current assets :					
(i) Trade receivables		?	5,00,000	10	11.90
(ii) Cash and cash equivalent		?	1,30,000	5	3.10
<b>Total</b>		<b>28,00,000</b>	<b>42,00,000</b>	<b>100</b>	<b>100</b>

**Explanation :** The total of balance sheet is the base of all assets and liabilities for common size balance sheets. The proportion of the assets and liabilities is ascertained as the total of balance sheet. It's formula is as follows :

$$\text{Proportion liabilities/assets to total of balance sheet} = \frac{\text{Amount of liability in rupee/asset}}{\text{Amount of total of balance sheet in rupee}} \times 100$$



Here, in place of amount, their percentage to total of balance sheet are given. On the basis of percentage the amount will be determined. This will be calculated as follows :

Amount of liability/assets of respective year =

$$\frac{\text{Total of balance sheet of respective year} \times \text{Percentage of respective liability/asset}}{100}$$

100

**Ans. :**

**Explanation :** Necessary calculation :

No.	Particulars	2017 (Equity-liabilities side)	No.	Particulars	2016 (Assets side)
(1)	Share capital	$\frac{42,00,000 \times 50}{100}$ = ₹ 21,00,000	(1)	Tangible assets	$\frac{28,00,000 \times 45}{100}$ = ₹ 12,60,000
(2)	Reserves and surplus	$\frac{42,00,000 \times 10}{100}$ = ₹ 4,20,000	(2)	Intangible assets	$\frac{28,00,000 \times 40}{100}$ = ₹ 11,20,000
(3)	Long-term borrowings	$\frac{42,00,000 \times 30}{100}$ = ₹ 12,60,000	(3)	Trade receivables	$\frac{28,00,000 \times 10}{100}$ = ₹ 2,80,000
(4)	Trade payables	$\frac{42,00,000 \times 8}{100}$ = ₹ 3,36,000	(4)	Cash and cash equivalent	$\frac{28,00,000 \times 5}{100}$ = ₹ 1,40,000
(5)	Other liabilities	$\frac{42,00,000 \times 2}{100}$ = ₹ 84,000			

### Common Size Balance Sheet

as on 31-3-2016 and 31-3-2017 of Amarnath Limited

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016	31-3-2017	31-3-2016	31-3-2017
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital		14,00,000	21,00,000	50	50
(b) Reserves and surplus		3,50,000	4,20,000	12.5	10
(2) Non-current liabilities					
Long-term borrowings		7,00,000	12,60,000	25	30
(3) Current liabilities					
(i) Trade payables		2,00,000	3,36,000	7.14	8
(ii) Other liabilities		1,50,000	84,000	5.36	2
<b>Total</b>		<b>28,00,000</b>	<b>42,00,000</b>	<b>100</b>	<b>100</b>

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016	31-3-2017	31-3-2016	31-3-2017
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets		12,60,000	20,00,000	45	47.62
(ii) Intangible assets		11,20,000	15,70,000	40	37.38
(2) Current assets :					
(i) Trade receivables		2,80,000	5,00,000	10	11.90
(ii) Cash - cash equivalent		1,40,000	1,30,000	5	3.10
<b>Total</b>		<b>28,00,000</b>	<b>42,00,000</b>	<b>100</b>	<b>100</b>

**Illustration 20 :** Find out balancing figures of common size balance sheet as at 31-3-2016 and 31-3-2017 of Dahod Ltd.

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016	31-3-2017	31-3-2016	31-3-2017
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital					
(i) Equity share capital		?	14,52,000	20	22
(ii) Preference share capital		?	7,26,000	10	11
(b) Reserves and surplus					
(i) General reserve		?	3,63,000	10	5.5
(ii) Profit-loss account		?	14,52,000	20	22
(2) Non-current liabilities					
(i) 15 % debentures		?	7,26,000	10	11
(ii) Loan of BOB		?	7,26,000	10	11
(3) Current liabilities					
(i) Short-term borrowings		?	3,63,000	8	5.5
(ii) Other current liabilities		?	3,63,000	7	5.5
(iii) Short-term provisions		?	4,29,000	5	6.5
<b>Total</b>		<b>50,00,000</b>	<b>66,00,000</b>	<b>100</b>	<b>100</b>

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016	31-3-2017	31-3-2016	31-3-2017
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets					
Land		15,00,000	19,80,000	30	?
Plant-machines		5,00,000	6,60,000	10	?
Building		7,50,000	11,88,000	15	?
(b) Non-current investments		10,00,000	7,92,000	20	?
(2) Current assets :					
(i) Current investments		5,00,000	9,90,000	10	?
(ii) Stock		5,00,000	6,60,000	10	?
(iii) Cash - cash equivalent		2,50,000	3,30,000	5	?
<b>Total</b>		<b>50,00,000</b>	<b>66,00,000</b>	<b>100</b>	<b>100</b>

#### Explanation :

This illustration is mixed in nature.

- (1) Amount-liability side is to be found out from percentage for 2016. For this, the following formula will be used :
- $$\text{Amount in rupees for equity} = \frac{\text{Total of balance sheet of 2016} \times \text{Percentage of respective liability}}{100}$$
- and liabilities side of year 2016

- (2) Percentage of assets side is to be found out from amount for 2017. For this, the following formula will be used :
- $$\text{Percentage of assets with the total of the balance sheet} = \frac{\text{Amount of respective asset}}{\text{Total of balance sheet}} \times 100$$

#### Necessary calculation :

No.	Particulars	2016 (Equity liability side) (₹)	No.	Particulars	2017 (Assets side) (%)
(1)	Equity share capital	$\frac{50,00,000 \times 20}{100}$ = ₹ 10,00,000	(1)	Land	$\frac{19,80,000}{66,00,000} \times 100$ = 30 %
(2)	Preference share capital	$\frac{50,00,000 \times 10}{100}$ = ₹ 5,00,000	(2)	Plant-machines	$\frac{6,60,000}{66,00,000} \times 100$ = 10 %
(3)	General reserve	$\frac{50,00,000 \times 10}{100}$ = ₹ 5,00,000	(3)	Building	$\frac{11,88,000}{66,00,000} \times 100$ = 18 %

No.	Particulars	2016 (Equity liability side) (₹)	No.	Particulars	2017 (Assets side) (%)
(4)	Profit-loss account	$\frac{50,00,000 \times 20}{100}$ = ₹ 10,00,000	(4)	Non-current investments	$\frac{7,92,000}{66,00,000} \times 100$ = 12 %
(5)	15 % debentures	$\frac{50,00,000 \times 10}{100}$ = ₹ 5,00,000	(5)	Current investments	$\frac{9,90,000}{66,00,000} \times 100$ = 15 %
(6)	Loan of BOB	$\frac{50,00,000 \times 10}{100}$ = ₹ 5,00,000	(6)	Stock	$\frac{6,60,000}{66,00,000} \times 100$ = 10 %
(7)	Short-term borrowings	$\frac{50,00,000 \times 8}{100}$ = ₹ 4,00,000	(7)	Cash and cash equivalent	$\frac{3,30,000}{66,00,000} \times 100$ = 5 %
(8)	Other current liabilities	$\frac{50,00,000 \times 7}{100}$ = ₹ 3,50,000			
(9)	Long-term provisions	$\frac{50,00,000 \times 5}{100}$ = ₹ 2,50,000			

### Exercise

#### 1. Choose the correct option for every question :

- (1) Which of the following analysis shows stakeholder-based classification ?
  - (a) External analysis
  - (b) Horizontal analysis
  - (c) Short-term analysis
  - (d) Vertical analysis
- (2) How many assets are analysed in the financial statement analysis ?
  - (a) 1
  - (b) 2
  - (c) 3
  - (d) 4
- (3) The information regarding the use of assets gives the analysis of ..... .
  - (a) profitability
  - (b) liquidity
  - (c) solvency
  - (d) efficiency
- (4) The analysis of the financial statements ..... .
  - (a) presents only results
  - (b) provides historical information
  - (c) makes interpretation
  - (d) none of the above
- (5) The expenses of the current year of a company is ₹ 6,00,000; and if it is increased by 20 % compared to the previous year, what would be the expenses of the previous year ?
  - (a) ₹ 1,20,000
  - (b) ₹ 5,00,000
  - (c) ₹ 7,20,000
  - (d) None of these

**2. Answer the following questions in one sentence :**

- (1) What is financial analysis ?
- (2) Describe the types of financial analysis on the basis of parties.
- (3) Describe the types of financial analysis on the basis of time.
- (4) What is horizontal analysis ?
- (5) What is vertical analysis ?

**3. Answer in brief :**

- (1) Describe the different types of financial analysis.
- (2) Discuss any three objectives of financial analysis.
- (3) Discuss any three uses of financial analysis.
- (4) Discuss any three limitations of financial analysis.
- (5) State the users of financial analysis.
- (6) Explain the significance of comparative financial statements.
- (7) Discuss in brief the steps of financial analysis.
- (8) Explain comparative statements.
- (9) Explain common size statements.

**4. The abridged profit and loss statement ending on 31-3-2016 and 31-3-2017 of Saman Company Limited are given as follows. Prepare comparative statement of profit and loss.**

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue		33,00,000	22,00,000
Other income		2,25,000	1,50,000
Expenses		23,76,000	15,40,000
Income tax rate 30 %			

**5. The abridged profit and loss statement ending on 31-3-2016 and 31-3-2017 of Srushti Company Limited are given as follows. Prepare comparative statement of profit and loss :**

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue		25,35,000	19,50,000
Other income		2,85,000	1,90,000
Cost of goods consumed		11,40,000	9,50,000
Financial cost		90,000	1,50,000
Depreciation		60,000	60,000
Other expenses		4,25,000	3,40,000
Income tax rate is 30 %.			



6. Profit and loss statement for the year ending on 31-3-2016 and 31-3-2017 of Shankar Limited are given as follows. Prepare comparative statement of profit and loss.

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue		60,75,000	45,00,000
Other income		7,00,000	10,00,000
<b>Expenses :</b>			
Cost of goods consumed		36,00,000	30,00,000
Net purchase for resale		2,70,000	2,00,000
Changes in stock		90,000	70,000
Employee benefit expenses		5,60,000	4,00,000
Financial cost		1,35,000	90,000
Depreciation and amortized amount		1,05,000	70,000
Income tax rate 30 %			

7. Profit and loss statement for the year ending on 31-3-2016 and 31-3-2017 of Mina Company Limited are as follows. Prepare comparative profit and loss statement.

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
Sales revenue		45,00,000	52,00,000
Other income		2,00,000	10,00,000
Net purchase		32,00,000	38,00,000
Other Expenses (% of sales)		22 %	18 %
Changes in stock		(2,00,000)	(1,00,000)
Income tax rate 30 %			

8. Find out balancing figures of comparative statement of Kalpana Company Limited.

Particulars	Note No.	31-3-2016 (₹)	31-3-2017 (₹)	Increase/ Decrease (₹)	Increase/ Decrease (%)
1	2	3	4	5(4 - 3)	6 ( $\frac{5}{3} \times 100$ )
(I) Sales revenue		?	15,00,000	5,00,000	50
(II) Expenses :					
(i) Purchase		?	7,20,000	1,20,000	20
(ii) Changes in stock		?	1,50,000	—	—
(iii) Depreciation		?	1,00,000	50,000	100
<b>Total Expenses</b>		?	<b>9,70,000</b>	<b>1,70,000</b>	<b>21.25</b>
(III) Profit before tax		?	5,30,000	3,30,000	165
(IV) Less : Income tax (30 %)		?	1,59,000	99,000	165
(V) Profit after tax		?	<b>3,71,000</b>	<b>2,31,000</b>	165

9. Balance sheet of Small Company Ltd. as at 31-3-2016 and 31-3-2017 are as follows. Prepare comparative balance sheet.

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
<b>(I) Equity and Liabilities</b>			
(1) Shareholders' funds :			
(a) Share capital			
(i) Equity share capital		22,00,000	17,00,000
(ii) Preference share capital		10,00,000	12,00,000
(b) Reserves and surplus			
(i) General reserve		2,40,000	2,00,000
(ii) Profit-loss account		2,10,000	1,80,000
(2) Non-current liabilities			
10 % debentures		6,00,000	8,00,000
(3) Current liabilities			
(i) Short-term borrowings		90,000	45,000
(ii) Trade payables		90,000	1,35,000
(iii) Other current liabilities		70,000	70,000
<b>Total</b>		<b>45,00,000</b>	<b>43,30,000</b>
<b>(II) Assets :</b>			
(1) Non-current assets :			
(a) Fixed assets			
(i) Tangible assets : Machines		16,00,000	15,00,000
Furniture		6,00,000	5,00,000
(ii) Intangible assets : Goodwill		80,000	1,00,000
Patent		7,50,000	7,30,000
(b) Non-current investments		9,00,000	8,00,000
(2) Current assets :			
(i) Stock		1,80,000	1,60,000
(ii) Trade receivables		1,80,000	2,00,000
(iii) Current investments		1,40,000	2,70,000
(iv) Cash and cash equivalent		70,000	70,000
<b>Total</b>		<b>45,00,000</b>	<b>43,30,000</b>

10. You are provided comparative balance sheets as at 31-3-2016 and 31-3-2017 of Shivani Company Limited ascertain balancing figures :

Particulars 1	Note No. 2	31-3-2016 (₹) 3	31-3-2017 (₹) 4	Increase/ Decrease (₹) 5(4 - 3)	Increase/ Decrease (%) 6 ( $\frac{5}{3} \times 100$ )
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital					
Equity share capital		24,00,000	?	?	25.00
(b) Reserves and surplus		12,00,000	?	?	25.00
(2) Non-current liabilities					
(i) 10 % debentures		10,00,000	?	?	20.00
(ii) 11 % bank loan		12,00,000	?	?	25.00
(3) Current liabilities		2,00,000	?	?	5.00
<b>Total</b>		<b>60,00,000</b>	<b>?</b>	<b>?</b>	<b>23.50</b>
<b>(II) Assets :</b>					
(1) Non-current assets :					
(i) Tangible assets		?	32,10,000	2,10,000	?
(ii) Intangible assets		?	22,00,000	2,00,000	?
(2) Current assets		?	20,00,000	10,00,000	?
<b>Total</b>		<b>?</b>	<b>74,10,000</b>	<b>14,10,000</b>	<b>?</b>

11. Prepare common size statement of profit and loss from the following profit and loss statements of two years.

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
(I) Sales revenue		48,00,000	40,00,000
(II) Other income		4,80,000	2,40,000
<b>(III) Total income</b>		<b>52,80,000</b>	<b>42,40,000</b>
<b>(IV) Expenses :</b>			
(i) Cost of goods consumed		26,40,000	20,80,000
(ii) Net purchase for resale		2,40,000	1,60,000
(iii) Changes in stock		(2,40,000)	1,20,000
(iv) Employees benefit expenses		7,20,000	6,00,000
(v) Financial cost		4,80,000	4,80,000
(vi) Depreciation		5,76,000	4,00,000
<b>Total Expenses</b>		<b>44,16,000</b>	<b>38,40,000</b>
(V) Profit before tax		8,64,000	4,00,000
(VI) Less : Income tax 30 %		2,59,200	1,20,000
<b>(VII) Profit after tax</b>		<b>6,04,800</b>	<b>2,80,000</b>

12. Find out balancing figures of common size profit and loss statements of two years :

Particulars	Note No.	Amount (₹)		Percentage to sales	
		31-3-2017 (₹)	31-3-2016 (₹)	31-3-2017 (%)	31-3-2016 (%)
(I) Sales revenue		45,00,000	60,00,000	100	100
(II) Expenses :					
(i) Cost of goods		?	?	68	70
(ii) Financial cost		?	?	10	12
(iii) Depreciation		?	?	2	3
<b>Total Expenses</b>		<b>36,00,000</b>	<b>51,00,000</b>	<b>80</b>	<b>85</b>
(III) Profit before tax		9,00,000	9,00,000	20	15
(IV) Less : Income tax 30 %		?	?	?	?
(V) <b>Profit after tax</b>		<b>?</b>	<b>?</b>	<b>?</b>	<b>?</b>

13. Balance sheets of two years of Saurashtra Limited are as follows. Prepare common size statements.

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
(I) <b>Equity and Liabilities</b>			
(1) Shareholders' funds :			
(a) Share capital			
(i) Equity share capital		25,00,000	25,00,000
(ii) Preference share capital		15,00,000	—
(b) Reserves and surplus			
(i) General reserve		8,00,000	6,00,000
(ii) Profit-loss account		4,50,000	6,00,000
(2) Non-current liabilities			
9 % bank loan		15,00,000	15,00,000
(3) Current liabilities			
(i) Short-term borrowings		6,00,000	2,00,000
(ii) Other current liabilities		1,50,000	6,00,000
<b>Total</b>		<b>75,00,000</b>	<b>60,00,000</b>

Particulars	Note No.	31-3-2017 (₹)	31-3-2016 (₹)
<b>(II) Assets :</b>			
(1) Non-current assets :			
(a) Fixed assets			
(i) Tangible assets : Machines		15,00,000	20,00,000
Land-building		25,00,000	15,00,000
(ii) Intangible assets : Trademark		5,00,000	3,40,000
Goodwill		4,50,000	—
(b) Non-current investments		15,00,000	15,00,000
(2) Current assets :			
(i) Debtors		3,75,000	3,00,000
(ii) Stock		3,75,000	2,40,000
(iii) Cash and cash equivalent		3,00,000	1,20,000
<b>Total</b>		<b>75,00,000</b>	<b>60,00,000</b>

14. Balance sheets of two years of Shyam Limited are as follows. Ascertain balancing figures.

Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016	31-3-2017	31-3-2016	31-3-2017
<b>(I) Equity and Liabilities</b>					
(1) Shareholders' funds :					
(a) Share capital					
(i) Equity share capital		?	20,00,000	40	?
(ii) Preference share capital		?	10,00,000	20	?
(b) Reserves and surplus					
Profit-loss account		?	8,00,000	15	?
(2) Non-current liabilities					
10 % debentures		?	10,00,000	20	?
(3) Current liabilities					
(i) Trade payables		?	1,00,000	3	?
(ii) Other liabilities		?	1,00,000	2	?
<b>Total</b>		<b>34,00,000</b>	<b>50,00,000</b>	<b>100</b>	<b>100</b>



Particulars	Note No.	Amount (₹)		Percentage to total of balance sheet	
		31-3-2016	31-3-2017	31-3-2016	31-3-2017
<b>(II) Assets :</b>					
(1) Non-current assets :					
(a) Fixed assets					
(i) Tangible assets		10,20,000	?	?	35
(ii) Intangible assets		6,80,000	?	?	30
(b) Non-current investments		8,50,000	?	?	22
(2) Current assets					
(i) Trade receivables		3,40,000	?	?	3
(ii) Stock		2,38,000	?	?	8
(iii) Cash - cash equivalent		2,72,000	?	?	2
<b>Total</b>		<b>34,00,000</b>	<b>50,00,000</b>	<b>100</b>	<b>100</b>



# Accounting Ratios and Analysis

- |                                  |                         |
|----------------------------------|-------------------------|
| 1. Introduction                  | 7. Profitability Ratios |
| 2. Characteristics of Ratios     | 8. Liquidity Ratios     |
| 3. Objectives of Ratio Analysis  | 9. Solvency Ratios      |
| 4. Limitations of Ratio Analysis | 10. Efficiency Ratios   |
| 5. Presentation of Ratios        | – Exercise              |
| 6. Classification of Ratios      |                         |

## 1. Introduction

The financial statements analysis assists to understand the information disclosed in the financial statements of the business entity easily. Due to this simplicity, different stakeholders find it very convenient to make their investment decision. In this context, comparative statements and common size financial statements information is obtained in the previous chapter. Ratio analysis is included as another tool of financial analysis. Ratio analysis is a traditional and widely used tool.

### Definition and Explanation :

I. M. Pandey says that, "The relationship between two accounting figures, expressed mathematically, is known as financial ratio". Ratios help to summarise the large quantities of financial data and to make qualitative judgement about firm's financial performance.

Financial statements show accounting statistics. Gross profit, net profit, sales, equity share capital, equity shareholders' funds, current liabilities, current assets etc. are included as a component of financial statements. Accounting analysis is done between two relevant components based on a specific relation. As discussed earlier, the gross profit and sales are two relevant components. There is a relation between these two from the view point of accounting. Assume sales is ₹ 3,00,000 and gross profit is ₹ 90,000.

Here, ₹ 90,000 shows accounting information. This figure does not explain the interpretation of any analysis. If this information is to be presented in the form of ratio it can be presented as follows :

$$\text{Gross profit (\%)} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

$$\begin{aligned} \text{So, Gross profit ratio} &= \frac{90,000}{3,00,000} \times 100 \\ &= 30 \% \end{aligned}$$

This analysis shows that for every sale of ₹ 100, gross profit is ₹ 30. Due to the ratios, accounting figures can be presented in useable form. Detailed discussion in this regard is given subsequently.

## 2. Peculiarity of Ratios :

In ratio analysis comparison is done for useful interpretation of financial statements. An individual ratio does not indicate any favourable or adverse situation. It is to be compared with a standard ratio. e.g. Above stated gross profit ratio 30 % does not indicate any favourable or adverse situation. It represents result only. Thus, when ratios are compared with any standards than the utility of it is proved. These standards can be as under. By comparing these standards, the information of good-bad results can be obtained.

- (i) The comparison with ratios calculated based on past financial statements
- (ii) The comparison with ratios developed by the business entity
- (iii) The comparison with ratios of industry
- (iv) The comparison with ratios of competitors

Gross profit ratio is revenue ratio. Assume that it was 25 % in the previous year and 30 % during the current year. It shows that there is a growth in the condition of gross profit of the business. If the ratio of the previous year is 40 %, it means the gross profit condition is reported adverse in the current year.

## 3. The Objectives of Ratio Analysis :

The objectives of ratio explain its significance. Due to ratio analysis the information of financial statements can easily, be understood briefly and scientifically. Ratio analysis is useful to different users of financial statements, to make their decisions. Their objectives or significance is as follows :

**(1) For financial statement analysis :** Only accounting statistics information is available from details disclosed in financial statements. These figures do not represent any analysis. Ratio analysis works as indicator to the users of financial statements. Different stakeholders undertake analysis of profit and loss statement and balance sheet. To make this analysis meaningful and useful, ratio analysis is used.

**(2) For simple presentation of accounting information :** Ratio analysis represents accounting figures in more simple, in brief and in scientific form. The components of financial statements have specific relation with each other and the ratio analysis clarifies the meaning of this relation. e.g. Debt-equity ratio. This ratio shows the proportion of equity against debt. Many components depend on the other component. e.g. Net profit-ratio. Here, the creation of profit is from sales. This ratio shows the proportion of net profit to sales.

Ratio analysis represents the relation between two related components and their simple understanding to the users.

**(3) To know profitability status of the entity :** The basic objective of a business is to earn profit. In accounting the profitability of the business can be measured by applying the ratio analysis in different forms where gross profit ratio, net profit ratio, return on capital employed, rate of return on equity share capital etc. are included here.

**(4) To know liquidity status of the entity :** The liquidity ratio explains the capacity to meet short-term liabilities of the entity. From the liquidity short-term solvency of the business can be measured, where current ratio, liquid ratio etc. are included.

**(5) To know long-term solvency of the entity :** The long-term solvency of a business entity is measured by deducting total liabilities from total assets. Higher the positive difference, higher the solvency. This is the ideal measurement for the entity to obtain borrowings. The lenders of the business

entity focus on solvency. The analytical presentation in this context is availed by ratio analysis, where debt-equity ratio, total assets-debt ratio etc. are included.

**(6) To know operating efficiency of business entity :** Different types of assets are acquired by the business entity. For measurement of effective and efficient use of assets, ratio analysis is useful. For this, turnover ratios are used. e.g. stock turnover ratio.

**(7) For forecasting :** The trend of respective item can be seen by ratio analysis. e.g. during last 5 years the gross profit rate is 20 %, 23 %, 24 %, 26 % and 29 % respectively. Here, it is observed that there is a growth in the gross profit ratio during the last five years. This indicates favourable trend for a company. This trend can be useful to the company to undertake planning and forecast.

**(8) The information about weak aspect :** There may be over all good result of the business entity. Out of different aspects like profitability, liquidity, solvency or efficiency, there may be weak performance of any one aspects and good performance of any other aspects. Thus the average result will be satisfactory. But under ratio analysis each aspects is evaluated individually. So the information for weak aspect can be obtained and necessary remedies can be undertaken.

**(9) For interfirm and intrafirm comparison :** The comparison of the operating performance of a business entity with the other business entities is known as interfirm comparison. This ratio analysis assists to know how and to what extent a business entity is strong or weak as compared to the other business entity. This can be obtained by ratio analysis. When the comparison among different divisions of a business entity is done, it is known as intrafirm comparison. This ratio analysis is useful to know which division is strong and which one is weak as compared to the other division of the business entity.

Ratio analysis is used for different objectives. The uses of ratio analysis, explain its significance.

#### **4. Limitations of Ratio Analysis**

Ratio analysis is a traditional tool for measurement of different aspects of a business. Through it, the strengths and weaknesses of business entity are measured. This tool has limitations also. They are discussed as under :

**(1) Dependent on results of financial statements :** Under ratio analysis the evaluation of different aspects is done on the basis of information of financial statements. The success of this analysis is based on information disclosed in the financial statements. If true and fair information is not disclosed by the financial statements, the analysis would also present incorrect picture.

**(2) Absence of standard ratios :** Any individual ratio does not provide any analysis or interpretation. The use of ratio can be established only when the standard ratios are available for comparison. If standard ratios are not determined, the computed ratios become useless. Thus, the absence of standard ratios show uselessness of ratio analysis.

**(3) Influence of price changes :** The base of ratio analysis is financial statements. Financial statements are prepared with historical information. In historical information, the effect of inflation is not considered. Thus, price changes are not considered in ratio analysis also. This is also a limitation.



**(4) Avoidance of qualitative factors :** Ratio analysis is a method of quantitative analysis. Ratio analysis is purely based on quantitative information, but the qualitative aspects for measurement of operating results like honesty, loyalty, tempo which are strongly associated with employees or officers or management are ignored. These factors also have influence on the operation of the business entity.

**(5) Difficulty in comparison :** When two business entities, follow different accounting policies, the information obtained by ratio analysis becomes useless. e.g. the use of different methods like depreciation or stock valuation by two business entities. In these circumstances, the use of ratio analysis does not become useful.

## 5. Presentation of Ratios

The presentation of ratios can be done in different ways. These forms are as follows :

**(1) In terms of proportion :** Under this form two amounts are used on the basis of their relation. One amount is used as numerator and the other one is as denominator and then the proportion is determined. e.g. To measure liquidity current ratio is used, its formula is as follows.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

e.g. current assets are of ₹ 3,00,000 and current liabilities of ₹ 2,00,000.

$$= \frac{3,00,000}{2,00,000}$$

∴ Current ratio is 1.5.

It means current ratio is 1.5:1. It explains that, where against current assets of ₹ 1.5, current liability is ₹ 1.

**(2) In terms of percentage :** In this form also two variables are used on the basis of their relation; one amount is used as numerator, another one as denominator and then percentages are determined. e.g. Net profit ratio, its formula is as follows :

$$\text{Net profit ratio} = \frac{\text{Net profit}}{\text{Sales}} \times 100$$

e.g. sales is of ₹ 3,00,000 and net profit is of ₹ 60,000

$$= \frac{60,000}{3,00,000} \times 100 = 20 \%$$

∴ Net profit ratio is 20 %. It shows that ₹ 20 profit is earned from the sales of ₹ 100.

**(3) In terms of times :** Like proportion, here also one amount is disclosed as numerator and another is disclosed as denominator. But here the interpretation of ratio is in terms of time. This term is used for special type of components of accounting. e.g. stock turnover, its formula is as follows :

$$\text{Stock turnover} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

e.g. cost of goods sold is ₹ 3,00,000 and average stock is ₹ 1,00,000.

$$= \frac{3,00,000}{1,00,000} = 3 \text{ times}$$

Stock turnover is 3 times, it means the stock of business is converted 3 times into cost of goods sold.



.(4) **In terms of fraction** : To determine the proportion of one component against the other component, this form is used. e.g. The share capital of business unit is ₹ 5,00,000. Non-current assets of business are  $\frac{2}{5}$  of share capital.

In these circumstances,

$$\begin{aligned}\text{Non-current assets} &= \text{Share capital} \times \text{Share of non-current assets in share capital} \\ &= 5,00,000 \times \frac{2}{5} \\ &= ₹ 2,00,000\end{aligned}$$

(5) **In terms of days/weeks/months** : In accounting, through certain ratios time period is determined. This time period is calculated in terms of days, weeks and months. This ratio provides information about collection period and payment period. e.g. the formula of collection period is as follows :

$$\text{Collection period} = \frac{\text{Debtors} + \text{Bills receivables}}{\text{Credit sales}} \times 365$$

e.g. Debtors are of ₹ 50,000, bills receivable ₹ 23,000 and credit sales ₹ 7,30,000

$$\begin{aligned}&= \frac{50,000 + 23,000}{7,30,000} \times 365 \\ &= \frac{73,000}{7,30,000} \times 365 = 36.5 \text{ days means } 37 \text{ days}\end{aligned}$$

The collection period is 37 days. It shows that the amount of every credit sales will be paid by debtors on 37th day from the date of sales.

Thus the computation or presentation of the ratios can be done in different ways. It is important to note that all ratios can not be computed in all forms. e.g. The ratios of proportion can not be disclosed in the time form and vice versa. The detailed discussion in this regard is done under the head classification of ratios.

## 6. Classification of Ratios

The classification of ratios can be done into two categories :

- (i) Traditional classification
- (ii) Functional classification

The detailed explanation is as follows :

(i) **Traditional Classification** : The computation of accounting ratios is done on the basis of financial statements. In these statements, trading account, profit and loss account and balance sheet are included. (Now in the company form income statement and balance sheet are prepared.) As per traditional classification,

- (1) Ratios of trading A/c and profit and loss A/c
- (2) Ratios of balance sheet
- (3) Composite ratios are covered.

For computation of ratios of trading A/c and profit and loss A/c, both numerator and denominator are from trading A/c and profit and loss A/c. e.g. Net profit ratio, net profit and sales both components are from trading A/c and profit and loss A/c. For computation of ratios of balance sheet, both numerator and denominator are from balance sheet. e.g. Debt-equity ratio. Both components are of balance sheet. In case of third type, one component is from trading A/c or profit and loss A/c and second component is from the balance sheet. e.g. Fixed assets turnover. In this ratio assets are from balance sheet and sales is from trading A/c.

**(ii) Functional Classification :** To measure financial health or to acquire information about different aspects of accounting of business entity, ratio analysis is used. These aspects include

- |                   |                |
|-------------------|----------------|
| (1) Profitability | (3) Solvency   |
| (2) Liquidity     | (4) Efficiency |

This aspects measure performance of the business entity according to their name. This classification is known as functional classification. In this classification profitability ratios, liquidity ratios, solvency ratios and efficiency ratios are included. Each aspect is a result of specific performance. In practice this classification is widely used. In this book explanation is given as per functional classification. Only functional classification is expected. On the basis of this classification all ratios are explained as under.

## 7. Profitability Ratios

The main objective of every business is to earn profit. The earning capacity of the company is known as profitability. There are different ratios to measure profitability.

As per the syllabus, the following profitability ratios are to be studied. Generally these ratios are calculated in terms of percentage.

- (i) Gross profit ratio
- (ii) Operating ratio
- (iii) Operating profit ratio
- (iv) Net profit ratio

### (i) Gross profit ratio :

**Meaning :** Gross profit ratio discloses the relation between gross profit and total net sales. Gross profit ratio is an income based ratio. Where gross profit is an income and its proportion to sales (is also income) is determined. This ratio indicates percentage of gross profit to sales. Sales means revenue from operation. Operating income means the income which is generated from the business in which company deals. Sales means net sales (sales less sales return).

What is total sales ? Credit sales + Cash sales

What is gross profit ? Gross profit means excess of sales over cost of goods sold.

What is cost of goods sold ? Cost of goods sold is determined as follows :

Opening stock of raw metarial	✓
+ Purchase of raw metarial	✓
+ Purchase expense	✓
	✓
— Closing stock of raw material	✓
Cost of goods consumed	✓
+ Wages	✓
+ Factory expenses	✓
Cost of goods sold	✓

**Note :** (1) For determination of cost of goods sold, production expenses are considered for manufacturing units. Trading units do not have production expenses. Therefore for trading units cost of goods consumed is treated as cost of goods sold. (2) Instead of disclosure of opening stock and closing stock, how changes in stock are disclosed is discussed in the previous chapter.

(1) Change in stock = Opening stock > Closing stock

Positive difference : Added to cost of goods sold or deducted from income

(2) Change in stock = Opening stock < Closing stock

Negative difference : Deducted from cost of goods sold or added to income

**Note :** Negative amount (figures) are shown in bracket.

Gross profit = Total net sales – Cost of goods sold

**Formula :**  $\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Total net sales}} \times 100$

**Objective :** Gross profitability of the business can be measured through gross profit ratio.

**Trend :** It is income based ratio. Thus it's increasing trend indicates enhancement in profitability.

**Illustration 1 :** Calculate gross profit ratio from the given information of 'Z' Co. Ltd.

Particulars	2016 (₹)	2017 (₹)
Sales	4,80,000	6,00,000
Gross profit	1,20,000	1,80,000

**Note :** Question can also be asked on the basis of information of one year.

**Ans. :**

$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$

$$= \frac{1,20,000}{4,80,000} \times 100 = \frac{1,80,000}{6,00,000} \times 100$$

25 %                      30 %

**Interpretation :** (i) As compared to previous year gross profit ratio is increased from 25 % to 30 %. It indicates growth in gross profitability.

(ii) Gross profit = Sales – Cost of goods sold

2016 : 25 % = 100 % – 75 %

2017 : 30 % = 100 % – 70 %

It can be said that as compared to the previous year cost of goods sold is reduced in current year from 75 % to 70 %. Therefore gross profit rate is increased.

**Illustration 2 :** From the given information of 'O' business entity calculate gross profit ratio.

Particulars	2016 (₹)	2017 (₹)
Sales	8,00,000	12,00,000
Cost of goods sold	6,00,000	10,00,000

**Ans. :**

Gross profit is not provided. Thus gross profit is required to be calculated.

Gross profit = Sales – Cost of goods sold

2016 : 2,00,000 = 8,00,000 – 6,00,000

2017 : 2,00,000 = 12,00,000 – 10,00,000

Gross profit ratio =  $\frac{\text{Gross profit}}{\text{Total net Sales}} \times 100$

2016	2017
$= \frac{2,00,000}{8,00,000} \times 100$	$= \frac{2,00,000}{12,00,000} \times 100$
= 25 %	= $16\frac{2}{3}$ % (16.66... %)

**Illustration 3 :** Information of two years of ‘Q’ company is as follows. Calculate gross profit ratio.

Particulars	2016 (₹)	2017 (₹)
Sales	10,20,000	15,50,000
Sales return	20,000	50,000
Opening stock	1,40,000	1,60,000
Purchase	6,00,000	8,00,000
Purchase expenses	30,000	40,000
Closing stock	1,60,000	1,50,000

**Ans. :**

To calculate gross profit ratio, gross profit is to be ascertained by preparing income statement :

Particulars	2016		2017	
<b>Net sales :</b> Sales	10,20,000	10,00,000	15,50,000	15,00,000
Less : Sales return	20,000		50,000	
Less : Cost of goods consumed				
Opening stock	1,40,000		1,60,000	
Purchase	6,00,000		8,00,000	
Purchase expenses	30,000		40,000	
	7,70,000		10,00,000	
Less : Closing stock	1,60,000	6,10,000	1,50,000	8,50,000
<b>Gross profit</b>		<b>3,90,000</b>		<b>6,50,000</b>

$$\begin{aligned}
 \text{Gross profit ratio} &= \frac{\text{Gross profit}}{\text{Net sales}} \times 100 \\
 &= \frac{3,90,000}{10,00,000} \times 100 &= \frac{6,50,000}{15,00,000} \times 100 \\
 &= 39 \% &= 43.33 \%
 \end{aligned}$$

**Illustration 4 :** Two years information of 'F' & Co. is given below. Calculate gross profit ratio.

Particulars	2016 (₹)	2017 (₹)
Sales	10,20,000	15,50,000
Sales return	20,000	50,000
Purchase	6,00,000	8,00,000
Purchase expenses	30,000	40,000
Changes in stock	(20,000)	10,000

**Ans. :**

To calculate gross profit ratio, gross profit is to be ascertained by preparing income statement.

Particulars	2016		2017	
<b>Net Sales :</b> Sales	10,20,000	10,00,000	15,50,000	15,00,000
Less : Sales return	20,000		50,000	
Less : Cost of goods consumed				
Purchase	6,00,000	6,10,000	8,00,000	8,50,000
Purchase expenses	30,000		40,000	
Changes in stock	(20,000)		10,000	
<b>Gross profit</b>		<b>3,90,000</b>		<b>6,50,000</b>

$$\begin{aligned}
 \text{Gross profit ratio} &= \frac{\text{Gross profit}}{\text{Sales}} \times 100 &= \frac{3,90,000}{10,00,000} \times 100 &= \frac{6,50,000}{15,00,000} \times 100 \\
 & &= 39 \% &= 43.33 \%
 \end{aligned}$$

**Note :** To explain the treatment of stock, the details except stock of illustration 3 and 4 are kept identical.

## (ii) Operating ratio :

**Meaning :** Operating ratio discloses the relation of operating cost and sales. Operating ratio is cost (expense) based ratio. This ratio shows proportion of operating cost to sales.

**What is operating cost ? Operating cost = Cost of goods sold + Operating expenses**

What are the operating expenses ? Operating expenses are those expenses which are incurred for operating activities of business, where office expenses (administrative expense), sales distribution expenses, employees benefit expenses, depreciation, amount written off etc. are included.

**Note :** Non-operating incomes like interest received, dividend received, profit on sales of asset are not considered during the determination of operating cost. The interest paid and loss on sale of assets



are also not considered. Interest expense is financial expense, not an operating expense. Loss on sale of asset is other expense, not operating expense.

**To avoid the dilemma of students, non-operating expenses and incomes should be clearly stated.**

**Formula :** Operating ratio =  $\frac{\text{Cost of goods sold} + \text{Operating expenses}}{\text{Net sales}} \times 100$

**Objective :** This ratio explains the operating cost of business entity, the business in which the unit is engaged. e.g. A company manufactures and sales textile, would acquire information about production cost of textile. If production cost is more than pre determined cost, necessary efforts are made to control it.

**Trend :** The decreasing trend of this ratio is favourable which indicates increasing operating profitability.

**Illustration 5 :** From the following information calculate operating ratio of 'E' Company.

Cost of goods sold ₹ 4,80,000, operating expenses ₹ 1,20,000, financial expenses ₹ 1,00,000 and sales ₹ 8,00,000.

**Ans. :** Operating ratio =  $\frac{\text{Cost of goods sold} + \text{Operating expenses}}{\text{Net sales}} \times 100$

$$= \frac{4,80,000 + 1,20,000}{8,00,000} \times 100$$

$$= 75 \%$$

**Note :** Financial expenses are not considered as operating expenses.

**Illustration 6 :** From the given information of 'K' & Company Limited calculate operating ratios of two years :

Particulars	2016 (₹)	2017 (₹)
Sales	15,00,000	20,00,000
Cost of goods sold	7,50,000	9,00,000
Administrative expenses	1,00,000	1,50,000
Sales expenses	2,50,000	3,00,000
Depreciation	1,00,000	1,00,000
Financial expenses	1,00,000	1,00,000
Income of interest - Dividend	2,00,000	2,00,000
Other expenses (Non-operating)	50,000	50,000

**Ans. :**

**Computation of Operating Expenses**

Particulars	2016 (₹)	2017 (₹)
Administrative expenses	1,00,000	1,50,000
Sales expenses	2,50,000	3,00,000
Depreciation	1,00,000	1,00,000
	<b>4,50,000</b>	<b>5,50,000</b>

$$\begin{aligned}
 \text{Operating ratio} &= \frac{\text{Cost of goods sold} + \text{Operating expenses}}{\text{Net sales}} \times 100 \\
 &= \frac{7,50,000 + 4,50,000}{15,00,000} \times 100 &= \frac{9,00,000 + 5,50,000}{20,00,000} \times 100 \\
 &= \frac{12,00,000}{15,00,000} \times 100 &= \frac{14,50,000}{20,00,000} \times 100 \\
 &= 80 \% &= 72.5 \%
 \end{aligned}$$

As compared to the previous year, reduction in operating ratio, it discloses increase in profit.

**Illustration 7 :** From the following information of 'S' Limited calculate operating ratio.

Net sales ₹ 28,00,000; cost of goods sold ₹ 18,00,000; salary ₹ 1,20,000; other administrative expenses ₹ 1,80,000; sales expenses ₹ 1,50,000; interest on loan ₹ 1,25,000; loss due to fire ₹ 25,000; interest income on investments ₹ 1,80,000

**Ans. :**

$$\begin{aligned}
 \text{Operating ratio} &= \frac{\text{Cost of goods sold} + \text{Operating expenses}}{\text{Net sales}} \times 100 \\
 &= \frac{18,00,000 + 4,50,000}{28,00,000} \times 100 \\
 &= \frac{22,50,000}{28,00,000} \times 100 \\
 &= 80.36 \%
 \end{aligned}$$

Operating expenses =	Salary	₹ 1,20,000
	Other administrative expenses	₹ 1,80,000
	Sales expenses	₹ 1,50,000
		₹ 4,50,000

### (iii) Operating Profit Ratio :

**Meaning :** This ratio discloses relationship between operating profit and sales. This is an income based ratio. This ratio shows the proportion of operating profit to sales.

**What is the operating profit ? Sales — Operating cost**

**Formula :** Operating profit ratio =  $\frac{\text{Operating profit}}{\text{Net sales}} \times 100$

**Objective :** This ratio indicates that how much is profit earned by the unit, from the business in which unit deals. To determine this ratio in alternative way, assume the sales as 100 % and deduct operating ratio from it, the remaining percentage will be operating profit ratio.

**Trend :** Since this ratio is income based, the increasing trend of it indicates enhancement in profit.

**Illustration 8 :** From the following information of 'H' Limited, calculate operating profit ratio.

Sales ₹ 7,50,000, cost of goods sold ₹ 3,00,000, operating expenses ₹ 1,50,000

Ans. :

$$\text{Operating profit ratio} = \frac{\text{Operating profit}}{\text{Sales}} \times 100$$
$$\text{Operating profit} = \text{Sales} - \text{Operating cost}$$

Operating cost = Cost of goods sold	₹ 3,00,000
+ Operating expenses	₹ 1,50,000
	<u>₹ 4,50,000</u>

$$= ₹ 7,50,000 - ₹ 4,50,000$$
$$= ₹ 3,00,000$$
$$\frac{3,00,000}{7,50,000} \times 100 = 40 \%$$

OR

$$\text{Operating profit ratio} = 100 \% - \text{Operating ratio}$$
$$\text{Operating ratio} = \frac{\text{Cost of goods sold} + \text{Operating expenses}}{\text{Sales}} \times 100$$
$$= \frac{4,50,000}{7,50,000} \times 100 = 60 \%$$
$$= 100 \% - 60 \% = 40 \%$$

**Illustration 9 :** From the information of 'J' Company Ltd. given below, calculate operating profit ratio.

Opening stock ₹ 60,000, purchase ₹ 5,00,000, purchase expenses ₹ 20,000, office expenses ₹ 50,000, interest paid ₹ 15,000, dividend received ₹ 15,000, Depreciation ₹ 40,000, loss due to accident ₹ 10,000, sales ₹ 8,00,000, closing stock ₹ 70,000, sales return ₹ 30,000, income tax rate 30 %.

Ans. :

$$\text{Operating profit ratio} = \frac{\text{Operating profit}}{\text{Sales}} \times 100$$
$$\text{Operating profit} = \text{Net Sales} - \text{Operating cost}$$

Net Sales = Sales - Sales return	
= 8,00,000 - 30,000	
= ₹ 7,70,000	

Operating cost = Opening stock	₹ 60,000
+ Purchase	₹ 5,00,000
+ Purchase expenses	₹ 20,000
	<u>₹ 5,80,000</u>
- Closing stock	₹ 70,000
Cost of goods sold	<u>₹ 5,10,000</u>
+ Office expenses	₹ 50,000
+ Depreciation	₹ 40,000
	<u>₹ 6,00,000</u>

$$= 7,70,000 - 6,00,000$$
$$= ₹ 1,70,000$$
$$= \frac{1,70,000}{7,70,000} \times 100 = 22.08 \%$$

**(iv) Net Profit Ratio :**

**Meaning :** This ratio discloses the relationship between net profit and sales. This is an income based ratio. This ratio shows the percentage of net profit to sales.

**What is net profit ?** The amount remaining after deducting all the expenses from the total income. This profit can be calculated as under :

Particulars	(₹)	(₹)
Sales	✓	
Less : Sales return	✓	
Net sales		✓
Add : Non-operating income		✓
Total income		✓
Less : Cost of goods sold	✓	
Operating expenses	✓	
Financial expenses	✓	
Non-operating expenses	✓	✓
Profit before tax		✓
Less : Income tax		✓
Profit after tax		✓

$$\text{Formula : Net profit ratio} = \frac{\text{Net profit after tax}}{\text{Net sales}} \times 100$$

**Objective :** The overall profitability of business can be seen through this ratio. All incomes and expenses are considered.

**Trend :** Since this ratio is income based, increasing trend of it indicates enhancement in total profitability. (Net profitability)

**Illustration 10 :** From the given information in illustration no. 9, calculate net profit ratio.

Net profit ratio = $\frac{\text{Net profit after tax}}{\text{Net sales}} \times 100$		(₹)	(₹)
Sales		8,00,000	
Less : Sales return		30,000	
Net sales			7,70,000
Add : Non-operating income : Dividend			15,000
Total income			7,85,000
Less : Cost of goods sold			
Opening stock		60,000	
+ Purchase		5,00,000	
+ Purchase expenses		20,000	
		5,80,000	
— Closing stock		70,000	
		5,10,000	

+ Operating expenses :		
Office expenses	50,000	
Depreciation	40,000	
+ Financial expenses :		
Interest	15,000	
+ Other expenses :		
Loss due to accident	10,000	6,25,000
Profit before tax		1,60,000
<b>Less : Tax 30 %</b>		48,000
Profit after tax		<b>1,12,000</b>

$$\frac{1,12,000}{7,70,000} \times 100 = 14.55 \%$$

## 8. Liquidity Ratios

The basic objective of every business is to earn profit. The creditworthiness provides fuel to the earning capacity of the business. The credit worthiness depends upon the financial solvency of the company. In accounting the solvency is determined with two view points : (i) long-term solvency and (ii) short-term solvency. Short-term solvency is known as liquidity. Liquidity means the ability of business unit to pay short-term liabilities. Short-term liabilities means current liabilities. As per the syllabus the following ratios are to be studied. Generally, these ratios are presented in terms of proportion.

(i) Current Ratio

(ii) Liquid Ratio

**(i) Current Ratio :**

**Meaning :** Current ratio shows relation between current assets and current liabilities. What is the proportion of current liabilities against current assets is indicated by this ratio. It can be said that the liquidity position of business entity is good, if the proportion of current assets is higher than current liabilities. More liquidity means more short-term solvency.

**Formula :** Current ratio =  $\frac{\text{Current assets}}{\text{Current liabilities}}$

Current assets means which is in the cash form or cash equivalent or which can be converted into cash within 12 months or which can be converted into cash equivalent. The following can be included in it.

Current investments, stock (excluding loose tools), trade receivables (bills receivable and debtors after deduction of bad debts reserve) cash and cash equivalent (cash on hand, bank balance, cheque/ draft on hand), short-term lending and advances, expenses paid in advance, incomes outstanding, taxes paid in advance etc.

Current liabilities means such liabilities which are payable within the time period of 12 months.

Short-term borrowings, trade payables (bills payable and creditors), interest payable on long-term liabilities, due but not paid liability, due but not paid interest, expenses outstanding, uncalled dividend, instalments received in advance, short-term provisions are included in current liabilities.

**Objective :** The objective of this ratio is to know the capacity of the business unit to pay short-term obligation.



**Trend :** The proportion of this ratio varies industry to industry. Generally 2:1 proportion of this ratio is considered to be an ideal. If this ratio is greater than the standard, it indicates the loss of interest and the lower ratio than the standard creates interruption in manufacturing process. Thus, its standard proportion is desirable.

The difference of current assets and current liabilities is known as working capital. Working capital also used for the measurement of liquidity.

In brief, Current assets / Current liabilities = Current ratio (in proportion)

Current assets – Current liabilities = Working capital (₹)

**Illustration 11 :** From the following information of ‘P’ Company Ltd., calculate current ratio.

Debtors ₹ 1,80,000, bills receivables ₹ 30,000, bad debts reserve ₹ 10,000, stock ₹ 30,000, cash and cash equivalent ₹ 45,000, machinery ₹ 1,20,000, furniture ₹ 90,000, bills payable ₹ 20,000, short-term loan ₹ 90,000, outstanding expenses ₹ 27,500.

**Ans. :**

Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$		(₹)	(₹)
Current ratio =	<b>Current assets :</b> Debtors	1,80,000	
	Bills receivables	30,000	
		2,10,000	
	– Bad debts reserve	10,000	2,00,000
	Stock		30,000
	Cash and cash equivalent		45,000
			2,75,000
	<b>Current liabilities :</b> Bills payables	20,000	
	Short-term loan	90,000	
	Outstanding expenses	27,500	
			1,37,500
		$= \frac{2,75,000}{1,37,500} = 2:1$	

**Analysis :** ‘P’ Company has the current assets of ₹ 2 to pay the current liabilities of ₹ 1. The receivable is ₹ 2 and the payable is ₹ 1. When the current assets are more than the current liabilities, it indicates short-term solvency. Here the answer of current ratio is shown 2:1. If only 2 was disclosed, then also the meaning does not change. When the numerator is divided by the denominator and the answer arrived at is 1, which is always for the denominator. Here the denominator is 1 against which the proportion of numerator 2.

**Illustration 12 :** From the following information of ‘R. K.’ Ltd., calculate current ratio and working capital.

Particulars	(₹)	Particulars	(₹)
Debtors	90,000	Bills receivables	30,000
Land-building	5,00,000	Furniture	60,000
Outstanding expenses	40,000	Non-current investments	70,000
Current investments	30,000	Cash and cash equivalent	30,000
Creditors	60,000	Bills payables	20,000
Bad debts reserve	20,000	Stock	60,000

Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$	(₹)	(₹)
<b>Current assets :</b> Debtors	90,000	
Bills receivables	30,000	
	1,20,000	
— Bad debts reserve	20,000	1,00,000
Current investments		30,000
Cash and cash equivalent		30,000
Stock		60,000
		2,20,000
<b>Current liabilities :</b> Outstanding expenses		40,000
Creditors		60,000
Bills payables		20,000
		1,20,000
$= \frac{2,20,000}{1,20,000} = 1.83$		

**Illustration 13 :** From the following information of ‘M’ Ltd., calculate current ratio.

**Ans. :**

**(ii) Liquid Ratio :**

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**Note :** Here, current assets excluding stock and expenses paid in advance are considered to determine liquid assets.

$$\text{Formula : Liquid ratio} = \frac{\text{Liquid assets}}{\text{Current liabilities}}$$

Liquid assets are such assets which are easily convertible in cash and cash equivalent.

Current liabilities which are considered for current ratio, are also considered for this ratio.

**Objective :** The objective of this ratio is also to measure liquidity. The purpose is to measure capacity to pay short-term liabilities. This ratio indicate better capacity in paying short-term liabilities than the current ratio. This ratio is also known as quick ratio. There is no time period of 12 months prescribed for the conversion of assets into cash. Thus, this ratio is faster than current ratio to pay short-term liabilities.

**Trend :** Generally, the proportion of this ratio 1:1 is desirable.

**Illustration 14 :** From the following information of 'S. L.' Limited, calculate liquid ratio.

Particulars	(₹)	Particulars	(₹)
Current liabilities	1,60,000	Current assets	2,00,000
Stock	30,000	Expenses paid in advance	10,000
Debtors	20,000	Bills receivables	15,000

**Ans. :**

Liquid ratio = $\frac{\text{Liquid assets}}{\text{Current liabilities}}$		(₹)	(₹)
	Liquid assets : Current assets		2,00,000
	<b>Less : Stock</b>	30,000	
	Expenses paid in advance	10,000	40,000
			1,60,000
		</	

**Illustration 15 :** From the following information of 'I' Limited, calculate current ratio and liquid ratio.

Particulars	(₹)	Particulars	(₹)
Cash and cash equivalent	1,80,000	Creditors	2,00,000
Debtors	1,20,000	Bills payables	1,00,000
Bills receivables	60,000	Outstanding expenses	80,000
Stock	1,40,000	Taxation provision	80,000
Current investments	1,00,000		

Ans. :

Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$		(₹)	(₹)
<b>Current assets :</b> Cash Debtors Bills receivables Current investments Stock		1,80,000 1,20,000 60,000 1,00,000 1,40,000	
		6,00,000	
<b>Current liabilities :</b> Creditors Bills payables Outstanding expenses Taxation provision		2,00,000 1,00,000 80,000 80,000	
		4,60,000	
$= \frac{6,00,000}{4,60,000} = 1.30 : 1$			
Liquid ratio = $\frac{\text{Liquid assets}}{\text{Current liabilities}}$			
<b>Liquid assets :</b> Current assets Less : Stock			6,00,000 1,40,000
			4,60,000
$= \frac{4,60,000}{4,60,000} = 1 : 1$			

#### Relation of current assets and current liabilities with current ratio :

The current ratio emerges from two variables : (i) current assets and (ii) current liabilities. Thus, there is an influence of change in current assets and current liabilities on current ratio. This influence is as follows :

**Increase in current assets → Increase in current ratio**  
**Decrease in current assets → Decrease in current ratio**

This relation shows that there is a direct relation between the current assets and the current ratio.

**Increase in current liabilities → Decrease in current ratio**  
**Decrease in current liabilities → Increase in current ratio**

This relation shows that there is an inverse relation between the current liabilities and the current ratio.

**Note :** The relation between the liquid assets and the current liabilities with liquid ratio is also the same.

**Increase in liquid assets → Increase in liquid ratio**  
**Decrease in liquid assets → Decrease in liquid ratio**  
**and**  
**Increase in current liabilities → Decrease in liquid ratio**  
**Decrease in current liabilities → Increase in liquid ratio**

## 9. Solvency Ratios

Generally economic or financial solvency is considered in the context of long-term. Solvency is used to measure economic health of business entity. This ratio is used to measure how far the business entity is competent enough to pay long-term liabilities. This ratio is computed for economic aspects. As per the syllabus the following ratios are to be studied. These ratios are disclosed in terms of proportion.

- (i) Debt to equity ratio
- (ii) Total assets to debt ratio
- (iii) Proprietary ratio
- (iv) Interest coverage ratio

### (i) Debt to equity ratio :

**Meaning :** Debt to equity ratio shows relation between debt and equity (shareholders' funds). This ratio indicates the proportion of equity against debt. Here, equity means shareholders' funds. Equity share capital and reserves and surplus are included in shareholders' funds. A business entity is considered as solvent, when the proportion of equity is greater than debt, business entity is considered as less solvent when the proportion of the equity is less than the debt.

$$\text{Formula : } \frac{\text{Debt (Non-current / long-term liabilities)}}{\text{Equity (Shareholders' funds)}}$$

The equity and liabilities side of balance sheet shows three divisions.

- (1) Shareholders' funds (2) Non-current liabilities (3) Current liabilities

Shareholders' funds and non-current liabilities are the long-term sources of funds of a business entity. That remains for long-time in business. These are not procured every year. But shareholders' funds are owners' funds and non-current liabilities are the liabilities towards external parties. Both are long-term sources of finance but are different from ownership viewpoint.

Here, liabilities means long-term liabilities where (i) long-term borrowings (ii) deferred tax liability (iii) other long-term liability and (iv) long-term provisions are included. **(But for computation of this ratio deferred tax liability and other long-term liabilities will not be considered. Thus, these two items should not be included.)**

Shareholders' funds = Equity share capital + Preference share capital + Reserves and surplus

If debit balance of profit and loss account is appeared in the balance sheet, it will be deducted for the determination of shareholders' funds. Then the arrived amount of shareholders' funds will be used to compute this ratio. Preference share capital is included in shareholders' funds.

**Objectives :** The objective of this ratio is to know the proportion of owners capital (shareholders' funds) and borrowed funds (non-current liabilities) which are acquired by the business as a long-term sources of finance.

**Trend :** There is no standard measure for this ratio. This varies industry to industry. If this ratio is higher, it indicates that the business unit is more dependent on the borrowed funds and if this ratio is lower, it indicates that the business unit is less dependent on the borrowed capital. If this ratio is reported high, it is risky for the lenders and if it is reported low, it is less risky for the lenders to lend their funds.



### Balance Sheet

Equity-Liabilities	Companies		
	X	Y	Z
(A) Shareholders' funds	25 %	37.5 %	50 %
(B) Non-current liabilities	50 %	37.5 %	25 %
(C) Current liabilities	25 %	25 %	25 %
<b>Total</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>
Assets	Companies		
	X	Y	Z
(A) Non-current assets	100 %	100 %	100 %
(B) Current assets			
<b>Total</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>

Debt-Equity ratio =

$$\frac{\text{Liabilities (Long-term liabilities)}}{\text{Shareholders' funds}}$$

- (1) In case of X company, the proportion debt is higher against shareholders' funds, thus it is less solvent than Y and Z.
- (2) Y company has less debt than that of X, thus it is more solvent against X company but less solvent against Z company.
- (3) Z has the lowest debts against all companies, thus it is more solvent.

X	Y	Z
$\frac{50}{25}$	$\frac{37.5}{37.5}$	$\frac{25}{50}$
2 : 1	1 : 1	0.50 : 1

When in question total liabilities are given with a view to arrive at non-current liabilities deduct current liabilities from it.

**Illustration 16 :** From the following information of 'F. L.' Ltd., calculate debt equity ratio.

Particulars	(₹)	Particulars	(₹)
Equity share capital	10,00,000	Outstanding expenses	1,00,000
General reserve	6,00,000	Long-term loan	2,00,000
Profit-loss A/c	4,00,000	Long-term provisions	2,00,000

**Ans. :**

$$\text{Debt to Equity ratio} = \frac{\text{Liabilities (Long-term liabilities)}}{\text{Equity (Shareholders' funds)}}$$

**Liabilities : (Non-current liabilities)**

Long-term loan	₹	2,00,000
Long-term provisions	₹	2,00,000
	₹	<b>4,00,000</b>

**Equity (Shareholders' funds) :**

Equity share capital	₹	10,00,000
General reserve	₹	6,00,000
Profit-loss A/c	₹	4,00,000
	₹	<b>20,00,000</b>

$$\frac{4,00,000}{20,00,000} = 0.20 : 1$$

Against owners' funds of ₹ 1 of the business entity, non-current liability is ₹ 0.20.

**Note :** Outstanding expenses and current liability, will not be included in debt-equity. Only non-current liabilities will be considered.

**Illustration 17 :** From the following information of 'N' Company, calculate debt-equity ratio.

Total Assets ₹ 25,00,000, Long-term loan ₹ 6,00,000

Long-term provisions ₹ 4,00,000, Current liabilities ₹ 5,00,000

**Ans. :**

$$\text{Debt-Equity ratio} = \frac{\text{Debt (Long-term liabilities)}}{\text{Equity (Shareholders' funds)}}$$

	₹	₹
<b>Non-current liabilities :</b> Long-term loan		6,00,000
Long-term provisions		4,00,000
		<b>10,00,000</b>
<b>Equity (Shareholders' funds) :</b>		
<b>Total Assets</b>		<b>25,00,000</b>
<b>Less :</b>		
Long-term loan	6,00,000	
Long-term provisions	4,00,000	
Current liabilities	5,00,000	15,00,000
		<b>10,00,000</b>

$$\frac{10,00,000}{10,00,000} = 1 : 1$$

**Explanation :** Equity (shareholders' funds) can also be calculated by preparing balance sheet.

### Balance Sheet

Equity-Liabilities	Amt. (₹)	Assets	Amt. (₹)
Equity shareholders' funds	10,00,000	Assets	25,00,000
Non-current liabilities	6,00,000		↓
Long-term provisions	4,00,000		
Current liabilities	5,00,000		
	<b>25,00,000</b>	←	<b>25,00,000</b>

**Illustration 18 :** From the following information of 'R' Co. Ltd., calculate debt-equity ratio.

Particulars	(₹)	Particulars	(₹)
Non-current assets	28,00,000	Creditors	90,000
Current assets	17,00,000	Bills payables	40,000
Total liabilities	15,00,000	Outstanding expenses	70,000

**Ans. :**

$$\text{Debt-Equity ratio} = \frac{\text{Debt (Long-term liabilities)}}{\text{Equity (Shareholders' funds)}}$$

	₹	₹
<b>Debt : Non-current liabilities (Long-term liabilities)</b>		
Total debts		15,00,000
<b>Current liabilities :</b>		
<b>Less : Creditors</b>	90,000	
Bills payables	40,000	
Outstanding expenses	70,000	2,00,000
		<b>13,00,000</b>
<b>Equity = Total Assets – Total liabilities</b>		
Non-current assets		28,00,000
Current assets		17,00,000
		45,00,000
<b>Less : Total liabilities</b>		15,00,000
		<b>30,00,000</b>

$$\frac{13,00,000}{30,00,000} = 0.43 : 1$$

**Explanation :** Computation through balance sheet.

### Balance Sheet

Equity-Liabilities	Amt. (₹)	Assets	Amt. (₹)
Equity Shareholders' funds	30,00,000	Non-current assets	28,00,000
Non-current liabilities (See working given above)	13,00,000	Current assets	17,00,000
Current liabilities	2,00,000		
	<b>45,00,000</b>		<b>45,00,000</b>

#### (ii) Total Assets to Debt Ratio :

**Meaning :** Total Assets to debt ratio shows relation between total Assets and debt (Non-current liabilities). Out of total assets, the proportion of assets acquired by debt, can be ascertained from this ratio.

$$\text{Formula : Total Assets to Debt ratio} = \frac{\text{Total Assets}}{\text{Debt (Long-term liabilities)}}$$

To determine total assets, other non-current assets are not to be considered. (e.g. trade receivables of more than 12 months, expenses not written off etc.)

To determine debt, non-current liabilities are to be considered but other long-term liabilities are not to be considered. (e.g. payables of more than 12 months, debenture redemption premium (when debentures are disclosed under the head of long-term liabilities.)).

**Objectives :** It can be ascertained that out of total assets, what proportion of total assets is acquired through non-current liabilities.

**Trend :** There is no standard measure for this ratio. This ratio indicates reverse trend to trend of debt equity ratio. Generally, when this ratio is higher, it is less risky to the lenders to lend their funds and if it is lower it is more risky to lend funds.

### Balance Sheet

Equity-Liabilities	Companies		
	X	Y	Z
(A) Shareholders' funds	25 %	37.5 %	50 %
(B) Liabilities (Non-current liabilities)	50 %	37.5 %	25 %
(C) Current liabilities	25 %	25 %	25 %
<b>Total</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>
Assets	Companies		
	X	Y	Z
Non-current assets and Current assets	100 %	100 %	100 %
<b>Total</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>

Total assets-debt ratio =

$$\frac{\text{Total Assets}}{\text{Debt (Long-term liabilities)}}$$

- (1) X company has acquired 50 % assets from debt, X company is less solvent as compared to Y and Z company.
- (2) Y company has less debt, thus it is more solvent as compared to X company.
- (3) The quantum of debt is lowest in case of Z company, thus it is the most solvent.

X	Y	Z
$\frac{100}{50}$	$\frac{100}{37.5}$	$\frac{100}{25}$
2 : 1	2.67 : 1	4 : 1

**Illustration 19 :** From the following information of 'U' Ltd., calculate total assets to debt ratio.

Share capital ₹ 30,00,000; reserves and surplus ₹ 5,00,000; non-current liabilities ₹ 10,00,000; current liabilities ₹ 5,00,000

**Ans. :**

$$\text{Total Assets to Debt ratio} = \frac{\text{Total Assets}}{\text{Debt (Long-term liabilities)(Non-current liabilities)}}$$

Total assets are not given but all items of equity-liabilities sides are given. Thus the total of equity-liabilities is total of assets side.

Total of equity-liabilities	=	Total Assets
Equity share capital	₹	30,00,000
Reserve and surplus	₹	5,00,000
Non-current liabilities	₹	10,00,000
Current liabilities	₹	5,00,000
		<b>50,00,000</b>

$$\frac{50,00,000}{10,00,000} = 5 : 1$$

It can be interpreted that out of total assets of ₹ 5, the assets of ₹ 1 are purchased from debt (non-current liabilities). It means the remaining assets of ₹ 4 are purchased from shareholders' funds.

**Illustration 20 :** From the following information of 'D. V.' Co. Ltd., calculate total assets to debt ratio.

	(₹)
Non-current assets (Gross)	28,00,000
Accumulated depreciation on fixed assets	3,00,000
Current assets	5,00,000
Equity share capital	18,00,000
Reserves and surplus	5,00,000
Total liabilities	7,00,000
Current liabilities	1,00,000

**Ans. :**

$$\text{Total Assets to debt ratio} = \frac{\text{Total Assets}}{\text{Debt (Long-term liabilities)}}$$



<b>Total Assets =</b>	(₹)
Non-current assets (Gross)	28,00,000
Less : Depreciation	<u>3,00,000</u>
	25,00,000
Add : Current assets	<u>5,00,000</u>
	<u>30,00,000</u>

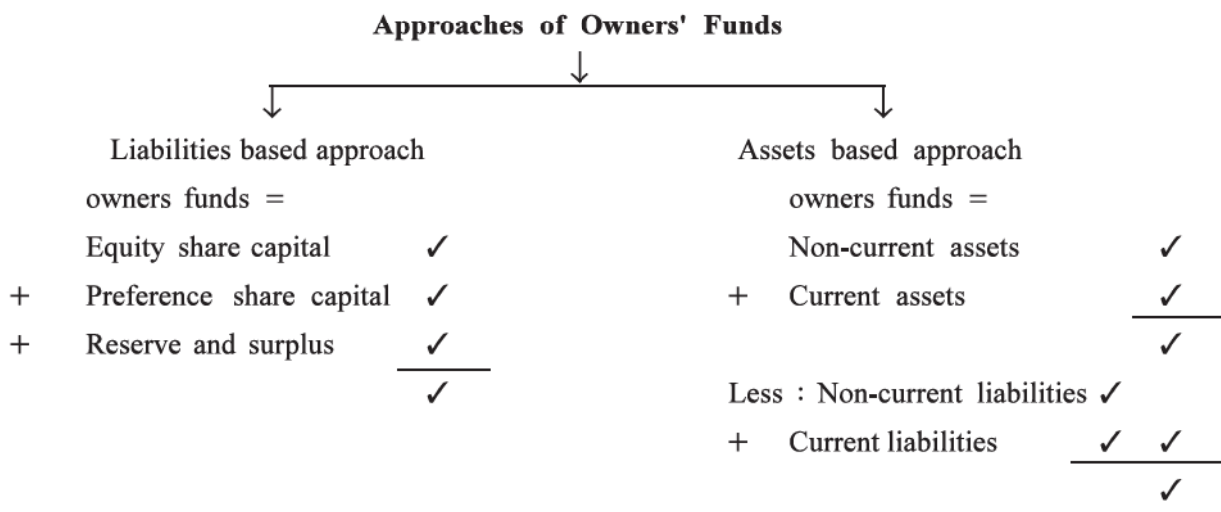
<b>Debt =</b>	(₹)
Total liabilities	7,00,000
Less : Current liabilities	<u>1,00,000</u>
	<u>6,00,000</u>

$$\text{Total Assets-Debt ratio} = \frac{30,00,000}{6,00,000} = 5:1$$

### (iii) Proprietary Ratio :

**Meaning :** Proprietary ratio shows relation between the total assets and the owners' funds (shareholders' funds).

There are two approaches used to determine the owners funds. Under both the approaches, owners' funds remain identical.



$$\text{Formula : Proprietary ratio} = \frac{\text{Owners' funds}}{\text{Total Assets}}$$

**Objective :** This ratio shows what proportion of total assets is acquired by owners funds. It is further assumed that remaining assets are acquired by borrowed funds.

**Trend :** This ratio provides information of economic solvency and margin of safety to the creditors of business. The higher the ratio higher the economic margin of safety and the lower the ratio the lower the economic margin of safety.

**Illustration 21 :** From the following information of 'M' Ltd., calculate Proprietary ratio.

**Balance Sheet as on 31-3-2017**

Particulars	Amt. (₹)	Amt. (₹)
<b>(I) Equity and Liabilities :</b>		
(1) Shareholders' funds :		
Equity share capital	20,00,000	
Preference share capital	10,00,000	
Reserves and surplus	15,00,000	45,00,000
(2) Non-current liabilities		15,00,000
(3) Current liabilities		10,00,000
<b>Total</b>		<b>70,00,000</b>
<b>(II) Assets :</b>		
(1) Non-current assets		50,00,000
(2) Current assets		20,00,000
<b>Total</b>		<b>70,00,000</b>

**Ans. :**

$$\text{Proprietary ratio} = \frac{\text{Proprietor's fund (Owner's funds)}}{\text{Total Assets}}$$

To determine total assets either liabilities based approach or assets based approach can be used.

Liabilities Based Approach	Amt. (₹)	Assets Based Approach	Amt. (₹)
Equity share capital	20,00,000	Non-current assets	50,00,000
Preference share capital	10,00,000	+ Current assets	20,00,000
Reserves and surplus	15,00,000	Less :	
		Non-current liabilities	15,00,000
		Current liabilities	10,00,000
	<b>45,00,000</b>		<b>25,00,000</b>
			<b>45,00,000</b>

$$\begin{aligned} \text{Proprietary ratio} &= \frac{\text{Proprietor's fund}}{\text{Total Assets}} \\ &= \frac{45,00,000}{70,00,000} \\ &= 0.64 : 1 \end{aligned}$$

$$\begin{aligned} &\text{₹ 1.00 Assets} \\ - &\text{₹ 0.64 Assets from owners fund} \\ \hline &\text{₹ 0.36 Assets from borrowed funds} \end{aligned}$$

Out of assets of ₹ 1, assets of ₹ 0.64 are acquired through owners funds and remaining assets of ₹ 0.36 are obtained through borrowed funds.

**(iv) Interest Coverage Ratio :**

**Meaning :** This ratio shows the relation between the earning before interest and tax and the interest on the long-term debt. This ratio shows earning capacity, thus if calculated in terms of times.

$$\text{Formula : Interest coverage ratio} = \frac{\text{Earning before interest and tax}}{\text{Interest on long-term debt}}$$

$$\begin{array}{rcl} \text{Earning before interest and tax} & = & \text{Earning after tax} \quad \checkmark \\ & + & \text{Tax} \quad \checkmark \\ & + & \text{Interest} \quad \checkmark \\ & & \hline & & \checkmark \end{array}$$

**Objectives :** There are two ways to provide capital to the business. Capital provided by the owners and capital borrowed from the external parties. No interest is paid on the owners' capital but the interest is paid on the borrowed capital. Before lending funds to the business, lenders examines the interest payment capacity of the business enterprise. To examine status of interest payment capacity, this ratio is used.

**Trend :** This ratio indicates the interest payment capacity of the business. Thus higher the ratio higher the interest payment capacity of the business and vice versa.

**Illustration 22 :** From the following information of 'N. K.' Company Ltd., calculate interest coverage ratio.

10 % debentures ₹ 10,00,000, 12 % bank loan ₹ 30,00,000, Earning before interest and tax ₹ 20,70,000

**Ans. :**

$$\begin{array}{l} \text{Interest coverage ratio} = \frac{\text{Earning before interest and tax}}{\text{Interest on long-term liabilities}} \\ \left| \begin{array}{l} \text{Interest on long-term liabilities} = \\ \quad \begin{array}{rcl} 10 \% \text{ debentures ₹ 10,00,000} & = & 1,00,000 \\ 12 \% \text{ bank loan ₹ 30,00,000} & = & 3,60,000 \\ \hline & & 4,60,000 \end{array} \end{array} \right. \\ \left| \frac{20,70,000}{4,60,000} = 4.5 \text{ times} \right. \end{array}$$

Company has 4.5 times earnings to pay interest. This indicates good earning.

**Illustration 23 :** From the following information of 'R. J.' Company, calculate interest coverage ratio.

Profit after tax ₹ 10,50,000; tax at 30 % ₹ 4,50,000; 10 % loan of ₹ 50,00,000

**Ans. :**

$$\begin{array}{l} \text{Interest coverage ratio} = \frac{\text{Profit before interest and tax}}{\text{Interest on long-term liabilities}} \\ \left| \begin{array}{l} \text{Profit before interest and tax} = \quad (\text{₹}) \\ \quad \begin{array}{rcl} \text{Profit after tax} & & 10,50,000 \\ + \text{Tax} & & 4,50,000 \\ + \text{Interest (50,00,000} \times 10 \%) & & 5,00,000 \\ \hline & & 20,00,000 \end{array} \end{array} \right. \\ \left| \frac{20,00,000}{5,00,000} = 4 \text{ times} \right. \end{array}$$

## 10. Efficiency (Activity) Ratios :

The profitability of the business increases, when all resources and equipments acquired by the business entity are used efficiently. In this context efficiency or activity ratios are developed. The following ratios are covered in the syllabus. These ratios are calculated in terms of times. Another ratio in this category are debtors' turnover and creditors' turnover. From these two ratios debtors' collection period and creditors' payment periods are determined. This period may be in terms of days, weeks or months.

- (i) Stock turnover
- (ii) Working capital turnover
- (iii) Debtors turnover
- (iv) Creditors turnover

### (i) Stock turnover ratio :

**Meaning :** This ratio shows relation between the cost of goods sold and average stock. How many times stock is converted into production and sales, can be ascertained by this ratio.

**Formula :** 
$$\text{Stock turnover} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

How to determine cost of goods sold, is already studied under the gross profit ratio determination. It is again represented as follows.

### Cost of goods sold :

	Opening stock of raw material	✓
+	Purchase of raw material	✓
+	Purchase expenses	✓
		✓
–	Closing stock of raw material	✓
	Cost of goods consumed	✓
+	Wages	✓
+	Factory expenses	✓
		✓
	Cost of goods sold	✓

Cost of goods sold can be determined also as follows :

Gross profit = Sales – Cost of goods sold. This formula can be modified as follows :

Cost of goods sold = Sales – Gross profit

In case of gross loss

Cost of goods sold = Sales + Gross loss

$$\text{Average stock} = \frac{\text{Opening stock} + \text{Closing stock}}{2}$$

**Objective :** This ratio is the measurement of efficiency for the conversion of stock in to sales.

**Trend :** Generally, the increasing trend is acceptable. The increasing trend shows that very often the stock is converted into cost of goods sold and finally into sales. Generally, it is established that higher the ratio - higher the sales - higher the profit.

Theoretically higher ratio can be a result of deficit (shortage) of working capital and lower ratio can be the result of unnecessary investment in working capital. Thus it is desirable to maintain optimum level of stock.

**Illustration 24 :** From the following information of 'H. N.' Limited, calculate stock turnover ratio.

Sales ₹ 25,00,000; gross profit ₹ 4,00,000; opening stock ₹ 4,00,000 and closing stock ₹ 3,00,000

**Ans. :**

$$\text{Stock turnover} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

Cost of goods sold =		(₹)
Sales		25,00,000
– Gross profit		4,00,000
		21,00,000

$$\text{Average stock} = \frac{\text{Opening stock} + \text{Closing stock}}{2}$$

$$= \frac{4,00,000 + 3,00,000}{2}$$

$$= ₹ 3,50,000$$
  

$$\frac{21,00,000}{3,50,000} = 6 \text{ times}$$

**Illustration 25 :** From the following information of 'D. D.' Company Ltd., calculate stock turnover ratio.

Particulars	(₹)	Particulars	(₹)
Opening stock	30,000	Closing stock	40,000
Purchase	4,80,000	Purchase expenses	20,000

**Ans. :**

$$\text{Stock turnover} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

Cost of goods sold =		(₹)
Opening stock		30,000
+ Purchase		4,80,000
+ Purchase expenses		20,000
		5,30,000
– Closing stock		40,000
		4,90,000

$$\text{Average stock} = \frac{\text{Opening stock} + \text{Closing stock}}{2}$$

$$= \frac{30,000 + 40,000}{2}$$

$$= ₹ 35,000$$
  

$$\frac{4,90,000}{35,000} = 14 \text{ times}$$



## (ii) Working Capital Turn-over Ratio :

**Meaning :** This ratio shows the relation between sales and working capital. If sales is not available, the relation between the cost of goods sold and the working capital is examined. From this ratio it is ascertained that how many times the working capital generates sales.

$$\text{Formula : Working capital turnover} = \frac{\text{Sales (or cost of goods sold)}}{\text{Working capital}}$$

When sales is not given in the question the ratio is to be calculated on the basis of cost of goods sold.

**Objective :** The purpose to invest in working capital is to yield revenue. This ratio is used to examine the efficiency of working capital. As compared to stock turnover ratio this ratio gives better results for efficiency measurement. In stock turnover, only stock is considered, but for this ratio working capital is considered.

**Trend :** Generally, the increasing trend is favourable. Theoretically, the increasing trend shows the efficient use of working capital, which is the cause of higher sales and consequently of higher profit.

**Illustration 26 :** From the following information of 'H. R.' Limited, calculate working capital turnover.

Total sales ₹ 22,20,000; Sales return ₹ 20,000

Current assets ₹ 6,00,000; Current liabilities ₹ 2,00,000

**Ans. :**

$$\text{Working capital turnover} = \frac{\text{Sales}}{\text{Working capital}}$$

<b>Sales :</b>	(₹)
Total Sales	22,20,000
Less : Sales return	<u>20,000</u>
	<u>22,00,000</u>
<b>Working capital :</b>	
Current assets	6,00,000
Less : Current liabilities	<u>2,00,000</u>
	<u>4,00,000</u>

$$= \frac{22,00,000}{4,00,000} = 5.5 \text{ times}$$

**Illustration 27 :** From the following information of 'M. N.' Limited, calculate working capital turnover.

Working capital ₹ 3,00,000, Cost of goods sold ₹ 15,00,000, Gross profit rate 25 %.

**Ans. :**

$$\text{Working capital turnover} = \frac{\text{Sales}}{\text{Working capital}}$$

**Sales :** Cost of goods sold + Gross profit

Assume sales 100 = 75 % + 25 %

<u>20,00,000</u>	= 15,00,000 + 5,00,000
------------------	------------------------

$$= \frac{20,00,000}{3,00,000} = 6.67 \text{ times}$$

On the basis of cost of goods sold :

$$= \frac{15,00,000}{3,00,000} = 5 \text{ times}$$

**Illustration 28 :** From the following information of 'M. M.' Company Ltd., calculate working capital turnover.

Total assets ₹ 45,00,000, Non-current assets ₹ 30,00,000, Total liabilities ₹ 20,00,000

Non-current liabilities ₹ 10,00,000, Sales ₹ 25,00,000

**Ans. :**

$$\begin{aligned} \text{Working capital turnover} &= \frac{\text{Sales}}{\text{Working capital}} \\ \text{Working capital} &: \text{Current assets} - \text{Current liabilities} \\ \text{Current assets} &= \text{Total Assets} - \text{Non-current assets} \\ &= 45,00,000 - 30,00,000 \\ &= ₹ 15,00,000 \\ \text{Current liabilities} &= \text{Total liabilities} - \text{Non-current liabilities} \\ &= 20,00,000 - 10,00,000 \\ &= ₹ 10,00,000 \\ &= ₹ 15,00,000 - 10,00,000 \\ &= ₹ 5,00,000 \\ &= \frac{25,00,000}{5,00,000} = 5 \text{ times} \end{aligned}$$

### (iii) Debtors Turnover Ratio :

**Meaning :** This ratio is known as receivable turnover ratio also. From this ratio it can be ascertained that how many times debtors and receivables emerge from credit sales. This ratio shows relation between credit sales and trade receivables.

$$\text{Formula : Debtors turnover} = \frac{\text{Credit sales}}{\text{Average trade receivables}}$$

Trade receivables means average of debtors and bills receivables of credit sales.

$$\text{Average trade receivables} = \frac{\text{Opening trade receivables} + \text{Closing trade receivables}}{2}$$

**Note :** During determination of trade receivables, bad debts reserve should not be deducted from the debtors. This ratio is for collection period not for receivable amount.

**Objectives :** From this ratio it can be ascertained that how many times debtors and bills receivables are emerged due to credit sales. This turnover shows that how quickly the collection is converted into cash or cash equivalent.

**Trend :** This is performance measurement ratio. Higher ratio shows higher collection efficiency and lower investment in debtors and bills receivable, while lower ratio shows lower collection efficiency and high investment in debtors and bills receivables.

The collection period is determined from this ratio. As stated above the high turnover of debtors gives quick collection and the low turnover of debtors gives slow collection. This time period can be in terms of days, weeks and months. Formulas pertaining to this is as follows :

$$\text{Collection period in months} = \frac{12}{\text{Debtors turnover}}$$

$$\text{Collection period in weeks} = \frac{52}{\text{Debtors turnover}}$$

$$\text{Collection period in days} = \frac{365}{\text{Debtors turnover}}$$

**Note :** To compute this ratio clear instruction should be given to the students. e.g. 12 months, 52 weeks or 365 days.

**Illustration 29 :** From the following information of 'R. R.' Limited determine debtors turnover and collection period in months, weeks and days.

Particulars	(₹)	Particulars	(₹)
Total Sales	40,00,000	Cash Sales	3,50,000
Opening debtors and bills receivables	4,00,000	Closing debtors and bills receivables	3,30,000

**Ans. :** This kind of problems are solved in two stages, which are as follows :

(A) **Debtors turnover :**  $\frac{\text{Credit sales}}{\text{Average trade receivables}}$

<b>Credit sales :</b>	(₹)
Total sales	40,00,000
– Cash sales	3,50,000
	<u>36,50,000</u>

$$\begin{aligned} \text{Average trade receivables} &= \frac{\text{Opening debtors and bills receivables} + \text{Closing debtors and bills receivables}}{2} \\ &= \frac{4,00,000 + 3,30,000}{2} \\ &= ₹ 3,65,000 \end{aligned}$$

$$\frac{36,50,000}{3,65,000} = 10 \text{ times}$$

(B) **Collection period :**

In months	In weeks	In days
(A)	(B)	(C)
12	52	365
<u>Debtors turnover</u>	<u>Debtors turnover</u>	<u>Debtors turnover</u>
$\frac{12}{10}$	$\frac{52}{10}$	$\frac{365}{10}$
1.2 months	5.2 weeks	36.5 days (37 days)

**Note :** The above stated figures indicate that if collection period is calculated in terms of months, the collection will be received within 1.2 months. If it is calculated in terms of weeks, the collection will be received within 5.2 weeks and in terms of days the collection will be received within 36.5 days.

**Illustration 30 :** From the following information of 'R. H.' Company Limited, calculate debtors turnover and collection period in days.

Particulars	(₹)	Particulars	(₹)
Cost of goods sold	48,00,000	Gross profit	12,00,000
Cash Sales	12,00,000	Closing trade receivables	1,70,000
Opening trade receivables	2,30,000		

**Ans. :**

(A) **Debtors turnover** :  $\frac{\text{Credit sales}}{\text{Average trade receivables}}$

**Credit sales** : Total sales – Cash sales

Total sales = Cost of good sold + Gross profit

= 48,00,000 + 12,00,000

= ₹ 60,00,000

= ₹ 60,00,000 – ₹ 12,00,000 = ₹ 48,00,000

**Average trade receivables** =  $\frac{\text{Opening trade receivables} + \text{Closing trade receivables}}{2}$

=  $\frac{2,30,000 + 1,70,000}{2}$

= ₹ 2,00,000

$\frac{48,00,000}{2,00,000} = 24$  times

(B) **Collection period** =  $\frac{365 \text{ days}}{\text{Debtors turnover}}$

=  $\frac{365}{24}$

= 15.21 days = 15 days

(iv) **Creditors' Turnover Ratio :**

**Meaning :** This ratio is known as payable turnover ratio also. From this ratio it can be ascertained that how many times creditors and bills payables are emerged by credit purchase. This ratio shows the relation between the credit purchase and trade payables.

**Formula :** Creditors turnover =  $\frac{\text{Credit purchase}}{\text{Average trade payables}}$

Average trade payables means average of creditors and bills payables of credit purchase.

Average trade payables =  $\frac{\text{Opening trade payables} + \text{Closing trade payables}}{2}$

**Objectives :** From this ratio it can be ascertained that how many times creditors and bills payables are emerged due to credit purchase. This ratio indicates, how quickly the payment is made.

**Trend :** This is a performance measurement ratio. Lower ratio shows higher payment efficiency. Owner has to spare his own capital in low quantum due to creditors and bills payables. Higher ratio shows lower payment efficiency.

The payment period is determined from this ratio. This time period can be in months, weeks and days. Formula in this context similar to collection period, are as follows :

$$\text{The payment period in months} = \frac{12}{\text{Creditors turnover}}$$

$$\text{The payment period in weeks} = \frac{52}{\text{Creditors turnover}}$$

$$\text{The payment period in days} = \frac{365}{\text{Creditors turnover}}$$

**Illustration 31 :** From the following information of 'A. B.' Company Ltd., calculate creditors turnover and payment period in months, weeks and days.

Particulars	(₹)	Particulars	(₹)
Total purchase	30,00,000	Cash purchase	4,00,000
Opening trade payables	3,60,000	Closing trade payables	4,80,000

**Ans. :**

(A) **Creditors turnover :**  $\frac{\text{Credit purchase}}{\text{Average trade payables}}$

<b>Credit purchase :</b>	(₹)
Total Purchase	30,00,000
– Cash Purchase	4,00,000
	<u>26,00,000</u>

$$\begin{aligned} \text{Average trade payables} &= \frac{\text{Opening trade payables} + \text{Closing trade payables}}{2} \\ &= \frac{3,60,000 + 4,80,000}{2} \\ &= ₹ 4,20,000 \end{aligned}$$

$$\frac{26,00,000}{4,20,000} = 6.19 \text{ times}$$

(B) **Payment period :**

In months (A)	In weeks (B)	In days (C)
$\frac{12}{6.19}$	$\frac{52}{6.19}$	$\frac{365}{6.19}$
Creditors turnover	Creditors turnover	Creditors turnover
1.94 months	8.40 weeks	58.97 days (59 days)



**Illustration 32 :** From the following information of 'A. A.' Company Ltd., calculate creditors turnover and payment period in days.

Particulars	(₹)	Particulars	(₹)
Total purchase	35,00,000	Cash purchase	3,00,000
Purchase return	2,00,000	Opening trade payables	5,40,000
Closing trade payables	4,60,000		

**Ans. :**

(A) **Creditors turnover** :  $\frac{\text{Credit purchase}}{\text{Average trade payables}}$

<b>Credit purchase :</b>	(₹)
Total purchase	35,00,000
— Purchase return	2,00,000
	<u>33,00,000</u>
— Cash purchase	3,00,000
	<u>30,00,000</u>

$$\begin{aligned} \text{Average trade payables} &= \frac{\text{Opening trade payables} + \text{Closing trade payables}}{2} \\ &= \frac{5,40,000 + 4,60,000}{2} \\ &= ₹ 5,00,000 \end{aligned}$$

$$\frac{30,00,000}{5,00,000} = 6 \text{ times}$$

$$\begin{aligned} \text{(B) Payment period in days} &= \frac{365}{\text{Creditors turnover}} \\ &= \frac{365}{6} = 60.83 \\ &= 61 \text{ days} \end{aligned}$$

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### Exercise

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1. Select appropriate option for each question :

- (1) Which of the following is correct for accounting ratios ?
- Comparison with ratios developed by the firm
  - Comparison with ratios of industry
  - Comparison with ratios of competitors
  - All of the above

- (2) In which terms ratios are presented ?
- (a) Proportion (b) Percentage  
(c) Time (d) All of the above
- (3) For which of the following items the ratio is computed in days ?
- (a) For total purchase (b) For credit sales  
(c) For credit purchase (d) Both (b) and (c)
- (4) Which of the following ratios are included in traditional classification ?
- (a) Composite ratios (b) Liquidity ratios  
(c) Profitability ratios (d) Solvency ratios
- (5) Which of the following ratios is revenue based profitability ratio ?
- (a) Gross profit ratio (b) Net profit ratio  
(c) Operating ratio (d) Both (a) and (b)
- (6) A company has the purchase of ₹ 90,000, the purchase expenses of ₹ 15,000, the changes in stock (₹ 15,000) and sales of ₹ 1,50,000. Determine the gross profit ratio.
- (a) 40 % (b) 13.33 %  
(c) 20 % (d) None of the above
- (7) Which of the following is not included in operating expense ?
- (a) Loss on sale of asset (b) Loss due to fire  
(c) Interest paid (d) All of the above
- (8) The cost of goods sold of a company is ₹ 10,00,000. Operating expenses are ₹ 2,00,000. Non-operating expenses are ₹ 3,00,000. Financial expenses are ₹ 1,00,000. If total sales is ₹ 20,00,000, determine operating profit ratio.
- (a) 20 % (b) 40 %  
(c) 30 % (d) 28 %
- (9) Liquidity ratio is ..... .
- (a) measurement of solvency (b) measurement of short-term profitability  
(c) measurement of profitability (d) measurement of liquidity
- (10) Which of the following is not included to compute current ratio ?
- (a) Debtors (b) Stock  
(c) Bills receivables (d) Furniture
- (11) Working capital means ..... .
- (a) difference between current assets and non-current assets  
(b) difference between current liabilities and non-current assets  
(c) difference between current assets and non-current liabilities  
(d) difference between current assets and current liabilities
- (12) To arrive at liquid assets which of the following is deducted from current assets ?
- (a) Stock (b) Cash and cash equivalent  
(c) Debtors (d) Bills receivables

**2. Answer the following questions in one sentence :**

- (1) What is ratio ?
- (2) When ratio is useful ?
- (3) In which forms ratios can be presented ?
- (4) What is the cost of goods sold ?
- (5) The gross profit ratio and the net profit ratios are revenue based ratios or expense based ratios ?
- (6) When the changes in stock is positive, whether it will be added to cost of goods sold or deducted ?
- (7) Give one illustration of financial expense.
- (8) Are financial expenses included to determine operating ratio ?
- (9) What is indicated by liquidity ratios ?
- (10) Will the current ratio increase or decrease when the current assets increase and the current liabilities remain unchanged ?
- (11) What is the shareholders' funds ?
- (12) What is indicated by interest coverage ratio ?
- (13) Which is better out of high interest coverage ratio and low interest coverage ratio ?
- (14) By which ratios efficiency is measured ?
- (15) In order to arrive at trade receivables is bad debts reserve deducted from debtors ?

**3. Answer the following questions in brief :**

- (1) Explain three objectives of ratio analysis.
- (2) Describe three limitations of ratio analysis.
- (3) When are the computed ratios useful ?
- (4) Explain the traditional classification of ratios.
- (5) Explain the functional classification of ratios.
- (6) Explain any one ratio of profitability.
- (7) Explain any one ratio of liquidity.
- (8) Explain any one ratio of solvency.
- (9) Explain any one ratio of efficiency.
- (10) What are included in operating expenses ?
- (11) Explain non-operating incomes.
- (12) Do we consider current investment for current ratio ?
- (13) Explain the approaches of proprietary funds.

**4. Determine gross profit ratio :**

- (1) Sales ₹ 10,00,000, Gross profit ₹ 3,00,000
- (2) Sales ₹ 15,00,000, Cost of goods sold ₹ 12,00,000

- (3) Sales ₹ 20,00,000                      Sales return ₹ 2,00,000  
 Opening stock ₹ 2,50,000,              Closing stock ₹ 3,50,000  
 Purchase ₹ 12,00,000                      Purchase expenses ₹ 50,000

5. From the following information calculate operating ratio :

Particulars	(₹)	Particulars	(₹)
Non-operating other expenses	35,000	Income of Interest-dividend	45,000
Depreciation	48,000	Sales expenses	52,000
Administrative expenses	75,000	Cost of goods sold	3,25,000
Sales	6,00,000	Financial expenses	85,000
Tax rate	30 %		

6. From the following information calculate (i) operating ratio and (ii) operating profit ratio :

Particulars	(₹)	Particulars	(₹)
Sales	39,00,000	Wages	2,00,000
Cost of goods consumed	25,00,000	Administrative expenses	1,75,000
Sales expenses	75,000	Interest on loan	60,000
Loss due to accident	40,000	Dividend received on investments	1,00,000
Factory expenses including depreciation	50,000	Tax rate	30 %

7. Calculate net profit ratio from information of question no. 5 and 6.

8. From the following information calculate current ratio and liquid ratio :

Particulars	(₹)	Particulars	(₹)
Stock	3,00,000	Bills receivables	75,000
Debtors	2,50,000	Bad debts reserve	20,000
Cash and cash equivalent	1,20,000	Expenses paid in advance	60,000
Furniture	1,60,000	Creditors	2,00,000
Bills payable	60,000	Outstanding expenses	50,000
Short-term loan	40,000		

9. From the following information of 'H' Limited, calculate debt-equity ratio :

Particulars	(₹)	Particulars	(₹)
Long-term liabilities	8,00,000	Equity share capital	8,00,000
Long-term provisions	4,00,000	Preference share capital	2,00,000
Debit balance of profit-loss A/c	50,000	Creditors	1,25,000
Bills payables	25,000	Outstanding expenses	10,000

10. From the following information of 'M' Limited, calculate debt-equity ratio :

Particulars	(₹)	Particulars	(₹)
Current liabilities	4,50,000	Long-term liabilities	8,00,000
Long-term provisions	6,00,000	Total assets	30,00,000

11. From the following information of 'N' Company Limited, calculate debt-equity ratio :

Particulars	(₹)	Particulars	(₹)
Creditors	1,60,000	Non-current assets	12,00,000
Bills payables	1,40,000	Current assets	10,00,000
Outstanding expenses	1,00,000	Total liabilities	10,00,000

12. From the following information of 'R' Company Limited, calculate total assets-debt ratio.

Particulars	(₹)	Particulars	(₹)
Preference Share capital	6,00,000	Non-current liabilities	4,00,000
Equity Share capital	10,00,000	Current liabilities	4,00,000
Reserves and surplus	2,00,000		

13. From the following information of 'T' Company Ltd., calculate proprietary ratio :

Particulars	(₹)	Particulars	(₹)
Equity share capital	12,00,000	Current liabilities	4,00,000
Preference share capital	8,00,000	Non-current assets	12,00,000
Reserves and surplus	4,00,000	Current assets	24,00,000
Non-current liabilities	8,00,000		

14. From the following information of 'K' Company Ltd., calculate interest coverage ratio :

Particulars	(₹)	Particulars	(₹)
Profit after tax	7,50,000	Taxes paid	2,50,000
10 % debentures	20,00,000	12 % loan	10,00,000

15. Calculate stock turnover ratio, from the following information of 'L' Company Ltd. :

Particulars	(₹)	Particulars	(₹)
Sales	30,00,000	Opening stock	3,50,000
Closing stock	2,50,000	Purchases	12,00,000
Gross profit rate	30 %		

16. Calculate stock turnover ratio from the following information of 'Y' Company Ltd. :

Particulars	(₹)	Particulars	(₹)
Opening stock	2,00,000	Closing stock	1,50,000
Sales	40,00,000	Purchases	22,00,000
Purchase expenses	1,00,000	Wages	2,50,000

17. Calculate working capital turnover ratio (based on sales and cost of goods sold), from the following information of 'Z' Company Ltd. :

Particulars	(₹)	Particulars	(₹)
Cost of goods sold	32,00,000	Gross profit	8,00,000
Non-current assets	10,00,000	Current assets	5,00,000
Non-current liabilities	6,00,000	Current liabilities	3,00,000



18. From the following information of 'B' Company Ltd., calculate debtors turnover and collection period in days. What will be answer if collection period is calculated in terms of weeks and months ? (Assume 360 days of the year)

Particulars	(₹)	Particulars	(₹)
Total Sales	4,50,000	Credit sales	3,65,000
Opening debtors	70,000	Closing debtors	50,000
Opening bills receivables	20,000	Closing bills receivables	6000
Opening creditors	45,000	Closing creditors	48,000

19. From the following information of 'C' Company Ltd., calculate creditors turnover and payment period in days. What will be answer if payment period is calculated in terms of weeks and months ? (Assume 360 days of the year)

Particulars	(₹)	Particulars	(₹)
<b>Opening balances :</b>		Credit sales	6,00,000
Creditors	45,000	Cash sales	4,00,000
Bills payables	15,000	Total sales	10,00,000
Bills receivables	30,000	Total purchase	6,00,000
Debtors	30,000	Cash purchase	2,40,000
<b>Closing balances :</b>			
Creditors	40,000		
Bills payables	20,000		
Bills receivables	40,000		
Debtors	20,000		



# 6

## Cash Flow Statement

- |   |  |
|---|--|
| 1. Introduction                           | 6. Cash Flow from Operating Activities |
| 2. Meaning of Terminology                 | 7. Cash Flow from Investing Activities |
| 3. Classification of Cash Flow Activities | 8. Cash Flow from Financing Activities |
| 4. Special Activities                     | — Exercise                             |
| 5. Cash Flow Statement                    |  |

### 1. Introduction

Profit and loss statement and balance sheet are included in financial accounts. Both the statements are prepared for predetermined objectives. Its preparation process is also predetermined. These statements are prepared on mercantile base. Where actual expenses and actual incomes (of respective year - whether paid in cash or not, whether received in cash or not) are recorded in the profit and loss statement. Revenue expenses and revenue incomes are disclosed in profit and loss statement. Equity-liabilities and assets are disclosed in balance sheet.

In brief, profit and loss account which is prepared on mercantile base, shows profitability of the business. Balance sheet provides information about economic solvency.

Besides, profit and loss statement and balance sheet, cash flow statement is also included as a component of financial accounts. Amongst all assets of the business, cash is the most liquid asset. Cash does not give any direct - return, unless it is invested. e.g. you have ₹ 1,00,000 and for one year you have kept it in locker, this will not give you any return. If this ₹ 1,00,000 is deposited in a bank, invested in share or debentures or invested in any other opportunity, would generate interest, dividend or profit. Thus, the investment of cash is very essential creation of reward and earnings.

The sources of cash and application of cash, both the decisions are very important. It is desirable to procure cash from an appropriate source at the same time it is important to invest cash in appropriate opportunity. This information is not disclosed by profit and loss statement and balance sheet. There are different objectives to prepare these statements. What are the sources of cash ? Where cash is invested ? This information is available from cash flow statement. Therefore the preparation of cash flow is mandatory for certain business enterprises. So that investors can take their decisions in appropriate manner.

As per accounting standard 3 disclosure of cash flow statement is mandatory from 1-4-2004 and onwards for certain business enterprises. The disclosure of cash flow statement is mandatory for those business entities whose equity or debt securities are listed or in the process of being listed on the Indian and foreign stock exchanges. As per accounting standard 3, these business enterprises have to prepare the cash flow statements under indirect method.

Under section 2(40) of Companies Act, 2013, the cash flow statement is included in the definition of financial statements.

## 2. Meaning of Terminologies

(1) **Cash flow** : There are two types of cash flows : (a) cash inflow and (b) cash outflow. Here cash flow means receipt-payment of cash and cash equivalent. A transaction due to which cash or cash equivalent increases is known as cash inflow. A transaction due to which cash or cash equivalent decrease is known as cash outflow.

The difference of cash inflow and cash outflow is called as net cash flow. This difference can be as follows :

		₹
●	Cash inflow	✓ 1,00,000
	Less : Cash outflow	✓ 85,000
	Net cash inflow	✓ 15,000
●	Cash inflow	✓ 85,000
	Less : Cash outflow	✓ 1,00,000
	Net cash outflow	✓ (15,000)

(2) **Cash** : Cash means cash on hand, bank balance.

(3) **Cash equivalent** : Cash equivalent means,

- highly liquid short-term investments
- such investments which can be quickly and with accurate estimated price convertible into cash
- The investment in which the risk of changes in the price is very rare.

e.g. (i) Government securities (ii) Any securities having above stated features.

(4) **Cash flow statement** : Three types of activities are disclosed in cash flow statement.

– Operating activities – Investing activities – Financing activities

There can be cash inflow and/or cash outflow in each activity. The opening balance of cash and cash equivalent is added to cash flows generated through these three activities. At the end whatever amount would arrive will be closing balance of cash and cash equivalent. Cash flow generated from these activities can be positive or negative.

## 3. Classification of Cash Flow Activities :

### Profit and Loss Account

Dr		Cr	
Particulars	Amt. (₹)	Particulars	Amt. (₹)
Opening stock		Operating incomes	
Purchase			
Purchase expenses		Non-operating incomes →	will be deducted from operating profit
Operating expenses in cash			
Non-cash operating expenses →	Will be added to operating profit		
Financial expenses and appropriation →			
Net profit			

### Balance Sheet

Equity-Liabilities	Amt. (₹)	Assets	Amt. (₹)
Shareholders' funds	Financial activities	Non-current assets	Investing activities
Non-current liabilities			
Current liabilities		Current assets	

Operating activities

In cash flow statement, activities of specific period are classified into three categories :

- (1) Operating activities and cash flow from operating activities
- (2) Investing activities and cash flow from investing activities
- (3) Financing activities and cash flow from financing activities

Their detailed explanation is as follows :

#### (1) Operating activities and cash flow from operating activities :

**Operating activities** : Operating activities are activities that emerge from profit and loss statement. Transactions recorded in profit and loss statements are classified for these activities. In this context operating expenses related discussion is done in the previous chapter of ratio analysis. Operating profit is computed as follows :

**Definition** : "Operating activities means main activities of business to earn income, which are neither investing activities nor financing activities.

These are those activities on the basis of which main income of the business is created.

The identification of operating activities is determined on the basis of the nature of industry of a business unit. The identification of operating activities of each business is based on the nature of business. This discussion is pertaining to main activities of income generation. e.g.

(1) **Trading Company** : For this kind of company, activities of purchase - sales of goods are main activities of income generation.

(2) **Insurance Company** : For this kind of company premium income and payment of claims are main activities of income generation.

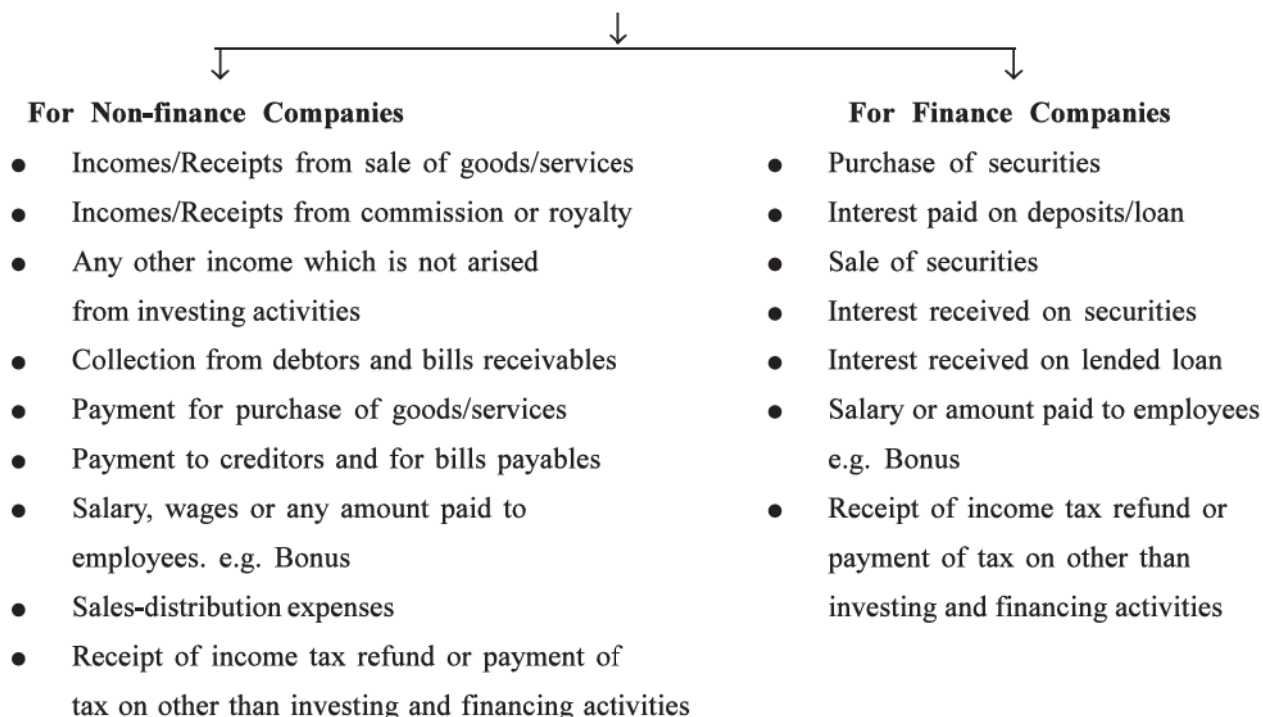
(3) **Bank** : For this kind of business unit lending of loan and acceptance of deposits are main activities of income generation.

Generally by dividing forms of company into two categories, clarity can be obtained.

- (1) Non-finance companies
- (2) Finance companies

The cash flow emerging given the operating activities of both the types of companies can be narrated as under :

### Cash Flow from Operating Activities



**Illustration 1 :** Identify operating activities from the following transactions of Meena Company.

- |                             |                                       |
|-----------------------------|---------------------------------------|
| (1) Salary paid             | (2) Wages paid                        |
| (3) Loan borrowed           | (4) Debentures redeemed               |
| (5) Received from debtors   | (6) Paid for bills payables           |
| (7) Sale of machine on cash | (8) Brokerage received                |
| (9) Purchase of furniture   | (10) Interest received on investments |
| (11) Paid interest on loan  | (12) Income tax refund                |

**Ans. :**

No.	Transactions	Explanation
(1)	Salary paid	Operating activity - Transaction of profit and loss statement
(2)	Wages paid	Operating activity - Transaction of profit and loss statement
(3)	Loan borrowed	Not operating activity - Transaction of equity and liabilities
(4)	Debentures redeemed	Not operating activity - Transaction of equity and liabilities
(5)	Received from debtors	Operating activity - Debtors are arised from sales Sales is operating activity.
(6)	Paid for bills payables	Operating activity - Bills payables arised from creditors and creditors from credit purchase - Purchase is operating activity.
(7)	Sale of machine on cash	Not operating activity - Transaction of assets
(8)	Brokerage received	Operating activity - Transaction of profit and loss statement



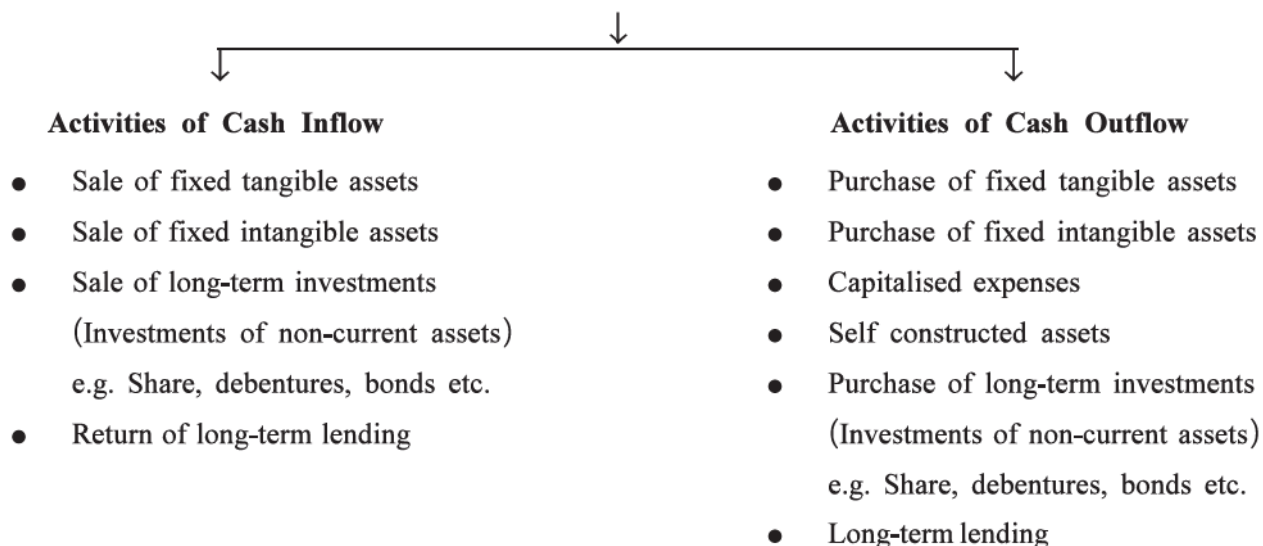
(9)	Purchase of furniture	Not operating activity - Transaction of assets
(10)	Interest received on investments	Not operating activity - Investments are assets. Interest arised on it is part of investment. Transaction of assets
(11)	Paid interest on loan	Not operating activity - Loan is liability. It's paid interest is result of liability. Transaction of equity and liabilities
(12)	Income tax refund	Operating activity - (When no clarification is provided whether it is refund of financing or investing activity, will be treated as operating activity.)

**Note :** There are certain transactions which are always included in operating activities. e.g. Salary, wages, bonus to workers, employees welfare expenses etc.

## (2) Investing Activities :

Investing activities, arise from transactions of assets side of balance sheet. Investing activities means purchase-sale of long-term investments and other investments. Cash and cash equivalent are not included. Long-term assets are those assets which are not acquired for sale purpose. They are used for business activities. Purchase of such assets is treated as cash out flow and sale is treated as cash inflow. e.g. land-building, machines, furniture and other assets held for the generation of income are also included in investing activities. The income received due to these investments like interest, dividend or rent is also included in investing activities.

### Cash Inflow and Outflow of Investing Activities



**Illustration 2 :** From the following transactions of Rita Company identify investing activities. Also state whether the respective activity is cash inflow or cash outflow :

- |                                   |                                 |
|-----------------------------------|---------------------------------|
| (1) Purchase of land              | (2) Sale of machine             |
| (3) Purchase of shares of X co.   | (4) Sale of debentures of Y co. |
| (5) Assets constructed in factory | (6) Purchase of copy-rights     |
| (7) Salary paid                   | (8) Carriage inward paid        |

Ans. :

No.	Transaction	Explanation
(1)	Purchase of land	Investing activity of cash outflow. Investment in asset is increased.
(2)	Sale of machine	Investing activity of cash inflow. Investment is reduced from assets.
(3)	Purchase of shares of X co.	Investing activity of cash outflow. Investment in assets is increased.
(4)	Sale of shares of Y co.	Investing activity of cash inflow. Investment is reduced from assets.
(5)	Assets constructed in factory	Investing activity of cash outflow. Investment is increased in assets.
(6)	Purchase of copy-rights	Investing activity of cash outflow. Investment is increased in assets.
(7)	Salary paid	Not investing activity. (Operating activity of cash outflow.)
(8)	Carriage inward paid	Not investing activity. (Operating activity of cash outflow.)

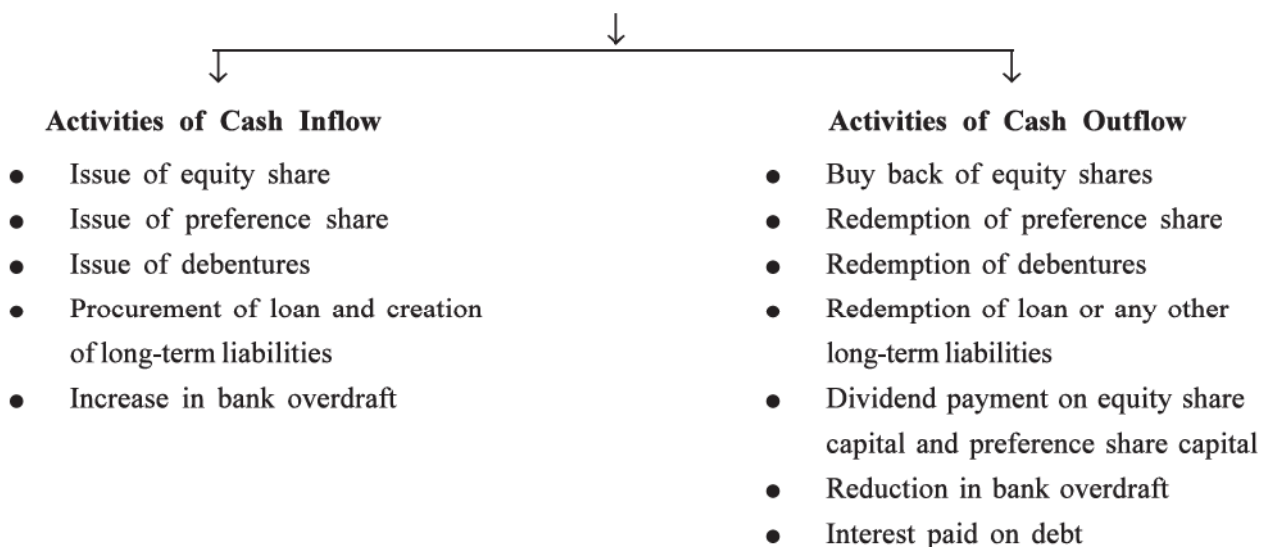
**Note :** There are certain transactions which are always included by investing activities for purchase of fixed (non-current) asset. (Investment in fixed assets) is not done for resale purpose. Thus these transactions are always considered as investing activities. e.g. purchase of patent, purchase of furniture etc. During transaction if cash/bank A/c is debited will be treated as cash inflow and if cash/bank A/c is credited will be treated as cash outflow.

### (3) Financing Activities :

Financing activities, arise from the transactions of equity and liabilities (except those of current liabilities) side of balance sheet. "Financing activities are such activities due to which size and/or composition of owners' capital (including preference share capital) and borrowed capital of business get changed."

Financing activities have relation with increase or decrease of equity share capital, preference share capital, debentures, loan etc. It means that the increase in long-term owners' capital and borrowed capital shows cash inflow and their reduction shows cash outflow of financing activities.

#### Cash Inflow and Cash Outflow of Financing Activities



**Illustration 3 :** From the following transactions of Nayana Company identify financing activities. Also state whether the respective activity is cash inflow or cash outflow.

- |                                    |  |
|------------------------------------|--|
| (1) Redemption of preference share | (2) Issue of debentures                |
| (3) Payment of dividend            | (4) Loan borrowed for 3 years from BOB |
| (5) Sale of machine                | (6) Wages paid                         |
| (7) Commission received            | (8) Interest received on investments   |

**Ans. :**

No.	Transactions	Explanation
(1)	Redemption of preference share	Financing activity of cash outflow. It reduces capital.
(2)	Issue of debentures	Financing activity of cash inflow. It increases liabilities.
(3)	Payment of dividend	Financing activity of cash outflow. Dividend paid in share capital. Thus it is financing activity.
(4)	Loan borrowed for 3 years from BOB	Financing activity of cash inflow. Liability is increased.
(5)	Sale of machine	Not financing activity. (Investing activity of cash inflow.)
(6)	Wages paid	Not financing activity. (Operating activity of cash outflow.)
(7)	Commission received	Not financing activity. (Operating activity of cash inflow.)
(8)	Interest received on investments.	Not financing activity. (Interest received on investments is investing activity of cash inflow.)

**Note :** There are certain transactions which are always included in financing activities. e.g. Dividend paid on share capital. This transaction is linked with capital, thus considered as financing activity.

#### 4. Special Activities :

(1) **Two activities from one transaction :** Two types of payments are included in each instalment of hire purchase - payment towards principal amount and interest amount.

- |   |   |
|---|---|
| ● Payment towards principal<br>(Payment towards cash price) | ● It is investing activity. Value of assets is increased. Investing activity of cash outflow.     |
| ● Interest payment  | ● It is return of liability, thus it is a financing activity. Financing activity of cash outflow. |

(2) **Cash transaction but no cash inflow - outflow :**

- |                          |  |
|--------------------------|--|
| Cash deposited with bank | → cash reduced, bank balance increased |
| Cash withdrawn from bank | → cash increased, bank balance reduced |

Cash balance and bank balance are shown at the same place in cash flow statement. It is known as cash and cash equivalent. This transaction has relation with cash, but does not influence cash and cash equivalent.

(3) **Non-cash transactions and provisions :** Many transactions of business are not done in cash form. Thus during preparation of cash flow these transactions are not considered as cash flow. e.g. Depreciation charged on tangible assets, amount amortized on intangible assets, issue of equity share and debenture without cash consideration, conversion of debentures into equity.

**Illustration 4 :** Following transactions of Bharati Company classified into operating, investing and financing activities.

- |                              |  |
|------------------------------|--|
| (1) Issue of equity share    | (2) Redemption of preference share         |
| (3) Long-term loan from bank | (4) Cash balance                           |
| (5) Bank balance             | (6) Quickly saleable short-term securities |

- |                                  |  |
|----------------------------------|--|
| (7) Short-term bank deposit      | (8) Commission received                    |
| (9) Amount received from debtors | (10) Payment to creditors                  |
| (11) Sale of machine             | (12) Purchase of furniture                 |
| (13) Manufacturing expenses      | (14) Commission paid                       |
| (15) Income tax paid             | (16) Purchase of investments (Non-current) |
| (17) Sales-distribution expenses | (18) Factory expenses                      |
| (19) Paid for trademark          | (20) Paid for goodwill                     |
| (21) Dividend payment            | (22) Interest received                     |
| (23) Income tax refund           | (24) Purchase of raw material              |
| (25) Rent received               | (26) Rent paid                             |

**Ans. :**

No.	Activities	Transaction Number
(1)	Operating activity	8, 9, 10, 13, 14, 15, 17, 18, 23, 24, 26
(2)	Investing activity	11, 12, 16, 19, 20, 22, 25
(3)	Financing activity	1, 2, 3, 21
(4)	Cash and cash equivalent	4, 5, 6, 7

No.	Transaction	Explanation	Cash Flow
(1)	Issue of equity share	Financing activity	Cash inflow
(2)	Redemption of preference share	Financing activity	Cash outflow
(3)	Long-term loan from bank	Financing activity	Cash inflow
(4)	Cash balance	Non-financing activity	Cash equivalent
(5)	Bank balance	Non-financing activity	Cash equivalent
(6)	Quickly saleable short-term securities	Non-financing activity	Cash equivalent
(7)	Short-term bank deposit	Non-financing activity	Cash equivalent
(8)	Commission received	Operating activity	Cash inflow
(9)	Amount received from debtors	Operating activity	Cash inflow
(10)	Payment to creditors	Operating activity	Cash outflow
(11)	Sale of machine	Investing activity	Cash inflow
(12)	Purchase of furniture	Investing activity	Cash outflow
(13)	Manufacturing expenses	Operating activity	Cash outflow
(14)	Commission paid	Operating activity	Cash outflow
(15)	Income tax paid	Operating activity	Cash outflow
(16)	Purchase of investments (Non-current)	Investing activity	Cash outflow



No.	Transaction	Explanation	Cash Flow
(17)	Sales-distribution expenses	Operating activity	Cash outflow
(18)	Factory expenses	Operating activity	Cash outflow
(19)	Paid for trademark	Investing activity	Cash outflow
(20)	Paid for goodwill	Investing activity	Cash outflow
(21)	Dividend payment	Financing activity	Cash outflow
(22)	Interest received	Investing activity	Cash inflow
(23)	Income tax refund	Operating activity	Cash inflow
(24)	Purchase of raw material	Operating activity	Cash outflow
(25)	Rent received	Investing activity	Cash inflow
(26)	Rent paid	Operating activity	Cash outflow

### 5. The Cash Flow Statement

The cash flow statement provides information about generation of cash flow from different activities. Cash flow is disclosed in terms of cash inflow and cash outflow. As discussed earlier cash inflow and outflow is determined on the basis of different activities.

Where (1) Cash flow from operating activities

(Prepared on the basis of profit and loss statement and profit and loss appropriation. Besides this, changes (increase/decrease) in current assets and current-liabilities are considered.)

(2) Cash flow from investing activities

(Prepared on the basis of assets side of balance sheet and non-operating incomes of profit and loss statement.)

(3) Cash flow from financing activities

(Prepared on the basis of equity and liabilities side of balance sheet, profit and loss statement and profit and loss appropriation.)

#### ● The Format of Cash Flow Statement (Indirect Method) :

**The Cash Flow Statement for ..... Co. Ltd. for the Year Ending on .....**

Particulars	(₹)	(₹)
<b>A</b> Cash flow from operating activities		✓
Net profit of current year		
<b>Less : Non-operating incomes</b>		
Profit on sale of investments	✓	
Profit on sale of assets	✓	
Interest received on investments	✓	
Dividend received on investments	✓	
Rent income on assets	✓	✓
		✓



Particulars	(₹)	(₹)
<b>Add : Non-cash transactions, provisions and financial expenses :</b>		
Depreciation written off	✓	
Intangible assets amortized	✓	
Fictitious assets written off	✓	
Loss on sale of asset	✓	
Taxation provision (of current year)	✓	
Transfer to general reserve	✓	
Proposed dividend (of current year)	✓	✓
<b>Add : Financing expenses</b>		✓
Dividend paid	✓	
Interest paid	✓	✓
Operating profit before changes in working capital		✓
Add : Decrease in current assets	✓	
Increase in current liabilities	✓	✓
		✓
Less : Increase in current assets	✓	
Decrease in current liabilities	✓	✓
		✓
Less : Tax paid of previous year		✓
Cash flow from operation		✓
<b>B Cash flow from investing activities :</b>		
Sale of assets (Tangible - Intangible)	✓	
Sale of non-current investments	✓	
Interest and dividend received	✓	
Rent received	✓	
Purchase of assets (Tangible - Intangible)	(✓)	
Purchase of non-current investments	(✓)	✓
Net cash flow from investing activities		✓
<b>C Cash flow from financing activities :</b>		
Issue of share - debentures	✓	
Proceeds from long-term borrowings	✓	
Short-term borrowings		
(i) Increase in bank overdraft and cash credit	✓	
(ii) Decrease in bank overdraft and cash credit	(✓)	
Payment of final dividend	(✓)	
Payment of interim dividend	(✓)	
Repayment of loan	(✓)	
Redemption of debentures / preference share	(✓)	
Interest paid on debentures / loan	(✓)	
Net cash flow from investing activities		✓
Net interest / decrease in cash - cash equivalent (A+B+C)		✓
Add : Cash - cash equivalent in the beginning of the year		✓
Cash - cash equivalent at the end of the year		✓

**Note :** Figures shown in ( ) are cash outflow.

From the following format of cash flow statement given on page no. 258 and 259, it can be ascertained that this statement is based on three activities. The information for each activity is as follows :

#### 6. Cash Flow from Operating Activities :

Cash flow from operating activities is prepared on the basis of

- (A) Details of profit and loss statement and appropriation of profit
- (B) Changes in current assets and current liabilities (changes in working capital)

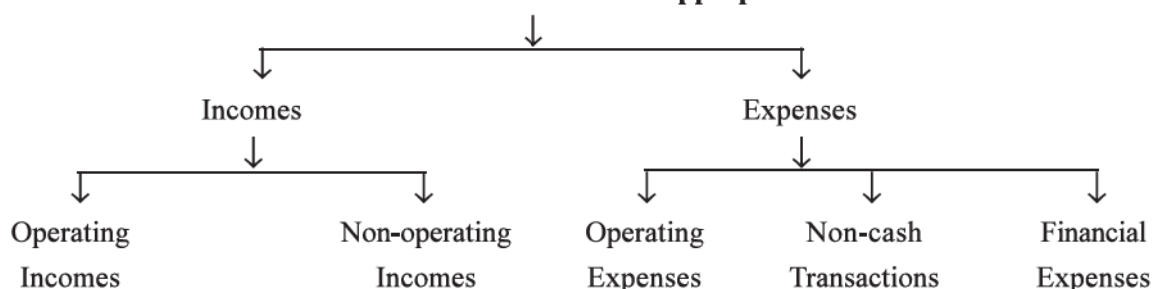
The cash flow from operating activities means the cash flow generated from the day to day transactions of a business entity.

#### (A) Details of Profit and Loss Statement and Appropriation of Profit :

Along with details of profit and loss statement, details of profit and loss appropriation are also included. Profit and loss appropriation statement is an extended form of profit and loss statement.

Details of this statement can be classified as follows :

#### Details of Profit and Loss Statement and Appropriation of Profit



The difference of above stated incomes and expenses is known as profit. In this profit non-operating incomes, non-cash transactions and financial transactions are included :

- Due to non-operating incomes profit increases (are added).
- Due to non-cash transactions profit decreases (are deducted).
- Due to financial expenses profit decreases (are deducted).

To determine cash flow from operating activities the above stated items of profit and loss statement will be given reverse effect.

Cash flow from operating activities is determined as follows :

Profit of current year as per profit and loss statement		✓
Less : Non-operating incomes	✓	
Add : Non-cash transactions (expenses) and appropriation	✓	
Add : Financial expenses	✓	✓
Cash flow generated from operating activities before the changes in working capital.		✓
		✓

#### ● What are Non-operating Incomes :

These are such incomes which do not arise from the business in which company deals. They are not a part of operating profit. Thus they are not considered for computation of cash flow.

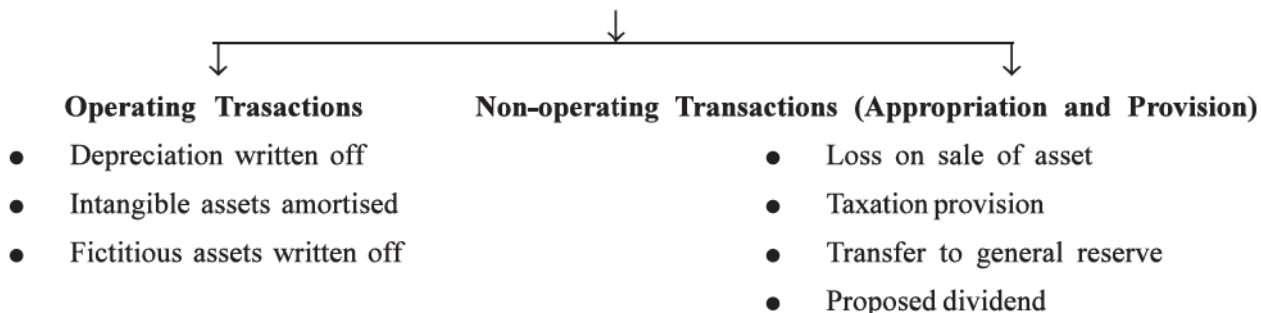
e.g. Profit on sale of investments, profit on sale of assets, interest on investments, dividend received on investments, rent for properties.

These kind of incomes are not considered to determine cash flow from operating activities during preparation of cash flow statement. These transactions are added in profit and loss statement. Thus, are deducted.

● **What are non-cash transactions, appropriation and provisions ?**

There are two types of non-cash transactions. These transactions are generally considered in reference to expenses.

**Non-cash Transactions, Appropriation and Provisions**



These kind of transactions do not generate cash flow (receipt / payment). Thus to determine cash flow from operating activities of cash flow statement, these are ignored. All these transactions will be added back because, these were debited to profit and loss account (statements).

● **What are the financial expenses ?**

Amounts which are paid as a return of capital are financial expenses. Capital is of two types : Owners capital and borrowed capital. Dividend is paid on equity share capital and preference share capital which are owners' capital while interest is paid on debt. Dividend and interest are expenses of capital. Thus it is financial expense. Thus to determine cash flow from operating activities of cash flow statement, these are ignored. Those are deducted from profit and loss statement and appropriation, so they are to be added back.

**(B) Changes in Current Assets - Current Liabilities (Working Capital)**

During determination of cash flow from operating activities, the effect of changes in current assets and current liabilities i.e. the working capital is considered. The effect of the increase-decrease in current assets and current liabilities is recorded here.

**Note :** Cash and cash equivalent are not included in current assets. It's separate effect is given in the cash flow statement.

**Relation of Cash and Cash Equivalent with Current Assets and Current Liabilities :** Current assets and cash and cash equivalent has inverse relation. Increase in current assets leads to, decrease in cash and cash equivalent, decrease in current assets leads to, increase in cash and cash equivalent.

Current liabilities and cash and cash equivalent has direct relation. Increase in current liabilities, leads to increase in cash and cash equivalent, decrease in current liabilities leads, decrease in cash and cash equivalent.

e.g. opening balance of debtors was ₹ 50,000 and at the end of the year it was ₹ 75,000.

**Explanation :** In the opening of year ₹ 50,000 was invested in debtors and at the end it is increased to 75,000. The investment is increased by ₹ 25,000. Thus cash and cash equivalent (means cash balance or bank balance) would reduce. This is cash outflow. If opening balance of debtors was ₹ 75,000 and at the end it was ₹ 50,000, it means that the investment in debtors is reduced. Consequently cash or cash equivalent would increase, this is cash inflow. Current liabilities have opposite effect. Opening balance of creditors was ₹ 50,000 and at the end of the year it is ₹ 75,000.

Investment would reduce by ₹ 25,000 and thus cash and cash equivalent would increase. This is cash inflow. If opening balance of creditors was ₹ 75,000 and at the end of the year it is ₹ 50,000, the investment would reduce by ₹ 25,000 and this cash and cash equivalent would reduce. This is cash outflow.

**Effect of increase/decrease in current assets and current liabilities on operating cash flow**

No.	Particulars	Effect on Working Capital	Effect on Cash Flow
1.	Increase in current assets	Increase	Difference will be cash outflow.
2.	Decrease in current assets	Decrease	Difference will be cash inflow.
3.	Increase in current liabilities	Decrease	Difference will be cash inflow.
4.	Decrease in current liabilities	Increase	Difference will be cash outflow.

Stages for computation of cash flow from operating activities :

- (1) Ascertain the difference of closing balance and opening balance of profit and loss account or reserve and surplus. Show this difference as a first item of statement. It is profit of current year.
- (2) Add all non-cash transactions to profit of current year, stated in above (1).
- (3) Add all financial expenses to profit of current year, stated in above (1).
- (4) Deduct all non-operating incomes from profit of current year stated in above (1).
- (5) Also consider adjustments (additional information) if it influences the operating cash flow.

**Note :**

- (1) The following details are disclosed in profit and loss statement :

- Revenue incomes not received in cash
- Revenue expenses not paid in cash
- Depreciation on fixed assets
- Intangible assets amortized and fictitious assets written off
- Profit/loss on sale of non-current assets (investing activity)
- Interest on non-current liability (financing activity)
- Appropriation to reserves and provisions
- Appropriation - payment of dividend (financing activity)

In spite of having disclose of those transactions in profit and loss statements, they do not have influence on cash flow from operating activities. Their special effect is incorporated in cash flow statement.

- (2) Creditors and bills payables (current liabilities) emerge from credit purchase and debtors and bills receivables (current assets) emerge from credit sales.

So current assets and current liabilities are result of operating activities, therefore changes in their size have taken place during the current year, will be disclosed under cash flow from operating activities.



**Illustration 5 :** From the following transactions of Khushbu Company Ltd., calculate cash flow from operating activities.

Particulars	(₹)
Profit before taxes	1,32,000
Goodwill written off	28,000
Patent amortized	17,000
Depreciation wrtitten off	29,000
Transfer to general reserve	23,000
Interest received	12,000
Dividend received	9000
Interest paid	11,000
Dividend paid	25,000
Profit on sale of investments	13,000
Loss on sale of furniture	18,000

**Ans. :**

Therefore, computed amount is profit (cash flow) from operating activities before changes in working capital. In this question no information is provided for current assets and current liabilities.

**Cash Flow from Operating Activities**

Particulars	(₹)	(₹)
Profit before taxes		1,32,000
Add : Non-cash expenses, appropriation and provisions :		
Goodwill written off	28,000	
Patent amortized	17,000	
Depreciation written off	29,000	
Transfer to general reserve	23,000	
Interest paid	11,000	
Dividend paid	25,000	
Loss on sale of furniture	18,000	1,51,000
		2,83,000
Less : Non-operating incomes :		
Interest received	12,000	
Dividend received	9000	
Profit on sale of investments	13,000	34,000
Profit (cash flow) before changes in working capital		2,49,000



**Illustration 6 :** From the following information of Ami Company, calculate cash flow from operating activities.

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
Profit and loss A/c	89,000	64,000
General reserve	34,000	18,000
Taxation provision	22,000	23,000
Depreciation	28,000	16,000
Goodwill	15,000	19,000
Debtors	38,000	18,000
Creditors	45,000	22,000
Bills receivable	8000	12,000
Bills payables	9000	15,000

**Ans. :**

**Cash Flow from Operating Activities for the Year Ending On 31-3-2017**

Particulars	(₹)	(₹)
Closing balance of profit and loss A/c	89,000	
<b>Less :</b> Opening balance of profit and loss A/c	64,000	
Profit of current year		25,000
<b>Add :</b> Non-cash expenses and provisions :		
General reserve	16,000	
Taxation provision (of current year)	22,000	
Depreciation (28,000 – 16,000)	12,000	
Goodwill written off (19,000 – 15,000)	4000	54,000
		79,000
<b>Less :</b> Non-operating incomes :		—
Profit (cash flow) before changes in working capital		79,000
<b>Add :</b> Decrease in current assets : Bills receivables	4000	
Increase in current liabilities : Creditors	23,000	27,000
		1,06,000
<b>Less :</b> Increase in current assets : Debtors	20,000	
Decrease in current liabilities : Bills payables	6000	26,000
		80,000
<b>Less :</b> Income-tax paid of previous year		23,000
<b>Cash flow from operating activities</b>		<b>57,000</b>

**Illustration 7 :** From the following information and balance sheets of two years of Nirav Company, calculate cash flow from operating activities.

### Balance Sheets as at 31-3-2016 and 31-3-2017

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
<b>I Equity and Liabilities :</b>		
<b>(1) Shareholders' funds :</b>		
(a) Share capital	5,00,000	3,00,000
(b) Profit and loss A/c	4,50,000	3,00,000
<b>(2) Non-current liabilities</b>		
12 % debentures	3,00,000	2,00,000
<b>(3) Current liabilities :</b>		
(a) Bank overdraft	40,000	60,000
(b) Trade payables (Creditors)	60,000	90,000
(c) Short-term provisions : Proposed dividend	50,000	30,000
Taxation provision	50,000	40,000
<b>Total</b>	<b>14,50,000</b>	<b>10,20,000</b>
<b>II Assets :</b>		
<b>(1) Non-current assets :</b>		
(a) Fixed assets		
(i) Tangible assets	8,00,000	4,00,000
(ii) Intangible assets	4,50,000	3,20,000
<b>(2) Current assets</b>	2,00,000	3,00,000
<b>Total</b>	<b>14,50,000</b>	<b>10,20,000</b>

**Additional information :**

Interim dividend paid ₹ 20,000.

New debentures are issued at the end of year.

Ans. :

**Cash Flow from Operating Activities for the Year Ending on 31-3-2017**

Particulars	(₹)	(₹)
Closing balance of profit and loss statement	4,50,000	
<b>Less :</b> Opening balance of profit and loss statement	3,00,000	
Difference of profit and loss statement		1,50,000
<b>Add :</b> Non-cash expenses (provisions)		
Proposed dividend (of current year)	50,000	
Taxation provision (of current year)	50,000	
Interim dividend (provisions)	20,000	
Debenture interest	24,000	
		1,44,000
		2,94,000
<b>Less :</b> Non-operating income		—
<b>Operating profit before changes in working capital</b>		<b>2,94,000</b>
<b>Add :</b> Decrease in current assets	1,00,000	
Increase in current liabilities	—	1,00,000
		3,94,000
<b>Less :</b> Increase in current assets	—	
Decrease in current liabilities : Trade payables	30,000	30,000
		<b>3,64,000</b>
<b>Less :</b> Payment of income tax		40,000
<b>Cash flow from operating activities</b>		<b>3,24,000</b>

**Explanation :**

- (1) Interim dividend is given as additional information. Thus it will be paid after it is provided for. This additional information will have two effects.
  - (a) Provision of interim dividend will be added to profit.
  - (b) Interim dividend will be added in financial activities as cash outflow.
- (2) Owners' funds and non-current liabilities of equity and liabilities side are components of financing activities. This will not be reported in cash flow from operating activities.
- (3) All current liabilities excluding provisions will be shown as current liabilities in cash flow from operating activities.
- (4) Under the head of current liabilities the proposed dividend and the taxation provision of the current year are added to profit to determine the cash flow from operating activities. A proposed dividend of previous year is paid and will be shown as cash outflow of financing activities. Taxation provision of previous year is paid during the current year.
- (5) Non-current assets are disclosed under investing activities. If there is any amount of depreciation or written off it is added back to profit in operating statement.
- (6) Changes in current assets are shown in cash flow statement from operating activities.

**Illustration 8 :** From the following details of Chirag Company compute cash flow from operating activities.

Particulars	(₹)
Profit of current year	3,20,000
Taxation provision	30,000
Proposed dividend	60,000
Goodwill written off	35,000
Depreciation charged	47,000
Loss on sale of asset	43,000
Rent received	45,000
Dividend received	65,000
Increase in current assets	1,00,000
Decrease in current liabilities	90,000

**Ans. :**

**Cash Flow from Operating Activities**

Particulars	(₹)	(₹)
Profit of current year		3,20,000
Add : Non-cash expenses and provisions :		
Taxation provision	30,000	
Proposed dividend	60,000	
Goodwill written off	35,000	
Depreciation charged	47,000	
Loss on sale of asset	43,000	2,15,000
		5,35,000
Less : Non-operating incomes :		
Rent received	45,000	
Dividend received	65,000	1,10,000
<b>Operating profit before changes in working capital</b>		<b>4,25,000</b>
Add : Decrease in current assets	—	
Increase in current liabilities	—	—
		<b>4,25,000</b>
Less : Increase in current assets	1,00,000	
Decrease in current liabilities	90,000	1,90,000
<b>Cash flow from operating activities</b>		<b>2,35,000</b>

**Illustration 9 :** From the following information of Gaurang Company, prepare statement of cash flow from operating activities.

Profit before changes in working capital ₹ 4,95,000; increase in debtors ₹ 75,000; decrease in bills receivables ₹ 40,000; decrease in stock ₹ 30,000; increase in prepaid expenses ₹ 25,000; outstanding expenses (increase) ₹ 15,000; decrease in creditors ₹ 20,000.

**Ans. :**

**Cash Flow from Operating Activities**

Particulars	(₹)	(₹)
Profit before changes in working capital		4,95,000
Add : Decrease in current assets :		
Bills receivable	40,000	
Stock	30,000	
Increase in current liabilities		
Outstanding expenses	15,000	85,000
		<b>5,80,000</b>
Less : Increase in current assets		
Debtors	75,000	
Prepaid expenses	25,000	
Decrease in current liabilities		
Creditors	20,000	1,20,000
<b>Cash flow from operating activities</b>		<b>4,60,000</b>

**Illustration 10 :** From the following details of Mira Limited, prepare cash flow statement of cash flow from operating activities.

**Profit and Loss Statement for the Year Ending on 31-3-2017**

Particulars	(₹)	(₹)
(I) Revenue from sales		28,00,000
(II) Other incomes :		
Income of rent	60,000	
Profit on sale of asset	40,000	
Interest income	90,000	1,90,000
(III) Total income		<b>29,90,000</b>



Particulars	(₹)	(₹)
<b>(IV) Expenses :</b>		
(a) Purchase of goods	21,20,000	
(b) Changes in stock (Opening stock 90,000, Closing stock 1,10,000)	(20,000)	
(c) Employees benefit expenses	1,48,000	
(d) Depreciation on fixed assets	25,000	
(e) Patent amortized	18,000	
(f) Loss on sale of asset	16,000	
(g) Manufacturing expenses	48,000	
(h) Insurance expense	6000	
(i) Salary expense	90,000	
(j) Administrative expense	63,000	
(k) Sales-distribution expenses	7000	25,21,000
<b>(V) Profit before tax</b>		<b>4,69,000</b>

**Information of Current assets and Current liabilities :**

Particulars	Closing balance (31-3-2017)(₹)	Opening balance (31-3-2016)(₹)
Debtors	90,000	78,000
Creditors	80,000	68,000
Bills payables	65,000	75,000
Bills receivables	8000	10,000
Stock	1,10,000	90,000
Outstanding salary	15,000	18,000
Prepaid insurance	7000	9000

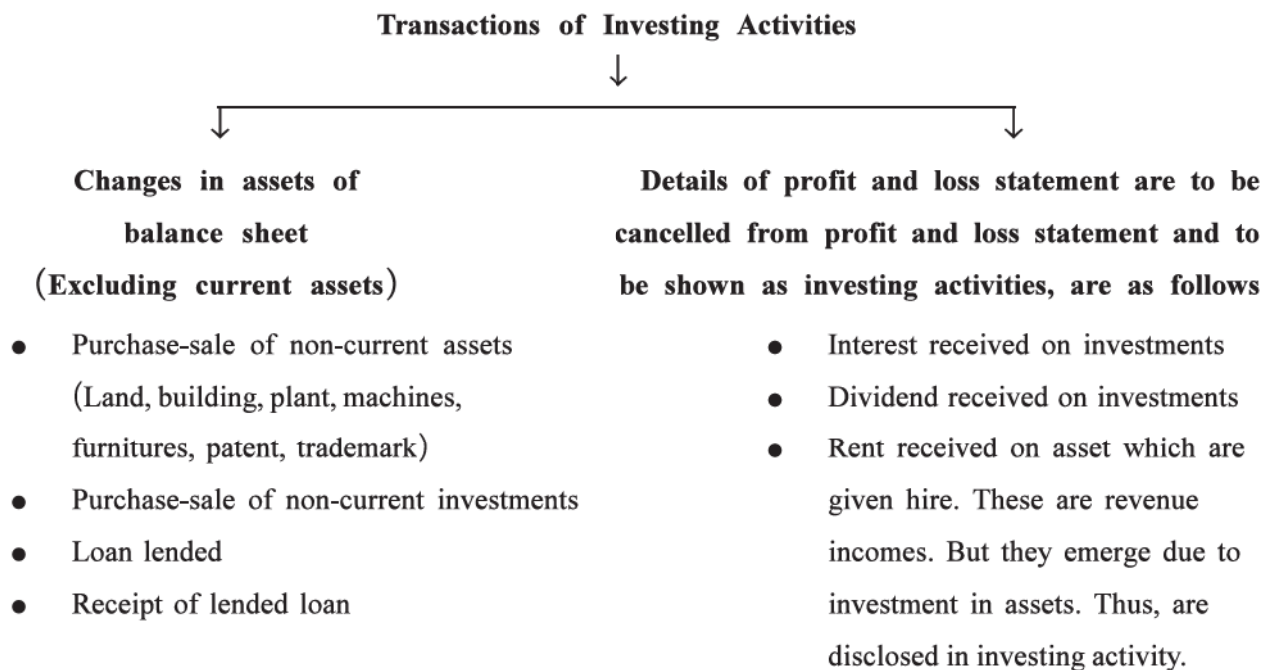
**Ans. : Cash Flow from Operating Activities**

Particulars	(₹)	(₹)
Profit before tax		4,69,000
Add : Non-cash expenses and provisions :		
Depreciation on fixed assets	25,000	
Patent amortized	18,000	
Loss on sale of asset	16,000	59,000
		<b>5,28,000</b>
Less : Non-operating incomes :		
Income of rent	60,000	
Profit on sale of asset	40,000	
Interest income	90,000	1,90,000
<b>Profit before changes in working capital</b>		<b>3,38,000</b>

Particulars	(₹)	(₹)
<b>Add : Decrease in current assets :</b>		
Bills receivable	2000	
Prepaid insurance	2000	
<b>Increase in current liabilities :</b>		
Creditors	12,000	16,000
		<b>3,54,000</b>
<b>Less : Increase in current assets :</b>		
Debtors	12,000	
Stock	20,000	
<b>Decrease in current liabilities :</b>		
Bills payables	10,000	
Salary outstanding	3000	45,000
<b>Cash flow from operating activities</b>		<b>3,09,000</b>

## 7. Cash Flow From Investing Activities

Transactions of investing activities means changes in details of assets (excluding current assets) side of balance sheet and changes in assets related items. A detailed explanation in this regard is as follows :



Fixed tangible assets are included as a part of non-current assets in investing activities. e.g. plant, machines, furniture (depreciable assets).

- Price of purchased asset is not provided.
- Price of sold asset is not provided.
- Amount of depreciation is not provided.
- Profit of sold asset is not provided.
- Loss of sold asset is not provided.

**Illustration 11 :** From the following information of Nirali Company Ltd. determine cash flow from investing activities.

Particulars	(₹)	Particulars	(₹)
Opening balance of machines	4,50,000	Depreciation provided on machines	50,000
Closing balance of machines	4,00,000	Selling price of machine	15,000
Book value of machine sold during the year	25,000		

## Machine Account

Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	4,50,000	By Depreciation A/c	50,000
To Cash A/c (?) (Purchase)	25,000	By Cash A/c (Sale)	15,000
		By loss on sale of machine A/c	10,000
		By balance c/d	4,00,000
	<b>4,75,000</b>		<b>4,75,000</b>

Particulars	Amt. (₹)
Sale of machine	15,000
Purchase of machine	(25,000)
Cash outflow from investing activities	(10,000)

- (1) Machine is an asset, thus its balance is debit balance. Therefore its opening balance is shown on debit side.
- (2) Depreciation machine : Journal entry will be as follows :  
Depreciation A/c ...Dr      50,000  

To Machine A/c                          50,000
- (3) Sale of machine : Book value    ₹ 25,000  
Selling price         ₹ 15,000  
Loss                     ₹ 10,000

Cash A/c ...Dr 15,000  
 Loss on sale of machine A/c...Dr 10,000  
     To Machine A/c 25,000

- (4) When machine account is closed, difference is appeared on debit side, it is purchase of new machine :

No.	Activity	Effect
1.	Sale of machine ₹ 15,000 – investing activity	Cash inflow from investing activity
2.	Purchase of machine ₹ 25,000 – investing activity	Cash outflow from investing activity
3.	Depreciation ₹ 50,000 – operating activity	Non-cash transaction, will be added to operating profit
4.	Loss on sale of machine ₹ 10,000	Non-cash transaction, will be added back to operating profit

**Illustration 12 :** From the following details of Mansi Company Ltd., determine and explain transactions influencing operating profit and cash flow from investing activities.

Particulars	(₹)	Particulars	(₹)
Opening balance of furniture	12,00,000	Sale of furniture	4,00,000
Closing balance of furniture	18,00,000	Book value of furniture sold	3,20,000
Depreciation on furniture	2,00,000		

**Ans. :** To find out investing activities, furniture account will be prepared as follows :

**Furniture Account**

Dr		Cr	
Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	12,00,000	By Cash A/c (Sale)	4,00,000
To Profit on sale of furniture	80,000	By Depreciation A/c	2,00,000
To Cash A/c (?) (Purchase)	11,20,000	By Balance c/d	18,00,000
	<b>24,00,000</b>		<b>24,00,000</b>

**Statement of Cash Flow From Investing Activities**

Particulars	Amt. (₹)
Sale of furniture	4,00,000
Purchase of furniture	(11,20,000)
Cash flow from investing activities	(7,20,000)

**Explanation :**

- (1) Furniture is an asset, therefore it's opening balance is debit balance.





## Machine Account

Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	2,00,000	By Depreciation A/c, 20 %	40,000
To Cash A/c (Purchase)	2,40,000	By Balance c/d	4,00,000
	<b>4,40,000</b>		<b>4,40,000</b>

### Furniture Account

Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	80,000	By Depreciation A/c, 10 %	8000
To Cash A/c (Purchase)	28,000	By Balance c/d	1,00,000
	1,08,000		1,08,000

### Investments Account

Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	4,00,000	By Cash A/c	3,00,000
To profit on sale of investment A/c	1,40,000		
To Cash A/c (Purchase)	3,60,000	By Balance c/d	6,00,000
	9,00,000		9,00,000

**Explanation :**

- (1) Opening balance of investments ₹ 4,00,000

Sale of 40 % (4,00,000 × 40 %)	₹ 1,60,000
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Less : Selling price	₹ 3,00,000
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Profit on sale of investments	₹ 1,40,000
-------------------------------	------------

(a)	Cash A/c ...Dr	3,00,000
-----	----------------	----------

To Investments A/c	3,00,000
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(b)	Investments A/c ...Dr	1,40,000
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To Profit on sale of investments A/c	1,40,000
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Sale of investments ₹ 3,00,000 will be shown as cash inflow of investing activity. Profit on sale of investment will be deducted from operating profit.

- (2) Depreciation on machine will be calculated on opening balance. Thus 20 % of ₹ 2,00,000 = ₹ 40,000, will be added to operating profit. Debit side difference of ₹ 2,40,000 is appeared, which is purchase of machine, it is shown as cash outflow from investing activity.

- (3) Depreciation on furniture will be calculated on opening balance. Thus 10 % of ₹ 80,000 = ₹ 8000, will be added to operating profit. Debit side difference of ₹ 28,000 is appeared which is purchase of furniture, which is treated as cash outflow from investing activity.
- (4) Interest on investment will be deducted from operating profit and will be shown cash inflow from investing activity.
- (5) Closing balance of patent is ₹ 80,000 and opening balance is ₹ 1,00,000, this shows decrease of ₹ 20,000. This is non-cash transaction, which will be added to operating profit.
- (6) Closing balance of goodwill is ₹ 60,000 and opening balance is ₹ 90,000. This shows decrease of ₹ 30,000. This is non-cash transaction, will be added to operating profit.

#### Statement of Cash Flow from Investing Activities

Particulars	(₹)
Sale of investments	3,00,000
Purchase of machine	(2,40,000)
Purchase of furniture	(28,000)
Interest on investments	60,000
Purchase of investments	(3,60,000)
Cash outflow from investing activities	(2,68,000)

Amounts other than brackets are cash inflow. Amounts shown in brackets are cash outflow.

#### 8. Cash Flow from Financing Activities :

Transactions of financing activities means changes in details of equity and liabilities (excluding current liabilities) side of balance sheet and changes in equity and liabilities related items.

Details included in financing activities are as follows :

#### Transactions of Financing Activities

<p style="text-align: center;">↓</p> <p style="text-align: center;">↓</p> <p><b>Changes in equity and liabilities of balance sheet (Excluding current liabilities)</b></p> <ul style="list-style-type: none"> <li>● Issue of equity and preference share</li> <li>● Buy back of equity shares and redemption of preference share</li> <li>● Issue of new debentures</li> <li>● Redemption of debentures</li> <li>● Borrowing through bank over draft or redemption of bank overdraft</li> <li>● Borrowing through loan or redemption of loan</li> </ul>	<p style="text-align: center;">↓</p> <p style="text-align: center;">↓</p> <p><b>Details of profit and loss statement are to be cancelled from profit and loss statement and to be shown as financing activities are as follows :</b></p> <ul style="list-style-type: none"> <li>● Equity share dividend</li> <li>● Preference share dividend</li> <li>● Interest on debentures or loan</li> </ul> <p>These transactions are expenses and appropriation. But for cash flow statement these are treated as return of capital. Thus, they are disclosed as financing activities.</p>
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● **Special Transactions :**

- (1) The following transactions show changes in size/composition of owners capital and borrowed capital of business entity. Still, these are not considered as cash flow from financing activities.
  - (a) Increase in equity share capital due to issue of bonus share. This transaction shows capitalization of profit or reserve. Capitalization of profit and reserve means conversion of credit balance of profit and loss A/c, general reserve into equity share capital. This transaction gives increase in equity without cash.
  - (b) There is a conversion of debentures into share. In this transaction also, there is no cash movement. Thus, there is no creation of cash flow.
- (2) (a) When issue of equity share and/or debentures is done at premium, the amount of premium is also considered as cash in flow from financing activities.
  - (b) Under writing commission paid at the time of issue of share or debentures is also financing activity and is shown as cash outflow from financing activity.
- (3) Bank overdraft and cash credit, both are short-term borrowings but are treated as financing activities.

**Illustration 14 :** From the following information of Hetal Company Ltd., calculate cash flow from financing activities.

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
Equity share capital	18,00,000	12,00,000
Preference share capital	8,00,000	10,00,000
Debenture	6,00,000	6,00,000

**Additional information :**

- (1) Dividend paid : Equity share capital ₹ 2,00,000, Preference share capital ₹ 1,00,000
- (2) Debenture interest paid ₹ 50,000

**Ans. :**

**Statement of Cash Flow from Financing Activities**

Particulars	(₹)
Equity share capital (Increase in capital)	6,00,000
Redemption of preference share capital (Reduction in share capital)	(2,00,000)
Debenture (No change)	—
Payment of equity share dividend	(2,00,000)
Payment of preference share dividend	(1,00,000)
Payment of debenture interest	(50,000)
Cash flow from financing activities	50,000

● **Stages for preparation of cash flow statement :**

- (1) First of all see adjustments (additional information) and accordingly prepare necessary accounts. As per the syllabus the fixed assets A/c, depreciation fund A/c and taxation provision A/c are included. Give accounting effects to the transactions of these accounts to the operating activities, investing activities or financing activities.

(2) Prepare cash flow statement :

- (a) In the beginning of this statement consider transactions pertaining to cash flow from operating activities. Add back non-cash expenses and provisions to the profit of current year. Deduct non-operating incomes from profit of current year.

After incorporation of accounting effects of these transactions, incorporate effects of changes in working capital. Add reduction in current assets and increase in current liabilities. Deduct increase in current assets and decrease in current liabilities. Deduct tax payment from profit, if any. Difference will be the cash flow from the operating activities.

- (b) Incorporate accounting effect of cash flow transactions of investing activities, where sale of non-current assets will be shown as cash inflow and purchase of non-current assets as cash outflow.

- (c) Finally, incorporate accounting effect of cash flow transactions to financing activities. Increase in share capital or increase in non-current liabilities, will be shown as cash inflow and reduction in share capital and non-current liabilities as cash outflow.

- (d) The total of above stated activities

- Cash flow from operating activities
- Cash flow from investing activities and
- Cash flow from financing activities, will be receipt or payment of cash and cash equivalent.

The addition of opening balance of cash and cash equivalent to this total would give closing balance of cash and cash equivalent.

When the final answer of these activities is identical to cash and cash equivalent to closing balance of cash and cash equivalent it shows possibilities of all correct calculations. The closing balance of cash and cash equivalent in cash flow statement establishes the correctness of answer.

**Illustration 15 :** Following are the balance sheets as at 31-3-2016 and 31-3-2017 of Dahod Company Ltd., prepare cash flow statement.

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
<b>I Equity and Liabilities :</b>		
<b>(1) Shareholders' Funds</b>		
(a) Share capital	20,00,000	18,00,000
(b) Reserves and surplus	7,50,000	5,00,000
<b>(2) Non-current Liabilities</b>		
10 % debentures	5,00,000	7,00,000
<b>(3) Current Liabilities</b>	4,00,000	3,00,000
<b>Total</b>	<b>36,50,000</b>	<b>33,00,000</b>
<b>II Assets :</b>		
<b>(1) Fixed assets</b>		
(i) Tangible assets : Land-building	22,00,000	20,00,000
(ii) Intangible assets : Patent	6,00,000	6,00,000
<b>(2) Current assets : (Excluding cash)</b>	7,00,000	6,00,000
Cash and cash equivalent	1,50,000	1,00,000
<b>Total</b>	<b>36,50,000</b>	<b>33,00,000</b>

**Note :** Debentures are redeemed at the beginning of the year.

**Ans. : Explanation :**

No.	Transaction	Effect
1.	Increase in equity share capital ₹ 2,00,000 (₹ 20,00,000 – ₹ 18,00,000)	Cash inflow of financing activity
2.	Profit of current year ₹ 2,50,000 (₹ 7,50,000 – ₹ 5,00,000)	It will be considered for operating activities
3.	Reduction in 10 % debentures ₹ 2,00,000 (₹ 5,00,000 – ₹ 7,00,000)	Cash outflow of financing activities
4.	Increase in current liabilities ₹ 1,00,000 (₹ 4,00,000 – ₹ 3,00,000)	It will be added to operating activities
5.	Increase in fixed assets (Land-building) ₹ 2,00,000 (₹ 22,00,000 – ₹ 20,00,000)	Cash outflow of investing activities
6.	No change in fixed assets(Patent)	No effect
7.	Increase in current assets ₹ 1,00,000 (₹ 7,00,000 – ₹ 6,00,000)	It will be deducted from operating activities

**Ans. : Cash Flow Statement as at 31-3-2017 of Dahod Company Limited**

Particulars	(₹)	(₹)
(A) Cash flow from operating activities		
Closing balance of P & L A/c (Reserves and surplus)	7,50,000	
Less : Opening balance of P & L A/c (Reserves and surplus)	5,00,000	
Profit for the year		2,50,000
Add : Non-cash expenses (Provisions)		—
Interest on debentures		50,000
Less : Non-operating incomes		—
Operating profit before changes in working capital		3,00,000
Add : Decrease in current assets		—
Increase in current liabilities	1,00,000	1,00,000
		4,00,000
Less : Increase in current assets	1,00,000	1,00,000
Decrease in current liabilities		
(A)		3,00,000
(B) Cash flow from investing activities		
Purchase of land-building	(2,00,000)	(2,00,000)
		1,00,000



Particulars	(₹)	(₹)
(C) Cash flow from financing activities :		
Increase in share capital	2,00,000	
Interest on debentures	(50,000)	
10 % debentures redeemed	(2,00,000)	(50,000)
(D) Increase in cash and cash equivalent (A + B + C)		50,000
Add : Opening balance of cash and cash equivalent		1,00,000
(E) Closing balance of cash and cash equivalent		1,50,000

**Special Note :** To provide comprehensive information of cash flow statement to the students, illustration no. 16 is given, where all three activities are covered. These kind of questions are not expected in exam.

**Illustration 16 :** From the following details of Somnath Company Ltd., prepare cash flow statement as at 31-3-2017.

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
<b>I Equity and Liabilities</b>		
<b>(1) Shareholders' Funds</b>		
(a) Equity share capital	18,00,000	16,00,000
Preference share capital	2,00,000	—
(b) Reserves and surplus : General reserve	1,00,000	80,000
Profit and loss A/c	48,000	40,000
<b>(2) Non-current Liabilities :</b>		
14 % debentures	2,60,000	2,40,000
<b>(3) Current Liabilities :</b>		
Bank overdraft	2,72,000	5,00,000
Trade payables	4,40,000	4,80,000
Short-term provisions :		
Taxation provision	1,68,000	1,20,000
Proposed dividend	2,32,000	2,00,000
<b>Total</b>	<b>35,20,000</b>	<b>32,60,000</b>
<b>II Assets :</b>		
<b>(1) Non-current assets :</b>		
Fixed assets : Tangible	16,00,000	16,40,000
Less : Depreciation fund	6,00,000	4,40,000
	10,00,000	12,00,000
<b>(2) Current assets :</b>		
Trade payables	9,60,000	8,00,000
Stock	14,00,000	12,00,000
Cash and cash equivalent	1,60,000	60,000
<b>Total</b>	<b>35,20,000</b>	<b>32,60,000</b>

**Additional information :**

- (1) Interest paid on debentures ₹ 36,000  
 (2) Taxes paid ₹ 1,68,000

**Ans. : Explanation :**

No.	Transactions	Effects
1.	Increase in equity share capital ₹ 2,00,000 (₹ 18,00,000 – ₹ 16,00,000)	Cash inflow of financing activity shown as cash inflow
2.	Increase in preference share capital ₹ 2,00,000 (₹ 2,00,000 – Zero)	Cash inflow of financing activity
3.	Increase in general reserve ₹ 20,000 (₹ 1,00,000 – ₹ 80,000)	It will be added to profit in operating statement under the head of provision
4.	Profit and loss A/c. Profit of current year ₹ 8000 (₹ 48,000 – ₹ 40,000)	It will be considered as operating activities
5.	Increase in 14 % debentures ₹ 20,000 (₹ 2,60,000 – ₹ 2,40,000)	Cash inflow of financing activities
6.	Current liabilities : – Decrease in bank overdraft ₹ 2,28,000 (₹ 2,72,000 – ₹ 5,00,000) – Decrease in trade payables ₹ 40,000 (₹ 4,40,000 – ₹ 4,80,000) – Taxation provision  – Proposed dividend	Cash outflow of financing activities  It will be deducted in operating statement  In adjustment payment is given, so account will be opened and accordingly treatments will be given. Proposed dividend of last year will be shown as cash outflow of financing activities. Proposed dividend of current year will be added to net profit under cash flow from operating activities.
7.	Fixed assets (tangible) and Depreciation	Fixed assets A/c and depreciation A/c will be opened and treatments will be given accordingly
8.	Current assets : – Increase in trade receivables ₹ 1,60,000 (₹ 9,60,000 – ₹ 8,00,000) – Increase in stock ₹ 2,00,000 (₹ 16,00,000 – ₹ 14,00,000)	It will be deducted from operating cash flow statement It will be deducted from operating cash flow statement
9.	Debenture interest paid ₹ 36,000	It will be added back to profit in operating statement and will be shown as cash outflow of financing activity

### Taxation Provision Account

Dr			Cr
Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Cash A/c (Payment) (will be deducted from operating activity)	1,68,000	By Balance b/d	1,20,000
To Balance c/d	1,68,000	By P & L A/c (Provision) (Will be added to operating activity)	2,16,000
	<b>3,36,000</b>		<b>3,36,000</b>

### Fixed Assets Account

Dr			Cr
Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	16,40,000	By Cash A/c (Sale) (Cash inflow from investing activity)	40,000
		By Balance c/d	16,00,000
	<b>16,40,000</b>		<b>16,40,000</b>

### Depreciation Fund Account

Dr			Cr
Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance c/d	6,00,000	By Balance b/d	4,40,000
		By Profit and Loss A/c (Provision)	1,60,000
	<b>6,00,000</b>		<b>6,00,000</b>

– Taxation provision and depreciation fund have credit balance.

Tax :

- |                                  |          |          |
|----------------------------------|----------|----------|
| (1) Taxation provision A/c ...Dr | 1,68,000 |          |
| To Cash A/c                      |          | 1,68,000 |
| (2) Profit and loss A/c ...Dr    | 2,16,000 |          |
| To Taxation provision            |          | 2,16,000 |

Depreciation and fixed assets :

- |                            |          |          |
|----------------------------|----------|----------|
| (1) Profit and loss ...Dr  | 1,60,000 |          |
| To Depreciation fund A/c   |          | 1,60,000 |
| (2) Fixed assets A/c ...Dr | 1,20,000 |          |
| To Cash A/c                |          | 1,20,000 |

**Note :** Journal entries are given for understanding of students. It is not required for examination purpose.

**Cash Flow Statement as at 31-3-2017 of Somnath Limited**

Particulars	(₹)	(₹)
(A) Cash flow from operating activities :		
Closing balance of profit and loss A/c	48,000	
Less : Opening balance of profit and loss A/c	40,000	
Profit of current year		8000
Add : Non-cash expenses (Provisions)		
Taxation provision	2,16,000	
Depreciation	1,60,000	
General reserve	20,000	
Proposed dividend	2,32,000	
Debenture Interest	36,000	6,64,000
		6,72,000
	—	—
Less : Non-operating income		6,72,000
Profit before changes in working capital		—
Add : Decrease in current assets		—
Increase in current liabilities		—
		6,72,000
Less : Increase in current assets		
Increase in trade receivables	1,60,000	
Increase in stock	2,00,000	
Decrease in current liabilities :		
Trade payables	40,000	4,00,000
		2,72,000
Less : Tax paid		1,68,000
		1,04,000
(B) Cash flow from investing activities :		
Sale of fixed assets	40,000	40,000
(C) Cash flow from financing activities :		1,44,000
Increase in equity share capital	2,00,000	
Increase in preference share capital	2,00,000	
Issued 14 % debentures	20,000	
Redemption of bank overdraft	(2,28,000)	
Proposed dividend	(2,00,000)	
Debenture interest paid	(36,000)	(44,000)
(D) Cash and cash equivalent		1,00,000
Add : Opening balance of cash and cash equivalent		60,000
Closing balance of cash and cash equivalent		1,60,000

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### Exercise

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**1. Select appropriate option for every question :**

- (1) How many activities are there in cash flow statement ?  
(a) Five (b) Four  
(c) Three (d) Two
- (2) Cash equivalent has ..... .  
(a) higher liquidity (b) higher solvency  
(c) higher profitability (d) all of the above
- (3) Decrease in current assets and increase in current liabilities ..... .  
(a) are cash inflow and cash outflow respectively  
(b) are cash outflow and cash inflow respectively  
(c) both are cash inflows  
(d) both are cash outflows
- (4) Increased in current assets and decrease in current liabilities ..... .  
(a) both are cash outflows  
(b) both are cash inflows  
(c) are cash outflow and cash inflow respectively  
(d) are cash inflow and cash outflow respectively
- (5) Collection of debtors and bills receivable is ..... .  
(a) cash inflow of operating activity  
(b) cash outflow of operating activity  
(c) cash inflow of financing activity  
(d) cash inflow of investing activity
- (6) Which of the following transaction is always transaction of operating activity ?  
(a) Interest paid on loan (b) Dividend received  
(c) Dividend paid (d) Salary expense
- (7) Dividend or interest received on investment is ..... .  
(a) added to cash flow of operating activity  
(b) deducted from cash flow of financing activity  
(c) added to cash flow of investing activity  
(d) deducted from cash flow of investing activity
- (8) Bank overdraft ..... .  
(a) is current liability but considered as financing activity  
(b) is current liability but considered as operating activity  
(c) is current liability but considered as investing activity  
(d) is not activity of cash flow statement
- (9) Rent received ..... .  
(a) is added to operating activity and deducted from financing activity  
(b) is added to operating activity and added to financing activity  
(c) is added to operating activity and added to investing activity  
(d) is deducted from operating activity and added to investing activity



- (10) Reduction in goodwill in current year as compared to previous year is ..... .  
 (a) sale of goodwill (b) purchase of goodwill  
 (c) written off goodwill (d) all of the above
- (11) Cash deposited in bank is ..... .  
 (a) cash outflow of operating activity  
 (b) cash outflow of financing activity  
 (c) cash outflow of investing activity  
 (d) not cash flow
- (12) Which of the following is included in financial expense ?  
 (a) Factory expenses (b) Administrative expenses  
 (c) Sales expenses (d) Interest expenses
- (13) Payment of interim dividend is ..... .  
 (a) deducted from operating statement and added to financing activity  
 (b) deducted from operating statement and added to investing activity  
 (c) added to operating statement and deducted from financing activity  
 (d) none of the above

**2. Answer the following in one sentence :**

- (1) What is cash flow ?
- (2) What is cash and cash equivalent ?
- (3) What is cash flow statement ?
- (4) What is operating activities ?
- (5) What is investing activities ?
- (6) What is financing activities ?
- (7) Which transactions are always operating activities ?
- (8) Which transactions are always investing activities ?
- (9) Which transactions are always financing activities ?
- (10) Give illustration of such transaction from where two activities are taking place.
- (11) Give illustration of is cash transaction but not cash flow'.
- (12) Where are the self constructed assets recorded ?
- (13) To which activity increase/decrease of bank overdraft is recorded ?
- (14) For which activity underwriting commission paid is considered ?
- (15) As which activity income tax payment and income tax refund are considered ? Why ?
- (16) Give illustration of any two operating incomes.
- (17) Where addition in general reserve is recorded ?
- (18) Describe whether cash flow would increase or decrease due to following transactions ?  
 (i) Increase in current assets (ii) Decrease in current assets  
 (iii) Increase in current liabilities (iv) Decrease in current liabilities
- (19) In which activity the received dividend and interest are recorded ?
- (20) In which activity the paid dividend and interest are recorded ?

**3. Answer the following questions in brief :**

- (1) Describe the operating activities for the following companies :  
 (i) Trading companies (ii) Insurance companies (iii) Bank

- (2) Explain cash flow from operating transactions of non-finance companies and finance companies.
- (3) From the following transactions, identify transactions of operating activities :
- |                           |   |
|---------------------------|---|
| (i) Wages paid            | (vii) Paid office expenses              |
| (ii) Purchase of building | (viii) Paid sales-distribution expenses |
| (iii) Sale of furniture   | (ix) Carriage inward                    |
| (iv) Payment to creditors | (x) Carriage outward                    |
| (v) Dividend paid         | (xi) Royalty paid                       |
| (vi) Rent paid            | (xii) Income tax paid                   |
4. Explain cash flow transactions of investing activities.
5. From the following transactions, identify transactions of investing activities :
- |                                       |  |
|---------------------------------------|--|
| (i) Salary paid                       | (vii) Sale of furniture                |
| (ii) Rent paid                        | (viii) Collection from debtors         |
| (iii) Purchase of investments         | (ix) Payment to creditors              |
| (iv) Sale of land                     | (x) Issue of equity shares             |
| (v) Purchase of building              | (xi) Redemption of debentures          |
| (vi) Interest received on investments | (xii) Dividend received on investments |
6. Explain – Cash flow transactions of financing activities.
7. From the following transactions, identify transactions of financing activities :
- |   |                                |
|---|--------------------------------|
| (i) Sale of machine                         | (vii) Purchase of investments  |
| (ii) Redemption of preference share capital | (viii) Issue new equity shares |
| (iii) Dividend paid                         | (ix) Paid interim dividend     |
| (iv) Interest paid                          | (x) Interest received          |
| (v) Dividend received                       | (xi) Borrowed bank loan        |
| (vi) Borrowed bank overdraft                | (xii) Commission received      |
8. What are non-cash transactions ? Give two illustrations.
9. What are non-operating incomes ? Give two illustrations.
10. Where interim dividend is recorded in cash flow statement ?
11. Where accounting treatments of taxation provision and tax payment are given in cash flow statement ?
12. Explain effect of bonus share in cash flow statement.
13. Where conversion of debentures into share is recorded in cash flow statement ?
14. Which kind of activity is the payment of underwriting commission ? Why ?
15. From the following transactions calculate cash flow from operating activities :

Particulars	(₹)
Profit before taxes	99,000
Income tax provision	29,000
Proposed dividend	39,000
Depreciation	22,000
Dividend received	21,000
Interest received	20,000
Interest paid	28,000
Goodwill written off	15,000
Profit on sale of asset	12,000

16. From the following information, calculate cash flow from operating activities :

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
Profit and loss A/c	45,000	30,000
Depreciation	90,000	70,000
Goodwill	40,000	55,000
Stock	60,000	45,000
Debtors	50,000	90,000
Creditors	40,000	60,000
Bills payables	70,000	20,000
Prepaid expenses	10,000	15,000

**Additional information :**

- (i) Dividend received ₹ 2000
- (ii) Interest paid ₹ 3000
- (iii) Rent received ₹ 10,000

17. From the following information calculate cash flow from operating activities :

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
Profit and loss A/c	60,000	25,000
General reserve	45,000	35,000
Taxation provision	38,000	48,000
Depreciation fund	42,000	32,000
Goodwill	27,000	38,000
Debtors	49,000	39,000
Creditors	39,000	29,000
Outstanding expenses	12,000	17,000
Prepaid expenses	14,000	10,000

**Additional information :**

- (i) Profit on sale of assets ₹ 15,000
- (ii) Loss on sale of furniture ₹ 8000
- (iii) Income of rent ₹ 48,000
- (iv) Interest paid on debentures ₹ 32,000
- (v) Dividend payment ₹ 10,000

18. From the following given information calculate cash flow from investing activities :

Particulars	(₹)
Sale of non-current investments	88,000
Purchase of land	1,48,000
Purchase of machine	98,000
Sale of furniture	45,000
Dividend received on investments	40,000
Paid for goodwill	32,000
Issue of shares	1,20,000
Redemption of debentures	45,000
Loan borrowed	28,000

19. From the following given details calculate cash flow from investing activities :

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
Plant and machines	9,20,000	7,20,000
Depreciation fund on plant and machines	1,50,000	1,20,000
Goodwill	90,000	95,000
Patent	70,000	1,30,000
10 % investments	95,000	2,70,000
General reserve	45,000	30,000
Profit and loss A/c	60,000	40,000
Equity share capital	6,00,000	4,50,000
Bank loan	1,00,000	1,50,000
Current liabilities	90,000	60,000
Interest received on investments ₹ 18,000		
Some of the patents were sold during the year.		

20. From the following information calculate cash flow from financing activities :

Particulars	(₹)
Purchase of land	1,88,000
Equity shares issued	1,45,000
Redemption of preference shares	60,000
Redemption of debentures	70,000
Borrowed bank loan	90,000
Debenture interest paid	6000
Dividend paid	8000
Dividend-interest received	9000
Sale of furniture	32,000
Purchase of machine	68,000
Interest received on investments	13,000
Paid for patents	19,000

21. From the following information calculate cash flow from financing activities :

Particulars	31-3-2017 (₹)	31-3-2016 (₹)
10 % debentures	2,45,000	1,95,000
Equity share capital	3,45,000	2,50,000
12 % debentures	1,00,000	1,50,000
Preference share capital	80,000	1,00,000
Bank overdraft	45,000	68,000

**Additional information :**

- (1) Debenture interest paid ₹ 12,000
- (2) Paid ₹ 22,000 for equity share dividend and preference share dividend
- (3) Paid bank overdraft ₹ 4000





# Answers

## Exercise 1

### 1. Select appropriate option for each question :

- (1) (c)      (2) (b)      (3) (a)      (4) (c)      (5) (d)      (6) (d)      (7) (b)  
(8) (c)      (9) (a)      (10) (c)
5. Share application amount received ₹ 22,50,000; Share allotment amount received ₹ 30,00,000; Share first and final call amount received ₹ 22,50,000.
6. Share application amount received ₹ 14,40,000; Amount returned on non-allotted shares ₹ 2,40,000; Share allotment amount received ₹ 9,00,000; Share final call amount received ₹ 8,94,000; amount of call in arrears ₹ 6000
7. Share application amount received ₹ 33,75,000; Application amount transferred to share capital ₹ 30,00,000, Amount returned to applicants ₹ 3,75,000; Share allotment amount received ₹ 30,00,000; Share first call amount received ₹ 23,98,080; Share second call amount received ₹ 35,93,520; Call in arrears received afterwards ₹ 8400 (1920 + 6480)
8. Share application amount received with call in advance ₹ 17,39,000; Share allotment amount received in advance with application ₹ 8000 and for call in advance ₹ 6000; Amount received on share allotment ₹ 19,99,500 (₹ 20,00,000 deduct amount of allotment received with application ₹ 8000 and add ₹ 7500 received for call with allotment amount); Share first and final call amount received ₹ 14,86,500 (₹ 15,00,000 - ₹ 7500 - ₹ 6000)
9. Amount received with application ₹ 14,00,000; Amount returned to applicants ₹ 2,00,000; Amount received for allotment ₹ 23,76,000; Share final call amount received ₹ 8,91,000.
10. Share application amount received ₹ 1,38,00,000; Amount returned to applicants ₹ 46,00,000; Amount received for allotment ₹ 1,35,83,000 (₹ 1,36,00,000 deduct ₹ 17,000 of Himmatbhai); Share final call amount received ₹ 51,89,600 (₹ 52,00,000 deduct ₹ 6500 Hemantbhai and ₹ 3900 of Hima).
11. Total amount of security premium with application ₹ 27,00,000;  
Total amount of security premium with allotment of ₹ 45,00,000;  
Total amount received for allotment ₹ 45,00,000;  
Total amount for allotment ₹ 62,91,600 (₹ 63,00,000 deduct ₹ 8400 of Abdul);  
Total amount received with share first and final call ₹ 8,98,000 (₹ 9,00,000 deduct ₹ 1200 of Abdul and ₹ 800 of Harun)
12. (i) Share forfeiture A/c credit ₹ 2400 at the time of share forfeiture; Share forfeiture A/c debit ₹ 1600 at the time reissue of shares; Credit balance of share forfeiture transfer to capital reserve ₹ 800.  
(ii) Share forfeiture A/c credit ₹ 3000, at the time of share forfeiture out of 600 share forfeited 400 shares are reissued, share forfeiture A/c Dr. ₹ 1600; The proportionate credit balance of share forfeiture account is transferred to capital reserve ₹ 400.  
(iii) Share forfeiture A/c credit ₹ 18,000, at the time of share forfeiture, share forfeiture A/c Dr ₹ 9000; at the time of reissue of forfeited shares, credit balance of share forfeiture transferred to capital reserve ₹ 9000.
13. (i) At the time of share forfeiture - Securities premium A/c Dr ₹ 12,000 and Share forfeiture A/c credited by ₹ 3600; When forfeited shares are reissued - bank A/c debit ₹ 8400, share forfeiture A/c debit ₹ 3600; there will be no balance to share forfeiture account.



- (ii) At the time of share forfeiture - share capital A/c debit by ₹ 4500 ( $600 \times ₹ 7.50$ ) and credited to share forfeiture A/c ₹ 3300. When forfeited share are reissued - share forfeiture A/c debit by ₹ 2400. Credit balance of share forfeiture ₹ 900 will be transferred to capital reserve.
- (iii) At the time of share forfeiture - share capital A/c debit ₹ 24,000 ( $400 \times ₹ 60$ ), securities premium A/c debit ₹ 8000 ( $400 \times ₹ 20$ ) and share forfeiture A/c credit ₹ 12,000. When forfeited shares are reissued share forfeiture A/c debit ₹ 4000, calls in advance credit by ₹ 16,000. Credit balance of share forfeiture will be transferred to capital reserve ₹ 8000.

14. Amount received for share application ₹ 44,10,000; Amount returned to applicants ₹ 8,10,000; Share allotment amount received ₹ 47,92,000 (₹ 48,00,000 – ₹ 8000 of Akash); Share first and final call amount received ₹ 35,90,400 (₹ 36,00,000 – ₹ 6000 of Akash and ₹ 3600 of Sunny); When shares are forfeited, share forfeiture A/c credit by ₹ 14,400; At the time of reissue of forfeited shares, share forfeiture A/c debited by ₹ 9600; the credit balance of share forfeiture ₹ 4800 transferred to capital reserve.
15. Amount received with application ₹ 91,20,000; Allotment amount received ₹ 66,64,000; Amount received for final call ₹ 33,32,000; Securities premium debit ₹ 70,000 and ₹ 6000 credit to share forfeiture A/c, when shares are forfeited; Amount received along with premium on reissue of forfeited shares ₹ 28,000; Balance of share forfeiture account ₹ 6000 transferred to capital reserve account.
16. Total amount received with application ₹ 1,04,00,000; Amount received for allotment ₹ 1,83,65,500 (1,84,00,000 – 34,500 of Vipul); When 1500 shares of Vipul are forfeited - securities premium A/c Dr ₹ 30,000, Share capital A/c Dr. ₹ 9000 while share forfeiture credit ₹ 4500 and share allotment A/c credit ₹ 34,500; When forfeited shares are reissued share forfeiture A/c Dr ₹ 1500; Balance of share forfeiture ₹ 3000 transferred to capital reserve; Amount received for final call ₹ 31,98,000 (₹ 32,00,000 deduct ₹ 2000 of Hema); 500 Shares of Hema forfeited so share forfeiture A/c credit ₹ 3000 and share forfeited A/c debit by ₹ 3000 when forfeited shares are reissued. There will be no balance in share forfeiture A/c
17. Amount received with share applications ₹ 90,00,000; Amount returned to applicants for rejected applications ₹ 30,00,000; Amount received for share allotment ₹ 23,76,000 (₹ 24,00,000 deduct ₹ 24,000 of Sidharaj); When 6000 shares of Sidharaj are forfeited – share forfeiture A/c credited by ₹ 18,000; Amount received for final call ₹ 17,70,000 (₹ 17,82,000 deduct ₹ 12,000 of Jaysinh); when 4000 shares of Jaysinh forfeited – shares forfeiture A/c credited by ₹ 28,000; when 6000 forfeited shares are reissued – shares forfeiture A/c Dr ₹ 18,000; when 4000 forfeited shares are reissued – share forfeiture A/c Dr. ₹ 16,000; the credit balance of share forfeiture ₹ 12,000 transferred to capital reserve.
18. Total amount received with applications ₹ 36,00,000; Total amount received for allotment ₹ 27,00,000; Total amount received for first call ₹ 26,10,000; Total amount received for final call ₹ 26,10,000; when 4000 shares forfeited securities premium A/c debited by ₹ 1,60,000 and share forfeiture credited by ₹ 20,000. When forfeited shares are reissued total amount received ₹ 3,20,000, Balance of share forfeiture ₹ 20,000 transferred to capital reserve.
19. Total amount received with applications ₹ 5,40,000; Amount transferred to share capital from share application ₹ 3,60,000; Additional amount ₹ 72,000 transfer to share allotment and amount for rejected 36,000 shares ₹ 1,08,000 returned; Amount received for allotment ₹ 2,88,000 (₹ 3,60,000 deduct ₹ 72,000); Total amount received with share final call ₹ 4,80,000.
20. Amount received with application ₹ 18,60,000; Amount received for allotment ₹ 10,80,000, Amount received for first call ₹ 9,00,000; Amount received for final call ₹ 8,98,000; 1000 shares of Mahesh forfeited and share forfeiture A/c credited by ₹ 8000. When forfeited shares are reissued, share forfeiture A/c debited by ₹ 5000. Balance of share forfeiture ₹ 3000, transferred to capital reserve A/c.

21. Amount received with application ₹ 84,00,000; Amount returned to the applicants for rejected application ₹ 48,00,000; Amount received for share allotment ₹ 30,00,000 (₹ 42,00,000 – ₹ 12,00,000 received with application); amount received for first and final call of shares ₹ 18,00,000.
22. Amount received with applications ₹ 47,93,25,000; Total amount of share application and share allotment ₹ 69,72,00,000 will be debited to share application and allotment A/c. ₹ 4,35,75,000 will be returned for 1,50,000 shares at ₹ 290.50 per share. Amount received with application ₹ 26,14,50,000 (Amount called up for allotment ₹ 34,86,00,000 – allotment money received in advance ₹ 8,71,50,000)
23. Amount received with application ₹ 56,25,000; Amount received for allotment ₹ 15,00,000; Amount received for share final call ₹ 22,27,500; When 7500 shares of Vishal forfeited, share forfeiture A/c credited by ₹ 52,500; when forfeited shares are reissued – share forfeiture A/c Dr. ₹ 7500; the credit balance of share forfeiture ₹ 45,000 transferred to capital reserve.
24. Amount received with application ₹ 2,16,75,000; Amount received for first and final call ₹ 25,00,000 (Amount called for first and final call ₹ 67,50,000 – advance received with application ₹ 42,50,000)

### Exercise 2

1. **Select appropriate option for each question :**  
 (1) (c)      (2) (b)      (3) (d)      (4) (a)      (5) (c)      (6) (d)      (7) (b)  
 (8) (b)      (9) (c)      (10) (b)
4. Amount received with debentures applications ₹ 4,50,000  
 Amount received for debentures allotment ₹ 5,40,000  
 Amount received for debentures call ₹ 3,00,000
5. Amount received with debentures applications ₹ 18,00,000  
 Amount received for debentures allotment ₹ 18,00,000  
 Amount received for debentures final call ₹ 12,00,000  
 Securities premium reserve A/c ₹ 12,00,000
6. Amount received with debentures applications ₹ 3,75,000  
 Debenture discount at the time of allotment ₹ 3,00,000  
 Amount received for debentures allotment ₹ 5,25,000  
 Amount received for debentures call ₹ 2,84,000
7. Amount received with debentures applications ₹ 10,50,000  
 Amount received for debentures allotment ₹ 12,09,000  
 Amount received in advance at the time of allotment ₹ 25,000 and calls not paid ₹ 16,000  
 Amount received for final call ₹ 7,15,000
8. Amount received with debentures applications ₹ 1,50,00,000  
 Amount received for debentures allotment ₹ 1,14,00,000  
 Amount called up for allotment ₹ 1,44,00,000 deduct received in advance for allotment with application ₹ 30,00,000
9. Debenture application and allotment are credited by ₹ 72,00,000;  
 Amount received for application and allotment ₹ 72,00,000 out of which to debenture A/c ₹ 50,00,000,  
 Transferred to securities premium ₹ 10,00,000 and to bank A/c ₹ 12,00,000
10. Amount received with debentures applications ₹ 3,15,000  
 Amount received for debentures allotment ₹ 2,80,000  
 Amount received for debenture final call ₹ 2,00,000  
 Debited to debenture issue expense ₹ 22,000  
 Deducted from profit and loss statement ₹ 20,400, debenture discount credited ₹ 16,000, debenture issue expenses credited ₹ 4400



11. To shikhar Machinery Ltd. 9 % debenture issued of ₹ 15,80,000 for ₹ 15,00,000, Consequently debenture discounted account debited by ₹ 80,000. While 9 % debentures issued of ₹ 14,10,000 for ₹ 15,00,000 to Shikhar Machinery, Securities premium reserve A/c will be credited by ₹ 90,000.
12. Net assets of ₹ 14,20,000, Purchase price ₹ 15,36,000, Goodwill ₹ 1,16,000; Purchase consideration 11 % debentures of ₹ 12,80,000 and securities premium reserve ₹ 2,56,000
13. (1) Two journal entries will be passed :
  - (i) Bank A/c Dr ₹ 5,50,000, To Bank loan A/c ₹ 5,50,000
  - (ii) Debenture suspense A/c Dr ₹ 5,00,000, To 10.5 % debenture A/c ₹ 5,00,000.
- (2) Only one journal entry : Bank A/c ...Dr ₹ 5,50,000, To Bank loan A/c ₹ 5,50,000
14. Amount received for application and allotment ₹ 18,00,000. Journal entry for interest on 30-9-2017 and 31-3-2018.  
 Debenture interest A/c Dr ₹ 1,08,000, To Debentureholders A/c ₹ 86,400, To TDS payable ₹ 21,600. At the end of the year debenture interest debited to profit and loss A/c ₹ 2,16,000, To debenture interest A/c ₹ 2,16,000
15. (1) Amount received for debenture application and allotment ₹ 8,50,000  
 (2) Amount received for debenture application and allotment ₹ 8,55,000, debited to debenture discount debited ₹ 95,000.  
 (3) Amount received for debenture application and allotment ₹ 17,60,000 credited to securities premium reserve ₹ 1,60,000
16. Amount received for debenture application and allotment ₹ 12,00,000; loss on issue of debentures debited ₹ 1,80,000, debenture redemption premium credited ₹ 1,80,000. Total amount returnable to debenture holders ₹ 13,80,000.
17. Amount received for debenture application and allotment ₹ 19,00,000; debited to debenture discount A/c ₹ 1,00,000 and loss on issue of debentures ₹ 2,00,000. While ₹ 2,00,000 credited debenture redemption premium. Total amount returnable to debentureholders ₹ 22,00,000
18. Amount received for debenture applications and allotment ₹ 44,10,000; loss on issue of debenture debited ₹ 4,20,000. Credited to securities premium reserve A/c ₹ 2,10,000 and debenture redemption premium ₹ 4,20,000. Total amount returnable to debentureholders ₹ 46,20,000.
19. Total amount received with debenture application ₹ 25,00,000; amount received for debenture allotment ₹ 55,00,000; ₹ 9,60,000 will be credited to debenture redemption premium A/c
20. Total amount received with debenture application ₹ 9,60,000; amount received for debenture allotment ₹ 4,80,000, debenture discount debited ₹ 1,60,000 while credited to debenture redemption premium A/c ₹ 1,28,000
21. Amount received on debenture application and allotment ₹ 17,60,000; debenture redemption investment A/c debited ₹ 2,40,000 (15 % of 16,00,000); credited debenture redemption reserve ₹ 4,00,000 (25 % of 16,00,000); paid to debentureholders ₹ 16,00,000; balance of debenture redemption reserve A/c ₹ 4,00,000 transferred to general reserve A/c
22. Amount received for debenture application and allotment ₹ 21,20,000; securities premium reserve A/c and debenture redemption premium will be credit by ₹ 1,20,000 and ₹ 2,00,000 respectively. ₹ 3,00,000 for debenture redemption investment, interest received on debenture redemption investment ₹ 19,250. ₹ 5,00,000 will be transferred to debenture redemption reserve, at the end of the year it will be transferred to general reserve. Interest received will be credited to profit and loss statement. Amount returned to debentureholders ₹ 22,00,000
23. Debenture redemption investment A/c ₹ 4,50,000; debenture redemption reserve A/c ₹ 30,00,000; Amount returned to debentureholders ₹ 33,60,000. The balance of debenture redemption reserve ₹ 30,00,000 transferred to general reserve A/c

24. Debenture redemption reserve ₹ 13,00,000 transferred from surplus of profit and loss statement. Investment for debenture redemption ₹ 3,60,000. Payment to debentureholders ₹ 25,92,000, the balance of debenture redemption reserve is transferred to general reserve ₹ 24,00,000
25. Own debentures purchased ₹ 1,44,000; Profit on redemption of debentures ₹ 6000.
26. Own debentures purchased ₹ 24,90,000; Loss on redemption of debentures ₹ 90,000.
27. Amount received on applications and allotment ₹ 18,00,000; Investment in own debentures ₹ 7,00,000; Profit on sale of investments ₹ 75,000, which is credited to profit and loss statement.
28. Amount received on application and allotment ₹ 48,00,000; Against debentureholders of ₹ 48,00,000, 3,20,000 equity shares are issued of ₹ 10 each of face value at premium of ₹ 5 per share.
29. Total amount returnable to debentureholders ₹ 8,48,000, where ₹ 48,000 for debenture redemption premium. 2703 preference shares at ₹ 130 to 3315 debentureholders, 3600 debentureholders are given 3975, 7 % debentures at ₹ 96 per debentures and cash to 1085 debentureholders.

### Exercise 3

**1. Select appropriate option for each question :**

- (1) (d)      (2) (b)      (3) (c)      (4) (d)      (5) (b)      (6) (d)      (7) (d)  
 (8) (d)      (9) (c)

**3.**

No.	Particulars	Head of Balance Sheet	Main Head	Sub Head
1.	Creditors	Equity-Liabilities	Current liabilities	Trade payables
2.	Security premium	Equity-Liabilities	Shareholders' funds	Reserve and surplus
3.	Bond	Equity-Liabilities	Non-current liabilities	Long-term borrowings
4.	Goodwill	Assets	Non-current assets	Fixed assets-intangible
5.	Bank overdraft	Equity-Liabilities	Current liabilities	Short-term borrowings
6.	Bills receivables	Assets	Current assets	Trade receivables
7.	Equity share capital	Equity-Liabilities	Shareholders' funds	Share capital
8.	Copyrights	Assets	Non-current assets	Fixed assets-intangible
9.	Debenture discount (To be written of during next year)	Assets	Current assets	Other current assets
10.	Calls in advance	Equity-Liabilities	Current liabilities	Other current liabilities
11.	Cash	Assets	Current assets	Cash - cash equivalent
12.	Provident fund	Equity-Liabilities	Non-current liabilities	Long-term liabilities
13.	Debentures	Equity-Liabilities	Non-current liabilities	Long-term borrowings
14.	Trademark	Assets	Non-current assets	Fixed assets-intangible
15.	Loose tools	Assets	Current assets	Inventory
16.	Loan (payable during next year)	Equity-Liabilities	Current liabilities	Other Current liabilities
17.	Bills payable	Equity-Liabilities	Current liabilities	Trade payables
18.	General reserve	Equity-Liabilities	Shareholders' funds	Reserve and surplus

No.	Particulars	Head of Balance Sheet	Main Head	Sub Head
19.	Public deposit	Equity-Liabilities	Non-current liabilities	Long-term borrowings
20.	Debtors	Assets	Current assets	Trade receivables
21.	Patents	Assets	Non-current assets	Fixed assets-intangible
22.	Calls in arrears	Equity-Liabilities	Shareholders' funds	Deducted from share capital
23.	Debenture redemption fund investment	Assets	Non-current assets	Non-current investments
24.	Stores and loose tools	Assets	Current assets	Inventory
25.	Licences	Assets	Non-current assets	Fixed assets-intangible
26.	Closing stock	Assets	Current assets	Inventory
27.	Bank balance	Assets	Current assets	Cash - cash equivalent
28.	Surplus as per statement of profit and loss	Equity-Liabilities	Shareholders' funds	Reserve and surplus
29.	Deposit in electricity co.	Assets	Non-current assets	Long-term loan and advances
30.	Premium on redemption of preference shares	Equity-Liabilities	Non-current liabilities	Other long-term liabilities

4. Non-current assets ₹ 7,46,000, Current assets ₹ 1,11,000, Total ₹ 8,57,000

5. Shareholders' funds ₹ 7,20,000, Non-current liabilities ₹ 7,01,000, Current liabilities ₹ 1,79,000, Total ₹ 16,00,000

6. Shareholders' funds ₹ 15,30,000, Non-current liabilities ₹ 2,25,000, Current liabilities ₹ 6,90,000, Non-current Assets ₹ 17,32,500, Current Assets ₹ 7,12,500, Total ₹ 24,45,000

7.	Particulars	Head of Profit and Loss Statement
	(1) Sales	Revenue from operation
	(2) Salary	Employees benefit expenses
	(3) Depreciation	Depreciation and amortized expenses
	(4) Debenture interest receipt	Other income
	(5) Debenture interest paid	Financial cost (expense)
	(6) Audit fee	Other expenses
	(7) Sale of scrape	Other income
	(8) Profit on sale of asset	Other income
	(9) Advertisement expense	Other expenses
	(10) Contribution to providend fund	Employees benefit expenses
	(11) Interest on bank overdraft	Financial cost (expenses)
	(12) Bank charges	Other expenses
	(13) Goodwill	Will not be shown in profit and loss statement
	(14) Bonus to employees	Employees benefit expenses
	(15) Debenture discount written off	Depreciation and amortized expenses



8. Total incomes ₹ 3,91,500, Total expenses ₹ 3,86,100, Profit after tax ₹ 3780
9. Total incomes ₹ 9,75,600, Total expenses ₹ 7,80,000, Profit after tax ₹ 97,800, Shareholders' funds ₹ 3,37,800, Non-current liabilities ₹ 1,20,000, Current liabilities ₹ 1,12,200, Non-current assets ₹ 3,48,000, Current assets ₹ 2,22,000, Total ₹ 5,70,000
10. Total incomes ₹ 11,55,000, Total expenses ₹ 8,55,000, Profit after tax ₹ 3,00,000, Owners' fund ₹ 11,10,000, Non-current liabilities ₹ 5,25,000, Current liabilities ₹ 90,000, Non-current assets ₹ 14,10,000, Current assets ₹ 3,15,000, Total ₹ 17,25,000

**Exercise 4**

1. Select appropriate option for each question :

(1) (a)      (2) (d)      (3) (d)      (4) (c)      (5) (b)

4.

Particulars	Increase/ Decrease (₹)	Increase/ Decrease (%)
(I) Sales revenue	11,00,000	50.00
(II) Other income	75,000	50.00
(III) Total income	11,75,000	50.00
(IV) Expenses	8,36,000	54.29
(V) Profit before tax	3,39,000	41.85
(VI) Income tax	1,01,700	41.85
(VII) Profit after tax	2,37,300	41.85

5.

Particulars	Increase/ Decrease (₹)	Increase/ Decrease (%)
(I) Sales revenue	5,85,000	30.00
(II) Other income	95,000	50.00
(III) Total income	6,80,000	31.78
(IV) Expenses		
(i) Cost of goods consumed	1,90,000	20.00
(ii) Financial expenses	(60,000)	(40.00)
(iii) Depreciation	—	—
(iv) Other expenses	85,000	25.00
<b>Total expenses</b>	2,15,000	14.33
(V) Profit before tax	4,65,000	72.66
(VI) Income tax	1,39,500	72.66
(VII) Profit after tax	3,25,500	72.66

6.

Particulars	Increase/ Decrease (₹)	Increase/ Decrease (%)
(I) Sales revenue	15,75,000	35
(II) Other incomes	(3,00,000)	(30)
(III) Total incomes	12,75,000	23.18
(IV) Expenses		
(i) Cost of goods consumed	6,00,000	20.00
(ii) Net purchase for resale	70,000	35.00
(iii) Changes in stock	20,000	28.57
(iv) Employees benefit expenses	1,60,000	40.00
(v) Financial expenses	45,000	50.00
(vi) Depreciation and amortized amount	35,000	50.00
<b>Total Expenses</b>	<b>9,30,000</b>	<b>24.28</b>
(V) Profit before tax	3,45,000	20.66
(VI) Income tax	1,03,500	20.66
(VII) Profit after tax	2,41,500	20.66

7.

Particulars	Increase/ Decrease (₹)	Increase/ Decrease (%)
(I) Sales revenue	(7,00,000)	(13.46)
(II) Other incomes	(8,00,000)	(80.00)
(III) Total incomes	(15,00,000)	(24.19)
(IV) Expenses		
(i) Net purchase	(6,00,000)	(15.79)
(ii) Other expenses	54,000	5.77
(iii) Change in stock	(1,00,000)	(100.00)
<b>Total expenses</b>	<b>(6,46,000)</b>	<b>(13.93)</b>
(V) Profit before tax	(8,54,000)	(54.60)
(VI) Income tax	(2,56,200)	(54.60)
(VII) Profit after tax	(5,97,800)	(54.60)

8.

Particulars	31-3-2016 (₹)
(I) Sales revenue	10,00,000
(II) Expenses	
(i) Purchases	6,00,000
(ii) Changes in stock	1,50,000
(iii) Depreciation	50,000
<b>Total expenses</b>	<b>8,00,000</b>
(III) Profit before tax	2,00,000
(IV) Income tax	60,000
(V) Profit after tax	1,40,000

9.

Particulars	Increase/ Decrease (₹)	Increase/ Decrease (%)
(1) Equity share capital	5,00,000	29.41
(2) Preference share capital	(2,00,000)	(16.67)
(3) General reserve	40,000	20.00
(4) Profit and loss A/c	30,000	16.67
(5) 10 % debentures	(2,00,000)	(25.00)
(6) Short-term liabilities	45,000	100.00
(7) Trade payables	(45,000)	(33.33)
<b>Total</b>	<b>1,70,000</b>	<b>3.93</b>
(8) Tangible assets : (i) Machines	1,00,000	6.67
(ii) Furniture	1,00,000	20.00
(9) Intangible assets : (i) Goodwill	(20,000)	(20.00)
(ii) Patent	20,000	2.74
(10) Non-current investments	1,00,000	12.5
(11) Current assets : (i) Stock	20,000	12.5
(ii) Trade receivables	(20,000)	(10.00)
Current investments	(1,30,000)	(48.15)
<b>Total</b>	<b>1,70,000</b>	<b>3.93</b>

10.

Particulars	31-3-2017 (4) (₹)	Increase/ Decrease (5)(₹)
(1) Equity share capital	30,00,000	6,00,000
(2) Reserves and surplus	15,00,000	3,00,000
(3) 10 % debentures	12,00,000	2,00,000
(4) 11 % bank loan	15,00,000	3,00,000
(5) Current liabilities	2,10,000	10,000
	31-3-2016 (3) (₹)	Increase/ Decrease (6)(₹)
(6) Tangible assets	30,00,000	7
(7) Intangible assets	20,00,000	10
(8) Current assets	10,00,000	100

11.

Particulars	% to sales	
	% of Previous year	% of Current year
(I) Sales revenue	100.00	100.00
(II) Other incomes	6.00	10.00
(III) Total incomes	106.00	110.00
(IV) Expenses		
(i) Cost of goods consumed	52.00	55.00
(ii) Net purchase	4.00	5.00
(iii) Changes in stock	3.00	(5.00)
(iv) Employees benefit expenses	15.00	15.00
(v) Financial expenses	12.00	10.00
(vi) Depreciation	10.00	12.00
<b>Total expenses</b>	96.00	92.00
(V) Profit before tax	10.00	18.00
(VI) Income tax	3.00	5.40
(VII) Profit after tax	7.00	12.60

12.

Particulars  1	Note No. 2	31-3-2017 (₹) 3	31-3-2016 (₹) 4	% to sales	
				31-3-2017 (%) 5	31-3-2016 (%) 6
(I) Sales revenue		—	—	—	—
(II) Expenses :					
(i) Cost of sales		30,60,000	42,00,000	—	—
(ii) Financial expenses		4,50,000	7,20,000	—	—
(iii) Depreciation		90,000	1,80,000	—	—
<b>Total Expenses</b>		<b>36,00,000</b>	<b>51,00,000</b>	<b>—</b>	<b>—</b>
(III) Profit before tax		—	—	—	—
(IV) Less : Income tax (30 %)		2,70,000	2,70,000	6	4.5
(V) Profit after tax		<b>6,30,000</b>	<b>6,30,000</b>	<b>14</b>	<b>10.5</b>

13.

Particulars	Note No.	% to Total of Balance Sheet	
		31-3-2016	31-3-2017
(I) <b>Equity - Liabilities :</b>			
<b>Share capital :</b> Equity share capital		41.67	33.33
Preference share capital		—	20.00
General reserve		10	10.67
Profit and loss A/c		10	6
Bank loan		25	20
Short-term liabilities		3.33	8
Other current liabilities		10	2
		100	100
(II) <b>Assets :</b>			
Machines		33.33	20
Land-building		25	33.33
Trademark		5.67	6.67
Goodwill		—	6.00
Non-current investment		25	20.00
Debtors		5	5
Stock		4	5
Cash and cash equivalent		2	4
		100	100



14.

Particulars	Note No.	31-3-2016	31-3-2017	% to Total of Balance Sheet	
		(₹)	(₹)	31-3-2016	31-3-2017
<b>(I) Share Capital :</b>					
(1) Equity share capital		13,60,000	—	—	40.00
(2) Preference share capital		6,80,000	—	—	20.00
(3) Profit and loss A/c		5,10,000	—	—	16.00
(4) 10 % debentures		6,80,000	—	—	20.00
(5) Trade payables		1,02,000	—	—	2.00
(6) Other liabilities		68,000	—	—	2.00
<b>Total</b>		<b>34,00,000</b>	<b>50,00,000</b>	<b>100.00</b>	<b>100.00</b>
<b>(II) Assets :</b>					
(1) Tangible assets		—	17,50,000	30.00	—
(2) Intangible assets		—	15,00,000	20.00	—
(3) Non-current investments		—	11,00,000	25.00	—
(4) Trade receivables		—	1,50,000	10.00	—
(5) Stock		—	4,00,000	7.00	—
(6) Cash - cash equivalent		—	1,00,000	8.00	—
<b>Total</b>		<b>34,00,000</b>	<b>50,00,000</b>	<b>100.00</b>	<b>100.00</b>

**Exercise 5**

1. Select appropriate option for each question :

- (1) (d)      (2) (d)      (3) (d)      (4) (a)      (5) (d)      (6) (a)      (7) (d)  
 (8) (b)      (9) (d)      (10) (d)      (11) (d)      (12) (a)

4. (i) 30 %    (ii) 20 %    (iii) Cost of goods sold ₹ 11,50,000, 36.11 %  
 5. Operating expenses ₹ 1,75,000, Operating ratio 83.33 %  
 6. Operating expenses ₹ 3,00,000, Operating ratio 76.92 %, Operating profit ratio 23.08 %  
 7. Net profit after tax ₹ 17,500, Net profit ratio 2.92 % for question no. 5  
 Net profit after tax ₹ 6,30,000, Net profit ratio 16.15 % for question no. 6  
 8. Current Assets ₹ 7,85,000, Current liabilities ₹ 3,50,000; Current ratio 2.24:1  
 Liquid assets ₹ 4,25,000, Liquid ratio 1.21:1  
 9. Debit-equity ratio 1.26, Debt ₹ 12,00,000, Equity ₹ 9,50,000  
 10. Debt ₹ 14,00,000, Equity ₹ 11,50,000, Debt-equity ratio = 1.22:1  
 11. Debt ₹ 6,00,000, Equity ₹ 12,00,000, Debt-equity ratio 0.5:1

12. Total assets ₹ 26,00,000, Total assets - Debt-ratio 6.5:1
13. Proprietary funds ₹ 24,00,000, Total assets ₹ 36,00,000, Proprietary ratio = 0.66:1
14. Profit before tax ₹ 13,20,000, Interest ₹ 3,20,000, Interest coverage ratio = 4.125 times
15. Cost of goods sold ₹ 21,00,000, Average stock ₹ 3,00,000, Stock turnover 7 times
16. Cost of goods sold ₹ 26,00,000, Average stock ₹ 1,75,000, Stock turnover 14.85 times
17. Working capital ₹ 2,00,000, Working capital turnover (Based on cost of goods sold), ₹ 16 times  
Working capital turnover (Based on sales) 20 times
18. Debtors turnover 5 times, Collection period 72 days, 10.4 weeks, 2.4 months
19. Creditors turnover 6 times, Payment period 60 days, 8.66 weeks, 2 months

### Exercise 6

**1. Select appropriate option for each question :**

- (1) (c)      (2) (a)      (3) (c)      (4) (a)      (5) (a)      (6) (d)      (7) (c)  
 (8) (a)      (9) (d)      (10) (c)      (11) (d)      (12) (d)      (13) (c)
15. Cash flow from operating activities ₹ 1,79,000
  16. Profit (cash flow) before changes in working capital ₹ 41,000;  
Cash flow from operating activities ₹ 1,01,000
  17. Profit (cash flow) before changes in working capital ₹ 91,000,  
Cash flow from operating activities ₹ 34,000
  18. Cash flow from investing activities (₹ 1,05,000) (Cash outflow)
  19. Purchase of machine ₹ 2,00,000, Depreciation provision ₹ 30,000, Cash flow from investing activities ₹ 53,000
  20. Cash flow from financing activities ₹ 91,000, Dividend - interest received, purchase of land, sale of furniture, purchase of machine, interest received on investments, payment for patents are investing activities.
  21. Cash flow financing activities ₹ 14,000

