केन्द्रीय विद्यालय संगठन

KENDRIYA VIDYALAYA SANGATHAN

निपुण भारत मिशन

हर बच्चे को उच्च गुणवत्ता वाली शिक्षा

शिक्षा एवं प्रशिक्षण का आंचलिक संस्थान, चंडीगढ़

ZONAL INSTITUTE OF EDUCATION AND TRAINING, CHANDIGARH

अध्ययन सामग्री / STUDY MATERIAL

शैक्षिक सत्र / SESSION – 2023-24

कक्षा / CLASS – बारहवीं / XII

विषय / SUBJECT – लेखांकन / ACCOUNTANCY

विषय कोड / SUBJECT CODE - 055

तैयारकर्ता - रवि कुमार, सह-प्रशिक्षक (वाणिज्य)

PREPARED BY: RAVI KUMAR, TRAINING ASSOCIATE (COMMERCE)

शिक्षा एवं प्रशिक्षण का आंचलिक संस्थान, चंडीगढ़

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SYLLABUS

ACCOUNTANCY (Code No.- 055)

Class-XII (2023-24)

Theory: 80 Marks ***3 Hours***

Project: 20 Marks

Units		Periods	Marks
Part A	**Accounting for Partnership Firms and Companies**		
	Unit 1. Accounting for Partnership Firms	105	36
	Unit 2. Accounting for Companies	45	24
		150	**60**
Part-B	**Financial Statement Analysis**		
	Unit 3. Analysis of Financial Statements	30	12
	Unit 4. Cash Flow Statement	20	8
		50	**20**
Part C	**Project Work**	20	**20**
	Project work will include:		
	Project File 12 Marks		
	Viva Voce 08 Marks		
	Or		
Part B	**Computerized Accounting**		
	Unit 4. Computerized Accounting	50	20
Part C	**Practical Work**	20	20
	Practical work will include:		
	Practical File 12 Marks		
	Viva Voce 08 Marks		

PART A: ACCOUNTING FOR PARTNERSHIP FIRMS AND COMPANIES

Unit 1: Accounting for Partnership Firms

Units/Topics	Learning Outcomes
• Partnership: features, Partnership Deed. • Provisions of the Indian Partnership Act 1932 in the absence of partnership deed. • Fixed v/s fluctuating capital accounts. Preparation of Profit and Loss Appropriation account- division of profit among partners, guarantee of profits. • Past adjustments (relating to interest on capital, interest on drawing, salary and profit sharing ratio). • Goodwill: meaning, nature, factors affecting and methods of valuation - average profit, super profit and capitalization. ***Note:*** *Interest on partner's loan is to be treated as a charge against profits.* Goodwill: meaning, factors affecting, need for valuation, methods for calculation (average profits, super profits and capitalization), adjusted through partners' capital/ current account. **Accounting for Partnership firms - Reconstitution and Dissolution.** • **Change in the Profit Sharing Ratio** among the existing partners - sacrificing ratio, gaining ratio, accounting for revaluation of assets and reassessment of liabilities and treatment of reserves, accumulated profits and losses. Preparation of revaluation account and balance sheet. **Admission of a partner** - effect of admission of a partner on change in the profit sharing ratio, treatment of goodwill (as per AS 26), treatment for revaluation of assets and re-assessment of liabilities, treatment of	**After going through this Unit, the students will be able to:** • state the meaning of partnership, partnership firm and partnership deed. • describe the characteristic features of partnership and the contents of partnership deed. • discuss the significance of provision of Partnership Act in the absence of partnership deed. • differentiate between fixed and fluctuating capital, outline the process and develop the understanding and skill of preparation of Profit and Loss Appropriation Account. • develop the understanding and skill of preparation profit and loss appropriation account involving guarantee of profits. • develop the understanding and skill of making past adjustments. • state the meaning, nature and factors affecting goodwill. • develop the understanding and skill of valuation of goodwill using different methods. • state the meaning of sacrificing ratio, gaining ratio and the change in profit sharing ratio among existing partners. • develop the understanding of accounting treatment of revaluation assets and reassessment of liabilities and treatment of

of reserves, accumulated profits and losses, adjustment of capital accounts and preparation of capital, current account and balance sheet. • **Retirement and death of a partner:** effect of retirement / death of a partner on change in profit sharing ratio, treatment of goodwill (as per AS 26), treatment for revaluation of assets and reassessment of liabilities, adjustment of accumulated profits, losses and reserves, adjustment of capital accounts and preparation of capital, current account and balance sheet. Preparation of loan account of the retiring partner. • Calculation of deceased partner's share of profit till the date of death. Preparation of deceased partner's capital account and his executor's account. • **Dissolution of a partnership firm:** meaning of dissolution of partnership and partnership firm, types of dissolution of a firm. Settlement of accounts - preparation of realization account, and other related accounts: capital accounts of partners and cash/ bank A/c (excluding piecemeal distribution, sale to a company and insolvency of partner(s)). **Note:** (i) If the realized value of tangible assets is not given it should be considered as realized at book value itself. (ii) If the realized value of intangible assets is not given it should be considered as nil (zero value). (iii) In case, the realization expenses are borne by a partner, clear indication should be given regardingthe payment thereof.	reserves and accumulated profits by preparing revaluation account and balance sheet. • explain the effect of change in profit sharing ratio on admission of a new partner. • develop the understanding and skill of treatment of goodwill as per AS-26, treatment of revaluation of assets and re-assessment of liabilities, treatment of reserves and accumulated profits, adjustment of capital accounts and preparation of capital, current account and balance sheet of the new firm. • explain the effect of retirement / death of a partner on change in profit sharing ratio. • develop the understanding of accounting treatment of goodwill, revaluation of assets and re-assessment of liabilities and adjustment of accumulated profits, losses and reserves on retirement / death of a partner and capital adjustment. • develop the skill of calculation of deceased partner's share till the time of his death and prepare deceased partner's and executor's account. • discuss the preparation of the capital accounts of the remaining partners and the balance sheet of the firm after retirement / death of a partner. • understand the situations under which a partnership firm can be dissolved. • develop the understanding of preparation of realisation account and other related accounts.

Unit-2: Accounting for Companies

Units/Topics	Learning Outcomes
Accounting for Share Capital • Features and types of companies Share and share capital: nature and types. • Accounting for share capital: issue and allotment of equity and preferences shares. Public subscription of shares - over subscription and under subscription of shares; issue at par and at premium, calls in advance and arrears (excluding interest), issue of shares for consideration other than cash. • Concept of Private Placement and Employees Stock Option Plan (ESOP), Sweat Equity. • Accounting treatment of forfeiture and re-issue of shares. • Disclosure of share capital in the Balance Sheet of a company. **Accounting for Debentures** • Debentures: Meaning, types, Issue of debentures at par, at a premium and at a discount. Issue of debentures for consideration other than cash; Issue of debentures with terms of redemption; debentures as collateral security-concept, interest on debentures. Writing off discount / loss on issue of debentures. **Note:** Discount or loss on issue of debentures to be written off in the year debentures are allotted from Security Premium Reserve (if it exists) and then from Statement of Profit and Loss as Financial Cost (AS16).	**After going through this Unit, the students will be able to**: • state the meaning of share and share capital and differentiate between equity shares and preference shares and different types of share capital. • understand the meaning of private placementof shares and Employee Stock Option Plan. • explain the accounting treatment of share capital transactions regarding issue of shares. • develop the understanding of accounting treatment of forfeiture and re-issue of forfeited shares. • describe the presentation of share capital in the balance sheet of the company as per schedule III part-I of the Companies Act 2013. • explain the accounting treatment of different categories of transactions related to issue of debentures. • develop the understanding and skill of writing of discount / loss on issue of debentures. • understand the concept of collateral security and its presentation in balance sheet. • develop the skill of calculating interest on debentures and its accounting treatment. • state the meaning of redemption of debentures.

PART B: FINANCIAL STATEMENT ANALYSIS

Unit 3: Analysis of Financial Statements

Units/Topics	Learning Outcomes
Financial statements of a Company: • Meaning, Nature, Uses and importance of financial Statement. Statement of Profit and Loss and Balance Sheet in prescribed form with major headings and sub headings (as per Schedule III to the Companies Act, 2013) ***Note:*** *Exceptional items, extraordinary items and profit (loss) from discontinued operations are excluded.* • **Financial Statement Analysis: Meaning, Significance** Objectives, importance and limitations. • **Tools for Financial Statement Analysis:** Comparative statements, common size statements, Ratio analysis, Cash flow analysis. • **Accounting Ratios:** Meaning, Objectives, Advantages, classification and computation. • **Liquidity Ratios:** Current ratio and Quick ratio. • **Solvency Ratios:** Debt to Equity Ratio, Total Asset to Debt Ratio, Proprietary Ratio and Interest Coverage Ratio. Debt to Capital Employed Ratio. • **Activity Ratios:** Inventory Turnover Ratio, Trade Receivables Turnover Ratio, Trade Payables Turnover Ratio, Fixed Asset Turnover Ratio, Net Asset Turnover Ratio and Working Capital Turnover Ratio. • **Profitability Ratios:** Gross Profit Ratio, Operating Ratio, Operating Profit Ratio, Net Profit Ratio and Return on Investment.	**After going through this Unit, the students will be able to:** • develop the understanding of major headings and sub-headings (as per Schedule III to the Companies Act, 2013) of balance sheet as per the prescribed norms / formats. • state the meaning, objectives and limitations of financial statement analysis. • discuss the meaning of different tools of 'financial statements analysis'. • develop the skill of preparation of comparative and common size statement understand their uses and difference between the two. • state the meaning, objectives and significance of different types of ratios. • develop the understanding of computation of current ratio and quick ratio. • develop the skill of computation of debt equity ratio, total asset to debt ratio, proprietary ratio and interest coverage ratio. • develop the skill of computation of inventory turnover ratio, trade receivables and trade payables ratio and working capital turnover ratio and others. • develop the skill of computation of gross profit ratio, operating ratio, operating profit ratio, net profit ratio and return on investment.

Note: *Net Profit Ratio is to be calculated on the basis of profit before and after tax.*

Unit 4: Cash Flow Statement

Units/Topics	Learning Outcomes
Meaning, objectives Benefits, Cash and Cash Equivalents, Classification of Activities and preparation (as per AS 3 (Revised) (Indirect Method only) ***Note:*** ***(i)*** *Adjustments relating to depreciation and amortization, profit or loss on sale of assets including investments, dividend (both final and interim) and tax.* ***(ii)*** *Bank overdraft and cash credit to be treated as short term borrowings.* • *Current Investments to be taken as Marketable securities unless otherwise specified.*	**After going through this Unit, the studentswill be able to:** • state the meaning and objectives of cash flow statement. • develop the understanding of preparation of Cash Flow Statement using indirect method as per AS 3 with given adjustments.

Note: *Previous years' Proposed Dividend to be given effect, as prescribed in AS-4, Events occurring after the Balance Sheet date. Current years' Proposed Dividend will be accounted for in the next year after it is declared by the shareholders.*

Project Work:-

One specific project based on financial statement analysis of a company covering any two aspects from the following:

1. Comparative and common size financial statements.
2. Accounting Ratios.
3. Segment Reports.
4. Cash Flow Statements.

OR

Part B: Computerised Accounting

Unit 4: Computerised Accounting

Overview of Computerised Accounting System

- Introduction: Application in Accounting.
- Features of Computerised Accounting System.
- Structure of CAS.
- Software Packages: Generic; Specific; Tailored.

Accounting Application of Electronic Spreadsheet.

- Concept of electronic spreadsheet.
- Features offered by electronic spreadsheet.
- Application in generating accounting information - bank reconciliation statement; asset accounting; loan repayment of loan schedule, ratio analysis.
- Data representation- graphs, charts and diagrams.

Using Computerized Accounting System.

- Steps in installation of CAS, codification and Hierarchy of account heads, creation of accounts.
- Data: Entry, validation and verification.
- Adjusting entries, preparation of balance sheet, profit & loss account with closing entries & opening entries.
- Need and security features of the system.

Part C: Practical Work

Please refer to the guidelines published by CBSE.

Prescribed Books:

Accountancy Part –I	Class XII	NCERT Publication
Accountancy Part –II	Class XII	NCERT Publication
Accountancy – Computerised Accounting System	Class XII	NCERT Publication.

Suggested Question Paper Design

Accountancy (Code No. 055)

Class XII (2023-24)

Theory: 80 Marks ***3 hrs***
Project: 20 Marks

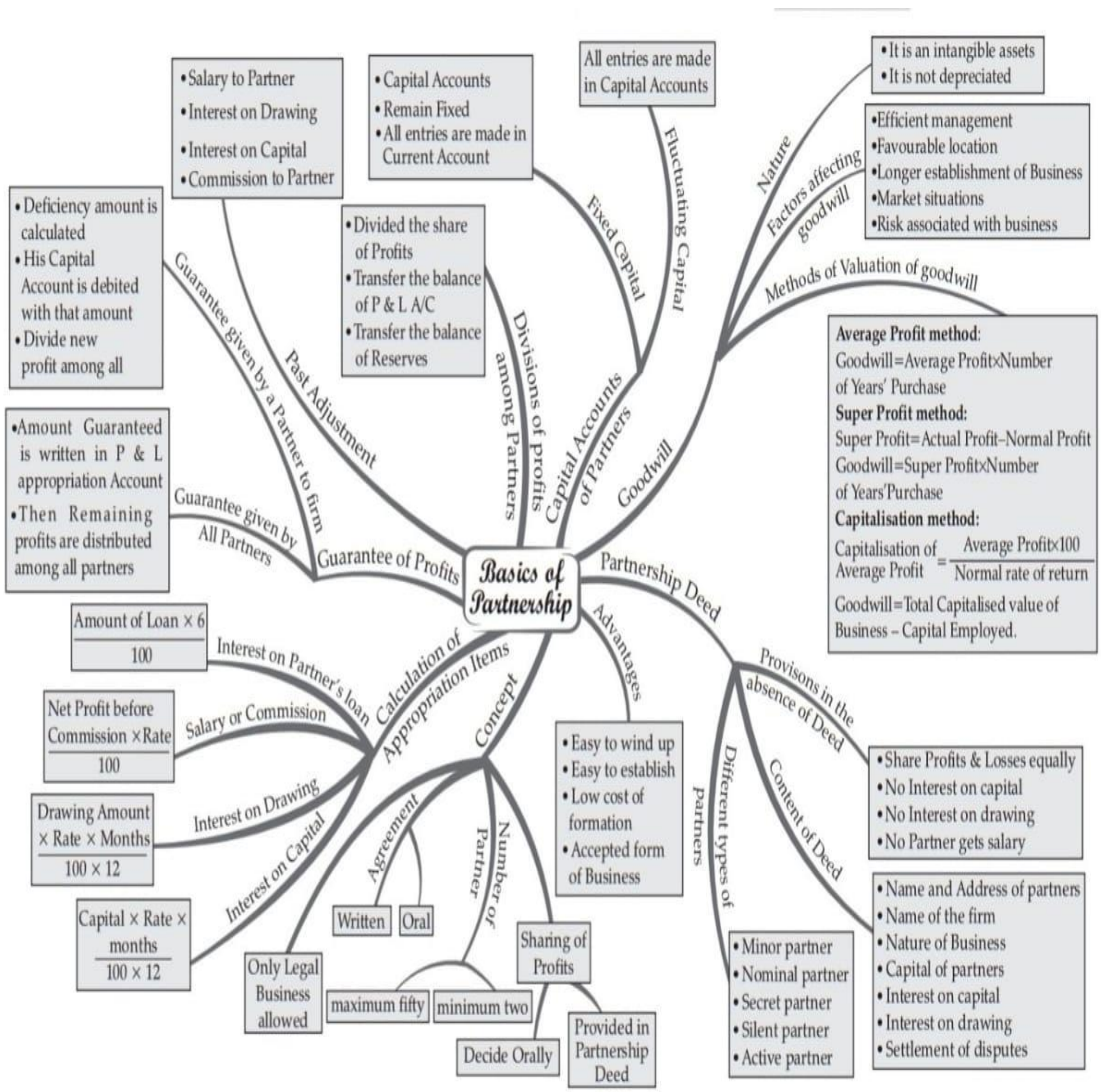
S.No.	Typology of Questions	Marks	Percentage
1	**Remembering and Understanding**: Exhibit memory of previously learned material by recalling facts,terms, basic concepts and answers. Demonstrate understanding of facts and ideas by organizing,comparing, translating, interpreting, giving descriptions and stating main ideas.	44	55%
3	**Applying**: Solve problems to new situations by applying acquired knowledge, facts, techniques and rules in a different way.	19	23.75%
4	**Analysing, Evaluating and Creating:** Examine and break information into parts by identifying motives or causes. Make inferences and find evidence to support generalizations. Present and defend opinions by making judgments about information, validity of ideas, or quality of work based on a set of criteria. Compile information together in a different way by combining elements in a new pattern or proposing alternative solutions.	17	21.25%
	TOTAL	**80**	**100%**

ACCOUNTANCY PART-I

UNIT - 01

CH-01: ACCOUNTING FOR PARTNERSHIP – BASIC CONCEPTS

(MIND MAP)



<u>Definition of Partnership</u>:

Section 4 of the Partnership Act, 1932, defines partnership as follows:

"Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

Features of partnership Firm:

(i) Association of two or more persons: - Minimum 02 & Maximum 50 members.

(ii) Partnership Agreement or Deed: either written or oral.

(iii) Legal Business

(iv) Sharing of Profits or Losses in a certain ratio.

(v) Mutual Agency

(vi) Unlimited Liability: Partners' liability to the third parties is unlimited.

Partnership Deed:

The written document, which contains terms & conditions of partnership is called *'Partnership Deed'*. It generally contains the details about all the aspects affecting the relationship between the partners including the objective of business, contribution of capital by each partner, ratio in which the profits and the losses will be shared by the partners, entitlement of partners to interest on capital, interest on loan, etc.

Provisions of Partnership Act, 1932 in the absence of Partnership Deed:

a) Interest on Capital: - No interest on capital is payable if the partnership deed is silent on the issue.

b) Interest on Drawings: - No interest is to be charged on the drawings made by the partners, if thereis no mention in the Deed.

c) Profit Sharing Ratio-: If the partnership deed is silent about the profit sharing ratio, the profits & losses of the firm are to be shared equally by partners.

d) *Remuneration for Firm's Work:* - No partner is entitled to get salary or other remuneration for taking part in the conduct of the business of the firm.

e) *Interest on Advances:* - If any partner has advanced some money to the firm beyond the amount of his capital for the purpose of business, s/he shall been titled to get an interest on the amount @ 6% p.a.

Maintenance of Partners Capital A/c

Partners' Capital A/c can be maintained by two methods:

1. *Fixed Capital Method*
2. *Fluctuating Capital Method*

In fixed capital method two accounts are prepared *Partners Capital Account and Partners Current Account* while in fluctuation method only one account is prepared i.e. *Partners' Capital Account.*

Final Accounts of Partnership firm:

Following accounts are prepared by a firm

1. Trading, Profit and loss A/c
2. Profit & Loss Appropriation A/c
3. Partners' Capital A/c
4. Balance sheet

- **FIXED CAPITAL METHOD:**

(1) In this method Partners Capitals shall remain fixed unless additional Capital is introduced a partof capital is withdrawn permanently.

(2) All adjustments like interest on Cap. or salary etc. are shown in a separate A/c named as Partners Current a/c

(3) Partners' Capital will always show Credit balance while partners Current A/c may have Dr. or Cr. balance.

Dr. Partner's Capital A/c Cr.

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Bank A/c (Permanent withdrawal)	xxx	xxx	By Balance b/d	xxx	xxx
To Balance c/d	xxx	xxx	By Bank A/c (Additional Cap.)	xxx	xxx
	xxxx	xxxx		xxxx	xxxx

Dr. Partner's Current A/c Cr.

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Balance b/d (If Dr. balance)	xxx	xxx	By Balance b/d (If Cr. balance)	xxx	xxx
To Drawings A/c	xxx	xxx	By Interest on Capital A/c	xxx	xxx
To Interest on Drawings A/c	xxx	xxx	By Salary A/c	xxx	xxx
To P&L Appro. A/c (Share of loss)	xxx	xxx	By Commission A/c	xxx	xxx
To Balance c/d (In case of Cr.Bal.)	xxx	xxx	By P/L Appro. A/c (Share of Profit)	xxx	xxx
			By Balance c/d (In case of Dr. bal.)	xxx	xxx
	xxxx	xxxx		xxxx	xxxx

Fluctuating Capital Method:

In this method Partners Capital doesn't remain fixed. It keeps on changing. Only one A/c is prepared by Partners i.e. Partners' capital A/c. All adjustments are recorded in capital A/c only. It may have Dr. or Cr. balance.

Dr. Partner's Capital A/c Cr.

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Balance b/d (If Dr. bal.)	xxx	xxx	By Balance b/d (If Cr. bal.)	xxx	xxx
To Bank(Permanent withdrawal) A/c	xxx	xxx	By Bank (Additional Cap.)	xxx	xxx
To Drawings A/c	xxx	xxx	By Interest on capital A/c	xxx	xxx
To Interest on drawings	xxx	xxx	By Salary A/c	xxx	xxx
To P&L Appro.(Share of loss)	xxx	xxx	By Commission A/c	xxx	xxx
To Balance c/d (In case of Cr. bal.)	xxx	xxx	By P&L Appro. A/c (Share of Profit)	xxx	xxx
			By Balance c/d (In case of Dr. bal.)	xxx	xxx
	xxxx	xxxx		xxxx	xxxx

Difference between Fixed and Fluctuating Capital Method

Basis	Fixed Capital	Fluctuating Capital
1. Number of Accounts	Two (02) Separate accounts are prepared.	Only One (01) account is prepared.
2. Adjustment	All adjustments are made in Current A/c.	All adjustments are made in Capital A/c.
3. Fixed Balance	The capital remains unchanged unless there is addition or withdrawalof Capital.	The balance of capital fluctuates from year to year.
4. Credit Balance	Capital A/c always shows credit balance.	Capital A/c may show debit or credit balance.

Distribution of profits among Partners:

- Profit & Loss Appropriation A/c.
- Profit & Loss Appropriation A/c is an extension of Profit & Loss A/c of the firm.
- All adjustments regard to salary Partners Commission, Interest on Capital,Interest on a drawings etc. are made through this account.
- It shows the appropriation of profits among partners.

Journal Entries

S.No.	Particulars		Dr. (₹)	Cr. (₹)
1.	**For transfer of profit from P&L A/c:** P & L A/c To P&L Appropriation A/c **In case of loss:** P & L Appropriation A/c To P&L A/c	Dr. Dr.		
2.	**Interest on Capital:** Interest on Capital A/c To Partners Capital/ Current A/c **For transferring to P&L Appropriation A/c:** P & L Appropriation A/c To Interest on capital A/c	Dr. Dr.		
3.	**Salary:** Salary A/c (individually) To Partners Capital/ Current A/c **For transferring to P&L Appropriation A/c** P & L Appropriation A/c To Salary A/c (individually)	Dr. Dr.		
4.	**Commission to partners:** Commission A/c (individually) To Partners Capital/ Current A/c	Dr.		
5.	**For transferring to P&L Appropriation A/c:** P & L Appropriation A/c To Commission A/c (individually)	Dr.		
6.	**Interest on drawings**: Partners' Capital/Current A/c To Interest on Drawings **For transferring to P&L Appropriation A/c:** Interest on Drawings A/c To P & L Appropriation A/c	Dr. Dr.		
7.	**Sharing of profit or loss after appropriations** **In case of Profits:** P & L Appropriation A/c To Partners Capital/ Current A/c (individually) **In case of losses:** Partners' Capital/ Current A/c To P & L Appropriation A/c	Dr. Dr.		

Profit and Loss Appropriation A/c for the year ended_______

Dr. **Cr.**

Particulars	(₹)	Particulars	(₹)
To P&L A/c (In case of loss)	xxx	By P&L A/c (In case of profits)	xxx
To Interest on Capital A/c	xxx	By Interest on Drawings A/c	xxx
To Salary A/c	xxx	By Partners Cap/ Current A/c (Share of loss)	xxx
To Commission A/c	xxx		
To Partners Cap/ Current A/c (Share of Profit)	xxx		
	xxxx		xxxx

★ *Interest on loan is a charge against profits.*

Calculation of Interest on Drawings

S.No.	Situation	Formula
1.	**When varying amounts are withdrawnat different intervals.**	**Interest is calculated through Product method and given for 1month =Total product x Rate/ 100 X 1/ 12**
2.	**When fixed amount is withdrawn (for Whole Year):** **(a) At the beginning of each month.** **(b) At the middle of each month.** **(c) At the end of each month.**	**(a) Total drawings X Rate/ 100 X 6.5/ 12** **(b) Total drawings X Rate/ 100 X 6/ 12** **(c) Total drawings X Rate/ 100 X 5.5/ 12**
3.	**When fixed amount is withdrawn:** **(a)In the beginning of each quarter.** **(b)At the middle of each quarter.** **(c) In the end of each quarter.**	**(a) Total drawings Rate/ 100 X 7.5/ 12** **(b) Total drawings X Rate/ 100 X 6/ 12** **(c) Total drawings X Rate/ 100 X 4.5/ 12**
4.	**When fixed amount is withdrawn:** **(a)In the beginning of eachhalf year.** **(b) At the middle of each half year.** **(c) In the end of each half year.**	**(a) Total drawings X Rate/ 100 X 9/ 12** **(b) Total drawings X Rate/ 100 X 6/ 12** **(c) Total drawings X Rate/ 100 X 3/ 12**
5.	**When fixed amount is withdrawn (during 06 months):** **(a) At the beginning of each month.** **(b) At the middle of each month.** **(c) At the end of each month.**	**(a) Total drawings X Rate/ 100 X 3.5/ 12** **(b) Total drawings X Rate/ 100 X 3/ 12** **(c) Total drawings X Rate/ 100 X 2.5/ 12**

Past Adjustment:

Sometimes after closing the accounts, i.e., preparing the financial statement, some errors or omission in the accounts of the earlier years are noticed. For example, interest on capital or drawings is omitted, allowed or charged at higher or lower rate, profits or losses are distributed among the partners in a wrong ratio and so on. These errors and omissions are rectified by adjusting the CapitalAccounts of the affected partners by passing **(A)** an adjustment entry, or **(B)** Adjusting entries.

Particulars	X (₹)	Y (₹)	Z (₹)	Firm (₹)
+ Interest on Capital	+	+	+	-
+ Partner's Salary/Commission	+	+	+	-
- Interest on Drawings	-	-	-	+
	+	+	+	-
Excess profit taken back in their P & L Sharing Ratio	-	-	-	
	+	-	+	

- **+ Means Cr. the Partner's Capital A/c.**
- **- Means Dr. the Partner's Capital A/c.**

<u>Guarantee of Profit to a Partner</u>:

Guarantee of profit means a minimum amount of profit to be paid to a partner. This amount shall be given to him if her/ his share of profit is lower than the guaranteed amount. The deficit shall be borne either by one of the old partners or by all the old partners in a particular agreed ratio.

If there is no agreement, then in their old profit sharing ratio, if his actual share of profit is more than the guaranteed amount, then s/he will be given his actual share of profit. S/He gets the guaranteed amount or the actual share of profit, **whichever is higher.**

(a) Guarantee given by all partners:
The deficiency shall be shared by other partners in their profit sharing ratio.

(b) Guarantee given by One Partner only:
First calculate his share of profit. Compare it with the guaranteed amount. The amount of deficiency is to be charged from the partner who gave guarantee.

(c) Guarantee given to a partner by other partners in a ratio different from their profit sharing ratio:-
Distribute profit among all the partners in the profit sharing ratio. Workout the amount of deficiencyby comparing it with the guaranteed amount and his actual share of profit. The other partners will bear the deficiency in an agreed new ratio.

Illustration 1: A, B & C share profit in the ratio of 2:3:5.They earned a profit of ₹ 1, 50,000 for the year ended 31st March, 2023. The profit was by mistake distributed among A, B & C in the ratio of 3:2:1, respectively. This error was noted in the beginning of the New Year. Pass necessary adjustment entry.

Particulars	A (₹)	B (₹)	C (₹)	Firm (₹)
1. Profit distributed in wrong ratio taken back Dr.	(-) 75,000	(-) 50,00	(-) 25,000	+ 1,50,000
2. The same profit now correctly distributed incorrect ratio Cr.	+ 30,000	+ 45,000	+ 75,000	1,50,000
Adjustment required Dr.	**- 45,000**	**- 5,000**	**+ 50,000**	

Pass necessary adjustment entry:

A's Capital A/c … Dr. 45,000
B's Capital A/c … Dr. 5,000
To C's capital A/c 50,000
(Being adjustment entry made)

Practical Problems:

Partnership Deed

1. Mohan and Shyam are partners in a firm. State whether the claim is valid if the partnership agreement is silent in the following matters:

(i) Mohan is an active partner. He wants a salary of ₹10,000 per year.

(ii) Shyam had advanced a loan to the firm. He claims interest @10% p.a.

(iii) Mohan has contributed ₹ 20,000 and Shyam ₹ 50,000 as capital.

(iv) Mohan wants equal share in profits.

(v) Shyam wants interest on capital to be credited @ 6% p. a.

2. State whether the following statements are true or false:

(i) Valid partnership can be formulated even without a written agreement between the partners.

(ii) Each partner carrying on the business is the principal as well as the agent.

(iii) Methods of settlement of dispute among the partners can't be part of the partnership deed.

(iv) If the deed is silent, interest @ 6% p.a. would be charged on the drawings made by the partner.

Interest on Capital & Interest on Drawings:-

3. A & B are partners sharing profits & losses in the ratio of 3:2. Their capital accounts showed balances of ₹1, 50,000 & ₹ 2, 00,000 respectively on 1st April, 2022. Show the treatment of interest on capital for the year ending 31st March, 2023 in each of the following alternatives:

(a) If the partnership deed is silent as to the payment of interest on capital & the profit for the year is ₹ 50,000;

(b) If partnership deed provides for interest on capital @ 8% p.a. and the firm incurred a loss of ₹ 10,000 during the year;

(c) If partnership deed provides for interest on capital @ 8% p.a. and the firm earned a profit of ₹ 50,000 during the year;

(d) If the partnership deed provides for interest on capital @ 8% p.a. and the firm earned a profit of ₹ 14,000 during the year.

Hint: In the absence of any information interest on capitals will be appropriation of profit.

Guarantee of Profit:

4. Ram, Mohan & Sohan are partners with capitals of ₹ 5, 00,000, ₹ 2, 50,000 & ₹ 2, 00,000 respectively. After providing interest on capital @10% p.a. the profits are divisible as follows: Ram1/2 , Mohan 1/3 & Sohan 1/6. Ram and Mohan have guaranteed that Sohan's share in the profit shall not be less than ₹ 25, 000, in any year.The Net Profit for the year ended 31st March, 2023 is ₹ 2, 00,000 before charging interest on capital. You are required to show distribution of profit.

(Ans: Profit to Ram ₹ 48,000, Mohan ₹ 32,000 and Sohan ₹ 25,000).

Past Adjustment

5. The Net Profit of X, Y and Z for the year ended 31st March, 2023 was ₹ 60, 000 and the same was distributed among them in their agreed ratio of 3:1:1. It was subsequently discovered that the under mentioned transactions were not recorded in the books:

(i) Interest on Capital @ 5% p.a.

(ii) Interest on drawings amounting to X ₹ 700, Y ₹ 500 and Z ₹ 300.

(iii) Partner's Salary: X ₹1, 000, Y ₹1,500 p.a.

The capital accounts of partners were fixed as: X ₹ 1, 00,000, Y ₹ 80, 000 and Z ₹ 60, 000.

Record the adjustment entry.

(Ans: X Dr. ₹ 2,700, Y Cr. ₹ 2,600 and Z Cr. ₹ 100)

MULTIPLE CHOICE QUESTIONS:-

1. Salary to a partner under fixed capital account is credited to.
(a) Partner's Capital A/c (b) Partners current A/C
(c) Profit & Loss A/c (d) Partner's Loan A/c [b]

2. Rani and Shyam is partner in a firm. They are entitled to interest on their capital but the net profit was not sufficient for paying his interest, then the net profit will be disturbed among partner in.
(a) 1 : 2 (b) Profit Sharing Ratio
(c) Capital Ratio (d) Equally [c]

3. Which one of the following items is recorded in the Profit and Loss Appropriation account:-
(a) Interest on Loan (b) Partner salary
(c) Rent paid to Partner's (d) Managers Commission [b]

4. A, B and C were partner in a firm sharing Profit in the ratio of 3:2:1, during the year the firm earned profit of ₹ 84,000.Calculate the amount of Profit or Loss transferred to the Capital A/c of B.
(a) Loss ₹ 87,000 (b) Profit ₹ 87,000
(c) Profit ₹ 28,000 (d) Profit ₹14,000 [c]

5. Closing entry for interest on loan allowed to partners

(a) Interest on Partner's loan … Dr.
To Profit and Loss A/c

(b) Interest on loan … Dr.
To Profit and Loss Appropriation A/c

(c) Profit and Loss Appropriation A/c … Dr.
To Interest on Partners loan A/c

(d) Profit and Loss Appropriation A/c … Dr.
To Interest on loan A/c [c]

6. In the absence of partnership deed partner share profit and loss in.
(a) Ratio of capital Employed (b) Equal Ratio
(c) 2 : 1 (d) 1 : 2 [b]

7. The relation of the partner with the firm is that of.
(a) An owner (b) An agent and a Principal
(c) An agent (d) Manager [b]

8. As per section a minor may be admitted for the benefit of the partnership if:-
(a) One partner agree (b) More than one agree
(c) All Partners agree (d) Both (a) or (b) [c]

9. If the partner carries on the business that is similar to firm competition with the firm & profit earned from it, the profit.

(a) Shall be retained by the partner (b) Shall be paid to firm

(c) Can be retained or gained to the firm (d) Both (a) or (b) [b]

10. A, B & C are partner's sharing profits in the ratio of 5:3:2 According to the partnership agreement C is to get a minimum amount of ₹ 10,000 as his share of profits every year. The net profit for the year ended 31st March, 2021 amounted to ₹ 40,000. How much amount contributed by A?

(a)₹ 1,350 (b) ₹ 1,250

(c) ₹ 750 (d) ₹ 1,225 [b]

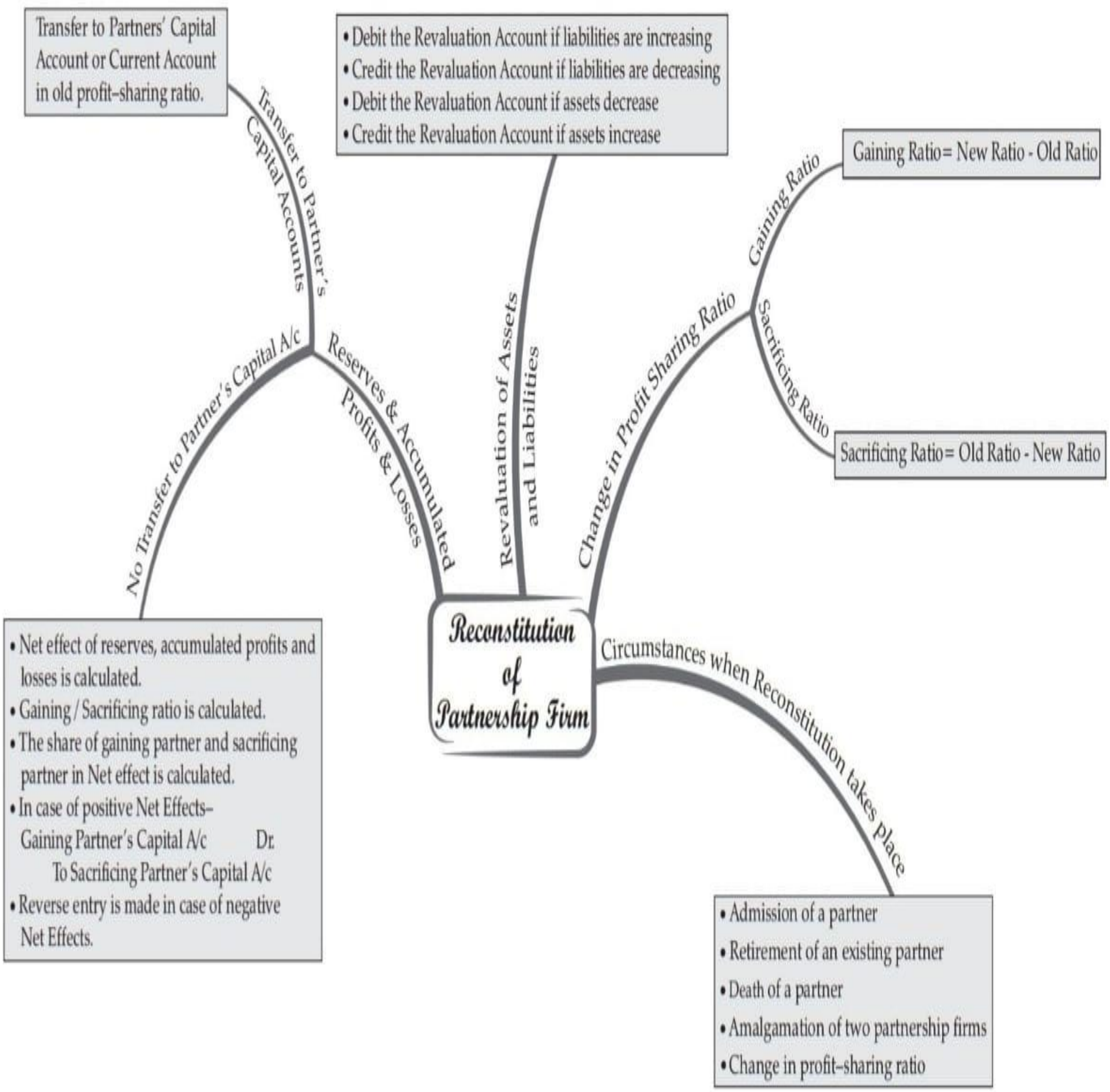
TRUE / FALSE:

1. The nature of Profit and Loss Account is real. [F]
2. Registration of partnership is optional. [T]
3. A body corporate can be a partner in partnership firm. [F]
4. Sleeping partner are those who do not take part in conduct of the business. [F]
5. When the Partnership agreement is silent about the treatment of interest on capital then it will be treated as charge on profit. [F]
6. Fixed capital always shows Debit balance. [F]
7. When a partnership firm gives loan to its partner then interest on loan will be debited in P& L A/c. [T]
8. In case of fixed capital account method drawing out of capital is shown in partner current A/c. [F]
9. Manager's commission is shown in Profit and Loss Appropriation A/c. [F]
10. Interest as a charge means interest on capital is to be allowed whether the firm has earned profit or incurred loss. [T]

CH – 02 : RECONSTITUTION OF A PARTNERSHIP FIRM – ADMISSION OF A PARTNER

(MIND MAP)

RECONSTITUTION OF PARTNERSHIP FIRM



Reconstitution of Partnership Firm:

Any change in existing agreement among farmers amounts to reconstitution of the firm. This results in an existing agreement and a new agreement comes into existence. However, the firm continues modes of Reconstitution Partnership. Reconstitutions of a firm usually take place in any of the filling following situations:

- Change in Profit sharing ratio among partners.
- Admission of a new partner
- Retirement and Death of Partner
- Sale of Business to others.
- Amalgamation of firms.

Effects of Reconstitution:

In case of Change in Profit sharing ratio. When there is change in profit sharing ratio amongst existing partners, there is sacrifice and gain; one partner may gain and the other sacrifice.

Sacrificing ratio: The ratio in which one partner sacrifices his share in favour of another partner is called sacrificing ratio

Gaining ratio: The ratio in which one partner gains due to change in profit sharingratio is called gaining ratio.

Effect on Accumulated Reserve and surplus:

In case of reconstitution of firm old accumulated reserves and surplus are distributed among partners in their old ratio. If the partners don't want to distribute the profits, then adjustment should be made through Capital/ Current A/c in their gain and sacrifice.

In case of Distribution of Accumulated Profits/ Reserves etc.

Reserve A/c
    To Partner's Cap / Current A/c (individually)

**In case of loss will be reversed entry.*

In case partners don't want to Share/ distributer

Gaining Partners Capital/ Current A/c
    To Sacrificing Partners Capital/ Current A/c

Treatment of Revaluation of Assets and Liabilities:

At the time of reconstitution the assets and liabilities of firm Re assessed are or revalued & the Profit/ Loss on revaluation is distributed among partners in their old ratio. If the partners don't want to show the changes values in the balance sheet then the profits on revaluation will be adjusted through partners' Capital / Current Alc.

Journal Entries:

(1) If assets there is increase in the value of assets:

Assets A/c Dr.
    To Revaluation A/c

(2) If there is decrease in the value of assets:

Revaluation A/c Dr.
To Assets A/c

(3) *If there is an increase in liability:*

Revaluation A/c Dr.
To Liability A/c

(4) If there is decrease in Liability:

Liability A/c Dr.
To Revaluation A/c

(5) for unrecorded asset (if any):

Unrecorded Assets A/c Dr.
To Revaluation A/c

(6) for unrecorded liability (if any):

Revaluation A/c Dr.
To unrecorded Liability

(7) In case of Profit on Revaluation (net effect):

Revaluation A/c Dr.
To Partners Capital / Current A/c

(8) If there is a loss on revaluation:

Partners' Capital/ Current Dr.
To Revaluation A/c

In case no changes will be made through then adjustment will be made through Capital / Current A/c are to be recorded:

Gaining Partners Capital / Current A/c Dr.
To Sacrificing Partner's Capital / Current (In their gaining / sacrificing shares)

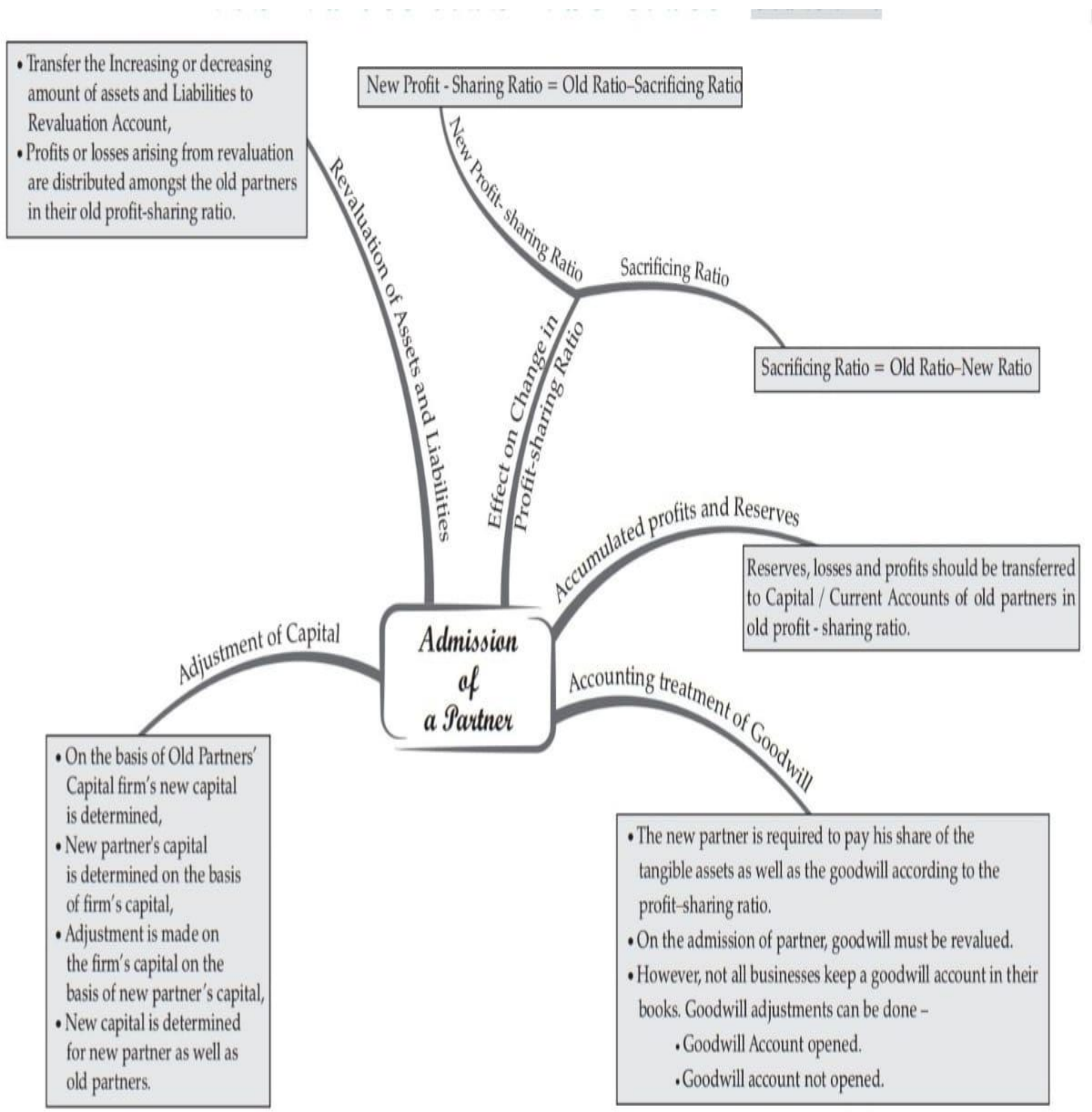
Treatment of Goodwill -

If there is an existing goodwill in books it has to be written off

Partners Capital/ Current A/c Dr.
To Goodwill A/c

ADMISSION OF A PARTNER

(MIND MAP)



Admission of a Partner:

A firm can be reconstituted on admission of a partner to a firm. Admission of a partner means a new member is admitted to the firm along with capital. The new partner brings:

- *Capital*
- *Premium for Goodwill*

The new partner acquires right:

- *Right to share the profits /losses*
- *Right to share the assets.*

The old partners sacrifice their share of profits in favour of a new partner. Applicability of AS-26 Intangible asset:

- *Intangible assets should be recognised by fulfilling criteria as recognised.*
- *If an intangible asset doesn't satisfy recognition Criteria, it should be expensed*
- *Intangible assets should be written off as early as possible but not exceeding its estimated life, which normally should not be beyond two years*
- *Internally generated goodwill should not be recognised as an asset.*

AS 26 implies thatPurchased goodwill may be accounted for in the books and shown as an "asset, where it is accounted for in the books and shown as assets. It should be written off as early as possible but where it is to be written-off in more than one accounting year Goodwill appearing in the balance sheet is written off at the time of the firm's reconstitution.

Self-generated goodwill is not accounted for in the books and not shown as an asset. Thus if self-generated goodwill be debited to a goodwill account it should be written off in the same financial year and should not be shown as an asset in the balance Sheet Alternative valueof goodwill may be adjusted by deducting new partners current account and credited in their sacrificing partner's current account in sacrificing ratio.

Accounting Steps:

STEP 1: Revaluation of Assets and Reassessment of Liabilities.
STEP 2: Treatment of Accumulated Profits or Losses. After welcome of New Partner
STEP 3: New Profit Sharing Ratio and Sacrificing Ratio.
STEP 4: Treatment of Goodwill.
STEP 5: Adjustment of Capital and New Balance Sheet.

***Note:* -** First two steps are calculated on the basis of old balance sheet, Old Partners' Capital A/c's & Old Profit Sharing Ratio. If, firstly these two steps are completed by students then there will be no chance of mistake in accounting treatment.

STEP 1: Revaluation of Assets and Reassessment of Liabilities.

The Journal Entries recorded for revaluation of assets and reassessments of liabilities are as follows:-

(a) For increase in the value of an asset:-

Asset A/c Dr.
To Revaluation A/c (Gain)

(b) For reduction in the value of an asset:-
Revaluation A/c Dr.
To Asset A/c (Loss)

(c) Appreciation in the amount of a liability:-
Revaluation A/c Dr.
To Liability A/c (Loss)

(d) For reduction in the amount of a liability:-
Liability A/c Dr.
To Revaluation A/c (Gain)

(e) For an unrecorded asset:-
Asset A/c Dr.
To Revaluation A/c

(f) For an unrecorded liability(Gain):-
Revaluation A/c Dr.
To Liability A/c (Loss)

(g) For transfer of gain on Revaluation if credit balance:-
Revaluation A/c Dr.
To Old Partners Capital A/c (Old ratio) (Individually)

(h) For transferring loss on revaluation:-
Old Partner's Capital A/c Dr. (Individually) (Old ratio)
To Revaluation A/c

STEP 2: Treatment of Accumulated Profits or Losses.

The journal entries recorded for Accumulated Profits or Losses are as follows:

1. ***For Accumulated Profit:-***
   Profit & Loss A/c Dr. (Profit)
   Reserve A/c Dr.
   Workmen's Compensation Fund A/c Dr.
   Investment Fluctuation Reserve A/c Dr.
   To Old Partners' Capital A/c (Individually) (In Old Profit Sharing Ratio)

2. ***For Losses:-***
   Old Partners' Capital A/c Dr (Individually)
   To Profit & Loss A/c (Loss)
   To Deferred Revenue Expenses A/c (In Old Profit Sharing Ratio)

STEP 3: New Profit sharing ratio and sacrificing ratio:-

New Profit Sharing Ratio

When new partner is admitted he acquires his share in profits from the old partners. In other words, on the admission of a new partner, the Old Partners Sacrifice share of their profit in favour of the new partner. But, what will be the share of new partner and how he will acquire it from the existing partners is decided mutually among the old partners and the new partner. However, if nothing is specified as to how the new partner acquires his share from the old partners; it may be assumed that hegets it from them in their profit sharing ratio.

* In any case, on admission of a new partner, the profit sharing ratio among the old partners will change keeping in view their respective contribution to the profit sharing ratio of the incoming partner. Hence, there is a need to ascertain the new profit sharing ratio among all the partners. This depends upon how the new partner acquires his share from the old partners for which there are many possibilities. Let us understand it with the help of the following illustrations.

Illustration 1:-

Anil & Vishal are partners sharing profits in the ratio of 3:2. They admitted Sumit as a new partner for 1/5th share in the future profits of the firm. Calculate new profit sharing ratio of Anil, Vishal & Sumit.

Solution: Sumit's Share = 1/5; Remaining Share =1-1/5 = 4/5.

Anil's New Share = 4/5 x 3/5 = 12/25

Vishal's New Share = 4/5 x 2/5 = 8/25

Sumit's Share = 1 x 5/5 x 5 = 5/25

New profit sharing ratio of Anil, Vishal and Sumit will be 12:8:5.

Note: It has been assumed that the new partner acquired his share from old partners in old ratio.

Illustration 2:-

Akshay & Bharati are partners sharing profits in the ratio of 3:2. They admit Dinesh as a new partner for 1/5th share in the future profits of the firm, which he gets equally from Akshay and Bharati. Calculate New Profit Sharing Ratio of Akshay, Bharati and Dinesh.

Solution: Dinesh's share = 1/5 or 2/10 ;

Akshay's share = 3/5 – 1/10 = 5/10

Bharti,s share = 2/5 – 1/10 = 3/10

So, New profit sharing ratio is 5:3:2.

Illustration 3:-

Ram & Shyam are partners in a firm sharing profits in the ratio of 3:2. They admit Ghanshyam as a new partner. Ram surrenders 1/4th of his share and Shyam 1/3rd of his share in favour of Ghanshyam. Calculate new profit sharing ratio of Ram, Shyam and Ghanshyam.

Solution: Ram sacrifice = 3/5 x 1/4 = 3/20; Shyam sacrifice = 2/5 x 1/3 = 2/15;

Ram's new share = 3/5 – 3/20 = 9/20 x 3/3= 27/60

Shyam's new share = 2/5 – 2/15 = 4/15 x 4/4 = 16/60

Ghanshyam's new share = 3/20 + 2/15 = 17/60.

So, New ratio is 27:16:17.

<u>Sacrificing Ratio</u>

The ratio in which the old partners agree to sacrifice their share of profit in favour of the incoming partner is called sacrificing ratio. The sacrifice by a partner is equal to:

Old Share of Profit – New Share of Profit.

Meaning of Goodwill:-

It is the reputation that helps the business to earn more profits as compared to‥a newly set up business. In accounting, the monetary value of such advantage is known as "goodwill".

Factors Affecting the Value of Goodwill:-

The main factors affecting the value of goodwill are as follows:

(a) Nature of Business (b) Location

(c) Efficiency of Management. (d) Market situation.

Need for Valuation of Goodwill:

In a partnership firm, goodwill needs to be valued in the following circumstances:

1. Change in the profit sharing ratio amongst the existing partners; 2. Admission of a New Partner;
3. Amalgamation of Partnership firm. 4. Death of a Partner
5. Dissolution of a firm involving sale of business as a going concern. 6. Retirement of a Partner;

Methods of Valuation of Goodwill:-

1. Average Profits Method:-

(a) Simple Average:-

Stepwise procedure to calculate Goodwill under this method:

Step 1: Work out profits or losses given for each of the past year after taking into account abnormalities, if any.

Step 2: Calculate average by dividing the total profit of all the years by the number of years.

Step 3: Goodwill = Average Profit x Number of year's purchase.

(b) Weighted Average Profit:-

Under this method, earlier years are less important than the recent year. Thus, each year's profit is multiplied by its respective number (weight) in chronological order. The latest year will be given the highest weight & the earliest year will be given lowest weight. Each profit figure will be multiplied by its weight & then the total of these products will be calculated. This total will be divided by the total of weights.

Then, **Goodwill = Weighted Average Profit x No. of years' purchase.**

2. Super Profit Method:-

Stepwise procedure to calculate Goodwill under this method:

Step 1: Calculate the Average Profit,

Step 2 : Calculate the Normal Profit on the Capital Employed on the basis of the Normal Rate of Return,

Formula , *Normal Profit = Capital Employed* x *NRR /100*

Step 3: Calculate the Super Profits by deducting normal profit from the average profits,

Formula, Super Profit = Average Profit - Normal Profit

Step 4: Then, Goodwill = Super Profits x Number of years Purchase.

3. Capitalisation Method:-

Under this method the goodwill can be calculated in two ways:

(a) By Capitalizing the Average Profits (b) By Capitalizing the Super Profits.

(a) Capitalisation of Average Profits: This involves the following steps:

(i) As certain the Average Profits based on the past few years' performance.

(ii) Capitalize the Average Profits on the basis of the Normal Rate of Return to ascertain the capitalized value of Average Profits as follows:

Average Profits x *100/ Normal Rate of Return*

As certain the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).
Capital Employed/ Net Assets = Total Assets (excluding Goodwill) – Outside Liabilities.
Compute the Value of Goodwill by deducting Net Assets from the Capitalised Value of Average Profits, i.e. (ii)-(iii).

(b) Capitalisation of Super Profits: It involves the following steps.
(i) Calculate Capital Employed of the firm, which is equal to Total Assets minus Outside Liabilities.
(ii) Calculate Normal Profit = Capital Employed x Normal Rate of Return/ 100
(iii) Calculate Average Profit for past years, as specified.
(iv) Super profits = Average Profits/ Actual Profit - Normal Profits
(v) Goodwill = Super Profits x 100/ Normal Rate of Return

Note:- In other words, goodwill is the capitalised value of super profits. The amount of goodwill worked out by this method will be exactly the same as calculated by capitalising the average profits.

STEP 4: Treatment of Goodwill.

Treatment of Goodwill

As stated earlier, the incoming partner who acquires his share in the profits of the firm from the existing partners brings in additional amount to compensate them for loss of their share in super profits. It is termed as his share of goodwill (also called premium for goodwill).

When the new Partner brings goodwill in cash.

The amount of premium brought in by the new partner is shared by the existing partners in their ratio of sacrifice. If this amount is paid to the old partners directly (privately) by the new partner, no entry is passed in the books of the firm. But, when the amount is paid through the firm, which is generally the case, the following journal entries are passed:

(i) Bank A/c Dr.
To Premium for Goodwill A/c
(Amount brought by new partner as premium)

(ii) Goodwill A/c Dr.
To Sacrificing Partners Capital A/c (Individually)
(Goodwill distributed among the existing partners' in their sacrificing ratio).

Alternatively, it is credited to the new partner's capital account & then adjusted in favour of the existing partners in their sacrificing ratio. In that case the journal entries will be as follows:

(i) Bank A/c Dr.
To New Partner's Capital A/c
(Amount brought by new partner for his share of goodwill).

(ii) New Partner's Capital A/c Dr.
To Sacrificing Partner's Capital A/c's (Individually)
(Goodwill brought by new partners distributed among the existing partners in their sacrificing ratio)

If the partners decide that the amount of premium for goodwill credited to their capital accounts should be retained in business, an additional entry is not passed. If, however, they decide to withdraw their amounts, (in full or in part) the following additional entry will be passed:

Existing Partner's Capital A/c (Individually) Dr.

To Bank A/c

(The amount of goodwill withdrawn by the existing partners)

Illustration 4:-

Anil & Deepak are partners in a firm sharing profits & losses in the ratio of 5:3. Achin is admitted in the firm for 1/5th share of profits. He brings in ₹ 20,000 as capital & ₹ 4,000 as his share of goodwill by cheque. Give the necessary journal entries.

(a) When partners decided to retain goodwill in business.

(b) When the amount of goodwill is fully withdrawn.

(c) When 50% of the amount of goodwill is withdrawn.

Solution: (a) When the amount of goodwill credited to existing partners is retained in business.

Books of Anil and Deepak

Journal

Date	*Particulars*	*L.F*	*Dr. (₹)*	*Cr. (₹)*
(i)	Bank A/c Dr.		*24,000*	
	To Achin's Capital A/c			*20,000*
	To Premium for Goodwill A/c			*4,000*
	(The amount brought in by Achin as Capital and Goodwill)			
(ii)	Premium for Goodwill A/c Dr.		*4,000*	
	To Anil's Capital A/c			*2,500*
	To Deepak's Capital A/c			*1,500*
	(Goodwill transferred to Anil and Deepak in the ratio of 5:3)			

Alternatively,

(i) Cash A/c Dr. 24,000

To Achin's Capital A/c 24,000

(ii) Achin's Capital A/c Dr. 4,000

To Anil's Capital A/c 2,500

To Deepak's Capital A/c 1,500

Note: **It assumed that the sacrificing ratio is the same as old profit sharing ratio.**

(b) When the amount of goodwill credited to existing partners is fully withdrawn.

Journal

Date	*Particulars*	*L.F*	*Dr. (₹)*	*Cr. (₹)*
(i)	Bank A/c Dr.		*24,000*	
	To Achin's Capital A/c			*20,000*
	To Premium for Goodwill A/c			*4,000*
	(The amount brought in by Achin as Capital and Goodwill)			
(ii)	Premium for Goodwill A/c Dr.		*4,000*	
	To Anil's Capital A/c			*2,500*
	To Deepak's Capital A/c			*1,500*

	(Goodwill transferred to Anil and Deepak in the ratio of 5:3)			
(iii)	Anil's Capital A/c Dr. Deepak's Capital A/c Dr. To Bank A/c (Cash withdrawn by Anil & Deepak equal to their share of goodwill)		*2,500* *1,500*	 *4,000*

(c) When 50% of the amount of goodwill credited to existing partners is withdrawn.

Journal

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Bank A/c Dr. To Achin's Capital A/c To Premium for Goodwill A/c (The amount brought in by Achin as Capital and Goodwill)		*24,000*	 *20,000* *4,000*
(ii)	Premium for Goodwill A/c Dr. To Anil's Capital A/c To Deepak's Capital A/c (Goodwill transferred to Anil and Deepak in the ratio of 5:3)		*4,000*	 *2,500* *1,500*
(iii)	Anil's Capital A/c Dr. Deepak's Capital A/c Dr. To Bank A/c (Cash withdrawn for 50% of their share of goodwill)		*1,250* *750*	 *2,000*

Illustration 5:-

Vijay & Sanjay are partners in a firm sharing profits and losses in the ratio of 3:2. They admitted Ajay into partnership with 1/4 share in profits. Ajay brings in ₹ 30,000 for capital & the requisite amount of premium in cash. The goodwill of the firm is valued at ₹ 20,000. The new profit sharing ratio is 2:1:1. Vijay & Sanjay withdraw their share of goodwill. Give necessary journal entries.

Solution:

(a) Ajay will bring ₹ 5,000 (1/4 of ₹ 20,000) as his share of goodwill (Premium)

(b) Sacrificing Ratio is 2:3 as calculated below:

For Vijay, old ratio is 3/5 & the new ratio is 2/4, hence, his sacrificing ratio is = $\frac{3}{5} - \frac{2}{4} = \frac{12 - 10}{20} = \frac{2}{20}$

For Sanjay, old ratio is 2/5 & the new ratio is 1/4, hence, his sacrificing ratio is = $\frac{2}{5} - \frac{1}{4} = \frac{8 - 5}{20} = \frac{3}{20}$

Books of Vijay and Sanjay

Journal

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Bank A/c Dr. To Ajay's Capital A/c To Premium for Goodwill A/c (The amount of capital and goodwill brought by Ajay)		*35,000*	 *30,000* *5,000*
(ii)	Premium for Goodwill A/c Dr. To Vijay's Capital A/c To Sanjay's Capital A/c (The amount of goodwill brought by Ajay shared by Vijay & Sanjay		*5,000*	 *2,000* *3,000*

	in their sacrificing ratio)			
(iii)	Vijay's Capital A/c Dr. Sanjay's Capital A/c Dr. To Bank A/c (Cash withdrawn by Vijay and Sanjay for their share of goodwill)		*2,000* *3,000*	 *5,000*

Note: **Alternatively, journal entries (1) and (2) could be as given on the next page:**

Books of Vijay and Sanjay
Journal

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Bank A/c Dr. To Ajay's Capital A/c (Ajay brought in ₹ 30,000 for capital and ₹ 5,000 as goodwill)		*35,000*	 *35,000*
(ii)	Ajay's Capital A/c Dr. To Vijay's Capital A/c To Sanjay's Capital A/c (The amount of goodwill brought by Ajay shared by Vijay & Sanjay in their sacrificing ratio)		*5,000*	 *2,000* *3,000*

When goodwill already exists in books: Goodwill, if existing in the books of the firm, it is written off at the time of admission of a partner.
For example, in Illustration 5, the goodwill of the firm is valued at ₹ 20,000 and Ajay who is admitted to 1/4 share in its profits, brings in ₹ 5,000 as his share of goodwill. Suppose, goodwill already appeared in books at ₹10,000 the following additional journal entry shall be passed for writing off the existing amount of goodwill.

Journal

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Vijay's Capital A/c Dr. Sanjay's Capital A/c Dr. To Goodwill A/c (Goodwill written-off in old ratio)		*6,000* *4,000*	 *10,000*

Illustration 6:-
Shrikant and Ramana are partners in a firm sharing profits and losses in the ratio of 3:2. They admit Venktesh into partnership with 1/3 share in the profits. Venktesh brings in ₹ 30,000 as his capital. He also brings in the necessary amount for his share of goodwill. On the date of admission, the goodwill is valued at ₹ 24,000 and the goodwill account appears in the books at ₹ 12, 000. Venktesh brings in the necessary amount for his share of goodwill and agrees that the existing goodwill account be written off.
Record the necessary journal entries in the books of the firm.

Journal

Date	*Particulars*	*L.F*	*Dr. (₹)*	*Cr. (₹)*
(i)	Bank A/c Dr. To Venktesh's Capital A/c To Premium for Goodwill A/c (Amount brought in by Venktesh as his capital & his share of goodwill)		*38,000*	 *30,000* *8,000*
(ii)	Premium for Goodwill A/c Dr. To Shrikant's Capital A/c To Ramana's Capital A/c (Goodwill brought in by Venktesh shared by old partners in their ratio of sacrifice)		*8,000*	 *4,800* *3,200*
(iii)	Shrikant's Capital A/c Dr. Ramana's Capital A/c Dr. To Goodwill A/c (Goodwill already appearing in books written-off in the old ratio)		*4,800* *3,200*	 *8,000*

Note: **Since nothing is given about the ratio in which the new partner acquires his share of profit from Shrikant & Ramana, it is implied that they sacrifice their share of profit in favour of Venktesh in the old ratio i.e., 3:2.**

When the new partner does not bring goodwill in cash, partly or fully:

Goodwill not brought by the new partner will be debited to current account of new partner while sacrificing partners' capital accounts will be credited for their respective shares.

When the new partner does not bring the share of goodwill, there exist two possibilities:
(a) Goodwill does not exist in the books; and.
(b) Goodwill exists in the books.

Goodwill does not exist in the books

When goodwill does not exist in the books, sacrificing partners are credited with their share of goodwill & new partner is debited by the amount of goodwill not brought by him. The journal entry in this case is:

Incoming (New) Partners Current A/c Dr.
To Sacrificing Partners Capital A/c (individually)
(Account of goodwill not brought in by new partner)

Sometimes the new partner brings part of premium for goodwill in cash. In such a situation, new partners current account will be debited by the amount not brought by new partner.

For example, for the share of goodwill of ₹ 50,000 the new partner brings ₹ 20,000 only. In this situation the journal entry will be:

Journal

Date	*Particulars*	*L.F*	*Dr. (₹)*	*Cr. (₹)*
(i)	Bank A/c Dr. To Premium for Goodwill A/c (Premium for goodwill brought by the new partner)		*20,000*	 *20,000*

(ii)	Premium for Goodwill A/c Dr. Incoming Partners Current A/c Dr. To Sacrificing Partners Capital A/c's (individually) (Goodwill credited in sacrificing ratio)		*20,000* *30,000*	 *50,000*

When goodwill exists in the books:

Goodwill appearing in the books will be written-off by debiting old partners 'capital accounts in their old profit sharing ratio. Thereafter new value of goodwill will be given effect by crediting sacrificing partners' capital accounts and debiting new partners' current account.

The journal entries will be as under:-

(i) When the value of goodwill appears in the books and is written off
Partners capital A/c (old) Dr. (In profit sharing ratio)
To Goodwill A/c
(Goodwill appearing in the books written-off)

(ii) For new value of goodwill :-
Incoming partners' current A/c. Dr.
To Sacrificing partners capital A/c. [In sacrificing ratio) (individually)

Illustration 7:-

Raman and Rehman are partners in a firm sharing profits and losses in the ratio of 3:2. Raja is admitted into partnership for 1/3 share in profits. He brings in ₹ 10,000 as capital, but is not in a position to bring any amount for his share of goodwill which has been valued at ₹ 30,000. Give necessary journal entries under each of the following situations:

(a) When there is no goodwill appearing in the books of the firm; and
(b) When the goodwill appears at ₹ 15,000 in the books of the firm;

Solution: *(a) When no goodwill appears in the books*

Books of Raman and Rehman
Journal

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Bank A/c Dr. To Raja 's Capital A/c (Amount brought by Raja as Capital)		*10,000*	 *10,000*
(ii)	Raja 's Current A/c Dr. To Raman 's Capital A/c To Rehman 's Capital A/c (Goodwill not brought by Raja debited to his current account and credited to old partners in sacrificing ratio)		*30,000*	 *18,000* *12,000*

(b) When goodwill appears in the books at ₹ 15,000

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Bank A/c Dr. To Raja 's Capital A/c (Amount brought by Raja as Capital)		*10,000*	 *10,000*

(ii)	Raja 's Current A/c Dr. To Raman 's Capital A/c To Rehman 's Capital A/c (Goodwill not brought by Raja debited to his current account and credited to old partners in sacrificing ratio)		*15,000*	 *9,000* *6,000*
(iii)	Raman 's Capital A/c Dr. Rehman 's Capital A/c Dr. To Goodwill A/c (Goodwill affecting in the books written - off in old profit sharing ratio)		*9,000* *6,000*	 *15,000*

Hidden Goodwill:

Sometimes the value of Goodwill is not given. It is inferred or estimated from other relatedinformation given in question

***Illustration 8*:-** Aina & Binod are two partners in 3:2 ratios. Their capitals are ₹ 1, 20,000 and ₹ 1, 00,000 respectively. Chand is admitted for $1/5^{th}$ share and he is brings ₹ 80,000 as his capital. Calculate the value of goodwill.

Solution:

Value of Goodwill = (C's Capital x 5/1) – (Aina's Capital + Binod's Capital + Chand's Capital)
= (₹ 80,000 x 5/1) – (₹ 1, 20,000 + ₹ 1, 00,000 + ₹ 80,000)
= ₹ 4, 00, 000 – ₹ 3, 00,000
= ₹ 1, 00,000

So, Chand's share of Goodwill = ₹ 1, 00,000 x 1/5 = ₹ 20,000

*Note: It means new partner Chand doesn't bring his share of goodwill in cash. So, In this case journal entries will be same as given in table of (II) situation

STEP 5: Adjustment of capital and New Balance Sheet.

After the admission of a partner, the capitals of all partners may be adjusted as per agreement. The adjustment may take any of the following forms:

I-Adjustment of the capitals of the old partners on the basis of new partner's capital.

Steps:

(i) Calculate the total capital of the firm on the basis of new partner's capital and his share in profits.
Total Capital/ New Capital= New partner's capital x Reciprocal of the proportion of his share in profit.

(ii) Calculate the new capitals of all partners by dividing total capital in new ratio.

(iii) Prepare old partners' capital A/c's (after all adjustments regarding Revaluation, General Reserve, Goodwill etc.) and find out the actual balances of their capitals.

(iv) Compare the new capitals as in (ii) with old capital balances as in (iii) and work out surplus or deficiency.

(v) Surplus will be paid back to the old partners and if there is deficiency the same will be contributed in cash by the old partners.
(If it is specifically required under agreement, the surplus can be Cr. to their current A/c's & deficiency can be Dr. to their current A/c's)

(vi) If goodwill is not brought in cash, it can be adjusted either (i) through new partner's capital A/c – this will reduce his original capital contributed by him or (ii) if it is adjusted through new partner's current A/c – this will not affect the original capital contributed by him.

II. Finding the new partner's sufficient capital on the basis of the old partners' capital or the total capital of the firm:

Steps:

(i) Prepare Old Partners' Capital A/c's (after all adjustments regarding Revaluation, General Reserve, Goodwill etc.)

(ii) Calculate the total Capital of the new firm as follows:
Total Capital of the firm = Combined adjusted x Capital of old partners Reciprocal of the Combined Proportion of their share of profit.

(iii) New partner's capital will be equal to his share of the Total Capital.

(iv) If goodwill is not brought in cash by the new partner, it should be better Dr. to his Current Account. This will make the calculation of his sufficient capital more accurate & simple.

MULTIPLE CHOICE QUESTIONS:-

1. In case of reconstitution of the firm the following will happen.
   (a) firm will be closed (b) agreement will be changed
   (c) both a & b (d) none of the above (b)

2. X, Y& Z shared profits as 3:2:1. On1 March, 2023 they decided to change the ratio to equal ratio. Goodwill was valued at ₹ 24,000. What will be journal entries to give effect to the change in ratio.
   (a) Z's Cap A/c Dr. 4,000
   To X's Cap. A/c 4,000
   (b) X's Cap A/c Dr. 4,000
   To Z's Cap A/c 4,000
   (c) Goodwill A/c Dr. 24,000
   To X's Capital A/c 12,000
   To Y's Capital A/c 8,000
   To Z's Capital A/c 4,000
   (d) none of the above. (a)

3. Reconstitution of a partnership firm, can take place on which occasion?
   (a) Change in profit sharing ratio (b) Admission of partner
   (c) Retirement and death of partner (d) all of the above. (d)

4. In case of change in profit sharing ratio, workmen compensation reserves existing in the Balance sheet is transferred to Capital A/c of Partners.
   (a) After providing for claim of workmen if any (b) Ignoring the claim of workmen (if any)
   (c) Both a & b the above (d) None of the above (a)

5. S, T& W were partners in a firm. They admitted V as a new partner. S & T sacrifice $1/3^{rd}$ & $1/4^{th}$ of their share respectively in favour of V. Calculate the new profit sharing ratio of S, T, W &V.
   (a) 8: 9: 10: 10 (b) 8: 9: 12: 7
   (c) 8: 9: 7: 10 (d) 8: 7: 9 : 10 (b)

Valuation of Goodwill:

1. Compute the value of goodwill on the basis of four years' purchase of the average profits based on the last five years? The profits/losses for the last five years were as follows:
2017 – ₹ 25,000; 2018 – ₹ 40,000; 2019 - (₹ 15,000) loss; 2020 –₹ 80,000; 2021 – ₹ 1, 00,000
Ans: ₹ 1, 84,000.

2. Capital employed in a business is ₹ 2, 00,000. The normal rate of return on capital employed is 15%. During the year 2002 the firm earned a profit of ₹ 48, 000. Calculate good will on the basis of 3 years purchase of super profit?
Ans: ₹ 54, 000.

3. A business has earned average profits of ₹ 1, 00,000 during the last few years. Find out the value of goodwill by capitalisation method, given that the assets of the business are ₹ 10, 00,000 & its external liabilities are ₹ 1, 80,000. The normal rate of return is 10%?
Ans: ₹ 1, 80,000.

MULTIPLE CHOICE QUESTIONS:-

1 Super profit can be calculated:-
(a) Average profit-Normal profit (b) Net profit – Average profit
(c) Capital Employed –Net Profit (d) Net Profit – Capital Employed [a]

2. Which step is not involved in valuing the goodwill according to Super Profit Method?
(a) Ascertain Average profit (b) Multiply Super Profit with Number of yearspurchased
(c) Ascertain Normal Profit (d) Ascertain Super Profit [a]

3. If Average Profit =₹ 1, 60,000, Actual Capital Employed = ₹ 5, 00,000. If rate of Normal Profit =20%. What is the amount of Super Profit?
(a) ₹ 60,000 (b) ₹ 1, 00,000
(c) ₹ 20,000 (d) ₹ 80,000 [a]

4. If Goodwill is ₹ 1, 20,000, Average Profit is ₹ 60,000 Normal. Rate of Return is @10% on Capital Employed ₹ 4, 80,000. Calculate Capitalized Value of the firm:-
(a) ₹ 6, 00,000 (b) ₹ 5, 00,000
(c) ₹ 4, 00,000 (d) ₹ 7, 00,000 [a]

5. Tangible Assets of the firm are ₹ 14,00,000 and Outside liabilities are ₹ 4,00,000, Profit of the firm is ₹ 1,50,000 and Normal Rate of Return is 10% Calculate Capital Employed
(a) ₹ 10, 00,000 (b) ₹ 1, 00,000
(c) ₹ 50,000 (d) ₹ 20,000 [a]

6. A business has earned Super profit of ₹ 1,00,000 during the last few years and Normal rate of returns in 10% Calculate goodwill
(a) ₹10, 00,000 (b) ₹ 54,000
(c) ₹ 20,000 (d) ₹ 36,000 [a]

7. Goodwill of the firm on the basis of 2 years' purchase of average profit of the last 3 years is ₹ 25,000. Find average profit.
(a) ₹ 50,000 (b) ₹ 25,000
(c) ₹ 10,000 (d) ₹ 37,500 [d]

8. Calculate the value of goodwill at 3 years' purchase of Super Profit, when: Capital employed ₹ 2, 50,000; Average profit ₹ 30,000 and normal rate of return is 10%.
(a) ₹ 3000 (b) ₹ 25,000 (c) ₹ 30,000 (d) ₹15,000 [d]

9. What are super profits:-
(a) Actual profit – Normal Profit (b) Normal Profit - Actual profit
(c) Actual profit + Normal Profit (d) None of the above [a]

10. Which of the following items are added to previous year's profits for finding normal profits for valuation of goodwill?
(a) Loss on sale of fixed assets.
(b) Loss due to fire, earthquake etc.
(c) Undervaluation of closing stock.
(d) All of the above. [a]

TRUE / FALSE:

1. Sacrificing Ratio = New Profit Share - Old Profit Share. (F)
2. Location of business does not affect the goodwill of business. (F)
3. "Average profit method" takes into consideration the future maintainable profits. (T)
4. Goodwill can be sold in part. (F)
5. Purchased goodwill may arise on acquisition of an existing business concern. (T)

MULTIPLE CHOICE QUESTIONS (Admission):-

1. When goodwill is not recorded in the books at all on admission of a partners
(a) If paid privately (b) If brought in cash
(c) If not brought in cash (d) If brought in Kind [a]

2. There is a need of revaluation of assets and liabilities on admission of a partner because
(a) Assets and Liabilities should appears at revised values
(b) Any profit and loss an account of change in values belong to old partners
(c) All unrecorded assets and liabilities get recorded
(d) None of Above [b]

3. On admission of a partner, which of the following items in the Balance Sheet is transferred to the credit of Capital Accounts of old partners in the old Profit-sharing Ratio, if Capital Accounts are maintained following Fluctuating Capital Accounts Method
(a) Deferred Revenue Expenditure; (b) Profit and Loss Account (Debit Balance);
(c) Profit and Loss Account (Credit Balance); (d) Balance in Drawings Account of partners. [c]

4. If the new partner brings his share of goodwill in cash , it will shared by old partner in :
(a) Sacrificing ratio (b) Old profit sharing Ratio
(c) New Ratio (d) Capital ratio [a]

5. Revaluation Account is a :
(a) Real Account (b) Nominal Account
(c) Personal Account (d) None of the Above [b]

6. When new partner brings cash for goodwill , the amount is credited to :
(a) Realisation Account (b) Cash account
(c) Premium for Goodwill Account (d) Revaluation Account [c]

7. The Credit Balance of Profits and Loss appears in the books at the time of admission of partner will be transferred to :
(a) Profit and Loss Appropriation Account (b) All Partners Capital Account
(c) Old Partners Capital Account (d) Revaluation Account [c]

8. Goodwill of the firm is valued at ₹ 1, 00,000. Goodwill also appears in the books at ₹ 50,000. C is admitted for $1/4^{th}$ Share. The amount of goodwill to be brought in by C will be :
(a) ₹ 20,000 (b) ₹ 25,000
(c) ₹ 30,000 (d) ₹ 40,000 [b]

9. If the new partner brings any additional amount of cash other than his capital contributions then it is termed as :
(a) Capital (b) Reserves (c) Profits (d) Premium for Goodwill [d]

10. X & Y are partners sharing profits and losses in the ratio of 3 : 2. Z is admitted for $1/5^{th}$ share in profits which he gets from X. New profit sharing ratio will be
(a) 12 : 8 : 5 (b) 8 : 12 : 5 (c) 2 : 2 : 1 (d) 2 : 2 : 2 [c]

11. A & B are partners sharing profits in the ratio of 7 : 3. C is admitted as a new partner. A gave $1/7^{th}$ of his share and B gave $1/3^{rd}$ of his share to C. New Profit-sharing Ratio will be:
(a) 6 : 2 : 2 (b) 4 : 1 : 1 (c) 3 : 2 : 2 (d) None [a]

12. X & Y share profits & losses in the ratio of 4: 3. The admit Z in the firm for $3/7^{th}$ share which he gets $2/7^{th}$ from X and $1/7^{th}$ from Y. New Profit-sharing Ratio will be :
(a) 7 : 3 : 3 (b) 2 : 2 : 3 (c) 5 : 2 : 3 (d) 2 : 3 : 3 [b]

13. A & B are partners, sharing profits in the ratio of 5: 3. They admit C for $1/5^{th}$ share in profits,which he acquires equally from both A and B. New profit sharing ratio will be:
(a) 21 : 11 : 8 (b) 20 : 10 : 4 (c) 15 : 10 : 5 (d) 10 : 5 : 4 [a]

14. A, B & C share profits and Losses in the ratio of 3 : 2 : 1. D is admitted for $1/6^{th}$ share which he gets from A. New ratio will be:
(a) 2 : 2 : 1 : 1 (b) 3 : 1 : 1 : 1 (c) 2 : 2 : 2 : 1 (d) 1 : 1 : 2 : 2 [a]

15. A & B are partners sharing profits in the ratio of 3:2. On admission of C for 1/5th share, Land is appreciated by 10% (Book Value ₹ 80,000), Building is decreased by 20% (₹ 2, 00,000), Unrecorded Debtors of ₹ 1,250 are bought in the books & Creditors of ₹ 2,750 need not be paid. The Gain (profit) / loss on revaluation will be:
(a) Loss ₹ 28,000 (b) Loss ₹ 40,000 (c) Profit ₹ 28,000 (d) Profit ₹ 40,000 [a]

16. X and Y are partners sharing profits in the ratio of 3:1. They admit Z as a partner who pays ₹ 4,000 as Goodwill .New Profit-sharing Ratio being 2 : 1 : 1 among X, Y& Z. Goodwill will be credited to:
(a) X and Y as ₹ 3,000 and ₹ 1,000 (b) X only
(c) Y Only (d) None [b]

17. R & S are partners sharing profits in the ratio of 5 : 3. T joins the firm and R gives him $1/4^{th}$ of his share and S gives $1/5^{th}$ of his share to him. New Profit-sharing Ratio will be:
(a) 75 : 48 : 37 (b) 45 : 32 : 27 (c) 13 : 7 : 4 (d) 35 : 30 : 25 [a]

18. A, B & C are partners haring profits in ratio of 3:2:1. They admit D as partner in the firm. A,B & C give 1/3rd, 1/6th & 1/9th share of their respective profits. The share of profit of D will be:
(a) 1/10 (b) 13/54 (c) 12/54 (d) 10/55 [b]

19. A & B are partners sharing profits in ratio of 3:2. A's Capital is ₹ 30,000 and B's Capital is ₹15,000. They admit C for 1/5th share of profits. C will bring as his capital:-
(a) ₹ 9,000 (b) ₹ 12,000 (c) ₹ 14,500 (d) ₹ 11,250 [d]

20. X & Y are partners Z is admitted as partner for 1/7th share. New Profit sharing Ratio will be-
(a) 2 : 3 : 1 (b) 3 : 3 : 1 (c) 6 : 5 : 2 (d) 1 : 1 : 1 [b]

Practical Questions:-

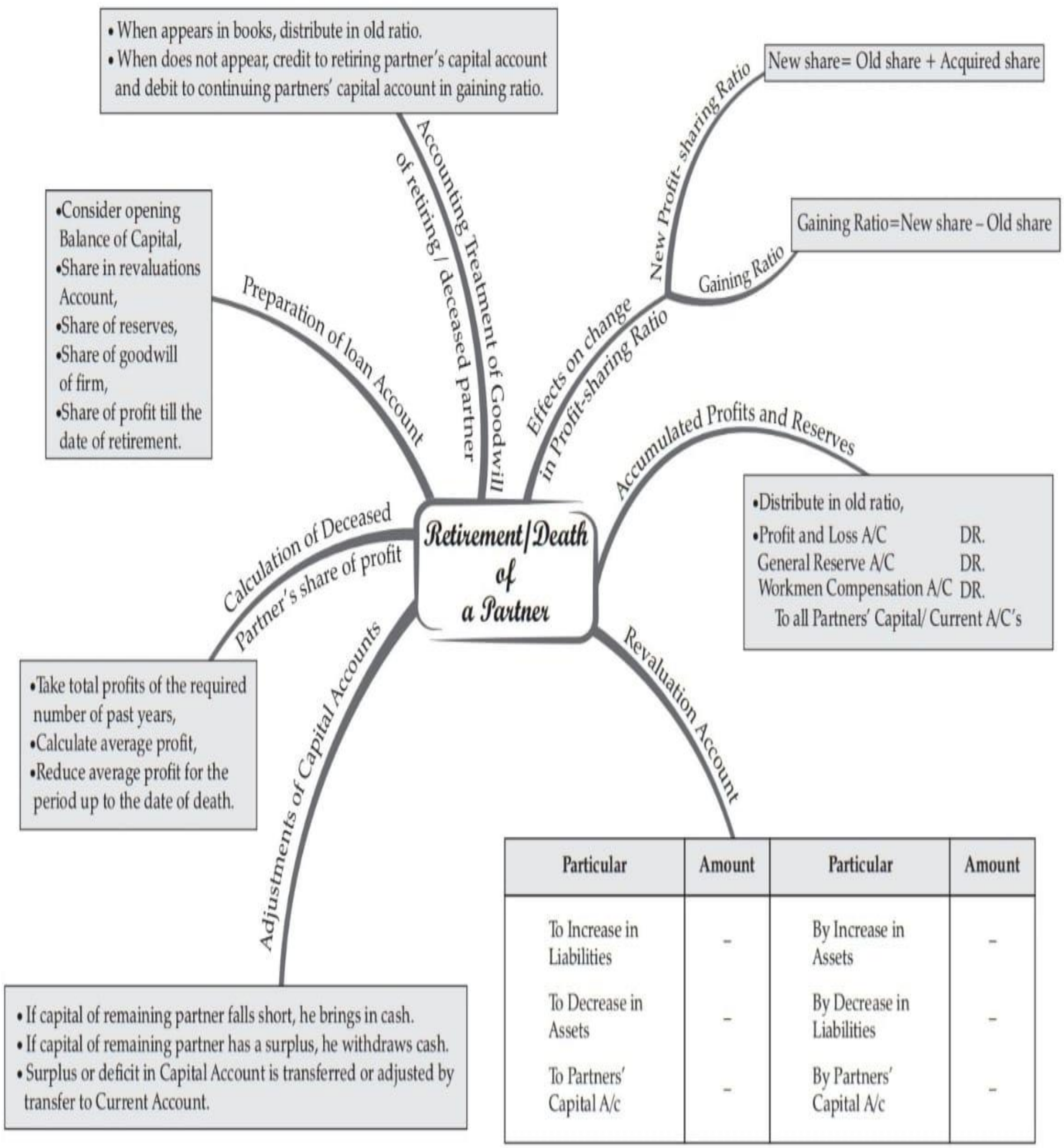
1. A & B were partners in a firm sharing profits and losses in the ratio of 3:2.They admits C into the partnership with 1/6th share in the profits. Calculate the new profit sharing ratio? (Ans- 3:2:1)

2. P & Q are partners sharing profits in 2:1 ratio. They admitted R into partnership giving him 1/5th share which he acquired from P and Q in 1:2 ratio. Calculate new profit sharing ratio. (Ans- 3:1:1)

3. Anju & jyoti are partners in a firm sharing profits in 5:3 ratios. They admitted Ruhi into the firm & the new profit sharing ratio was agreed at 4:2:1. Calculate the sacrificing ratio? (Ans- 1:1)

CH – 03 : RECONSTITUTION OF A PARTNERSHIP FIRM – RETIREMENT / DEATH OF A PARTNER

(MIND MAP)



RETIREMENT OF A PARTNER:

A partner has right to retire from the firm after giving due notice in advance. After retirement a new partnership comes into existence between the remaining partners. Partner can retire from the firm in the following circumstances.

(a) *With the consent of all the partners*
(b) *As per the terms of the partnership agreement*
(c) *By giving a notice in writing to all other partners, if the partnership is at will.*

The retirement of a partner is called reconstitution of the partnership firm because the old agreement is terminated but the firm continues and the new agreement comes into force.

Ascertaining the Amount Due to Retiring/ Deceased Partner:

The sum due to the retiring partner (in case of retirement) and to the legal representatives/ executors (in case of death) includes:

(i) Credit balance of his capital account;
(ii) Credit balance of his current account (if any);
(iii) His share of goodwill;
(iv) His share of accumulated profits (reserves);
(v) His share in the gain of revaluation of assets and liabilities;
(vi) His share of profits up to the date of retirement/ death;
(vii) Interest on his capital, if involved, up to the date of retirement/ death; and
(viii) Salary/commission, if any, due to him up to the date of retirement/ death.

The following deductions, if any, may have to be made from his share:

(i) Debit balance of his current account (if any);
(ii) His share of goodwill to be written off, if necessary;
(iii) His share of accumulated losses;
(iv) His share of loss on revaluation of assets and liabilities;
(v) His share of loss up to the date of retirement/ death;
(vi) His drawings up to the date of retirement/ death;
(vii) Interest on drawings, if involved, up to the date of retirement/ death.

Thus, similar to admission, the various accounting aspects involved on retirement or death of a partner are as follows:

1. Ascertainment of new profit sharing ratio and gaining ratio;
2. Treatment of goodwill;
3. Revaluation of assets and liabilities;
4. Adjustment in respect of unrecorded assets and liabilities;
5. Distribution of accumulated profits and losses;
6. Ascertainment of share of profit or loss up to the date of retirement/ death;
7. Adjustment of capital, if required;
8. Settlement of the amounts due to retired/ deceased partner;

CALCULATION OF NEW RATIO AND GAINING RATIO:

***** New ratio = Old share + Acquired share

* Gaining ratio=New ratio – Old ratio

Gaining ratio is calculated to ascertain the amount of goodwill payable to retiring or deceased partner by the remaining partners.

Illustration 1:-

Anu, Harpal and Surya are partners sharing profits in the ratio of 3:2:1. Anu retires and her share is taken up by Harpal and Surya in the ratio of 3:2. Calculate the new profit sharing ratio.

Solution:

Gaining Given, Ratio of Harpal and Surya = 3 : 2 = 3/5 : 2/5

Old Profit Sharing Ratio of between Anu, Harpal and Surya = 3 : 2 : 1 = 3/6 : 2/6 : 1/6.

Share acquired by Harpal = 3/5 of 3/6 = 9/30

Share acquired by Surya = 2/5 of 3/6 = 6/30

New Share = Old Share + Acquired Share

Harpal's New Share = 2/6 + 9/30 = 19/30

Shura's New Share = 1/6 + 6/30 = 11/30

New Profit Sharing Ratio of Harpal and Surya = 19 : 11

Illustration 2:-

Ranju , Sanju and Kamini are partners sharing profits in the ratio 4:3:2. Ranju retires; Sanju & Kamini decided to share profits in future in the ratio of 5:3. Calculate the Gaining Ratio.

Solutio:

Gaining Share = New Share – Old Share

Sanju's Gaining Share $= \frac{5}{8} - \frac{3}{9} = \frac{45 - 24}{72} = \frac{21}{72}$

Kamini's Gaining Share $= \frac{3}{8} - \frac{2}{9} = \frac{27 - 16}{72} = \frac{11}{72}$

Gaining Ratio between Sanju and Kamini = 21:11.

TREATMENT OF GOODWILL:-

The retiring or deceased partner is entitled to his share of goodwill at the time of retirement/death because the goodwill has been earned by the firm with the efforts of all the existing partners.

When goodwill does not appear in the books:

When goodwill does not appear in the books of the firm, credit is given to the retiring partner for the share in goodwill by debiting the goodwill account to gaining partners' capital accounts (individually) in their gaining ratio. The journal entry is:

Gaining Partners Capital A/c Dr. (Individually)

To Retiring Partners Capital A/c

(Share in goodwill of retiring partner adjusted)

Let us take an example to understand the treatment of goodwill.

Annu, Bina and Chinmay are partners in a firm sharing profits in the ratio of 3:2:1 Bina retired and the value of goodwill of the firm in valued at ₹ 60,000. Annu and Chinmay continue the business sharing profits in the ratio of 3:1. The journal entry for adjustment of goodwill will be:

Annu 's Capital A/c Dr. 15,000
Chinmay's Capital A/c Dr. 5,000
To Bina's Capital A/c 20,000
(Bina's share of goodwill adjusted to remaining partners' capital accounts in their gaining ratio)

It may also happen that as a result of decision on the new profit sharing ratio among the remaining partners, a continuing partner may also sacrifice a part of his share in future profits. In such a situation his capital account will also be credited along with the retiring/ deceased partner's capital account in proportion to his sacrifice and the other continuing partners' capital accounts will be debited based on their gain in the future profit ratio.

Illustration 3:-

Keshvani, Nirmala and Paaki are partners sharing profits and losses in the ratio of 4 : 3 : 2. Nirmala retires and the goodwill is valued at ₹ 72,000. Keshvani & Paaki decided to share future profits & losses in the ratio of 5 : 3.

Record necessary journal entries.

Solution:

Journal

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Keshvani's Capital A/c Dr. Paaki's Capital A/c Dr. To Nirmala's Capital A/c (Nirmala's share of goodwill adjusted to Keshvani & Paaki in their gaining ratio of 13 : 11)		*13,000* *11,000*	 *24,000*

Working Notes:

1. Nirmala's share of goodwill = ₹ 72,000 x 3/9 = ₹ 24,000

2. Calculation of Gaining Ratio.

Gaining Share = New Share – Old Share

Keshvani's Gaining Share = 5/8 - 4/9 = 13/72
Paaki's Gaining Share = 3/8 - 2/9 = 11/72

Hence, Gaining Ratio between Keshvani and Paaki is 13 : 11 i.e. 13/24 : 11/24

Illustration 4:-

Manu, Pammi & Suraj are partners sharing profits in the ratio of 3 : 2 : 1. Goodwill is appearing in the books at a value of ₹ 60,000. Pammi retires & at the time of Pammi's retirement, goodwill is valued at ₹ 84,000. Manu & Suraj decided to share future profits in the ratio of 2:1. Record the necessary journal entries.

Solution:

Books of Manu and Suraj
Journal

Date	*Particulars*	*L.F*	*Dr. (₹)*	*Cr. (₹)*
(i)	Manu's Capital A/c Dr. Pammi's Capital A/c Dr. Suraj's Capital A/c Dr. To Goodwill A/c (Existing goodwill written-off in old ratio)		*30,000* *20,000* *10,000*	 *60,000*
(ii)	Manu's Capital Dr. Suraj's Capital Dr. To Pammi's Capital A/c (Pammi's share of goodwill adjusted to Manu's and Suraj's capital account to the extent of their gain)		*14,000* *14,000*	 *28,000*

Working Notes:

(i) Pammi's share of current value of goodwill 1/3 of ₹ 84,000 = ₹ 84,000 x 1/3 = ₹ 28,000

(ii) Gaining Share = New Share – Old Share

Manu's Gaining Share = 2/3 - 3/6 = 1/6

Suraj's Gaining Share = 1/3 - 1/6 = 1/6

This gaining Ratio of Manu and Suraj is 1/6 : 1/6 = 1:1

<u>Hidden Goodwill</u>:

If the firm has agreed to settle the retiring or deceased partner's account by paying him a lump sum amount, then the amount paid to him in excess of what is due to him, based on the balance in his capital account after making necessary adjustments in respect of accumulated profits/ losses & revaluation of assets & liabilities, etc., shall be treated as his share of goodwill (known as hidden goodwill).

For example: Peter, Qurashi & Ram are partners in a firm sharing profits in the ratio of 3:2:1. Ram retires & the balance in his capital account after making necessary adjustments on account of reserves, revaluation of assets & liabilities workout to be ₹ 60,000. Peter & Qurashi agreed to pay him ₹ 75,000 in full settlement of his claim. It implies that ₹ 15,000 is Ram's share of goodwill of the firm. This will be debits to the capital accounts of Peter & Qurashi in their gaining ratio (3:2 assuming no change in their own profit sharing ratio) & crediting Ram's capital Account as follows:

Journal

Date	*Particulars*	*L.F*	*Dr. (₹)*	*Cr. (₹)*
(i)	Peter's Capital A/c Dr. Qurashi's Capital A/c Dr. To Ram's Capital A/c (Ram's share of goodwill adjusted in Peter's & Qurashi's Capital accounts in their gaining ratio of 3:2)		*9,000* *6,000*	 *15,000*

Journal entry for the transfer of profit and loss on revaluation at the time of retirement/ death of a partner.

For Profits:

Revaluation A/c Dr.

To All Partner's Capital A/c (in Old Ratio)

(Being Profit on Revaluation transferred to All Partners' Capital A/c in Old Profit Sharing Ratio)

For losses:

All the Partners' Capital A/c Dr. (in Old Ratio)

To Revaluation A/c

(Being loss on Revaluation transferred to All Partners' Capital A/c in Old Profit Sharing Ratio**)**

Treatment of undistributed profit at the time of Retirement/ Death of the partner.

The undistributed **profits** are transferred to all partners' Capital A/c in the old profit sharingratio.

General Reserve A/c Dr.

Profit& Loss A/c Dr.

To All Partners' Capital A/c (in Old Ratio)

(Being undistributed profits transferred to All Partners' Capital A/c in Old Profit Sharing Ratio)

Treatment of undistributed losses at the time of Retirement/ Death of a partner:

The **undistributed losses** are transferred to All Partners' Capital A/c in their old profit sharing ratio.

All Partners' Capital A/c Dr. (in Old Ratio)

To Profit & Loss A/c

To Advertisement Suspense A/c

To Deferred Revenue A/c

(Being undistributed losses are transferred to All Partners' Capital A/c in Old Profit Sharing Ratio)

Practice Questions:-

Q1. A, B, & C are partners with ratio 4:5:6. Find out new ratio if i) A retires, B retires, C retires.

Sol. Old Ratio between partners A, B & C is 4:5:6. So, New Ratio i) 5:6 ii) 4:6 iii) 4:5

Q2. A, B & C are partners with ratio 3:2:1.Find out new ratio if A retires and his share is purchased by B alone.

Sol. Old Ratio between partners A, B, & C is 3:2:1. A retires leaving the share of 3/6 and this share is purchased by B. So, B's New Share 2/6 + 3/6 = 5/6 and C's share is 1/6. So, New Ratio is 5:1.

Q3. Roman, Preet and Sanjay are partners with equal profit sharing ratio. Roman decided to retire from the firm and new ratio is fixed as 5:3, determine the Gaining Ratio.

Sol. Gaining Ratio = New Ratio – Old Ratio

Preet's Gaining Share = 5/8 - 1/3 = 15/24 - 8/24 = 7/24

Sanjay's Gaining Share = 3/8 - 1/3 = 9/24 - 8/24 = 1/24

Gaining Ratio=7:1

Q4. A, B and C were partners sharing profits in the ratio of 5:3:2. B retires on 1st Jan, 2016 with Aand C agreed to share the profits in future in the ratio of 6:4. Find the Gaining ratio.

Sol. **Gaining Ratio = New Ratio – Old Ratio**

A's Gaining Ratio = 6/10 - 5/10 = 1/10

C's Gaining Ratio = 4/10 - 2/10 = 2/10

Gaining ratio = 1 : 2

Q5. A, B & C are partners in a firm sharing profits in the ratio of 5:3:2. A retires and his share is taken up by B and C equally. Goodwill of the firm is ₹ 60,000. Pass necessary journal entry.

Sol:- B's Capital A/c Dr 15,000

C's Capital A/c Dr 15,000

To A's Capital A/c 30,000

(Being adjustment of goodwill done on retirement of A)

Working Note:- Old Ratio is 5:3:2; New Ratio11:9; and Gaining Ratio is1:1.

A's share of goodwill = ₹ 60,000 x 5/10 = ₹ 30,000

Q6. L, M & N were partners sharing profits and losses in the ratio of 5:3:2. On 31st March, 2022 their Balance Sheet was as under:

Prepare Revaluation Account, Partners' Capital A/c and Balance sheet.

N retired on 31st March 2022 and it was agreed that:

Goodwill of the firm is to be valued at ₹ 2, 00,000.

Machinery be valued at ₹ 1, 40,000; Patents at ₹ 40, 000 and Property at ₹ 1, 50,000 on this date.

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Capitals:		Property	1,20,000
L - 1,50,000		Patents	30,000
M - 1,25,000		Machinery	1,50,000
N - 75,000	3,50,000	Stock	1,90,000
General Reserve	30,000	Bank	40,000
Creditors	1,50,000		
	5,30,000		**5,30,000**

Solution:

Dr. **Revaluation A/c** **Cr.**

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Machinery	10,000	By Patents	10,000
To Profit transferred to CapitalA/c:-		By Property	30,000
L - 15,000			
M - 10,000			
N - 5,000	30,000		
	40,000		**40,000**

Dr.				Partner's Capital A/c			Cr.
Particulars	**L (₹)**	**M (₹)**	**N (₹)**	**Particulars**	**L (₹)**	**M (₹)**	**N (₹)**
To N's Loan A/c	....	....	85,000	By Balance b/d	1,50,000	1,25,000	75,000
To Balance c/d	1,80,000	1,45,000	......	By General Reserve A/c	15,000	10,000	5,000
				By Profit on Revaluation A/c	15,000	10,000	5,000
	1,80,000	**1,45,000**	**85,000**		**1,80,000**	**1,45,000**	**85,000**

Opening Balance Sheet of New Firm

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Capitals:		Property	1,50,000
L - 1,80,000		Patents	40,000
M - 1,45,000	3,25,000	Machinery	1,40,000
N 's Loan A/c	85,000	Stock	1,90,000
Creditors	1,50,000	Bank	40,000
	5,60,000		**5,60,000**

Adjustment of Partners' Capitals:

At the time of retirement or death of a partner, the remaining partners may decide to adjust their capital contributions in their profit sharing ratio. In such a situation, the sum of balances in the capitals of continuing partners may be treated as the total capital of the new firm, unless specified otherwise
Then, to ascertain the new capital of the continuing partners, the total capital of the firm is divided amongst the remaining partners as per the new profit sharing ratio, and the excess or deficiency of capital in the individual capital account's may be worked out. Such excess or shortage shall be adjusted by withdrawal of contribution in cash, as the case may be, for which the following journal entries will be recorded.

(i) For excess capital withdrawn by the partner:
Partners' Capital A/c Dr.
To Cash / Bank A/c

(ii) For amount of capital to be brought in by the partner:
Cash / Bank A/c Dr.
To Partners' Capital A/c

Consider the following situations:
The adjustment of the continuing partner's capitals may involve any one of the three ways as illustrated as follows :

1. When the capital of the new firm as decided by the partners is specified.
Illustration 5:-

Mohit, Neeraj and Sohan are partners in a firm sharing profits in the ratio of 2 : 1 : 1. Neeraj retires and Mohit & Sohan decided that the capital of the new firm will be fixed at ₹ 1, 20,000. The capital accounts of Mohit & Sohan show a credit balance of ₹ 82,000 & ₹ 41,000 respectively after making all the adjustments. Calculate the actual cash to be paid off or to be brought in by the continuing partners.
Pass the necessary journal entries.

Solution: The New Profit Sharing Ratio between Mohit and Sohan = 2 : 1

	Mohit (₹)	***Sohan (₹)***
New Capital based new ratio is	80,000	40,000
Existing Capital (after adjustments) is	82,000	41,000
Cash to be brought in on (Paid off)	**2,000**	**1,000**

Books of Mohit and Sohan
Journal

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Mohit's Capital A/c Dr.		*2,000*	
	Sohan's Capital A/c Dr.		*1,000*	
	To Cash A/c			*35,000*
	(Excess capital withdrawn by Sohan)			

2. <u>When the total capital of new firm is not specified.</u>

Illustration 6:
Asha, Deepa and Lata are partners in a firm sharing profits in the ratio of 3 : 2 : 1. Deepa retires. After making all adjustments relating to revaluation, goodwill and accumulated profit etc., the capital A/c's of Asha & Lata showed a credit balance of ₹ 1, 60,000 & ₹ 80,000 respectively. It was decided to adjust the capitals of Asha & Lata in their new profit sharing ratio.
You are required to calculate the new capitals of the partners & record necessary journal entries for bringing in or withdrawal of the necessary amounts involved.

Solution
a. Calculation of new capitals of the existing partners

Balance in Asha's Capital (after all adjustments) = ₹ 1, 60,000
Balance in Lata's Capital = ₹ 80,000
Total Capital of the New Firm = ₹ 2, 40,000
Based on the new profit sharing ratio of 3:1

Asha's New Capital = ₹ 2,40,000 x $\frac{3}{4}$ = ₹ 1,80,000

Lata's New Capital = ₹ 2, 40,000 x $\frac{1}{4}$ = ₹ 60,000

Note: *The total capital of the new firm is based on the sum of the balance in the capital accounts of the continuing partners.*

b. Calculation of cash to be brought in or withdrawn by the continuing partners:

	Asha (₹)	***Lata (₹)***
New Capitals	1, 80,000	60,000
Existing Capitals	1, 60,000	80,000
c. Cash to be brought in on (paid off)	**20,000**	**20,000**

Journal

Date	***Particulars***	***L.F***	***Dr. (₹)***	***Cr. (₹)***
(i)	Bank A/c Dr.		*20,000*	
	To Asha Capital A/c			*20,000*

	(Cash brought by Asha)			
(ii)	Lata's Capital A/c Dr. To Bank A/c (Surplus capital withdrawn by Lata)		*20,000*	 *20,000*

3. <u>When the amount payable to retiring partner will be contributed by continuing partners in such a way that their capitals are adjusted proportionate to their new profit sharing ratio:</u>

Illustration 7:-

Lalit, Pankaj & Rahul are partners sharing profits in the ratio of 4 : 3 : 3. After all adjustments, on Lalit's retirement with respect to general reserve, goodwill & revaluation etc., the balances in their capital accounts stood at ₹ 70,000, ₹ 60,000 & ₹ 50,000 respectively. It was decided that the amount payable to Lalit will be brought by Pankaj & Rahul in such a way as to make their capitals proportionate to their profit sharing ratio. Calculate the amount to be brought by Pankaj and Rahul & record necessary journal entries for the same. Also record necessary entry for payment to Lalit. After Lalit's retirement, the new profit sharing ratio between Pankaj and Rahul is 3: 3, i.e. 1: 1.

Solution

a. Calculation of total capital of the new firm

Balance in Pankaj's Capital account (after adjustment) = ₹ 60,000
Balance in Rahul's Capital account (after adjustment) = ₹ 50,000
Amount payable to Lalit (Retiring partner) = ₹ 70,000
Total capital of new firm (i) + (ii) + (iii) = ₹ 1,80,000

b. Calculation of new capitals of the continuing partners

Pankaj's New Capital = ₹ 1, 80,000 x $\frac{1}{2}$ = ₹ 90,000

Rahul's New Capital = ₹ 1, 80,000 x $\frac{1}{2}$ = ₹ 90,000

c. Calculation of the amounts to be brought in or withdrawn by the continuing partners

	***Pankaj* (₹)**	***Rahul* (₹)**
New Capital (₹1,80,000 in the ratio of 1 : 1)	90,000	90,000
Existing capital (after adjustment)	60,000	50,000
Cash to be brought in	**<u>30,000</u>**	**<u>40,000</u>**

Books of Pankaj and Rahul
Journal

Date	***Particulars***	***L.F***	***Dr.* (₹)**	***Cr.* (₹)**
(i)	Bank A/c Dr. To Pankaj's Capital A/c To Rahul's Capital A/c (Amounts brought by Pankaj and Rahul)		*70,000*	 *30,000* *40,000*
(ii)	Lalit's Capital A/c Dr. To Bank A/c (Amount paid to Lalit on retirement)		*20,000*	 *20,000*

DEATH OF PARTNER:

Accounting treatment in the event of death of a partner is similar to that in case of retirement of a partner, and that in case of death of a partner his claim is transferred to his executors and settled in the same manner as that of the retired partner. However, there is one major difference that, while the retirement normally takes place at the end of an accounting period, the death of a partner may occur any time. Hence, in case of a partner, his claim shall also include his share of profit or loss, interest on capital, interest on drawings (if any) from the date of the last Balance Sheet to the date of his death of these, the main problem relates to the calculation of profit for the intervening period (i.e., the period from date of the last balance sheet and the date of the partner's death. Since, it is considered cumbersome to close the books and prepare final account, for the period, the deceased partner's share of profit may be calculated on the basis of last year's profit (or average of past few years) or on the basis of sales.

Illustration 8:-

Babu, Chandu and Dhanu were partners in a firm sharing profits in the ratio of 5:4:1. The profit of the firm for the year ending on March 31, 2022 was ₹ 1, 00,000. Chandu died on 30th June, 2022. Babu and Dhanu decided to share profits equally. Chandu's share of profit for the period from 1st April to 30th June, 2022, shall be calculated as follows:

Solution: Total profit for the year ending on 31st March, 2022 = ₹ 1, 00,000

Chandu's share of profit:

= Proceeding Year's Profit X Proportionate Period X Share of Deceased Partner

$$= ₹\ 1,00,000 \times \frac{3}{12} \times \frac{4}{10} = ₹\ 10,000$$

The journal entry will be recorded as follows:

Profit & Loss Suspense A/c Dr. 10,000
 To Chandu's Capital A/c 10,000
(Chandu's share of profit transferred to his capital account)

Alternatively, if Chandu's share of profit was to be calculated on the basis of average profits of the last three years, which were ₹ 1, 36,000 for 2019-20, ₹ 1, 54,000 for 2020-21 and ₹ 1, 00,000 for 2021-22; Chandu's share of profit for the period from 7th April, 2022 to 30th June, 2022 shall be calculated on the basis of average profit based on profits for the last year calculation as follows:

$$\text{Average Profit} = \frac{\text{Total Profit}}{\text{No. of years}} = \frac{₹\ 1,36,000 + ₹\ 1,54,000 + ₹\ 1,00,000}{3} = ₹\ \frac{3,90,000}{3} = ₹\ 1,30,000$$

$$\text{Chandu's share of profit} = ₹\ 1,30,000 \times \frac{3 \text{ months}}{12 \text{ months}} \times \frac{4}{10} = ₹\ 13,000$$

The Journal entry will be:

Profit & Loss Suspense A/c Dr. 13,000
 To Chandu's Capital A/c 13,000

In case, the agreement provides, that share of profit of the deceased partner will be worked out on the basis of sales, and it is specified that the sales during the year 2021-22 were Rs. 8, 00,000 and the sales from April 1, 2022 to June 30, 2022 were ₹ 1, 50,000. Champak's share of profits for the period from April 1, 2022 to June 30, 2022 shall be calculated as follows.

If Sales is ₹ 8, 00,000, the Profit = ₹ 1, 00,000

If Sale is ₹ 1, the Profit = ₹ $\frac{1,00,000}{8,00,000}$

If Sales is ₹ 1, 50,000, the Profit = ₹ $\frac{1,00,000}{8,00,000} \times 1,50,000$ = ₹ 18,750

Chandu's share of profit = ₹ 18,750 X 4/10 = ₹ 7,500

The Journal entry will be:

Profit & Loss Suspense A/c Dr. 7,500
    To Chandu's Capital A/c 7,500

For being deceased partner's share of profits for the intervening period to books of account, the following journal entry is recorded.

(i) Profit and Loss (Suspense) A/c Dr.
    To Deceased Partner's Capital A/c
  (Share of profit for the intervening period)

Later Profit and Loss Suspense account is closed by transferring the account to Gaining Partners' Capital Account in their gaining ratio. The journal entry is:

(ii) Gaining Partners Capital A/c Dr. [In gaining ratio]
    To Profit and Loss Suspense A/c
  (P&L Suspense account transferred).

Alternatively the following journal entry can also be passed in Place of (i) & (ii)

(ii) Gaining Partners' Capital A/c Dr.
    To Deceased Partner Capital A/c
  (Share of profit of Deceased Partner credited)

Illustration 9:-

Neeraj, Ravi & Vasu were partners in a firm sharing profits & losses in the ratio of 5:4:1. Their Balance Sheet as at 31st March, 2022 was as follows:

Balance Sheet of Neeraj, Ravi & Vasu as at 31st March, 2022

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Capitals:		Plant & Machinery	5,50,000
Neeraj - 1,80,000		Stock	1,20,000
Ravi - 1,45,000		Debtors	1,30,000
Vasu - 1,00,000	6,00,000	Bank	40,000
Profit for the year 2021-22	1,55,000	Advertisement Expenditure	20,000
Creditors	1,10,000		
	8,60,000		**8,60,000**

Neeraj died on 30th June, 2022. According to the partnership deed, in addition to the deceased partner's capital, the executors are entitled to:

(i) His Share in profits on the basis of Average Profits of the last two years. The profit for the year 2020-21 was ₹ 50,000.

(ii) His share in the goodwill of the firm. Goodwill was to be calculated on the basis of two year's purchase of the average profits of the last two years. Neeraj withdrew ₹ 60,000 on 1st June, 2022.

Prepare Neeraj's capital A/c which is to be rendered to his executor.

Solution:

Dr. **Neeraj's Capital A/c** **Cr.**

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Drawings A/c	60,000	By Balance b/d	3,00,000
To Advertisement Expenditure A/c	10,000	By Profit & Loss A/c (2021-22) (₹ 1,50,00 X 5/10)	75,000
To Neeraj's Executor A/c (Balancing figure)	4,17,500	By Profit & Loss Suspense A/c	12,500
		By Ravi's Capital A/c	80,000
		By Vasu's Capital A/c	20,000
	4,87,500		**4,87,500**

Working Note:

1. Calculation of Neeraj's Share of Profit till death:

Average profit of the last two years = $\frac{₹\ 1,50,000 + ₹\ 50,000}{2}$ = ₹ 1,00,000

Neeraj's Share of Profit = ₹ 1, 00,000 X 5/10 X 3/12 = ₹ 12,500

2. Adjustment of Goodwill:

Firms Goodwill = Average Profit X No. of Year's Purchase = ₹ 1, 00,000 X 2 = ₹ 2, 00,000

Neeraj's Share of goodwill = ₹ 2, 00,000 X 5/10 = ₹ 1, 00,000, which has been debited to Ravi & Vasu in their gaining ratio i.e., 4:1.

More Practice Questions:

Q1. X, Y and Z are partners in a firm with 3:2:1.

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Provision for Doubtful debtors	1,300	Cash at bank	10,000
Creditors	15,000	Debtors	16,000
Capitals:		Stock	20,300
X - 78,750		Machinery	60,000
Y - 70,000		Land & Building	1,20,000
Z - 61,250	2,10,000		
	2,26,300		**2,26,300**

Z retires on the above date and the new profit sharing ratio between X and Y will be 5:4.

Following terms were agreed:

(a) Land and buildings be reduced by10%.

(b) Out of the Insurance premium paid during the year ₹ 5, 000 be carried forward as unexpired.

(c) There is no need of any provision for doubtful debts.

(d) Goodwill of the firm be valued at ₹ 36, 000 & adjustment in this respect be made without raising a goodwill A/c.

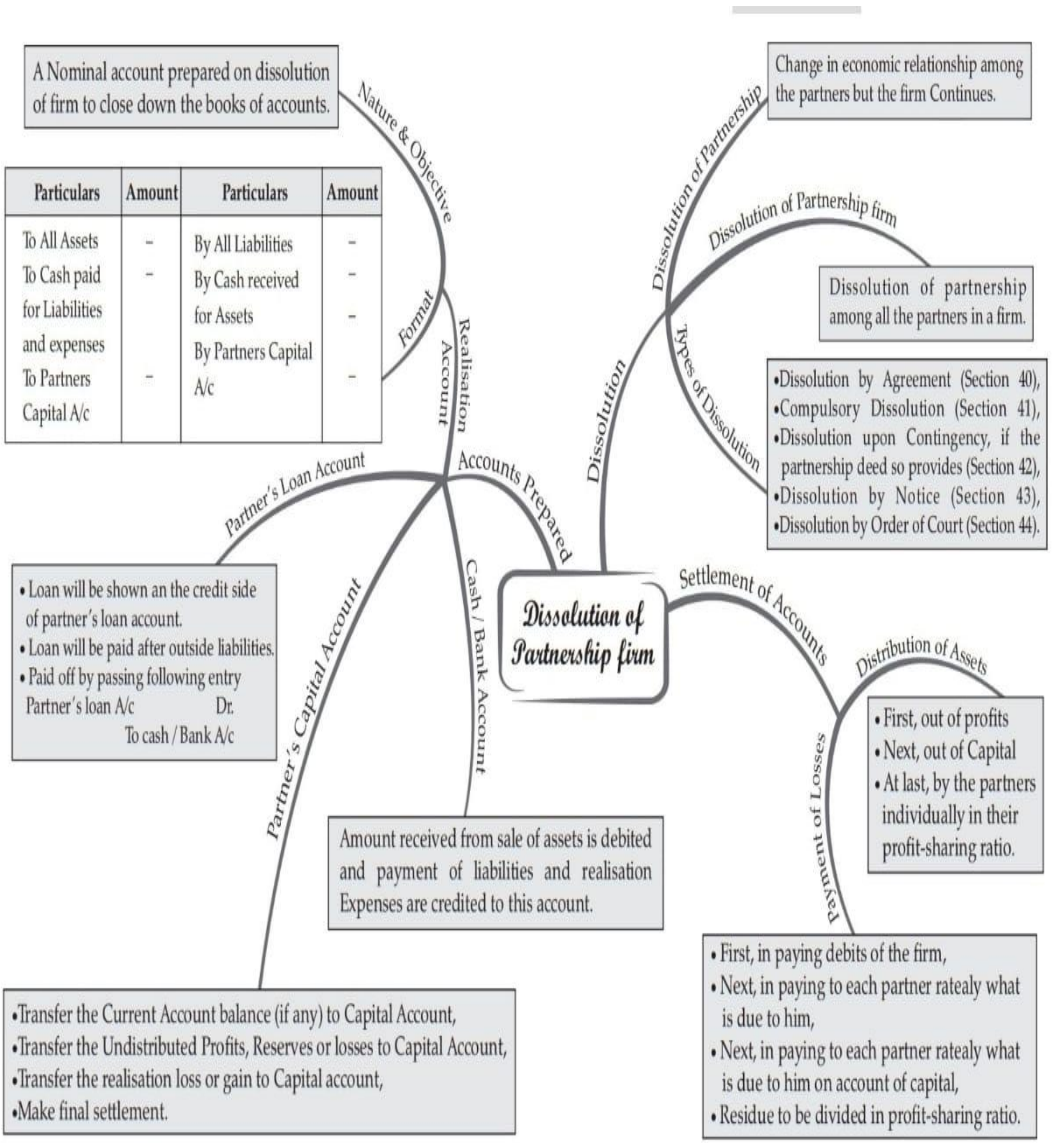
Pass necessary Journal Entries & Prepare the Capital Accounts & the New Balance sheet.

Q2. A, B, C and D were partners sharing profits in the ratio of 3 : 3 : 2 : 2 respectively. On 1st April, 2022. D retired owing to ill health. It was decided by A, B and C that in future their profit sharing ratio would be 3 : 2 : 1. Complete the following Journal in this regard.

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. D's Capital A/c Dr. To…………………. (Being the existing goodwill written off)		………. ………. ………. 10,000	……….
	A's Capital A/c Dr. B's Capital A/c Dr. To C's Capital A/c To D's Capital A/c (Being the adjustment for the Goodwill made on account of Change in Profit Sharing Ratio)		1,20,000 ……….	………. ……….

CH-04: DISSOLUTION OF PARTNERSHIP FIRM

(MIND MAP)



Meaning of Dissolution of Partnership Firm

As per Indian Partnership Act, 1932: "Dissolution of firm means termination of Partnership among all the partners of the firm". When a firm is dissolved, the business of the firm terminates.

Dissolution of Partnership: Dissolution of Partnership refers to termination of Old Partnership agreement (i.e., Partnership Deed) and a Reconstruction of the Firm. It may take place on Change In profit sharing ratio among the existing partner; – Admission of a Partner; and– Retirement or Death of a Partner. It may or may not result into closing down of the business as the remaining partner may decide to carry on the business under a new agreement.

Modes of Dissolution

1. Dissolution by agreement:- A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners (Section 4)

2. Compulsory Dissolution:- A firm is dissolved

(a) By the adjudication of all the partners or of all partners but one as insolvent or,

(b) By the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership. (Section 41)

3. Dissolution on the happening of certain contingencies:-

(a) If constituted for a fixed term, by the expiry of that term.

(b) If constituted to carry out one or more adventures or undertakings by the completion there of.

(c) By the death of a partner.

(d) By the adjudication of a partner as an insolvent. *(Section 42)*

4. Dissolution by notice of partnership at will:–

(a) Where the partnership is at will the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

(b) The firm is dissolved as from the date mentioned in the` notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice. (Section 43)

5. Dissolution by the Court:- At the suit of a partner, the Court may dissolve a firm on any of the following grounds, namely:

(a) A partner has become of unsound mind

(b) A partner has become permanently in capable of performing his duties as partner.

(c) A partner is found guilty of misconduct.

(d) Breach of Agreement by partner.

(e) A Partner transfer his right.

(f) That the business of the firm cannot be carried on at a loss.

(g) On any other ground which renders it just and equitable at the firm should be dissolved

DISSOLUTION OF FIRM VS DISSOLUTION OF PARTNERSHIP FIRM

Basis	Dissolution of Firm	Dissolution of Partnership
1. Meaning	**Dissolution of partnership between all the partners in the firm.**	**Change in the present agreement.**
2. Effect on business	**Business is Closed down.**	**Business is continued by the remaining partners.**
3. Effect on accounts	**All Accounts Books are closed.**	**Accounts Books are not closed.**
4. Dissolution bycourt	**Dissolution of firm may be ordered by court in some cases.**	**Dissolution of Partnership is not ordered by the court.**
5. Calculation of profit or loss	**Assets are realized and liabilities are paid by preparing Realization A/c and profits are distributed among the partners.**	**Assets are revaluated & liabilitiesare reassessed by preparing Revaluation A/c. Profit or loss calculate disposed to the partners Capital A/c.**

<u>Main Activities at the time of Dissolution:</u>

1. Settlement of Accounts [Section 48]

In setting the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed.

(a) Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital & lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits.

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:-

(i) Payment of outside liabilities or third parties' liabilities.

(ii) Payment of Loan if any extended by the partner to the firm.

(iii) Balance in capital A/c of partners on date.

(iv) The residue, if any shall be divided among the partner's in their profit sharing ratio.

At the time of Dissolution of a firm, all the assets of the firm are sold or realized, & all liabilities are paid off. Following accounts are prepared:

1. Realisation A/c – For realising assets and payment off outside liabilities.
2. Partner's Loan A/c- For payment of partner's loan if any.
3. Partner's Capital A/c- calculation of amount due to/due by partners (Capital A/c's are to be closed)
4. Cash A/c- to check the receipts and payments of cash (should be tallied)

Main Journal entries:

(a) When assets are transferred to the Realisation Account:

Realisation A/c Dr.
To Sundry Assets A/c

(b)When Provisions of related assets are transferred to Realisation A/c:

Provision for Depreciation A/c Dr.
To Realisation A/c

(c) When Assets are realized:

Cash/ bank A/c Dr.
    To Realisation A/c

(d) When liabilities are transferred to the Realisation Account:

Sundries Liabilities A/c Dr.
    To Realisation A/c

(e) When Liabilities are paid:

Realisation A/c Dr.
    To Cash/Bank A/c

(f) When Asset is taken over by the Partner:

Partner's capital A/c Dr.
    To Realisation A/c

(g) When Liability taken over by the Partner:

Realisation A/c Dr.
    To Partners capital A/c

(h) When Liabilities are paid:

Realisation A/c Dr.
    To Cash/Bank A/c

(i) When Asset is taken over by the Partner:

Partner's Capital A/c Dr.
    To Realisation A/c

Dr. **Realisation A/c** **Cr.**

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Sundry Assets:	xxx	By Sundries Liabilities	xxx
Land and Building		(Only outsiders liabilities)	
Plant and Machinery		By Provision on Assets	xxx
Furniture		By Cash/Bank (Assets realized)	xxx
Debtors		By Cash/Bank (unrecorded Asset)	xxx
Bills Receivable etc.	xxx	By Partners Capital A/c	xxx
To Cash/ Bank (Liability paid)	xxx	(Asset taken by Partner)	
To Partners Capital A/c	xxx	By Partners Capital A/c	xxx
(liability taken by partner)		(Loss transfer to Partners if any)	
To Cash/ Bank (Realisation Exp.)			
To Partners Capital A/c's	xxx		
(Profit Transfer to Partners)			
	xxxxx		xxxxx

Dr. **Partner's Capital A/c** **Cr.**

Particulars	LF	A (₹)	B (₹)	Particulars	LF	A (₹)	B (₹)
To P&L A/c (Loss)		xxx	xxx	By balance b/d		xxx	xxx
To Realisation A/c				By General Reserve		xxx	xx
(Loss on Realisation)		xx	xxx	By P&L A/c (Profit)		xxx	xxx
To Realisation A/c				By Realisation A/c		xxx	xxx
(Asset taken over)		xxx	xxx	(Profit on realization)			
To Bank A/c (Final Payment)		xxx	xxx				
		xxxx	xxxx			xxxx	xxxx

Preparation of Bank A/c:- Since the business is being closed, no need to prepare a balance sheet, we prepare Cash/ Bank Account. All cash realized are shown on the debit side of cash/ Bank account & all cash payments are shown on the credit side of Cash/ Bank A/c.

DIFFERENCE BETWEEN REVALUTION A/c AND REALISATION A/c

Basis	Revaluation Account	Realisation Account
Meaning	Revaluation Account is related with the revaluation of assets and re-assessment of liabilities.	Realisation Account is prepared to realize the assets and to pay the liabilities.
Objective	Main purpose is to record the fluctuating values of assets & liabilities and to calculate the profit or loss on revaluation.	Main purpose is to calculate the profit/ loss after realizing the assets & payment of liabilities.
Need	Revaluation account is needed at the time of admission and retirement or death of a partner.	Realisation Account is needed when dissolution takes place.
Result	Profit or loss calculated in Revaluation A/c is distributed among the old partners only.	Profit or loss calculated in Realisation A/c is distributed among the all the partners.

Q1. Charu, Dhwani, Iknoor and Paavni were partners in a firm. They had entered into partnership firm last year only, through a verbal agreement. They contributed Capitals in the firm and to meet other financial requirements, few partners also provided loan to the firm. Within a year, their conflicts arisen due to certain disagreements and they decided to dissolve the firm. The firm had appointed Ms. Kavya, who is a financial advisor and legal consultant, to carry on the dissolution process. In the first instance, Ms. Kavya had transferred various assets and external liabilities to Realisation A/c. Due to her busy schedule; Ms. Kavya has delegated this assignment to you, being an intern in her firm. On the date of dissolution, you have observed the following transactions:

(i) Dhwani's Loan of ₹ 50,000 to the firm was settled by paying ₹ 42,000.

(ii) Paavni's Loan of ₹ 40,000 was settled by giving an unrecorded asset of ₹ 45,000.

(iii)Loan to Charu of ₹ 60,000 was settled by payment to Charu's brotherloan of the same amount.

(iv) Iknoor's Loan of ₹ 80,000 to the firm and she took over Machinery of ₹60,000 as part payment.

You are required to pass necessary entries for all the above mentioned transactions.

Sol. **Journal Entries**

Date	*Particulars*	*LF*	*Debit (₹)*	*Credit (₹)*
(i)	Dhwani's Loan A/c Dr.		50,000	
	To Bank A/c			42,000
	To Realisation A/c			8,000
	(Dhwani's Loan of ₹ 50,000 settled at ₹42,000)			
(ii)	Paavni's Loan A/c Dr.		40,000	
	To Realisation A/c			40,000
	(Paavni's Loan of ₹ 40,000 settled by giving an unrecorded asset)			
(iii)	Realisation A/c Dr.		60,000	
	To Loan to Charu A/c			60,000

	(Loan to Charu was settled by payment to Charu's brother Loan)			
(iv)	Iknoor's Loan A/c Dr. To Realisation A/c To Bank A/c (Iknoor's Loan of ₹ 80,000 & Machinery was given as part payment and rest through bank)		80,000	 60,000 20,000

Q2. X Y & Z who were sharing profits in the ratio of 3:2:1. Decided to dissolve the firm on 31st March, 2022 when their Balance Sheet was as follows:

Liabilities	**Amt. (₹)**	**Assets**	**Amt. (₹)**
Creditors	34,000	Cash	25,000
Capital A/c		Debtors	62,000
X – 1,20,000		Stock	37,000
Y - 90,000		Tools	8,000
Z - <u>60,000</u>	2,70,000	Car	12,000
		Machinery	60,000
		Building	1,00,000
	3,04,000		**3,04,000**

Following transactions took place at the time of dissolution:

There was an old furniture which had been written off from the books. Y agreed to take it at ₹ 8,000. Firm had to pay ₹ 8,000 for outstanding salary which were not provided earlier.

Creditors accepted Stock in settlement of their dues. There was an unrecorded asset valued at ₹ 3,000 which was taken by X for ₹ 2,000.

Assets realized are: Car ₹ 25,000; Debtors ₹ 59,000; Machinery ₹ 82,000; Tools ₹ 5,000; Building ₹ 84,000 & Goodwill ₹ 60,000.

Prepare Realisation A/c, Partners Capital A/c & Cash A/c.

Sol. Dr. Realisation A/c Cr.

Particulars	**Amt. (₹)**	**Particulars**	**Amt. (₹)**
To Sundry Assets- Transfer		By Creditors	34,000
Debtor - 62,000		By Cash A/c (Assets realised)	
Stock - 37,000		Machinery - 82,000	
Tools - 8,000		Car - 25,000	
Car - 12,000		Debtors - 59,000	
Machinery - 60,000		Tools - 5,000	
Building - <u>1,00,000</u>	2,79,000	Building - 84,000	
To Bank A/c (Outstanding Salary)	8,000	Goodwill - <u>60,000</u>	3,15,000
To Gain (Profit) on Realisation trf. to		By Y's Capital A/c (Old Furniture)	8,000
X's Capital A/c - 36,000		By Y's Capital A/c (Unrecorded Assets)	2,000
Y's Capital A/c - 24,000			
Z's Capital A/c - <u>12,000</u>	72,000		
	3,59,000		**3,59,000**

Dr.			Partners' Capital A/c				Cr.
Particulars	**X (₹)**	**Y (₹)**	**Z (₹)**	**Particulars**	**X (₹)**	**Y (₹)**	**Z (₹)**
To Realisation A/c	2,000	8,000	…...	By Balance b/d	1,20,000	90,000	60,000
To Balance c/d	1,54,000	1,06,000	72,000	By Realisation A/c (Gain)	36,000	24,000	12,000
	1,56,000	**1,14,000**	**73,000**		**1,56,000**	**1,14,000**	**73,000**

Dr.	Cash A/c		Cr.
Liabilities	**Amt. (₹)**	**Assets**	**Amt. (₹)**
To Balance b/d	25,000	By Realisation A/c (Outstanding Salary)	8,000
To Realisation A/c –Assets Realised)		By X's Capital A/c (Final Payment)	1,54,000
		By Y's Capital A/c (Final Payment)	1,06,000
		By Z's Capital A/c(Final Payment)	72,000
	3,40,000		**3,40,000**

QUESTIONS FOR PRACTICE:-

Q1. The firm of X, Y, and Z was dissolved on1st April, 2020.Y demands that his loan of ₹ 25, 000 be paid before payment of capitals of the partners. But X and Z demand that capital be paid before payment of loan by Y. Who is correct and why?

Ans. Y is correct because according to Section48 of the Indian Partnership Act, 1932, loan by partner is paid before payment to partner's capitals.

Q2. A and B are partners in a firm sharing profits in the ratio of 3:2. Mrs. A has given a loan of ₹ 20,000 to the firm and the firm had also taken a loan of ₹ 10,000 from B. The firm was dissolved and its assets were realised for ₹ 25, 000. State the order of payment of Mrs. A's loan and B's loan with reason, if there were no other creditors of the firm.

Ans. According to the Section 48 of the Indian Partnership Act, 1932, Mrs. A's loan of ₹ 20, 000 being outside party's debt will be paid before repayment of B's loan. B will be paid up to the available cash i.e., ₹ 5,000.

Q3. Pass necessary Journal entries on the dissolution of a partnership firm in the following cases:

(i) Leena, a partner, was appointed to look after the dissolution process for which he was given remuneration of ₹ 10,000.
(ii) Dissolution expenses ₹ 8,000 were paid by the partner, Meena.
(iii) Dissolution expenses were ₹ 5,000.
(iv) Pooja, a partner, was appointed to look after the process of dissolution for which he was allowed a remuneration of ₹ 7,000. Pooja agreed to bear the dissolution expenses. Actual dissolution expenses ₹ 4,000 were paid by Pooja.
(v) Neetu, a partner was appointed to look after the process of dissolution for which he was allowed a remuneration of ₹ 9,000. Neetu agreed to bear the dissolution expenses. Actual dissolution expenses ₹ 4,000 were paid by the firm.
(vi) Quadir, a partner was appointed to look after the process of dissolution for whivh he was allowed a remuneration of ₹ 18,000. Quadir agreed to take over stock worth ₹ 18,000 as his remuneration. The stock had already been transferred to Realisation Account.

Solution: **Journal Entries**

Date	*Particulars*	*LF*	*Debit (₹)*	*Credit (₹)*
(i)	Realisation A/c Dr. To Leena's Capital A/c (Remuneration provided to Leena)		10,000	10,000
(ii)	Realisation A/c Dr. To Meena's Capital A/c (Dissolution expenses payable to Meena)		8,000	8,000
(iii)	Realisation A/c Dr. To Bank / Cash A/c (Realisation Expenses Paid)		5,000	5,000
(iv)	Realisation A/c Dr. To Pooja's Capital A/c (Remuneration allowed to Pooja & dissolution expenses paid by him)		7,000	7,000
(v) (a)	Realisation A/c Dr. To Neetu's Capital A/c (Remuneration paid to Neetu)		9,000	9,000
(b)	Neetu's Capital A/c Dr. To Cash/ Bank A/c (Dissolution expenses paid by firm on behalf of Neetu)		4,000	4,000
(vi)	**----No Entry------**: Neither for remuneration for dissolution not for stock taken over. **Or Alternatively** Realisation A/c Dr. To Quadir's Capital A/c (Remuneration allowed to Quadir) Quadir's Capital A/c Dr. To Realisation A/c (Stock taken by Quadir as remuneration)		18,000 18,000	18,000 18,000

Q4. Journalise the following transactions regarding Realisation expenses:

(a) Realisation expenses amounted to ₹ 2,500

(b) Realisation expenses amounting to ₹ 3, 000 were paid by Ashok, one of the partners.

(c) Realisation expenses ₹ 2,300 borne by Tarun, personally.

(d) Amit, a partner was appointed to realise the assets, at a cost of ₹ 4, 000. The actual amount of realization amounted to ₹ 3,000.

Solution:

Journal Entries

Date	*Particulars*	*LF*	*Debit (₹)*	*Credit (₹)*
(a)	Realisation A/c ....Dr. To Bank A/c		2,500	2,500
(b)	Realisation A/c ....Dr. To Ashok capital A/c		3,000	3,000

(c)	------No Entry------		----	----
(d)	Realisation A/c... Dr. To Amit capital A/c		4,000	 4,000

Q5. Shanti and Sathya were partners in a firm sharing profits in the ratio of 4:1. On 31st March, 2022 their Balance Sheet was as follows:

On the above date the firm was dissolved:

(a) Shanti took over 40% of the stock at10% less than its book value and the remaining stock was sold for ₹ 40, 000. Furniture realised ₹80, 000.

(b) An unrecorded investment was sold for₹20, 000. Machinery was sold at a loss of ₹ 60, 000.

(c) Debtors realised ₹ 55,000.There was an outstanding bill for repairs for which ₹ 19,000 was paid.

Prepare Realisation A/c.

Liabilities	**Amt. (₹)**	**Assets**	**Amt. (₹)**
Creditors	45,000	Bank	55,000
Workmen Compensation fund	40,000	Debtors	60,000
Satya's Current A/c	65,000	Stock	85,000
Capital A/c's:		Furniture	1,00,000
Shanti - 2,00,000		Machinery	1,30,000
Satya - 1,00,000	3,00,000	Shanti's Current A/c	20,000
	4,50,000		**4,50,000**

Solution:

Dr. **Realisation A/c** **Cr.**

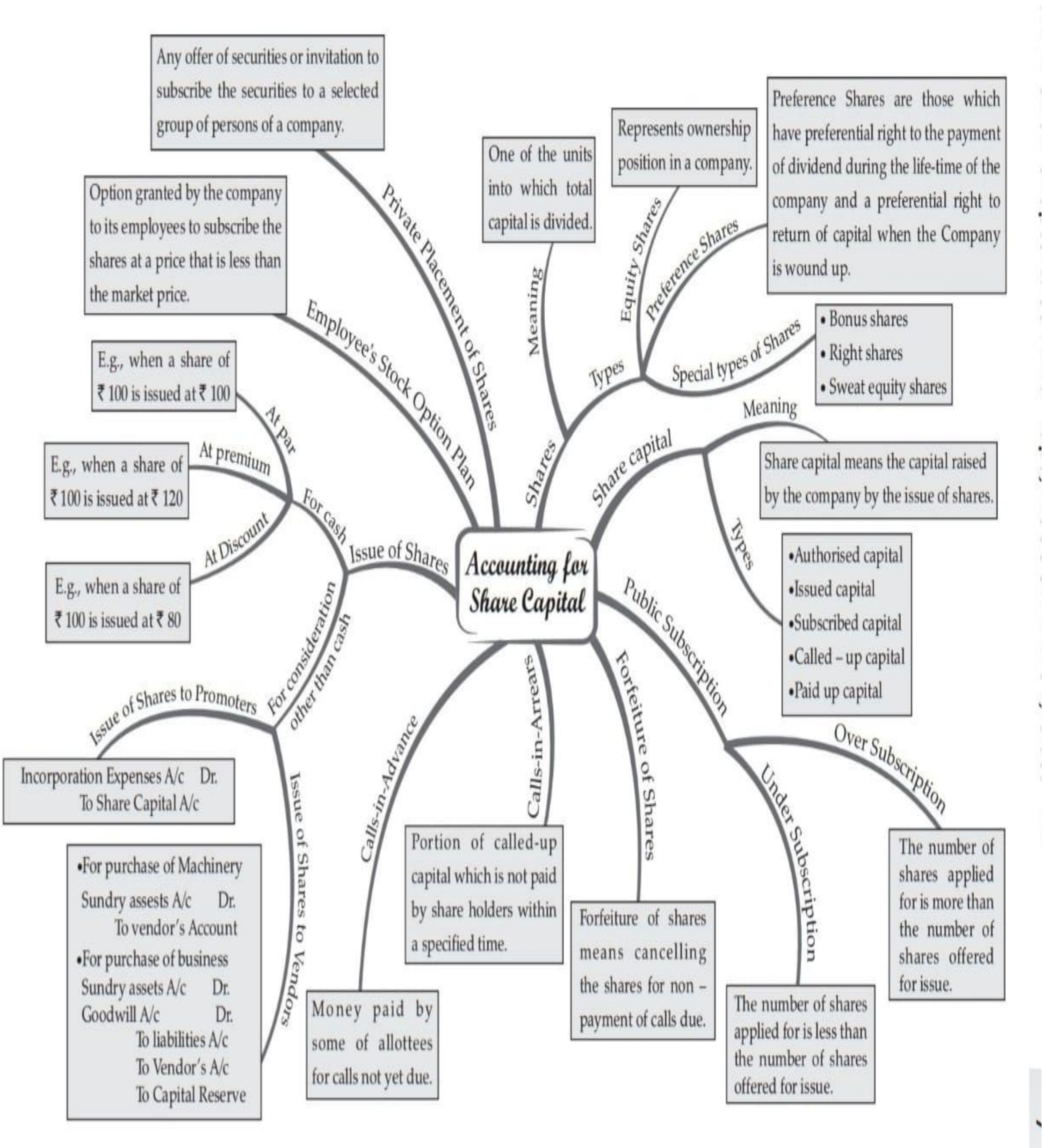
Particulars	**Amt. (₹)**	**Particulars**	**Amt. (₹)**
To Debtors	60,000	By Creditors	45,000
To Stock	85,000	By Shanti's Capital A/c	30,600
To Furniture	1,00,000	(Stock 34,000 - 3,400)	
To Machine	1,30,000	By Bank A/c (Assets Realised)	
To Bank A/c		Stock (Remaining) - 40,000	
Outstanding Bill		Furniture - 80,000	
for Repairs - 19,000		Investment - 2,20,000	
Creditors - 45,000	64,000	Machinery - 70,000	
		Debtor - 55,000	2,65,000
		By Loss transferred to	
		Santi's Capital A/c - 78,720	
		Satya's Capital A/c - 19,680	98,400
	4,39,000		**4,39,000**

ACCOUNTANCY PART-II

UNIT-2

CH-01 : ACCOUNTING FOR SHARE CAPITAL

(MIND MAP)



Accounting for Share Capital:

Total capital of the company is divided into a number of small indivisible units of a fixed amount and each such unit is called a share. The fixed value of a share, printed on the share certificate, is called nominal/ par / face value of a share. However, a company can issue shares at a price different from the face value of a share.
Fundamentals of Accounting: Issue; Forfeiture and Re-issue of Shares.

As per SEBI guidelines, a company is free to price its issue, if it has a three years track record of consistent profitability and in case of new company, if it is promoted by a company with a five years track record of consistent profitability.

1. Authorised Share Capital.
2. Issued Share Capital.
3. Subscribed Share Capital.
4. Called-up Share Capital.
5. Paid-up Share Capital.
6. Reserve Share Capital.

Reserve Capital is different from Capital reserve, Capital reserves are part of 'Reserves and Surplus' and refers to those reserves which are not available for declaration of dividend.

Types of Shares

Share issued by a company can be divided into following categories:

(i) Preference Shares They enjoy preferential rights in the matter of:

(a) Payment of dividend, and

(b) Repayment of capital.

Types of Preference Shares

Preference shares can be of various types, which are as follows:

(a) Cumulative Preference Shares.

(b) Non-cumulative Preference Shares.

(c) Participating Preference Shares.

(d) Non-participating Preference Shares.

(e) Redeemable Preference Shares.

(f) Non-redeemable Preference Shares.

(g) Convertible Preference Shares.

(h) Non-convertible Preference Shares Equity Shares.

The shares can be issued by a company either For cash or For consideration other than cash.

A public limited company cannot make any allotment of shares unless the amount of minimum subscription stated in the prospectus has been subscribed and the sum payable as application money for such shares has been paid to and received by the company.

As per guidelines of the Securities Exchange Board of India (SEBI), a company must receive a minimum of 90% subscription.

Against the entire issue (including devolvement on underwriters in case of underwritten issue) before making any allotment of shares or debentures to the public.

The minimum application money to be paid by an applicant along with the application money shall not be less than 25% of the issue price. Companies (Amendment) Bill, 2003 require application money to be not less than 25% of the nominal value of security. Thus, the issue price of shares is generally received by the company in instalments and these instalments are known as under:

JOURNAL ENTRIES FOR ISSUE OF SHARES FOR CASH:

Upon the issue of share capital by a company, the under mentioned entries are made in the financial books:

(i) On receipt of the application money

Bank Account Dr. (with the actual amount received)
To Shares Application Account

(ii) On allotment of share

Share Allotment Account Dr. (With the amount due on allotment)
Share Application Account Dr. (With the application amount received on allotted shares.)
To Share Capital (With the amount due Account on allotment and application).

(iii) On receipt of allotment money

Bank Account Dr. (with the amount actually received on allotment.)
To Share Allotment Account

Sometimes separate Application and Allotment Accounts are not prepared and entries relating to application and allotment monies are passed through a combined Application and Allotment Account.

(iv) On a call being made

Share Call Account Dr. (with the amount due on the call.)
To Share Capital Account

(v) On receipt of call money

Bank Account Dr. (with the due amount actually received on call)
To Share Call Account

When shares are issued at a premium, the premium amount is credited to a separate account called "Securities Premium Account" because it is not a part of share capital.

(ii) Share Application A/c Dr. [No. of Shares Applied for x Application Amount per share]
To Securities Premium A/c [No. of Shares allotted x Premium Amount per share]
To Share capital A/c [No. of Shares allotted x per share for capital]

(b) *Premium Amount called with Allotment Money*

(i) Share Allotment A/c Dr. [No. of Shares Allotted x Allotted and Premium Money per share]
To Share Capital A/c [No. of Shares Allotted x Allotment Amount per share]
To Securities Premium A/c [No. of Share Allotted x Premium Amount per share]
(Amount due on allotment of Shares @ ₹ per share including premium)

(ii) Bank A/c Dr.
To Share Allotment A/c (Money received including premium consequent upon allotment)

Kinds of Companies:

(i) Private companies According to Section 2 (68) of the Companies Act, 2013, it is a company with minimum paid-up share capital of 1,00,000 or such higher amount as may be prescribed in the

Companies Act, 2013 and which by its Articles of Association

(a) Restricts the right to transfer its shares, if any.

(b) Except in one person company, limits the number of its members excluding its present and past employee members to 200; if the past or present employee acquired the shares while in employment and continue to hold them. If any share is held jointly by two or more persons, they shall be treated as a single member.

(c) Prohibits any invitation to the public to subscribe for any securities of the company. The minimum number of members required to form a private company is two. The name of a private company ends with the words, 'Private Limited'.

(ii) Public company As per Section 2 (7) of Companies Act, 2013, public company is a company which

(a) is not a private company.

(b) has minimum capital of Rs 5 lakh or such higher paid-up capital as may be prescribed.

(c) is a private company, which is a subsidiary of a public company. Minimum requirement of a public company is seven persons.

(iii) One person company is a company which has only one person as a member. It is a company incorporated as a private company which has only one member. Rule 3 of the Companies (Incorporation)

5. <u>Types of Shares</u>:-

Preference shares According to Section 43 (b) of the Companies Act, 2013, preference shares are the shares which carry the following two preferential rights:

Preferential right of dividend to be paid as fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income tax.

Return of capital on the winding up of the company before that of equity shares. Holders of preference shares are called preference shareholders.

Equity shares According to Section 43(a) of the Companies Act 2013, equity share is that share which isnot a preference share. Equity shares are the most commonly issued class of shares which carry the maximum 'risks and rewards' of the business. The risks being losing part or all of the value of shares if the business incurs losses, the rewards being payment of higher dividends and appreciation in the market value.

6. Share Capital It is that part of the capital of a company, which is represented by the total nominal value of shares, which it has issued.

7. <u>Kinds of Share Capital</u>:

(i) Authorised share capital According to Section 2(8) of Companies Act, 2013, 'authorised capital' or 'nominal capital' means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of a company.

(ii) Issued capital According to Section 2(50) of the Companies Act, 2013, issued capital means such capital as the company issues from time to time for subscription. Subscribed capital According to Section 2(86) of the Companies Act, 2013, 'subscribed capital' means such part of the capital which is for the time being subscribed by the members of a company.

(a) Subscribed and fully paid-up Shares are said to be 'subscribed and fully paid-up' when the entire nominal (face) value is called and also paid-up by the shareholders.

(b) Subscribed but not fully paid-up Shares are said to be 'subscribed but not fully paid-up' when

- the company has called-up the entire nominal (face) value of the share but has not received it.

- the company has not called-up the entire nominal (face) value of share.

A reference has been made two terms

- Called-up capital According to Section 2(15) of the Companies Act, 2013, 'called-up capital' means such part of the capital, which has been called for payment. Thus, it means the amount ofnominal (face) value called-up by the company to be paid by the shareholders towards the sharecapital.
- Paid-up share capital According to Section 2(64) of the Companies Act, 2013, 'paid-up share capital' or 'share capital paid-up' means the amount that the shareholder has paid and the company has received against the amount 'called up' against the shares towards share capital.

8. Reserve Capital It is that portion of uncalled share capital which shall not be capable of being called up except in the event and for the purpose of the company being wound up.

9. Capital Reserve 'Capital reserve' is the reserve which is not free for distribution as dividend. It is mandatory to create capital reserve in case of capital profits earned by the company. Reserves which are created out of capital profits are not readily available for distribution as dividend among the shareholders, e.g. premium on issue of shares of debentures, profits on re- issue of shares, profits priorto incorporation, premium on redemption of debentures.

10. Minimum Subscription It is the amount stated in the prospectus as the minimum amount that mustbe subscribed. Unless the sum payable on application for the sum so stated (minimum subscription) has been paid to and received by the company by cheque or other instruments, security cannot be allotted.

11. Presentation of Share Capital in Company's Balance Sheet.

    As per Schedule III of Companies Act, 2013, share capital is to be disclosed in company's balancesheet in the following manner.

Comprehensive Question

Himalaya Company Ltd issued for public subscription of 1, 20,000 equity shares of ₹ 10 each at a premium of ₹ 2 per share payable as under:

With Application	**₹ 3 per share**
On allotment (including premium)	**₹ 5 per share**
On First call	**₹ 2 per share**
On Second and Final call	**₹ 2 per share**

Applications were received for 1, 60,000 shares. Allotment was made on pro-rata basis. Excess money on application was adjusted against the amount due on allotment.

Rohan, whom 4,800 shares were allotted, failed to pay for the two calls. These shares were subsequentlyforfeited after the second call was made. All the shares forfeited were reissued to Teena as fully paid at ₹7 per share.

Record journal entries in the books of the company to record these transactions relating to share capital.Also show the company's balance sheet.

Sol. **Journal Entries**

Date	**Particulars**		**L.F**	**Debit (₹)**	**Credit (₹)**
	Bank A/c	Dr.		4,80,000	
	To Share Application A/c				4,80,000

	(Share Application money received for 1,60,000shares @ ₹ 3 per share)			
	Share Application A/c Dr.		4,80,000	
	To Equity Share Capital A/c			3,60,000
	To Share Allotment A/c			1,20,000

	(Share Application for 1,20,000 shares @ ₹ 3 pershare transferred to Share Capital Account and remaining amount adjusted to Allotment)				
	Share Allotment A/c	Dr.		6,00,000	
	To Equity Share Capital A/c				3,60,000
	To Securities Premium				2,40,000
	(Share Allotment due on 1,20,000 shares @ ₹ 5per share including ₹ 2 Securities Premium)				
	Bank A/c	Dr.		4,80,000	
	To Share Allotment A/c				4,80,000
	(Share allotment for 1,20,000 shares @ ₹ 5 pershare received)				
	Share First Call A/c	Dr.		2,40,000	
	To Equity Share Capital A/c				2,40,000
	(Share First Call due on 1,20,000 shares @ ₹ 2per share)				
	Bank A/c	Dr.		2,30,400	
	To Share First Call A/c				2,30,400
	(Share First Call received on 1,15,200 shares @ ₹ 2 per share and 4,800 shares failed to pay)				
	Share Final Call A/c	Dr.		2,40,000	
	To Equity Share Capital A/c				2,40,000

	(Share Final call due on 1,20,000 shares @ ₹ 2per share)			

	Bank A/c	Dr.		2,30,400	
	To Share Final Call A/c				2,30,400
	(Share Final Call received on 1,15,200 shares @ ₹ 2 per share and 4,800 shares failed to pay)				
	Equity Share Capital A/c (4,800×10)	Dr.		48,000	
	To Share First Call A/c (4,800×2)				9,600
	To Share Final Call A/c (4,800×2)				9,600
	To Share Forfeiture A/c (4,800×6)				28,800
	(4,800 shares forfeited for the non-payment of First Call and Final Call)				
	Bank A/c	Dr.		33,600	
	Share Forfeiture A/c	Dr.		14,400	
	To Equity Share Capital				48,000
	(4,800 shares reissued @ ₹ 7 per share, fully paid-up)				
	Share Forfeiture A/c	Dr.		14,400	
	To Capital Reserve A/c				14,400
	(Share forfeiture balance of 4,800 shares transferred to Capital Reserve Account)				

Balance Sheet

Particulars	**Note No.**	**Amount (₹)**
I. Equity and Liabilities		
1. Shareholders' Funds		
a. Share Capital	1	12,00,000
b. Reserves and Surplus	2	2,54,400
2. Non-Current Liabilities		
3. Current Liabilities		
Total		**14,54,400**
II. Assets		
1. Non-Current Assets		
2. Current Assets		

a. Cash and Cash Equivalents	3	14,54,400
Total		**14,54,400**

Notes to Accounts:-

Note No.	Particulars		Amt. (₹)
1	**Share Capital**		
	Authorised Share Capital		
	…….. shares of ₹ 10 each		–
	Issued Share Capital		
	1,20,000 shares of ₹ 10 each		12,00,000
	Subscribed, Called-up and Paid-up Share Capital		
	1,20,000 shares of ₹ 10 each		12,00,000
2	**Reserves and Surplus**		
	Securities Premium	2,40,000	
	Capital Reserve	14,400	2,54,400
3	**Cash and Cash Equivalents**		
	Cash at Bank		

Practical unsolved Questions

1. Prince Ltd. issued a prospectus inviting applications for 20,000 equity shares of ₹. 10 each at a premium of ₹ 3 per share payable as follows:

With Application	**₹. 2**
On Allotment (including premium)	**₹. 5**
On First Call	**₹. 3**
On Second Call	**₹. 3**

Applications were received for 30,000 shares and allotment was made on pro-rata basis. Money overpaid on applications was adjusted to the amount due on allotment.

Mr. Mohit whom 400 shares were allotted, failed to pay the allotment money & the first call and his shares were forfeited after the first call. Mr. Jolly, whom 600 shares were allotted, failed to pay for the two calls and hence, his shares were forfeited.

Of the shares forfeited, 800 shares were reissued to Supriya as fully paid for ₹ 9 per share, the whole of Mr. Mohit’s shares being included.

Record journal entries in the books of the Company and prepare the Balance Sheet.

2. Journalise the following transactions in the books Bhushan Oil Ltd.:

200 shares of ₹. 100 each issued at a premium of ₹ 10 were forfeited for the non-payment of allotment money of ₹ 60 per share. The first & final call of ₹ 20 per share on these shares were not made. The forfeited shares were reissued at ₹ 70 per share as fully paid-up.

150 shares of ₹10 each issued at a premium of ₹ 4 per share payable with allotment were forfeited fornon-payment of allotment money of ₹ 8 per share including premium. The first & final calls of ₹ 4 per share were not made. The forfeited shares were reissued at ₹ 15 per share fully paid-up.

400 shares of ₹ 50 each issued at par were forfeited for non-payment of final call of ₹ 10 per share.These shares were reissued at ₹ 45 per share fully paid-up.

Solved Practice Question (Important)

1. Amisha Ltd inviting application for 40,000 shares of ₹ 100 each at a premium of ₹ 20 per share payable; on application ₹ 40 ; on allotment ₹ 40 (Including premium): on first call ₹ 25 and Second & final call ₹ 15.

Application were received for 50,000 shares and allotment was made on pro-rata basis. Excess money on application was adjusted on sums due on allotment.

Rohit to whom 600 shares were allotted failed to pay the allotment money and his shares were forfeited after allotment. Ashmita, who applied for 1,000 shares failed to pay the two calls and his shares were forfeited after the second call. Of the shares forfeited, 1,200 shares were sold to Kapil for ₹ 85 per share as fully paid, the whole of Rohit's shares being included.

Record necessary journal entries.

Solution: **Journal Entries**

Books of Amisha Ltd.

Date	**Particulars**	**L.F.**	**Debit (₹)**	**Credit (₹)**
	Bank A/c Dr.		20,00,000	
	To Share Application A/c			20,00,000
	(Share Application money received on 50,000 shares @ ₹ 40 per share)			
	Share Application A/c Dr.		20,00,000	
	To Share Capital A/c			16,00,000
	To Share Allotment A/c			4,00,000
	(Share Application money adjusted)			
	Share Allotment A/c Dr.		16,00,000	
	To Share Capital A/c			8,00,000
	To Share Premium A/c			8,00,000
	(Share Allotment money due including premium)			
	Bank A/c Dr.		11,82,000	
	To Share Allotment A/c			11,82,000
	(Share Allotment money received except 600 shares)			

	Share Capital A/c Dr.		36,000	
	Share premium A/c Dr.		12,000	
	To Share Allotment A/c			18,000
	To Share Forfeiture A/c			30,000
	(600 shares forfeited after allotment)			
	Share First Call A/c Dr.		9,85,000	
	To Share Capital			9,85,000
	(First Call money in due on 39,400shares)			
	Bank A/c Dr.		9,65,000	
	To Share First Call A/c			9,65,000
	(First Call money received except800 shares)			
	Share Second and Final Call A/c Dr.		5,91,000	
	To Share Capital A/c			5,91,000
	(Second and Final Call money due on 39,400 shares)			
	Bank A/c Dr.		5,79,000	
	To Share Second and Final CallA/c			5,79,000
	(Second and Final Call moneyreceived except 800 shares)			
	Share Capital A/c Dr.		80,000	
	To Share First Call A/c			20,000
	To Share Second & Final Call A/c			12,000
	To Share Forfeiture A/c			48,000
	(800 share forfeited)			
	Bank A/c Dr.		1,02,000	
	Share Forfeiture A/c Dr.		18,000	
	To Share Capital A/c			1,20,000
	(Forfeited shares reissued 1,200@ 85 per share)			
	Share Forfeiture A/c Dr.		48,000	
	To Capital Reserve A/c			48,000
	(Profit on 1,200 reissued sharesare transfer to capital reserve account)			

Cash Book (Bank Column)

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
	Share Application		20,00,000		Balance c/d		48,28,000

	Share Allotment	11,82,000				
	Share First Call	9,65,000				
	Share Final Call	5,79,000				
	Share Capital	1,02,000				
		48,28,000				**48,28,000**

Working Notes:

1. Number of shares applied by Rohit

$$= \frac{\text{Total number of applied shares}}{\text{Total number of alloted shares}} \times \text{Number of alloted shares.}$$

$$= \frac{50,000}{40,000} \times 600 = 750 \text{ shares}$$

1. Call in arrears by Rohit on allotment

Money received on Application	(750×40)	=	30,000
Less: Amount adjusted on Application	(600×40)	=	24,000
Amount adjusted on Allotment			6,000
Money due on Allotment	(600×40)	24,000	
Money adjusted		6,000	
Balance due to allotment		18,000	

4. Number of shares alloted to Ashmita

$$= \frac{\text{Total number of alloted shares}}{\text{Total number of applied shares}} \times \text{Number of shares applied}$$

$$= \frac{40,000}{50,000} \times 1,000 = 800 \text{ shares}$$

5. Profit on the forfeiture of 600 share of Rohit = ₹ 30,000

Profit on the forfeiture of 600 share of Ashmita = ₹ 36,000

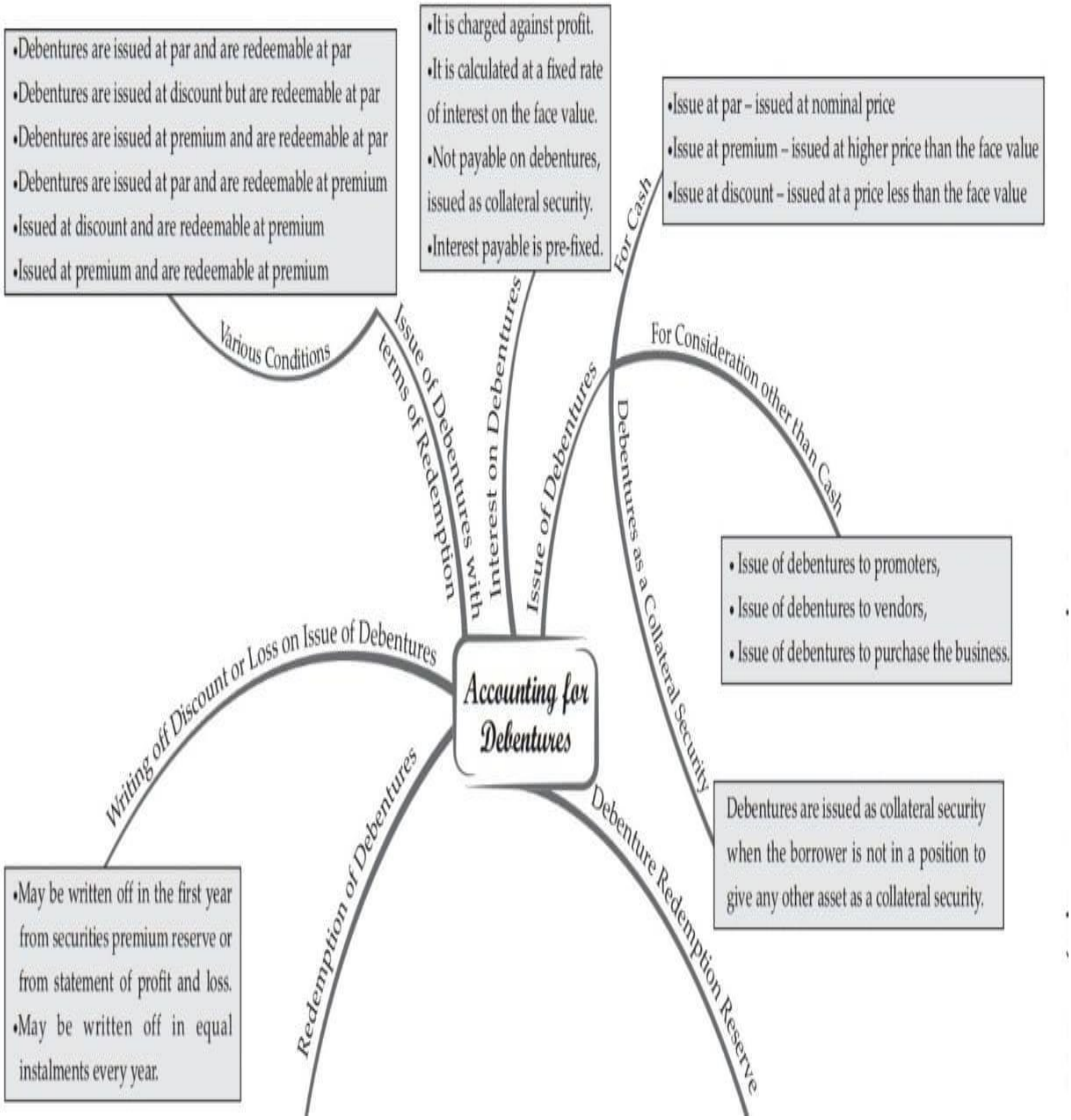
₹48,000 x ₹ 600/ 800 = ₹ 36,000

Profit on forfeiture of 1200 shares (30,000 + 36,000)	=	66,000
Less: Loss on reissue of shares	=	18,000
Transfer to Capital Reserve	=	48,000

6. Balance in Share Forfeiture Account (₹ 48,000 - ₹ 36,000) =₹ 12,000

CH-02 : ISSUE AND REDEMPTION OF DEBENTURES

(MIND MAP)



***DEBENTURE: -** Debenture is a written acknowledgement of a debt by the company. It contains the terms for the repayment of the principal debt on specified date and for payment of interest at a fixed percent until the principal sum is paid.

***DISCLOSURE OF DEBENTURES IN COMPANY'S BALANCE SHEET:-**

As per schedule III of the companies act, 2013, debentures are shown in balance sheet as a Long-Term borrowings under non-current liabilities but debentures, shown as long - term borrowings & payable within 12 months for the date of balance sheet or within the period of operating cycle is shown as current maturity of long term debts under other current liabilities under the head current liability interest accrued [due and not due] is shown as other current liability under current liabilities.

DEBENTURE TRUST DEED:- It is document created by the company where by trustees are appointed to protect the interest of debenture holder before they are offered for public subscription.

ISSUE OF DEBENTURES:-Debenture like shares can be issued for

[i] Cash and

[ii] Consideration other than cash.

These debentures can be issued

(a) at par or

(b) at premium or

(c) at discount.

Accounting for issue of debenture for cash is the same as the accounting for issue of shares with one change i.e. the word 'share' shall be replace by 'debenture' and 'share capital' by 'Debenture'. The terms used for the issue of the share will be changed at the time of issue of debenture.

Debentures: **Disclosure in the balance sheet:-**

(a)If the debentures are shown as 'long term borrowing' then it is shown in equity and liabilitiespart of the balance sheet under the head 'non-current liabilities' and sub head 'other long term liabilities'.

(b) If the debentures are shown as 'short term borrowing' then it is shown in the equity & liabilities part of the balance sheet under the head 'current liabilities' and sub head 'other current liabilities'.

(c) If the debentures are shown as 'current maturities of a long term debts' then it is shown under the head 'current liabilities' and subhead ‘other current liabilities'.

INTEREST ON DEBENTURES- is considered as an expense it is charged against the profit of the company and is payable whether profit are earned or not.

TAX DEDUCTED AT SOURCE [TDS] tax is deducted on interest at the specified rate & deposited in the government account on the due date.

ISSUE OF DEBENTURES FOR CONSIDERATION OTHER THAN CASH

A company can issue debentures to the vendors as a payment for the purchase of the assets such as issue of debentures is known as an issue of debenture consideration other than cash.

ISSUE OF DEBENTURES AS COLLATERAL SECURITY:-

Means issue of debentures as a subsidiary or secondary security collateral security means additional security i.e., in addition to the prime security. It is only to be realised when the prime security fails to pay the amount of the loan.

Debentures issued as collateral security may or may not be recorded in the books of accounts if an accounting entry is not passed it is disclose under the loan if an accounting entry is passed it is shown below the loan first as debenture issued and there after Debenture Suspense Account is deducted.

Case	***Conditions of Issue***	***Condition on Redemption***
1	Issued at Par	Redeemable at Par
2	Issued at Discount	Redeemable at Par
3	Issued at Premium	Redeemable at Premium
4	Issued at Par	Redeemable at Premium
5	Issued at Discount	Redeemable at Premium
6	Issued at Premium	Redeemable at Premium

Kinds of Debentures
1. Secured or Mortgaged Debentures
2. Unsecured or Naked Debentures
3. Registered or bearer Debentures
4. Redeemable or Irredeemable Debentures
5. Convertible and Non-Convertible Debentures

Issue Of Debentures (Solved Practical Questions)

Q1.X limited issued 5,000, 12% debentures of ₹ 100 each on 1st April, 2021 at par redeemable at a premium of 5%. Interest on these debentures is paid half yearly, i.e., on 30th September and 31st March. Pass necessary journal entries for the year ended 31st March, 2022 assuming Income tax is deducted @ 20% on the Amount of Interest.

Solution: **Journal**

Date	**Particulars**	**L.F**	**Dr. (₹)**	**Cr. (₹)**
2021 Apr. 1	Bank A/c Dr. To Debentures Application and Allotment A/c (Amount received on Application.)		5,00,000	 5,00,000
Apr. 1	Debenture Application & Allotment A/c Dr. Loss on Issue of Debenture A/c Dr. To 12% Debentures A/c To Premium on Redemption of Debentures A/c (Issue of Debentures at par and Redeemable at 5% premium)		5,00,000 25,000	 5,00,000 25,000
Sep. 30	Interest on Debenture A/c Dr. To Debenture holder's A/c To Income Tax Payable A/c (Half-yearly Interest due on Debentures and Tax deducted at source)		30,000	 24,000 6,000

Sep. 30	Debenture holders A/c Dr. To Bank A/c (Payment of Interest)		24,000	24,000
Sep. 30	Income Tax Payable A/c Dr To Bank A/c (TDS deposited with Income tax authorities)		6,000	6,000
2022 Mar. 31	Interest on Debentures A/c Dr To Debenture holders A/c To Income Tax Payable A/c (Half-yearly Interest due on Debentures and Tax deducted at source)		30,000	24,000 6,000
Mar. 31	Debenture holders A/c Dr To Bank A/c (Payment of Interest)		24,000	24,000
Mar. 31	Income Tax Payable A/c Dr To Bank A/c (TDS deposited with Income tax authorities)		6,000	6,000
Mar. 31	Statement of Profit & Loss A/c Dr. To Interest on Debentures A/c (30,000 + 30,000) (Interest transferred to Statement of Profit & Loss A/c)		60,000	60,000

Q 2. Give Journal Entries for the Issue of Debentures in the following conditions.

1. Issued 2,000, 12% Debentures of ₹ 100 each at par, redeemable also at par.
2. Issued 2,000, 12% Debentures of ₹ 100 each at a discount of 2%, redeemable at par.
3. Issued 2,000, 12% Debentures of ₹ 100 each at a premium of 5%, redeemable at par.
4. Issued 2,000, 12% Debentures of ₹ 100 each at par but redeemable at 5% premium.
5. Issued 2,000, 12% Debentures of ₹ 100 each at a discount of 2%, redeemable at a premium of 5%.
6. Issued 2,000, 12% Debentures of ₹ 100 each at a premium of 5%, redeemable at a premium of 10%.

Solution

Journal

Date	Particulars	L.F	Dr. (₹)	Cr. (₹)
Case 1	Bank A/c Dr. To 12% Debentures Application & Allotment A/c (Application money received)		2,00,000	2,00,000
	12% Debentures Application & Allotment A/c Dr. To 12% Debentures A/c (Transfer of application money to Debentures A/c, issued at par)		2,00,000	2,00,000
Case 2	Bank A/c Dr. To 12% Debentures Application & Allotment A/c (Application money received)		1,96,000	1,96,000
	12% Debentures Application & Allotment A/c Dr. Discount on Issue of Debentures A/c Dr. To 12% Debentures A/c (Transfer of Application money to Debentures A/c, issued at a discount of 2%)		1,96,000 4,000	2,00,000

Case 3	Bank A/c Dr. To 12% Debentures Application & Allotment A/c (Application money received)		2,10,000	2,10,000
	12% Debentures Application & Allotment A/c Dr. To 12% Debentures A/c To Securities premium reserve A/c (Transfer of Application money to Debenture A/c,issued at a premium of 5%)		2,10,000	2,00,000 10,000
Case 4	Bank A/c Dr. To 12% Debentures Application & Allotment A/c (Application money received)		2,00,000	2,00,000
	12% Debentures Application & Allotment A/c Dr. Loss on Issue of Debentures A/c To 12% Debentures A/c To Premium on Redemption A/c (Transfer of Application money to Debenture A/c, issued at par, but Redeemable at a Premium of 5%)		2,00,000 10,000	2,00,000 10,000

Case 5	Bank A/c Dr. To 12% Debentures Application & Allotment A/c (Application money received)		1,96,000	1,96,000
	12% Debentures Application & AllotmentA/cDr. Loss on Issue of Debentures A/c Dr. To 12% Debentures A/c To Premium on Redemption A/c (Transfer of Application money to Debentures A/c, issued at a discount of 2% and Redeemable at a Premium of 5%)		1,96,000 14,000	2,00,000 10,000
Case 6	Bank A/c Dr. To 12% Debentures Application & Allotment A/c (Application money received)		2,10,000	2,10,000
	12% Debentures Application & Allotment A/c Dr. Loss on Issue of Debentures A/c Dr. To 12% Debentures A/c To Securities Premium Reserve A/c To Premium on Redemption A/c (Transfer of Application money to Debentures A/c, issued at a Premium of 5% and Redeemable at a Premium of 10%)		2,10,000 20,000	2,00,000 10,000 20,000

WRITING OFF DISCOUNT / LOSS ON ISSUE OF DEBENTURES

Q1. X Ltd. issued ₹ 2,00,000, 10% Debentures at a discount of 5% .The terms of issue provide the repayment at the end of 4 years . Y Ltd. has a balance of ₹ 5, 00,000 in Securities Premium Reserve. The company decided to write off discount on issue of debentures from Securities Premium Reserve in the first year. Pass the journal entry.

Solution: **JOURNAL**

Date	Particulars	LF	Debit (₹)	Credit(₹)
	Securities Premium Reserve A/c Dr To Discount on Issue of Debentures A/c (Being Discount on Issue of Debentures written off)		10,000	10,000

Note: Discount on Issue of Debentures = ₹ 2, 00,000 × 5% = ₹ 10,000

Q2. Y limited company issued ₹ 1, 00,000, 9% Debentures at a discount of 6% on 1st April, 2021. These debentures are to be redeemed equally, spread over 5 annual installments.
Pass the Journal entries for issue of debentures and writing off the discount on issue of debentures.

Date	Particulars	LF	Debit(₹)	Credit (₹)
2021 Apr 1	Bank A/c Dr To Debenture Application &Allotment A/c (Being Application money received)		94,000	94,000
Apr 1	Debenture Application & Allotment A/c Dr Discount on Issue of Debentures A/c Dr To 9% Debentures A/c		94,000 6,000	1,00,000
2022 Mar 31	Statement of Profit & Loss A/c Dr To Discount on issue of debentures A/c (Being Discount on Issue of Debentures written off)		6,000	6,000

Q3.On 1st April, 2021, S Ltd. issued 6,000, 8% Debentures of nominal (face) value of ₹ 100 each redeemable at 5% premium in equal proportions at the end of 5, 10 and 15 year. It has a balance of ₹ 10,000 in Securities Premium Reserve.
Pass Journal entries. Also give Journal entry for writing off Loss on Issue of Debentures.

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
2021 Apr1	Bank A/c Dr To Debenture Application &Allotment A/c (Being Application money received)		6 , 00,000	6 , 00,000
Apr 1	Debenture Application &Allotment A/c Dr Loss on Issue of Debentures A/c Dr To 9% Debentures A/c To Premium on Redemption of Debentures (Being Application money transferred)		6,00,000 30,000	6,00,000 30,000
2022 Mar31	Securities Premium Reserve A/c Dr Statement of Profit & Loss A/c Dr To Loss on Issue of Debentures A/c (Being Loss on Issue of Debentures written off)		10,000 20,000	30,000

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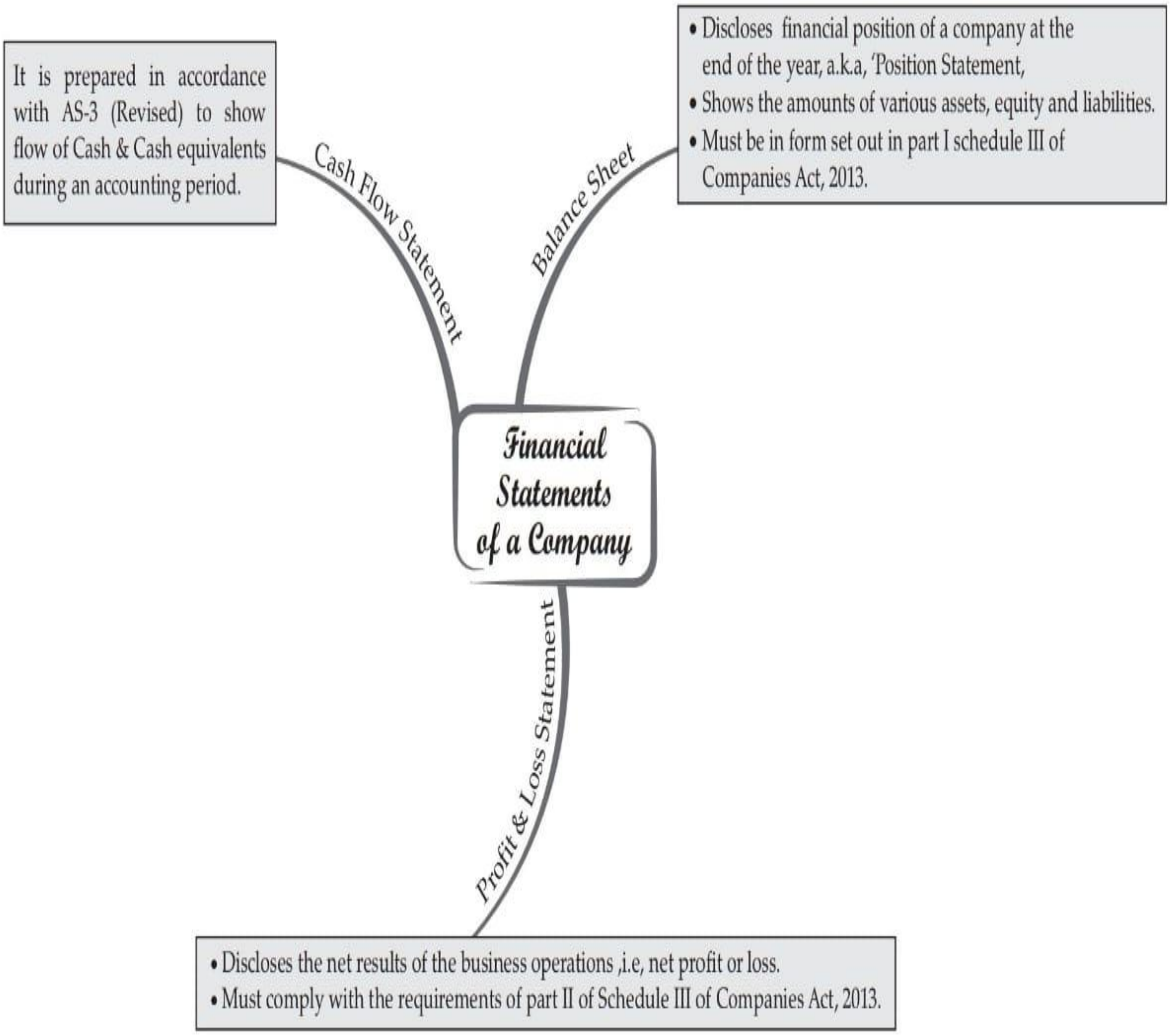
UNIT -3

CH-03: FINANCIAL STATEMENTS OF COMPANY

(MIND MAP)



Financial Statements of Company:

Financial statements are the basic and formal annual reports through which the corporate management communicates financial information to its owners and various other external parties which include investors, tax authorities, government, employees, etc.

These refer to the balance sheet (position statement) as at the end of accounting period, the statement of profit & loss of a company and the cash flow statement.

PART 1

Form of balance sheet

REVISED SCHEDULE III OF THE COMPANIES ACT 2013

BALANCE SHEET AS AT……………….

PARTICULARS (1)	NOTE NO (2)	FIGURES AS AT THE END OF CURRENT REPORTING PERIOD (3)	FIRGURES AS AT THE END OF THE PREVIOUS REPORTING PERIOD (4)
1. EQUITY AND LIABILITIES			
(1) Shareholders' Funds			
(a) Share Capital			
(b) Reserves and Surplus			
(c) Money received against share warrants			
(2) Share Applications Money Pending Allotment			
(3) Non-Current Liabilities			
(a) Long-term borrowings			
(b) Deferred tax liabilities(Net)			
(c) Other Long-term Liabilities			
(d) Long-term provisions			
(4) Current Liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
TOTAL			
II ASSETS			
1. Non-Current Assets			
(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) Current Assets			
(a) Current investments			
(b) Inventories			
(c) Trade receivables			
(d) Cash and cash equivalents			
(e) Short-term loans and advances			
(f) Other current assets			
TOTAL			

PART -II STATEMENT OF PROFIT AND LOSS (₹ In………..)			
PARTICULARS (1)	**NOTE NO (2)**	**FIGURES FOR THE CURRENT RERPORTING PERIOD (3)**	**FIGURES FOR THE PREVIOUS REPORTING PERIOD (4)**
I. Revenue from operations			
II. Other income			
III. Total Revenue (I+II)			
IV. Expenses: **Cost of materials consumed** **Purchases of stock-in-trade** **Changes in inventories of finished goods** **Work-in-progress and stock-in-trade** **Employees benefits expenses** **Finance costs** **Depreciation and amortization expenses** **Other expenses**			
Total expenses			
V. Profit Before Tax (III-IV)			
VI. Tax			
VII. Profit After Tax (V-VI)			

PRACTICE QUESTIONS:-

Q 1.Under which sub headings will the following items be placed in the Balance sheet of a company as per revised Schedule III of the Companies act 2013.

(1) Capital reserve (2) Bonds (3) Loans repayable on demand
(4) Vehicles (5) Goodwill (6) Loose Tools

Q2.Under which major headings and sub headings will the following items be shown in the balance Sheet of a company as per schedule III of the Companies act 2013.

(1) Balance of the statement of profit and loss. (2) Loan of 1, 00,000 payable three years.
(3) Short- term deposits payable on demand (4) Loose tools
(5) Trademark (6) Land
(7) Cash at bank (8) Trade payables.

MULTIPLE CHOICE QUESTIONS:-

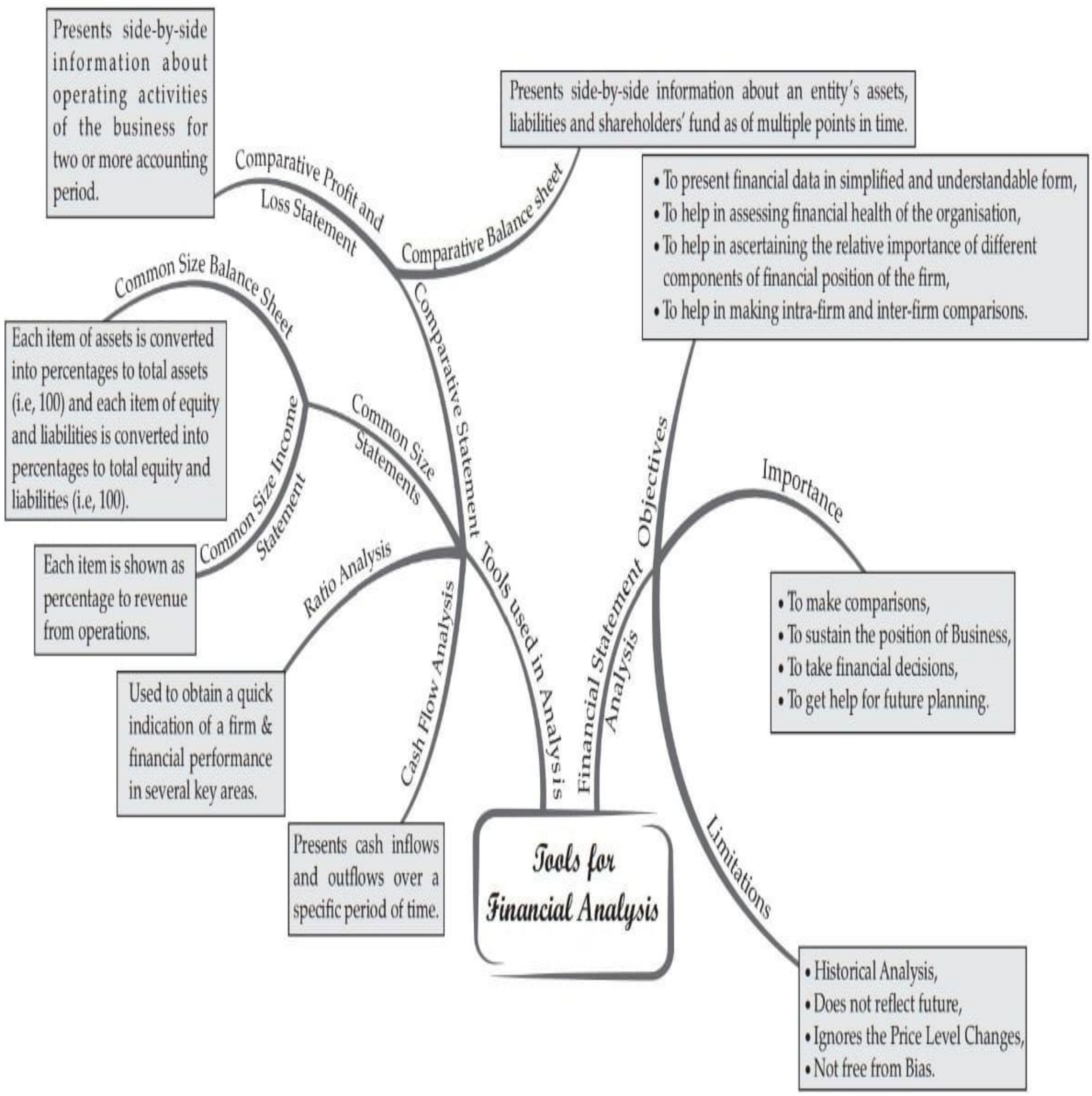
Q1. While preparing the Balance sheet of a company, Securities Premium Reserve is shown under:
(a) Non-Current liabilities (b) Share capital
(c) Long term borrowings (d) Reserves and surplus

Q2. Call in advance appears in a Company's Balance sheet under:
(a) Current liabilities (b) Share Capital
(c) Long term Borrowings (d) Reserves and Surplus

Q3. Analysis of financial statement is significant for:
(a) Creditors (b) Management
(c) Employees (d) All of the above

CH-04: ANALYSIS OF FINANCIAL STATEMENTS

(MIND MAP)



ANALYSIS OF FINANCIAL STATEMENTS:

The process of critical evaluation of the financial information contained in the financial statements in order to understand and make decisions regarding the operations of the firm is called 'Financial Statement Analysis'. It is basically a study of relationship among various financial facts & figures as given in a set of financial statements, and the interpretation there of to gain an insight into the profitability & operational efficiency of the firm to assess its financial health and future prospects.

Significance of Analysis of Financial Statements

Financial analysis is useful and significant to different users in the following ways:

(**a) Finance manager:** Financial analysis focuses on the facts & relationships related to managerial performance, corporate efficiency, financial strengths, weaknesses & creditworthiness of the company.

(b) Top management: The importance of financial analysis is not limited to the finance manager alone. It has a broad scope which includes top management in general and other functional managers.

(c) Trade payables: Trade payables, through an analysis of financial statements, appraises not only the ability of the company to meet its short-term obligations, but also judges the probability of its continued ability to meet all its financial obligations in future.

(d) Lenders: Suppliers of long-term debt are concerned with the firm's long term solvency and survival.

(e) Investors: Investors, who have invested their money in the firm's shares, are interested about the firm's earnings. As such, they concentrate on the analysis of the firm's present and future profitability.

(f) Labour unions: Labour unions analyse the financial statements to assess whether it can presently afford a wage increase and whether it can absorb a wage increase through increased productivity or by raising the prices.

(g) Others: The economists, researchers, etc., analyse the financial statements to study the present business and economic conditions. The government agencies need it for price regulations, taxation & other similar purposes.

Tools of Analysis of Financial Statements:

The most commonly used techniques of financial analysis are as follows:

1. Comparative Statements: These are the statements showing the profitability & financial position of a firm for different periods of time in a comparative form to give an idea about the position of two or more periods.

2. Common Size Statements: These are the statements which indicate the relationship of different items of a financial statement with a common item by expressing each item as a percentage of that common item.

3. Trend Analysis: It is a technique of studying the operational results and financial position over a series of years. Using the previous years' data of a business enterprise, trend analysis can be done to observe the percentage changes over time in the selected data.

4. Ratio Analysis: It describes the significant relationship which exists between various items of a balance sheet and a statement of profit and loss of a firm.

5. Cash Flow Analysis: It refers to the analysis of actual movement of cash into and out of an organisation. The flow of cash into the business is called as cash inflow or positive cash flow and the flow of cash out of the firm is called as cash outflow or a negative cash flow. The difference between the inflow and outflow of cash is the net cash flow.

Comparative Statements:

The following steps may be followed to prepare the comparative statements:

Step 1: List out absolute figures in rupees relating to two points of time (as shown in columns 2 and 3 of Exhibit 4.1).

Step 2: Find out change in absolute figures by subtracting the first year (Col.2) from the second year (Col.3) and indicate the change as increase (+) or decrease (–) and put it in column 4.

Step 3: Preferably, also calculate the percentage change as follows and put it in column 5.

$$\frac{\textbf{Absolute Increase or Decrease (Col.4)}}{\textbf{First year absolute figure (Col.2)}} \times \textbf{100}$$

Objectives of Financial Statements:-

(a) To assess the profitability of the organization.
(b) To assess the operational efficiency.
(c) To judge the financial health of the organization.
(d) To assess the solvency position of the organization.

Limitations of Financial Statements:-

(a) Financial analysis does not consider price level changes.
(b) Financial analysis may be misleading without the knowledge of the changes in accounting procedure followed by a firm.
(c) Financial analysis is just a study of reports of the company.
(d) Monetary information alone is considered in financial analysis while non-monetary aspects are ignored.
(e) The financial statements are prepared on the basis of accounting concept, as such, it does not reflect the current position.

Comparative Statement: Comparative statements refer to the statement of profit and loss and the balance sheet prepared by providing columns for the figures for both the current year as well as for the previous year and for the changes during the year, both in absolute and relative terms.

Comparative Statement

Particulars	**First Year**	**Second Year**	**Absolute Increase (+) or Decrease (–)**	**Percentage Increase (+) or Decrease (–)**
1	2	3	4	5
	(₹)	**(₹)**	**(₹)**	**%**

Illustration 1:-

From the following statement of profit and loss of Agarwal Co. Ltd., prepare comparative statement of profit and loss for the year ended March 31, 2022 and 2023:

Particulars	**Note No.**	**2021-22 (₹)**	**2022-23 (₹)**
(i) Revenue from operations		60, 00,000	75, 00,000
(ii) Other incomes		1, 50,000	1, 20,000
(iii) Expenses		44, 00,000	50, 60,000
(iv) Income tax		35%	40%

Solution: Comparative statement of profit and loss of Agarwal Co. Ltd. for the year ended 31st March, 2022 & 2023:

Particulars	2021-22 (₹)	2022-23 (₹)	Absolute Increase (+) or Decrease (–)	Percentage Increase (+) or Decrease (–)
	(₹)	(₹)	(₹)	%
I. Revenue from operations	60, 00,000	75, 00,000	15, 00,000	25.00
II. Add: Other incomes	1, 50,000	1, 20,000	30,000	20.00
III. Total Revenue I+II	**61, 50,000**	**76, 20,000**	**14, 70,000**	**23.90**
IV. Less: Expenses	44, 00,000	50, 60,000	6, 60,000	15.00
Profit before tax	**17, 50,000**	**25, 60,000**	**8, 10,000**	**46.20**
V. Less: Tax	6, 12,500	10, 24,000	4, 11,500	67.18
Profit after tax	**11, 37,500**	**15, 36,000**	**3, 98,500**	**35.03**

Illustration 2:-

The following are the Balance sheets of Z Ltd. As at March 2022 & 2023. Prepare a Comparative Balance Sheet.

Particulars	Note No.	March 31, 2023 (₹)	March 31, 2022 (₹)
I. Equity and Liabilities			
1. Shareholder's Funds			
a) Share Capital		20, 00,000	15, 00,000
b) Reserve and Surplus		3, 00,000	4, 00,000
2. Non- current Liabilities			
Long-term borrowings		9, 00,000	6, 00,000
3. Current Liabilities			
Trade Payables		3, 00,000	2, 00,000
Total		**35,00,000**	**27,00,000**
II Assets			
1. Non-Current Assets			
a) Fixed Assets			
- Tangible Assets		20, 00,000	15, 00,000
- Intangible Assets		9, 00,000	6, 00,000
2. Current Assets			
- Inventories		3, 00,000	4, 00,000
- Cash and Cash Equivalents		3, 00,000	2, 00,000
Total		**35,00,000**	**27,00,000**

Solution:

Comparative Balance Sheet of Z Ltd. as at March 31, 2022 and March 31, 2023

Particulars	March 31, 2022 (₹)	March 31, 2023 (₹)	Absolute Change	Percentage Change
	(₹)	(₹)	(₹)	%
I. Equity and Liabilities				
1. Shareholder's Funds				
a) Share Capital	15, 00,000	20, 00,000	5, 00,000	33.33
b) Reserve and Surplus	4, 00,000	3, 00,000	(1, 00,000)	(25.00)
2. Non- current Liabilities				
Long-term borrowings	6, 00,000	9, 00,000	3, 00,000	50.00
3. Current Liabilities				
Trade Payables	2, 00,000	3, 00,000	1, 00,000	50.00
Total	**27,00,000**	**35, 00,000**	**8, 00,000**	**29.63**

II Assets				
1. Non-Current Assets				
a) Fixed Assets				
- Tangible Assets	15, 00,000	20, 00,000	5, 00,000	33.33
- Intangible Assets	6, 00,000	9, 00,000	3, 00,000	50.00
2. Current Assets				
- Inventories	4, 00,000	3, 00,000	(1, 00,000)	(25.00)
- Cash and Cash Equivalents	2, 00,000	3, 00,000	1, 00,000	50
Total	**27, 00,000**	**35, 00,000**	**8, 00,000**	**29.63**

Common Size Statement: Common Size Statement, also known as component percentage statement, is a financial tool for studying the key changes and trends in the financial position and operational result of a company.

Common Size Statement

Particulars	Year One	Year Two	Percentage Year 1	Percentage Year 2
1	2	3	4	5

Illustration 3:-

Particulars	2022-23 (₹)	2021-22 (₹)
Net Sales	18, 00,000	25, 00,000
Cost of goods sold	10, 00,000	12, 00,000
Operating Expenses	80,000	1, 20,000
Non-operating expenses	12,000	15,000
Depreciation	20,000	40,000
Wages	10,000	20,000

Solution:

Common Size Income Statement
For the year ended March 31, 2022 and March 31, 2023

Particulars	Absolute Amounts		Percentage of Net Sales	
	2021-22 (₹)	2022-23 (₹)	2021-22 (%)	2022-23 (%)
Net Sales	25, 00,000	18, 00,000	100	100
(Less) Cost of goods sold*	12, 00,000	10, 00,000	48	55.56
Gross Profit	**13, 00,000**	**8, 00,000**	52	44.44
(Less) Operating Expenses**	1, 20,000	80,000	4.80	4.44
Operating Income	**18, 80,000**	**7, 20,000**	47.20	40
(Less) Non-operating expenses	15,000	12,000	0.60	0.67
Profit	**11, 65,000**	**7, 08,000**	**46.60**	**39.33**

*** Wages is the part of Cost of goods sold**
**** Depreciation is part of Operating Expenses**

Illustration 4.

Prepare common size Balance Sheet of Soni Ltd. from the following information:

Particulars	Note No.	March 31, 2022(₹)	March 31, 2023 (₹)
I. Equity and Liabilities			
1. Shareholder's Funds			
a) Share Capital		15, 00,000	12, 00,000
b) Reserve and Surplus		5, 00,000	5, 00,000
2. Non- current Liabilities			
Long-term borrowings		6, 00,000	5, 00,000
3. Current Liabilities			
Trade Payables		15, 50,000	10, 50,000
Total		**41,50,000**	**32,50,000**
II Assets			
1. Non-Current Assets			
a) Fixed Assets			
- Tangible Assets			
Plant & Machinery		14, 00,000	8, 00,000
- Intangible Assets			
Goodwill		16, 00,000	12, 00,000
b) Non-Current Investments		10, 00,000	10, 00,000
2. Current Assets			
- Inventories		1, 50,000	2, 50,000
Total		**41,50,000**	**32,50,000**

Solution:

Common Size Balance Sheet
As at March 31, 2022 and March 31, 2023

Particulars	Absolute Amounts		Percentage of Net Sales	
	31/03/2022 (₹)	31/03/2023 (₹)	31/03/2022 (%)	31/03/2023 (%)
I. Equity and Liabilities				
1. Shareholder's Funds				
a) Share Capital	15, 00,000	12, 00,000	36.14	36.93
b) Reserve and Surplus	5, 00,000	5, 00,000	12.05	15.38
2. Non- current Liabilities				
Long-term borrowings	6, 00,000	5, 00,000	14.46	15.38
3. Current Liabilities				
Trade Payables	15, 50,000	10, 50,000	37.35	32.31
Total	**41,50,000**	**32,50,000**	**100**	**100**
II Assets				
1. Non-Current Assets				
a) Fixed Assets				
- Tangible Assets				
Plant & Machinery	14, 00,000	8, 00,000	33.73	24.62
- Intangible Assets				
Goodwill	16, 00,000	12, 00,000	38.55	36.92
b) Non-Current Investments	10, 00,000	10, 00,000	24.10	30.77
2. Current Assets				
- Inventories	1, 50,000	2, 50,000	3.62	7.69
Total	**41,50,000**	**32,50,000**	**100**	**100**

PRACTICE QUESTIONS:-

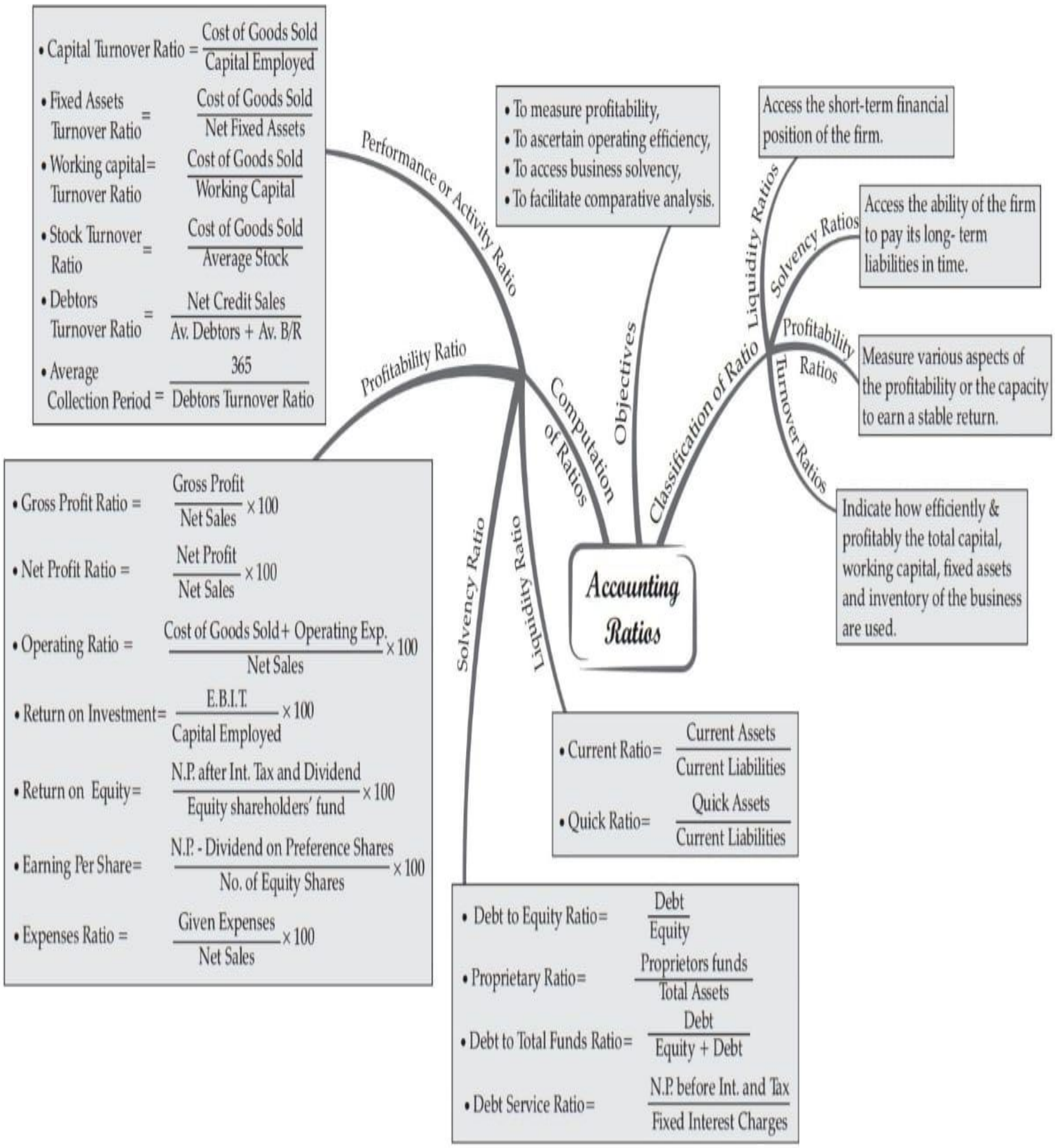
(1) What do you mean by financial statements analysis?

(2) State any three tools of financial analysis.

(3) State any four limitations of financial analysis.

CH-05: ACCOUNTING RATIOS

(MIND MAP)



Accounting Ratios:

Relationship between two figures, expressed in arithmetical terms is called a ratio. Accounting ratio is one of the tools of financial analysis which requires regrouping of data by application of arithmetical relationships which provides crucial financial information and points out the areas which require investigation.

OBJECTIVES:-

1. To know the areas of the business which need more attention;
2. To know about the potential areas which can be improved with the effort in the desired direction;
3. To provide a deeper analysis of the profitability, liquidity, solvency and efficiency levels in the business;
4. To provide information for making cross sectional analysis by comparing the performance with the best industry standards;
5. To provide information derived from financial statements useful for making projections & estimates for the future.

Methods of Expressing Ratios:-

(a) Proportion Ratio Pure Ratio or Simple Ratio

(b) Rate or so many times Method

(c) Percentage Method

(d) Fraction Method.

CLASSIFICATION OF RATIOS:-

A. Liquidity Ratio ***B. Solvency Ratio*** ***C. Activity Ratio*** ***D. Profitability Ratio.***

A. Liquidity Ratios:

To meet its commitments, business needs liquid funds. The ability of the business to pay the amount due to stakeholders as and when it is due is known as liquidity, and the ratios calculated to measure it are known as 'Liquidity Ratios'. Liquidity ratios are also known as short-term solvency ratio. There are two types of Liquidity ratios, they are:-

1. Current Ratio:- Current Ratio is the proportion of current assets to current liabilities. It is also known as working capital ratio. The ideal ratio of current ratio is 2:1.It is expressed as follows:

$$\textbf{Current Ratio} = \frac{\textbf{Current Assets}}{\textbf{Current Liabilities}}$$

List of Current assets:- *Current Investments, Inventories, Trade Receivables (less provision, Cash and Cash Equivalents, Short-term loans And advances, Other Current Assets(Prepaid exp., Accrued income, Advance Tax.)*

List of current liabilities:- *Short-term Borrowings (including Bank overdraft),Trade payables, other current liabilities(Unpaid dividends, int. Accrued on borrowings, income received in advance, outstanding exp.) Short-term provisions (provision for tax and proposed dividend).*

2. Liquid Ratio:-

Liquid ratio is also known as Quick Ratio or Acid Test Ratio. Current ratio is theproportion of Current Assets to Current Liabilities. An ideal Quick ratio is said to be 1:1. It is expressed as below:-

$$\textbf{Quick Ratio} = \frac{\textbf{Quick Assets}}{\textbf{Current Liabilities}}.$$

Quick Assets = Current Assets – (Prepaid expenses + Closing Stock)

B. Solvency Ratio:-

These ratios are calculated to assess the ability of the firm to meet its long-term liabilities as & when they become due. Some important solvency ratios are:-

1. Debt Equity Ratio:- Debt Equity Ratio measures the relationship between Long-term Debt &

Equity.

Ideal ratio of Debt Equity ratio is 2:1.

$$\textbf{\textit{Debt Equity Ratio}} = \frac{\textbf{\textit{Debt}}}{\textbf{\textit{Equity}}}$$

Debt here means Lon-term Debt and Equity means shareholders fund or Net worth.
Long-term Debt includes Long-term Borrowings and Long-term Provisions.

For Example:- Debentures, Mortgage Loan, Bank loan, loan from financial institutions, Public Deposits, etc. Shareholder's Fund = Share Capital and Reserve and Surplus.

2. Total Assets to Debt Ratio:- Total assets to Debt ratio establishes relationship between Total Assets and Long-term Debt.

$$\textbf{Total Assets to Debt Ratio} = \frac{\textbf{Total Assets}}{\textbf{Debt}}$$

Total Assets = Non-Current Assets (Tangible and Intangible + Non-current Investments+ Long-term Loans and Advances) + Current Assets.

Debt = Long-term Borrowings and Long-term Provisions.

3. Proprietary Ratio:- Proprietary ratio expresses relationship of Proprietor's(Shareholders) funds to Net Assets and is calculated as follows :

$$\textbf{Proprietary Ratio} = \frac{\textbf{Shareholders fund}}{\textbf{Total Assets}}$$

4. Interest coverage Ratio:- This ratio is calculated by dividing the Profit before Charging Interest and Income-tax by fixed interest charges. An Interest Coverage Ratio of 6 to 7 times is considered appropriate and is calculated as follows :

$$\textbf{Interest Coverage Ratio} = \frac{\textbf{Net Profit before charging Interest and Tax}}{\textbf{Fixed Interest Charges}}$$

$$\textbf{5. Debt to Capital Employed Ratio} = \frac{\textbf{Debt}}{\textbf{Capital Employed.}}$$

C. Activity (or Turnover) Ratios:-

The turnover ratios basically exhibit the activity levels characterised by the capacity of the business to make more sales or turnover. The activity ratios express the number of times assets employed.

Higher turnover ratio means better utilisation of assets and signifies improved efficiency and profitability, and as such are known as efficiency ratios. The important activity ratios calculated underthis category are :

1. Inventory Turnover Ratio:- It expresses the relationship between the cost of Revenue from operations and average inventory during the year. The higher the ratio, the better it is, since it indicates that inventory is selling quickly.

$$\textbf{Inventory Turnover Ratio} = \frac{\textbf{Cost of Revenue from Operation}}{\textbf{Average Inventory}}$$

Cost of Revenue from operation= Opening Inventory + Purchases + Direct Expenses – Closing Stock

or

= Revenue from operations - Gross Profit

$$\text{Average Inventory} = \frac{\text{Opening Inventory + Closing Inventory}}{2}$$

$$\text{Average Age of Inventory} = \frac{\text{Months/ Days in a Year}}{\text{Inventory Turnover Ratio}}$$

2. Trade Receivables Turnover Ratio:- It expresses the relationship between Credit Revenue from Operations and Average Trade Receivables during the year.

$$\text{Trade Receivables Turnover Ratio} = \frac{\text{Net Credit Revenue from Operations}}{\text{Average Trade Receivables}}$$

$$\text{Average Trade Receivables} = \frac{\text{Opening Trade Receivables + Closing Trade Receivables}}{2}$$

$$\text{Average Collection Period} = \frac{\text{Months/ Days in a Year}}{\text{Trade Receivables Turnover Ratio}}$$

3. Trade Payables Turnover Ratio:- It expresses the relationship between credit Purchase & average trade payables during the year.

$$\text{Trade Payables Turnover Ratio} = \frac{\text{Net Credit Purchase}}{\text{Average Trade payables}}$$

$$\text{Average Trade payable} = \frac{\text{Opening Trade Payables + Closing Trade Payables}}{2}$$

$$\text{Average Payment Period} = \frac{\text{Months/ Days in a Year}}{\text{Average Trade payable}}$$

1. Working Capital Turnover Ratio:- This ratio indicates the velocity of utilization of net working capital. A higher ratio measures the efficient utilization of working capital.

$$\text{Working Capital Turnover Ratio} = \frac{\text{Cost of Revenue from operations/ Net Revenue from operations}}{\text{Working Capital}}$$

$$\text{Fixed Assets Turnover Ratio} = \frac{\text{Net Revenue from Operations}}{\text{Average Fixed Assets}}$$

$$\text{Net Assets Turnover Ratio} = \frac{\text{Net Revenue from Operations}}{\text{Average Assets}}$$

A. Profitability ratios:- Profitability ratios are calculated to analyse the earning capacity of the business which is the outcome of utilisation of resources employed in the business. There is a close relationship between the profit and the efficiency with which the resources employed in the business are utilised. Following are the important profitability ratios:-

1. Gross Profit Ratio:- This ratio shows the relationship between Gross Profit & Revenue from operations.

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Revenue from operations}} \times 100$$

(Gross Profit = Revenue from operations – Cost of Revenue from operations)

Cost of Revenue from operation= Opening Inventory + Purchases + Direct Exp. – Closing Stock

or

= Revenue from operations – Gross Profit.

2. Operating Ratio:- It is computed to analyse cost of operation in relation to Revenue from operations. Lower the Operating Ratio, better it is, because it will leave higher margin of profit on Revenue from operations. It is calculated as follows:

$$\text{Operating Ratio} = \frac{\text{Cost of Revenue from operations + Operating Expenses}}{\text{Revenue from operations}} \times 100$$

Operating Expenses = Employee Benefit Exp. + Depreciation + Other Exp. (i.e. Office & Administration Exp. + Selling and Distribution Exp. + Discount + Bad debts + Interest on short-term loans)

3. Operating Profit Ratio:- It is calculated to reveal operating margin. It may be computed directly oras a residual of operating ratio. It is calculated as follows:

$$\text{Operating Profit Ratio} = \frac{\text{Operating Profit}}{\text{Revenue from operations}} \times 100$$

Operating Expenses = Employee Benefit Exp. + Depreciation + Other Exp. (i.e. Office & Administration Exp. + Selling and Distribution Exp. + Discount + Bad debts + Interest on short-term loans)

Operating Profit = Gross Profit – other operating Exp. + Other operating incomes

Other operatingincomes = commission Received + Discount Received.

Operating Profit Ratio = 100 - Operating Ratio.

4. Net Profit Ratio:- It establishes the relationship between Net Profit and Revenue from operations. It is calculated as follows:

$$\text{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Revenue from operations}} \times 100$$

Net Profit = Gross Profit – Indirect Expenses. & losses + Other Incomes.
Generally, Net Profit refers to Profit after Tax (PAT).

5. Return on Investment:- It is also known as Return on Capital Employed or Rate of Return Yield on Capital. It explains the overall utilisation of funds by a business enterprise.

It is calculated as follows:

$$\text{Return on Investment} = \frac{\text{Net Profit before Interest, Tax \& Dividend}}{\text{Capital Employed}} \times 100$$

Capital Employed = Shareholder's Funds + Non-Current Liabilities (Long-term Borrowings +Long-termProvisions)

Capital Employed = Non-current assets + working capital
Non-current assets = Tangible Assets + Intangible assets + Non-Current Investments + Long term Advances.
Working capital = Current Assets – Current Liabilities.

MULTIPLE CHOICE QUESTION:-

Q1	Working Capital is the: (a) Cash and Bank Balance (b) Capital borrowed from the Banks (c) Difference between Current Assets and Current Liabilities (d) Difference between Current Assets and Fixed Assets (c)
Q2	Current assets include only those assets which are expected to be realised within ……………………… (a) 3 months (b) 6 months (c) 1 year (d) 2 years (c)
Q3	On the basis of following data, the Proprietary Ratio of the company will be: Equity share capital ₹10, 00,000; Debentures ₹ 5, 00,000; Statement of Profit & Loss Dr. Balance ₹ 1, 00,000; Current Liabilities ₹ 6, 00,000, Current Assets ₹ 8, 00,000. (a) 70% (b) 50% (c) 45% (d) 75% (c)
Q4	Current Ratio is 1.5:1. Working Capital is 30,000. What will be the amount of current liabilities? (a) 20,000 (b) 60.000 (c) 1,65,000 (d) 1,20,000 (b)
Q5	Capital Employed can be calculated by: (a) Debt + Equity (b) Non-Current Assets + Working Capital (c) Total Assets – Current Liabilities (d) Any of the above (d)
Q6	Net Profit can be greater than Operating Profit when: (a) Cost of Revenue from Operations is more than Operating Expenses (b) Operating Expenses are more than Non-operating Expenses (c) Non-operating Expenses are more than Non-operating Income (d) Non-operating Expenses are less than Non-operating Income (d)
Q7	From the following information, Calculate Return on Investment: Net Profit after Interest and Tax ₹ 4,50,000, 10% Debentures ₹ 15,00,000 Tax @ 10% Capital employed ₹ 2 6,00,000 (a) 17.31% (b) 25% (c) 15.85 (d) 10.98% (b)
Q8	The ideal Current ratio is: (a) 1:2 (b) 2:1 (c) 1:1 (d) 40% (b)

9	Opening Inventory of a firm is ₹ 80,000. Cost of revenue from operation is ₹ 6, 00,000. Inventory Turnover Ratio is 5 times. Its closing inventory will be: (a) ₹ 1,60,000 (b) ₹ 1,20,000 (c) ₹ 80,000 (d) ₹ 2,00,000 (a)

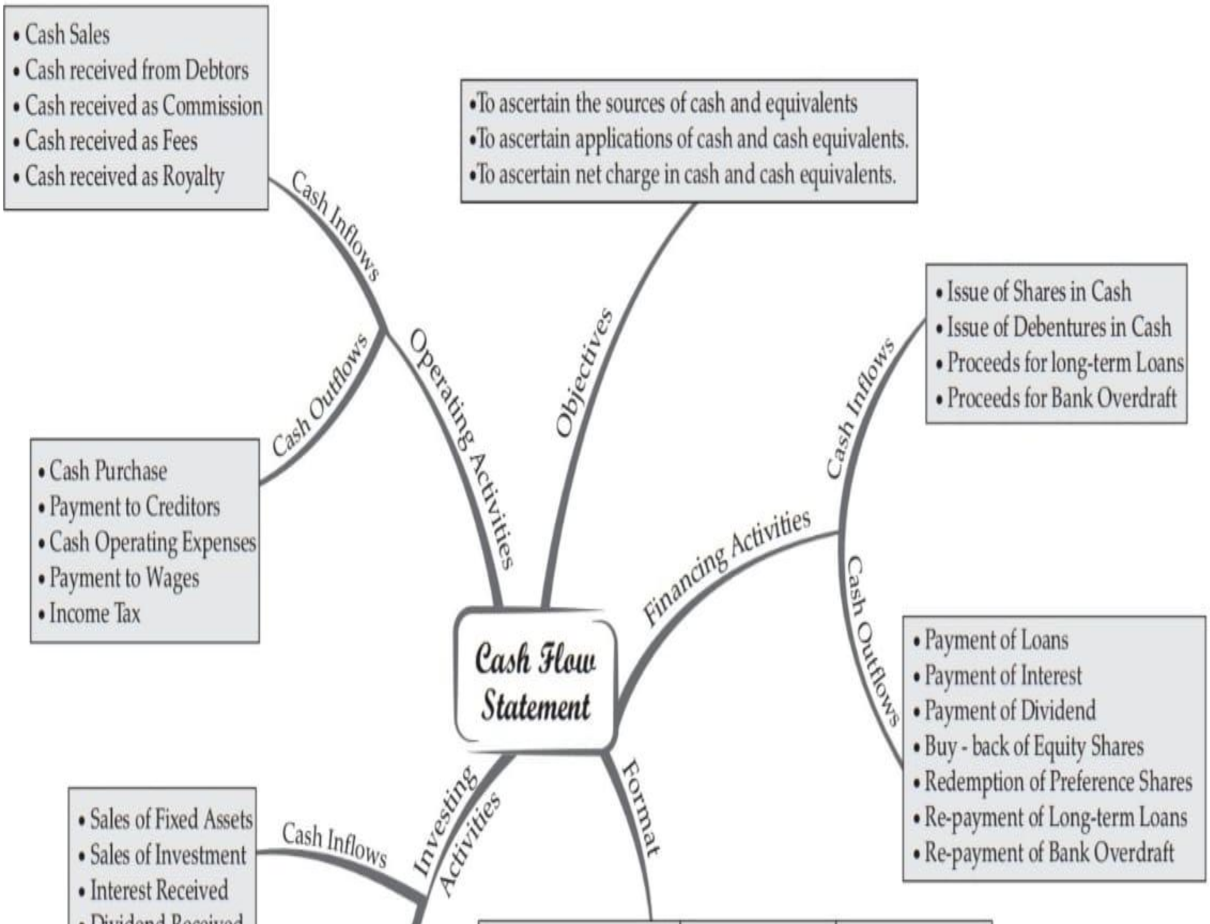
PRACTICE QUESTIONS:-

1.	A company has a Current Ratio of 4:1 and Quick Ratio is 2.5:1. Assuming that the Inventories are ₹ 22,500, find out Total Current Assets and Current Liabilities. **Ans.** Current ratio = 4:1; Quick Ratio = 2.5:1 Inventory = 4 - 2.5 = 1.5 If Inventory is 1.5, then Current Assets = 4 If Inventory = ₹ 22,500, then Current Assets = 4 x ₹ 22,500/1.5 = ₹ 60,000 and the Current Liabilities = ₹ 60,000/ 4 = ₹ 15,000.
2.	From the following, Calculate Stock Turnover Ratio— Net Revenue = ₹ 2, 00,000; Gross Profit = 25%, Opening Inventory = ₹ 5000 Closing Inventory = ₹ 15,000 **Ans.** Inventory Turnover Ratio = Cost of Revenue from Operation/Average inventory = ₹ 1, 50,000/ 10,000 = 15 Times. **Working:** Cost of Revenue= Revenue - Gross Profit Cost of Revenue = ₹ 2, 00,000 – ₹ 50,000 = ₹ 1, 50,000 Average Inventory = $\frac{\text{Opening Inventory + Closing Inventory}}{2}$ = $\frac{₹\,5{,}000 + ₹\,15{,}000}{2}$ = ₹ 20,000/2 = ₹ 10,000
3.	Calculate Gross Profit and Revenue— Average Inventory = ₹ 80,000 Inventory Turnover Ratio = 6 times Selling price = 25% above cost. **Ans.** Inventory Turnover Ratio = Cost of Revenue/Average Inventory 6 = Cost of Revenue/ 80,000 Cost of Revenue = ₹ 80,000 x 6 = ₹ 4,80,000 Gross Profit = ₹ 4,80,000 x 25/100 = ₹ 1,20,000 Revenue = Cost of Revenue + Gross Profit = ₹ 4, 80,000 + ₹ 1, 20,000 = ₹ 6, 00,000.

UNIT- 4

CH-06: CASH FLOW STATEMENT

(MIND MAP)



Particular	Amount	Amount
(A) Net cash flow from operating Activities	-	
(B) Net cash flow from Financing Activities	-	
(C) Net cash flow from Investing Activities	-	
Net cash flow from A + B + C, activities	-	

MEANING OF CASH FLOW STATEMENT:-

Cash Flow Statement is a statement that shows the flow of cash & cash equivalents during the period under report.

OBJECTIVES OF CASH FLOW STATEMENT:-

1. To ascertain the sources of cash and cash equivalents under operating, investing & financing activities by the enterprise.
2. To ascertain the applications of cash and cash equivalents under operating, investing & financing activities by the enterprise.
3. To ascertain net change in cash and cash equivalents being the difference between receipts & payments under operating, investing and financing activities between the dates of two balance sheets.

FORMAT OF CASH FLOW STATEMENT

(INDIRECT METHOD) FOR THE YEAR ENDED……………………..

{As per Accounting Standard-3 (Revised)}

Particulars	₹	₹
I. CASH FLOW FROM OPERATING ACTIVITIES		
(A) Net profit before tax and extraordinary items (as per working note)		…..
(B) Add : Items to be added		
*Depreciation	…..	
*Goodwill, Patents and Trademarks amortized	…..	
*Interest on Bank Overdraft/Cash Credit	…..	
*Interest on Borrowings and Debentures	…..	
*Loss on Sale of Fixed Assets	…..	
*Increase in Provision for doubtful debts	…..	…..
		…..
(C) Less : Items to be deducted		
*Interest Income	…..	
*Dividend Income	…..	
*Rental Income	…..	
*Gain on Sale of Fixed Assets	…..	
*Decrease in Provision for doubtful debts	…..	…..
(D) Operating profit before Working Capital changes (A+B-C)		…..
(E) Add : Decrease in Current Assets & Increase in Current Liabilities	…..	
(F) Less : Increase in Current Assets & Decrease in Current Liabilities	…..	…..
(G) Cash generated from Operations (D+E-F)	…..	…..
(H) Less : Income tax paid (Net of tax refund)	…..	
Cash flow before Extraordinary items		…..
*Extraordinary items (+/-)		----
Cash Flow From (or Used in) Operating Activities		

II. <u>CASH FLOW FROM INVESTING ACTIVITIES</u>		
● Proceeds from sale of fixed assets	…..	
● Proceeds from sale of investments (other than Current Investments to be included in cash & cash equivalents and Marketable Securities)	…..	
● Proceeds from sale of intangible assets	…..	
● Interest and Dividend received (for non-financial companies Only)	…..	
● Rent received	…..	
● Payment for Purchase of Fixed Assets	(…..)	
● Payment for Purchase of Investments (Other than Marketable Securities)	(…..)	
● Payment for purchase of intangible assets like goodwill	(…..)	
● Extraordinary items (e.g. Insurance Claim on machinery against fire) (+/-)	(…..)	
Cash Flow From (or used in) Investing Activities		.-.-.-.
III. <u>CASH FLOW FROM FINANCING ACTIVITIES</u>		
● Proceeds from Issue of Shares and Debentures	…..	
● Proceeds from Other Long-term Borrowings	…..	
● Increase/decrease in Bank Overdraft/Cash Credit	…..	
● Payment of Final Dividend	(…..)	
● Payment of Interim Dividend	(…..)	
● Payment of Interest on Debentures and Loans (Short-term and long-term)	(…..)	
● Repayment of Loans	(….)	
● Redemption of Debentures/Preference Shares	(…..)	
● Payment of Share Issue Expenses	(….)	
● Payment for Buy-back of Shares as Extraordinary Activities	(.....)	
● **Cash Flow From (or Used in) Financing Activities**		.-.-.-.
IV. Net Increase/Decrease in cash & Cash Equivalents (I+II+III)		.-.-.-.
V. Add: Cash & Cash Equivalents in the beginning of the year		…..
VI. Cash & Cash Equivalents at the end of the year		…..

WORKING NOTES:

Net Profit Before tax and extraordinary items:

Net Profit as per Statement of Profit & Loss or difference between closing balance & opening balance of surplus i.e., balance in statement of profit & loss

Add: + Transfer to Reserves.
+ Proposed Dividend for current year.
+ Interim Dividend paid during the year.
+ Provision for Tax for the current year.
+ Extraordinary Items, if any, Debited to the Statement of Profit & Loss.

Less: - Extraordinary Items, if any, Credited to the Statement of Profit & Loss.
- Refund of Tax Credited to the Statement of Profit & Loss.

Net Profit Before Tax and Extraordinary Items.

NOTES:

1. Amounts in brackets mean amounts that are to be deducted.
2. Increase/ Decrease in unpaid interest on debentures/ loans affect Cash Flow from Financing Activities.
3. Increase/ Decrease in Unclaimed dividend affect Cash Flow from Financing Activities.
4. Increase/ Decrease in Accrued interest on investments affects Cash Flow from Investing Activities.

ASCERTAINING MISSING AMOUNTS OF FIXED ASSETS OR DEPRECIATION:-

Case 1 : When fixed asset is shown at written down value.

Under this case, depreciation is credited to the Assets Account & balance of the asset account shows the written down value of the asset, which is also called the book value.

Dr. **Fixed Asset A/c (at Written Down Value)** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	xxx	By Bank A/c (Sale of Fixed Asset)	xxx
To Profit/Gain on Sale of Fixed Assets (Statement of Profit & Loss)*	xxx	By Loss on Sale of Asset A/c (Statement of Profit &Loss)*	xxx
To Bank A/c. (Purchase)	xxx	By Accumulated Depreciation A/c (Accumulated depreciation on fixed asset sold)	xxx
		By Balance c/d.	xxx
	xxxx		xxxx

Note : Purchase of fixed asset is a balancing amount on the debit side of the account and sale of fixedasset on the credit side of the account.

Dr. **Accumulated Depreciation A/c** **Cr.**

Particulars	₹	Particulars	₹
To Fixed Assets A/c(Accumulated depreciation on fixed asset) (Statement of Profit & Loss)*	xxx	By Balance b/d	xxx
To Balance c/d	xxx	By Depreciation A/c (Current Year)	xxx
	xxxx		xxxx

Note : Accumulated depreciation on the fixed asset sold or depreciation charged for the current accounting year may not be given, which shall be the balancing figure

ASCERTAINING MISSING FIGURES

(E.G. PURCHASE, SALE AND GAIN OR LOSS ON SALE RELATED TO INVESTMENTS)

Dr. **Investment Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	xxx	By Bank A/c. (Sale of Investment)	xxx
To Profit/Gain on Sale of Investment (Statement of Profit & Loss A/c)*	xxx	By Loss on sale of asset A/c. (Statement of Profit & Loss A/c)*	xxx
To Bank A/c. (Purchase)	xxx	By Balance c/d.	xxx
	xxxx		**xxxx**

PRACTICE QUESTIONS:-

(1) While preparing cash flow statement what type of activity is payment of cash to acquire Debentures by an investment company?
Hint: - Operating Activity.

(2) State how cash flow statements are historical in nature?
Hint: - Cash flow statement is historical in nature because it is prepared on the Profit and Loss A/c and Balance sheet, which is based on past transactions.

(3) Under which type of activity will you classify 'Issue of Equity Shares at Premium' while preparing cash flow statement?
Hint: - Financing Activity.

(4) Give any two transactions which result into Inflow of cash.
Hint: - Sale of goods for cash and cash received from trade receivables.

(5) Give an example of the activity which remains financing activity for every enterprise.
Hint: - Payment of dividend on shares.

(6) When is dividend received considered as Operating Activity?
Hint:- Dividend received in case of a finance company is considered as an Operating Activity.

(7) When is interest received considered as Financing Activity?
Hint: - Interest received on calls- in- arrear by a company is considered as Financing Activity.

(8) Dividend paid by a trading or manufacturing company is classified under which activity while preparing Cash Flow Statement?
Hint: - Financing Activity.

(9) Interest paid by an investment company will come under which kind of activity while preparing Cash Flow Statement?
Hint: - Operating Activity.

(10) Under which type of activity will you classify 'Commission & Royalty received' while preparing Cash Flow Statement?
Hint: - Operating Activity.

(11) Under which type of activity will you classify interest paid on long-term borrowings while preparing Cash Flow Statement?
Hint: - Financing activity.

(12) Interest received by a finance company is classified under which kind activity while preparing a Cash Flow Statement.

(13) State why Cash Flow Statement is not a substitute for Income Statement?
Hint: - Because Cash Flow Statement shows only the Inflows and Outflows of cash as Incomes Statement shows both Cash and Non-cash items of Revenue nature and shows the Net Income duringthe year.

(14) State whether the payment of cash to trade payables will result in Inflow, Outflow or No flow of Cash.
Hint: - Outflow.

(15) State whether depreciation charged by a company will result in Inflow, Outflow or No flow of Cash.
Hint:- No flow.

More Questions:-

1. Calculate Cash Flow from Operating Activities from the following :

Profit made during the year ₹ 2, 50,000 after considering the following items:

Depreciation on fixed assets	₹ 10,000
Amortization of goodwill	₹ 5,000
Loss on sale of machinery	₹ 7,000
Profit on sale of land	₹ 3,000

Additional information:-

Particulars	**31/03/2013 (₹)**		**31/03/2012 (₹)**
Trade receivables	23,000		22,000
Trade payables	10,000		15,000
Prepaid expenses	4,000		6,000

Solution: **Calculation of Cash flows from Operating Activities**

Particulars	**Details (₹)**	**Amt. (₹)**
Net Profit		2,50,000
Adjust Non-Cash and Non-Operating Items:		
Add - Depreciation	10,000	
Amortization of Goodwill	5,000	
Loss on Sale of Machinery	7,000	
Less - Profit on Sale of Land	(3,000)	19,000
Operating Profit Before Working Capital Changes		2,69,000
Add - Decrease in CA & Increase in CL		
Prepaid Expenses	2,000	2,000
Less - Increase in CA & Decrease in CL		
Trade Receivables	(1,000)	
Trade Payables	(5,000)	(6,000)
Cash flows from Operating activities		**2,65,000**

2. Following are the Balance Sheets of XYZ Ltd., as on 31st March, 2021 and 2022

Particulars	Note No.	2020-21 (₹)	2021-22 (₹)
EQUITY AND LIABILITIES			
(1) Shareholder's Funds			
(a) Share capital		14,00,000	10,00,000
(b) Reserves & Surplus		5,00,000	4,00,000
(2) Non Current Liabilities			
Long Term borrowings		6,00,000	2,00,000
(3) Current Liabilities			
Short Term Provision (Proposed Dividend)		80,000	60,000
Total		**16,60,000**	**25,80,000**
ASSETS			
(1) Non Current Assets			
(a) Fixed assets			
(i) Tangible assets		16,00,000	9,00,000
(ii) Intangible assets		1,40,000	2,00,000
(2) Current Assets			
(a) Inventories		2,50,000	2,00,000
(b) Trade Receivables		5,00,000	3,00,000
(c) Cash & Cash equivalents		90,000	60,000
Total		**16,60,000**	**25,80,000**

Prepare a Cash Flow Statement after taking into account the following adjustments:
Depreciation provided on machinery during the year ₹ 2, 00,000.

Solution: **Cash Flow Statement**

(A) Cash Flows From Operating Activities

Particulars	Details (₹)	Amt. (₹)
Net Profit		1,00,000
Add: Proposed dividend		80,000
Net Profit Before Tax and Dividend		**1,80,000**
Adjust non-cash and non-operating items:		
Add- Depreciation	2,00,000	
Amortization of Intangible assets	60,000	2,60,000
Operating Profit Before Working Capital Changes		4,40,000
Add- Decrease in CA & Increase in CL		

Less- Increase in CA & Decrease in CL		
Inventories	(50,000)	
Trade Receivables	(2,00,000)	2,50,000
Cash flow from Operating activities		**1,90,000**
B) Cash Flows From Investing Activities		
Purchase of Tangible Assets		9,00,000
Cash Used in Investing Activities		**(9,00,000)**
C) Cash Flows From Financing Activities		
Proceed from Issue of Shares	4,00,000	
Proceed From Issue Of Debentures	4,00,000	
Dividend Paid	(60,000)	7,40,000
Cash Flows From Financing Activities		**7,40,000**
Net Increase in Cash Flows (A + B + C= 190,000 + (9,00,000) + 740,000)		30,000
Add: Opening Balance of Cash and Cash Equivalents		60,000
Closing Balance of Cash and Cash Equivalents		**90,000**

Working note:

Purchase of Tangible Assets:

Dr. **Tangible Assets A/c** **Cr.**

Particulars	**Amt. (₹)**	**Particulars**	**Amt. (₹)**
To Balance b/d	9,00,000	By Depreciation	2,00,000
To Bank A/c (Purchase)	9,00,000	By Balance b/d	16,00,000
	18,00,000		**18,00,000**

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