RESERVES AND SURPLUS

Sample Balance Sheet

Balance Sheet of ABC Ltd. As on 31/12/06			
Liabilities	**Amount**	**Assests**	**Amount**
SHARE CAPITAL		**FIXED ASSETS**	
Authorised Capital		Goodwill	
Issued Capital		Building	
Subscribed Capital		Machinary	
Called-up Capital		Land	
RESERVES AND SURPLUS		**INVESTMENTS**	
Share premium			
Capital fund			
Capital Redemption Reserve		**CURRENT ASSETS**	
General Reserves		Debtors	
Sinking Fund		Bills receivable (B/R)	
		Cash	
LOANS		Bank	
Secured loans		Inventory	
Debentures			
Loans and advances (borrowings)		**Miscellanious expenditure**	
		Preliminary expenses	
Unsecured Loans		Discount on shares	
		Brokerage	
CURRENT LIABILTIES		Underwriting commission	
Creditors			
B/P			
Outstanding rent/salary etc			
PROVISIONS			
Provision for bad debts			
Provision for Leave Encashment			
	xxxxxx		xxxxx

Reserves and Surplus

- When a business creates a "Reserve", they are essentially setting aside a certain amount of money for a specific purpose. Often times, reserves are set aside to act as a buffer against future losses.
- Surplus is a result of retained earnings (which would increase the shareholder equity). There is a specific part of the surplus that comes from other sources (such as increasing the value of fixed assets carried on the balance sheet, the sale of stock at a premium, or the lowering of the par value on common stock).

Reserves and Surplus - Examples

- If a business had a build up of inventories that risked losing their value, management would create a reserve to offset losses.

- If a manufacturing corporation decided to save money to build a new widget plant, they would put money in a reserve until they had saved enough to pay for it.

- Proprietorship Reserves are set up to alert investors that a certain part of the shareholder's equity cannot be paid out as cash dividends since they have another purpose.

Source http://beginnersinvest.about.com/cs/investinglessons/l/blles3capsurres.htm

Components of Reserves and Surplus

Main Components under this head includes:

I. Share premium
II. Capital Fund
III. Capital Redemption Reserve
IV. General Reserves
V. Sinking Fund

Share Premium and its application

Where a company issues shares at a premium, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called "the securities premium account";

Application (Section 78 of Companies Act, 1956):

•Paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

•Writing off the preliminary expenses of the company.

•Writing off the expenses of, or commission paid or discount allowed on, any issue of shares or debentures of the company.

•Providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

Capital Reserve

- A part of shareholders' funds that comes from a revaluation of capital assets and not from the normal operations that are recorded in the profit and loss account.

- Created out of capital profit and not available for distribution

- Example : Profits or reissue of forfeited shares, profit on sale of a business or part of a business, profit on sale of fixed assets

Capital Redemption Reserve

- A reserve fund into which profits are allocated for the purpose of redeeming or buying back shares in the company.
- S170 Companies Act 1985 provides that where shares of a company are redeemed or purchased wholly out of the company's profits, or by a fresh issue the amount by which the company's issued share capital is diminished on cancellation of the shares shall be transferred to a reserve called "Capital Redemption Reserve"

General Reserve

- Undistributed Profits that are usually reinvested into the business
- Part of shareholders fund
- It maybe created to meet a contingent liability or for expansion purpose
- Increase in general reserves vis-à-vis capital employed leads to shareholders being given free shares or nominal price of shares being increased

Sinking Fund

- Certain fixed amount being set aside annually

- Compound interest received by investing the amounts set aside

Application

- Replace fixed assets

- Payment of a liability at a future date

THANK YOU