



केन्द्रीय विद्यालय संगठन  
KENDRIYA VIDYALAYA SANGATHAN



**शिक्षा एवं प्रशिक्षण का आंचलिक संस्थान, चंडीगढ़**  
**ZONAL INSTITUTE OF EDUCATION AND TRAINING, CHANDIGARH**

**अध्ययन सामग्री /Study Material**

**शैक्षिक सत्र /Session - 2022-23**

**कक्षा / Class – बारहवीं / XII**

**विषय / Subject - लेखांकन/ ACCOUNTANCY**

**विषय कोड / Subject Code - 055**

**तैयारकर्ता - सेवाकालीन प्रशिक्षण पाठ्यक्रम के प्रतिभागियों (पी. जी. टी वाणिज्य) द्वारा.**

**Prepared by: Participants of In-service Course (PGT Commerce).**

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## निदेशक महोदय का संदेश



विद्यार्थियों की शैक्षिक प्रगति को ध्यान में रखते हुए उपयोगी अध्ययन सामग्री उपलब्ध कराना हमारा महत्वपूर्ण उद्देश्य है। इससे न केवल उन्हें अपने लक्ष्य को प्राप्त करने में सरलता एवं सुविधा होगी बल्कि वे अपने आंतरिक गुणों एवं अभिरुचियों को पहचानने में सक्षम होंगे। बोर्ड परीक्षा में अधिकतम अंक प्राप्त करना हर एक विद्यार्थी का सपना होता है। इस संबंध में तीन प्रमुख आधार स्तंभों को एक कड़ी के रूप में देखा जाना चाहिए- अवधारणात्मक स्पष्टता, प्रासंगिक परिचितता एवं आनुप्रयोगिक विशेषज्ञता।

राष्ट्रीय शिक्षा नीति 2020 के उद्देश्यों की मूलभूत बातों को गौर करने पर यह तथ्य स्पष्ट है कि विद्यार्थियों की सोच को सकारात्मक दिशा देने के लिए उन्हें तकनीकी आधारित समेकित शिक्षा के समान अवसर उपलब्ध कराए जाएँ। बोर्ड की परीक्षाओं के तनाव और दबाव को कम करने के उद्देश्य को प्रमुखता देना अति आवश्यक है।

यह सर्वमान्य है कि छात्र-छात्राओं का भविष्य उनके द्वारा वर्तमान कक्षा में किए गए प्रदर्शन पर ही निर्भर करता है। इस तथ्य को समझते हुए यह अध्ययन सामग्री तैयार की गई है। उम्मीद है कि प्रस्तुत अध्ययन सामग्री के माध्यम से वे अपनी विषय संबंधी जानकारी को समृद्ध करने में अवश्य सफल होंगे।

शुभकामनाओं सहित।

मुकेश कुमार  
उपायुक्त एवं निदेशक

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# SYLLABUS

## ACCOUNTANCY (Code No. 055)

### Class-XII (2022-23)

*Theory: 80 Marks*

*3 Hours*

**Project: 20 Marks**

Units		Periods	Marks
<b>Part A</b>	<b>Accounting for Partnership Firms and Companies</b>		
	Unit 1. Accounting for Partnership Firms	105	36
	Unit 2. Accounting for Companies	45	24
		<b>150</b>	<b>60</b>
<b>Part B</b>	<b>Financial Statement Analysis</b>		
	Unit 3. Analysis of Financial Statements	30	12
	Unit 4. Cash Flow Statement	20	8
		<b>50</b>	<b>20</b>
<b>Part C</b>	<b>Project Work</b>	20	20
	Project work will include:		
	Project File	4 Marks	
	Written Test	12 Marks (One Hour)	
	Viva Voce	4 Marks	
<b>Or</b>			
<b>Part B</b>	<b>Computerized Accounting</b>		
	Unit 4. Computerized Accounting	50	20
<b>Part C</b>	<b>Practical Work</b>	20	20
	Practical work will include:		
	Practical File	4 Marks	
	Practical Examination	12 Marks (One Hour)	
	Viva Voce	4 Marks	

## Part A: Accounting for Partnership Firms and Companies

### Unit 1: Accounting for Partnership Firms

Units/Topics	Learning Outcomes
<ul style="list-style-type: none"> <li>• Partnership: features, Partnership Deed.</li> <li>• Provisions of the Indian Partnership Act 1932 in the absence of partnership deed.</li> <li>• Fixed v/s fluctuating capital accounts. Preparation of Profit and Loss Appropriation account- division of profit among partners, guarantee of profits.</li> <li>• Past adjustments (relating to interest on capital, interest on drawing, salary and profit sharing ratio).</li> <li>• Goodwill: meaning, nature, factors affecting and methods of valuation - average profit, super profit and capitalization.</li> </ul> <p><i>Note: Interest on partner's loan is to be treated as a charge against profits.</i></p> <p>Goodwill: meaning, factors affecting, need for valuation, methods for calculation (average profits, super profits and capitalization), adjusted through partners capital/ current account or by raising and writing off goodwill (AS 26)</p> <p><b>Accounting for Partnership firms - Reconstitution and Dissolution.</b></p> <ul style="list-style-type: none"> <li>• <b>Change in the Profit Sharing Ratio</b> 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.</li> </ul> <p><b>Admission of a partner</b> - effect of admission of a partner on change in the profit sharing ratio, treatment of goodwill</p>	<p><b>After going through this Unit, the students will be able to:</b></p> <ul style="list-style-type: none"> <li>• state the meaning of partnership, partnership firm and partnership deed.</li> <li>• describe the characteristic features of partnership and the contents of partnership deed.</li> <li>• discuss the significance of provision of Partnership Act in the absence of partnership deed.</li> <li>• differentiate between fixed and fluctuating capital, outline the process and develop the understanding and skill of preparation of Profit and Loss Appropriation Account.</li> <li>• develop the understanding and skill of preparation profit and loss appropriation account involving guarantee of profits.</li> <li>• develop the understanding and skill of making past adjustments.</li> <li>• state the meaning, nature and factors affecting goodwill.</li> <li>• develop the understanding and skill of valuation of goodwill using different methods.</li> <li>• state the meaning of sacrificing ratio, gaining ratio and the change in profit sharing ratio among existing partners.</li> <li>• develop the understanding of accounting treatment of revaluation assets and reassessment of liabilities and treatment of</li> </ul>

(as per AS 26), treatment for revaluation of assets and re-assessment of liabilities, treatment 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).

(ii) In case, the realization expenses are borne by a partner, clear indication should be given regarding the payment thereof.

reserves and accumulated profits by preparing revaluation account and balancesheet.

- 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
<p><b>Accounting for Share Capital</b></p> <ul style="list-style-type: none"> <li>• Features and types of companies Share and share capital: nature and types.</li> <li>• 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.</li> <li>• Concept of Private Placement and Employees Stock Option Plan (ESOP), Sweat Equity.</li> <li>• Accounting treatment of forfeiture and re-issue of shares.</li> <li>• Disclosure of share capital in the Balance Sheet of a company.</li> </ul> <p><b>Accounting for Debentures</b></p> <ul style="list-style-type: none"> <li>• 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.</li> </ul> <p>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)</p>	<p><b>After going through this Unit, the students will be able to:</b></p> <ul style="list-style-type: none"> <li>• state the meaning of share and share capital and differentiate between equity shares and preference shares and different types of share capital.</li> <li>• understand the meaning of private placement of shares and Employee Stock Option Plan.</li> <li>• explain the accounting treatment of share capital transactions regarding issue of shares.</li> <li>• develop the understanding of accounting treatment of forfeiture and re-issue of forfeited shares.</li> <li>• describe the presentation of share capital in the balance sheet of the company as per schedule III part I of the Companies Act 2013.</li> <li>• explain the accounting treatment of different categories of transactions related to issue of debentures.</li> <li>• develop the understanding and skill of writing of discount / loss on issue of debentures.</li> <li>• understand the concept of collateral security and its presentation in balance sheet.</li> <li>• develop the skill of calculating interest on debentures and its accounting treatment. state the meaning of redemption of debentures.</li> </ul>



## Part B: Financial Statement Analysis

### Unit 3: Analysis of Financial Statements

Units/Topics	Learning Outcomes
<p><b>Financial statements of a Company:</b></p> <ul style="list-style-type: none"> <li>• 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)</li> </ul> <p><i>Note: Exceptional items, extraordinary items and profit (loss) from discontinued operations are excluded.</i></p> <ul style="list-style-type: none"> <li>• <b>Financial Statement Analysis: Meaning, Significance</b> Objectives, importance and limitations.</li> <li>• <b>Tools for Financial Statement Analysis:</b> Cash flow analysis, ratio analysis.</li> <li>• <b>Accounting Ratios:</b> Meaning, Objectives, Advantages, classification and computation.</li> <li>• <b>Liquidity Ratios:</b> Current ratio and Quick ratio.</li> <li>• <b>Solvency Ratios:</b> Debt to Equity Ratio, Total Asset to Debt Ratio, Proprietary Ratio and Interest Coverage Ratio. Debt to Capital Employed Ratio.</li> <li>• <b>Activity Ratios:</b> Inventory Turnover Ratio, Trade Receivables Turnover Ratio, Trade Payables Turnover Ratio, Fixed Asset Turnover Ratio, Net Asset Turnover Ratio and Working Capital Turnover Ratio.</li> <li>• <b>Profitability Ratios:</b> Gross Profit Ratio, Operating Ratio, Operating Profit Ratio, Net Profit Ratio and Return on Investment.</li> </ul>	<p><b>After going through this Unit, the students will be able to:</b></p> <ul style="list-style-type: none"> <li>• 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.</li> <li>• state the meaning, objectives and limitations of financial statement analysis.</li> <li>• discuss the meaning of different tools of 'financial statements analysis'.</li> <li>• state the meaning, objectives and significance of different types of ratios.</li> <li>• develop the understanding of computation of current ratio and quick ratio.</li> <li>• develop the skill of computation of debt equity ratio, total asset to debt ratio, proprietary ratio and interest coverage ratio.</li> <li>• develop the skill of computation of inventory turnover ratio, trade receivables and trade payables ratio and working capital turnover ratio and others.</li> <li>• develop the skill of computation of gross profit ratio, operating ratio, operating profit ratio, net profit ratio and return on investment.</li> </ul>

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

#### ***Unit 4: Cash Flow Statement***

<b>Units/Topics</b>	<b>Learning Outcomes</b>
<p>Meaning, objectives Benefits, Cash and Cash Equivalents, Classification of Activities and preparation (as per AS 3 (Revised) (Indirect Method only)</p> <p><b>Note:</b></p> <p>(i) <i>Adjustments relating to depreciation and amortization, profit or loss on sale of assets including investments, dividend (both final and interim) and tax.</i></p> <p>(ii) <i>Bank overdraft and cash credit to be treated as short term borrowings.</i></p> <ul style="list-style-type: none"><li>• <i>Current Investments to be taken as Marketable securities unless otherwise specified.</i></li></ul>	<p><b>After going through this Unit, the students will be able to:</b></p> <ul style="list-style-type: none"><li>• state the meaning and objectives of cash flow statement.</li><li>• develop the understanding of preparation of Cash Flow Statement using indirect method as per AS 3 with given adjustments.</li></ul>

**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 shareholder*

#### **Project Work:-**

**Note:** Kindly refer to the Guidelines published by the CBSE. The comprehensive project may contain simple GST calculations.

**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 and loss account with closing entries and opening entries.
- Need and security features of the system.

**Part C: Practical Work**

Please refer to the guidelines published by CBSE.

***Prescribed Books:***

Financial Accounting -I	Class XI	NCERT Publication
Accountancy –I	Class XI	NCERT Publication
Accountancy -I	Class XII	NCERT Publication
Accountancy -II	Class XII	NCERT Publication
Accountancy – Computerised Accounting System	Class XII	NCERT Publication

Guidelines for Project Work in Accounting and Practical work in computerised Accounting Class XII CBSE  
Publication

## Suggested Question Paper Design Accountancy

(Code No. 055)

Class XII (2022-23)

*Theory: 80 Marks*

*3 hrs*

**Project: 20 Marks**

SNo.	Typology of Questions	Marks	Percentage
1	<b>Remembering and Understanding:</b> 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	<b>Applying:</b> Solve problems to new situations by applying acquired knowledge, facts, techniques and rules in a different way.	19	23.75%
4	<b>Analysing, Evaluating and Creating:</b> 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%
	<b>TOTAL</b>	<b>80</b>	<b>100%</b>

## **Ch-01: Accounting for Partnership Firms-Fundamental**

### **Meaning and Definition of Partnership**

According to Section 4 of the Partnership Act 1932 “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

- 1) Association of two or more persons:- Minimum-2 & maximum-50 members
- 2) Partnership Agreement or Deed
- 3) Legal Business
- 4) Sharing of Profits or Losses in a certain ratio.
- 5) Mutual Agency
- 6) Unlimited Liability: Partners' liability to the third parties is unlimited.

**Partnership Deed:** The document, which contains terms of the agreement, 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 and entitlement of partners to interest on capital, interest on loan, etc.

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

- a) *Profit Sharing Ratio*:- If the partnership deed is silent about the profit sharing ratio, the profits and losses of the firm are to be shared equally by partners
- b) *Interest on Capital*: - No interest on capital is payable if the partnership deed is silent on the issue.
- c) *Interest on Drawings*: - No interest is to be charged on the drawings made by the partners, if there is no mention in the Deed.
- d) *Interest on Advances*: - If any partner has advanced some money to the firm beyond the amount of his capital for the purpose of business, he shall be entitled to get an interest on the amount @ 6% p.a.
- e) *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.

### **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. P/L 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 apart of 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 Alc may have Dr. or Cr. balance.

Dr.		Partners Capital A/c		Cr.	
Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To Bank(permanent withdrawal)	xxx	xxx	By bal·b/d	xxx	xxx
To bal cld	xxx	xxx	By Bank (additional Cap)	xxx	xxx
	<b>xxxx</b>	<b>xxxx</b>		<b>xxxx</b>	<b>xxxx</b>

Dr.		Partners Current A/c		Cr.	
Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To bal b/d (if Dr bal)	xxx	xxx	By bal. b/d (if cr bal)	xxx	xxx
To Drawings	xxx	xxx	By Int on capital	xxx	xxx
To Int on drawings	xxx	xxx	By Salary	xxx	xxx
To P/L APP(share of loss)	xxx	xxx	By Commission	xxx	xxx
To bal c/d (in case of cr.bal.	xxx	xxx	By P/L App (Share of Profit)	xxx	xxx
			By bal c/d (incase of dr. bal.	xxx	xxx
	<b>xxxx</b>	<b>xxxx</b>		<b>xxxx</b>	<b>xxxx</b>

**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.

### Partners Capital A/c

Dr.

Cr.

Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To bal b/d (if Dr bal)	xxx	xxx	By bal. bld (if cr bal)	xxx	xxx
To Bank(permanent withdrawal)	xxx	xxx	By Bank (additional Cap)	xxx	xxx
To Drawings	xxx	xxx	By Int on capital	xxx	xxx
To Int on drawings	xxx	xxx	By Salary	xxx	xxx
To P/LAPP(share of loss)	xxx	xxx	By Commission	xxx	xxx
To bal c/d (incase of cr. bal.	xxx	xxx	By P/L App (Share of Profit)	xxx	xxx
			By bal c/d (incase of dr. bal.	xxx	xxx
	xxxx	xxxx		xxxx	xxxx

### Difference between fixed and fluctuating Capital method

BASIS	FIXED CAPITAL	FLUCTUATING CAPITAL
Number of Accounts	2 Separate A/c are prepared.	Only 1 A/c is prepared.
Adjustment	All adjustments are made in Current A/c	All adjustments are made in Capital A/c
Fixed Balance	The capital remains unchanged unless there is addition or withdrawal of Cap.	The balance of capital fluctuates from year to year
Credit Balance	Capital A/c always shows Cr balance.	Capital A/c may Show Dr or Cr. bal.

#### Distribution of profits among Partners

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

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



**Profit and Loss Appropriation A/c for the year ended \_\_\_\_**

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	xxx	By Interest on drawings	xxx
To salary	xxx	To Partners Cap/Current A/c (share of losses)	xxx
To commission	xxx		
To Partners Cap/Current A/c (share of profit)	xxx		
	xxxxx		xxxxx

★ Interest on loan is a charge against profits.

**Calculation of Interest on Drawings**

S.No	Situation	Formula
1	When varying amounts are withdrawn at different intervals	Interest is calculated through Product method and given for 1 month Total product X R/100 X 1/12
2	When fixed amount is withdrawn a) At the beginning of each month b) At the end of each month c) During the month or mid of each month	a) Total drawings X R/100 X 6.5/12 b) Total drawings X R/100 X 5.5/12 c) Total drawings X R/100 X 6/12
3	When fixed amount is withdrawn	a) Total drawings X R/100 X 7.5/12
	a) In the beginning of each quarter b) In the end of each quarter	b) Total drawings X R/100 X 4.5/12
4	When fixed amount is withdrawn a) In the beginning of each half year b) In the end of each half year	a) Total drawings X R/100 X 9/12 b) Total drawings X R/100 X 3/12

**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 Capital Accounts of the affected partners by passing (A) an adjustment entry, or (B) Adjusting entries.

Particulars	A(₹)	B(₹)	C(₹)	Firm(₹)
+ Interest on Capital	+	+	+	-
+ Partner's Salary/Commission	+	+	+	-
- Interest on Drawings	-	-	-	+
	+	+	+	-
<b>Excess profit taken back in their P &amp; L Sharing Ratio</b>	-	-	-	
	+	-	+	

+ means Cr. the Partner's Capital A/c

- means Dr. the Partner's Capital A/c.

### **Guarantee of Profit to a Partner**

Guarantee of profit means a minimum amount of profit to be paid to a partner. This amount shall be given to him if 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, he will be given his actual share of profit. 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. Work out the amount of deficiency by comparing it with the guaranteed amount and his actual share of profit. The other partners will bear the deficiency in an agreed new ratio.

Q. X, Y and Z share profit in the ratio of 2:3:5. They earned a profit of ₹ 1,50,000 for the year ended 31/12/2022. The profit was by mistake distributed among X, Y and Z in the ratio of 3:2:1, respectively. This error was noted in the beginning of the new year.

Pass necessary adjustment entry.

Particulars	X (₹)	Y (₹)	Z (₹)	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 in correct ratio Cr.	+30,000	+45,000	+75,000	1,50,000

Adjustment required	Dr.	-45,000	-5,000	+50,000	
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**Pass necessary adjustment entry**

X's capital A/c Dr 45,000  
 Y's capital A/c Dr 5,000  
 To Z'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% per annum.

**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 at the rate of 6% p.a. would be charged on the drawings made by the partner.

**Interest on Capital & Interest on Drawings:-**

3. A and B are partners sharing profits and losses in the ratio of 3:2. Their capital accounts showed balances of ₹1,50,000 and ₹ 2,00,000 respectively on Jan 01, 2003. Show the treatment of interest on capital for the year ending December 31, 2006 in each of the following alternatives:

- (a) If the partnership deed is silent as to the payment of interest on capital and 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 and Sohan are partners with capitals of ₹ 5, 00,000, ₹ 2, 50,000 and ₹ 2, 00,000 respectively. After providing interest on capital @10% p.a. the profits are divisible as follows:

Ram 1/2, Mohan 1/3 and 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 March 31, 2016 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 31<sup>st</sup> March, 2021 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 QUESTION:-

1. 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]

2. 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]

3. 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]

4. 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]

5. 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]

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. 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]

8. If the partner carries on the business that is similar to firm competition with the firm and 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]

9. 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]

10. A, B, and 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]

11. Goodwill is

- (a) Tangible asset
- (b) Intangible asset
- (c) Fictitious asset
- (d) Both (b) & (c) [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 Dr. balance. [F]
7. When a partnership firm gives loan to its partner then interest on loan will be debited in profit and loss account. [T]
8. In case of fixed capital account method drawing out of capital is shown in partner current account. [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]
11. In the absence of partnership deed mutual relations are governed by the Indian partnership act 2013. [T]
12. Capital in the beginning is calculated by subtracting drawing and adding profit distributed. [F]

## **Ch-02: Goodwill: Nature and Valuation:**

**Meaning of Goodwill:-**It is the reputation that helps the business to earn more profits as compared to a newly setup 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 new partner;
3. Amalgamation of partnership firm.
4. Death of a partner and
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 and the earliest year will be given lowest weight. Each profit figure will be multiplied by its weight and 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 Number of years' purchase.**

#### **2. Super Profit Method:-**

Stepwise procedure to calculate Goodwill under this method:

Calculate the average profit,

Calculate the normal profit on the capital employed on the basis of the normal rate of return,

Formula ,  $Normal\ Profit = Capital\ Employed \times NRR / 100$

Calculate the super profits by deducting normal profit from the average profits,

Formula,  $Super\ Profit = Average\ Profit - Normal\ Profit$

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, or (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 capitalised 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

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.*

### **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 and its external liabilities are ₹ 1, 80,000. The normal rate of return is 10%?

*Ans: ₹ 1, 80,000.*

### **ACCOUNTING TREATMENT OF GOODWILL**

#### **GOODWILL TO BE ADJUSTED THROUGH PARTNERS' CAPITAL/CURRENT ACCOUNTS OR BY RAISING AND WRITING OFF GOODWILL.**

#### **CHANGE IN PROFIT-SHARING RATIO AMONG EXISTING PARTNERS:-**

Treatment of existing Goodwill appearing in the Balance Sheet:

#### **Journal entry:**

Old Partners' Capital/Current A/c.....Dr.      (In Old Profit Sharing Ratio)  
    To Goodwill A/c  
(Being the existing goodwill is written off)

**Method 1:** When goodwill is adjusted through Partners' Capital /Current accounts

#### **Journal Entry:**

Gaining Partners Capital/ Current A/c.....Dr.      (In Gaining Ratio)  
    To Sacrificing Partners 'Capital /Current A/c      (In Sacrificing Ratio)



(Being the compensation of gaining partners to Sacrificing partners)

**Method 2:** When Goodwill is raised and Written off:-

Goodwill A/c..... Dr. (Full Revised Value of Goodwill)

To Old Partners' Capital/ Current A/c (In Old Profit Sharing Ratio)

(Being the goodwill raised and credited to Partners Capital accounts in old profit sharing ratio)

All Partners Capital/ Current A/c Dr. (In New Profit Sharing Ratio)

To Goodwill A/c (With value of Goodwill)

(Being the goodwill debited to Partners Capital accounts in New profit sharing ratio)

### MULTIPLE CHOICE QUESTION:-

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 years purchased  
(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) ₹ 1 5,000      [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. The net assets of the firm including fictitious assets of ₹ 5,000 are ₹ 85,000. The net liabilities of the firm are ₹ 30,000. The normal rate of return is 10% & the average profits of the firm are ₹ 8,000. Calculate the goodwill as per capitalization of super profits

- (a) ₹ 20,000      (b) ₹ 30,000  
(c) ₹ 25,000      (d) None of the above

11. 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]

12. The profits earned by a business over the last 5 years are as follows ₹ 12,000; ₹ 13,000; ₹ 14,000; ₹ 18,000 and ₹ 2,000 (loss). Based on 2 years purchase of the last 5 years profits, value of Goodwill will be :

- (a) ₹ 23,600      (b) ₹ 22,000  
(c) ₹ 1,10,000      (d) ₹ 1,18,000      [d]

13. Following are the methods of calculating goodwill except:

- (a) Super Profit method      (b) Average Profit method  
(c) Weighted Average Profit method      (d) Capital Profit method      [d]

**TRUE / FALSE :**

1. Location of business does not affect the goodwill of business. (F)
2. "Average profit method" takes into consideration the future maintainable profits. (T)
3. Goodwill can be sold in part. (F)
4. Purchased goodwill may arise on acquisition of an existing business concern. (T)
5. Self-Generated goodwill is recorded in the books of accounts as some consideration is paid for it. (F)
6. Goodwill is a fictitious asset. (F)
7. Goodwill is valued during dissolution of a firm. (F)
8. In the event of change in profit sharing ratio, General Reserve existing in the Balance Sheet is transferred to capital accounts of partners in their new ratio. (F)

### **Ch-03: Change in profit sharing Ratio Among the Existing Partners**

Any change in existing agreement among partners 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 takes place in any of the 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 among 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 sharing ratio 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 Alc 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 and 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 Alc

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

Revaluation A/c Dr

    To Assets Alc.

(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

    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 Alc

    To Partners Cap / Current A/c

(8) *If there is a loss on revaluation:*

Partners Cap/Current Alc

    To Revaluation A/c

*In case no changes will be made through then adjustment will be made through Capital / Current Alc... are to be recorded*

Gaining Partners Cap / Current A/c Dr.

    To Sacrificing Partner's Cap / Current (In their gain / Sacrificing shares)

#### **Treatment of Goodwill -**

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

Partners Cap/ Current A/c Dr

    To Goodwill A/c

#### **MULTIPLE CHOICE QUESTION:-**

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

Ans. (b)

2. X, Y, Z shared profits as 3:2:1. On January 1, 2010 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.

Ans- (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

Ans- (d)

4. In case of change in profit sharing ratio, workmen compensation reserves existing in the Balance sheet is transferred to Capital Alc 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

Ans. (a)

5. S, T & W were partners in a firm. They admitted V as a new partner. S and T sacrifice  $\frac{1}{3}^{\text{rd}}$  &  $\frac{1}{4}^{\text{th}}$  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

Ans. (b)

## Ch-04: ADMISSION OF 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 that

Purchased 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 value of goodwill may be adjusted by deducting new partners current account and credited in their sacrificing partner's current account in sacrificing ratio

### **Accounting Steps:**

**Step1: Revaluation of Assets and Reassessment of Liabilities.**

**Step2: Treatment of Accumulated Profits or Losses. After welcome of New Partner**

**Step3: New Profit Sharing Ratio and Sacrificing Ratio.**

**Step4: Treatment of Goodwill.**

**Step5: 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 and Old Profit Sharing Ratio. If, firstly these two steps are completed by students then there will be no chance of mistake in accounting treatment.

### **Step1: Revaluation of Assets and Reassessment of Liabilities.**

The Journal Entries recorded for revaluation of assets and reassessment 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's (Old ratio) (Individually)

(h) For transferring loss on revaluation:-

Old Partner's Capital A/c's 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 (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 a 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 he gets 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 does the new partner acquire 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 and Vishal are partners sharing profits in the ratio of 3:2. They admitted Sumit as a new partner for  $\frac{1}{5}$ <sup>th</sup> share in the future profits of the firm. Calculate new profit sharing ratio of Anil, Vishal and Sumit.

**Solution:** Sumit's Share =  $\frac{1}{5}$ ;

Remaining Share  $1 - \frac{1}{5} = \frac{4}{5}$ .

Anil's New Share =  $\frac{4}{5} \times \frac{3}{5} = \frac{12}{25}$

Vishal's New Share =  $\frac{4}{5} \times \frac{2}{5} = \frac{8}{25}$

Sumit's Share =  $1 \times \frac{5}{5} \times \frac{1}{5} = \frac{1}{5}$

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 and Bharati are partners sharing profits in the ratio of 3:2. They admit Dinesh as a new partner for  $\frac{1}{5}$ <sup>th</sup> 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 =  $\frac{1}{5}$  or  $\frac{2}{10}$  ;

Akshay's share =  $\frac{3}{5} - \frac{1}{10} = \frac{5}{10}$

Bharti,s share =  $\frac{2}{5} - \frac{1}{10} = \frac{3}{10}$

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

**Illustration 3:-**

Ram and Shyam are partners in a firm sharing profits in the ratio of 3:2. They admit Ghanshyam as a new partner. Ram surrenders  $\frac{1}{4}$ <sup>th</sup> of his share and Shyam  $\frac{1}{3}$ <sup>rd</sup> of his share in favour of Ghanshyam. Calculate new profit sharing ratio of Ram, Shyam and Ghanshyam.

**Solution:** Ram sacrifice =  $\frac{3}{5} \times \frac{1}{4} = \frac{3}{20}$ ; Shyam sacrifice =  $\frac{2}{5} \times \frac{1}{3} = \frac{2}{15}$ ;

Ram's new share =  $\frac{3}{5} - \frac{3}{20} = \frac{9}{20}$

Shyam's new share =  $\frac{2}{5} - \frac{2}{15} = \frac{4}{15}$

Ghanshyam's new share =  $\frac{3}{20} + \frac{2}{15} = \frac{17}{60}$ .

So, New ratio is 27:16:17.

**Sacrificing Ratio**

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.***

**Step4: Treatment of Goodwill.**

There are different situations relating to the accounting treatment of goodwill at the time of admission of new partner. When a new partner is admitted, goodwill can be treated by –

1) Premium method and , 2) Revaluation method.

All these are given in detail under the following categories:

**1) Premium method:**

This method is followed when the new partner brings his share of goodwill in cash. Amount of



premium (share of goodwill) is shared by old partners in sacrificing ratio.

**Journal:**

a) Cash A/c Dr  
    To Premium for Goodwill A/c  
(Premium brought in by new partner)

b) Premium for Goodwill A/c Dr  
    To Old Partner's Capital A/c  
(Goodwill shared in sacrificing ratio)

**(I) Goodwill paid by the New Partner to the Old Partners privately:**

*No entry will be passed in the books of the firm for premium paid privately.* Entry for cash brought in by him as capital shall only be passed. However if there is any goodwill A/c existing in the balance sheet of old partners before admission, it should be immediately written off among the old partners in old ratio.

**(II) Goodwill paid by new partner retained in business:**

(a) Cash A/c Dr  
    To Premium for Goodwill A/c  
(Premium brought in by New Partner)

(b) Premium for Goodwill A/c Dr  
    To Sacrificing Partner's Capital A/c  
(Goodwill shared in Sacrificing Ratio)

**(III) Goodwill withdrawn by old partners:**

Entries (a) and (b) same as above.

**For withdrawal:**

c) Sacrificing Partner's Capital A/c Dr  
    To Cash A/c

**Treatment of existing Goodwill appearing in the Balance Sheet:**

Existing goodwill to be written off by debiting Old partner's Capital Account in Old Ratio.

**Journal entry:**

Old Partners' Capital A/c.....Dr. (In Old Profit Sharing Ratio)  
    To Goodwill A/c  
(Being the existing goodwill written off)

Eg: A and B are partners sharing profits and losses in the ratio 3:2. They admitted C into partnership for 1/4<sup>th</sup> share. Goodwill of the firm is valued at ₹ 20,000. At the time of C's admission goodwill already appears in the books at ₹ 10,000. C brings ₹ 5,000 as premium.

**For writing off goodwill:**

A's capital A/c Dr       6,000  
B's capital A/c Dr       4,000  
    To Goodwill A/c           10,000  
(Being goodwill written off in old ratio)

However, if partners decide to maintain goodwill account as it is, the new partner is required to bring in as his share of goodwill only in respect of the difference between its total value and the book value. So, in the above case C, the new partner will bring ₹ 2,500 only as premium. [1/4 of ₹ 10,000 (₹ 20,000 - ₹ 10,000)] which will be credited to old partner's A/c in sacrificing ratio.

**2) Revaluation Method:**

This method is followed when the new partner does not bring his share of goodwill in cash. Goodwill account is raised in the books by crediting old partners in old profit sharing ratio. At that time possibilities are:

**(a) No goodwill appears in books at the time of admission.**

**Goodwill account must be raised at its full value:**

Goodwill A/c Dr  
 To Old Partner's Capital A/c

**When the Incoming or New Partner does not bring his share of Goodwill:**

- (i) Goodwill A/c.....Dr. (With Value of Goodwill)  
 To Old Partners' Capital/Current A/c (In old Profit Sharing Ratio)  
 (Being the Goodwill account raised)
- (ii) All Partners Capital/ Current A/c Dr. (In New Profit Sharing Ratio)  
 To Goodwill A/c (With value of Goodwill) (Being the Goodwill account written off)

**When the Incoming or New Partner brings a PART of his share of Goodwill:**

- (i) Premium for Goodwill A/c.....Dr. (With Goodwill brought)  
 New Partner's Current A/c .....Dr. (With unpaid Value of Goodwill)  
 To Sacrificing Partners Capital/Current A/c (In Sacrificing Ratio)  
 (Being the Goodwill transferred in Sacrificing Ratio)

**(b) Goodwill already appears in the books:**

**When goodwill appearing in books is less than the agreed value:**

Goodwill A/c Dr  
 To Old Partner's Capital A/c  
 (Being goodwill raised to its agreed value)

**When goodwill appearing in books is more than agreed value:**

Old Partner's Capital A/c Dr  
 To Goodwill A/c  
 (Being goodwill brought down to its agreed value)

**When the Incoming or New Partner does not bring his share of Goodwill:**

1. Amar and Sachin are partners sharing profits of 3:2. Chetan is admitted as partner w.e.f. 1<sup>st</sup> April 2021 and their new profit sharing ratio is 3:2:1. Goodwill appeared in the books at ₹ 20,000. Goodwill as on the date of admission was valued at ₹1, 80,000. Pass the journal entries giving effect to the arrangement under both the methods.

*First Method:*

<i>Date</i>	<i>Particulars</i>	<i>L</i> <i>F</i>	<i>Debit</i> <i>(₹)</i>	<i>Credit</i> <i>(₹)</i>
(i)	Amar's Capital/ Current A/c Dr. Sachin's Capital/ Current A/c Dr. To Goodwill A/c (Being existing goodwill written off in their Old profit sharing ratio)		12,000 8,000	20,000

<i>Date</i>	<i>Particulars</i>	<i>L</i> <i>F</i>	<i>Debit</i> <i>(₹)</i>	<i>Credit</i> <i>(₹)</i>
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(ii)	Chetan's Capital A/c ...Dr. (1,80,000x1/6) To Amar's Capital/ Current A/c (30,000x3/5) To Sachin's Capital/ Current A/c (30,000x2/5) (Being the goodwill credited to sacrificing partners in their sacrificing ratio)		30,000		18,000 12,000
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**Working Note:**

Calculation of sacrificing ratio Old ratio 3:2 ;

New ratio 3:2:1

Amar  $\frac{3}{5} - \frac{3}{6} = \frac{3}{30}$  (Sac);

Sachin  $\frac{2}{5} - \frac{2}{6} = \frac{2}{30}$  (Sac);

Sacrificing ratio is 3:2

**Second Method:**

Date	Particulars	LF	Debit (₹)	Credit (₹)
(i)	Amar's Capital/ Current A/c Dr. Sachin's Capital/ Current A/c Dr. To Goodwill A/c (Being existing goodwill written off in their Old profit sharing ratio)		12,000 8,000	20,000
(ii)	Goodwill A/c ..Dr. To Amar's Capital/ Current A/c (1,80,000x3/5) To Sachin's Capital/ Current A/c (1,80,000x2/5) (Being the goodwill raised in old profit sharing Ratio)		1,80,000	1,08,000 72,000
(iii)	Amar's Capital/ Current A/c Dr. Sachin's Capital/ Current A/c Dr. Chetan's Capital/ Current A/c Dr. To Goodwill A/c ( Being goodwill written off in New profit sharing Ratio)		90,000 60,000 30,000	1,80,000

**When the Incoming or New Partner brings a PART of his share of Goodwill:**

2. Bharat and Sunil were partners in a firm sharing profits and losses in the ratio of 1:2. On 1<sup>st</sup> April, 2021 Rajiv was admitted as a new partner for  $\frac{1}{4}$ <sup>th</sup> share in the profits. Rajiv's share of goodwill is ₹ 2, 50,000 out of which he bought ₹ 1,00,000.

Pass the necessary Journal Entries when the Goodwill Account is raised for the amount not brought by the incoming partner and is also written off.

**Journal Entries**

- (i) Goodwill A/c Dr. (2,50,000-1,00,000) 1,50,000  
To Bharat's Capital/Current A/c 50,000  
To Sunil's Capital/Current A/c 1,00,000

(Being the goodwill raised for the amount not brought by New Partner and distributed among Sacrificing Partners in Sacrificing Ratio 1:2)

(ii) Rajiv's Capital/ Current A/c      Dr.      1,50,000  
                                 To Goodwill A/c    1,50,000  
 (Being goodwill written off by same amount)

**When New Partner brings his share of goodwill in kind:**

Ex: Supposed there are two partners A and B. C is admitted as new partner.

When new partner brings his share of goodwill in kind				
Date	Particulars	LF	Debit (₹)	Credit (₹)
	<b>If there is any goodwill A/c in the balance sheet of old partners</b>			
	A's Capital A/c      Dr		XXX	
	B's Capital A/c      Dr		XXX	
	To Goodwill A/c			XXXX
	(Being Old Goodwill written off in Old Ratio)			
	Assets A/c      Dr		XXXX	
	To Premium for Goodwill A/c			XXX
	To C's Capital A/c			XXX
	(Being Assets brought in by New Partner for Premium and Capital)			
	Premium for Goodwill A/c      Dr		XXXX	
	To A's Capital A/c			XXX
	To B's Capital A/c			XXX
	(Being Premium amount transferred to Old Partners' Capital A/c's in Sacrificing Ratio)			
	<b>If premium amount withdrawn by old partners</b>			
	A's Capital A/c      Dr		XXX	
	B's Capital A/c      Dr		XXX	
	To Cash/Bank A/c			XXXX

**Hidden Goodwill:**

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

**Example:-** A & B are two partners in 3:2 ratio. Their capitals are ₹ 1, 20,000 and ₹ 1, 00,000 respectively. C is admitted for 1/5<sup>th</sup> share and he is bringing ₹ 80,000 as his capital. Calculate the value of goodwill.

**Solution:**

$$\begin{aligned} \text{Value of Goodwill} &= (\text{C's Capital} \times 5/1) - (\text{A's Capital} + \text{B's Capital} + \text{C's Capital}) \\ &= (\text{₹ } 80,000 \times 5/1) - (\text{₹ } 1, 20,000 + \text{₹ } 1, 00,000 + \text{₹ } 80,000) \\ &= \text{₹ } 4,00, 000 - \text{₹ } 3,00,000 \\ &= \text{₹ } 1, 00,000 \end{aligned}$$

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

\*Note: It means new partner C 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.  
$$\text{Total Capital/New Capital} = \text{New partner's capital} \times \text{Reciprocal of the proportion of his share in profit.}$$
- (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 and 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:  
$$\text{Total Capital of the firm} = \text{Combined adjusted} \times \text{Capital of old partners} \times \frac{\text{Reciprocal of the Combined Proportion of their share of profit}}{\text{Proportion of their share of profit}}$$
- (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 and simple.

#### **MULTIPLE CHOICE QUESTIONS:-**

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 appear at revised values  
 (b) Any profit and loss on 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 be 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 a 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 a 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  $\frac{1}{4}$ 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 contribution then it is termed as :  
 (a) Capital (b) Reserves (c) Profits (d) Premium for Goodwill [d]
10. X and Y are partners sharing profits and losses in the ratio of 3:2. Z is admitted for  $\frac{1}{5}$ 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 and B are partners sharing profits in the ratio of 7:3. C is admitted as a new partner. A gave  $\frac{1}{7}$ th of his share and B gave  $\frac{1}{3}$ 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 and Y share profits and losses in the ratio of 4:3. They admit Z in the firm for  $\frac{3}{7}$ th share which he gets  $\frac{2}{7}$ th from X and  $\frac{1}{7}$ 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 and B are partners, sharing profits in the ratio of 5: 3. They admit C for  $\frac{1}{5}$ <sup>th</sup> 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 and C share profits and Losses in the ratio, of 3 : 2 : 1. D is admitted for  $\frac{1}{6}$ <sup>th</sup> 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 and B are partners sharing profits in the ratio of 3:2. On admission of C for  $\frac{1}{5}$ <sup>th</sup> 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 and 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 and S are partners sharing profits in the ratio of 5:3. T joins the firm and R gives him  $\frac{1}{4}$ <sup>th</sup> of his share and S gives  $\frac{1}{5}$ <sup>th</sup> 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 and C are partners haring profits in ratio of 3:2:1. They admit D as partner in the firm. A, B and C give  $\frac{1}{3}$ <sup>rd</sup>,  $\frac{1}{6}$ <sup>th</sup> &  $\frac{1}{9}$ <sup>th</sup> share of their respective profits. The share of profit of D will be:  
 (a)  $\frac{1}{10}$       (b)  $\frac{13}{54}$       (c)  $\frac{12}{54}$       (d)  $\frac{10}{55}$       [b]
19. A and B are partners sharing profits in ratio of 3:2. A's Capital is ₹ 30,000 and B's Capitalis ₹ 15,000. They admit C for  $\frac{1}{5}$ <sup>th</sup> share of profits. C will bring as his capital:-  
 (a) ₹ 9,000      (b) ₹ 12,000      (c) ₹ 14,500      (d) ₹ 11,250      [d]
20. X and Y are partners Z is admitted as partner for  $\frac{1}{7}$ <sup>th</sup> share. New Profit sharing Ratio will be  
 (a) 2:3:1      (b) 3:3:1      (c) 6:5:2      (d) 1:1:1      [b]
21. A and B share profits equally. They admit C for  $\frac{1}{7}$ <sup>th</sup> share. New Profit sharing Ratio of Aand B is: (a)  $\frac{4}{7}$ ,  $\frac{1}{7}$       (b)  $\frac{3}{7}$ ,  $\frac{3}{7}$       (c)  $\frac{2}{7}$ ,  $\frac{2}{7}$       (d)  $\frac{2}{7}$ ,  $\frac{4}{7}$ .      [b]
22. A and B are partners C is admitted for  $\frac{1}{5}$ <sup>th</sup> share. C brings ₹ 1, 20,000 as his share in Capital. Net worth of the firm is:  
 (a) ₹ 1,00,000      (b) ₹ 4,00,000      (c) ₹ 1,20,000      (d) ₹ 6,00,000      [d]
23. A and B share profits in the ratio of 3:4. C is admitted for  $\frac{1}{5}$ <sup>th</sup> share. New Profit-sharing ratio will be  
 (a) 3:4:1      (b) 12:16:7      (c) 16:12:7      (d) 12:6 :7      [b]

**Practical Questions:-**

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

2. P and Q are partners sharing profits in 2:1 ratio. They admitted R into partnership giving him  $\frac{1}{5}$ <sup>th</sup> share which he acquired from P and Q in 1:2 ratio. Calculate new profit sharing ratio. (Ans- 3:1:1)
3. Sandeep and Navdeep are partners in a firm sharing profits in 5:3 ratios. They admit C into the firm and the new profit sharing ratio was agreed at 4:2:1. Calculate the sacrificing ratio? (Ans- 1:1)

**Goodwill**

4. Amar and Samar were partners in a firm sharing profits and losses in 3:1 ratio. They admitted Kanwar for  $\frac{1}{4}$  share of profits. Kanwar could not bring his share of goodwill premium in cash. The Goodwill of the firm was valued at ₹ 80,000 on Kanwar's admission. Record necessary journal entry for goodwill on Kanwar's admission.

Revaluation A/c, Accumulated Profit or Losses, Partners' Capital A/c's & their adjustment, Balance Sheet of New Firm



## Ch-05 : Retirement and Death of a partner.

### Accounting for Partnership firms – Retirement and death of a partner-

- Effect of retirement / death of a partner on change in profit sharing ratio, treatment of goodwill, treatment for revaluation of assets and reassessment of liabilities, adjustment of accumulated profits and reserves and preparation of balance sheet.
- Calculation of deceased partner's share of profit till the date of death.
- Effect of retirement / death of a partner on change in profit sharing ratio, treatment of goodwill, treatment for revaluation of assets and reassessment of liabilities, adjustment of accumulated profits and reserves and preparation of balance sheet.
- Calculation of deceased partner's share of profit till the date of death.

### RETIREMENT AND DEATH 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.

*Following accounting treatment required while retiring a partner.*

- (a) Calculation of a new ratio and gaining/sacrificing ratio (in some cases) ratio.*
- (b) Treatment of goodwill.*
- (c) Adjustment of revaluation of assets and reassessment of liabilities.*
- (d) Adjustment of undistributed reserves and profits and losses A/c.*
- (e) Capital adjustments and preparation of new balance sheet.*

### 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

### TREATMENT OF GOODWILL:-

The retiring partner share of goodwill is credited to capital account of respective partner and debited to remaining partners' capital in gaining ratio.

### JOURNAL ENTRY:-

Gaining Partner Capital or Current A/c Dr (in Gaining Ratio)  
To Retiring or Deceased Partner's Capital A/c (With the Share of Goodwill)

The existing goodwill (if any) will be written off by Debiting All Partners' Capital account in their Old Ratio and Crediting the Goodwill A/c.

Old Partners' Capital A/c or Current A/c Dr (in Old Ratio)  
To Goodwill A/c (Goodwill existing goodwill)

**Special Note:** - Goodwill cannot be shown in books unless and until it is purchased by paying some

consideration.(AS-26).

**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 account in the old profit sharing ratio.

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 accounts 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  $\frac{3}{6}$  and this share is purchased by B. So, B's New Share  $\frac{2}{6} + \frac{3}{6} = \frac{5}{6}$  and C's share is  $\frac{1}{6}$ . 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 =  $\frac{5}{8} - \frac{1}{3} = \frac{15}{24} - \frac{8}{24} = \frac{7}{24}$

Sanjay's Gaining Share =  $\frac{3}{8} - \frac{1}{3} = \frac{9}{24} - \frac{8}{24} = \frac{1}{24}$

Gaining Ratio = 7:1

**Q4.** A, B and C were partners sharing profits in the ratio of 5:3:2. B retires on 1<sup>st</sup> January, 2016 with A and 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 and 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 Ratio 1:1 and Gaining Ratio is 1:1.

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

**Q6.** L, M and N were partners sharing profits and losses in the ratio of 5:3:2. On 31st March, 2016 their Balance Sheet was as under:

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

N retired on 31st March 2016 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- <u>75,000</u>	3,50,00	Stock	1,90,000
General Reserve	30,000	Bank	40,000
Creditors	1,50,000		
	5,30,000		5,30,000

**Sol.**

**Revaluation A/c**

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

**Partner's Capital A/c**

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 - <u>1,45,000</u>	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
	<b>5,60,000</b>		<b>5,60,000</b>

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

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Provision for Doubtful Debts	1,300		
Sundry creditors	15,000	Cash at bank	10,000
Capitals:		Debtors	16,000
X 78,750		Stock	20,300
Y 70,000		Machinery	60,000
Z 61,250	2,10,000	Land and Building	1,20,000
	<b>2,26,300</b>		<b>2,26,300</b>

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

- Land and buildings be reduced by 10%.
- Out of the Insurance premium paid during the year ₹5, 000 be carried forward as unexpired.
- There is no need of any provision for doubtful debts.
- Goodwill of the firm be valued at ₹ 36, 000 and adjustment in this respect be made without raising a goodwill A/c.

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

Q.2. A, B, C and D were partners sharing profits in the ratio of 3:3:2:2 respectively. On 1<sup>st</sup> April, 2014 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-06: Dissolution of Partnership Firm**

### **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 thereof.
- (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 incapable 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 that the firm should be dissolved

## DISSOLUTION OF FIRM VS DISSOLUTION OF PARTNERSHIP FIRM

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

### Main Activities at the time of Dissolution

#### 1. Settlement of Accounts [ Section 48]

In settling 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 and 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, and 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

### REALISATION A/c

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



### Partner's Capital A/c

Particulars	LF	A (₹)	B (₹)	Particulars	LF	A (₹)	B (₹)
To Realisation A/c (Loss on Realisation)		xxx	xxx	By balance b/d		xxx	xxx
To Realisation A/c (Asset taken over)		xx	xxx	By General Reserve		xxx	xx
To Bank A/c (final Payment)		xxx	xxx	By P/L A/c		xxx	xxx
				By Realisation A/c (Profit on realization)		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 and 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 accounts 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 and liabilities and to calculate the profit or loss on revaluation.	Main purpose is to calculate the profit/loss after realizing the assets and 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 account is distributed among the old partners only.	Profit or loss calculated in Realisation Account is distributed among the all the partners.

### QUESTIONS FOR PRACTICE:-

Q. The firm of X, Y, and Z was dissolved on 1<sup>st</sup> 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 Section 48 of the Indian Partnership Act, 1932, loan by partner is paid before payment to partner's capitals.

Q. 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.

Q. 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.

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

Q. Prateek, Neeraj and Umang were partners in a firm, sharing profits and losses in the ratio of 7:2:1. The firm was dissolved on 31<sup>st</sup> March, 2021. After transfer of assets (other than cash) and external liabilities to the realisation Account, the following transactions took place. Pass journal entry.

(a) Furniture of ₹ 45,000 was sold by auction for ₹ 66,000 and the auctioneer's commission amounted to ₹ 2,000.

(b) Office equipment worth ₹ 90, 000 was taken over by creditors of the book value of ₹ 82,000 in full settlement.

(c) Umang had given a loan of ₹1, 09,000 to the firm. He accepted ₹1, 00,000 in full settlement of his loan.

(d) Investments worth ₹ 53,000 out of which ₹ 23,000 was taken by Neeraj at ₹ 25,000. Balance of the investments was sold for ₹ 35,000.

(e) Expenses incurred on dissolution were ₹ 21,000 and were paid by Prateek.

(f) Loss on revaluation was ₹ 40,000

**Ans.**

a) Cash/Bank A/c Dr 64,000  
To Realization A/c 64,000

(b) Realisation A/c Dr 2,000  
To Bank A/c 2,000

(c) No Entry

(d) Umang's Capital A/c Dr 1,90,000  
To Cash/Bank A/c 1,00,000  
To Realization A/c 90,000

(e) Neeraj's Capital A/c Dr 25,000  
Cash/Bank A/c Dr 35,000  
To Realization A/c 60,000

(f) Realisation A/c Dr 21,000  
To Prateek's Capital A/c 21,000

(g) Prateek's Capital A/c Dr 28,000  
Umang Capital A/c Dr 4,000  
Neeraj Capital A/c Dr 8,000  
To Realization A/c 40,000

Q. Shanti and Sathya were partners in a firm sharing profits in the ratio of 4:1. On 31<sup>st</sup> March, 2020 their Balance Sheet was as follows:

On the above date the firm was dissolved:

(a) Shanti took over 40% of the stock at 10% 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		Furniture	1,00,000
Shanti	2,00,000	Machinery	1,30,000
Satya	1,00,000	Shanti's Current A/c	20,000
	<b>4,50,000</b>		<b>4,50,000</b>

Sol.

**Realisation A/c**

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

## **Ch-07 : Company Accounts- 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.

(i) 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. Types of Shares:-**

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 is not 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. Kinds of Share Capital**

(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 of nominal (face) value called-up by the company to be paid by the shareholders towards the share capital.
- 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 prior to incorporation, premium on redemption of debentures.

10. Minimum Subscription It is the amount stated in the prospectus as the minimum amount that must be 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 balance sheet in the following manner.

### Comprehensive Question

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

<b>With Application</b>	<b>₹ 3 per share</b>
<b>On allotment (including premium)</b>	<b>₹ 5 per share</b>
<b>On First call</b>	<b>₹ 2 per share</b>
<b>On Second and Final call</b>	<b>₹ 2 per share</b>

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 subsequently forfeited 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 1,60,000 shares @ ₹ 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 per share 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 @ ₹ 5 per 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 per share 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 @ ₹ 2 per 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 @ ₹ 2 per 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 (₹)
<b>I. Equity and Liabilities</b>		
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		
<b>Total</b>		<b>14,54,400</b>
<b>II. Assets</b>		
1. Non-Current Assets		
2. Current Assets		

a. Cash and Cash Equivalents	3	14,54,400
<b>Total</b>		<b>14,54,400</b>

Notes to Accounts:-

Note No.	Particulars	Amt. (₹)	
1	<b>Share Capital</b>		
	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	<b>Reserves and Surplus</b>		
	Securities Premium	2,40,000	
	Capital Reserve	14,400	2,54,400
3	<b>Cash and Cash Equivalents</b>		
	Cash at Bank		

**Practical unsolved Questions**

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

<b>With Application</b>	<b>₹. 2</b>
<b>On Allotment (including premium)</b>	<b>₹. 5</b>
<b>On First Call</b>	<b>₹. 3</b>
<b>On Second Call</b>	<b>₹. 3</b>

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 and the first call, and his shares were forfeited after the first call. Mr. Joly, 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 and 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 for non-payment of allotment money of ₹. 8 per share including premium. The first and 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 and 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.

Sol.

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 39,400 shares)			
	Bank A/c	Dr.	9,65,000	
		To Share First Call A/c		9,65,000
	(First Call money received except 800 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 Call A/c		5,79,000
	(Second and Final Call money received 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 shares are 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			
	<b>48,28,000</b>			<b>48,28,000</b>

**Working Notes:**

**1. Number of shares applied by Rohit**

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

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

**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 allotted to Ashmita**

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

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

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

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

$$\text{₹ } 48,000 \times \text{₹ } 600/800 = \text{₹ } 36,000$$

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-08 : Company Accounts- Accounting Issue of Debentures**

**\*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 and 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:-** 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 replaced 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 liabilities part 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 and 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 is earned or not.

**TAX DEDUCTED AT SOURCE [TDS]** tax is deducted on interest at the specified rate and 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 disclosed under the loan if an accounting entry is passed it is shown below the loan first as debenture issued and thereafter Debenture Suspense Account is deducted.

<i>Case</i>	<i>Conditions of Issue</i>	<i>Condition on Redemption</i>
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)**

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

Solution      Journal

<b>Date</b>	<b>Particulars</b>	<b>L.F</b>	<b>Dr. (₹)</b>	<b>Cr. (₹)</b>
2021 April 1	Bank A/c      Dr. To Debentures Application and Allotment A/c (Amount received on Application.)		5,00,000	5,00,000
April 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
Sept. 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

Sept. 30	Debenture holders A/c Dr. To Bank A/c (Payment of Interest)		24,000	24,000
Sept. 30	Income Tax Payable A/c Dr To Bank A/c (TDS deposited with Income tax authorities)		6,000	6,000
2022 March 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
March 31	Debenture holders A/c Dr To Bank A/c (Payment of Interest)		24,000	24,000
March 31	Income Tax Payable A/c Dr To Bank A/c (TDS deposited with Income tax authorities)		6,000	6,000
March 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)		2,00,00	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.		1,96,000 4,000	



	To 12% Debentures A/c (Transfer of Application money to Debentures A/c, issued at a discount of 2%)			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 & Allotment A/c Dr. 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 instalments.

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	Debit (₹)	Credit (₹)
2021 Apr 1	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 Mar 31	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

\*\*\*\*\*

## Ch-09: 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 and 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)	FIGURES AS AT THE END OF THE PREVIOUS REPORTING PERIOD (4)
<b>1. EQUITY AND LIABILITIES</b>			
(1) Shareholders' Funds			
(a) Share Capital			
(b) Reserves and Surplus			
(c) Money received against sharewarrants			
(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			
<b>TOTAL</b>			
<b>II ASSETS</b>			
<b>1. Non-Current Assets</b>			
(a) Fixed Assets			
(i) Tangible Assets			
(ii) Intangible assets			
(iii) Capital work-in progress			
(iv) Intangible assets underdevelopment			
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long-term loans and advances			
(e) Other non-current assets			
<b>(2) Current Assets</b>			
(a) Current investments			
(b) Inventories			
(c) Trade receivables			
(d) Cash and cash equivalents			
(e) Short-term loans and advances			
(f) Other current assets			
<b>TOTAL</b>			

PART -II STATEMENT OF PROFIT AND LOSS (₹ In.....)			
PARTICULARS (1)	NOTE NO (2)	FIGURES FOR THE CURRENT REPORTING PERIOD (3)	FIGURES FOR THE PREVIOUS REPORTING PERIOD (4)
<b>I. Revenue from operations</b>			
<b>II. Other income</b>			
<b>III. Total Revenue ( I+II )</b>			
<b>IV. Expenses:</b> 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			
<b>Total expenses</b>			
<b>V. Profit Before Tax (III-IV)</b>			
<b>VI. Tax</b>			
<b>VII. Profit After Tax (V-VI)</b>			

### 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 QUESTION:-

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-10: Financial Statements Analysis**

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'.

### **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.

### **Importance/significance of financial analysis:**

- (1) Significance for management:-
- (2) Significance for investors:-
- (3) Significance for Government:-
- (4) Significance for financial institutions:-
- (5) Significance for employees:-

### **PRACTICE QUESTIONS:-**

- (1) What do you mean by financial statements analysis?
- (2) State any four limitations of financial analysis.
- (3) State any four limitations of financial analysis.

## Ch-11: 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 and 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:

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

**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 the proportion of Current Assets to Current Liabilities. An ideal Quick ratio is said to be 1:1. It is expressed as below:-

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

*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 and when they become due. Some important solvency ratios are:-

**1. Debt Equity Ratio:-** Debt Equity Ratio measures the relationship between Long-term Debt and Equity. Ideal ratio of Debt Equity ratio is 2:1.

**Debt Equity Ratio =  $\frac{\text{Debt}}{\text{Equity}}$**

*Debt here means Long-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.

**Total Assets to Debt Ratio =  $\frac{\text{Total Assets}}{\text{Debt}}$**

*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 :

**Proprietary Ratio =  $\frac{\text{Shareholders fund}}{\text{Total Assets}}$ .**

**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 :

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

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

### **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 under this 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.

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

$$\begin{aligned} \text{Cost of Revenue from operation} &= \text{Opening Inventory} + \text{Purchases} + \text{Direct Expenses.} - \text{Closing Stock} \\ &\text{or} \\ &= \text{Revenue from operations} - \text{Gross Profit} \end{aligned}$$

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

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

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

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

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

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

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

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

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

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

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

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

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

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



**D. 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 and 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:

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

*Operating Expenses = Employee Benefit Exp. + Depreciation + Other Exp. (i.e. Office and 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 or as 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 and 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 operating incomes = 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-term Provisions)*

*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
HINT	(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
HINT	(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%
HINT	(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
HINT	(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
HINT	(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
HINT	(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%
HINT	(b)



## Ch-12: Cash Flow Statement.

**MEANING OF CASH FLOW STATEMENT:-** Cash Flow Statement is a statement that shows the flow of cash and 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 and financing activities by the enterprise.
2. To ascertain the applications of cash and cash equivalents under operating, investing and financing activities by the enterprise.
3. To ascertain net change in cash and cash equivalents being the difference between receipts and 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	₹	₹
<b>I. <u>CASH FLOW FROM OPERATING ACTIVITIES</u></b>		
(A) Net profit before tax and extraordinary items (as per working note)		.....
(B) Add : Items to be added		
*Depreciation	.....	
*Goodwill, Patents and Trademarks amortised	.....	
*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)		.....
(I) Cash flow before Extraordinary items		.....
*Extraordinary items (+/-)		----
<i>Cash Flow From (or Used in) Operating Activities</i>		
<b>II. CASH FLOW FROM INVESTING ACTIVITIES</b>		
● 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) (+/-)	(.....)	
<i>Cash Flow From (or used in) Investing Activities</i>	.....	.....
<b>III. CASH FLOW FROM FINANCING ACTIVITIES</b>		
● 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 affects 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 and 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 fixed asset 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
	xxxxx		xxxxx

#### **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 and 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 during the 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
<b>Operating Profit Before Working Capital Changes</b>		<b>2,69,000</b>
<b>Add - Decrease in CA &amp; Increase in CL</b>		
Prepaid Expenses	2,000	2,000
<b>Less - Increase in CA &amp; Decrease in CL</b>		
Trade Receivables	(1,000)	
Trade Payables	(5,000)	(6,000)
<b>Cash flows from Operating activities</b>		<b>2,65,000</b>



2. Following are the Balance Sheets of XYZ Ltd., as on 31st March, 2021 and 2022

Particulars	Note No.	2020-21 (₹)	2021-22 (₹)
<b>EQUITY AND LIABILITIES</b>			
<b>(1) Shareholder's Funds</b>			
(a) Share capital		14,00,000	10,00,000
(b) Reserves & Surplus		5,00,000	4,00,000
<b>(2) Non Current Liabilities</b>			
Long Term borrowings		6,00,000	2,00,000
<b>(3) Current Liabilities</b>			
Short Term Provision(Proposed Dividend)		80,000	60,000
<b>Total</b>		<b>16,60,000</b>	<b>25,80,000</b>
<b>ASSETS</b>			
<b>(1) Non Current Assets</b>			
(a) Fixed assets			
(i) Tangible assets		16,00,000	9,00,000
(ii) Intangible assets		1,40,000	2,00,000
<b>(2) Current Assets</b>			
(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
<b>Total</b>		<b>16,60,000</b>	<b>25,80,000</b>

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
<b>Net Profit Before Tax and Dividend</b>		<b>1,80,000</b>
<b>Adjust non-cash and non-operating items:</b>		
Add- Depreciation	2,00,000	
Amortization of Intangible assets	60,000	<b>2,60,000</b>

<b>Operating Profit Before Working Capital Changes</b>		4,40,000
Add- decrease in CA & Increase in CL		
-----		
<b>Less- Increase in CA &amp; Decrease in CL</b>		
Inventories	(50,000)	
Trade Receivables	(2,00,000)	(2,50,000)
<b>Cash flows from operating activities</b>		<b>1,90,000</b>
<b>B) Cash Flows From Investing Activities</b>		
Purchase of Tangible Assets		(9,00,000)
<b>Cash Used In Investing Activities</b>		<b>(9,00,000)</b>
<b>C) Cash Flows From Financing Activities</b>		
Proceed from Issue of Shares	4,00,000	
Add: Proceed From Issue Of Debentures	4,00,000	8,00,000
Less: Dividend Paid	(60,000)	(60,000)
<b>Cash Flows From Financing Activities</b>		<b>7,40,000</b>
Net Increase in Cash Flows A+B+C		30,000
190,000+ (900,000)+740,000		
Add: Opening Balance of Cash and Cash Equivalents		60,000
<b>Closing Balance of Cash and Cash Equivalents</b>		<b>90,000</b>

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		
	<b>18,00,000</b>		<b>18,00,000</b>		

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